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POLITICAL ECONOMY AND FOREIGN POLICY  
IN POST-SOVIET SUCCESSOR STATES

by

ARKADY S. TORITSIN

A Dissertation submitted to the

Graduate School - New Brunswick

Rutgers, the State University of New Jersey

in partial fulfillment of the requirements

for the degree of

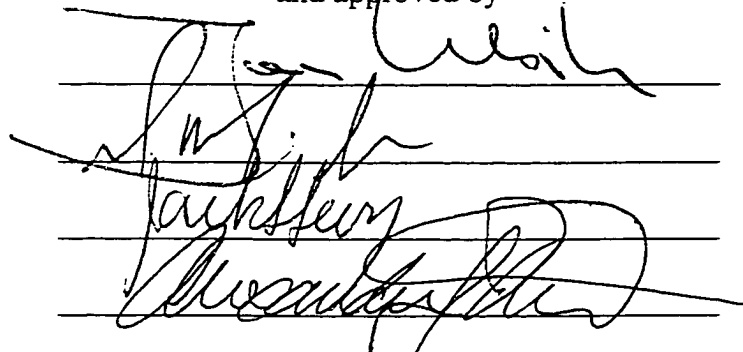
Doctor of Philosophy

Graduate Program in Political Science

written under the direction of

Professor Jan Kubik

and approved by

The image shows three handwritten signatures in black ink, written over four horizontal lines. The top signature is the most legible, appearing to read 'Jan Kubik'. The middle signature is more stylized and less legible. The bottom signature is also highly stylized and difficult to decipher.

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ABSTRACT OF THE DISSERTATION  
POLITICAL ECONOMY AND FOREIGN POLICY  
IN POST-SOVIET SUCCESSOR STATES  
by ARKADY S. TORITSIN

Dissertation Director:

Professor Jan Kubik

Once the Soviet Union collapsed in 1991, it was reasonable to expect that those post-Soviet states that shared a number of common features at the moment of imperial collapse would pursue more or less similar policies towards their former hegemon. However, the foreign policies of successor states toward their former core constitutes a puzzle for traditional approaches in security studies.

This project is an attempt to explain the continuity and change in foreign policies of peripheral post-Soviet states towards their former core. Peripheral elites, as core actors in this analysis, cope with transitional difficulties and institutional imperfections by concentrating economic potential in their hands. Foreign policy plays an important role in ruling elites' calculations and, in addition to its traditional goal of improving the state's security in the international system, becomes exploited as a resource maximization device.

More specifically, in those cases where the ruling elites do not experience problems with economic resources, they continue to pursue foreign policy independent from Russia. In contrast, if ruling elites do not have significant economic resources and they do not introduce liberal economic reforms, opening access to foreign investments and external financial aid, they are tempted to make political concessions and express their loyalty to Russia via foreign policy means.

Theory testing is conducted by employing the case study method. In order to control the impact of possible third variables, this project examines cases with fairly uniform background conditions, namely Ukraine, Belarus and Estonia. Since the case of Ukraine has the widest range of values of the dependent variable from 1991 to 1997, it constitutes the core case of this project.

This project reveals that post-Soviet ruling elites are even more concerned with domestic threats to their security than with the goal of maximizing state power in the international system. In those cases where the ruling elites did not experience problems mobilizing economic resources, they tended to adopt foreign policy independent from Russia (Ukraine 1991, Belarus 1991 and Estonia 1991).

When the need for resources increased, the ruling elites' foreign policies were shaped by domestic political and economic constraints. In the case of Estonia (1997), where reforms were implemented, the leaders continuously pursued anti-Russian foreign policy. In contrast, when economic reforms were absent, peripheral leaders tended to make pro-Russian foreign policy shifts, expecting some form of economic benefits in return. In the case of Belarus (1997) the display of loyalty went so far that we witnessed a transition from an independent state to a form of Russian gubernia.

## Table of contents

Title Page	i
Abstract	ii
Table of contents	iv
List of Tables	v
Chapter 1. Introduction	1
Chapter 2. Post-Soviet Foreign Policy Making Process: A Theoretical Perspective	16
Chapter 3. Historical Legacies, Institutions and Foreign Policymaking in the Post-Soviet Space	44
Chapter 4. Ukraine and its Foreign Policy Towards Russia – Why, When and How Domestic Political Economy Starts to Matter (1991-1994)	65
Chapter 5. Kuchma Adopts a Pragmatic Approach to Foreign Policy – Economic Optimization of Two-Level Game	130
Chapter 6. Belarus - Explaining Pro-Russian Foreign Policy Shift	184
Chapter 7. Estonia - Explaining the Continuity in Foreign Policy Towards Russia	204
Chapter 8. Conclusion	222
Bibliography	242
Curriculum Vita	254

## List of tables

1.1 The Linkage between Domestic Political Economy of Peripheral Post-Soviet States and their Foreign Policy Towards Russia Viewed as a Continuum	13
2.1 An Attempt to Integrate Systemic and Domestic Theories of Foreign Policy Making with Systemic Factors Playing the Dominant Role	25
2.2 Two-Level Games Approach	27
2.3 Elements Shaping Strategies of Post-Soviet Ruling Elites with Regard to Resource Mobilization	40
3.1 Economic Reforms and Political Factors Influencing Their Success Viewed as Continuum	60
3.2 Two-Level Strategic Choices Available to Those Post-Soviet Peripheral Ruling Elites Which Failed to Implement Radical and Cohesive Economic Reforms: An Institutional Perspective	64
4.1 Variables and Their Operationalization (Ruling Elites' Need for Resources if Given)	68
4.2 Standard Model for Each Case under Consideration	68
4.3 Values of Independent, Intervening and Dependent Variables	124
4.4 Independency Rating of Former Soviet Republics (Their Potential According to the Deutsche Bank)	125
4.5 Ukraine: Imports in thousands US\$ (1993-1994)	126



4.6 Ukraine: Exports in thousands US\$ (1993-1994)	126
4.7 Reforms in Eastern Europe and the Former Soviet Union	127
4.8 Ukraine: Economic Development	128
4.9 Unlovely Patchwork: Ukrainian Election Results	129
5.1 Values of Independent, Intervening and Dependent Variables	176
5.2 Basic Economic Indicators (percentage change on previous year)	177
5.3 Main Economic Indicators: Ukraine 1992 –1996	178
5.4 Principal Exports and Imports Destinations	179
5.5 “Unofficial” Payments by Enterprises for Official Permits, Licenses and other “Favors” in Ukraine and Russia, 1994 and 1996	180
5.6 March 29, 1998 Parliamentary Election	181
5.7 In What Way Will the Relations Between Ukraine and Russia Develop? In What Way Will Relations Between Ukraine and Europe Develop?	182
5.8 Estimated Range of the Price Component of Implicit Russian Subsidies to Ukraine, 1992 – 1995	183
5.9 The Top Three Largest Recipients of Direct U.S. Government Aid in Millions of U.S. Dollars. Figures Don’t Include Loans	183
6.1 Values of Independent, Intervening and Dependent Variables	202
6.2 Foreign Trade of Belarus with the CIS States in 1995	203
6.3 Balance of Merchandise Trade, 1992 -1995, millions of US\$	203
7.1 Values of Independent, Intervening and Dependent Variables	218
7.2 Economies in Transition: Growth of Real GDP, 1992 - 1997 (annual percentage change)	219

7.3 Distribution of Foreign Investment by Branch in the First Half of 1994	220
7.4 Preferences Concerning the Future Political Status of Estonia (%)	220
7.5 Armed Forces Personnel	221
8.1 Summary Table. Values of Independent, Intervening and Dependent Variables for all Periods under Consideration	225

## Chapter 1

### Introduction

"In sum, the field of security studies seems poorly equipped to deal with the post-cold war world, having emerged from the cold war with a narrow military conception of national security and a tendency to assert its primacy over other public policy goals. Its preoccupation with military statecraft limits its ability to address the many foreign and domestic problems that are not amenable to military solutions."<sup>1</sup>

Once the Soviet Union collapsed in 1991, it was reasonable to expect that those post-Soviet states that shared many common features at the moment of imperial collapse such as geographical proximity, extensive economic links with the former hegemon, significant Russian minorities, and the presence of nationalist movements could embark on more or less similar policies towards their former hegemon. However, the foreign policies of successor states toward their former core constituted a puzzle for traditional approaches in security studies, which were preoccupied with military statecraft and were incapable of addressing a wide variety of domestic and international factors. The traditional theories hardly could explain why the states of Central Asia, resource-rich, culturally distinctive from Russia, and capable of creating a strong anti-Russian coalition and maximizing their power, embarked on a pro-Russian policy in 1991-1997; tiny Estonia, geographically proximate to strong and ambitious Russia, chose an anti-Russian policy stance; and why Ukraine has shifted constantly from anti-Russian to pro-Russian policy and vice-versa.

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<sup>1</sup> David A. Baldwin, "Security Studies and the End of the Cold War," *World Politics* 48 (October 1995), p.132.

In this project I attempt to explain the continuity and change in foreign policies of peripheral post-Soviet states towards their former core by examining the peculiarity of post-Soviet transition, where domestic political and economic developments have more profound effects on the foreign policy decision making process than changes in the structure of international system itself. More specifically, I focus on the peripheral post-Soviet political elites which are viewed as a product of large organizational and bureaucratic hierarchies unified by functional necessity.<sup>2</sup> Members of the elite need one another to execute the interests of the corporate organizations in which they are positioned, and when the country's survival is at stake, their interests tend to fuse and lead ultimately to coherent domestic and foreign policies.

I develop a set of arguments and reach a conclusion that short-term political survival of any peripheral post-Soviet elite, operating in conditions of high political and economic instability and uncertainty, depends to a large extent on effective resolution of the most acute domestic political and economic problems. In order to address these problems, the post-Soviet ruling elites, unified by a common concern about regime survival, try to establish effective and responsible government and accumulate sufficient power to make the government's writ effective across the country.<sup>3</sup> Meanwhile, the peripheral elites, in the presence of fragile institutions that cannot mediate effectively the

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<sup>2</sup> See, for instance, John Higley and Richard Gunther, eds., *Elites and Democratic Consolidation in Latin America and Southern Europe* (Cambridge and New York: Cambridge University Press, 1992), and Charles Wright Mills, *The Power Elite* (New York: Oxford University Press, 1956).

<sup>3</sup>On dual domestic political games, particularly on retaining political power/political survival, see Joe D. Hagan, "Domestic Political Explanations in the Analysis of Foreign Policy," in *Foreign Policy Analysis: Continuity and Change in its Second Generation*, eds., Laura Neack, Jeanne A. K. Hey, and Patrick J. Haney (Englewood Cliffs, NJ:

distinct interests of domestic groups, cope with these pressures and institutional imperfections by concentrating economic potential in their hands. Accumulated resources can be directed towards a wide range of tasks facing transitional states: building coalitions, coping with the opposition, subsidizing the declining agricultural sector, reducing the impact of ecological disasters and securing ethnic stability.<sup>4</sup> Foreign policy plays an important role in the ruling elites' calculations and, in addition to its traditional goal of improving the state's security in the international system, becomes exploited as a resource maximization device.<sup>5</sup>

More specifically, in those cases where the political elites possess substantial natural resources or where they are capable of mobilizing economic resources, they can continue to pursue foreign policy disregarding Russia's interests. In contrast, if political elites do not have significant natural or other economic resources and they do not introduce liberal economic reforms, opening access to foreign investments and external financial aid, most likely, they will be tempted to make political concessions and express their loyalty to Russia via foreign policy means. Such a move, as the peripheral elites believe, may secure their access to Russian direct and indirect economic aid.

This project focuses on the distinct domestic and international strategies of regime survival selected by peripheral post-Soviet elites, or more specifically, on the strategic

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Prentice-Hall, 1995), pp.117-143.

<sup>4</sup> Donald M. Snow, *Uncivil Wars. International Security and the New Internal Conflicts* (Boulder: Lynne Rienner Publishers, 1996).

<sup>5</sup> I acknowledge the existence of competing explanations of foreign policy making in the post-Soviet space which emphasize the role of historical legacies, external Western support, and other factors. However, as I try to present in this project, domestic politico-economic factors played an important role in determining the foreign policy stances of peripheral post-Soviet states towards Russia in 1991-1997.

choices made by the small number of persons who hold the highest offices in the state bureaucracy. As the available evidence on the transitional states clearly indicates, the post-Soviet elites exercise significant freedom from the preferences of their constituencies and formulate policies that deviate from behavior that would serve their constituencies. This happens because the ruling elite's security incorporates different notions of threat and response than those entailed in the security of state or nation. While the national security emphasizes the long-term international security of the nation-state, the ruling elite's survival deals with the short-term perspective -- it depends on the strategies the top-level state elites pursue for the moment. As a result, it sometimes becomes rational for the ruling elite to consider democratic developments as threatening the stability established under authoritarian rule, to channel scarce economic resources for military equipment and manpower, or to disregard the positive long-term effects of economic reforms and restructuring and engage in extensive rent-seeking instead. Getting enhanced security for themselves, even at the expense of pursuing domestic and foreign policies favorable for the state and national security, is a common bargain for the post-Soviet state elites, who in the absence of democratic traditions and institutions, tend to prioritize their interests over public concerns.

At the initial stages of post-Soviet transition, the peripheral ruling elites enjoyed a significant degree of independence in all aspects of domestic and foreign policy making. This happened because they inherited a political system preserving the power of hierarchically organized bureaucratic structures and imposing significant constraints on formal or informal opposition. The leaders had control over the information and could limit the access of potential opponents to it, while the new patterns of democratic foreign

policy making have not been institutionalized. Therefore, the policy makers were quite independent from domestic institutional and political constraints in selecting their strategic stances towards Russia.

The honeymoon of independent policy making was pretty short and lasted for a year or two after the breakup of the Soviet Union. The autonomy of the ruling elites has diminished substantially due to the appearance of interest groups pursuing clearly defined objectives. Main gains and losses associated with any policy option became more clear and certain. As a result, the interest groups concentrated and started to exercise direct and indirect pressures on the leadership. The ruling elite had to learn how to manage conflicting external and internal demands and mediate among diverse and often contradicting interests in foreign as well as domestic politics.<sup>6</sup> By balancing conflicting demands and selecting options, the peripheral elites learned how to prioritize the most urgent and challenging issues and compensate for the lack of institutions designed to function independently from Moscow.

The post-Soviet ruling elites, mediating among various conflicting interests, tend to prioritize domestic threats to their security and address them at once. This trend resembles policy making in the Third World where the unstable political environment and internal tensions invite policymakers to focus on the nature of domestic politics in

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<sup>6</sup> On the pluralist model of state-society relations and foreign policy behavior, see David Skidmore and Valerie M. Hudson, "Establishing the Limits of State Autonomy. Contending Approaches to the Study of State-Society Relations and Foreign Policy-Making," in *The Limits of State Autonomy: Societal Groups and Foreign Policy Formulation*, eds., David Skidmore and Valerie M. Hudson (Boulder: Westview Press, 1993), pp. 9-15.

framing foreign policy.<sup>7</sup> Therefore, the Third World leaders are incapable of pursuing their foreign policies relying solely on international power maximization strategies, they have to take into consideration and address such peculiar domestic issues as political and ethnic instability, social tensions, economic growth, and trade friction.

Facing significant resource gaps and coping with domestic social and political instability, Third World leaders form external alliances to secure resources that they need to manage their internal problems and stay in power.<sup>8</sup> The availability of external resources becomes especially important when the ruling elites do not have a direct access to all of society's resources or their capacity to extract these resources is limited. So, Third World leaders do not choose among foreign policy options through an objective and rational calculation of what should be done for the state as a whole. Instead, they select rationally which foreign policy strategy is most likely to enhance their short-term domestic standing, and make alignment concessions in return for economic support.<sup>9</sup>

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<sup>7</sup> See, for instance, Christopher S. Clapham, *Third World Politics: An Introduction* (Madison, Wis.: University of Wisconsin Press, 1984); Brian L. Job, ed., *The Insecurity Dilemma: National Security of Third World States* (Boulder: Lynne Rienner Publishers, 1992); Edward Azar and C. Moon, eds., *National Security in the Third World: the Management of Internal and External Threats* (Aldershot, Hants: Edward Elgar; College Park, MD, 1988); and Robert C. Good, "State-Building as a Determinant of Foreign Policy in the New States," in *Neutrality and Nonalignment: the New States in World Affairs*, ed. Laurence W. Martin (New York: Frederick A. Praeger, 1962), pp.3-12; Robert L. Rothstein, *Alliances and Small Powers* (New York: Columbia University Press, 1968).

<sup>8</sup> On political economy and Third World alliance making, see Jack S. Levy and Michael M. Barnett, "Alliance Formation, Domestic Political Economy and Third World Security," *The Jerusalem Journal of International Relations*, vol.14, no.4, (December 1992), pp.19-40.

<sup>9</sup> Douglas Van Belle, "Domestic Imperatives and Rational Models of Foreign Policy Decision Making," in *The Limits of State Autonomy. Societal Groups and Foreign Policy Formulation*, eds. David Skidmore and Valerie Hudson (Boulder: Westview Press, 1993), pp.151-177.



In general, the post-Soviet transitions, even though they have their own peculiarities, look pretty similar: the major threats to ruling elite's survival are of a domestic nature, and the economic and financial resources that are so urgently needed may be acquired both from domestic and international sources. Since the need for resources is extraordinary high due to the complexity of internal threats, the post-Soviet ruling elites try to maximize their utility by playing games on the international and domestic playing tables simultaneously, where the dynamics of two processes are closely connected and cannot be understood independently.<sup>10</sup>

In theory, those post-Soviet ruling elites that do not possess substantial natural resources may pursue two distinct strategies of enhancing their resource mobilization capacities. To a large extent such strategic choices are determined by which dimension of state power, namely the despotic (i.e. the degree of centralized rule, or arbitrary power exercised through force) or the infrastructural (effectiveness and reach of the state institutions that provide and extract resources from citizens) is emphasized.<sup>11</sup>

First, the ruling elites may attempt to steer their countries in the direction of economic autarky. State resources are maximized by increasing bureaucratic interference

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<sup>10</sup> On two-level game theoretical approach, see Peter B. Evans, Harold K. Jacobson, Robert D. Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993); George Tsebelis, *Nested Games: Rational Choice in Comparative Politics* (Berkeley: University of California Press, 1990); Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization*, no.42 (1988), pp. 427-69.

<sup>11</sup> Michael Mann, "The Autonomous Power of the State: Its Origins, Mechanisms and Results," in *States in History*, ed. John A. Hall (Oxford, New York: Basil Blackwell, 1986), pp.109-136; on politics in Eastern Europe, see Janos Matyas Kovacs, ed., *Transition to Capitalism? The Communist Legacy in Eastern Europe* (New Brunswick, NJ: Transaction Publishers, 1994).

in society's life. The ruling elites improve their coercive capabilities to suppress or marginalize resistance.

It was a traditional Soviet approach that eventually produced a country that may be characterized by authoritarian politics and economic underdevelopment but significant power in international system. In the contemporary world this path most likely cannot produce a stable and economically efficient system.<sup>12</sup> The performance of an advanced economy in the long run would be less productive under coercion than if based on voluntary compliance emerging out of collective negotiation.<sup>13</sup>

Second, ruling elites may rely on extensive support organized by the independent forces of civil society, allowing them to implement economic reforms and achieve returns in terms of economic growth, investment and new enterprises. According to this model, the ruling elites develop extensive social interaction networks and limit the presence of the central polity. By accepting and cooperating with almost all segments of society, the elites get public support and increase state power in infrastructural terms.<sup>14</sup> Necessary for economic growth, cohesion in society is maintained by establishing a kind of compromise formula between the various societal factions on how society should be ruled, where the principles of free market economy and democracy are considered to be essential. Such a

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<sup>12</sup> John A. Hall, "Politics and the Market. Reflections on the Rise and Current Condition of Capitalist Society," in *State and Society in International Relations*, eds. Michael Banks and Martin Shaw (New York: St. Martin's Press, 1991), pp.115-135.

<sup>13</sup> Robert A. Dahl, *Polyarchy: Participation and Opposition* (New Haven: Yale University Press, 1971), p.77.

<sup>14</sup> On the role of state in economic development, see Alice H. Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).

compromise is maintained via democratic institutions of cooperation and conflict resolution.

Under this scenario, state resources are maximized by linking the economies of these states with the main world economies not only by the means of trade and investment but also through the internationalization of production and finance. This integration enables newly independent states to produce substantial levels of technology transfer, trade, foreign aid and investment.

These two scenarios of improving the ruling elite's resource mobilization capacity, given the extensive linkage between domestic and foreign policies in the post-Soviet space, envisage two corresponding foreign policy stances towards Russia. In order to explain how and why the distinct patterns of resource mobilization selected by peripheral state elites promote different foreign policy stances towards Russia, I develop and test a middle-range theory, which, unlike the grand theories studying the international relations in an abstract and timeless fashion, concentrates in depth on a narrow topic of peripheral post-Soviet states' foreign policy making towards Russia in 1991-1997.<sup>15</sup>

The middle-range theoretical focus can adequately reflect the complexity of transitional processes in the post-Soviet space and produce a set of descriptive, explanatory, and predictive propositions.<sup>16</sup> Also it makes possible a combination of complex causal explanation of foreign policy behavior with the reconstruction of

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<sup>15</sup> Theodore A. Coulombis and James H. Wolfe, *Introduction to International Relations: Power and Justice*, 2nd edition (Englewood Cliffs, NJ: Prentice-Hall, 1982), pp.24-26.

<sup>16</sup> James Rosenau, "Toward Single-Country Theories of Foreign Policy: The Case of the USSR," in *New Directions in the Study of Foreign Policy*, eds. Charles F. Hermann, Charles W. Kegley, Jr., and James N. Rosenau (Boston: Allen and Unwin, 1987), pp.53-74.

historical context of the post-Soviet transition.<sup>17</sup> Although I argue that the domestic political economy is an important factor shaping foreign policy outcomes, the effects of these domestic circumstances are dependent upon additional contingencies associated with the political strategies by which the ruling elites cope with domestic and foreign policy imperatives. To address these issues, I introduce a broad historical context of post-Soviet transitional processes and employ the case study method that allows me to trace the process of foreign policy making in detail.

The aspirations of this project are shaped by several additional considerations. Chief among them is a concern that a simple listing of empirically discovered sources of foreign policy in peripheral post-Soviet states does not explain their international behavior. Such an approach does not allow us to organize the post-Soviet states according to their attributes and to examine the resultant categorizations for identifiable patterns of foreign policy towards Russia. Therefore, a major task of this inquiry is to conceptualize domestic and international constraints along with the ruling elites' strategies in a manner allowing us to capture important variations among different post-Soviet peripheral states. To pursue this goal, I approach the linkage between domestic political economy and foreign policy of peripheral post-Soviet states towards Russia in three dimensions: theoretical, historical-institutional and empirical.

Theoretical issues are the concern of the next chapter. Chapter 2 assesses the analytical potential of realist and psychological theories of international relations with regard to the problem raised in this project. Since these two diverse approaches fail to

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<sup>17</sup> For more on holism, positivism and combined approach in Soviet studies, see Jack

explain the variations in foreign policy outcomes, I examine the peculiarity of post-Soviet transitions and justify the primary focus of this project on the domestic sources of foreign policy.

Then I discuss some of the existing approaches studying the causal linkage between domestic politics, international conditions and foreign policy-making. This allows me to place this project into this literature and develop a theory expressed within the two-level-game framework to account for the distinctive foreign policy outcomes. More specifically, I examine the domestic and international constraints imposed on post-Soviet ruling elites and reach a conclusion that since the major threats to transitional regimes are of domestic origin, the leaders emphasize the domestic game and address the existing domestic threats by improving state resource mobilization capabilities. Ultimately, the nature and extent of domestic constraints impose limitations on foreign policy repertoire, reflecting the peculiarity of domestic politics. Therefore, the political leaders have only limited room for maneuver in making foreign policy choices.

Historical-institutional analysis of the ruling elites' strategies towards Russia is conducted in the third chapter. I examine the institutional legacies of center-periphery relations under the Soviet Empire, where I emphasize the role of political economy in shaping the patterns of these relations. In the USSR the republican and local Soviet authorities, in order to maximize the inflow of centrally allocated resources and minimize the plan targets set by Moscow, had to be involved in extensive vertical and horizontal, formal and informal networks based on paternalism and clientelism. Since this project

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Snyder, "Science and Sovietology: Bridging the Methods Gap in Soviet Foreign Policy Studies," *World Politics* 40, no.2 (January 1988), pp.169-193.

covers a limited period of time immediately following the imperial collapse, it would be reasonable to argue that the peripheral post-Soviet ruling elites may have tried to learn from these experiences and use these patterns of relations as a reference point in making their foreign policy decisions.

Taking this argument into consideration, I conceptualize basic foreign policy choices towards Russia open for post-Soviet peripheral ruling elites with regard to domestic and international constraints they operate under. Although this research approach excludes certain types of mixed foreign policy outcomes, it still captures the general mechanism of foreign policy making in peripheral post-Soviet states.

To narrow down a wide range of political and economic factors, I specifically focus at the ruling elites' strategic choices addressing the dependence of their countries on Russian energy resources. Specifying the general argument of this project with regard to the energy issues, I argue that to compensate for dependence on Russian oil and gas, those peripheral successor states that do not have their own natural resources may pursue two distinctive strategies.

First, if the process of reforms accelerates, the ruling elite acquires new resources and institutional means to extract them. It expands a new tax base, brings foreign investments and economic aid that enable the elite not only to address various domestic threats to its security but also secure on time and full payment of the energy bills to Russia. In the foreign policy dimension, it allows the pursuit of foreign policy disregarding Russian interests.<sup>18</sup> This happens because fast and radical economic reforms

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<sup>18</sup> It should be noted that the meaning of anti-Russian vs. pro-Russian foreign policy is

create and institutionalize alternatives to existing Soviet imperial patterns of economic relations and growth, thus limiting the importance of economic linkages with the former core, Russia.

Second, if reforms are absent, or they are slow and inconsistent, the necessity of generating sufficient resources to address the ruling elite's security needs and to cover the energy trade deficit with Russia revitalize the importance of maintaining extensive economic links with the former hegemon. This happens because the economies of these states, in the absence of reforms and restructuring, cannot be effectively integrated into the Western markets and supported by international financial institutions. In order to secure their resources, particularly to obtain Russian direct or indirect energy subsidies, the peripheral ruling elites display their loyalty to Russia via foreign policy means.

**Table 1.1**

**The Linkage between Domestic Political Economy of Peripheral Post-Soviet States and their Foreign Policy Towards Russia Viewed as a Continuum**

radical and successful economic reforms	successful economic reforms	slow but consistent economic reforms	inconsistent economic reforms	absence of, or limited, economic reforms
<u>anti-Russian foreign policy</u>	<u>close to independent from Russia's interests foreign policy</u>	<u>moderate policy towards Russia</u>	<u>foreign policy displays loyalty to Russia</u>	<u>clearly pro-Russian foreign policy</u>

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contextualized and limited by the boundaries of Russia and newly independent states relations only.

The comparative empirical analysis capturing variations among different post-Soviet peripheral states is conducted in chapters four through seven. Chapter 4 explains the operationalization of all variables of the project along with the procedures for case selection. The theory testing is conducted by employing the case study method. I select cases with extreme values of dependent variable (pro-Russian -- anti-Russian foreign policies), and one case with large within-case variance in the value of dependent variable.<sup>19</sup> In order to control the impact of possible third variables, I select cases with fairly uniform background conditions among the countries depending on Russian energy imports. I focus on Ukraine, Belarus and Estonia. These are the western newly independent states sharing many significant features, namely, geographical proximity, intensity of economic relations with their core under the Soviet Empire, substantial Russian minorities and a wide range of economic, social and political problems common among transitional states. Since the case of Ukraine has the widest range in the values of dependent variable from 1991 to 1997, it constitutes a core case in my dissertation. Such a focus allows me to perform multiple within-case comparisons and to test the validity of the proposed theory across time.

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<sup>19</sup> For more on case study method, see Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton, NJ: Princeton University Press, 1994); Charles C. Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies* (Berkeley: University of California Press, 1987); Robert K. Yin, *Case Study Research: Design and Methods*, 2nd edition (Thousand Oaks: Sage Publications, 1994).



In chapters six and seven I conduct case studies of Estonia and Belarus with regard to my hypothesis.<sup>20</sup> My observations cover the period of 1991-1997 and I look at the same indicators that I used in the case of Ukraine.

The contribution of this project into the existing body of literature on foreign policy making in the post-Soviet space lies in its detailed empirical analysis of domestic constraints and international limitations under which the strategies linking domestic and international arenas emerge. The cases presented here suggest that the domestic constraints play a dominant role in shaping the ruling elites' strategic choices; however, a simple and straightforward focus on domestic politics is often insufficient to account for distinct peripheral states' stances towards Russia. Thus, a dynamic two-level model is an appropriate tool for analyzing the international politics of post-Soviet transition.

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<sup>20</sup> Alexander L. George, "Case Studies and Theory Development: The Method of Structured, Focused Comparison," in *Diplomacy. New Approaches in History, Theory, and Policy*, ed. Paul Gordon Lauren (New York: Free Press, 1979), pp.43-68.

## Chapter 2

### **Post-Soviet Foreign Policy Making Process:**

#### **A Theoretical Perspective**

In order to explain the distinctive foreign policy stances of newly independent states towards Russia theoretically, it seems plausible to assess initially the analytical power of some influential approaches in International Relations operating at the different levels of analysis.<sup>21</sup> The level of analysis sets the range of causes of state behavior under the investigation for each competing group of explanations. Following Kenneth Waltz, I distinguish three levels of analysis: international, or systemic, where the position of states along with the distribution of power in the system are considered as the main factors shaping foreign policy; domestic, where the explanations of state's foreign behavior focus at the domestic sources such as political institutions, public opinion, society and culture; and individual, where the emphasis is made on the role of personal and psychological characteristics of individual statesmen.<sup>22</sup> The sole purpose of the discussion presented below is to assess which level of analysis is the most promising one with regard to the question raised in this project.

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<sup>21</sup> On the levels-of-analysis concept, see, for instance, J. David Singer, "The Levels-of-Analysis Problem in International Relations," in *International Politics and Foreign Policy: A Reader in Research and Theory*, ed. James N. Rosenau, rev. edition (New York: Free Press, 1969), pp.20-29.

<sup>22</sup> Kenneth N. Waltz, *Theory of International Politics* (Reading, MA: Addison-Wesley Pub., 1979).

Systemic theories are based on the common assumption that nation-states are unitary actors that respond to systemic constraints and incentives. Realism, as the most well developed systemic approach, sees international politics as governed by objective laws where a struggle for power or security is considered to be essential.<sup>23</sup> The state, as a unitary actor, acts in pursuit of its national interests where universal moral principles do not affect the state's behavior: in order to survive, the state accumulates the means of power and violence.<sup>24</sup>

These interests common to all states, along with the anarchical nature of the international system, tend to produce uniformity within certain limits in foreign policy outcomes in the face of substantial variations within the units.<sup>25</sup> For instance, in order to improve their security, states, regardless of differences in their domestic politics, try to build a system based on a commonly shared goal of reaching a stable power relationship and opposing aggression.<sup>26</sup> The power-balancing mechanism works through alliance making, or building of formal or informal arrangements for security purposes among

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<sup>23</sup> For a good review of realism and neo-realism, see Scott Burchill, "Realism and Neo-realism," in *Theories of International Relations*, eds. Scott Burchill and Andrew Linklater with Richard Devetak, Matthew Paterson and Jacqui True (New York: St.Martin Press, 1996), pp.67-92.

<sup>24</sup> The classical realist school of thought in international relations has been associated with the following body of literature: Edward H. Carr, *The Twenty-Years' Crisis, 1919-1939: An Introduction to the Study of International Relations* (New York, NY: Harper & Row, 1964); Hans J. Morgenthau, *Politics Among Nations: The Struggle for Power and Peace*, 6th edition, (New York: Knopf, 1985).

<sup>25</sup> Kenneth N. Waltz, *Man, the State, and War: A Theoretical Analysis* (New York: Columbia University Press, 1959).

<sup>26</sup> Balance of power concept is surrounded with ambiguity: it has been used to describe the actions aimed at making alliances, the intentions of states pursuing these policies, and the ultimate results of these actions. For more on the ambiguities and arguments clustered around this issue, see Frederick H. Hartmann, *The Relations of Nations*, 5th edition (New York: Macmillan, 1978), pp.309-314.

states. States join the weaker side and form coalitions against the stronger party. The historical development of the Eurocentric international system, which was essentially a struggle among states for power, presents a convincing example supporting the plausibility of this argument.

As a more advanced theory of alliance making introduced by Stephen Walt suggests, the alliance-making behavior of states is directed against threats rather than against power alone.<sup>27</sup> In addition to the power factor, the level of threat is affected by geographical proximity, offensive capabilities, and perceived intentions. If the states are confronted by a significant external threat, and the source of threat is not necessarily the most powerful state in the system, the states may either balance (ally with other states against the external threat), or bandwagon (ally with the source of danger). Usually the states pursue the policy of balancing. Only in some cases, when a great power proximate to a small state poses significant threat, the small state, most likely, will ally with the source of danger. This happens because weak and isolated states can add little to the strength of a defensive coalition, and, as a result, cannot significantly affect the ultimate distribution of threats in the system.<sup>28</sup> The small states may also bandwagon because they calculate that there is no better alternative open to them, particularly in the circumstances when the major powers have failed to play a balancing role against the threatening state.<sup>29</sup>

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<sup>27</sup> Stephen M. Walt, *The Origins of Alliances* (Ithaca: Cornell University Press, 1987).

<sup>28</sup> *Ibid.*, pp.262-266.

<sup>29</sup> On Balancing vs. Bandwagoning, see Symposium in *Security Studies*, 1/3 (Spring 1992): Eric J. Labs, "Do Weak States Bandwagon?" pp.383-416; Robert G. Kaufman, "To Balance or to Bandwagon? Alignment Decisions in 1930s Europe," pp.417-447;

Once applied to the analysis of alliance-making strategies of the newly independent states, balance of threat theory may argue that the collapse of the Soviet Empire produced a new imbalance of threats where Russia with its imperial ambitions, aggregate power, and geographical proximity represents a significant threat to its former periphery. As the balance of threats theory might predict, the weak peripheral states, most likely, will bandwagon with Russia, while strong states will follow balancing strategies. International realities are quite different, however: tiny Baltic states select a clearly anti-Russian stance, while a strong Ukraine, with a population of 52 million, the biggest army in Europe, potentially capable of constituting the nucleus of an anti-Russian coalition, shifts constantly between anti-Russia and pro-Russia stances. So, the realist approach lacks the explanatory potential to reveal the reasons why post-Soviet states situated similarly in the international system respond differently to common stimuli, and pursue distinct policies towards Russia in a manner contradicting the predictions made by the balance of power/threat theory.<sup>30</sup>

One of the major factors limiting the analytical potential of systemic realist theories with regard to the problem raised in this project deals with the fact that the

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Stephen M. Walt, "Alliance, Threats, and U.S. Grand Strategy: A Reply to Kaufman and Labs," pp.448-82. See also, Paul W. Schroeder, "Historical Reality vs. Neo-Realist Theory," *International Security* 19 (Summer 1994), pp.108-48; John A. Vasquez, "The Realist Paradigm and Degenerate versus Progressive Research Programs: An Appraisal of Neotraditional Research on Waltz's Balancing Proposition," *American Political Science Review*, 91/4 (December 1997), pp. 899-912; Randall L. Schweller, "Bandwagoning for Profit: Bringing the Revisionist State Back In," *International Security* 19 (Summer 1994), pp. 72-107.

<sup>30</sup> As Dan Reiter convincingly presented, the alliance choices of minor powers in the twentieth century were determined mainly by lessons drawn from national experiences, and only marginally by variations in the levels of external threat. See Dan Reiter, "Learning, Realism, and Alliances: The Weight of the Shadow of the Past," *World Politics*

central building blocs of realism such as nation-state, territoriality, sovereignty, separation of domestic and foreign policy, and stability of state foreign and domestic preferences, are in flux in the post-Soviet context. The realities they denote are fluid and hardly approximate the reality of rapid post-Soviet developments. Thus, the grounds for making and operating under these assumptions is ambiguous. The failure to acknowledge this fact, for instance, precluded neorealism from predicting and explaining the Soviet unilateral concessions allowing revolutions overthrowing East European communist regimes to take place.

To a large extent these limitations of balance of power/threat theory with regard to the post-Soviet space may be explained by the fact that this theory has been developed with the great powers in mind and assumed the existence of an “anarchic” system. Since a regional post-Soviet system hardly can be qualified as anarchic, given external actors of significant importance, the application of balance of power/threat theory may be considered only as a good starting point in developing a theory of foreign policymaking in the post-Soviet space.

Another perspective on the former center-periphery relations may be suggested by the individual-level theories, where the process of foreign policy making is explained by examining leaders’ belief systems, personal attributes along with the patterns of how an individual at the pinnacle of decision making perceives, processes and interprets information with regard to foreign policy. Distinct foreign policies of peripheral states

towards Russia may be attributed within this approach to differences in leaders' views and perceptions of reality.

People act and react according to their images of an environment which are based on individuals' evaluations and perceptions of this environment.<sup>31</sup> Even the most well-informed foreign policymakers cannot know all the relevant factors; their images of reality will always be different from reality. These perceptions and distortions might have been caused by attitudes, beliefs, values, faulty expectations and other psychological factors.

The "operational code" approach, as a psychological theory of foreign policy making, focuses on the impact of political actors/elites' beliefs on foreign policy. Beliefs may be considered as propositions that policy makers hold to be true, even if they are based on unexamined assumptions. According to the "operational code" approach, the political actor reduces complexity of the world and structures it according to his/her "cognitive map."<sup>32</sup>

Since every policymaker tends to simplify the image of her environment, knowledge about the scope and limits of policymaker's beliefs and views can clarify the set of possible tools, assessing opportunities and reactions of this political actor. This analytical approach is especially promising when: 1) the actor's information is

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<sup>31</sup> On perceptions and misperceptions and their role in foreign policy making, see Robert Jervis, *Perception and Misperception in International Politics* (Princeton, NJ: Princeton University Press, 1976); Richard Ned Lebow, *Between Peace and War: the Nature of International Crisis* (Baltimore: Johns Hopkins University Press, 1990).

<sup>32</sup> Lawrence S. Falkowski, ed. *Psychological Models in International Politics* (Boulder, Colo.: Westview, 1979).

incomplete, and 2) “his knowledge of ends-means relationships is generally inadequate to predict reliably the consequences of choosing one or another course of actions.”<sup>33</sup>

Since the process of post-Soviet transition is complex and ambiguous in many aspects, and top-level policymakers enjoyed at the initial stages of transition a relative autonomy from institutional and political constraints, it might be plausible to argue that the foreign policy decisions were grounded on individual policymakers’ perceptions of reality. As the “operational code” approach would predict, any particular stance in foreign policy of peripheral post-Soviet states towards Russia could be explained by examining leaders’ attitudes and beliefs. For example, the shift in foreign policy of Ukraine from an anti-Russian to a moderate pro-Russian stance in 1994-1995 might be explained by detecting significant differences in belief systems of two Ukrainian presidents, Leonid Kravchuk (1991-1994) and Leonid Kuchma (1994-present).

Even if an attempt is made to map the educational and professional backgrounds of these politicians, supported by an extensive analysis of their political views, it most likely would not detect significant differences in attitudes and beliefs of these leaders. As I present in Chapters 4 and 5, their beliefs and political views, susceptible to change in response to shifts in political environment, clearly indicate that the differences in their belief systems, even if they exist, are insignificant and cannot be considered as main determinants of the foreign policy shift.

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<sup>33</sup> Nathan Leites, *A Study of Bolshevism* (Glencoe, Ill.: Free Press, 1953), p.198.



The applications of two distinct theories of international relations to the analysis of peripheral states' policies towards their former hegemon indicate that in order to select the most promising level of analysis, a clear understanding of post-imperial transitional process has to be developed. As the area specialists writing on the subject argue, the foreign policies of post-Soviet states, or more specifically, the existing goals, mechanisms and practices through which these goals are realized, are shaped by a wide range of factors: historical, geographical, economic, political and ethnic. It would be a gross oversimplification, however, to argue that all these factors have an equal impact on foreign policy outcomes.

Since the peripheral post-Soviet states have experienced dramatic social and economic transitions, where the foundations of domestic politics have been changed drastically, the key to the puzzle raised in this project may be searched by examining the linkage between domestic politics, international circumstances and foreign policy making. Since the impact of domestic politics on foreign policy may be completely different across different situations and contexts, central to this project is an effort to approach theoretically and empirically those domestic and international factors peculiar to the post-Soviet transition that led to particular foreign policy decisions. As a result of this analysis, I offer a middle range theory explaining the distinctive foreign policy strategies of peripheral post-Soviet states towards Russia. By doing that I start filling the existing gap between the theoretical writings on international relations and empirical studies of post-Soviet foreign policy making.

It is widely assumed in the international relations literature that the linkage between domestic politics, international circumstances and foreign policy making plays an important role in shaping the ultimate foreign policy outcomes. This linkage is an extremely complex phenomenon because it involves diverse kinds of political and economic factors with alternative causal mechanisms. Some systemic theorists have tried to integrate international and domestic politics; however, they still consider domestic politics as a source of deviations from rational responses to international circumstances, where domestic political processes play an independent but clearly secondary role in shaping foreign policy outcomes. Therefore, they argue, statesmen formulate foreign policy largely autonomously of societal influences, and the national interest, which is defined by the state's position in the international system, guides the policy making process.

Some scholars go even further and argue that domestic processes do not play an independent role and that the impact of international factors is so significant that, in addition to framing the foreign policy itself, it may push domestic politics and domestic structures to adjust to systemic pressures. This argument is supported by an extensive literature on international regimes, which claims basically that international regimes can exist and function successfully only when the participants introduce and institutionalize reliable patterns of expectations of each other's behavior, or, in other words, when the domestic structures institutionalize the norms envisaged by the systemic factors.<sup>34</sup> These

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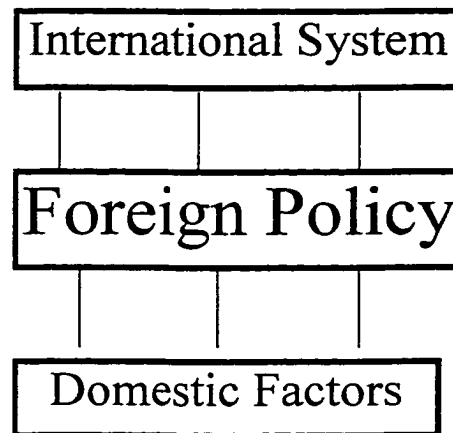
<sup>34</sup> See, for instance, Oran R. Young, "International Regimes: Towards a New Theory of Institutions," *World Politics* 39 (October 1986), pp.104-122.

patterns, reflecting the international circumstances, have to be deeply incorporated into the national decision making procedures.

Small industrial states, for instance, appeared to be very sensitive to world economic developments when a perception of a common fate and common fears, reflecting world economic disturbances, produced a dramatic shift in domestic structures. In order to protect their economies against unexpected impacts from outside, the small states started to pursue the policies of economic centralization and specialization, which produced the ultimate change in the nature of domestic structures towards corporatism.<sup>35</sup>

**Table 2.1**

**An Attempt To Integrate Systemic and Domestic Theories of Foreign Policy  
Making with Systemic Factors Playing the Dominant Role**




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<sup>35</sup> See, for instance, Peter Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985); Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Political Alignments* (Princeton, NJ: Princeton University Press, 1989).

Domestic explanations, in contrast, neglect the impact of systemic factors and claim that states respond differently to common systemic stimuli because their foreign policies are the product of a wide range of country-specific domestic sources. Under this category they include, for instance, domestic social groups that exercise their pressure through public opinion, elections, and the legislature, and bureaucracy and decision-making apparatuses that have their own goals and logic of functioning. However, as the developments in the field have illustrated, the controversy over the primacy of external vs. internal factors is to a large extent superficial and analytically unproductive.<sup>36</sup> Rather, an integrative perspective has come to dominate the scientific inquiry. Levels of analysis “interpenetrate,” therefore micro- and macro-approaches to the study of international relations have to be brought together.<sup>37</sup>

James N. Rosenau, for instance, in his seminal work “Pre-Theories and Theories and Foreign Policy” introduces an analytical framework where individual, societal and systemic variables along with governmental factors, constitute the variables that directly shape the nation’s foreign policy.<sup>38</sup> He views foreign policy as an adaptive behavior, where the nation behaves like a biological organism trying to adapt to threatening internal and external changes. Every nation seeks to maintain its basic structures and pursues

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<sup>36</sup> The need for examining interaction effects between domestic and external levels has been emphasized in Jack S. Levy, “The Causes of War: A Review of Theories and Evidence,” in *Behavior, Society, and Nuclear War*, eds. Philip E. Tetlock, et al. (New York: Oxford University Press, 1989), vol.1, pp.209-333.

<sup>37</sup> Philip E. Tetlock, “Methodological Themes and Variations,” in *Behavior, Society, and Nuclear War*, eds. Philip E. Tetlock, et al. (New York: Oxford University Press, 1989), vol.1, p.366.

<sup>38</sup> James N. Rosenau, “Pre-Theories and Theories and Foreign Policy,” in *Approaches to Comparative and International Politics*, ed. R. Barry Farrell (Evanston, Ill.: Northwestern University, 1966), pp.27-92.

compensatory policies when threatening change takes place domestically or internationally. As a result, foreign policy may be selected with the purpose of alleviating the pressure on domestic structures, rather than stemming solely from or in response to systemic factors.

Another theory of international relations, a two-level games approach, studying international bargaining, invites scholars to view the foreign policy decisions as those that lie at the intersection of domestic and international politics. The statesmen are restricted in their choices not only by the limits imposed by the international system but by the domestic constraints and opportunities as well.<sup>39</sup>

**Table 2.2**

**Two-Level Games Approach**




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<sup>39</sup> Robert D. Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42, (1988), pp.427-460.

The ruling elite, as a particular political group or coalition of groups that occupies the highest government's policymaking bodies, and seeks to coordinate its efforts in addressing the greatest threats to its security, can use favorable situation on the international level as leverage in strengthening its positions at home. For example, if, as a result of the developments on the international level, the ruling elite acquires significant economic resources, it can buy political support from the most important domestic interest groups and strengthen its positions domestically. At the same time, the leadership may use its domestic position with regard to resource allocation or agenda-setting issues in order to improve its position in the international arena. More specifically, the ruling elite's privileged position in the domestic arena allows it to manipulate, or, at least, to affect the domestic constraints in a way that makes admissible the deal previously unacceptable to other international actors. Once a configuration of domestic factors favorable to the leadership is achieved, the elite might attempt to convince the international actors that only a narrow range of deals can be ratified by the legislature and therefore will not jeopardize its domestic standing.

Although the concept of the ruling elite's security binds together a wide range of different levels of threats, such as individual, domestic, regional and systemic, it incorporates a narrow set of objectives that does not correspond necessarily to the interests of state or nation as a whole. Therefore, if the post-Soviet ruling elite adopts a narrow concept of security, its members define national security narrowly, with regard only to the vulnerabilities that threaten, or have the capacity to weaken significantly the state structures -- both territorial and institutional -- and consequently challenge positions

of the ruling elite.<sup>40</sup>

If the major threats to the ruling elite are domestic in their nature, the state leaders focus on internal affairs. Transitional elites cannot develop and adopt a comprehensive strategy of coping with the internal threats, therefore they tend to focus on the immediate threats to their stability first. They closely monitor domestic political developments and try to incorporate them into their domestic and foreign policy calculations. This does not mean necessarily that the international factors have to be excluded from the analysis of the peripheral post-Soviet states' policies towards Russia. It means rather that the foreign policy decisions should be considered as a response to the greatest threats to the leadership's security, regardless of whether the threats are international or domestic.

Any ruling elite in transition has concerns about its political survival, therefore, it attempts to establish and strengthen its authoritative position, or the leadership's ability to enforce the rules of the political system on the citizenry.<sup>41</sup> These efforts, however, are restricted in four dimensions:<sup>42</sup>

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<sup>40</sup> For the Third World context, see Bahgat Korany, *How Foreign Policy Decisions Are Made in the Third World: A Comparative Analysis* (Boulder, Colo: Westview Press, 1986); Mohammed Ayoob, "The Security Problematic of the Third World," *World Politics* 43 (January 1991), pp. 257-83.

<sup>41</sup> Joe D. Hagan, "Domestic Political Explanations in the Analysis of Foreign Policy," in *Foreign Policy Analysis: Continuity and Change in Its Second Generation*, eds. Laura Neack, Jeanne A. K. Hey, and Patrick J. Haney (Englewood Cliffs, NJ.: Prentice Hall, 1995), pp.117-143; Joe D. Hagan, *Political Opposition and Foreign Policy in Comparative Perspective* (Boulder, Colo: Lynne Rienner Publishers, 1993); Barbara G. Salmore and Stephen A. Salmore, "Political Regimes and Foreign Policy," in *Why Nations Act: Theoretical Perspectives for Comparative Foreign Policy Studies*, eds. Maurice A. East, Stephen A. Salmore, and Charles F. Hermann (Beverly Hills, Calif.: Sage Publications, 1978), pp.103-122.

<sup>42</sup>The idea to focus on coalition-building and state legitimacy issues is borrowed from Daniel S. Geller, *Domestic Factors in Foreign Policy: A Cross-National Statistical Analysis* (Cambridge, MA: Schenkman Pub Co., 1985), pp.61-67.

First, any ruling elite is constrained by its capability to mobilize national financial, productive and human resources to implement its policies. This limitation is determined by the physical presence of needed resources, availability of effective institutional means and the willingness of the legislature to support methods of mobilization favored by the leadership. If two nations possess comparatively equal resource bases, but the levels of institutionalization and legislative support are different, the ruling elite with a better-institutionalized political order and legislative support holds respectively larger mobilization potential.

Second, the degree of public support, which reflects a more general issue of ruling elite legitimacy, imposes limitations on leadership's policy repertoire. Legitimacy refers to a situation when the people freely and willingly confer the right to govern to the state. More specifically, political legitimacy may be defined as a "characteristic of a society which enables men to disagree vigorously over the policies that government should pursue or the personnel that should occupy the decision-making posts."<sup>43</sup> Failure to maintain legitimacy challenges not only the position of the leadership itself, but threatens the stability of the system as a whole. Thus, any ruling elite treats the issue of legitimacy seriously.

Legitimizing appeals do not always come in peaceful forms. Weak state authority, underdeveloped institutions, multiple party systems with ultranationalist parties wishing to gain political support through risky foreign policy moves, polarization of society, and uncertain results of economic reforms may significantly increase internal instability.

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<sup>43</sup> Definition by Charles Anderson cited in Mohammed Ayoub, *The Third World Security*



When a regime is about to collapse, the leaders may seek to boost their popular support. In such conditions, positive public perceptions of foreign policy can serve as a major source of legitimization for the ruling elite, especially when such legitimacy is difficult to achieve through domestic policies. As one possible scenario predicts, the ruling elite can try to achieve a unifying effect through the external conflict when the nation unites against a common enemy. Implementing this policy, the leadership creates or exaggerates the danger of the external enemy and supports a concept of limited war. This allows the elite to consolidate its positions at home, eventually alleviating internal strain and securing the leaders' positions.<sup>44</sup>

Third, the ruling elite is constrained by its capacities with regard to coalition building, which reflects to a large extent the relations between the leadership and organized interests. Operating within a fragile economic system, in conditions of political instability, absence of institutions and political entrepreneurs capable of mobilizing public support, interest groups have strong incentives to advance their special interests without taking into consideration the costs that their activities impose on the economy and society as a whole. These groups are inclined to maximize their interests at the expense of productivity, efficiency and economic growth.<sup>45</sup> In the post-Soviet context a constituency of winners who enjoyed extraordinary gains from partial and distorted

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*Predicament: Statemaking, Regional Conflict, and the International System* (Boulder, Colo.: Lynne Rienner Publishers, 1995), p.40.

<sup>44</sup> On external scapegoating, see Jack S. Levy, "The Diversionary Theory of War: A Critique," in *Handbook of War Studies*, ed. Manus I. Midlarsky (Boston: Unwin Hyman, 1989), pp.259-288.

<sup>45</sup> Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, MA: Harvard University Press, 1971); and Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven: Yale

reforms have attempted to preserve those gains by preserving the imbalances of partial reforms over time.<sup>46</sup>

The leadership may address this problem by achieving a consensus among the relevant groups in support of its policies, or coalition-building.<sup>47</sup> The leaders may bargain with different and concentrated interests by providing each group with what it wants most in return for tolerating the adverse effects of the policies its coalition partners desire.<sup>48</sup>

The ruling elite, as a dominant center of power in political system in the absence of a strong power base, may reflect and shape simultaneously the interests and ideological inclinations of the coalition with which it is associated. If the leaders are successful in achieving agreement among the set of relevant actors, they can commit the nation's resources and implement the policy most favorable for them.<sup>49</sup> To a large extent effective coalition building may alleviate the limitations imposed on the leadership with regard to its ability to mobilize economic resources.

Fourth, and closely related to the previous factor, is the capacity of the ruling elite to introduce institutional changes. This limitation depends to a large extent on the institutional legacies of the past, and on the presence and political strength of the pro-

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University Press, 1982).

<sup>46</sup> Joel S. Hellman, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions," *World Politics* 50 (January 1998), pp.232-234.

<sup>47</sup> On prioritization of regime survival goal in the Third World political context, see, for instance, Steven R. David, "Explaining Third World Realignment," *World Politics* 43 (January 1991), pp.233-56.

<sup>48</sup> Jack Snyder, *Myths of Empire: Domestic Politics and International Ambition* (Ithaca and London: Cornell University Press, 1991), p.44.

<sup>49</sup> On coalition-building processes see, for example, Peter Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," *International Organization* 32 (Autumn 1978), pp.881-911; Ronald Rogowski, *Commerce and Coalitions: How Trade Affects Domestic Alignments* (Princeton, NJ: Princeton University

leadership coalition that can control parliamentary and/or representative bodies and assure the adoption of institutional change favorable to the leadership.

Since post-Soviet leaders are the rational players enhancing their political base to stay in office, and the domestic pressure in the majority of the cases is more threatening to regime stability than any external threat, they tend to prioritize domestic issues over international ones.<sup>50</sup> More specifically, it might be argued that due to the complex and multidimensional nature of domestic threats, the leadership is engaged in multiple domestic games simultaneously, prioritizing those games where the outcomes may be the most devastating for the ruling elite. I argue, however, that regardless of the nature of the domestic games leadership is involved in, its position in any game can be improved radically by increasing the ruling elite's resource mobilization capability. Although in some instances where a straightforward allocation or reallocation of economic resources does not have a direct impact, such as in ethnic or religious conflicts, leadership's resources may have an indirect impact and reduce ultimately the extent of existing or emerging threats.

Concerns about resource mobilization capacities are not entirely new for the post-Soviet leaders: the Russian state during its long history had to improve constantly its

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Press, 1989).

<sup>50</sup> Rationality means that self-interested actors are able to order their alternative goals, tastes, and strategies and make the best choice to maximize their satisfaction. The set of alternative is finite and fixed in content at the time of choice. The foreign policy of Russia might be explained by the fact that the foreign policymaking bodies were dominated by the interest groups interested in maintaining good relations with the West. See, for instance, Michael McFaul, "A Precarious Peace: Domestic Politics in the Making of Russian Foreign Policy," *International Security*, vol.22, no.3, (Winter 1997/98), pp.5-35.

capacity to concentrate economic and political powers in order to address effectively state security needs. The absence of natural borders, and a far-flung territory inhabited by ethnically diverse populations resistant to control from above presented a continuous challenge to state security. The need to generate more economic and political resources led the tsar to seek new ways to penetrate society and establish more control over the state apparatus and economy. “ By expanding eastward and westward, it greatly increased the area from which it could extract resources without enlarging substantially the borders it was required to defend.”<sup>51</sup>

In the contemporary world, the post-Soviet peripheral ruling elites, lacking significant natural and economic resources, may follow two different strategies aimed at improving their domestic resource mobilization capacities:

First, leadership may reduce the distributive pressure from the interest groups by strengthening the pro-leadership coalition and bargaining extensively with the major players. Since the composition of coalitions changes across issues and over time and any policy decision affects the material interests of various groups differently, the leadership, in order to secure its political survival, may not only select whether to cooperate with, compromise with, or resist the major players, it may try also to support those domestic groups that back the ruling elite.

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<sup>51</sup> David A. Lake, “The Rise, Fall, and Future of the Russian Empire. A Theoretical Interpretation,” in *The End of Empire? The Transformation of the USSR in Comparative Perspective*, eds. Karen Dawisha and Bruce Parrott. Series: International Politics of Eurasia (Armonk, NY: M.E. Sharpe, 1997), vol.9, p.38.

Second, the leadership may appeal directly to the public in order to strengthen its legitimacy and obtain public support, allowing them to adopt the resource maximization strategy most favorable to the leaders. Strong state legitimacy, along with a homogeneous and integrated citizenry loyal to the state that can restrict the appetites of the interest groups, constitutes a necessary prerequisite for both maintaining office and maximizing influence of the leadership across a wide range of issues.

Ruling elite legitimacy may be enhanced via political legitimization, or the process in which the leaders try to mobilize support by pursuing popular policies, showing strong leadership abilities and employing other strategies enhancing their positions. Legitimization efforts should establish the newly emerged state as a political entity as well as enhance a sense of national identity among the people.<sup>52</sup>

Under any strategy employed, the linkages between foreign policy and domestic politics emerge. Therefore, the foreign policy of peripheral post-Soviet states towards their former center may be studied as a complicated process, shaped by international and domestic constraints and opportunities. At the national level, domestic groups pressure the leadership to adopt those policies that would favor their interests. If the ruling elite tries to construct coalitions among these interest groups, it may use foreign policy tools to reach this goal. For instance, if the previously adopted foreign policy stance does not reflect the domestic bargaining outcomes with regard to coalition building and is too costly, it might threaten to evict leadership from power. To avoid this least desirable

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<sup>52</sup> On nation-building and international relations, see William Broom, *Personal Identity, National Identity and International Relations* (Cambridge; New York: Cambridge University Press, 1990).

outcome, the leadership adjusts its foreign policy to satisfy the interests of domestic groups, while keeping the international pressures and developments under control.

The new post-Soviet ruling elites could learn from extensive experiences of the Soviet leaders in developing their own linking strategies. Stalin, for example, adjusted his foreign policy to legitimize his position in power and to enhance the ruling elite's resource mobilization capacity.<sup>53</sup> Pursuing this goal, Stalin employed the myth of capitalist encirclement to justify his move against the opposition at home.<sup>54</sup>

In the post-Stalinist era Soviet leaders developed a set of more complicated linking strategies. Since the Communist ideology could not provide the concrete answers to arising international problems, the room for equally legitimate policy options allowed the distinct domestic interest groups to carry a preponderant influence on the foreign policy making process. Even though the major power of decision making was in hands of the Politburo members, the existing interest groups remained cohesive over the long periods of time and grew to the point where their strength was sufficient to challenge the leadership's monopoly on policy making.<sup>55</sup> This peculiarity urged the exploitation of linking strategies which reflected the dynamics of coalition building processes where, for

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<sup>53</sup> Joe D. Hagan, *Political Opposition and Foreign Policy in Comparative Perspective* (Boulder, Colo.: Lynne Rienner Publishers, 1993).

<sup>54</sup> William O. McCagg, Jr. *Stalin Embattled, 1943-1948* (Detroit: Wayne State University Press, 1978).

<sup>55</sup> See, for instance, Roger Kanet, "Political Groupings and Their Role in the Process of Change in Eastern Europe," in *Innovation in Communist Systems*, eds. Andrew Gyorgy and James Kuhlman (Boulder, Colo.: Westview Press, 1978), pp.41-58.

instance, the distinct interests of hardliners and more moderate “consumer-agriculture-public service” groupings in the Politburo had to be somehow reconciled.<sup>56</sup>

There is substantial evidence that a strong linkage between domestic politics and foreign policymaking existed in the USSR.<sup>57</sup> Brezhnev, for example, by pursuing détente in relations with Europe and favoring more aggressive policies in the Third World, exploited foreign policy as a mechanism of enhancing his domestic standing. He tried to strengthen his coalition as well as improve the regime's legitimacy by balancing between two contradictory domestic commitments: on the one side, he had to satisfy the interests of the party apparatus, military and heavy-industrial sectors standing for expansion of the military budget and hence traditional foreign policy stance; on the other side, some Politburo members veiled doubts about the system's economic dynamism, and technical and cultural intelligentsia favored the relaxation of international tensions. Thus, a paradoxical strategy supporting radical pro-Soviet or pro-socialist developments in the Third World, and favoring détente in relations with Europe was selected.<sup>58</sup> This policy allowed a decrease in the isolation of the USSR from the world economy and provided some access to western technology and grain to compensate for the shortcomings of the centrally planned economy; it also helped to strengthen the leadership's sense of political legitimacy by showing its capacity to lead the international communist movement.

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<sup>56</sup> Vernon Aspaturian, “Internal Politics and Foreign Policy in the Soviet System,” in *Approaches to Comparative and International Politics*, ed. Barry Farrell (Evanston, Ill.: Northwestern University Press, 1966), pp.212-287.

<sup>57</sup> Paul R. Bennett, *The Soviet Union and Arms Control: Negotiating Strategy and Tactics* (New York: Praeger, 1989), pp.30-36.

<sup>58</sup> Jack Snyder, “East-West Bargaining Over Germany: The Search for Synergy in a Two-Level Game,” in *Double-Edged Diplomacy: International Bargaining and Domestic*

The linkage between domestic and foreign policies was radically intensified under Gorbachev, who in order to gain popular support for his reforms and build a strong pro-reform domestic coalition, adopted a strategy of international concessions and political accommodation with major powers, particularly the United States. He stressed that the internal socioeconomic threats to the Soviet system exceeded the external threats. To resolve this problem, he tried to strengthen the ruling elite's confidence in the Soviet economic and political system. Starting from an initial emphasis on revitalizing the USSR's economic capacity to compete against the West, Gorbachev realized that economic progress could not be achieved without integrating his country into the world markets, which could be accomplished by making an appropriate strategic change in the international game.

In the long run Gorbachev's policy of pro-reform domestic coalition-building through the international game generated significant tensions between the domestic and international policies of the USSR.<sup>59</sup> By shifting goals and methods of foreign policy conduct, Gorbachev lost an important instrument capable of boosting the regime's legitimacy and preserving himself in power. Once it adopted a pro-Western liberal stance, Moscow could not employ anymore its traditional pattern of justifying the existence of domestic empire either by ideological or military means. Aware of the country's possible political disintegration, Gorbachev tried to adjust his foreign policy to domestic politico-economic conditions. Ironically, the shift in orientation from pro-

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*Politics*, eds. Peter B. Evans, Harold K. Jacobson, and Robert D. Putnam (Berkeley: University of California Press, 1993), pp.104-127.

<sup>59</sup> John Van Oudenaren, "Gorbachev and His Predecessors: Two Faces of New Thinking," in *New Thinking and Old Realities. America, Europe, and Russia*, eds. Michael



Western towards more conservative policies generated further leakage of central power in the republics.

In the absence of tangible economic benefits from cooperation with the West that could boost the public support of new policies and curtail the power of old institutions simultaneously, Gorbachev did not gain significant leverage to build a new strong domestic pro-reform coalition. His concessions involved costly retreats and frequently were not directly connected with substantial economic payoffs, thus leaving him without significant resources to pay off his domestic supporters.

Three major conclusions framing the remainder of this project may be drawn from this discussion:

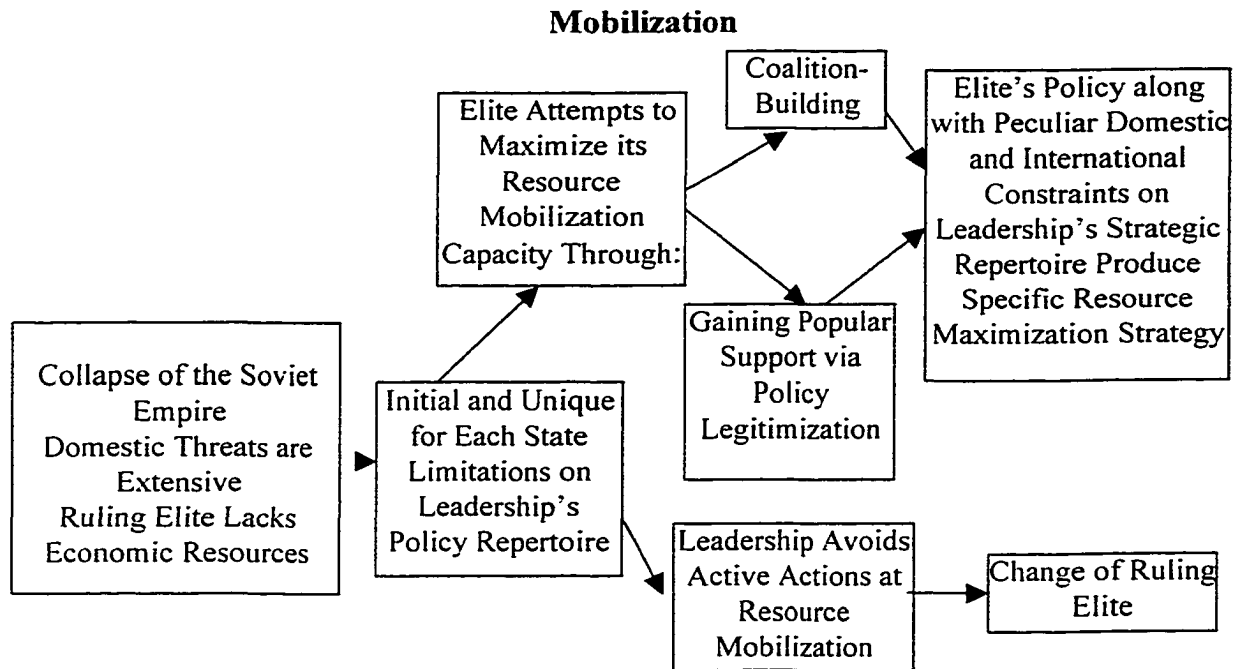
First, peripheral post-Soviet ruling elites, lacking substantial natural, economic and financial resources, in order to secure their political survival, pursue a set of policies aimed at improving their resource mobilization capacity. They attempt to achieve this goal by building a strong pro-leadership coalition and strengthening their legitimacy.

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T. Clark and Simon Serfaty (Washington: Seven Locks Press, 1991), pp.3-27.

Table 2.3

### Elements Shaping Strategies of Post-Soviet Ruling Elites With Regard to Resource



Second, once the pattern of resource mobilization, reflecting the balance of the interest groups and degree of ruling elite's legitimacy, is established, the linkage between domestic and foreign policies of peripheral states intensifies for at least two reasons:

- a) it was widely exploited under the Soviet Empire;
- b) the nature and extent of domestic threats make foreign policy tools vitally important for the ruling elite's survival.

Third, since the linkage between domestic politics and foreign policy making is intense in the post-Soviet states, careful examination of resource maximization strategies pursued by transitional ruling elites can shed light on their foreign policy repertoires with regard to Russia.

These conclusions do not mean necessarily that internal constraints and incentives, usually outweighing the international ones, have predominant influence on the ultimate foreign policy decisions -- sometimes the international constraints play the leading role. Put differently, the pressures from the domestic level push the leadership to exploit advantages provided by the room for maneuver existing on the international level, up to the point where the character and extent of constraints on the international level become evident and make the further exploitation of the international arena in the direction visualized by the domestic pressure groups impossible. The leadership has to choose between domestic rewards at some international cost or international rewards at some domestic cost.

Since the post-Soviet leaders usually operate in political environment of rapidly changing coalitions, when the ruling elites do not have sufficient resources to address all the challenges they encounter, the constant danger of elite turnover limits policy inconsistency, particularly with regard to the available economic resources. As Ivan Rybkin, Secretary of the Security Council of Russian Federation, put it: "After all, the fewer resources there are, the more accurately the priorities of our practical activity need to be defined."<sup>60</sup>

However, the predictability of linking strategies increases not only because the ruling elites in transitional societies seek to enhance their resource mobilization capacity but also because historically the foreign policies of post-Soviet states towards Russia

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<sup>60</sup> Ivan Rybkin, "Domestic Challenges to Russia's Security," *International Affairs* (A

grew out of “domestic” relations between the center and periphery under the Soviet Empire. It would be a gross oversimplification to argue that the web of multilevel center-periphery relations, particularly extensive economic interdependence among republics, institutionalized by the centrally planned economy, was eliminated once the Soviet Union collapsed. The new post-Soviet ruling elites rely extensively on political and economic legacies of the Empire; and extensive economic interdependence among republics provides them with a powerful tool to manage these relations.<sup>61</sup> Since foreign policy making incorporates a significant economic component, and the ruling elites of peripheral post-Soviet states are directly involved in managing the economic activities as well as foreign policy making, they exploit their privileged positions and play two-level games with the purpose of maximizing their resource mobilization capabilities.

Another reason for prioritizing the economic dimension in the two-level game strategies of the post-Soviet leaders deals with the post-Cold war era developments, when the threat of war lost its top priority and the states started to care as much about military security as about their economic wealth, social issues or ecological changes -- a set of issues not amenable to military solutions.<sup>62</sup> Such a shift in leaders’ concerns was followed by a corresponding change in the instruments of the foreign policy: many leaders find it more costly to use traditional military force in achieving their goals rather

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Russian Journal of World Politics, Diplomacy and International Relations) vol.43, no.4, (1997), p.134.

<sup>61</sup> For a more general argument assessing the impact of international economic interdependence on national security in the post-Cold war era, see Beverly Crawford, “Hawks, Doves, but no Owls: International Economic Interdependence and Construction of the New Security Dilemma,” in *On Security*, ed. Ronnie D. Lipschutz (New York: Columbia University Press, 1995), pp.149-186.

<sup>62</sup> Jessica T. Mathews, “Redefining Security,” *Foreign Affairs* 68, no.2 (Spring 1989),

than employ the economic mechanisms instead.<sup>63</sup> Economic instruments are especially effective because national economies are closely integrated through international trade, international production and development, where the effective resolution of domestic problems such as balance of payments, employment, and maintenance of an efficient welfare system is impossible without the participation of international actors.<sup>64</sup>

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pp.162-77.

<sup>63</sup> Joseph S. Nye, Jr., *Understanding International Conflicts: An Introduction to Theory and History* (New York: HarperCollins College Publishers, 1993), pp.5-7; for the European security context, see Klaus Becher, "Security Co-operation in Europe: Domestic Challenges and Limitations," in *Beyond East-West Confrontation: Searching for a New Security Structure in Europe*, eds. Armand Clesse and Lothar Ruhl (Baden-Baden: Nomos Verlagsgesellschaft, 1990), pp.62-79.

<sup>64</sup> Susan Strange, "What About International Relations," in *Paths to International Political*

### Chapter 3

## **Historical Legacies, Institutions and Foreign Policymaking in the Post-Soviet Space**

The purpose of this chapter is to offer institutional and historical arguments theoretically and empirically supporting my theory. In the previous chapter I argued that economic considerations play an important role in foreign policymaking process, and that the present foreign relations among newly independent post-Soviet states grew out of relations domestic by their nature between the center and periphery under the Soviet Empire. Therefore, the learning process of post-Soviet peripheral leaders on how to optimize the inflow of economic resources by exploiting foreign policy means, relied on the Soviet era legacies. Accordingly, this chapter is devoted to a conceptual and historical analysis of institutional legacies and their role in establishing and strengthening the linkage between domestic political economy and foreign policy towards the former hegemon.<sup>65</sup> I analyze the logic of political and economic relations between the imperial center and periphery longitudinally and try to separate those elements of these relations that may have survived the imperial collapse and could constitute a reference point for post-Soviet leaders in making their foreign policy choices. I analyze particularly the

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*Economy*, ed. Susan Strange (London; Boston: G. Allen & Unwin, 1984), pp.183-197.

<sup>65</sup> The importance of historically grounded and empirically detailed analysis of institutional context with regard to the collapse of the socialist dictatorships in Europe has been emphasized by Valerie Bunce, *Subversive Institutions: The Design and the Destruction of Socialism and the State* (Cambridge, New York: Cambridge University Press, 1999), pp.141-147.

immediate context and conditions of post-Soviet transition under which past legacies may shape the calculations and choices of the ruling elites.<sup>66</sup>

Traditionally institutions are defined as rules, procedures and norms that allow, prescribe or proscribe certain behavior, define expectations, limit and facilitate opportunities, provide information and shape human interaction.<sup>67</sup> There are a wide variety of institutions existing in the modern society: the government, the business corporation, the educational system, the hospital, the church, marriage, etc. Institutions introduce the rules of political and economic games and reduce the level of uncertainty by providing a structure to economic, political and social exchange.<sup>68</sup> They reconcile rationality on the part of individuals with rationality on the part of society, where sanctions can be employed by the institutional hierarchy in order to make the self-interested behavior of individuals consistent with the collective good.

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<sup>66</sup> For analysis of competing approaches emphasizing respectively the unique historical inheritance of Leninism and the immediate contextual circumstances as the major factors that constrain and shape the calculations and choices of political and economic actors in the post-Soviet environment, see Beverly Crawford and Arendt Lijphart, "Explaining Political and Economic Change in Post-Communist Eastern Europe: Old Legacies, New Institutions, Hegemonic Norms, and International Pressures," *Comparative Political Studies* vol.28, no.2 (July 1995), pp.171-199.

<sup>67</sup> James F. Alt and Kenneth A. Shepsle, eds. *Perspectives on Positive Political Economy* (Cambridge, New York: Cambridge University Press, 1990); Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge, New York: Cambridge University Press, 1990); Walter W. Powell and Paul J. DiMaggio, eds. *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991).

<sup>68</sup> New institutionalism, in addition to traditional emphasis on organizational characteristic of state and society, takes into consideration such issues as norms, social obligations and communicative actions. See, for instance, James G. March and Johan P. Olsen, *Rediscovering Institutions: The Organizational Basis of Politics* (New York: Free Press, 1989).

Institutions establish standards, both cognitive and normative, regarding what should be expected and how people have to behave and relate to each other. They develop and maintain complex codes of behavior regulating who is supposed to do what and where that relieve all members of society of the necessity of engaging personally in many decision-making and conflict management processes. All members of the community share knowledge about expectations and codes of behavior associated with certain institutions that help in understanding the situations correctly and anticipating what is more likely or unlikely to happen.

In the economic dimension, for instance, institutions encourage cooperative behavior, reduce transaction costs and maintain the organizational basis of production. In the political sphere, institutions coordinate the different aspects of societal life, namely the extensive linkages between society and decision making bodies through which societal demands are channeled to the political system. Political institutions constitute a crucial element in this connection determining the nature and scope of societal demands acceptable by the central authority.<sup>69</sup>

Institutions can be characterized by relative stability that is usually captured by a mechanical and static metaphor, “inertia.” Claus Offe offers a better metaphor drawn

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<sup>69</sup> A domestic structure approach analyzing the impact of state strength/weakness with regard to society on foreign policy decision making has been developed, for instance, by Stephen Krasner, *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton, NJ: Princeton University Press, 1978); and G. John Ikenberry, David A. Lake and Michael Mastanduno, eds. *The State and American Foreign Economic Policy* (Ithaca, NY: Cornell University Press, 1988).



from biology that implies a process, “identical reproduction.”<sup>70</sup> This means that institutions are capable of reproducing themselves because they are not only the products of human activities, but they also make people accept the rules, norms, and values embodied in them. Institutions shape people’s minds, cognitive mechanisms and moral principles. Since people cannot change their beliefs, values and norms overnight, they tend to follow for some time the old patterns of relations and expectations of human behavior when the institutional arrangements have been changed.<sup>71</sup> Moreover, institutions may produce vested interests in keeping them alive -- once people are socialized to a specific institutional pattern, formal and informal networks are established, institutions continue to produce acceptable outcomes and to maintain a set of rules and expectations, the costs of institutional innovation and resultant uncertainty may be too high to be readily accepted by those who directly benefit from these institutions.

Keeping these characteristics of institutions in mind, I will examine how historically derived institutions shape the process of peripheral ruling elites’ foreign policymaking towards Russia. More specifically, I examine the pattern of center-periphery relations institutionalized under the Soviet Empire, and argue that this pattern, reflecting the politico-economic peculiarity of the Soviet system, constituted a point of departure in the learning process of the post-Soviet leaders. I acknowledge, however, that

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<sup>70</sup> Jerzy Hausner, Bob Jessop, and Klaus Nielsen, eds. *Strategic Choice and Path-Dependency in Post-Socialism: Institutional Dynamics in the Transformation Process* (Aldershot, UK; Brookfield, Vt.: Edward Elgar Publishing, 1995).

<sup>71</sup> Kathleen Thelen and Svein Steinmo, “Historical Institutionalism in Comparative Politics,” in *Structuring Politics - Historical Institutionalism in Comparative Analysis*, eds.

this chapter examines the overall impact of institutional legacies at foreign policymaking process, while the particular dynamics and outcomes of preference formation of peripheral ruling elites at each particular point cannot be adequately analyzed by examining structural and organizational factors alone. Cognitive and cultural elements are essential and should be incorporated in a more complete analysis.<sup>72</sup>

Institutional transition in the post-Soviet space clearly indicates that legacies of the past continue to matter. Although the institutions of the Soviet era were discredited and they lost their capacity to cope with functional problems of their environment, intentional attempts at institutional innovation necessarily face the problems of institutional legacies. Initial expectations of some post-Soviet leaders and their Western advisers to create capitalism and democracy by design through the mere replication of some tried and trusted models, operating in the Western hemisphere, have not been completely realized. Instead of an institutional vacuum open to any kind of institutional design, reformers faced the resistance of informal networks formed under the Soviet regime. Such networks developed their own practices and routines, as well as social ties and patterns of making credible commitments.<sup>73</sup> Moreover, the Soviet system created a

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Sven Steinmo, Kathleen Thelen, and Frank Longstreth (Cambridge, New York: Cambridge University Press, 1992), pp.1-32.

<sup>72</sup> Richard Scott emphasizes the fact that institutions consist of regulative, normative and cognitive structures. He advances a sociological version of new institutionalism, where the cultural analysis, focusing at the cognitive dimension, can be conducted. Richard W. Scott, *Institutions and Organizations* (Thousand Oaks, Calif.: Sage Publications, 1995).

It seems, this aspect of institutional dynamism in the post-Soviet context is worth another dissertation. Since I cannot address all aspects of the cultural dimension here, I will try to present this issue in general terms.

<sup>73</sup> It is no wonder that the reformers' mantra - democracy, civil society and market economy has not produces the desired outcomes in many places, since reformers have

moral and cultural infrastructure with deeply incorporated rules of behavior that cannot be easily substituted for a new one in extremely short historical period. Even the newly introduced institutions were deliberately adapted from Western democratic societies, and they offered a clear vision of an alternative institutional order, fragments of the old socialist order survived and continue to exist alongside the newly introduced institutions.

“Just as there can be no market without property rights, so there can be no market without people. And just as the macro-economic system affects individual behavior, collectively the behavior of individuals has an impact upon the macro-economy. In the unique circumstances of these societies, we cannot rely upon the experience of Western societies, and especially of Anglo-American societies, to tell us what will happen in societies in transformation.”<sup>74</sup>

This observation can be extended to virtually all aspects of post-Soviet transition because the inexperienced and ill-equipped peripheral elites lack substantial normative and instrumental power to assure the effective wholesale introduction and functioning of new institutions.

The remnants of the old institutional arrangement constitute a barrier, which does not allow the new institutions to function properly -- a set of expectations and assumptions that dominated under the Empire still matters.<sup>75</sup> In order to be successful, the new ruling elite has to introduce and maintain a new sense of loyalty, faithfulness and

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failed to understand that institutions of the past matter. See, for instance, Paul Aligica, “The Institutionalists’ Take on Transition,” *Transition*, 7 March 1997, pp.46-49.

<sup>74</sup> Richard Rose, “Contradictions Between Micro- and Macro-Economic Goals in Post-Communist Societies,” *Europe-Asia Studies* vol.45, no.3 (1993), p. 419.

<sup>75</sup> Although I examine in this project only one aspect of Soviet legacies, I would agree with Philip Roeder who introduces the broader perspective: “In all republics, regardless of level of social modernization, the legacy of the Soviet institutions may make the bureaucratic survivors a potent base for new bureaucratic authoritarianism, although the exact balance of bureaucracies in each republic is likely to differ from the constitution of Bolshevism.” In Philip G. Roeder, *Red Sunset: The Failure of Soviet Politics* (Princeton, NJ: Princeton University Press, 1993), p.250.

obligation towards the rules of the new institutional order. Since the dynamics of economic reforms clearly indicate that the institutions inherited by the newly independent regimes from the Soviet Empire are not susceptible to radical change, it would be reasonable to argue that the institutional legacies of center-periphery relations that existed under the Soviet Empire still matter. Therefore, I will analyze Soviet domestic structures, or more specifically, the organizational apparatus of societal and political institutions, the decision making rules and procedures, along with the values and norms prescribing certain types of behavior that framed the pattern of center-periphery relations under the Soviet Empire.

In the post-Stalinist USSR political authority has been dispersed and different bureaucratic groups within the central authority and on the republican level enjoyed various degrees of autonomy from the top leadership. Because the Soviet regime could not resolve all its problems by traditional means of terror, it had to give more power and autonomy to bureaucracy and local authorities. This allowed the local authorities to operate opportunistically and exploit any devolution of additional control rights in order to acquire organizational and economic assets.

The power of these actors grew also as a by-product of constant competition for power among senior political leaders in the Politburo, who relied on the political support of various interest groups, such as military-industrial complex, heavy industry and

agriculture.<sup>76</sup> The importance of interest groups increased because the rules of the political game changed and any secretary general of the Communist Party after Stalin could not enjoy anymore virtual autonomy in policymaking. Although the leader had a large say in picking the committee's members and in framing policy, his power was not absolute -- he had to secure a voting majority when any major action had to be taken. Working in these new circumstances, political leaders had to master their skills of mobilizing active coalitional support, because the constant uncertainty surrounding the top level decision making bodies made the danger of leadership succession permanent. Each interest group has been recognized by the central policy making authority and incorporated into the political processes through the formal and informal links. This political dynamic is different from Western-type pluralist models. Even though the bureaucratic and republican authorities provided information and played a significant role in policymaking process, they did not enjoy institutional and associational independence, and the ultimate decisions were made by the political leaders in the Politburo.<sup>77</sup>

Generally speaking, the competition of interest groups in the Soviet political context has been limited through the structure of interest intermediation which made the policy trade-offs among different interest groups quite stable and predictable. Eventually these patterns of relations among the interest groups, including republican authorities, and the imperial center have been institutionalized and produced a code of behavior, or repertoire of actions, that the interest groups had to follow in order to obtain different

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<sup>76</sup> Harry Gelman, *The Brezhnev Politburo and the Decline of Détente* (Ithaca, NY: Cornell University Press, 1984).

forms of benefits from the center.<sup>78</sup> More specifically, if any interest group was willing to have selected the policy option most favorable to its members, it had to display loyalty and offer political support to the most influential Politburo members.

In any political and economic system, loyalty, or the subordinate's unconditional support for any position taken by his or her superior, is rewarded. In the Soviet system, however, where transparent rules were virtually absent, it was definitely rewarded more lavishly than other attributes of the subordinate's performance. Loyal subordinates were particularly needed by top officials in their intra-party or intra-bureaucratic games aimed at attaining better political power positions and higher economic rents.<sup>79</sup>

Loyalty and displays of loyalty to superiors (or the center in Moscow) were institutionalized as the main rules of resource maximization game. This was incorporated into the Soviet political economy which was based on the Russian-Communist interpretation of Marxian ideology. After the revolutionary transfer of power in 1917 the necessity of substituting the impersonal market mechanism for the conscious rational control of the socialized means of production in the interests of the working class led to the elimination of independent private economic activity, while plans and central decision

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<sup>77</sup> Jiri Valenta, *Soviet Intervention in Czechoslovakia, 1968: Anatomy of a Decision*, rev. edition (Baltimore: Johns Hopkins University Press, 1991).

<sup>78</sup> Approaches combining the institutionalist and coalition-building approaches may be found in Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca, NY: Cornell University Press, 1986); and Peter J. Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca, NY: Cornell University Press, 1985).

<sup>79</sup> Networks based on loyalty played an important role in reproduction of the elite in Poland. See Jacek Wasiliewski and Edmund Wnuk-Lipinski, "Poland: Winding Road From the Communist to the Post-Solidarity Elite," *Theory and Society* vol.24/5 (October 1995), pp.669-696.

making came to dominate the economic system.<sup>80</sup> With the liquidation of the money economy, such economic categories as wages, price, value and profit became irrelevant to the conduct of socialist economic activities.

Pretending to move towards the idealistic goal of human fulfillment, the Soviet regime produced an inefficient and dictatorial command economy. Plan targets were aimed toward rapid growth of the physical stock without much concern for its productivity. Agriculture was collectivized and the peasants were dispossessed of their property and land. Economic growth within this system occurred when producer goods developed faster than consumer goods.<sup>81</sup>

The design of the Soviet system imposed a set of specific rules on the competition among different interest groups, ministries and republics for investment and other scarce resources. Leaders, or more specifically the most influential Politburo members, played a key role in this competition and extensive bargaining, and were a source of stability and change. To a large extent such dependence of interest groups/republican authorities on the Politburo was enforced via a planning and administrative system which could be easily manipulated by the Politburo members in conditions promoting irresponsibility and limiting incentives.<sup>82</sup> As a result, the Soviet centralized decision-making structure

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<sup>80</sup> Daniel Gros and Alfred Steinherr, *Winds of Change: Economic Transition in Central and Eastern Europe* (London; New York: Longman, 1995).

<sup>81</sup> For a comprehensive analysis of the political economy of communism, see Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, NJ: Princeton University Press, 1992).

<sup>82</sup> The socialist economic organizations may be viewed as self-legitimizing bureaucracies. For more on this, see Deborah Duff Milenkovitch, "An Organizational Theory of the Socialist Economy," in *Reform and Transformation in Eastern Europe: Soviet-type Economics on the Threshold of Change*, eds. Janos Matyas Kovacs and

always tended to produce substantively less rational policies because the ultimate decisions were made usually on the basis of the information possessed by the Politburo members, which was bound to be incomplete and tended to be biased to their personal interests, views and experiences.

Under a close supervision of the top Party organs, the State Planning Office produced a fully detailed plan for the whole national economy. The plan was presumed to be both internally consistent and optimal from the perspective of the top political leadership. Since the plan operated on the aggregates described, addressees, or the different ministries and agencies, allocated their plans for every directorate heading a sector or sub-sector. Ultimately, when the plan had been enacted into law, the directorate transmitted a compulsory plan to the individual firms it controlled by issuing legally binding, operational instructions which had to be obeyed and fulfilled.

Even though economic decision making was highly centralized, the plan grew out of a long and complicated succession of steps. Since the competence and performance of every participant in the process of planning was ultimately assessed by its success in fulfilling or overfulfilling the plan targets assigned to them, all of the participants, except for the central decision making authority, were interested in minimizing the plan targets set for them. Every subordinate had an interest in being assigned a plan with generous allowances for machinery, labor and materials but with low output targets. On the firm level, each firm tried to maximize credit, investment and inputs and strove to minimize its supplies to other firms. Firms sent false signals to superior bureaucratic levels to obtain

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Marton Tardos (London; New York: Routledge in association with the Institut für die Wissenschaften vom Menschen, 1992), pp.40-61.



easier production targets and more inputs; therefore the final plan represented the outcome of extensive bargaining and bureaucratic compromise between the interest groups and the central authority.

All parties involved in the economic activities under the Soviet system, and particularly top level policy makers, have tried to personalize exchanges among different actors. In a democratic capitalist system, where the variety and number of exchanges is high, the personalization of exchange is difficult to achieve, while the socialist system with its restricted number of exchanges and vertical integration of enterprises, facilitated such attempts. Legally, personalization was achieved by issuing regulations, laws, rules and decrees that often were contradictory and unenforceable. This system was intended to make any manager, local or republican official liable to dismissal at any time as a result of discretionary application of sanctions for nonobservance of these regulations. If all the laws and regulations were to be strictly observed, operations of the firms, branches of the economy and the republics' economies could come to a standstill. Since it was not acceptable to anybody, managers and other officials directly responsible for plan fulfillment had to disregard formal procedures and secure their positions by maintaining personalized relations with their superiors based on loyalty.<sup>83</sup> The loyalty could be expressed differently. For instance, if any manager on the firm level undertook any successful economic activity, she had to attribute her success to a particular economic or

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<sup>83</sup> Branko Milanovic, *Liberalization and Entrepreneurship: Dynamics of Reform in Socialism and Capitalism* (Armonk, NY: M.E. Sharpe, 1989).

political superior. These forms of behavior emphasizing patronage and co-optation as a source of success constituted the cultural and moral foundations of the Soviet institutions.

A dense network of informal ties and personalized exchange existed not only in the vertical dimensions, but also on the horizontal one, connecting different enterprises, as well as firms with local organizations. Managers of the socialist enterprises as well as local and republican elites became an integrative part of the paternalistic bargaining system, where personal contacts and other non-economic factors played a decisive role. Because of the extensive fusion of political, social and economic power under the Soviet regime, economic managers were subject to the legitimate control of the specialized commissions and local officials of the Communist Party, trade union bodies, regional or local governing councils and their bureaus. Since these organizations had their own specific interests and concerns and they could exert pressure on managers and administrators by providing information about their activities to the top leadership, managers had to bargain constantly and express loyalty to the socialist system in general and to these players in particular as well.<sup>84</sup>

The web of personalized connections existing vertically as well as horizontally has been established among people sharing similar social and bureaucratic biographies, which contributed towards cohesiveness of such informal links. Without these informal ties based on loyalty/displays of loyalty, the task of meeting plan targets on the

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<sup>84</sup> See, for instance, Paul M. Johnson, *Redesigning the Communist Economy: The Politics of Economic Reform in Eastern Europe* (Boulder: East European Monographs, 1989), pp.5-33.

enterprise, local and republican levels would be quite difficult to achieve; the centrally planned economy with its ineffective bureaucracy could not manage this process effectively. Moreover, the system did not improve its efficiency, and the ruling elite failed to check the erosion of its authority and restore its reputation by disciplining local authorities and low-level bureaucrats during Gorbachev's perestroika.<sup>85</sup>

Such rules of the game amount to the institutional legacy that affects the outcomes within a context shaped by post-Soviet international developments.<sup>86</sup> Since the alternative patterns of policy making and new institutions were not introduced externally, the patterns of center-periphery relations inherited from the Soviet Empire had a privileged position in framing peripheral states' policies towards Russia. This happened because the costs of creating new institutions and linkages, measured in terms of time, resources and ambiguity associated with such processes, were high. Thus the easiest and least expensive method of managing relations with the former hegemon was to extend and adjust existing patterns to new international circumstances. This provided a means of reducing bargaining costs associated with building new institutions as well as limiting the ambiguity associated with radical institutional innovations. Thus the relations of peripheral ruling elites with their former hegemon may be viewed as an institutionally

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<sup>85</sup> For neoinstitutional analysis of the Soviet institutions, see Steven L. Solnick, *Stealing the State: Control and Collapse in Soviet Institutions* (Cambridge, MA; London, UK: Harvard University Press, 1998).

<sup>86</sup> The importance of past institutional structures in the process of interest group formation in Russian provinces has been emphasized in Kathryn Stoner-Weiss, *Local*

dense environment in which the expectations of new leaders were shaped by the practices and rules that had framed the relations between the center and periphery under the Soviet Empire.

During the initial stages of post-Soviet developments there was a high probability that the legacies of Soviet Empire would be substituted for the linking strategy connecting economic reforms and pro-Western foreign policy, which would promote market and democracy in the region. This linking strategy could secure the access of newly independent states to finance and world markets that eventually would offset the high costs associated with the market transition and provide reform-minded ruling elites with sufficient resources to gain wide political support and build strong pro-reform coalitions. The initially widespread popular perceptions assuming that support of the transitional processes in the post-Soviet space was in the West's ideological and political interest did not approximate the political realities.

The collapse of the USSR, alleviating the military threat in Europe, made questionable the necessity of wide economic concessions on the part of the West. Once it became clear that the restoration of a strong and cohesive Soviet bloc was impossible, geopolitical factors receded in significance. As a result, the level of aid, reflecting primarily the level of Western commitment, was increasingly guided by the national interest of individual countries participating in these activities and varied radically across issues and countries. Since different domestic economic and political interests had very specific concerns about investment opportunities and trade linkages with the former

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*Heroes: The Political Economy of Russian Regional Governance* (Princeton, NJ: Princeton University Press, 1997).

Soviet states, this resulted in varying commitments to aid. For instance, assisting the trade liberalization efforts of post-Soviet states, Western governments faced resistance from the sheltered sectors in which the eastern transitional states had some competitive advantage, such as steel or agriculture.

Western domestic interests also shaped the nature and extent of political and economic conditions to be imposed: post-Soviet recipients were required to maintain democratic institutions and adopt the programs of structural adjustment produced by the International Monetary Fund and World Bank. The domestic costs associated with implementation of these programs were so high that full compliance with external conditionality became unrealistic, and domestic political opposition to reforms strengthened. As a result, the scenario of radical economic reforms, where the generous and to a large degree unconditional Western aid that would have allowed reformers to buy the political support of the opposition and gain wide public support of reforms, did not materialize. Thus alternative scenarios, exploiting the linkage between domestic and international games, have to be found.

When the ruling elites started to address the issue of their resource mobilization capabilities seriously and the need for the linking strategies emerged, the peripheral elites had to find a proper reference point in framing their relations with Russia. The fundamental economic problems inherited by peripheral post-Soviet regimes were structural in character and could not be resolved overnight: all post-Soviet states in 1991 possessed an economic system based on state ownership, dependency on Moscow in economic policy issues, and a centralized pattern of resource allocation and pricing. This system experienced a severe economic crisis. The crisis can be partially explained by the

fact that the central decision-making authority in Russia was dismantled, delegating authority of economic policy decision-making and resource allocation to the local elites untrained to do so. As a result, at the very beginning of post-Soviet transition state elites had to implement at least some economic reforms and seek external sources of economic resources and financing.

**Table 3.1**  
**Economic Reforms and Political Factors Influencing their Success**  
**Viewed as Continuum**

Reforms are Successful	Reforms are not Successful
Ruling Elite Desperately Needs Economic Resources to Assure Its Position Ruling Elite is Willing to Implement Radical Economic Reforms There is a Strong Pro-reform Coalition	Ruling Elite Desperately Needs Economic Resources to Assure Its Positions Ruling Elite is not Willing and/or is Incapable of Implementing Radical Economic Reforms A Strong Pro-Reform Coalition is Absent

Although the coincidence of extremely positive or extremely negative values of all of the above independent variables barely exists in the post-Soviet space (and there is no logical reason why these extreme values may cluster) I intentionally conceptualize the variable in this way to analyze the widest theoretically possible values of the reform-success continuum. I examine only those states where the ruling elites desperately need economic resources to address the domestic threats to their positions, but distinctive domestic political and economic constraints determine the correspondingly different survival strategies.

On the left side (see Table 3.1 above), post-Soviet peripheral ruling elites, backed by a strong pro-reform coalition and popular support, approach the task of mobilizing economic resources by adopting radical reforms and a policy of economic internationalization. This policy limits dependence on the former hegemon that frequently remains enmeshed in the life of its former periphery, acting as the major trade partner and the principal supplier of investment capital. In the foreign policy dimension, it allows the new leadership to pursue foreign policy independently of Russia and makes any possible adjustments accommodating Russian interests unnecessary.

On the right side of the above continuum, the ruling elite does not pursue radical economic reforms, and the pro-reform coalition is absent. As the economic theory may quite correctly argue, these imperfections could be resolved in the long run by establishing a deregulated economy with well-managed foreign investments and technical assistance, which in conjunction with a willing local government, would be followed by the expansion of the healthier private sector. However, the absence of a critical mass of political and business market-oriented entrepreneurs, a lack of financial and legal infrastructure, and vested interests of some interest groups uninterested in introducing effective economic mechanisms, are the main obstacles to achieving this goal. The post-Soviet ruling elites often lack an adequate capacity to monitor and control economic markets and to introduce stable and well-defined property rights, while the distributive pressure remains high. These conditions as well as the lack of state power, expertise and willingness to implement radical economic reforms, along with the uncertainties of transition, encourage the ruling elite to privilege short-term outcomes and discount the shadow of the future.

The dependence of peripheral states on goods produced in Russia, or for the Russian market, and their increasing vulnerability to disruptions in the flow of raw materials, goods and services from Russia challenge the autonomy of new leaders in economic policy making and increase political entanglements that restrict foreign policy options. Even if the newly emerged peripheral post-Soviet states have deliberately or inadvertently established rules, institutions, and mechanisms to regulate their relations with Russia, these new formal arrangements are incapable of sustaining the continuity in independent foreign policy -- domestic political and economic conditions necessitate a set of appropriate adjustments.

The closed networks of former Communist party functionaries, managers of state-owned enterprises and Soviet bureaucracy constitute the core of transitional elites, thus clientelism (that is, no more than a simple adaptation of patterns of local politics under the Empire) remains at the center of post-Soviet politics. The alternative vision and patterns of politics did not become dominant in the majority of transitional post-Soviet states: even the mobilization around national and ethnic issues failed to breach patronage networks inherited from the Soviet Union. It would be quite naïve to expect that in these "new old" circumstances, peripheral ruling elites would embark on radical economic reforms and adopt alternative strategies in foreign policy making -- the point of departure in all spheres was rooted in the socialist past. Furthermore, in the absence of an independent tradition of foreign policy making, it would be reasonable to expect that foreign policy decisions should reflect the relations between the center and periphery institutionalized under the Soviet Empire.



In order to enhance their security, the new state leaders, who used to be an integral part of the Soviet personalistic networks and know the rules of the game, may express their loyalty towards Russia via foreign policy means to acquire additional resources from the former imperial center. Such expressions of loyalty were common practice in bargaining with the core, therefore peripheral ruling elites would reasonably expect an appropriate reaction, namely allocation of economic resources which may take a wide range of forms from payment rescheduling for gas and oil to direct economic aid. Since the expression of loyalty to their superiors, or the imperial center, is a strategy they are accustomed to, and they lack the qualities needed to play the game of efficiency imposed by transitional processes, most ruling elites in the post-Soviet space always have an easy option to obtain premiums and economic benefits regardless of their domestic economic performance.

If, however, Russia is unable to provide sufficient economic resources, some reform measures might be adopted. Since the ruling elite in transition tends to avoid offending powerful segments of the electorate benefiting from the status quo, it may agree to maintain the economic arrangements favorable to these groups, regardless of the effects upon efficiency and economic performance. Since the most powerful groups at the initial stages of transition, bureaucrats and apparatchiks, learned under the Soviet system that their wealth does not depend primarily upon the creation of wealth but rather on the interference in the wealth creation process, they constitute the main obstacle to reform.<sup>87</sup>

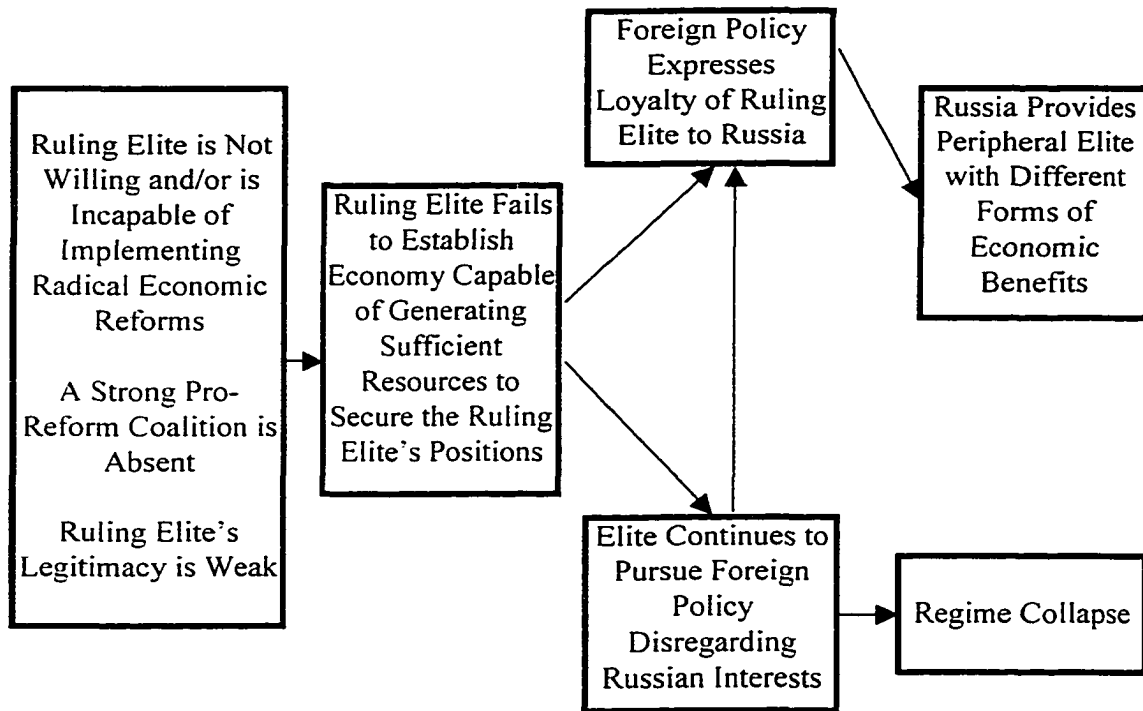
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<sup>87</sup> This argument is extensively developed in Jan Winiiecki, *Resistance to Change in the Soviet Economic System: A Property Rights Approach* (London, New York: Routledge, 1991).

Only when the economy hits bottom, and Russia is unable to provide sufficient resources, the ruling elite is most likely to become sensitive to falling efficiency and a shrinking tax base, and therefore ready to adopt changes addressing the issues of economic performance.

**Table 3.2**

**Two-Level Strategic Choices Available to Those Post-Soviet Peripheral Ruling Elites Which Failed to Implement Radical and Cohesive Economic Reforms: An Institutional Perspective**



## Chapter 4

# Ukraine and its Foreign Policy Towards Russia - Why, When and How Domestic Political Economy Starts to Matter (1991-1994)

In the following chapters I test the middle-range theory about the strategic linkages peripheral post-Soviet ruling elites may establish in their two-level games. I start with the analysis of initial foreign policy stances towards Russia immediately following independence, when the peripheral ruling elites did not experience problems with their resource mobilization capabilities and could make foreign policy choices disregarding economic issues. Then I examine how the patterns of linking strategies have changed when the importance of ruling elites' resource mobilization capacities increased.

More specifically, I test two major hypotheses deriving from the theory: 1) if ruling elites are incapable of/or unwilling to pursue radical economic reforms,<sup>88</sup> a strong

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<sup>88</sup> Since the economic reforms may be defined differently, I rely on the following definitions:

1. Economic reform: Changes in government policy, institutional structure, or administrative procedures designed to alter economic activity and improve performance.
2. Stabilization: Correction of imbalances in foreign payments, government budgets, and the money supply, with the aim of controlling inflation and otherwise reducing macroeconomic instability.
3. Structural adjustment: Reforms aimed at changing the structure of production (towards tradable goods) and consumption (towards nontradable goods) and increasing the efficiency and flexibility of the economy. Stabilization is generally considered a precondition of longer-term structural adjustment policies.
4. Outward-looking (-oriented) strategy: A complex of policies in which export expansion is the engine of economic growth and development. Policies in this strategy can employ market forces or government interventions, but have in common the establishment of incentives for export growth (and efficient import substitution),

pro-reform coalition is absent and elites do not have a high degree of legitimacy, the process of economic reform will be slow and leaders, in order to secure their political survival, will be tempted to depart from initially independent foreign policy and move in a pro-Russian direction, expecting economic benefits in return; 2) by contrast, if elites are capable of and willing to pursue radical economic reforms and they enjoy a high degree of legitimacy and outstanding support of a strong pro-reform coalition, the reforms are accelerated. As a result, the leaders may continuously pursue independent and, most likely, anti-Russian foreign policy.

For my comparative study I select cases with fairly uniform background conditions among western newly independent states dependent on Russian energy imports. I examine the cases of Belarus, Estonia and Ukraine. These countries share many common features, such as similar geopolitical location, intensity of economic relations with their core under the Soviet Empire, and significant Russian minorities.

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with pivotal domestic prices closely related to world prices. Structural adjustment is often designed to achieve an outward-looking economy.

5. Liberalization or deregulation: A subset of structural adjustment, dealing with removal of government interventions of all kinds: price controls, quantity restrictions, investment and import licensing, and other barriers to entry.
6. Privatization: The sale of government-owned corporations to private investors and the contracting of formerly governmental functions to private agents.
7. Budget rationalization: Reforms to bring government's resources more closely into balance and to make them more productive in support of economic growth.
8. Institutional reform: Changes in government (and sometimes private) institutions that make it possible for economic reforms to work, predominantly involving shifts away from administered controls towards mechanisms that support private activity." In Michael Roemer and Steven C. Radelet, "Macroeconomic Reform in Developing Countries," in *Reforming Economic Systems in Developing Countries*, eds. Dwight H. Perkins and Michael Roemer (Cambridge, MA: Harvard Institute for International Development, Harvard University, 1991), pp.56-57.

In this chapter I test these hypotheses by conducting multiple, within-case comparisons of the case of Ukraine which are based on four observations: the first year of independence, when the ruling elite did not experience problems with economic resources - 1991; 1993; 1994 - when Leonid Kuchma was elected President, and 1997. For all these periods I make a number of paired observations of the values of independent, intervening and dependent variables.

More specifically, I apply a process-tracing technique and try to divide the cause-effect links into smaller steps. Implementing this method, I explore step by step how the initial foreign policy stance has been affected by changes in the corresponding values of independent and intervening variables. The method of dividing the cause-effect links into smaller steps and observing evidence of each step allows me to test as many predictions derived from my hypotheses as possible. To test these predictions I record the observed values of intervening, intervening and dependent variables for each of my cases (see Table 4.1 and Table 4.2). I then test whether the values co-vary in a manner congruent with the predictions or not. Passing the test will confirm strongly the theory, while flunking the test will infirm it.

The case of Ukraine also allows us to test the reverse causality argument claiming that the pattern of policy towards Russia determines the balance of power of domestic groups with regard to economic reforms and influences the ruling elites' willingness to pursue economic reforms. More specifically, it might be stated that an anti-Russian policy strengthens the domestic pro-reform coalition and supports the ruling elites' desire to adopt radical reform measures, while a pro-Russian foreign policy favors an anti-reform approach. Since I apply a process-tracing technique and examine the causal

relationships, I prove that this argument, even though it sounds plausible, barely corresponds to the political realities in Ukraine. Since in the case of Ukraine I rely on primary sources and document domestic as well as international developments as extensively as possible, I show that the anti-Russian policy of Ukraine in 1990-1993 did not produce the changes in the values of independent and intervening variables predicted by this argument.

**Table 4.1**

**Variables and Their Operationalization (Ruling Elites' Need for Resources is Given)**

Independent Variable	Operationalization	Intervening Variable	Operationalization	Dependent Variable	Operationalization
1) Economic strategy (position of ruling elite on the economic reform) Values: 1.1 Willingness 1.2 Unwillingness 2) pro-reform coalition Values: 2.1 Present 2.2 Absent 3) Ruling Elite's Legitimacy 3.1 High 3.2 Low	1) a) Content analysis of the President's economic initiatives; b) Assessment of the role of economic reforms in President's overall strategic approach; 2) a) Composition of interest groups; b) Main political forces and their representation in the parliament; 3) The applicability of non-economic tools/legitimization policy reducing the distributive pressure	Progress of economic reforms Values 1. High 2. Low	1) Overall economic performance; 2) Main trade partners and trade flows; 3) External independent assessment of the country's economic performance.	Continuity in foreign policy towards Russia Values: 1. Continuity 2. Change (shift in pro-Russian direction)	1) Analysis of the main treaties, agreements with Russia or the third parties reflecting the foreign policy towards Russia; 2) Indirect indicators of the foreign policy stance towards Russia

**Table 4.2**

**Standard Model for Each Case under Consideration**

Periods	Independent Variables			Intervening Variable	Dependent Variable
	Position of the Ruling Elite on the Economic Reforms	Pro-Reform Coalition	Ruling Elite's Legitimacy	Progress of Economic Reforms	Continuity in Foreign Policy towards Russia

### **Period 1 (January 1991 - January 1993)**

#### **When the Ruling Elite Does not Encounter Problems with Economic Resources, the Necessity of Playing a Loyalty Game with Russia Does not Exist**

It was not Ukraine who initiated the collapse of the Soviet Empire, therefore the events of August 1991 were unexpected for the Ukrainian elites. When the government of Russia replaced that of the USSR at the center of power in Moscow, Ukraine like the other non-Russian republics had no choice but to become a fully independent state or to transform itself into a province of the new Russia.<sup>89</sup> Ukraine selected the first option - - the Ukrainian independence referendum and presidential election was held on December 1, 1991. The referendum approved independence with 90% in favor - - Ukrainian citizens shared a broad consensus on the desirability of national independence and voted overwhelmingly in favor of the Ukrainian independence declaration adopted on August 24, 1990. Proclaimed in December 1991, Ukrainian independence represented a decisive break with the legacy of the Soviet Empire and a formal espousal of national self-determination, independent economic and social policy making, and multiparty democracy as the guiding principles of state-building.

Independence was supported by overwhelming majorities in most regions and among all ethnic groups. One exception was the Crimea, where Russians made up two-thirds of the region's population. There, independence was approved by a relatively modest 54%, in contrast to 83-98% support in other regions. The decisive vote in favor of

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<sup>89</sup> Roman Szporluk, "Reflections on Ukraine After 1994: The Dilemmas of Nationhood,"

independence surprised many observers, especially those in Russia who expected strong opposition to independence in the largely Russified South and East of Ukraine.

The fundamental problem both the Ukrainian and Russian ruling elites encountered when the Soviet Union had collapsed was figuring out the basis and character of relations between these two newly independent states. To a large extent it stemmed from “different concepts of Ukrainian state-building and great-Russian nation-building.”<sup>90</sup> The initial, clearly anti-Russian foreign policy stance of Ukraine can be attributed to a wide range of factors which I divide analytically into three general categories:

First, historical legacies of Ukraine-Russia relations mattered a great deal. Lacking any formal institutional framework for international relations as independent states, Russia and Ukraine tried to base their policies on historical memories and myths which reached as far back as the tenth century.<sup>91</sup> On the Russian side, these memories did not envision Ukraine as an independent from Russia political entity, but rather as a part of the Russian Empire where Ukrainians occupied a position of “younger brothers.”<sup>92</sup> On the Ukrainian side, lacking continuous statehood, these memories considered Russia a

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*The Harriman Review* vol.7, no.7-9, (March-May 1994), p.3.

<sup>90</sup> Gerard Snel, “At the Border of European Security: The Case of Ukraine,” in *Rising Tensions in Eastern Europe and the Former Soviet Union*, eds. David Carlton, Paul Ingram and Giancarlo Tenaglia (Aldershot, UK, Brookfield, USA: Dartmouth Publishing, 1996), p.113.

<sup>91</sup> For more on historical legacies, see Karen Dawisha and Bruce Parrott, *Russia and the New States of Eurasia* (Cambridge, New York: Cambridge University Press, 1994), pp.23-45.

<sup>92</sup> Mikhailo Hrushevsky, “The Traditional Scheme of “Russian” History,” *The Annals of the Ukrainian Academy of Arts and Sciences in the US* vol.2, no.2 (New York, 1952),



threat for re-establishing the correspondence between citizenship, ethnicity and language.<sup>93</sup>

The erosion of the correspondence between Ukrainian ethnicity and language emerged in the 17th century when Ukraine was placed under the protection of the Moscovite czar, and two distinct political entities came into contact. Since the political institutions of Ukraine in the 17th century were weak and represented a mixture of amorphous and disparate trends, they could not withstand the penetration by their well-developed Russian counterparts. This eventually produced the transfer of Ukrainian intellectual and political elites to Russia, leading to the transformation of a relatively advanced Ukrainian society to the status of a peasant culture.

In the countryside peasants' ambivalence over their national identity was prevalent in the Ukrainian provinces of the Russian Empire in the 19th and at the beginning of the 20th centuries. Ukrainian peasants, constituting the majority of the population of this region, did not perceive themselves in terms of nationality. They rather viewed themselves as Orthodox and the members of particular local communities speaking a language that is distinct from the languages outside their region. They defined themselves not in terms of their own characteristics, but only in comparison with outsiders; identity was often defined by identifying "the other."

A short experience with independent statehood came when both the Hapsburg and the Russian empires collapsed at the end of World War I, and two independent Ukrainian

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pp.355-364.

<sup>93</sup> Naoki Wada, *The Transformed Role of the North Atlantic Treaty Organization in Managing Russia-Ukraine Security Relations*, series: Policy Analysis Exercise (Cambridge, MA: John F. Kennedy School of Government, 1992), p.5.

states were declared: one on the territory of the former Russian Ukraine, the other in the formerly Hapsburg West. These states could not gain full control over the territories they claimed for more than a couple of months at a time. Such a brief experience of independent Ukrainian statehood in 1917-1921 when the two major relevant powers Russia and Germany refused to recognize Ukrainian independence, resulted in the Bolsheviks' occupation of Eastern Ukraine while Western Ukraine came under the rule of newly independent Poland.<sup>94</sup> By 1920 the Bolsheviks were firmly in power, and in 1922 Ukraine was incorporated into the USSR. The Soviet period had its negative consequences as well: the victims of the famine which accompanied Stalin's enforced collectivization of agriculture in the early 1930s can be counted in the millions.

Ukraine's historical legacy of lengthy external domination, its failures to obtain independence (first, in 1917-1921 and then in 1941-1945), its weak and underdeveloped national consciousness and a prevalent mistrust of Russia made the efforts at nation and statebuilding the first priority of the new ruling elite. Learning from the historical experience of Russia-Ukraine relations, the state builders feared Russia and searched for all available means to strengthen the security of the newly emerged state. Since the previous attempts to achieve independence were unsuccessful, the ruling elite and major political forces reached a consensus on the need to build an independent state and ensure its security by preventing any chances of possible re-integration with Russia by pursuing clearly anti-Russian foreign policy.

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<sup>94</sup> Mark von Hagen, "The Dilemmas of Ukrainian Independence and Statehood, 1917-1921," *The Harriman Institute Forum* vol.7, no.5 (January 1994), pp.7-11; Orest Subtelny, *Ukraine: A History* (Toronto: University of Toronto Press, 1991), pp.355-380.

Implementing this policy in order to solidify the social base and strengthen the ruling elite's legitimacy, the Ukrainian leadership - taking into consideration the specific process of national self-identification - appealed directly to the citizens and tried to emphasize the distinctiveness of Ukrainian ethnicity and culture as well as to show the negative impact of Russian tzarist (and later Soviet) policies on the development of Ukrainian identity and culture. The attempts to preserve the ruling elite's initially high legitimacy were supported by anti-Russian foreign policy, which emphasized a new, widely accepted interpretation of Russia's policies in Ukraine. According to it,

“Russian centralizing policies in Ukraine had three goals: (1) to coerce the Ukrainian elite and general populace into complete obedience; (2) to coordinate Ukrainian government, economy, and culture with those of Russia; and (3) to extract the maximum from Ukraine's human and economic resources.”<sup>95</sup>

Generally speaking, the anti-Russian policy became a necessary element of the statebuilding project. The ruling elites, composed of national communists and nationalists, allowed the culture and historical memories in, and manipulated the culture from above to create a strong power base to ensure their security.<sup>96</sup> Independence was portrayed by the ruling elite as an implementation of the national democratic movement's “liberation” program, treating the Soviet empire's policies as a continuation of anti-Ukrainian policies of the Tzarist empire. This interpretation was strongly supported by

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<sup>95</sup> Subtelny Orest, *Ukraine: A History* (Toronto: University of Toronto Press, 1991), p.166.

<sup>96</sup> On relations between the state and nationalist culture in the USSR, see Alexander J. Motyl, *Will the Non-Russians Rebel? State, Ethnicity, and Stability in the USSR* (Ithaca, NY: Cornell University Press, 1987).

the nomenklature who needed a nationalist foundation for its claims of being not a provincial but rather a state power.<sup>97</sup>

Second, the initial anti-Russian foreign policy stance of Ukraine was influenced by geopolitical considerations. Immediately after independence, Ukraine with a population of 52 million and the biggest army in Europe could not make itself comfortable located geopolitically between NATO and Russia. A strong and ambitious Russia was quite dangerous for Ukraine because it remained internally unstable, when any rightward shifts in domestic politics may have had serious repercussions on the domain of foreign policies, particularly on Russia-Ukraine relations. To address this security issue the movement for establishing a strong Ukrainian army capable of securing the country's existing territorial frontiers and protecting it against would-be aggressors started in February 1991. The task of building the armed forces has been widely supported by all ethnic groups.<sup>98</sup> Pursuing this goal, the state authorities started with nationalizing ex-Soviet military equipment deployed on the Ukrainian soil and encouraging ethnic Ukrainian officers to serve in its armed forces.

Internationally, the Ukrainian leadership tried to distance itself from its Russian counterpart and showed its willingness to join the EU as well as to develop its cooperation with NATO. Such a clear pro-Western orientation in 1991-1992 has been

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<sup>97</sup> Taras Kuzio and Andrew Wilson, *Ukraine: Perestroika to Independence* (New York: St. Martin's Press, 1994).

<sup>98</sup> Steven A. Grant, *Ukrainian Elites View Their Country and the World. Results of a Focus Group Study* (Office of Research and Media Reaction: U.S. Information Agency, December 1996), pp.29-33.

reflected particularly in the unwillingness of president Leonid Kravchuk to settle a wide range of issues on Russian terms, including the ownership of the former Soviet Union's foreign assets and the fate of nuclear weapons located on Ukrainian territory.

Particularly acute were tensions over the Crimea, the territory that Khrushchev had given to Ukraine as a present in 1954. The peninsula used to be a Russian territory - - the Crimea was seized from Turkish suzerainty in 1772 and formally annexed to Russia in 1783. In the Soviet times, it was an oblast within the RSFSR. In 1954 Crimea was transferred to Ukraine as a gesture of "eternal friendship" between Russia and Ukraine, marking a decisive break with Stalin's Ukrainophobia, in the year when both republics celebrated the three hundredth anniversary of their "reunion".

With the imperial breakdown, the times when the people perceived the Soviet Union's internal borders as a polite fiction has passed, opening an arena for political struggle. Russian nationalists in both the Crimea and Russia argued that the Crimea, inhabited mostly by Russian speakers, should be annexed to the Russian Federation.<sup>99</sup> Responding to these claims, in August 1991 Boris Yeltsin's press office issued a controversial statement stating that Russia reserved the right to review its borders with seceding republics except for the three Baltic states. As the presidential spokesman elaborated later, this statement referred to the Donbas, Crimea, and northern Kazakhstan, areas with significant Russian minorities.

The Russian Parliament went even further -- it could not unanimously accept Ukrainian sovereignty over the Crimea and voted on May 21, 1992 to nullify the 1954

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<sup>99</sup> Russians make up 67% of Crimea's population; Ukrainians, only 26%.

transfer of the Crimea. While denying that Russia had any territorial claims on Ukraine, the parliament asserted that Russia has to participate in any future talks on the status of the Crimea. Ukraine condemned this Russian move and emphasized that the Crimea is a purely internal matter.<sup>100</sup>

Third, the economic interests of the Ukrainian elites favored the initial anti-Russian foreign policy stance.<sup>101</sup> Aside from Russia, Ukraine had the greatest economic potential of any Commonwealth of Independent States country, producing more than three times the output of the next-ranking republic. Ukraine boasts large deposits of coal (nearly 60 percent of the USSR coal output), anthracite, and lignite. On top of this, it has deposits of manganese and iron ore, uranium, graphite, mineral salts, gypsum and alabaster. Its fertile black soil generated more than one-fourth of Soviet agricultural output, and its farms provided substantial quantities of meat, milk, grain, and vegetables to other republics. Likewise, its diversified heavy industry supplied equipment and raw materials to industrial and mining sites in other regions of the former USSR.

During the last years of the Soviet Empire, Union resources became drastically limited as a result of economic stagnation. It reduced the ability of the central authorities to maintain programs that awarded private goods to local and national state elites. An attempt to decentralize the Soviet economy without creating an effectively functioning

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<sup>100</sup> Taras Kuzio, *Russia-Crimea-Ukraine. Triangle of Conflict* (London: Research Institute for the Study of Conflict and Terrorism, 1994).

<sup>101</sup> See, for instance, Karen Dawisha and Bruce Parrott, *Russia and the New States of Eurasia. The Politics of Upheaval* (Cambridge, New York: Cambridge University Press, 1994), pp.161-186; Mark Webber, *The International Politics of Russia and the Successor States* (Manchester, New York: Manchester University Press, 1996), pp.279-337; Taras

viable market produced a large number of economic autocracies at all levels. As a result, in the late Soviet period, the narrow base of political support shrank and the leadership could not strengthen its coalition by traditional means of mobilizing ideology - all interest groups and bureaucrats demanded material benefits to be delivered in exchange for their political support. This goal could not be accomplished: the central authority was constrained by budgetary limitations and inefficient economic structures, restraining its direct access to societal resources, while the institutionally empowered elites of the national republics enjoyed significant bargaining power in intensive jurisdictional struggles against the center.<sup>102</sup>

A competition for these ever-scarcer resources contributed to attempts at ethnic mobilization over the advantages of economic independence from the center at all levels.<sup>103</sup> As a result,

"republic, regional, and local governments began to look after their own economic interests. Local leaders began to seal off their districts and cities from the national economy with trade barriers or a wide variety of rationing schemes in the belief that economic independence might protect local populations and their living standards from the consequences of the center's increasingly incoherent economic policies."<sup>104</sup>

As a part of these centrifugal economic tendencies all grain deliveries outside Ukraine that exceeded the norms set in the Soviet state plans were canceled, and a special program

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Kuzio, *Ukrainian Security Policy* (Westport, Conn.: Praeger, 1995), pp.46-51.

<sup>102</sup> Rogers Brubaker, "Nationhood and the National Question in the Soviet Union and post-Soviet Eurasia: An Institutional Account," *Theory and Society* 23 (1994), p.61.

<sup>103</sup> Philip G. Roeder, "Soviet Federalism and Ethnic Mobilization," *World Politics* 43 (January 1991), pp.196-232.

<sup>104</sup> John Blaney and Michael Gfoeller, "Lessons from the Failure of Perestroika," *Political Science Quarterly* (Fall 1993), p.489.

of consumer protection was adopted. Special coupons were issued for Ukrainians and distributed with salaries, pension payments and stipends. They had to be used to purchase goods and services, thus certifying the buyer was the resident of Ukraine.<sup>105</sup>

The population at large had high expectations of economic prosperity associated with independence from Moscow. These illusions were enhanced by early international reports, that almost unanimously chose Ukraine as the country with the best chance of achieving political stability and economic prosperity in the whole post-Soviet space (see Table 4.4). Such views were also grounded in widespread disillusionment with the competence and legality of the USSR government that proved incapable of addressing the needs of the Ukrainian economy. It was commonly believed that Ukraine had great economic potential within the USSR, but it was held back by its dependence on the former central planning system. Studies of Moscow's economic policy in Ukraine proved that it was incongruous with the needs of the national economy - there were no essential investments into the reconstruction of outdated enterprises. For example, the negative consequences of Moscow's policy in coal mining industry were widely publicized: 70% of coal mining enterprises had not been renovated for more than 20 years; therefore "from 1976 to 1990 coal extraction in Ukraine decreased to the level of 1930s."<sup>106</sup>

The leading Western specialists argued that the unrequited transfers of the national income from Ukraine was a clear indication of the economic exploitation of Ukraine by the central government in Moscow. According to some estimates made on the

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<sup>105</sup> Stephen White, ed. *Handbook of Reconstruction in Eastern Europe and the Soviet Union* (Harlow, UK: Longman, 1991), p.226.



basis of Ukraine's balance of payments for 1988, the republic's unrequited loss was about 20 percent of the national material product (NMP).<sup>107</sup> Therefore, despite a wide variety of previously articulated approaches to economic development and relations with Russia, these economic calculations emphasized the necessity to break the economic relations with Russia and orient the economy to the Western market, a task that could be successfully accomplished if anti-Russian policy is continuously pursued.<sup>108</sup>

### **Period 2 (February 1993 - July 1994)**

#### **Domestic Political Economy Begins to Matter - Continuity in Foreign Policy**

#### **Cannot be Sustained. Pro-Russian Shift as a Resource Maximization Device.**

#### **Ruling Elite is Unwilling to Pursue Economic Reforms**

In 1991, President Leonid Kravchuk (1991-1994) began an effort to construct a fundamentally new state. But the new ruling elite's political and economic weakness and

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<sup>106</sup> Boris Hertsenov, "Market and Destiny in Donbas," *Ukraine* (Kyiv) no.10 (1991), p.10.

<sup>107</sup> Volodimir N. Bandera, "Income Transfers and Macroeconomic Accountability from the Standpoint of Ukraine," in *The Ukrainian Economy. Achievements, Problems, Challenges*, ed. I.S.Koropecykj (Cambridge, MA: Harvard University Press, 1992), pp.384-409.

<sup>108</sup> As an overview of the programs of political parties conducted in 1992 suggests, they viewed the economic perspectives of Ukraine differently, especially in terms of economic relations with Russia. We can distinguish at least 5 main concepts:

1. Closed economic system with strict customs control. Total independence from the Russian market.
  2. Nationally oriented market economy. Only small degree of cooperation with the Russian market. The development of the Ukrainian businesses.
  3. Socially oriented market economy. State protectionism in regard to the heavy industry enterprises and military complex. Expanding of economic relations with the Russian market.
  4. Liberally oriented market economy. Small business and foreign capital protection. Good relations with the Russian market.
  5. Soviet economic system. Collective form of property. State control over redistribution.
- See Arthur Belous, *Political Parties in Ukraine* (Kyiv, 1993), pp.51-105.

inexperience hampered its capacity to generate a coherent conception of the national interest that could realistically assess short and long-term threats to national security, policy instruments and strategies. Although the Ukrainian ruling elite expressed formal support for democracy, political pluralism, and the establishment of a market-oriented economy, most of these commitments remained for a long time just that: expressions of intent waiting to be translated into action.

In addition to international threats, the new leadership had to address a wide range of domestic threats to its security, such as inadequate social cohesion and the lack or limited social consensus on fundamental issues of economic and political organization. To a large degree the existing or potential tensions could be alleviated through the proper allocation of economic resources.

Theoretically, in the absence of domestic or external threats post-communist states have to spend their revenue for two major purposes: to maintain conditions in which economic growth may be achieved, and to support conditions for social harmony. The first task is accomplished by spending money on all sorts of programs that improve the productivity of physical and human capital, such as medical care, housing, research and development, and education. The second task is fulfilled by allocating money to some welfare programs.

The Ukrainian leadership, operating under pressure to dismantle the old Communist bureaucracies, to create new economic regulatory agencies, to maintain the social services, and to address effectively all sorts of societal needs, did not have enough revenue to cover all these expenditures. “Whereas fiscal crises in capitalist and socialist

states become evident as expenditures rise faster than revenues, fiscal crises in post-communist states are revealed as revenues decline faster than expenditures.”<sup>109</sup>

In theory, the ruling elite’s limited resource mobilization capacity can be improved by implementing economic reforms. The fundamental idea of economic reforms establishing market institutions in the post-Soviet space is very simple: a willing local government, operating within a deregulated economy supported by well-managed external capital inflow and technical assistance, may achieve significant expansion of the private sector. The free market will eventually equilibrate as completely as possible supply and demand, thus allowing prices to reflect opportunity costs. Once a regulatory framework favoring the development of market relations is established, it will attract foreign investors and bring back previously exported hard currency. Eventually, increasing private wealth and a booming economy create more taxable income. Also the need to collect more taxes will disappear as the government would be left with only a few major tasks to perform - - it might intervene only to protect infant industries, develop infrastructure, and regulate monopolies.

The practical side of reform process in Ukraine was quite different, however. At the beginning of post-Soviet transition there was a widespread conviction, bordering on euphoria, that the transition from the centralized planned economy to a capitalist system would be relatively fast and smooth. It was assumed that the existing conflicts of interest could be easily resolved by adopting a strategy of piecemeal incorporation of the

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<sup>109</sup> John L. Campbell, “Reflections on the Fiscal Crisis of Post-Communist States,” in *Strategic Choice and Path-Dependency in Post-Socialism: Institutional Dynamics in the Transformation Process*, eds. Jerzy Hausner, Bob Jessop, and Klaus Nielsen (Aldershot, UK; Brookfield, Vt: Edward Elgar, 1995), p.85.

opposition, which would divide its supporters and neutralize its different segments. Such a plan could have been comparatively easily implemented in 1991-1992, when the communist groups were either banned or unorganized, and the population was ready to accept sacrifices and hardships that come along with actual economic reforms, because they believed that these sacrifices were necessary to achieve long-term economic prosperity.<sup>110</sup>

Pretty soon the opportunity to implement economic reforms by empowering reform-oriented elites and insulating them from pressure of the interest groups ceased to exist. The Ukrainian ruling elite failed to exploit the readiness of the population to bear the economic sacrifices on the way of reforms, and eventually the number of politically mobilized people demanding their participation in political activities and in the distribution of the economic cake substantially increased. The technical capacity of ruling elites to pursue radical and well-balanced economic reforms was also limited: Ukraine did not inherit an independent decision-making and decision-implementing body and its central-government ministries employed only 12,400 people untrained to take independent decisions and set adequate policies.

Moreover, strategically the Ukrainian leadership was preoccupied with the tasks of state building by centralizing power and could not accept the idea that a significant

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<sup>110</sup> In this project I intentionally do not analyze the role of state in economic transition in Eastern Europe. With regard to these issues, some scholars support the Bretton Woods institutions' strategy which is based on the idea that the state should become a "night watchman," monitoring a liberalized market. Other scholars believe that some state intervention during the transition process is needed. For more on this discussion, see Alice H. Amsden, Jacek Kochanowicz and Lance Taylor, *The Market Meets Its Match. Restructuring the Economies of Eastern Europe* (Cambridge, MA: Harvard University Press, 1994).

decentralization of decision making and reduction of the size of the public sector were desperately needed to achieve efficiency and sustainable economic development. Since these issues were overlooked, the leadership failed to introduce the institutional infrastructure necessary for functioning markets. In the absence of legal foundations for market activities, secure property rights, and transparent rules supported by various institutional innovations and structural transformations in social and political spheres, the process of transition represented a stop-and-go process, where the subsequent policy steps were motivated not by strategic calculations but represented rather a set of diverse rescue operations addressing arising problems. Such negative features of the Soviet centrally planned economy as a high degree of unionization, lack of modern technologies and equipment, lax work ethic, high social and job security were not addressed. Doing nothing has contributed to the deterioration of promising and inherently viable state-owned enterprises producing the lion's share of industrial output and exports under the Soviet empire.

The question of economic reforms was sacrificed by the leadership to the independence cause: the methods of approaching the economic issues as well as the economic policy makers were adopted from the Soviet times. In 1991-1992, for instance, premier Vitold Fokin's "shock without the therapy" justified the hyperinflation as well as issuance of "soft" unbacked credits to loss-making enterprises and collective farms.

Although in October 1992 the prime minister Fokin and his cabinet resigned, Leonid Kuchma, who succeeded him, did not have a clear and cohesive reform strategy. Nevertheless, premier Kuchma, enjoying the special powers that were granted to him in October 1992 by the parliament, made significant progress on the way of reforms: the

attempts to impose some budget discipline and to make a substantial departure from macroeconomic populism of 1991-1992 were made, the privatization process was accelerated, and a temporary currency, the karbovanets, was introduced.

These measures were not radical enough to withstand the pressure of the interest groups, and the government's deficit skyrocketed as a consequence of issuing massive credits to state enterprises. Ukraine was also too late in leaving the ruble zone, therefore its capacity to pursue independent monetary policy was limited. As a result, by mid-1993 inflation became rampant, the newly introduced Ukrainian currency could not keep the same value as the ruble, and industrial production had fallen rapidly. These processes triggered a struggle between the executive and legislative branches and in May 1993 Kuchma was stripped of his special powers by the parliament.

#### **A Strong Pro-Reform Coalition Is Absent**

To be successfully implemented economic reforms demand extensive cooperation from a number of governmental agencies. Since the bureaucratic apparatus enjoyed total control over the enormous Ukrainian state sector, radical economic reforms would necessarily jeopardize its possibilities for rent-seeking. Therefore bureaucrats at all levels, in order to preserve their privileged positions, defended the gradual approach to reforms, referring to the high social costs of radical reforms, such as closures of ineffective plants, growing unemployment, and necessary cuts in the social sphere. Some of them fundamentally opposed reforms and even deliberately sabotaged the reform process.

The ranks of potential opposition to reform included a wide range of social groups: economic elites that used to benefit from the centrally planned economy, bureaucrats and party functionaries sustained through patronage and clientele networks,

management and employees of inefficient state-owned enterprises. Since the failed August 1991 coup did not produce radical changes and the former state and party functionaries were left mostly in their places, the network of apparatchiks did not want to give their power away voluntarily. In the absence of competitive political mechanisms, only the President and the top ruling elite could overcome the resistance to reforms from the bureaucratic and communist nomenklature networks, especially from the managers of inefficient state-owned enterprises demanding the continuation of state subsidies and market-entry constraints preserving their secure position on the market. President Kravchuk did not make substantial efforts to limit the considerable influence of the old communist elite networks and informal power structures and failed to create a sufficiently large constituency committed to reforms.<sup>111</sup>

The new formally democratic structure, composed of true reformers and former Communist nomenklatura alike, dictated a gradual pace of economic reforms as the only possible way of achieving political consensus. Since Kravchuk relied on political support of the old nomenklatura, his economic policies favored these anti-reform interest groups. Therefore Ukraine's first two years of independence were marked by massive and unbacked credits to heavy industry and the agricultural sector, hyperinflation, limited economic liberalization, and irrationally high taxation policy. Particularly favorable for the nomenklatura were regulations on foreign trade, allowing top government officials

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<sup>111</sup> Oleh Havrylyshyn, "Ukraine," in *The Political Economy of Policy Reform*, ed. John Williamson (Washington, DC: Institute for International Economics, 1994), p.429.

and other members of extensive paternalistic networks inherited from the Soviet times to take advantage and enrich themselves.<sup>112</sup>

In response to domestic and international pressure, Kravchuk trusted the bureaucracy to implement some limited reforms. However, the extraordinary power of the established bureaucracy, having vested interests in maintaining its power and prestige, determined a zigzag course of initiative and retrenchment in reforming the economy. By bargaining extensively with all interest groups, the president achieved only an illusion of short-term political stability. In the long run, however, the leadership's unwillingness to create a strong pro-reform coalition contributed to economic crisis of 1993-1994.

Although any coalition maintenance requires substantial resources to be allocated for this purpose, the initial widespread support of reforms could drastically lower the volume of resources needed. Continuous wasting of state resources in support of half-hearted measures alleviating the high social costs of economic transition via subsidies to large inefficient enterprises neither established a solid social security net nor increased the ranks of the pro-reform coalition. The lack of communication with reform-minded interest groups and the failure of the leadership to send positive signals to all actors in all possible spheres who would benefit from economic reforms eroded further the ranks of supporters of reforms. The party system, potentially capable of facilitating the process of pro-reform coalition building, remained anarchic and ineffective, where a large number of

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<sup>112</sup> John Jaworsky, *Ukraine: Stability and Instability*. McNair Paper 42 (Washington, DC: Institute for National Strategic Studies, National Defense University, 1995), p.8.



small and poorly organized political parties promoted instability rather than stability and hindered the process of building a stable civil society and market economy.<sup>113</sup>

Theoretically, in the Ukrainian historical, political and economic context a strong pro-reform coalition could unite around the nationalist forces, who in order to assure the country's independence and to break the pattern of imperial domination may lead the reform process and intensify economic relations with the West. The Ukrainian People's Movement for Perestroika (Rukh), which was created in September 1989 and incorporated nearly all the opposition groups, potentially could play this unifying role. The movement emerged in the times when all political parties except for the Communist Party were still banned. Therefore Rukh accepted a role of an umbrella civic-political organization for all sorts of non-official parties and groups, including among others Memorial, the Helsinki Rights Group, and the Ukrainian Language Society. Since its inception, the name has changed and the political platform has gone from supporting perestroika to outright independence for Ukraine. At some point the national Communists joined the movement, and astonishing convergence of the western and eastern Ukrainian opposition movements emerged.

Although Rukh was successful in building a stable interethnic coalition leading the movement for independence, its leaders did not emphasize the importance of economic reforms. Therefore, the Rukh's agitation for national independence, which did not include a clear economic program, had limited appeal in the Eastern Ukraine, where

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<sup>113</sup> Andrew Wilson and Arthur Bilous, "Political Parties in Ukraine," *Europe-Asia Studies*

the vote for independence reflected predominantly the belief that economic recovery could be better achieved by independent Ukraine. Too radical nationalist slogans, including for instance the withdrawal from the CIS, hardly could be supported in Eastern Ukraine because the reorientation from the Russian market would impose a heavy burden on this region which could not be structurally reoriented from Russian supplies and market to alternative markets in the short run.

Moreover, the internal tensions within Rukh produced radical realignments in Ukrainian politics in February 1992, and Rukh split essentially between moderate intellectuals like Ivan Drach and Mykhailo Horyn, who wanted Rukh to remain a broad-based political movement offering support to president Kravchuk and his efforts to secure Ukrainian statehood, and the other wing led by Vyacheslav Chornovil who wanted Rukh to challenge Kravchuk to move more rapidly on economic and democratic reforms. In early 1992 the alliance between nationalists and national communists that had backed independence was consummated.<sup>114</sup> A further split within Rukh occurred between nationalist-oriented groupings and those that put less emphasis on national issues and prioritized economic reforms.

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vol.45, no.4 (1993), p.693.

<sup>114</sup> Andrew Wilson, "Ukraine: Two Presidents and Their Powers," in *Postcommunist Presidents*, ed. Ray Taras (Cambridge, New York: Cambridge University Press, 1997), p.73.

**Measuring Ruling Elite's Legitimacy - Examining the Applicability of Non-Economic Tools  
Capable of Reducing the Distributive Pressure**

Any post-Soviet ruling elite may decrease the distributive pressure on its resources by attempting to establish a high degree of congruence between the ruling elite's values and the corresponding values of its constituency.

"If one detects a significant degree of congruence between the key (or at least politically relevant) values and principles held by both the rulers and the ruled, then there is (actual) legitimacy concerning some or all political institutions in that sociopolitical system. In order to assess the degree of such congruence one must compare the public discourses developed by the rulers and the ruled and try to determine to what degree the visions of (among other things) history, political community, national identity, and democracy contained in these discourses are similar. The higher the degree of similarity the higher the degree of legitimacy."<sup>115</sup>

Although it is difficult to envisage a fully consensual regime undergoing fundamental transformation in the post-Soviet space, it is essential for any post-Soviet ruling elite to have a basic amount of behavioral compliance and some degree of support that may be achieved by adopting a program which is attractive to a large segment of society. It may be accomplished through a complicated process of dissemination, discussion, deliberation, and ultimately public acceptance of legal norms, which are established by the new political actors.<sup>116</sup>

Theoretically, if the country is ethnically, ideologically monolithic or the differences among its parts are negligible, the ruling elite may exploit nationalistic

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<sup>115</sup> Jan Kubik, *The Power of Symbols Against the Symbols of Power: The Rise of Solidarity and the Fall of State Socialism in Poland* (University Park, PA: Pennsylvania State University Press, 1994), pp.8-9.

<sup>116</sup> Oleksandr Dergachov, editor et al. *Ukrainian Statehood in the Twentieth Century*

rhetoric to divert attention of the population from the economic issues and ultimately decrease the distributive pressure. Since Ukraine is divided along ethnic and cultural lines, the applicability of such a non-economic legitimacy-building technique is limited. The differences between Eastern and Western Ukrainians, who traditionally define their ethnic identities differently, limit the applicability of Ukrainian nationalist rhetoric as a viable tool to limit distributive pressure. Moreover, if this rhetoric is exploited to its extreme, it may reinforce a whole spectrum of social and political divisions, and ultimately end up in Ukraine splitting along ethnic lines.<sup>117</sup>

Although the Ukrainian ruling elite relied on history in its legitimization policy, this process was plagued with problems. During the Soviet era the historical record was frequently rewritten to serve the political interests of the Soviet regime. When Ukraine gained independence in 1991, the Ukrainian leadership supported the critical and open reexamination of history, particularly of the relationship between Ukraine and Russia. Although the official interpretation claimed a victimized status of Ukraine at the hands of Moscow, such representation of historical experience radically contradicted personal experiences of those who identified themselves with Soviet collective history. Once the Soviet system had been discredited, its achievements dismissed, and the history of Ukraine-Russia relations revised, these people could not easily understand and articulate their place and identity in the post-Soviet era. Instead, they tended to entertain pro-Soviet nostalgia and felt alienated in the transitional society.

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(Kyiv, Political Thought, 1996), p.317.

<sup>117</sup> Roman Szporluk, "Reflections on Ukraine after 1994: The Dilemmas of Nationhood," *The Harriman Review* vol.7, no.7-9 (March-May 1994), pp.1-10.

Those who identified themselves with the Soviet collective historical experience as well as a large Russian minority could treat their continuing incorporation within the larger polity as a form of cultural repression and political subjugation. Even though the official statistics indicated that approximately three-quarters of Ukraine's population consisted of ethnic Ukrainians, this figure was misleading because a significant portion of them spoke Russian in everyday life, and were strongly influenced by Russian culture. If the nationalist rhetoric was exploited further, the emerging split could nurture the imperial ambitions in Russia that ceased to be an empire without Ukraine, as well as aggravate tensions between Ukrainian and Russian speakers within Ukraine, a process which, in turn, could challenge ruling elite's legitimacy.

Although resentment concerning past mistreatment of ethnic Ukrainians under the Soviet Empire remained strong and could be justified, the attempts to pursue radical changes in cultural and linguistic policies necessarily ran the risk of alienating the sizable group of Russophone Ukrainians as well as other ethnic minorities. In Eastern and Southern parts of Ukraine, national identification was more a consequence of the Soviet collapse than a factor substantially contributing to it. Therefore, the Ukrainian leaders strongly opposed the implementation of "Ukrainization" policies in a rapid and injudicious fashion, by crude administrative measures, because it could seriously threaten interethnic harmony in Ukraine.

Some Ukrainian politicians refused to grasp the nature and implications of this specificity. Leaders of UNA-UNSO, an extreme nationalist party based in Lviv, for instance, claimed that Ukraine did not have time for democracy, that force, order and well-being had to be the main priorities of the state. They professed a strong interest in

the aesthetics of terrorism and promised to launch a campaign of terror in Moscow if any part of Ukraine tried to secede. Seeing such extremists wearing camouflage confirmed Eastern Ukrainians' suspicions about seriousness of these claims. Therefore, in the 1994 parliamentary elections, Eastern Ukraine, inhabited mainly by the Russian speaking population economically and culturally closely tied to Russia, backed the Communists, who supposedly could protect them from this radicalism and re-establish extensive contacts with Russia. As a result of the ruling elite's failure to accomplish fast and radical economic reforms and to make the benefits of reforms visible, the re-alignment of the united leftist block of the revived Communist party and socialists enjoyed a landslide victory in parliamentary elections and formed a parliamentary majority (see Table 4.9).

This occurred also because the president Kravchuk mistakenly treated the issues of economic reforms and legitimization independently. Preoccupation of Ukrainian policymakers with statebuilding, external threats and nationalist rhetoric in strengthening the ruling elite's legitimacy barely approximated the views of ordinary Ukrainians whose main concerns focused primarily on domestic affairs.<sup>118</sup> Although the legitimization efforts strengthened Kravchuk's nationalist credentials and public support in Western Ukraine, a rapidly declining economy challenged his positions nationwide. As public opinion polls convincingly indicated, the leadership's popular support fluctuated strongly with its economic performance.

The Kyiv's state-building ethno-linguistic policy, along with the contrast between Russia's relative success in implementing economic reforms and Ukraine's failure to

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<sup>118</sup> "Pro Polituchne Y Sozialne Stanovushe v Ukrayini. Dopovid Presudenta Ukrainu L.

improve living standards of the population, have given the population of Eastern Ukraine an additional cause for complaint. Early indications of regionally distinctive views had grown into persistent calls for autonomy, especially among the Russian-speaking population in Eastern Ukraine and Crimea that eventually ended up in strikes and demonstrations calling for greater local autonomy and even outright separation from Ukraine.<sup>119</sup> In September 1992, for instance, miners from the Eastern Ukrainian Donetsk region, who had played a significant role in struggle against the Soviet system, called for greater autonomy from Kyiv in response to Kyiv's economic policy and the domination of the government by Western Ukrainians. The tensions were temporarily resolved by issuing credits to the most vocal mines and regions.

The leadership assumed that too radical and comprehensive economic reforms would lead necessarily to excessive unemployment which, in the absence of social programs capable of cushioning rising social tensions, could lead to negative political consequences. The Kravchuk administration feared that economic reforms would bring negative political repercussions, challenge the state-building process and increase tensions between Western and Eastern Ukraine. Although the fears that radical economic reforms could end up in social unrest were well grounded, the negative impact of the failure to reform the economy was far more significant. In spite of political and economic polarization between the Western Ukraine, where nationalist fervor ran high, and its Eastern part, where the Russian-speaking population favored the preservation of the

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Kravchuka na Shostiy Sesiyi Verxovnoyi Radu Ukrainu," *Uryadovuy Kuryer*, (Kyiv) no. 40-41, 2 October 1992.

<sup>119</sup> Natalya Yakavenko, *Independent Ukraine, 1991-1995: A Difficult Stage of Development* (Lancashire: UK: Centre for Defence and International Security Studies.

existing economic order, radical economic reforms, providing benefits to the major social strata, could create a political basis of the ruling elite and strengthen the public confidence in desirability of pro-Western foreign policy.

As some polls clearly indicate, the population in all parts of Ukraine was dissatisfied with the economic hardships of transitional period. Shortly before the 1991 vote, an opinion poll indicated that 78 percent of the population named “escape from economic crisis” as their major concern, while the other opinion poll taken prior to the 1994 vote displayed that 71 percent of the population identified “economic crisis” as their most important concern.<sup>120</sup> Despite different political contexts, the election/referendum of 1991 and the elections of 1994 communicated compatible messages, namely the importance of economic issues for the electorate. According to a comprehensive US intelligence analysis, Ukraine’s worsening economy could spark ethnic conflict that would provoke the country’s partition into two states.<sup>121</sup> Therefore the tactic of explaining domestic economic and social difficulties by exploiting the nationalist rhetoric, particularly by blaming the infamous hand of Moscow, which was frequently used by some Ukraine’s politicians, while the reforms were being put off, hardly could unite the country and enhance ruling elite’s legitimacy.

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Lancaster University, 1995).

<sup>120</sup> Zenovia A. Sochor, “No Middle Ground? On the Difficulties of Crafting a Consensus in Ukraine,” *The Harriman Review* vol.9, no.1-2, (Spring 1996), p.58.

<sup>121</sup> Daniel Williams and R. Jeffrey Smith, *The Washington Post*, 25 January 1994, Sec. A, p.7, col.1.



### **Progress of Economic Reforms: Reforms are Virtually Absent**

Ukraine started its transition from the same initial point as the rest of the successor states: the Soviet economy in the late stage of Gorbachev's perestroika was in complete disarray, characterized by a severe balance-of-payment crisis, market shortages, and deep fiscal crisis. Government did not have effective control over state-owned enterprises due to spontaneous decentralization of corporate governance and uncontrolled privatization processes transferring assets and profits of these enterprises either to their managers or other persons. Interrepublican trade declined rapidly as the traditional payment mechanisms deteriorated.

Prior to the declaration of independence, the Ukrainian parliament adopted a set of measures making all USSR Presidential decrees null and void unless they were passed by Ukraine's parliament. In order to create instruments essential for establishing independent statehood, Ukraine nationalized All-Union property by the end of 1991, and placed all external trade under the republic's jurisdiction. An independent national bank and the country's own customs service were established as well.<sup>122</sup>

The existence of a model of democratic market economy to emulate, and the distinct pressures of the domestic and international arenas, put an enormous burden on the Ukrainian ruling elite which had to transform its juridical statehood into effective statehood. The reform blueprint consisted of the following major points: macroeconomic stabilization and structural adjustment including hard budget constraints, tight credit policy to reduce inflation; privatization of state owned companies, deregulation of all

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<sup>122</sup> Alexander Motyl and Bohdan Krawchenko, "Ukraine: From Empire to Statehood," in *New States, New Politics: Building the Post-Soviet Nations*, eds. Ian Bremmer and Ray

sorts of economic activities, establishment of clearly defined and enforced property rights, liberalization with freeing prices, devaluating the national currency, eliminating barriers to the movement of goods, services, technology and ideas; development of a market-supporting institutions with legal, regulatory, fiscal, monetary and social insurance reforms; and to make the process of change, irreversible foreign aid - moral, intellectual and financial - is required.<sup>123</sup> Only when all these components supplement one another reforms can be successful.<sup>124</sup>

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Taras (Cambridge, New York: Cambridge University Press, 1997), p.254.

<sup>123</sup> Shafiqul Islam and Michael Mandelbaum, *Making Markets. Economic Transformation in Eastern Europe and the Post-Soviet States* (New York: Council of Foreign Relations Press, 1993), p.183.

<sup>124</sup> I will analyze in general form how the recommendations transmitted toward developing economies by the International Monetary Fund (IMF) and World Bank were implemented in Ukraine. These recommendations emphasize the following aspects:

“ W1. Balancing the fiscal budget, with a deficit of at most a few percent of GDP, light spending controls, and broadly based taxation programs with low marginal rates;

W1. Price reform, aiming at positive (presumably moderate) real interest rates and a weak, stable exchange rate;

W3. Trade liberalization and a cordial attitude toward direct foreign investment (DFI);

W4. Privatization of state enterprises; and

W5. Deregulation of market, especially for labor.

To these principles, Fischer (1990) and the World bank's 1991 *World Development Report* (or WDR) would add

W6. A need for “sound” macroeconomic policy and at least a rudimentary social safety net,

with the World Bank also stressing

W7. The positive effects on growth and distribution of accumulation of human capital.

Finally, there is agreement on policy sequencing:

W8. “Stabilization” or removal of macroeconomically disabling balance of payments and fiscal gaps as well as inflation has to come before “adjustment” or creation of conditions for sustainable growth. As noted at the outset of this chapter, together with institutional changes, stabilization and adjustment are supposed to produce viable “reform.” In Lance Taylor, “Stabilization, Adjustment, and Reform,” in *The Rocky Road to Reform. Adjustment, Income Distribution, and Growth in the Developing World*, ed. Lance Taylor (Cambridge, MA: The MIT Press, 1993), pp.40-41.

Since the leadership was unwilling to pursue radical economic reforms, and the pro-reform coalition was absent, the Kravchuk administration tended to define economic issues restrictively and approached them in terms of crisis management rather than addressing them strategically. Instead of pursuing economic reforms, the Ukrainian leadership expended most of its energy on political squabbling and ultimately the transition was shaped by a process of negotiations and compromises, that limited the government's ability to implement unpopular austerity and adjustment programs. When the costs of transition for the population definitely exceeded expectations, the pressure for the welfare re-orientation of economic policy and less capitalism increased. Lack of patience with the pace of change, incompetence and corruption on the part of political leaders, and absence of tangible benefits of economic reforms led the people to become discontented with their conditions. Therefore, the so-called reform syndrome - "leaders firmly committed to major change, widespread public acceptance or demand for such change, new governments with strong centralized authority, and a disabled opposition"<sup>125</sup> - was absent. As a result, the economy spun increasingly out of control.<sup>126</sup>

Inability to cut a huge bureaucracy and change its behavioral patterns from traditional repression and suffocation of all initiative to the promotion and steering of initiative and the reform process resulted in an inefficient system. A wide range of rent

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<sup>125</sup> Joan M. Nelson, "The Politics of Long-Haul Economic Reform," in *Fragile Coalitions: The Politics of Economic Adjustment*. Joan M. Nelson and contributors (New Brunswick, NJ: Transaction Books, 1989), p.12.

<sup>126</sup> I agree with Beth Breger who argues that "economic reform in Ukraine presents a prime example of the problems associated with "political economy"." Beth Breger, *Developing a Competitive Edge: Strategies for Belarus and Ukraine to Attract Foreign Investments*, series: Policy Analysis Exercise (Cambridge, MA: John F. Kennedy School of Government, 1993), p.13.

seekers, including the former Communist party highly-ranked officials, Soviet-type bureaucracy and plant managers constituted a powerful alliance of interest groups opposing reforms and benefiting from administrative interventions into the economy.<sup>127</sup> A substantial administrative control over exports, for instance, allowed the bureaucracy to continue extracting rents by manipulating a complicated set of licenses and quotas designed to control trade and access to hard currency.<sup>128</sup> Since the difference between domestic and world prices was substantial, it allowed the informal networks of state bureaucracy and new business people to acquire significant benefits from issuing licenses and quotas. For example, the government granted a license to import oil from Russia to a company with an obscure structure. The license gave it the right to pay for the oil with roubles bought at an exchange rate fixed at about a third of the market rate and eventually to sell the oil in Ukraine at the market prices. Also the state bureaucracy extensively exploited the informal linkages established under the Soviet Empire and enjoyed a direct and unrestricted access to functioning of the auctions-sales, dealing with both the problems of "big and small-scale privatization," dealer offices as well as to investments funds.

When the ruling elite made some attempts at dismantling the system of permanent subsidies, and trade with the West was partially liberalized, Western goods flooded in

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<sup>127</sup> Roman Shpek, "Zuttya Stane Kraschum," *Uryadovuy Kuryer* (Kyiv) no.19, 4 February 1995, p.3.

<sup>128</sup> The networks and connections allowed some state officials and members of the parliament to enjoy a preferential treatment in getting licenses to re-export imported from Russia oil (when Ukraine experienced severe energy crisis). See, Volodymyr Ilchenko, "Teche Nafta v Ukrainu, ale y Vutikaye," *Uryadovuy Kuryer* (Kyiv) no.60, 9 December 1992.

without producing significant tax revenue.<sup>129</sup> This threatened positions of many domestic producers who could not effectively compete with Western goods on the basis of quality. Instead of advancing the liberalization process, the export opportunities were suppressed and a foreign currency surrender was imposed. In conditions when the difference between the official and black-market exchange rate was threefold in the second half of 1993, these measures not only encouraged various forms of illegal activities but also imposed an additional exchange tax on exports. Industries and enterprises willing to gain state licenses to export and import had to become deeply involved in a web of corruption extending from state officials in Kyiv to customs officers. Although some progress was made in 1993 when firms were allowed to export regardless of the quota system by paying an export tariff, the export regulations remained complicated and restrictive, with many loopholes for the well-informed.<sup>130</sup>

Various commercial structures and private enterprises, exploiting their good connections with state officials, in the absence of transparent rules and institutions regulating foreign economic activities, benefited from continuous depreciation in the value of domestic currency and deposited illegally their revenues in foreign banks. As a result, the Ukrainian government has constantly experienced shortages of convertible funds and lost, according to some estimates, approximately \$15 billion in 1991-1994.<sup>131</sup>

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<sup>129</sup> The government introduced higher import duties only in 1995.

<sup>130</sup> Marek Dabrowski and Rafal Antczak, "Economic Transition in Russia, Ukraine, and Belarus," in *Economic Transition in Russia and the New States of Eurasia*, ed. Bartłomiej Kaminski (Armonk, NY: M.E. Sharpe, 1996), p.54.

<sup>131</sup> Serhii Pyrozhev and Valerii Popovkin, "Ukraine's Economy Today," *Ukrainian Economic Review* vol.1, no.1-2 (1995), p.6.

Moving to international prices for goods and services subjected Ukraine to a remarkable terms-of-trade loss in the energy sector. Due to the Soviet economic policy of energy intensive development, Ukraine ended up in 1991 as a major energy importer. While in 1970 Ukraine covered 100 percent of its energy needs, in 1975 this declined to 98 percent, in 1980 it was 75 percent, and in 1985 to 58 percent.<sup>132</sup> Instead of encouraging exports to offset its balance-of-payments deficit with Russia (due to rising energy bills) and prevent a frightening economic free-fall, the leadership continued to maintain a system of confiscatory taxes discouraging economic activities.

The increased administrative intervention designed to maintain the country's production and trade patterns and compensate for trade losses was quite ineffective. Since the Soviet type enterprises were indifferent to world prices and the whole idea of competing at the international markets was adverse to the institutional design of the centrally planned economy, significant government efforts were needed to reduce the antitrade bias and expose domestic firms to international competitive markets.

When Russia removed state subsidies on many items, prices soared and many Ukrainian goods went to Russia, harming the Ukrainian consumers. As a result, the Ukrainian authorities felt compelled to initiate remedial measures intended to protect Ukraine's economy from price increases in neighboring and tightly economically linked Russia.<sup>133</sup> The system of administered prices continued to dominate over the rest of 1992

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<sup>132</sup> Tetiana Pakhomova and Serhii Mischenko, "Ukraine's External Trade," in *The Ukrainian Economy. Achievements, Problems, Challenges*, ed. I.S. Koropecykj (Cambridge, MA: Harvard University Press, 1992), p.374.

<sup>133</sup> "Ukraine Approves an Economic Plan that Threatens to Weaken Ties to CIS," *The Wall Street Journal*, 25 March 1992, Sec.A, p.8, col.1.

and in 1993; however, the government raised most controlled prices substantially. In 1993 the government had planned to raise retail prices, but the parliament imposed a moratorium on such increases which was only lifted in June. Although prices of coal, natural gas, crude oil, electricity, municipal services, and rents were increased, pressure from the parliament and trade unions led to the rollback of certain increases and widening of the scope of price regulation. A more comprehensive approach to price liberalization was adopted only in October 1994 after signing a Systemic Transformation Facility agreement with the IMF.

In conditions when price liberalization proceeded faster than privatization, the Ukrainian leadership continued providing capital to inefficient state enterprises to keep them afloat. Instead of adjusting to newly introduced market relations, managers of these enterprises began to incur debt. The solution to the debt problem was usually socialist in its spirit: managers of large inefficient state enterprises, relying on their good informal contacts with state banks, were receiving credits at the expense of new private and potentially more efficient enterprises. Also the informal links were widely exploited in the horizontal interfirm relations where suppliers extended credit to their customers with a purpose of protecting their markets, while customers made loans to suppliers to guarantee the flow of necessary supplies.<sup>134</sup> As a result, enterprises were engaged in complex cross-indebtedness relations where delay or postponement of past-due payments was a common practice.

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<sup>134</sup> Only in January-March 1994 the volume of this type of indebtedness increased in 1.8 times. See, "Ekonomika Ukrainu u Sichni-Kvitni 1994," *Uryadovuy Kuryer* (Kyiv) no.80-81, 26 May 1994.

The ruling elite supported large inefficient state enterprises not only because the private sector was underdeveloped and unable to absorb all those who would be laid off if state owned enterprises went bankrupt, but also in response to pressure from a natural community of interest between management and workforce, equally attempting to prevent closure and lay-offs. Subsidies to producers and consumers took 40 percent of the total fiscal revenue. Particularly massively spread was the practice of subsidizing inefficient enterprises in Ukraine's agricultural sector: the government under the pressure of a strong and politically conservative agrarian lobby, increased seasonal subsidies for fuel and other inputs to agricultural sector, which spurred hyperinflation. According to some estimates, up to 70 percent of Ukraine's post-independence inflation (10,000 percent in 1993) was the consequence of printing money for cheap credits to the agricultural sectors.<sup>135</sup> The National Bank of Ukraine, as an institution accountable to the parliament, found it difficult and even impossible to refuse credit demands from industrial and agrarian interest groups whose representatives dominated the legislature.<sup>136</sup>

In the absence of clear market rules and institutions capable of enforcing these rules, private entrepreneurs accumulated capital in illegal or semi-legal ways. A wide range of small and large financial scams designed to milk money either from the state treasury or common people emerged. Obviously, the state had neither means nor

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<sup>135</sup> Chrystyna Lapychak, "Quarrels Over Land Reform," *Transition*, 1 December 1995, p.54.

<sup>136</sup> Adrian Karatnycky, Alexander Motyl, and Charles Graybow, eds. *Nations in Transit 1998: Civil Society, Democracy, and Markets in East Central Europe and the Newly Independent States* (New Brunswick, NJ: Transaction Books, 1999), p.628.



expertise to monitor and tax these activities hidden in the underground economy. Even if the enterprise was officially registered, underdeveloped regulatory structure, ambiguous law, and corrupted officials allowed it to avoid paying taxes, or at least decrease the tax burden. The most common practice in Ukraine was to keep two sets of books -- one for internal use, and another one for the state officials. Given the absurdity and confusing nature of some Ukrainian laws, even respectable business people were forced to break them to assure their survival. In the growing atmosphere of violence and distortion when the state could not guarantee social order and protection, links with organized crime capable of guaranteeing or pretending to guarantee personal security became an asset.

By 1994 it became clear that the Ukrainian government failed to introduce comprehensive economic reforms (see Table 4.7 and Table 4.8). The government's policies changed continuously, reforms were half-hearted and progress towards market economy was extremely slow. The state of disarray, political fragmentation, and absence of mechanisms of conflict resolution at the level of the state hampered the emergence of a broad consensus over the necessity of economic reforms. In the absence of consistent economic reforms, Ukraine experienced one of the worst combinations of depression and inflation - its real gross domestic product fell by 56 percent during 1991-1995, while gross industrial and agricultural production declined by 47 percent and 39 percent, respectively.<sup>137</sup> During 1993 the inflation was the highest among all Eastern European

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<sup>137</sup> Ben Slay, "An Economy at the Crossroads," *Transition*, 15 November 1996, p.51.

countries - - around 3,500% per year.<sup>138</sup> The government did not even try to decrease the budget deficit - - "in 1992 the government planned to spend 45% of GDP. It ended up spending over 70%. In 1993 it did not even try to cut back: the budget planned spending equal to 73.4% of GDP."<sup>139</sup> Moreover, macroeconomic uncertainties and lack of progress in economic reforms limited Ukraine's access to external financing. The Ukrainian goods could not effectively compete in the Western markets, and the economy remained closely tied to the CIS, and particularly Russian markets (see Table 4.5 and Table 4.6).<sup>140</sup>

### **Foreign Policy Towards Russia: Some Changes are Necessary**

In the following section of this chapter, I explore how the pattern of domestic economic reforms, affecting the ruling elite's ability to mobilize economic resources, necessitated the adjustment of foreign policy. I started this chapter with a comprehensive analysis of the initial foreign policy stance of Ukraine, immediately following independence. Since at that point the Ukrainian ruling elite did not face problems with mobilizing economic resources, economic issues were disregarded and the need to develop and exploit linking strategies maximizing the inflow of economic resources was absent. As soon as the major threats to the ruling elite's security shifted to the domestic level, requiring the improvement of the state's resource mobilization capacity, it appeared

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<sup>138</sup> Roth Terence, "Gap Widens Between Winners and Losers. Western, Domestic Investors Act as Judges," *Central European Economic Review* (Spring 1994), p.7.

<sup>139</sup> Andrew Cowley, "Ukraine. The Birth and Possible Death of a Country," *The Economist*, 7 May 1994, p.6.

<sup>140</sup> "Yakum Bytu Ekonomichnomu Soyuzovi?" *Uryadovuy Kuryer* (Kyiv), no. 111, 24 July 1993.

too politically costly for Leonid Kravchuk to ignore them; therefore since 1993 foreign policy making incorporates the ruling elite's economic calculations.

Although president Kravchuk always advocated the idea that the economic relations with Russia should be independent from political issues,<sup>141</sup> he hardly could sustain this approach in practice. Since the Ukrainian ruling elite was not willing to introduce economic reforms, a strong pro-reform coalition was absent, and the applicability of non-economic means limiting the distributive pressure was limited, the role of foreign policy in attracting economic resources increased tremendously.

### **Nuclear Legacy**

Shortly after the USA and the USSR signed the START Treaty on 31 July 1991, the USSR collapsed, and four states with nuclear weapons appeared on the map of Europe. Outside Russia, Ukraine possessed the largest inventory of strategic and tactical nuclear weapons in 1991: it inherited 176 inter-continental ballistic missiles (ICBMs) with a total of 1240 warheads as well as substantial arsenal of tactical nuclear weapons.

On December 30, 1991 the CIS states' leaders reached an agreement that the decision on the need for use of nuclear weapons should be made by the president of the Russian Federation in agreement with the leaders of Belarus, Kazakhstan, and Ukraine, and in consultation with the heads of the other CIS members; however, the real authority to launch nuclear weapons was moved to Russia. From the technical point of view, Russia could issue launch orders alone. Therefore joint CIS control of strategic nuclear weapons remained a polite fiction, even though Kravchuk claimed on several occasions

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<sup>141</sup> "Golovne - Vuzutu Ekonomichno. Leonid Kravchuk pro Podiyi b Moskvi i Pozuziyu Ukrainu," *Uryadovuy Kuryer* (Kyiv), no.48-49, 1 April 1993.

that Ukrainian authorities had the physical capacity to block the launch of missiles deployed on Ukrainian soil.

Realizing the fact that the existence of independent Ukraine should be guaranteed internationally, Kravchuk tried to pursue pro-Western foreign policy and obtain security guarantees. The West, however, failed to acknowledge the peculiarity of the Ukrainian situation and properly assist in its search for international security because of a Russocentric bias dominating the Western approach to the newly independent states. The bias was reflected, particularly, in the assessments of the attempts made by republics to explore for themselves the road to Europe and to establish independent contacts with the West which were often portrayed and perceived as a dangerous, isolationist nationalism.

The West's position towards Ukraine did not change dramatically when the Soviet Union collapsed. Even though the Western powers unanimously agreed that external support was essential for successful transition, the actual Western policy towards the newly independent states continued to be Russocentric, thus not allowing the former USSR republics to enter the international community as equals. In 1991-1992 the U.S. policy still sought to preserve the image of Russia as a still-powerful country - - Washington preferred to deal with a single big, de facto imperial, negotiating power in economic and security issues rather than to negotiate with a multiplicity of new and relatively unpredictable recently independent CIS states.<sup>142</sup> The West turned a blind eye to the extension of Russian influence throughout the newly independent states except for the Baltics. Therefore during the first year and a half of Ukraine's independence, US-

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<sup>142</sup> Yaroslav Bilinsky, "Basic Factors in the Foreign Policy of Ukraine. The Impact of the

Ukrainian relations were, to a large degree, one side of a triangular relationship involving Russia as well.<sup>143</sup>

The most immediate concern of the West was the fate of nuclear weapons and accompanying facilities located on Ukrainian territory. Ukraine attracted special attention because it was believed that the new leaders of this country may attempt to gain operational control of the large number of nuclear weapons. The West and Russia were particularly concerned about tactical nuclear weapons, which could be used by extremist groups in the event of chaos, or could easily be sold abroad.

Kravchuk tried to attract Western attention to Ukraine's security problems by questioning the right of Russia to ratify the START treaty on behalf of Ukraine possessing a large number of nuclear systems. In response to this pressure, on 23 May 1992 the Protocol to Facilitate the Implementation of the START Treaty (Lisbon Protocol) was signed by then US Secretary of State James Baker and the foreign ministers of Belarus, Kazakhstan, Russia and Ukraine. The protocol recognized all four states as parties to the START Treaty and provided for the adherence of Belarus, Kazakhstan and Ukraine to the NPT. The Lisbon Protocol did not resolve the nuclear weapons issue completely, and some problems remained, for instance, the sale of enriched uranium extracted from warheads located on the Ukrainian territory.

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Soviet Experience," in *The Legacy of History in Russia and the New States of Eurasia*, ed. S. Frederick Starr (Armonk, New York: M.E.Sharpe, 1994), p.173.

<sup>143</sup> *The Future of Ukrainian-American Relations. Joint Policy Statement with Joint Policy Recommendations* (Kyiv: The Atlantic Council of the USA and the Institute of World Economy and International Relations of the Academy of Sciences of Ukraine, February 1995), p.10.

Opponents of unilateral disarmament argued that Ukraine, taking into consideration Russian imperial ambitions as well as the clearly pro-Russian policy of the Western powers, had to keep its nuclear weapons in the face of unpredictable and potentially dangerous Russia.<sup>144</sup> A mistrust of real Western intentions in Ukraine grew in response to extremely limited foreign aid absolutely incompatible with the needs of reforming economy. Unable to acquire Western security guarantees, and responding to Russia's constant economic pressure and warnings that it could not allow Ukraine to remain a nuclear power, the position of Ukraine hardened over the strategic nuclear missiles that was reflected in its unwillingness to ratify START I, the Lisbon Protocol and the Nuclear Nonproliferation Treaty (NPT).

Unlike their Western and Russian counterparts, Ukrainian leaders treated the nuclear problem broadly, beyond the narrow military aspect. As the discussions in the Ukrainian Parliament over the nuclear issues clearly indicated, it was widely believed that nuclear weapons could assure the international security of Ukraine, and once Ukraine gets rid of its nuclear arsenal, its importance to the West would decline dramatically. It was believed that Ukraine needed its own nuclear arsenal to prevent possible Russian aggression and protect Ukraine's independence. Therefore Ukrainian nationalists continued to accuse the government of treason in acquiescing to the disarmament program.

Ukraine's hesitation to speed up the process of ratifying START I and joining the NPT regime was fueled by Russian claims to Sevastopol and the Black Sea Fleet and

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<sup>144</sup> Jane Perlez, "Fear of Russia is a Way of Life for Ukraine," *The New York Times*, 16

pronouncements by some Russian politicians and generals on the right of peacekeeping on former Soviet territory. It was believed that strategic nuclear weapons could play a deterrent role against Russia.<sup>145</sup> It was a radical turn from the initial position of July 1990 when the Ukrainian parliament clearly stated in its sovereignty declaration its intention to become a nuclear-weapon-free state.

In the absence of any significant progress in creating the framework for a well-functioning market economy, Ukraine entered acute economic crisis in 1993 and hit bottom. The international threats to the ruling elite's security receded in significance in comparison with the domestic ones. The ruling elites started to share the public's perceptions of threats to national security, which were expressed as early as February 1992 in a public opinion poll when 40 percent of Ukrainian respondents had mentioned domestic difficulties as the main threat to the country's security, while only 22 percent cited other CIS states, presumably Russia.<sup>146</sup>

Since 1993 the Ukrainian leaders have incorporated economic calculations into foreign policy making process: Ukraine made conditional its ratification of START I and the NPT, demanding compensation for nuclear weapons materials, security guarantees from the nuclear powers as well as financial assistance for its disarmament program.

Kravchuk clearly used nuclear weapons not just for deterrence, but also for political and

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January 1994, p.3, col.1.

<sup>145</sup> Nicholas S. H. Krawciw, "Ukrainian Perspectives on National Security and Ukrainian Military Doctrine," in *State Building and Military Power in Russia and the New States of Eurasia*, ed. Bruce Parrott (Armonk, New York: M.E.Sharpe, 1995), p.145.

<sup>146</sup> Ilya Prizel, "The Influence of Ethnicity on Foreign Policy. The Case of Ukraine," in *National Identity and Ethnicity in Russia and the New States of Eurasia*, ed. Roman Szporluk, series: The International Politics of Eurasia (Armonk, New York: M.E.Sharpe, 1994), vol.2, p.123.

economic demands upon NATO, the United States, and Russia.<sup>147</sup> In the parliamentary vote on November 18, 1993, Ukrainian lawmakers set strict conditions including security guarantees and additional foreign aid of \$2.8-\$5 billion.<sup>148</sup> When the US, Russia, France, the UK and China, as nuclear powers, offered assistance to Ukraine if a nuclear threat emerged, Kravchuk came up with a broad interpretation of security guarantees including assistance in cases when the pressure was either economic or political. He accused the West of failing to offer Ukraine help in disarmament and said that Ukraine did not have alternative but to keep some nuclear weapons.<sup>149</sup>

The Ukrainian ruling elite's hardened stance with regard to nuclear weapons, and particularly the strong linkage it tried to establish between ratification of the NPT and other treaties and provision of Western security guarantees and generous economic support, created and confirmed deep suspicions about the leadership's actual interests and intentions. As *The Economist* summarized it: the government and parliament have tried "... to use the nuclear missiles based in Ukraine to blackmail the rest of the world for handouts of cash."<sup>150</sup>

The Ukrainian leadership realized that Ukraine was excluded from nuclear related negotiations, and the fact of signing the 1993 START II treaty by the United States and

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<sup>147</sup> On April 8, 1993 the Ukrainian government emphasized that the timing of nuclear weapons removal from Ukraine would depend on a wide range of factors, such as the progress in Russia-Ukraine talks over the liquidation of these weapons including the issue of compensation for nuclear fussion. See, "Zayava Press-Sluzby Kabinetu Ministriv Ukrainu," *Uryadovuy Kuryer* (Kyiv), no. 52-53, 8 April 1993, p.2.

<sup>148</sup> Steven Erlanger, "Ukraine's Hedging on A-arms Angers Russia," *The New York Times*, 22 November 1993, Sec.A, p.3, col.1.

<sup>149</sup> *The Wall Street Journal*, 20 October 1993, Sec. A, p.1, col.3

<sup>150</sup> "Ukraine on the Brink," *The Economist*, 27 November 1993, p.17.



Russia when Ukraine had not been consulted clearly confirmed that. Lacking a pragmatic approach to foreign policy, pursuing a set of highly ambitious goals, the Ukrainian leadership decided to be tough by playing the nuclear card: the Ukrainian leaders asserted a non-conformist stance and assumed direct control over nuclear missiles and long-range nuclear capable bombers. Moreover, when joint CIS control over nuclear weapons was abolished. Kravchuk stated that Ukraine intended to keep 46 SS-24 ICBMs carrying 460 warheads. These ambitions hardly could materialize: even though Kyiv placed all military forces in Ukraine under its control, and Ukraine gained a direct control over the Strategic Rocket Troops, it was not enough to get actual control over nuclear missiles. Also Ukraine had neither the launch codes nor the adequate targeting software to re-target the missiles. In order to become a full-fledged nuclear power, Ukraine had to become capable of blocking the launch of nuclear missiles fired from the center in Moscow, re-targeting the security system, developing and maintaining the necessary infrastructure including early warning systems, communication centers, and assistance guidance software - - a task that hardly could be accomplished by a country experiencing dramatic transition and lacking sufficient economic resources.

In addition to bargaining with the Western powers and Russia for security guarantees, Kravchuk came up with a wide spectrum of cooperation proposals involving small and medium-sized post-Communist states of Central and Eastern Europe that ranged from economic cooperation to a defensive alliance. Since Ukraine was in a zone of instability, the president launched an initiative to establish in East Central Europe a region of stability and security which would encompass the countries from the Baltic to the Black Sea. Implementing this strategy, the Ukrainian ruling elite tried to approach the

Visegrad group, and though its members — the Czech Republic, Slovakia, Hungary and Poland — were open to bilateral cooperation, the prospects of autonomous Central and Eastern European integration were quite limited in comparison with dynamic and more attractive West European integration processes.

Pretty soon it became clear that further continuation of the nuclear autonomy policy would increase Ukrainian isolation from the West as well as from Russia. In the economic dimension, the Ukraine's increasingly pro-nuclear stance contributed to worsening relations with the West pressuring the World Bank and IMF to find reasons not to help Ukraine. Although during Kravchuk's visit to the USA in May 1992 the Bush administration agreed to extend most favored nation status to Ukraine, the actual results of direct and indirect economic assistance were limited. Moreover, the Clinton administration threatened in 1993 to withhold most US aid to Ukraine because of the Ukrainian leaders' unwillingness to give up the nuclear weapons inherited from the Soviet Union.<sup>151</sup>

Facing a desperate need for external economic resources to address domestic threats to ruling elite's security, and realizing that in the absence of real economic reforms those resources could not be obtained from the West, the Ukrainian leadership had to adjust the Soviet model of center-periphery relations to new conditions in order to obtain some forms of economic benefits from Russia. Although "emotions and ambitions"<sup>152</sup> dominated in relations with Russia in 1991-1993, one of the first attempts

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<sup>151</sup> Terry Atlas, "U.S. Warns Ukraine: Give up Nuclear Arms or Lose Aid," *Chicago Tribune*, 4 December 1993, Sec.1, p.1, col.2.

<sup>152</sup> Petro Tolochko, "Chu Potribna Ukraini Rossiya?" *Uryadovuy Kuryer* (Kyiv) no. 6, 11

to exploit foreign policy towards Russia to acquire economic resources was made in the autumn of 1993 when the Ukrainian and Russian presidents met in Massandra in the Crimea and reached an agreement to transfer all nuclear warheads from Ukraine to Russia for dismantling in exchange for fissionable resources.

Once the Ukrainian leadership realized that the domestic threats and costs of keeping nuclear weapons exceeded the international danger associated with an unpredictable and potentially dangerous Russia, the Ukrainian nuclear stance became more conciliatory. As a result, Leonid Kravchuk signed in January 1994 the “Trilateral Statement on Ukrainian Nuclear Weapons” which indicated that at least 200 warheads of Ukrainian SS-24s and SS-19s were to be removed within 10 months, while all the remaining warheads would be transferred to Russia in the shortest possible time.<sup>153</sup> According to this agreement, Ukraine agreed to accede to START-I and the NPT in return for compensation and security guarantees. In exchange, Ukraine was promised enriched uranium from these warheads as fuel for nuclear plants as well as financial assistance from the US for dismantling purposes — Ukraine had to receive nuclear fuel from Russia (its value was \$1 billion) and at least \$175 million from the US to dismantle Ukrainian nuclear forces.<sup>154</sup>

Although the Ukrainian officials mentioned security guarantees as the major reason they agreed to join NPT, the timing of this decision clearly indicates that the

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January 1994, p.6.

<sup>153</sup> “Trustoronnya Zayava Presudentiv Ukrainu, SShA ta Rosiyi,” *Uryadovuy Kuryer* (Kyiv) no.18, 18 January 1994, p.3.

<sup>154</sup> Olexiy Haran, *Disintegration of the Soviet Union and the US Position on the Independence of Ukraine*, series: CSIA Discussion Paper 95-09 (Cambridge, MA: Center for Science and International Affairs, John F. Kennedy School of Government,

economic calculations determined this foreign policy change. The ruling elite realized that the domestic economic threats to its security exceeded Russian military or political threats, therefore the leadership, in order to gain some economic benefits from Russia, displayed loyalty to its former hegemon by giving up its nuclear ambitions and nuclear weapons capable of limiting the extent of Russia's imperial pretensions.<sup>155</sup>

### CIS and Russia

Some Russian political figures often linked the question of Ukraine-Russia borders to Russia's prerogative in protecting the interests of Russians and Russian speakers in Ukraine, which accounted for almost 22% of the country's population. Initially such an approach was supported by Boris Yeltsin — two days after the Ukrainian declaration of independence, Yeltsin's press office issued a statement in his name claiming that Russia reserved the right to review its borders with those republics who express their intent to withdraw from the USSR (except for the Baltic states).<sup>156</sup>

As scholars of Russian politics almost unanimously point out, the Yeltsin government was unlikely to launch a massive military attack on Ukraine,<sup>157</sup> but fears about the future policies of a volatile and unsettled Russia mattered in the security calculations of the Ukrainian leadership.<sup>158</sup> Although the 1991 Minsk and Alma-Ata

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Harvard University, 1995), pp.33-35.

<sup>155</sup> Bohdan Lupiy, *Ukraine and European Security: International Mechanisms as Non-Military Security Options for Ukraine* (Berlin; New York: P. Lung, 1996), p.45.

<sup>156</sup> Roman Solchanyk, "The Politics of State Building: Centre-Periphery Relations in Post-Soviet Ukraine," *Europe-Asia Studies*, vol.46, no.1, 1994, p.47.

<sup>157</sup> Karen Dawisha, "Constructing and Deconstructing Empire in the Post-Soviet Space," in *The End of Empire? The Transformation of the USSR in Comparative Perspective*, eds. Karen Dawisha and Bruce Parrott, series: The International Politics of Eurasia (Armonk, NY: M.E.Sharpe, 1997), vol.9, p.347.

<sup>158</sup> Stephen J. Blank, *Russia, Ukraine and European Security* (Carlisle Barracks, PA:

accords considered Russia as the successor state of the USSR in the United Nations Security Council, Russian authorities decided to move further and declared Russia the Soviet Union's successor state in all respects, including disarmament and debt repayment. In addition, Russia immediately seized all Soviet property at home and abroad, all hard currency and gold reserves as well as all of the former USSR's embassies and consulates.<sup>159</sup> Andrei Kozyrev, Russian foreign minister, demanded UN and CSCE mandates to conduct peacekeeping operations within the former USSR, meaning ultimately the right of unilateral intervention if any threats to peace and stability in the region arose. The willingness of Russia to dominate the CIS process, particularly its claim to play a special role in assuring stability throughout the entire territory of the former Soviet Union, were viewed in Ukraine as an attempt to reestablish Russian dominance in the region.

The Russian authorities, acknowledging the inapplicability of military means, used economic instruments of exerting Russian influence in the "Near Abroad," and treated the CIS as the basis for a future political and military union of the former USSR republics with Russia leading the process. Although officially Russia claimed that the economic coordination within the CIS was necessary to enhance the economic efficiency and it had nothing to do with political integration, dependence of the post-Soviet states on Russian energy resources and market facilitated the advancement of the Russian version of CIS integration.

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Strategic Studies Institute, U.S. Army War College, 1993), p.3.

<sup>159</sup> Alexander J. Motyl, *Dilemmas of Independence: Ukraine After Totalitarianism* (New York: Council on Foreign Relations Press, 1993), p.107.

In 1991-1992 the Russian authorities heavily subsidized the peripheral energy importers and the energy and raw materials exports to the CIS were grossly underpriced. When the Ukrainian leadership decided to cut the economy off from Russia by trading at world prices in 1992, it grossly misjudged the real economic relations with Russia under the Soviet Empire, assuming that Russia had sucked out economic resources from Ukraine and did not give enough in return. Russia, instead, was heavily subsidizing Ukraine by supplying around 50 million tons of oil and a substantial amount of gas each year at a fraction of world prices. Due to the peculiar economic structure and incorporation into the Soviet military-industrial sector, the relationship between Ukrainian and Russian economies was extremely close. The closeness was reinforced by the energy policies of the imperial center.

When Ukraine gained independence, the Ukrainian leaders did not properly evaluate the importance of economic issues in securing their country's independence. Since Ukraine could meet only about 10 percent of its oil needs and 20 percent of its natural gas needs through domestic production, it had to import 30 to 35 million tons of oil and 85 billion to 90 billion cubic meters of gas per year, which required allocation of \$9 billion to \$15 billion for this purpose yearly.<sup>160</sup>

In June 1993 Russia and Ukraine reached an agreement regulating energy deliveries. According to it, Russia charges the world prices for its energy deliveries from the start of 1994, with Ukraine receiving payments in world prices for pipeline

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<sup>160</sup> Ustina Markus, "Debt and Desperation," *Transition*, 14 April 1995, p.14.

transshipment of Russia's oil and gas across its territory to Europe.<sup>161</sup> Taking into consideration the fact that prices of oil and gas for the former Soviet republics in 1991 were approximately 34-46 percent of the corresponding world levels, the Russia's decision to remove the implicit energy subsidies had a series of negative economic consequences for Ukraine. It increased the energy bill to Russia as well as depressed Ukraine's import capacities and domestic economic activities. It was a situation ironically resembling the lack of an adequate response to Moscow's unilateral decision to liberalize prices in early January 1992.

When the threat of an energy crisis became real, the Ukrainian ruling elite realized that it was utterly unprepared to adjust the economy to new circumstances. Repeated price hikes of Russian energy imports created sizable trade deficits and led to an overall shrinking of economic activities. In response, the Ukrainian leadership increased administrative intervention to maintain the country's production and trade patterns. Also some attempts at gaining access to alternative energy resources, such as Iran and Turkmenistan, were made. They hardly could bring any significant results because the ruling elite, in the absence of radical economic reforms providing it with economic resources, could not assure full payment for energy supplies.<sup>162</sup>

The Ukrainian leadership started to exploit Russia's dependence on Ukraine — since 90 percent of Russia's natural gas exports, constituting the biggest source of

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161 "Peregovoru u Pidmoskovyi," *Uryadovuy Kuryer* (Kyiv) no.91, 19 June 1993, pp.1-2.

162 This fact was emphasized by Prime-Minister Leonid Kuchma in 1993. See, "Ne Plutaymo Syogodnishni Zludni z Nashum Realnum Potenzialom. Vustyp Premyer-Ministra Ukrainu L.D.Kuchmu na Sasidanni Verxovnoyi Radu Ukrainu 31 serpnia 1993 r.," *Uryadovuy Kuryer* (Kyiv) no.132-33, 2 September 1993, p.5.

currency, ran through the territory of Ukraine, and the cost of a full shutoff of Russian gas supplies would be too great for Gazprom, Ukraine could always secure 50 million to 80 million cubic meters of gas daily as a transit fee. Moreover, when Russia started to cut off gas to Ukraine on March 3, 1994, because it did not pay for previous deliveries, Ukrainian officials openly warned that a cutoff might result in siphoning from pipelines that cross Ukraine to Western and Eastern Europe.<sup>163</sup> In some instances when Gazprom drastically reduced gas supplies to Ukraine to punish it for the unpaid gas bills, the Ukrainian authorities started to siphon off gas supplies that passed through Ukraine to Western Europe.

In general, the Ukraine's inability to pay world prices for imported gas and oil was a result of economic mismanagement and failure to accomplish economic reforms. By autumn 1993 the government was dominated by representatives of managers of state-owned enterprises who instead of economic reforms, favored traditional socialist approaches to managing the economy, including restoration of economic ties with Russia, previously broken as a result of imperial collapse. The failure to incorporate the tasks of economic transformation and recovery into the Ukrainian statehood building project along with a strong reliance upon gas and oil imports from Russia and Turkmenistan opened up the prospect of further, possibly unsustainable, burdens on the unreformed economy.

When it became clear that Ukraine could not rely on its own resources to assure ruling elite's security, the leadership changed its position with regard to the CIS process.

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<sup>163</sup> "Russia Cutting Fuel to Neighbors," *The New York Times*, 4 March 1994, Sec.A, p.6,



Starting from the famous Alma-Ata summit meeting when the former republics of the Soviet Union formed the CIS, Ukrainian president Leonid Kravchuk criticized the growing tendency towards development of the centralized structures within the CIS and clearly stated that Ukraine would not go any further than a loose form of cooperation. He emphasized that the CIS structures should base their activities on the principles promoted by the UN and OSCE, and that the CIS should not be viewed as a supra-national structure but rather as an international organization facilitating resolution of any problems and tensions among member-states.<sup>164</sup>

Pursuing this strategy, Ukraine signed the CIS Economic Union Treaty in 1991 while it had no part in attempts to forge political or military integration of the CIS. Ukraine was unwilling to join an agreement on collective security signed in Tashkent in May 1992 by representatives of six CIS governments, including Russia's. Kravchuk feared that this agreement could have been used potentially to legitimize the Russian military intervention in the internal affairs of newly independent states. The Ukrainian leadership also rejected any attempts at political integration resembling the Soviet Union structure and refused to sign a CIS charter on superstate structures at the Minsk summit of 22 January 1993.<sup>165</sup> Until early 1994 the leadership consistently resisted all attempts aimed at creating the institutional structure of the CIS, while supporting the idea of loose

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col.1.

<sup>164</sup> "Chu Virute Vu u Perspektivu SND?" *Uryadovuy Kuryer* (Kyiv) no.1-2, 1 January 1994.

<sup>165</sup> Oleh Oliynuk, "Pru Yeduniy Diyi. Do Pidsumkiv Vizuty Delegaziyi Verxovnoyi Radu Rosiyi do Kuyeva," *Uryadovuy Kuryer* (Kyiv) no.43, 23 March 1993.

economic cooperation through the consultative organ of the CIS Inter-Parliamentary assembly.

Capitalizing on Ukraine's awkward economic situation, Russian officials advocated the idea that Ukraine may consider the example of Belarus, which signed away most of its economic sovereignty to Moscow.<sup>166</sup> In the second half of 1993 Kravchuk, after a long period of hesitations and failures to bring economic benefits of his pro-Western foreign policy, supported the 'economic union' agreement drafted initially by Leonid Kuchma with the Russian and Belarusian governments. Geopolitical considerations and fears that Russia could exploit economic integration into the CIS with its demands of political and military concessions receded in significance in comparison with domestic threats to the ruling elite's security. As a result, Kravchuk started to advocate the idea of closer economic integration into the CIS. In his speech addressed to the Ukrainian parliament on September 1, 1993, Kravchuk, citing the integrative process in Western Europe and in North America, argued that it would be senseless for Ukraine to oppose economic integration. His statement: "...on the basis of euphoria and emotions one can quickly take a decision but the after-effects will be very complicated. It is time to learn something from experience"<sup>167</sup> indicated a turn towards a more pragmatic approach in foreign policy.

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<sup>166</sup> Andrew Nagorski, "Doing Moscow's Work," *Newsweek*, 25 April 1994, p.21.

<sup>167</sup> Cited in John Morrison, "Russian-Ukrainian Relationship," *International Affairs*, vol.69, no.4 (October 1993), p.691.

Playing the loyalty game, Ukraine intensified its participation in drafting the treaty on economic union of the CIS.<sup>168</sup> During the May 1994 meeting of the CIS Heads of States and Governments in Moscow Ukraine became an associated member of the CIS Economic Union and signed all economic documents. Member states decided to reestablish a common economic space and proceed with a long-term goal of construction of the Economic Union. Ukraine intensified its participation in military-industrial projects with other CIS members as well.<sup>169</sup>

### **Crimea and the Black Sea Fleet**

Ukraine's policy towards the highly disputed issue of Crimea and the Black Sea Fleet softened in 1993 as well. In 1991 the Ukrainian leadership clearly stated its willingness to recognize the autonomous status of Crimea and allow the republic to enact laws that do not conflict with the laws of Ukraine. In spite of significant local jurisdiction acquired by Crimea, the Ukrainian authorities applied pressure on the Crimean parliament and president to prevent any possible actions that could compromise the territorial integrity of Ukraine.

Although Russia's leaders assured their Ukrainian counterparts that they fully respected the independence of Ukraine and had no intention to reclaim Ukraine as part of Russia's historical patrimony, tensions over the Crimea were high. In May 1992 the Russian parliament declared, for instance, that the transfer of Crimea from Russia to Ukraine in 1954 was illegal. Despite the threats of some Russian politicians to renegotiate

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<sup>168</sup> "Proekt. Dogovir pro Stvorenniya Ekonomichnogo Soyuzu," *Uryadovuy Kuryer* (Kyiv) no.107, 17 July 1993.

<sup>169</sup> Oleh Oliynuk, "Viyskovi - Za Nove Spivrobotnuztvo," *Uryadovuy Kuryer* (Kyiv) no. 6, January 10-11, 1994, p.3.

borders with Ukraine, by June 1992 Moscow accepted the inviolability of Ukraine's borders and this issue was excluded from the agenda of the Kravchuk-Yeltsin meeting in Dagomys.

The Russian parliament moved further and declared Sevastopol, the Black Sea fleet's base, a Russian city in July 1993. Although Boris Yeltsin did not display any intention to enforce the resolution, the parliament's decision aggravated relations between Russia and Ukraine and raised fears in Ukraine as to what could happen if hard-liners occupied the presidential office.<sup>170</sup>

The most complicated issue of the Crimea was the ownership of the Black Sea fleet and its base, Sevastopol. Although the Minsk agreement of December 1991 had clearly stated that the Navy is under the CIS High Command, Kyiv started to view strategic forces as only those that carry nuclear weapons, and since the BSF did not carry them, it had to belong to Ukraine. In response to these claims, Russia asserted its control over the fleet, motivating this move by the necessity to assure the subordination of the Fleet to the CIS command. When the commander in chief of the CIS joint armed forces resigned to take a high-level position in the Russian government, it put an end to CIS joint military command and Russia started to form its own armed forces, claiming the BSF a specifically Russian fleet.

Following the spring 1992 war of decrees between Yeltsin and Kravchuk who claimed their respective command over the fleet, attempts to settle the issue were made during the Dagomys 1992 and Moscow 1993 summit meetings of the Russian and

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<sup>170</sup> Serge Schmemmann, "Russian Parliament Votes a Claim to Ukrainian Port of

Ukrainian presidents. The tough Ukrainian stance towards Russia brought results: the issue of Crimea was admitted to be of domestic political importance for Ukraine and Russia agreed to transfer 16.37 percent of the Soviet property overseas to Ukraine. Also in Dagomys Kravchuk and Yeltsin decided to postpone discussion of the Crimea to the indefinite future and agreed in principle on a division of the Black Sea Fleet, although this solution could not please both leaders. In August 1992 in Yalta Leonid Kravchuk and Boris Yeltsin agreed to put an end to CIS joint command and consider the Black Sea Fleet as a joint Ukrainian-Russian fleet under joint command until 1995 when another agreement resolving all existing problems was to be reached.<sup>171</sup>

As the content of the Russian-Ukrainian agreements on the Black Sea Fleet suggests, the economic aspects appeared only in September 1993 Massandra agreement when Ukraine, disregarding its previously voiced security concerns, agreed to surrender its share of the BSF to Russia in exchange for energy debt forgiveness.<sup>172</sup> By the time of Massandra 1993 meeting, Ukraine accumulated a \$2.5 billion trading debt to Russia, mostly for gas and oil supplies. Since the Ukrainian ruling elite could accumulate sufficient economic resources to address domestic threats to its security, the leadership decided to display its loyalty to the former hegemon by turning over the Black Sea Fleet to Russia in exchange for Russia's writing off a large part of Ukraine's debt for energy supplies.<sup>173</sup> Also at Massandra the Russian side made clear its desire to maintain its

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Sevastopol," *The New York Times*, 10 July 1993, Sec.A, p.3, col.1.

<sup>171</sup> "Yaltunskuy Kompromiss," *Uryadovuy Kuryer* (Kyiv), 7 August 1992.

<sup>172</sup> Mark Webber, *The International Politics of Russia and the Successor States* (Manchester, New York: Manchester University Press, 1996), pp.186-188.

<sup>173</sup> "Ukraine to Cede to Russia its Part of Black Sea Fleet," *The Wall Street Journal*, 7

Black Sea Fleet bases, including Sevastopol. It clearly indicated that in conditions when the threat to ruling elite's survival shifts to domestic level, despite a wide range of possible solutions proposed by the Ukrainian Ministry of Foreign Affairs,<sup>174</sup> the Ukrainian leadership tended to neglect international threats to national security and allowed the presence of foreign and potentially hostile military troops on its territory. In 1994 the final agreement was reached on dividing the fleet on two equal parts, where Ukraine agreed to hand over 30 percent of its share to Russia to cover its debt.

**Table 4.3**

**Values of Independent, Intervening and Dependent Variables**

Period under consideration	Independent Variables				Intervening Variable	Dependent Variable
	Ruling Elite's Need in Economic Resources	Economic Strategy (willingness/unwillingness to adopt economic reforms)	Pro-reform Coalition	Ruling Elite's Legitimacy		
Ukraine 1991	Low					Continuity independent from Russia's interests foreign policy
Ukraine 1993	High	Unwilling	Absent	Medium	Low	Change pro-Russian foreign policy move

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September 1993, Sec. A, p.12, col.4.

<sup>174</sup> Valery Dzugyn, "Za Nezaleznist Treba Platutu?" *Uryadovuy Kuryer* (Kyiv) no.135, 7 September 1993, pp.1-2.

**Table 4.4**  
**Independency Rating of Former Soviet Republics**  
**(Their Potential According to the Deutsche Bank)**

	High level of economic development				Average level of economic development					Low level of economic development			
	Ukraine	The Baltics	Russia	Georgia	Belarus	Kazakhstan	Moldova	Armenia	Azerbaijan	Uzbekistan	Turkmenistan	Kirgizstan	Tadzhikistan
Level of industrialization	9	10	8	6	8	5	2	3	3	3	2	2	2
Export potential of industry	6	5	6	3	4	4	2	1	2	2	1	1	1
Farming	10	8	6	7	5	5	9	3	3	3	3	2	1
Export potential	6	3	3	6	4	4	7	1	2	3	3	3	1
Level of self-supply with industrial goods	7	6	8	3	3	3	2	1	2	1	1	1	1
Mineral resources	8	0	10	4	9	9	0	4	7	6	5	4	3
Export potential of raw material	8	0	10	4	9	9	0	4	8	6	5	4	3
Psychological readiness for doing business	3	10	2	9	1	1	5	8	2	2	1	1	1
Geographical closeness to Europe	6	10	4	6	5	5	7	6	4	1	1	1	1
Level of education	6	9	5	5	3	3	5	4	4	2	2	2	2
Homogeneity of the population	6	6	5	2	6	2	2	6	6	1	1	1	1
Infrastructure	8	10	5	6	6	5	8	6	4	2	2	1	1
Total	83	77	72	61	55	55	49	47	47	32	27	24	18

10-good potential, 5-average potential, 0-potential absent

Source: *Ukraine* (Kyiv), no.2, 1993, p.3.

**Table 4.5****Ukraine: Imports in thousands US\$ (1993-1994)**

<b>Countries</b>	<b>December 1993</b>	<b>December 1994</b>
<b>Europe</b>	<b>119211</b>	<b>126967</b>
<b>Asia</b>	<b>18701</b>	<b>21524</b>
<b>Africa</b>	<b>11387</b>	<b>2553</b>
<b>America</b>	<b>10738</b>	<b>11882</b>
<b>Australia</b>	<b>29</b>	<b>66</b>
<b>CIS</b>	<b>194851</b>	<b>232531</b>
<b>Baltic Republics</b>	<b>26468</b>	<b>6820</b>
<b>Others</b>	<b>6765</b>	<b>1098</b>

Source: *Customs Statistics* (Kyiv: Ukrainian State Customs, 1995).

**Table 4.6****Ukraine: Exports in thousands US\$ (1993-1994)**

<b>Countries</b>	<b>December 1993</b>	<b>December 1994</b>
<b>Europe</b>	<b>91586</b>	<b>124427</b>
<b>Asia</b>	<b>77774</b>	<b>128704</b>
<b>Africa</b>	<b>3119</b>	<b>10110</b>
<b>America</b>	<b>12458</b>	<b>10757</b>
<b>Australia</b>	<b>287</b>	<b>645</b>
<b>CIS</b>	<b>249794</b>	<b>294102</b>
<b>Baltic Republics</b>	<b>9279</b>	<b>13111</b>
<b>Others</b>	<b>432</b>	<b>0</b>

Source: *Customs Statistics* (Kyiv: Ukrainian State Customs, 1995).



Table 4.7

## Reforms in Eastern Europe and the Former Soviet Union

Reform group	Rating (4-24)	Cumulative GDP (1989-94)	GDP Growth (1994)
<b>Strong Reform</b>			
Czech Republic	21	-15.49	3
Estonia	20	-29.15	5
Hungary	20	-17.94	2
Poland	20	-9.23	5
Slovakia	20	-19.53	5
Averages	20.4	-18.27	4
<b>Moderate Reform (15-19)</b>			
Croatia	19	-31.04	1
Slovenia	19	-13.26	5
Lithuania	18	-55.44	2
Macedonia	17	-51.30	-7
Kyrgyzstan	17	-42.30	-10
Latvia	17	-39.52	3
Romania	16	-30.79	3
Russia	16	-47.29	-15
Bulgaria	15	-26.41	1.4
Albania	15	-22.89	7
Averages	16.9	-36.02	-1
<b>Weak Reform (4-14)</b>			
Moldova	13	-54.30	-25
Uzbekistan	12	-11.75	-3
Armenia	11	-61.60	0
Belarus	10	-35.93	-22
Kazakhstan	10	-51.01	-25
Tajikistan	10	-70.37	-25
Azerbaijan	8	-54.32	-22
Ukraine	8	-51.36	-23
Georgia	8	-85.35	-35
Turkmenistan	7	-38.29	-35
Averages	9.7	-51.43	-21

Source: Jeffrey D. Sachs, *Reforms in Eastern Europe and the Former Soviet Union in Light of the East Asian Experiences* (National Bureau of Economic Research, Working Paper 5404, Cambridge, MA, January 1996), pp.64-65.

Table 4.8

## Ukraine: Economic Development

Real Growth Rate in Percent	1991	1992	1993
GDP at factor cost	-13.4	-14.0	-18.0
Exports	n.a.	-18.6	-16.0
Imports	n.a.	-25.6	-23.4
Private consumption	n.a.	-9.1	-9.6
As percent of GDP			
Domestic savings	16.8	9.9	7.4
Domestic investment	18.6	12.0	8.0
Total consumption	83.2	90.1	92.6
Resource balance	-1.7	-2.1	-0.6
Fiscal accounts			
Revenue and grants	26.0	29.0	34.4
Expenditure	36.8	45.5	38.4
Budget deficit	-10.8	-16.5	-4.0
Current account balance	-1.7	-2.1	-0.5
Inflation rate (CPI), percent	91.2	1,445.30	4,927
Exchange rate (krb./US\$)	1.7	221.3	7,629
Energy intensity index	90.6	95.5	100

Source: F.Desmond McCarthy, Chandra Pant, Kangbin Zheng, Giovanni Zanalda, "External Shocks and Performance Responses during Systematic Transition: The Case of Ukraine," *Ukrainian Economic Review*, vol.1, no.1-2 (1995), p.30.

Table 4.9

**Unlovely Patchwork: Ukrainian Election Results**

<b>Extreme nationalists</b>	
Ukrainian National Assembly	3
Ukrainian Conservative Republican Party	2
<b>Moderate Nationalists</b>	
Rukh	20
Ukrainian Republican Party	8
Congress of Ukrainian Nationalists	5
Democratic Party of Ukraine	2
<b>Centrists</b>	
Inter-regional Reform Block	4
Ukrainian Democratic Renaissance Party	4
Civil Congress of Ukraine	2
Social Democratic Party of Ukraine	2
Labor Party	4
Christian Democratic Party of Ukraine	1
<b>Communists:</b>	
Ukrainian Communist Party	86
Peasant Party	18
Ukrainian Socialist Party	14
Unaffiliated	163
Total*	338
*112 seats remain unfilled	

Source: Andrew Cowley, "Ukraine: The Birth and Possible Death of a Country," *The Economist*, 27 May 1994, p.10.

## **Chapter 5**

### **Kuchma Adopts a Pragmatic Approach to Foreign Policy -**

#### **Economic Optimization of Two-Level Game**

**Moment 3 (August 1994 - December 1996)**

#### **The Ruling Elite Has to Introduce Some Economic Reforms**

The willingness of some domestic groups, including Leonid Kravchuk, to keep the economy unreformed could not be sustained indefinitely. First, access to Western markets for Ukrainian goods could not be taken for granted. Second, credits from the International Monetary Fund (IMF), World Bank and other international financial institutions as well as direct foreign investments could not be expected if economic reforms were not implemented. Therefore, the ruling elite, lacking strong political institutionalization and incapable of extracting enough economic resources to cope with the opposition and to maintain stability, had to improve the effectiveness of the economic system.

In 1994 the probability that a reform package would be adopted increased dramatically with the severity of the crisis as inflation soared and state reserves dwindled. The dire condition of the economy, a constantly negative trade balance with energy suppliers Russia and Turkmenistan, and drastically declining gross national product shifted the major focus of the ruling elite's concerns to the domestic level, and urged it to assess critically the security consequences of preserving the economic status-quo. When in February 1994 Turkmenistan cut off supplies because of nonpayment on a debt totaling

\$700 million, it became clear that the attempts at diversification of energy supplies were pointless in the absence of reform measures.

The widespread perception of crisis was reflected by considerable pressure to implement at least some reforms to avoid dire economic and social consequences. Leonid Kuchma, who was elected president in 1994, enjoyed the momentum of popular support when he could blame all the problems, such as hyperinflation, a huge budgetary deficit, and a declining growth rate, along with substantial institutional imperfections promoting the underground economy and corruption, on the previous government. When the Ukrainian economy hit bottom, various interest groups and the population at large expressed their consent with the Kuchma's reform policy and agreed to undergo short-run sacrifices for their future benefits.<sup>175</sup> Under crisis conditions, public granted Kuchma wide leeway in developing and implementing reform programs. Even the communist hardliners in the parliament, being aware of domestic threats, expressed their support of Kuchma's reform plans. By 1994 Ukraine's elites and institutions had not only grown accustomed to one another, but they also realized that continued economic decline was unacceptable and some measures had to be taken.<sup>176</sup>

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<sup>175</sup> According to the prospect theory, a psychological theory of decision making under risk, people prefer risky choices when facing prospects of losses, but prefer caution when expecting gains. Put differently for this stage of reform process in Ukraine, Kuchma was inclined to adopt radical reform measures and citizens were willing to support them only when they faced deep economic crisis. On the application of the prospect theory to the economic reforms, see Kurt Weyland, "The Political Fate of Market Reform in Latin America, Africa, and Eastern Europe," *International Studies Quarterly* 42 (December 1998), pp.645-674. On prospect theory, see also Jack S. Levy, "Prospect Theory, Rational Choice, and International Relations," *International Studies Quarterly* 41 (March 1997), pp.87-112.

<sup>176</sup> Alexander J. Motyl and Bohdan Krawchenko, "Ukraine: From Empire to Statehood," in *New States, New Politics: Building the Post-Soviet Nations*, eds. Ian Bremmer and

Kuchma's economic plan presented to the parliament on 11 October 1994 was entitled "Along the Road of Radical Economic Reform." Following a dire assessment of the Ukrainian economy, Kuchma outlined the main tenets of his economic program, which included fiscal and monetary reform through introduction of a new national currency, reduction of budget expenditures and elimination of subsidies, rationalization of the tax law, price liberalization on all goods, including gradual lifting of control on such vital commodities as housing and energy, sweeping privatization, privatization of land and commercialization of agrarian relations, and liberalization of the export-import regime.

The program reinforced a 28 September 1994 agreement with the IMF and assured Ukraine's access to economic aid and credits capable of resolving a debt problem and securing a stable energy supply for industry and private consumption.<sup>177</sup> The reform efforts were supported by the IMF, World Bank, and the European Union as well as the major Western governments — at its annual meeting on July 7, 1994 the G-7 promised to provide Ukraine \$4 billion in economic assistance if the central authorities in Kyiv initiated real economic reforms with visible results. Financial aid and credits started to flow to Ukraine: for instance, during 1996 the international donors pledged more than \$5 billion in support of Ukraine's reforms over the next five years. Only one tranche of the IMF standby credit released to Ukraine in mid-December 1996 was worth around \$100 million.<sup>178</sup>

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Ray Taras (Cambridge and New York: Cambridge University Press, 1997), p.261.

<sup>177</sup> Monika Jung, "Looking Both Ways," *Transition*, vol.1, no.6, 28 April 1995, p.54.

<sup>178</sup> Chrystyna Lapychak and Ustina Markus, "Ukraine's Continuing Evolution,"

### **A Strong Pro-Reform Coalition is Still Absent**

Although the initiation of reforms requires some state autonomy from the pressure of interest groups, the reform process cannot be successful if it fails to appeal to, or even create, a new coalition of beneficiaries.<sup>179</sup> In the absence of political support from the beneficiaries of reforms, the actual results of reforms are moderate.

Instead of building a viable pro-reform coalition, president Kuchma emphasized the importance of a strong state in the reform process. Although any transitional ruling elite faces a tradeoff between the concentration of authority needed to launch and pursue reforms and institutionalization of effective representation, which is needed both to consolidate democracy and assure the existence of political underpinning for a stable market economy, too much emphasis on the first task might not always be positive. The failure to reduce state involvement at the stage when the reform process accelerates usually has a negative impact. Overly extensive state intervention usually becomes dysfunctional, because it hinders rather than stimulates economic activities. At this stage state control should contract, and some deregulation and denationalization are to be taken.<sup>180</sup>

If any peripheral post-Soviet ruling elite continues to advocate the policy of binding the state to the economy either by providing subsidies to various enterprises or by increasing legal involvement, the emergence of a viable and strong pro-reform coalition

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*Transition*, 7 February 1997, p.31.

<sup>179</sup> Stephan Haggard and Robert Kaufman, "The State in the Initiation and Consolidation of Market-Oriented Reform," in *State and Market in Development. Synergy or Rivalry?* eds. Louis Putterman and Dietrich Rueschemeyer (Boulder, Colo: Lynne Rienner Publishers, 1992), pp. 221-240.

<sup>180</sup> Luiz Carlos Bresser Pereira, "Economic Reforms and Cycles of State Intervention,"

hardly can be achieved because the involvement of state functionaries in the economy imposes significant constraints on independent economic activities and encourages various forms of explicit or implicit mutually beneficial linkages between firms and the state. Any entrepreneur, being afraid of overly extensive state involvement, expressed particularly in rent-seeking behavior of state officials, most likely would abstain from exercising political pressure on the ruling elite. Moreover, any entrepreneur may choose to go into the shadow economy in response to higher state involvement, which may encourage the ruling elite to search for alternative forms of economic resources, including international ones.

During the Kuchma administration the system dominated by the communists and Soviet-type bureaucracy inherited from Kravchuk was transformed into a slightly more economically dynamic regional-clan system. A clan may be defined as a shadowy and closed group which is organized on the basis of common economic and pecuniary interests of its members. The factor of country-fellowship, origin from the same region, constituted one of the main uniting determinants in the clan formation. The clan is united by mutual responsibility and cynical disregard of the public interest — its methods of conducting business are borrowed from the criminal sphere with its opaque character of decision making. The powerful clans became actively involved in Ukrainian politics. Trying to expand their influence on state and public institutions, they adopted themselves to the rules of the political game, embedding their protégés into politics and attracting leading political figures.

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*World Development*, vol.21, no.8 (1993), p.1339.



Some Ukrainian analysts, describing this political phenomenon, use a term “fratry,” which is associated with archaic paramilitary communities appropriating from a position of strength the results of other people’s economic activities. A “fratry” not only imposes on its members a strict set of mutual obligations, but also defends them from other corporate groups. The social structure based on fratrics undermines the power of legal norms and channels the reform process in the most favorable direction for these fratrics. The stratification of the Ukrainian parliament when the country’s social environment remained unstructured testified to the domination of fratry component in the process of framing the interest groups.<sup>181</sup>

Formation of fratrics was facilitated due to the transformation of black marketeers of the Soviet times into modern-time Mafiosi. “Black markets in Soviet times were supported by networks of business groups that ensured contract enforcement among themselves as the legal system could not be relied on.”<sup>182</sup> Since black market trading had involved substantial access to governmental officials, the new criminal structures could often rely on their powerful contacts to secure their positions in new circumstances.

The most powerful clans and fratrics constituted the party of power, composed of former Communist party functionaries, Soviet bureaucrats, state firm directors and modern-time Mafiosi who extensively exploited paternalistic networks incorporating top government officials with the purpose of promoting personal careers and lining their

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<sup>181</sup> Oleksandr Dergachev, editor et al. *Ukrainian Statehood in the Twentieth Century: Historical and Political Analysis* (Kyiv: Political Thought, 1996), pp.373-380.

<sup>182</sup> Martin Raiser, *Informal Institutions, Social Capital and Economic Transition: Reflections on a Neglected Dimension* (European Bank for Reconstruction and Development, Working Paper no. 25, August 1997), p.20.

pockets. The party of power represented the interlocked elite which did not allow a new or competing elite to enforce a model of ‘negotiated’ transition.<sup>183</sup> Particularly impressive in its “achievements” was the symbiosis of corrupted state bureaucracy and entrepreneurs operating on the market of energy supplies. In the absence of transparent rules regulating the energy market, the companies operating on this market were not only protected from potential competitors but also were granted a tax-free status. This resulted in billions hryvnas losses for the state budget.<sup>184</sup> What is more important, the existence of fratrics and clans with their well-established contacts with the government officials discriminated against the new private sector, namely small and medium-sized enterprises, which could not rely on such contacts and had to pay significant premiums to government officials and Mafiosi bosses to keep their businesses running.

#### **Ruling Elite’s Legitimacy is Medium**

The applicability of non-economic policy tools capable of limiting the distributive pressure imposed on the government has not changed dramatically since the Kravchuk period. Although Kuchma repeated in his inaugural address his campaign promise to reorient Ukraine toward Eurasia as well as to grant official status to the Russian language, (a statement which indicated his willingness to exploit, at least partially, non-economic tools of enhancing ruling elite’s legitimacy) he was more cautious in everyday politics. He argued, for instance, that Russian, together with Ukrainian, should be considered

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<sup>183</sup> To the same degree a similar phenomenon has been observed by James Hughes in Russia. See, James Hughes, “Sub-national Elites and Post-communist Transformation in Russia: A Reply to Kryshtanovskaya & White,” *Europe-Asia Studies*, vol.49, no.6 (September 1997), pp.1017-1032.

<sup>184</sup> V.T. Shlemko, I.F. Binko, *Ekonomichna Bezpeka Ukrainu: Sutnist i Napryamku Zabezpechennya* (Kyiv: National Institute of Strategic Studies, 1997).

official languages, emphasizing at the same time that Ukrainian would be the country's sole state language.<sup>185</sup> At the same time Kuchma was careful in avoiding the clear definition of differences in the status of official and state languages.

Although attempts at exploiting non-economic tools capable of enhancing the ruling elite's legitimacy were moderate, they sparked sharp protests by national democrats and their electorate, therefore Kuchma had to find a middle ground approach. On the one hand, he desperately needed the support of the national democrats in his struggle against the left majority in the parliament, which opposed Kuchma's attempts to reform the economy. On the other hand, the "nationalist" policy of his predecessor, emphasizing the national democratic formula of "return to Europe," hardly could assure his support in Eastern Ukraine which demanded closer relations with Russia. Taking these two aspects into consideration, Kuchma moved to a balanced policy capable of attracting both the West and the East of the country. In the ideological sphere, for instance, the already emphasized condemnation of speaking Russian and the emphasis of the historical enmity of Russia toward Ukraine were removed. Kuchma's government became more conciliatory towards the large Russian minority<sup>186</sup> and due to de facto

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<sup>185</sup> A transition towards more pragmatic approach in dealing with Russia is well traced in V.G.Kremin, D.M.Bezlyuda, V.D.Bondarenko, O.L.Valevskiy, M.F.Golovaty, M.D.Mischenko, S.G.Ryabov, P.K.Sytnyk, O.O.Yaremenko, *Sozialno-Politichna Sutyaziya v Ukraini: Postup Pyatu Rokiv* (Kyiv: National Institute of Strategic Studies, 1996).

<sup>186</sup> Anthony Hyman, "Russian Minorities in the Near Abroad," *Conflict Studies* 299 (May 1997), p.8.

decentralization of decision making, the West and the East of the country were allowed to speak different languages, linguistically and ideologically.<sup>187</sup>

The Ukrainian leadership realized that the applicability of non-economic tools of enhancing its legitimacy was limited, therefore it stressed the need for nonethnic sources of identity, unifying various regions of Ukraine, and suggested that the economic revival of Ukraine could represent a unifying principle acceptable by the entire population.<sup>188</sup>

The importance of economic issues became clear during the 1994 parliamentary elections. Since the Kravchuk administration failed to build a pro-reform coalition, pursue radical economic reforms and break the resistance of the old Communist elite and red directors, the high economic expectations associated with Ukrainian independence were not met in 1991-1993. The social policy which may have positively contributed to long-term social stability and enhance the ruling elite's legitimacy was poorly coordinated.<sup>189</sup> It drove the growth of nostalgic aspirations about economic prosperity of the Soviet period in Eastern Ukraine and Crimea, where the economic conditions, rather than nationalist aspirations, had been the main force driving the vote of independence.<sup>190</sup> As a result, those left parties and independent candidates who reflected the widespread electorate's dissatisfaction with the government's performance and offered the easy way

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<sup>187</sup> Volodymyr Kulyk, "The Search for Post-Soviet Identity in Ukraine and Russia and its Influence on the Relations Between the Two States," *The Harriman Review*, vol.9, no.1-2 (Spring 1996), p.24.

<sup>188</sup> John Jaworsky, *Ukraine: Stability and Instability*, McNair Paper 42 (Washington, DC: Institute for National Strategic Studies, National Defense University, 1995), p.27.

<sup>189</sup> Y.I.Pavlenko, *Transformaziya Suspilstva i Problemu Sozialnoyi Politiku* (Kyiv: National Institute of Strategic Studies, 1996).

<sup>190</sup> George Chuchman, "The Economics of our Sovereign State," *Ukraine* (Kyiv) no.4-5, (1992), pp.6-8.

to economic prosperity by intensifying pro-Russian and pro-CIS vectors received outstanding popular support in these regions.

Trying to improve the ruling elite's legitimacy, Leonid Kuchma, by implementing some reforms, restored only partially the popular confidence in the government's ability to manage the economy - the people continued to judge the government's economic performance by their own economic situations. According to a nationwide survey that was conducted between December 19, 1995 and January 10, 1996 with a nationally representative sample of 12,000 adults age 18 and older, 31 percent of the polled, defining two most serious problems facing the country, mentioned economic problems as the most important versus 14 percent who thought that socio-cultural issues were crucial, with political and foreign issues constituting respectively 13 and 3 percent.<sup>191</sup>

#### **Success in Economic Reforms is Limited**

Compared to those of his predecessor, Kuchma's achievements with regard to economic reforms were impressive. In 1994 Ukraine secured large credit pledges from the IMF, World Bank, the Group of Seven, the European Union, and the United States. In support of ambitious plans of economic reforms, including among others price liberalization, quicker privatization, banking reform announced by Kuchma on 11 October 1994, the IMF approved a \$371 million stabilization loan on 26 October while the World Bank approved a \$500 million credit on 22 December. As an integral part of reforms, a comprehensive privatization program, consisting of a broad scope of measures including among others spontaneous creation of investment funds, launching of mass

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<sup>191</sup> Volodymyr Zviglyanich, "Ukrainian Reforms: A Sociological Analysis," *The Ukrainian Weekly*, 7 July 1996, p.2.

privatization, and acceleration of small-scale privatization, was supported by a World Bank rehabilitation loan in 1994.

The government successfully slowed the severe contraction of GDP in 1995 in comparison with the 1993-1994 period. In 1995 GDP decreased by only 11.8 percent, and that was in part because of weather conditions which caused decrease in gross agricultural output of 17 percent (see Table 5.2 and Table 5.3). Due to the almost complete liberalization of domestic prices and tight fiscal and monetary policies, Ukraine's annual inflation rate at the end of 1996 was 40 percent, much lower than the 182 percent of 1995 and 400 percent of 1994. As a result in 1997, for the first time since the beginning of reforms, retail trade turnover increased and output of some industrial exports started to grow steadily.

These reform measures, however, did not produce a radical re-orientation of trade flows and the Ukrainian economy was still oriented to the CIS markets (see Table 5.4). Russia continued to be the major trade partner of Ukraine - - in 1994, the countries of the former Soviet Union accounted for 55 % of Ukrainian exports and 73% of its imports, out of which Russia accounted for 39% of Ukrainian exports and provided 38% of imports.<sup>192</sup>

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<sup>192</sup> For more on economic links with Russia and other CIS countries and their role in shaping Ukrainian foreign policy toward Russia and CIS, see Anton Filipenko, "The CIS Economic Union: Pros and Cons," *Politics and the Times* (Kyiv), October-December

**Foreign Policy Plays a Resource Mobilization Function - Pro-Western and Pro-Russian Policies are Pursued Simultaneously**

If the theory developed in this project holds, it would be reasonable to expect that once some economic reforms are implemented, the Ukrainian ruling elite can benefit the most if it strategically pursues pro-Russian and pro-Western policies simultaneously, which allows it to maintain access to both economic sources. Since the actual economic reforms were moderate, and the Ukrainian economy was still oriented towards the Russian market, I hypothesize that any substantial progress in the way of economic reforms that increased the inflow of credits, aid and various forms of investments from the West allowed the ruling elite to take a more independent stance towards Russia. In contrast, when the reform process slowed down, and the Ukraine's ability to acquire Western economic resources diminished, the leadership tended to embark on traditional Soviet-style policy and displayed its loyalty to Russia in order to acquire various forms of economic benefits from the former hegemon. Since such a linking strategy had been successfully exploited by the previous administration, the new leadership learned from this experience and played the loyalty game more frequently.

In 1994-1995 the Ukrainian authorities were still concerned about the CIS military alliance development which could potentially increase Russian involvement, and in particular could enable the Russian authorities to control the armed forces on the territory of Ukraine.<sup>193</sup> It was believed that Russia continued to be military dangerous for Ukraine because it kept its troops on the territories of the successor states, thus increasing the

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1995, pp.58-65.

<sup>193</sup> Ustina Markus, "Foreign Policy as a Security Tool," *Transition*, 28 July 1995, p.15.

probability of its interference into domestic affairs of these states. The majority of Ukrainian analysts acknowledged, however, that the danger of Russian invasion receded in significance, and the main threats to national security shifted to the domestic level.<sup>194</sup>

The end of the Cold War has ushered into Eurasia numerous threats to the national security of the Russian Federation when the danger of an outbreak of war could be attributed particularly to ethnic, political, social, religious, and other conflicts. Since these types of threats were largely absent for the past five decades and the military situation had worsened far beyond that of the Soviet era, the need to reform the military with the goal of making it a predictable and stable institution was of a paramount importance. The Russian leadership, however, failed to restore the viability of the Russian Federation's armed forces, therefore the decline in capability of all departments of the Russian armed forces continued.<sup>195</sup> On 1 October 1996, the newly appointed Minister of Defense, Igor Rodionov, stated that the military was in disarray and warned that the Russian leadership could no longer count on its services in a crisis. He mentioned the plummeting morale of the armed forces that may result in the failure of the military to respond to Moscow's orders as a primary threat to the national security.<sup>196</sup>

Taking into consideration these international realities, the Ukrainian leadership had to address a peculiar security complex where the danger of foreign invasion receded in significance in comparison with the domestic threats to the ruling elite's security.

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<sup>194</sup> *Nazionalna Bezpeka Ukrainu, 1994-1996 rr.* (Kyiv: National Institute of Strategic Studies of Ukraine, 1997).

<sup>195</sup> "Military Balance: Russia," *Asia-Pacific Defence Reporter: 1997 Annual Reference Edition*, (1998), pp.54-56.

<sup>196</sup> Spencer D. Bakich, "The Military Doctrine of the Russian Federation: Working



Especially acute threats resulted from the energy crisis, further criminalization of economic activities, corruption, and the merging of criminal and state power structures.<sup>197</sup> Leonid Kuchma acknowledged the importance of domestic issues and stressed that only radical economic reforms could assure Ukraine's sovereignty.<sup>198</sup>

The importance of domestic security threats facilitated the adoption of the foreign policy most economically beneficial for the Ukrainian elites.<sup>199</sup> Despite the formal non-coincidence of foreign policy priorities declared by the left-wing majority in the parliament, which supported closer integration into the CIS structures and criticized the system of agreements concluded by the government with the Euro-Atlantic institutions, and the policy pursued by the president, who periodically expressed Ukraine's long-term desire to join NATO, the existing tensions between the executive and legislative powers did not grow too high. The compromise solution was spelled out by president Kuchma who emphasized on several occasions that enhanced cooperation with Russia and the CIS should not be at the expense of relations with the West nor lead to the emergence of any threat to Ukraine's independence and territorial integrity.

On the one hand, the Kuchma administration was unwilling to and incapable of shifting its economic relations away from Russia that provided the energy supplies and

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Document or Anachronism?" *Conflict Studies* 301, (July/August 1997), p.10.

<sup>197</sup> Ronald H. Linden, "Domestic Change and International Relations in the New Eastern Europe," in *East European Security Reconsidered*, eds. John R. Lampe and Daniel N. Nelson (Washington, DC: The Woodrow Wilson Center Press and Sudosteuroopa-Gesellschaft, Baltimore, MD, 1993), pp.13-34.

<sup>198</sup> "Gluboki Ekonomichni Reformu - Shlyax do Vidrodzennya Ekonomiku, Zabezpechennya Suverenitetu Ukrainu. Vustyp Presudenta Ukrainu Leonida Kuchmu na naradi u Lvovi 13 lyutogo z.r.," *Uryadovuy Kuryer* (Kyiv) no.25-26, 16 February 1995, pp.3-4.

<sup>199</sup> Oleh Oliynuk, "Vid Romantuzmu do Pragmatuzmu. Ukraina v Konteksti

constituted the largest market for Ukrainian goods and services. In contrast with the previous administration's approach that assumed that statebuilding and economic independence of Ukraine could be achieved by radical reorientation from the East to the West,<sup>200</sup> Kuchma declared that "Ukraine no longer looks upon economic co-operation with Russia and the CIS as an unfortunate necessity but as an urgent requirement."<sup>201</sup> On the other hand, the Ukrainian leadership expressed its desire to become a part of the larger Western system of security arrangements, political and economic institutions that could assure access to Western economic resources.

Despite the strategic pro-Russian shift in foreign policy priorities, the Ukrainian leadership deepened its relations with the West. Since February 1994 when Ukraine became the first CIS country to join the NATO Partnership for Peace program, which provides 27 countries with a kind of associative membership in this security organization, and to sign the agreement on Partnership and Cooperation with the European Council, it has extensively participated in alliance activities, particularly in military exercises. Ukraine intensified its participation in NATO's Partnership-for-Peace (PfP) program, and, according to the Individual Partnership Program (IPP), agreed to cooperate in all 19 spheres of activities envisaged by PfP which included, for instance, preparation for joint

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Zagalnoevropeyskoyi Bezpeku," *Uryadovuy Kuryer* (Kyiv) no.39, 27 February 1996, p.6.

<sup>200</sup> "Zvernennya Presudenta Ukrainu do Verxovnoyi Radu," *Uryadovuy Kuryer* (Kyiv) no.158-159, 13 October 1994, p.3.

<sup>201</sup> Taras Kuzio, *Ukraine: Back From the Brink* (London: Institute for European Defence and Strategic Studies, 1995), p.31.

activities in cases of civil emergencies.<sup>202</sup> NATO PfP field training exercises such as Peaceshield 96 and Cooperative Neighbor 97 were conducted on the Ukrainian territory.

Ukraine signed the nuclear nonproliferation treaty in the Fall of 1994 and ratified the START I Treaty which was received in the West as the most substantial proof of Ukraine's intention to join the community of democratic states. Once the Ukrainian parliament ratified the NPT, the Organization for Security and Cooperation in Europe (OSCE) at its December 1994 summit in Budapest signed a memorandum providing security assurances from the five nuclear powers.<sup>203</sup> Also the US displayed the first signs of geopolitical pluralism in dealing with the post-Soviet states and retreated from its Russocentric approach. According to Zbigniew Brzezinski, the increased emphasis on Ukraine was a welcome adjustment of American priorities.<sup>204</sup>

A radical turn in Western attitude toward Ukraine was made during the October 1994 G-7 meeting in Winnipeg when Ukraine was promised \$4 billion in aid. Previously, during the April 1993 Vancouver summit Russia was offered \$1.6 billion in U.S. aid in contrast to Ukraine which was offered nothing. The improvement of the West-Ukraine relations became particularly visible during the visit of President Clinton to Ukraine in May 1995, when the "strategic partnership" between the USA and Ukraine was

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<sup>202</sup> Serhiy Tolstov, "Ukrainian Foreign Policy Formation in the Context of NATO Enlargement," *The Ukrainian Review* vol.44, no.2 (Summer 1997), p.9.

<sup>203</sup> *The Ukrainian Weekly*, 11 December 1994, p.3

<sup>204</sup> Zbigniew Brzezinski, "Getting Real on Central Europe," *The New York Times*, 28 June 1994, Sec.A, p.17, col.1.

proclaimed.<sup>205</sup> As a result, Ukraine ensured its access to Western credits, technologies, and investments which Russia could not provide.

Ukraine intensified its participation in UN peacekeeping missions, and it became the third largest provider of strategic air transport to the UN. Ukraine contributed to the international community's efforts to implement the peace settlement in Bosnia and Herzegovina where Ukrainian peacekeepers served side by side with NATO and partner forces in the Stabilization Force (SFOR). Ukraine was also among the first states to respond to the OSCE initiative in Nagorno-Karabakh by providing its observers for the long-term mission in the region.<sup>206</sup>

Ukraine reached an agreement with NATO on a 16 + 1 cooperation in September 1995, but the Ukrainian leadership did not raise the question of admission as a full member, and the state officials added emphasis to the importance of taking into consideration the interests of other parties, particularly of Ukraine and Russia, in preparing the expansion plans. "NATO expansion is no menace to Ukraine," said President Kuchma, but he cautioned that the alliance must take Russia into consideration when expanding. "A nation like Russia cannot be left out of processes currently under way," he added."<sup>207</sup>

Since the ruling elite failed to implement full-fledged reforms and reorient trade flows, Ukraine remained dependent on Russia for gas and oil, and most of its trade was

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<sup>205</sup> Ukraine became the third largest recipient of direct U.S. government aid (see Table 5.9).

<sup>206</sup> Volodymyr Horbulin, "Ukraine's Contribution to Security and Stability in Europe," *NATO Review* (Autumn 1998), p.11.

<sup>207</sup> Marta Kolomayets, "Ukraine to Seek Special Partnership with NATO," *The Ukrainian*

within the CIS.<sup>208</sup> The ruling elite could not secure its positions relying solely on Western aid and credits, therefore Kuchma tried to forge closer relations with Russia. These attempts included, for instance, establishment of Ukrainian-Russian joint ventures and creation of free-trade zones. The government submitted a bill on industrial-financial groups to the parliament in September 1995. According to it, some Ukrainian and Russian banks and industrial enterprises would unite with a purpose to reestablish the previously broken (as a result of imperial collapse) links of economic cooperation between Ukraine and Russia as well as facilitate access of Ukrainian goods to the markets of Russia, Belarus and Kazakhstan constituting an independent custom union. It was planned to create such industrial-financial groups in technologically advanced branches, such as shipbuilding, chemical and metallurgical industries, and military-industrial complex.<sup>209</sup>

The Ukrainian leadership learned from the experience of the previous administration that had cautiously adopted the rules of the loyalty game from Soviet times and exploited foreign policy to obtain Russian economic resources. Kuchma moved further in a pro-Russian direction and emphasized the symmetrical foreign policy priorities of Ukraine, defining Ukraine as a bridge between the West and Russia.<sup>210</sup> Also the meaning of the official rhetoric about Ukraine's neutrality changed dramatically. If

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*Weekly*, vol.Ixiv no.28, 30 June 1996, p.1.

<sup>208</sup> Volodymyr Pedchenko, "Ukraine's Delicate Balancing Act," *Transitions*, vol.4, no.1, (June 1997), pp.72-75.

<sup>209</sup> Volodymyr Ilchenko, "SND: Strategiya Ekonomichnux Vidnosun," *Uryadovuy Kuryer* (Kyiv) no.179-180, 30 November 1995, p.3.

<sup>210</sup> Oleksandr Pavliuk, "Ukrainian Foreign Policy," in *U.S. Relations with the Former Soviet States. Twenty-Third Conference April 17-21, 1998* (Washington, DC: The Aspen

Kravchuk's vision of non-participation in military alliances envisaged a pro-Western orientation, Kuchma's interpretation represented a more balanced approach.

The Ukrainian ruling elite displayed its loyalty to Russia by signing with some reservations a basic custom legislation and joining the CIS Common Air Defense Structure (CADS) at the CIS February 1995 Almaty meeting.<sup>211</sup> At the same time, the Ukrainian leadership, realizing that too radical a pro-Russian shift could represent a substantial threat and undermine Ukraine's access to Western resources, strongly opposed Russian President Boris Yeltsin's idea of preparing and signing the document on collective security of the CIS countries.<sup>212</sup>

The Ukrainian authorities made substantial progress in their negotiations with their Russian counterparts over the treaty on friendship and cooperation during 1995 — both sides were willing to reach a general accord and omit from the text the most controversial aspects of their relations such as dual citizenship or Ukraine's \$4.3 billion energy debt.<sup>213</sup> Such progress illustrated not only Russia's acceptance of Ukraine's independence but also indicated Ukraine's substantial shift towards a more conciliatory stance towards Russia.

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Institute, 1998), p.19.

<sup>211</sup> Mark R. Beissinger, "State Building in the Shadow of an Empire-State. The Soviet Legacy in Post-Soviet Politics," in *The End of Empire? The Transformation of the USSR in Comparative Perspective*, eds. Karen Dawisha and Bruce Parrott, series: The International Politics of Eurasia (Armonk, NY: M.E. Sharpe, 1997), vol.9, pp.174-175.

<sup>212</sup> Bohdan Lupiy, *Ukraine and European Security: International Mechanisms as Non-Military Security Options for Ukraine* (Berlin, New York: P. Lung, 1996), p.55.

<sup>213</sup> Ustina Markus, "Shoring Up Russian Relations," *Transition*, 28 April 1995, p.58.

Although the agreement was reached on the executive level, on the legislative level there were no such agreement. The Ukrainian Parliament ratified the Treaty on Friendship, Cooperation and Partnership on January 18, 1998, while some Russian politicians continued to call for Ukraine's reunion with Russia. The Lower House of the Russian Federation's Parliament ratified the Treaty only on December 25, 1998, that, in view of the Ministry of Foreign Affairs of Ukraine, would "raise relationships between Ukraine and the Russian Federation to a qualitative new level and open up new opportunities for further comprehensive development of Ukrainian-Russian relations."<sup>214</sup>

The Ukrainian leadership intensified its participation in the CIS process as well. During the Council of CIS heads meeting in Moscow in October 1994 the Ukrainian delegation supported the development of economic relations within the CIS, and signed the document setting up the Interstate Economic Committee (IEC) with reservations. The reservations dealt mostly with the internal legislation prohibiting participation of Ukraine in any kind of unions or associations with supra-state status which may be too excessively intrusive into national economic policies.<sup>215</sup>

According to its statute, the IEC had a right to make a number of decisions obligatory to all member-states. The Committee was supposed to deal with such transnational activities as energy systems, communications, gas and oil pipelines, agriculture, transport as well as to conduct a coordinated economic and social policy. According to the outline of the decision-making procedures, the decisions regarding a

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<sup>214</sup> "For the Record: Statement on Ukrainian-Russian Treaty," *The Ukrainian Weekly*, 10 January 1999, p.2.

<sup>215</sup> Serhiy Tolstov, "Ukraine's Foreign Policy: Course Correction of Changes of

common market, monetary and customs unions required consensus vote, while some financial issues required a qualified majority to be passed.<sup>216</sup> Afraid of going too far in pro-Russian direction, the Ukrainian delegation refused to join a proposed monetary union, citing the absence of a common payments system as the major objection.

The pragmatic balancing approach of Ukraine shaped the official foreign policy stance towards the war in Chechnya. On the one hand, Kuchma expressed his support to Yeltsin's firm approach with regard to Chechnya. On the other hand, he favored the peaceful solution to the Chechen problem.<sup>217</sup> The Ukrainian parliament supported the balancing stance and just expressed its hopes that the conflict would be resolved by political means.<sup>218</sup>

Although strategically the Ukrainian leadership pursued both pro-Western and pro-Russian foreign policy simultaneously, in those cases when the Western resources were sufficient to resolve (at least temporarily) Ukraine's energy debt problem with Russia, the Ukrainian ruling elite did not have to display its loyalty to Russia and could pursue policy more or less independent of Russia's interests. It became possible, in particular, in 1995 when Kuchma secured significant Western credits, aid and investments and was able to take an independent stance with regard to the very complicated issue of Crimea.

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Priorities?," *The Ukrainian Review*, vol.42, no.1 (Spring 1995), p.7.

<sup>216</sup> Alexander Pirogov, *Troubled Economic Relations: Ukraine and Integration in the East. Economic, Military and Military-Industrial Relations* (The Swedish Institute of International Affairs Conference Papers 16, 1995), p.46.

<sup>217</sup> "SND pered vuborom," *Uryadovuy Kuryer* (Kyiv) no. 12-13, 20 January 1996, p.2.

<sup>218</sup> "Zvernennya Verxovnoyi Radu Ukrainu do Derzavnoyi Dumy i Radu Federaziyi Rosiyi z Pruvodu Tragichnux Podiy u Chechenskiy Respublizi," *Uryadovuy Kuryer* (Kyiv)



When Yuri Meshkov, Crimea's first president, who ran on a pro-Russian platform, was elected in January 1994, it was a dangerous sign for the central authorities in Kyiv. Meshkov could benefit politically from his victory and press for greater autonomy for Crimea or even its separation from Ukraine. However, Meshkov's incompetence, escalated his conflict with the Crimean parliament and weakened his position in dealing with Kyiv. The Crimean leadership could not sustain a renewed claim of Crimean independence.

Meshkov and other Crimean politicians wrongly assumed that president Kuchma, who promised closer ties with Russia in his campaign platform, would support greater Crimean independence and closer integration with Russia. Ironically, Kuchma's drive for economic reforms allowed him to acquire extensive Western aid and credits, which ultimately worked against Crimean separatism. Eventually, in international conditions favorable for the Ukrainian leadership when Russia was deeply involved in Chechnya, and Ukraine, due to Western economic support, could withstand (at least temporarily) Russian economic pressure, the Ukrainian authorities took a decisive stance towards the Crimean authorities. On 17 March 1995, the current Constitution and the autonomous republic's presidency was temporarily banned by the Ukrainian Parliament's decree. On 31 March, Leonid Kuchma subordinated temporarily the Crimean government to the cabinet of ministers in Kyiv and reserved for himself the right to appoint prime minister of Crimea.<sup>219</sup>

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no.197-198, 22 December 1994.

<sup>219</sup> Roman Solchanyk, "Crimea: Between Ukraine and Russia," in *Crimea. Dynamics, Challenge, and Prospects*, ed. Maria Drohobycky (Lanham, MD: Rowman & Littlefield, 1995), p.3.

The improvement of economic relations with the West allowed Ukraine to withstand the Russian economic pressure with regard to the energy debt. According to the agreement reached by the Ukrainian government and the Russian gas company Gazprom in March 1995, the \$3bn debt for gas deliveries owned by Ukraine was restructured in exchange for Russian participation in the privatization of the Ukrainian gas sector. Also a joint venture “Gaztranzit” between Ukraine and Gazprom designed to manage the transport of Russian gas to Western Europe had to be created.<sup>220</sup>

Since the pipelines and the Bohorodchany and the Bilche Volytsia-Uhersk underground gas reserves were included in the starting capital of this joint venture, it sparked a heated discussion in the parliament because these facilities, according to the current Ukrainian legislation, were excluded from the privatization process. As a result, on December 22 the parliament voted to request the renegotiation by the government of this agreement. Since during 1995 the Ukrainian authorities improved their record of adherence to the restructured debt payment mostly due to the infusion of Western capital and the increases in the price of gas paid by the Ukrainian customers, it allowed the ruling elite to postpone the final decision over Russian participation in joint stock companies.<sup>221</sup>

In general, however, Ukraine’s dependence on energy imports from Russia, Turkmenistan, and Kazakhstan as well as its limited ability to compete in Western markets with its usually low-quality goods, tied the Ukrainian economy to the CIS

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<sup>220</sup> Oleksandr Sverdlov, “Gaz, Tranzit i “Gaztranzit,” *Uryadovuy Kuryer* (Kyiv) no.10-11, 18 January 1996, p.9.

<sup>221</sup> Oles M. Smolansky, “Ukraine and the Fuel Problem,” *Ukrainian Economic Review*,

markets. Aware of Russian economic pressure, the Ukrainian leadership constantly tried to diversify its sources of energy imports. To some extent its dependency on Russia has been alleviated by deliveries from Iran and Central Asian producers. In May 1994, for instance, Ukraine signed an agreement to construct a pipeline for shipping oil from Turkey. It was planned also to build an oil terminal in Odessa at an estimated cost of \$3.4 billion, providing Ukraine with an opportunity to purchase Middle Eastern oil.

#### **Moment 4 (January 1997 - December 1997)**

### **The Limited Character of Economic Reforms Necessitates Further Pro-Russian Foreign Policy Shift**

#### **The Leadership Does Not Want to Adopt Radical Economic Reforms**

President Kuchma was clearly willing to implement some economic reforms; particularly impressive progress has been achieved in improving fiscal discipline and curbing down inflation. On 2 September 1996, the hryvnya, a new permanent currency was successfully introduced. The reform process was not entirely smooth, however — in the long run Kuchma failed to capitalize on the country's awkward position and enhance his credibility by comprehensive, radical and rapid action.

The reform process was tremendously complicated due to intensive intrusion of political aspects into economic activities. Each center of power tried to increase its role in decision making which produced an illusion of a pluralistic democratic system. On the

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vol.2, no.3, 1996, p.127.

one side, president Kuchma tried to subordinate directly the power structures and strengthened the vertical structure of local administration. On the other side, the parliament opposed these attempts by advocating the idea of broadening the functions of the local administration. In 1995, for example, Kuchma was quite successful in expanding his executive powers and the parliament agreed to dilute its authority. This occurred only when Kuchma had carried out his threat to conduct a nationwide referendum on confidence in himself and the widely unpopular parliament. Since the direct confrontation at the polls could spark social, political and ethnic unrest threatening to challenge national security, the arrangement granting Kuchma with more power in reforming the economy and the government system has been set.

In 1997 the battle for power between the president and the parliament, a traditional feature of the Ukrainian political landscape, was overshadowed by a significant deterioration in relations between Leonid Kuchma and the prime minister, Pavlo Lazarenko. Lazarenko, preparing to challenge Kuchma for the presidency in the 1999 presidential elections, attempted to acquire a greater role for the cabinet and the premiership as well as forge stronger relations with the parliament. On several occasions Kuchma charged the government with failing to take responsibility for its actions. He accused ministers of using their positions of power to advance their own interests rather than those of the state. As a result, Kuchma found himself confronted not only by the parliament, but also by the Cabinet of Ministers or even prime ministers and ministers who he had appointed.<sup>222</sup>

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<sup>222</sup> Mykola Shulha, Olexander Potekhin, Natalya Boiko, Olena Parakhonska, Tetyana

In general, the Ukrainian president, legislative and executive branches gave the impression that they would rather be engaged in domestic politicking than in actual policy making: political conflicts and clashes taking place on Ukraine's political scene did not bring substantial changes but rather reflected the rotation and re-grouping of the interest groups composing the party of power. Since the leadership was more concerned about balancing between these various and often conflicting interests, overall economic policy remained confused, reflecting divisions between the president, government and parliament. The president and government were willing to implement reform at a moderate pace, spurred on by pressure from the international financial institutions, while the parliament was intent on wrecking the government's programs. It was the main reason behind the resignation of Viktor Pynzenyk, the deputy prime minister with responsibility for economic reform, in early April 1997. He protested against parliament's failure to adopt the government's tax reform package along with the 1997 budget and to introduce measures stimulating the development of small- and medium-sized enterprises and encouraging foreign investment.

#### **Pro-Reform Coalition is Still Absent**

In the absence of a strong pro-reform coalition, the president's reform efforts could not radically limit the appetites of industrial and agricultural interest groups. High dependence of Kuchma's administration on the pull of short-term distributive political pressures increased the insecurity of his tenure, especially when some reform measures were adopted. Therefore, instead of adopting a comprehensive reform strategy, the

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Shulha, *Ruling Elite in Contemporary Ukraine* (Kyiv: Ukrainian Centre for Peace,

president had to pass a threshold of popular support at every stage, encountering the resistance of various interest groups escalating their demands on the government and threatening to cut against the thrust of the reform efforts.<sup>223</sup>

Although the government was sending clear signals that it was going to balance the budget, and that it was no longer committed to extending unlimited credit to loss-making firms and agricultural sector, the parliament often supported the direct and usually non-returned credits. Incapable of resisting effectively competing claims on fiscal resources and unwilling to introduce and enforce the transparent economic rules, the ruling elite acted primarily in response to arising economic problems. Obviously, these temporarily measures were always short-lived and their positive impact on the economy were limited.

In the absence of well-developed institutionalized relations between state bureaucracies, parliament and socially based interests that allow for multiple channels of interest articulation and representation, parliamentary debates and the laws emerged out of them only vaguely reflected the everyday reality of social life and concerns of the population. This happened because a system of institutionalized political competition where the parties and candidates behave within clearly defined normative and legal boundaries and are dependent in their political choices on their electorate was not fully established. Lacking a framework of well-defined democratic institutions capable of institutionalizing the distributional conflicts, the interest groups, lacking confidence in

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Conversion and Conflict Resolution Studies, March 1998), pp.53-55.

<sup>223</sup> For a theoretical treatment of advantages of simultaneous reforms versus gradual approach, see Cesar Martinelli and Mariano Tommasi, "Sequencing of Economic Reforms in the Presence of Political Constraints," *Economics and Politics*, vol. 9, no. 2

institutional capacity to assure their equal opportunities in future, tended to disregard the shadow of the future and exploited all possible mechanisms to advance their interests.<sup>224</sup> To a large extent the weakness of democratic institutions can be attributed to the lack of a strong and independent capital-owning class capable of creating a viable pro-reform coalition, which may constitute an important bulwark against a predatory state and secure the protection of individual rights. The economic transition in Ukraine failed to establish such a class.<sup>225</sup>

Western donors did not facilitate the emergence of pro-reform coalition either. Instead of taking this objective into consideration, the IMF preferred to focus on macroeconomic technical parameters.<sup>226</sup> The IMF constantly urged the Ukrainian government to improve compliance with the conditions imposed by the Fund. In 1995-1996 the Fund was particularly irritated by parliament's failure to pass the 1996 budget,

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(July 1997), pp.115-131.

<sup>224</sup> On the positive impact of democratic conditions on economic reforms, see Adam Przeworski, *Democracy and the Market. Political and Economic Reforms in Eastern Europe and Latin America* (Cambridge, New York: Cambridge University Press, 1991), pp.180-187.

<sup>225</sup> On the linkage between democracy and economic reforms, see Larry Diamond, "Democracy and Economic Reform: Tensions, Compatibilities, and Strategies for Reconciliation," in *Economic Transition in Eastern Europe and Russia. Realities of Reform*, ed. Edward P. Lazear (Stanford, Calif.: Hoover Institution Press, 1995), pp.107-158.

<sup>226</sup> On August 25, 1997 the Council of Directors of the IMF approved a Stand-by loan for Ukraine. Following are the parameters monitored by the IMF: the maximum value of the National Bank of Ukraine's net domestic assets; the maximum value of the consolidated budget deficit; the maximum value of overdue internal government debts; the maximum of overdue external government debts; the minimum value of the National Bank of Ukraine's net international reserves; the maximum sum of foreign loans (non-preferential). The indicative (IMF - recommended) parameters of the Stand-by program are: the monetary base; the minimum volume of budget revenues; the accumulated government debt on payments for natural gas. Source: "IMF Council of Directors Approves Stand-By Loan for Ukraine," UBN, 31 August 1997.

and by the government's non-compliance with the agreed payment schedule for energy deliveries from Russia and Turkmenistan. In 1997 the situation did not radically change. As of September 30, 1997 Ukraine did not fulfill the IMF-monitored indicators, and the fact that the consolidated budget deficit limit and the size of the government's overdue internal debts (arrears of pensions, wages, and other social payments) had been violated, was accepted by Ukraine's Finance Minister Ihor Mitiukov. Nevertheless, the Ukrainian authorities expected that a negative IMF decision on continuation of the Stand-by program would be avoided because of political reasons: if a negative decision is adopted, it would threaten to impede Ukraine's capacity to attract foreign investments and loans, which could jeopardize the reform process in Ukraine, and ultimately challenge political and economic stability in the region.

The World Bank did not emphasize the importance of pro-reform coalition building either. Its officials defined poor governments' fiscal performance as a crucial factor restraining potential powerful economies. Although it may be valid for those transitional economies where politics is separated from the economy, any old or new ruling elite in Ukraine would adopt transparent rules and start pursuing efficient tax policy only when the other sources of economic resources were unavailable. Since the Ukrainian leadership was concerned mostly about its short-term perspective in the office, it tended to avoid radical economic solutions and resolved the economic problems by various forms of short-term measures, such as imposing high taxes on ordinary citizens, making more ambiguous regulations concerning both domestic and foreign private businesses, as well as exploiting the foreign policy means to assure the external inflow of resources.



### **Ruling Elite's Legitimacy Remains Moderate**

Potential danger to the ruling elite's legitimacy grew from the structural detachment of the population from their traditional dependency on government.

Moreover, the peculiarity of Ukrainian economic reforms, where the population had to bear the major costs of reforms, could have had negative consequences for the ruling elite's legitimacy as well. It prompted the widely shared anger and pessimism over the actual results of economic reforms and generated a significant increase of opposition to reforms.<sup>227</sup>

Since the leadership was concerned about its short term political survival, it was unwilling to challenge the positions of the most powerful interest groups. Therefore the high costs of reforms were imposed on the least-secured segments of the population, while benefits from reforms for them were delayed and obscure. The preservation of the status quo allowed the industrial and agricultural Soviet-type interest groups to pursue their goals of self-aggrandizement and self-enrichment, and secured the leadership's positions in the short run.

Since the degree of societal participation and the chances of counter-elites to gain popular support were high, the ruling elite, in order to secure its positions, had to maintain the existing pattern of distribution.<sup>228</sup> The state had to accumulate sufficient resources to introduce and maintain the safety net mechanisms, addressing the most socially explosive issues, such as unemployment and declining access to food and

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<sup>227</sup> It has been reflected during the 1998 Parliamentary election. See Table 5.6.

<sup>228</sup> Harald Muller and Thomas Risse-Kappen, "From the Outside In and From the Inside Out. International Relations, Domestic Politics, and Foreign Policy," in *The Limits of State Autonomy: Societal Groups and Foreign Policy Formulation*, eds. David Skidmore and

essential commodities. This eventually put an enormous burden on state structures that were barely able to perform the minimal tasks of statehood. Overwhelmed with the burden of state's financial commitments, the Ukrainian authorities had to search for all possible sources of economic resources, including the international ones.<sup>229</sup>

### **The Reform Process Slows Down**

Although Ukraine had its macroeconomic fundamentals in place, with the budget deficit cut, inflation brought down, and the exchange rate stabilized, it failed to embark on a path to recovery — Ukraine's economic reform measures have been erratic since July 1995.<sup>230</sup> For instance, in April 1996, the IMF, reacting to an unplanned increase in public spending (some \$52 million) and paper money in circulation, canceled the \$1.6 billion loan to Ukraine of which \$700 million had been already allocated. Although a decision to resume providing a standby loan was reached by the board of IMF directors shortly, it did not improve Ukraine's compliance. Pretty soon Ukraine violated one of the IMF loan programs basic effectiveness criteria by exceeding the consolidated budget deficit limit, and the IMF refused to grant the September 1997 tranche of its Stand-by loan to Ukraine (about \$ 49 mln.).

Western scholars suggested a long list of remedies to Ukraine's economic problems, including measures addressing such negative phenomena paralyzing business activity as excessive taxation, suffocating regulations, omnipresent bribery, unnecessary

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Valerie M. Hudson (Boulder, Colo.: Westview, 1993), pp.32-33.

<sup>229</sup> On different views on prospective relations of Ukraine with the West and Russia, see Table 5.7.

<sup>230</sup> *Ukraine's Parliamentary Election. March 29, 1998, A Report Prepared by the Staff of the Commission on Security and Cooperation in Europe, Commission on Security and Cooperation in Europe* (Washington, DC, April 1998), p.2.

restrictive policies and absence of a long-term growth strategy. Some Ukrainian analysts and politicians, in contrast, blamed the “shock therapy” methods recommended by the international monetary institutions that did not take into consideration the peculiarities of the Ukrainian economy and led ultimately to inflation, growth of the shadow economy, contraction of the middle class, and destruction of the domestic industry.<sup>231</sup>

The major obstacle to reforms in Ukraine lie, however, in the fusion of politics and economy that did not allow major economic management functions to be insulated from political pressure. The state could not distance itself from divergent social groups and interests and behave as an autonomous player — it did not have the technical capacity to formulate and implement specific policies of economic development. The state also did not have also a set of necessary institutions effectively monitoring bureaucratic performance at all stages of policy implementation.

Having inherited from the Soviet period social structures in which bureaucratic elites continued to figure heavily, the Kuchma administration failed to create a staff of competent officials, or a coherent entity capable of making decisions and implementing them, willing to subordinate their individual interests to the pursuit of public policy. Although the fundamentals of the economic system changed, and some attempts at reforming the economy were made, rent maximizing bureaucratic behavior adjusted accordingly.

The bureaucrats learned under the Soviet system that their wealth depended on their capacity to extract rent from various forms of economic activities and had nothing to

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<sup>231</sup> V.T. Shlemko, I.F. Binko, *Ekonomichna Bezpeka Ukrainu: Sytnist i Napryamku*

do with the ideology or the social order.<sup>232</sup> Under socialism, the bureaucrats, by intentionally making the inputs scarce, could extract bribes from any state firm in exchange for deliveries; at the same time, by making outputs scarce, they could expect the same behavior from the firm's customers. As some analysts argue, the major source of rent for bureaucracy in transitional Ukraine was the underground economy, which in conditions of limited regulatory transparency grew by establishing and exploiting contacts with the state apparatus.<sup>233</sup> Old and new bureaucrats at various levels, along with the leaders of shadow economic enterprises and Mafia bosses, established strong and powerful networks controlling production, distribution, foreign trade and other various forms of economic activities.<sup>234</sup> For example, it was common knowledge that directors of Donetsk region mines siphon off funds from mines, and they were regularly seen driving the latest model Mercedes or BMW's.<sup>235</sup>

Given the instability of economic and political institutions, the bureaucracy acquired a wide variety of mechanisms to be directly involved in the economy and to pursue private gain with official means. They established their own rent-maximizing system which was capable of preventing higher-level authorities from reviewing and

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*Zabezpechennya* (Kyiv: National Institute for Strategic Studies, 1997).

<sup>232</sup> On bureaucracy, rent-seeking and the failure of perestroika, see Peter J. Boettke, *Why Perestroika Failed: The Politics and Economics of Socialist Transformation* (London and New York: Routledge, 1993).

<sup>233</sup> See, for instance Olexander Turchynov, "Tynyova Ekonomika I Tynyova Polituka," in *Demonu Mury ta Bogu Viynu: Soziyalni Konflikty Postkomunistuchoi Dobu* (Kyiv, Polituchna Dumka, 1997), pp.428-440.

<sup>234</sup> Oleksandr Dergachev, and editorial board, *Ukrainian Statehood in the Twentieth Century: Historical and Political Analysis* (Kyiv, Political Thought, 1996), p.303.

<sup>235</sup> Natalia Feduschak, "Ukraine's Donbas - The Key to Future Security," *The Ukrainian Quarterly*, vol.LII, no.4 (Winter 1996), p.351.

intervening in what was going on below.<sup>236</sup> Once the bureaucrats adjusted their rent-maximizing technique to new political and economic circumstances, they developed vested interests in maintaining the status quo.

In these conditions, even if Kuchma made some attempts to break these patterns, he necessarily faced the resistance of these important interest groups threatening him to turn to his political competitors for support. As a result, the reform process represented rather a Soviet-type bargaining between the president who had the ultimate responsibility and could be blamed for any failure or imperfections of the system on one side, and a wide variety of actors on the other side, namely the opposition, interest groups, various groups of bureaucracy within the ruling stratum, and society at large.

In the agricultural sector, for instance, despite Kuchma's attempts to speed up land reform and bring radical changes, the sector remained almost unchanged from the Soviet era.<sup>237</sup> Not only the leftist forces, the so called agricrats, who ran many of the collective farms like personal fiefdoms and wanted to maintain the status quo, but also some reformers who did not support a swift and radical dismantling of collective farms in favor of small-scale family farms.<sup>238</sup>

In general, the reform process was biased in two aspects: first, it concentrated benefits of reforms on the well-organized and well informed while the costs were dispersed on the uniformed and ill-organized societal strata; and second, the ruling elite

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<sup>236</sup> Table 5.5 lists various "unofficial" payments demanded by bureaucracy from private enterprises in Ukraine and Russia.

<sup>237</sup> *Ukraine: The Agriculture Sector in Transition* (Washington, D.C.: The World Bank, 1995).

<sup>238</sup> Chrystyna Lapychak, "Quarrels Over Land Reform," *Transition*, 1 December 1995,

avored those policies that could bring short-term and easily identifiable benefits to its security, disregarding the long-term perspective. Addressing short-term threats to its security, the Ukrainian leadership, being unable to foster industrial growth and address effectively the negative external balance of trade, resorted to increasing the total tax liabilities of enterprises to 70-98% of their income. A shortsighted tax policy along with high taxation on citizens' incomes necessarily promoted the expansion of the shadow economy, which according to some estimates controlled from 30 to 50% of the GDP.<sup>239</sup> Although there was a ban on circulation of foreign currency as a method of payment in Ukraine, private entrepreneurs and small-medium businesses tried to settle all their deals in foreign currency in cash that shrunk the tax base further. When tax liabilities were extraordinary high, a banking system offering credits to entrepreneurs was not developed, laws were not transparent and their implementation depended on personal interests of the bureaucracy, the shadow economy had no incentives to legalize its activities.<sup>240</sup>

Since enterprises in Ukraine were hit hard by taxes and regulations, many firms preferred to submerge their operations, at least partly, and paid significant sums in bribes that allowed them to misreport substantial shares of their value added. Although the government frequently declared its intentions to introduce a set of corresponding policy measures, the practical actions were not taken. Also an overly extensive underground economy threatened the democratic process: the control of a significant portion of

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vol.1, no.22, p.57.

<sup>239</sup> Serhiy Tolstov, "Ukraine at the Economic Crossroads: Hopes and Opportunities," *The Ukrainian Review*, vol.42, no.4 (Winter 1995), p.5.

<sup>240</sup> Yuliya Mostovaya, Natalya Yazenko, "Roman Shpek o Realnux Dolgax i Potenzialnux Pribulyax," *Zerkalo Nedeli (Kyiv)*, 7 June 1997, p.7.

business activities by organized criminals as well as their penetration of the political and official worlds, discredited the fundamental ideas of democracy and capitalism in the eyes of the common people.

Foreign direct investment may facilitate the reform process - it can open access to new markets, help in introducing new standards of operational efficiency and product quality, and ensure transfer of managerial skills and technology. Although the geographical mobility of foreign capital, when investors may easily withdraw their capital at some point, makes it quite complicated to deal with, the need for more foreign direct investment was paramount, as was the development of investment-friendly banking and taxation systems. The political and economic uncertainty in Ukraine as well as inability of the bulk of domestic firms to effectively utilize foreign credit and investment limited the prospects for foreign investments.

Despite a promising significant increase in the volume of direct foreign investments in 1995-1996, the ruling elite failed to establish a set of transparent institutions attracting foreign investors, therefore foreign investors were not coming to Ukraine. Foreign direct investment in 1995 amounted to \$260 million. It rose to \$450 million in 1996 and went up to \$760 million in 1997, which was almost nothing in comparison with the thousands of millions of dollars being invested in far smaller Eastern European countries.<sup>241</sup> Despite some examples of improvement in the quality of the legal and institutional framework for foreign investment in Ukraine, the legislation was full of declaratory statements that lacked the conceptual coherence and details essential for

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<sup>241</sup> Robert Lyle, "Ukraine: Lending Depends on the Pace of Reforms," *RFE/RL Report*

establishing a concise framework for foreign investments. The uncertainty in the legislation not only made it difficult for the players to understand the rules of the game, but also opened an avenue for many interpretations of legislative intent, and for arbitrary decisions on the part of those who were in charge of implementing the legislation.<sup>242</sup> Rampant corruption, and an unstable economic and political situation kept many foreign investors at bay.<sup>243</sup>

Investor confidence was shaken in 1997 by stalling economic reforms and the continued failure to improve the institutional framework. A number of companies pulled out of deals or reduced their operations. For example, the US electronics company Motorola, which had planned to invest \$500 million in a large mobile telephone project, withdrew in March 1997. Optimistic expectations based on the assurances from Ukraine's Ministry of Communications that Motorola as well as other new entrants into the market would not be charged to reserve a frequency were ruined when the Motorola officials learned that they would have to cough up \$65 million a year.<sup>244</sup>

#### **Foreign policy - Pro-Russian Vector is Intensified**

In June 1996 the last nuclear warhead was removed from Ukraine, and the controversial issue of nuclear disarmament in Eastern Europe was resolved. Due to more receptive policy with regard to nuclear weapons, Ukraine could fully benefit from its

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(March 1998).

<sup>242</sup> Organization for Economic Co-operation and Development, *Foreign Direct Investment in Ukraine* (Paris: OECD, 1997), p.11.

<sup>243</sup> Tom Hundley, "Foreign Investment Comes Slowly as Ukraine Emerges, Fast and Loose," *Chicago Tribune*, 13 May 1996, Sec. 4, p.1, col.2.

<sup>244</sup> Matthew Brzezinski, "Ukraine's Bureaucrats Stymie U.S. Firms. Corruption, Red Tape Make Investors Consider Giving Up," *The Wall Street Journal*, 4 November 1996, p.A18.



membership in the IMF, World Bank and the International Bank of Reconstruction and Development (IBRD).

In 1997 Ukraine affirmed its intent to broaden and strengthen its cooperation with NATO: on July 9 the leaders of the 16 NATO member states and Ukrainian President Leonid Kuchma signed the Charter on Special Partnership between Ukraine and NATO in Madrid.<sup>245</sup> NATO allies reaffirmed their support for Ukrainian sovereignty and independence, its territorial integrity and democratic development.<sup>246</sup> Under the charter, NATO and Ukraine recognized that the openness of the alliance for new member states in accordance to Article 10 of the Washington Treaty was aimed at strengthening stability in Europe without restoring dividing lines. NATO and Ukraine agreed upon a broad range of issues for consultation and cooperation, including, for instance, the plans to

- “explore to the broadest possible degree the following areas for cooperation:
- armaments cooperation (beyond the existing CNAD dialogue);
  - military training, including PfP exercises on Ukrainian territory and NATO support for the Polish-Ukrainian peacekeeping battalion;
  - promotion of defense cooperation between Ukraine and its neighbors.”<sup>247</sup>

The Charter, however, did not provide any new NATO security guarantees to Ukraine, which under the terms of the Washington Treaty were available only to NATO

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<sup>245</sup> “Xartiya pro Osobluve Partnerstvo mizh Ukrainoyu ta Organizaziyeyu Pivchnoatlantuchnogo Dogovoru. Tekst pidpusano Presidentom Ukrainu L.Kuchmoyu ta lideramu 16 krayin-chleniv NATO (9 lupnya, Madrud),” *Uryadovuy Kuryer* (Kyiv) no.125-126, 12 July 1997, p.4.

<sup>246</sup> Donald McConnell, “Charter with NATO Will Help Ukraine Regain Its Rightful Place in Europe,” *NATO Review* (July-August, 1997), p.23.

<sup>247</sup> “Charter on a Distinctive Partnership between The North Atlantic Treaty Organization and Ukraine. Madrid, 8 July 1997,” *The Ukrainian Quarterly*, vol.LIII, no.1-2, (Spring-Summer 1997), p.164.

members. The Charter also did not restrict NATO's ability to act unilaterally.<sup>248</sup> With regard to the very sensitive issue of potential NATO military presence on Ukrainian territory, Ukraine and NATO shared the point of view that the presence of foreign troops on the territory of a signatory to the charter should be based on international law, the freely expressed consent of this country or a corresponding decision of the UN Security Council.

Ukraine sought closer relations with the Western European Union as well. As a result of the meeting of Jose Gatoilero, Secretary-General of the Western European Union with Leonid Kuchma and Foreign Minister Hennady Udovenko, a joint communiqué was signed. With regard to future cooperation, it was planned to have Ukraine involved in WEU peacekeeping operations, as well as in the WEU's space research and satellite-launch programs. The cooperation had to be facilitated by establishing a military liaison between Ukraine's Brussels embassy and the WEU. It was also stated that Ukraine may be granted, after a transitional period, a WEU "associate partner" status.<sup>249</sup>

The Ukrainian leadership attempted to get extensively involved into the EU enlargement process and prevent the emergence of new dividing lines in Europe. In the Ukrainian leadership's view, "accommodating 3-4-5 newcomers while ignoring the others which are indispensable for an integrated picture of a truly united Europe"<sup>250</sup>

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<sup>248</sup> *Fact Sheet. Charter on a Distinctive NATO-Ukraine Partnership* (Washington, DC: The White House, Office of the Press Secretary), 30 May 1997.

<sup>249</sup> "Chronicle of Events," *The Ukrainian Quarterly*, vol. LII, no. 4, (Winter 1996), p. 396.

<sup>250</sup> "Borderline Case Europe - Chances and Risks of the New Neighbourhood," Statement by H.E. Borys Tarasyuk, Minister for Foreign Affairs of Ukraine at the International Bertelsmann Forum (Berlin, July 4, 1998). Press-Release, Permanent Mission of Ukraine to the International Organizations in Vienna. 7 July 1998, p. 4.

policy should be substituted for a broad and concerted approach capable of minimizing negative consequences of EU enlargement for Ukraine.

The Ukrainian leadership moved in a pro-Russian direction as well. For instance, Ukraine's participation at the Ukrainian-Russian Wake of Peace-97 exercises was presented not as a counterbalance or opposition to the Sea Breeze-97 but rather as maneuvers of a peaceful nature. It was presented that both the Sea Breeze-97 and Wake of Peace-97 exercises were set out in the Partnership for Peace program, of which both Ukraine and Russia are members. As Col-General Ivan Bizhan, the Ukrainian first deputy minister of defense, stated during a news conference devoted to the commencement of the maneuvers, the exercises "are part of the foreign policy conducted by Ukraine, which, as is known, is a nonaligned state."<sup>251</sup>

The pragmatic approach of the Ukrainian leadership maximizing the inflow of external resources was applied with regard to the sale of Ukrainian turbines for a nuclear reactor that Russia was building in Iran. Ukraine came under pressure from the United States to withhold the sale of a giant turbine already built in Kharkiv, or encounter a possibility of denial of the second half of a U.S. foreign aid worth nearly \$100 million. Since the Ukrainian leadership did not want to be denied U.S. foreign aid, it decided to halt the sale of the Kharkiv turbine. In return, the U.S. not only cleared the way for Ukraine to receive the second half of the U.S. foreign aid, but also allowed Ukraine accession to the Missile Technology Control Regime treaty, which expanded Ukraine's

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<sup>251</sup> "Ukrainian Deputy Defence Minister Satisfied with Russo-Ukrainian Naval Exercises," (Kyiv: UNIAN news agency), 29 October 1997.

opportunities in the satellite launch industries. Also the U.S. signed an agreement with Ukraine on the peaceful use of nuclear technologies.

Despite some improvement in relations with the West, the Ukrainian leadership could not acquire significant Western resources to effectively withstand effectively the growing pressure to reintegrate within the CIS politically, economically and militarily. Therefore, the Ukraine's relations with Russia represented a stop-and-go policy: when the ruling elite could effectively address domestic threats, it could pursue policy independent from Russia, but once domestic resources were depleted, the Ukrainian leadership was tempted to make a clear pro-Russian shift. Whatever happened in Russia, Ukraine's failure to implement reforms continued to be its own enemy — Ukraine was still dependent on Russian energy resources and the Russian market. In contrast to Ukraine, the economic crisis of August 1998 in Russia had only a minor impact on more economically reformed Poland.<sup>252</sup>

Although the Ukrainian leaders made some attempts to diversify its energy supplies, they could not provide a cheap alternative to Russian energy. During the Council of Europe summit held in Strasbourg on October 10-11, 1997 the heads of four states — Azerbaijan, Georgia, Moldova and Ukraine — met at the invitation of President of Azerbaijan Aliyev. "The four" adopted a joint communiqué stating that these countries intended to improve their economic cooperation and coordinate their actions, both on a bilateral basis and in the context of regional structures. Ukraine, along with Moldova, expressed increased interest in the plan for a Transcaucasian transport corridor for Azeri

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<sup>252</sup> Christina Ling, "Russia Crisis Spreads Alarm in Ukraine," *Reuters*, 3 August 1998.

oil, bypassing Russia.<sup>253</sup> The diversification attempts overlooked Ukraine's major problem, which was not Russian threats to cut off gas and oil supplies for political reasons but Ukraine's inability to pay in full for energy supplies.<sup>254</sup> Also the dangers of energy cut-off were not very high — Russia could not press Ukraine too hard and, most likely, it would avoid confrontational or coercive tactics because 95 percent of Russia's natural gas exports to Europe were moved across Ukraine through pipelines.<sup>255</sup> The Russian authorities, realizing this limitation, adopted a more balanced approach and steadily reduced subsidies to Ukraine<sup>256</sup> (see Table 5.8).

Ukraine was dependent on Russian energy supplies and Russian market, and Moscow frequently used this dependence to keep Ukraine in its orbit. In 1995-1996, despite some improvement in Russia-Ukraine relations, the problems dealing with the trade issues remained. In response to Ukraine's refusal to become integrated in the military, political and economic structures of the CIS, the Russian authorities, being aware that Ukraine may become the eastern border of Europe, moved to a hard line in dealing with Kyiv. For instance, Russia was reluctant to implement the 1993 treaty and the agreement signed on February 8, 1995 on free trade with Ukraine, a policy which clearly was linked to Ukraine's reluctance to join a CIS customs union. On January 16, 1996, Leonid Kuchma, meeting with Boris Yeltsin, complained that Russia continued to

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<sup>253</sup> "Kiev and Chisinau Seek Own Route to Caucasian Oil, Bypassing Russia" (by Elmira Akhundova, journalist, *Izvestia*, Oct. 15, 1997), *The Current Digest of the Post-Soviet Press*, vol.XLIX, no.41 (1997), pp.16-17.

<sup>254</sup> Peter Rutland, "Search for Stability," *Transition*, 23 June 1995, p.23.

<sup>255</sup> Igor Khripunov and Mary Matthews, "Russia's Oil and Gas Interest Group and its Foreign Policy Agenda," *Problems of Post-Communism* (May/June 1996), p.43.

<sup>256</sup> Gregory V. Krasnov and Josef C. Brada, "Implicit Subsidies in Russian-Ukrainian

levy value-added tax (VAT) at 20%, and a special tax of 3% on its exports to Ukraine. As a result of this policy, raw materials imported from Russia were sold in Ukraine at a price 50% above the domestic price in Russia. In retaliation, the Ukrainian government had to increase excise duties on vodka, cigarettes, and pipe tobacco imported from Russia. Due to high import taxes, Ukrainian exports to Russia in the first eight months of 1997 fell by more than 27 percent compared to the same period of 1996.<sup>257</sup> An ongoing trade war between Russia and Ukraine hurt Ukraine far more than it hurt Russia.

Although such sharp phrases as “trade war” have been heard more and more in 1997, the resolution of issues dealing with import and export tax, particularly with sugar imported from Ukraine, was quite complicated. In 1997 the progress of reforms was slow, and Kuchma could not easily acquire Western economic support. Therefore, the display of loyalty to the former hegemon capable of bringing some economic benefits became necessary. Since the economic resources could not be acquired without the appropriate adjustment of foreign policy, in March 1997 Russia and Ukraine signed an agreement which allowed Russia to use two Soviet-era ballistic-missile radar stations located in Ukraine in exchange for spare parts for Ukraine’s military sector.<sup>258</sup> In contrast to Ukraine’s relations with NATO where the partnership did not involve the positioning of NATO troops or military facilities on Ukrainian soil, this agreement incorporated Ukraine, or at least these two military facilities, into Russia’s defense system.

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Energy Trade,” *Europe-Asia Studies*, vol.49, no.5 (July 1997), pp.838-839.

<sup>257</sup> Anatoly Verbin, “Yeltsin Hails Improved Russian-Ukrainian Ties.” Reuters, 16 September 97.

<sup>258</sup> “Chronicle of Events,” *The Ukrainian Quarterly*, vol.LIII, no.1-2 (Spring-Summer 1997), p.173.

The displays of loyalty were quite helpful in resolving, at least partially, the trade-related issues. On November 16, 1997, Leonid Kuchma held an informal meeting with Boris Yeltsin. In a joint declaration summarizing the results of the meeting, the parties declared that they arrived at an agreement canceling VAT on goods coming from Russia to Ukraine. The Presidents agreed to expand consultations involving the Presidents and Prime Ministers to intensify the implementation of the Agreement on Friendship and Cooperation between these states. It was also declared that the improvement of Russia-Ukraine relations will be a top priority goal of these states. The leaders expressed their intention to cooperate in the international arena and support each other in dealing with European economic institutions.<sup>259</sup> Following the meeting, the Russian government delegation headed by First Deputy Prime Minister Anatoli Chubais visited Ukraine and an annual quota of 600,000 tons for Ukrainian sugar exportation was allocated. Within the quota framework, Ukrainian sugar was exempted from the 25% duty on imported sugar introduced by Russia in March, 1997. Surplus sugar had to be imported to Russia on general conditions.<sup>260</sup>

Economic considerations continued to dominate the foreign policy calculations of the Ukrainian leadership: on 26 February - 1 March 1998, Leonid Kuchma paid a state visit to the Russian Federation and signed along with Boris Yeltsin the Program of Economic Co-operation between the Russian Federation and Ukraine for 1998-2007,

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<sup>259</sup> Gayaz Alimov, "Moskva i Kiev Prekratili "Torgovuyu Voynu,"" *Izvestiya* (Moscow), 18 November 1997, p.1

<sup>260</sup> As some experts argue, Ukraine should not cherish large hopes for exporting sugar to Russia because the Ukrainian sugar industry is currently non-competitive on the international market. See Oleksij Tolpyho, "Ukraine's Sugar Industry: Review of the Problems and Outlooks," *Uamonitor* (Kyiv), October 1997.

opening up the Ukrainian economy for Russian investment and contributing to creation of a common economic space. If these plans are implemented, Russia might steadily become the main source of investment and trade for Ukraine, and Ukraine will reorient itself economically and to a large extent politically towards Russia. Particular emphasis has been made on cooperation in such strategic fields as fuel and energy complex, space, nuclear energy, electronics, aircraft building, transport and agriculture.<sup>261</sup> The agreement was supported by Kuchma's assurances that Ukraine had no interest in joining NATO and that it would not apply for membership.

Since Russia supplied about 80% of all gas, oil and nuclear-fuel deliveries to Ukraine,<sup>262</sup> for which Kyiv still owed significant amounts in back payments, the leadership displayed its loyalty to Russia in resolving the Black Sea Fleet issue. On June 9, 1995 Russian president Boris Yeltsin and Ukrainian president Leonid Kuchma signed an agreement that resolved in principle the dispute over the Black Sea Fleet. Russia argued that for strategic reasons it needed the full use of the Sevastopol naval base and insisted on having a long-term lease on the bulk of the Crimea's naval bases and exclusive rights over Sevastopol, while Ukraine insisted that the base to be used jointly. Under this agreement the port where Ukraine would base its navy was not specified, leaving open the opportunity that two navies could share Sevastopol.<sup>263</sup> The two

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<sup>261</sup> Statement by the Presidents of the Russian Federation and Ukraine. Distributed at the Request of the Russian Federation and Ukraine, 5 March 1998.

<sup>262</sup> Matthew Brzezinski, "In Ukraine, Cold War Still Seems to Rage," *The Wall Street Journal*, 24 July 1996, p.A.16.

<sup>263</sup> Ustina Markus, "Black Sea Fleet Dispute Apparently Over," *Transition*, 28 July 1995, pp.31-34.



countries agreed in principle to split the fleet, with Russia purchasing most of the Ukrainian share, ending up with 82% of the vessels.<sup>264</sup>

The question of dividing the Black Sea Fleet for all practical purposes has been resolved as part of the cooperation treaty signed on 31 May 1997. The bilateral Treaty of Friendship, Cooperation and Partnership was signed by Russian President Boris Yeltsin and his Ukrainian counterpart Leonid Kuchma in Kyiv after six years of negotiation. In the treaty, Russia formally recognized Ukraine's independence and territorial integrity for the first time. The Ukrainian authorities agreed to give Russia 32 percent of its half-share of the Black Sea Fleet as compensation for its outstanding debt to Russia, while the remaining 18 percent would be used either to enhance its own navy or be sold for scrap.<sup>265</sup>

It was agreed also that the Russian fleet would be based in three bays in Sevastopol on a 20-year lease basis, while the Ukrainian fleet would use its own bay at the same naval base. Ukraine agreed also not to enter into any agreements with third parties aimed against Russia, nor to allow the stationing of NATO troops and nuclear weapons on its territory without becoming a member of the NATO. The signing of the treaty became possible after the conclusion on May 28 of a series of agreements between Russian Prime Minister Victor Chernomyrdin and Ukrainian Prime Minister Pavlo Lazarenko on the Black Sea Fleet and Ukraine's energy debt to Russia.

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<sup>264</sup> Steven Erlanger, "Russia and Ukraine Settle Dispute over Black Sea Fleet," *The New York Times*, 10 June 1995, Sec.A, p.3, col.1.

<sup>265</sup> Stephen D. Olynyk, "The State of Ukrainian Armed Forces. ROA National Security

Table 5.1

## Values of Independent, Intervening, and Dependent Variables

Period under consideration	Independent Variables				Intervening Variable	Dependent Variable
	Ruling Elite's Need in Economic Resources	Economic Strategy (willingness /unwillingness to adopt economic reforms)	Pro-reform Coalition	Ruling Elite's Legitimacy	Progress of Economic Reforms	Continuity in Foreign Policy Towards Russia
Ukraine 1994	High	Willing	Absent	Medium	Medium	Change Pro-Western and pro-Russian foreign policy pursued simultaneously
Ukraine 1997	High	Less Willing	Absent	Medium	Medium/Low	Change Pro-Russian Foreign Policy shift

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Report," *The Officer* (November 1997), p.27.

Table 5.2

## Basic Economic Indicators

(percentage change on previous year)

	1993	1994	1995	1996	1997 (Jan. - Aug.)
Official GDP	-14.2	-23.0	-12.2	-10.0	-5.7
Gross industrial output	-8.0	-27.3	-12.0	-5.1	-3.4
Gross agricultural output	1.5	-16.5	-3.6	-9.5	-7.2
Consumer goods production	15.8	-25.0	-17.8	-20.2	-18.3
Inflation rate (per cent, year-end)	10,155	401.1	181.7	39.7	5.4
Unemployment (per cent, year-end)	0.1	0.3	0.5	1.3	2.1
Capital investment	-10.3	-23.0	-28.6	-20.0	*-11.0
Budget deficit (per cent of GDP)	n.a.	-8.9	-6.6	-4.9	** -6.1

\* January-June 1997; \*\* January-July 1997

Source: Organization for Economic Co-operation and Development, *Foreign Direct Investment in Ukraine* (Paris: OECD, 1997), p.6

Table 5.3

## Main Economic Indicators: Ukraine 1992-1996

Economic Indicators	1992	1993	1994	1995	1996*
GDP at market prices HRN bn	50.3**	1.5	12.0	52.9	80.5
GDP at exchange rate \$ bn	1.0	24.3	14.1	36.0	44.0
GDP at purchasing power parity* \$ bn	181.5	168.4	132.9	119.9	111.1
Real GDP growth %	-17.0	-14.2	-24.3	-11.8	-10.0
Consumer price inflation %	1,310	4,735	891	377	80
Consolidated budget balance (% of GDP)	-12.2	-6.5	-10.5	-7.9	-4.6
Population m (mid-year)	52.15	52.18	51.92	51.64	51.23
Exports*** \$ m	11,308	12,796	13,894	14,244	16,398
Imports*** \$ m	11,930	15,315	16,469	16,946	19,996
Current account \$ m	-619	-849	-1,163	-1,152	-980
Reserves excl gold \$ m	469	162	470	906	1,764
Exchange rate (av)**** HRN:\$	0.0021	0.05	0.33	1.47	1.83

April 25, 1997 HRN 1.841:\$1 (Ukrainian Inter-Bank Currency Exchange rate).

\* EIU estimates. \*\* Million. \*\*\* IMF for 1992-93; EU and official government sources for 1994-95. \*\*\*\* The hryvnya replaced the karbovanets on September 2, 1996, at the rate of HRN1:Krb100,000.

**Table 5.4**  
**Principal Exports and Imports Destinations**

Principal exports 1996	% of total
Ferrous and non ferrous metals	32.3
Chemicals	11.9
Agricultural goods	10.3
Machinery & equipment	10.2
Food products	9.9

Principal imports 1996	% of total
Mineral products	55.4
Machinery & equipment	14.5
Chemicals	5.4
Plastic & rubber	4.2
Ferrous & non-ferrous metals	4.1

Main destinations of exports 1996	% of total
CIS	54.1
Russia	38.7
EU	10.9
China	5.4
Belarus	5.1
Germany	2.9
USA	2.9

Main origins of imports 1996	% of total
CIS	67.8
Russia	48.0
EU	14.1
Turkmenistan	8.8
Germany	5.5
USA	3.0
Poland	2.7

Source: The Economist Intelligence Unit Country Report. *Ukraine 2nd Quarter* (London: The Economist Intelligence Unit, 1997), p.5.

Table 5.5

**“Unofficial” Payments by Enterprises for Official Permits, Licenses and other  
“Favors” in Ukraine and Russia, 1994 and 1996**

	Ukraine				Russia	
	Average “unofficial” fee required for “favor”*		Percentage of enterprises admitting need to pay “unofficially”		Average “unofficial” fee required for “favor”*	Percentage of enterprises admitting need to pay “unofficially”
Type of license or “favor”	1996	1994	1996	1994	1996	1994
Enterprise registration	\$176	\$186	66	64	\$288	44
Each visit by fire or health inspector	\$42	\$40	81	72	\$67	23
Each regular visit by tax inspector	\$87	\$91	51	56	\$250	21
Each phone line installation	\$894	\$550	78	95	\$1.071	100
Lease in state space (sq. meter per month)	\$7	..	66	88	\$26	39
Each export license registration	\$123	\$217	61	96	\$643	43
Each import license registration	\$278	\$108	71	93	\$133	50
Each border crossing (lump sum)	\$211	\$194	100	90	..	..
Domestic currency preferential loan (percentage of value)	4	..	81	..	8	38
Hard currency preferential loan (percentage of value)	4	..	85	..	23	53

\*Average among those who admit making unofficial payments. Preliminary data based on March 1996 survey of 150 state or private enterprises in five large Ukrainian cities, and 50 enterprises in three large Russian cities. Caution should be exercised in interpretation of the data, which are not representative of the whole country (particularly in Russia, where the sample is small). The mid-1994 survey results for Ukraine are based on a similar survey instrument.

Source: Daniel Kaufmann, “Why is Ukraine’s Economy - and Russia’s - not Growing?” *Transition*, vol.8, no.2, April 1997, p.7.

**Table 5.6****March 29, 1998 Parliamentary Election**

Eligible Voters: n/av

Registered Voters: 37,540,092

Votes Cast: 26,571,273 [86.60% of Registered Voters]

Valid Votes: 24,251,899 [99.25% of Votes Cast]

Invalid Votes: 2,319,374 [0.65% of Votes Cast]

PARTY	VOTES	% [OF VALID VOTES]	SEATS
Ukrainian Communist Party (KPU)	6,550,353	27.01	124
Ukrainian People's Movement for Restructuring	2,498,262	10.30	46
Bloc of Socialists' and Peasants' Party	2,273,788	9.38	35
People's Democratic Party	1,331,460	5.49	28
Hromada Party	1,242,235	5.12	23
Green Party of Ukraine	1,444,264	5.96	19
Social Democratic Party of Ukraine (United)	1,075,118	4.43	18
Progressive Socialist Party of Ukraine	1,066,113	4.40	17
Agrarian Party of Ukraine	974,758	4.02	8
Reforms and Order Party	831,517	3.43	3
Other parties and independent candidates	6,264,031	25.83	129

Source: *Elections Today. News from the International Foundation for Election Systems* (Summer 1998), vol.7, no.4, p.30.

**Table 5.7****In What Way Will the Relations Between Ukraine and Russia Develop?**

answers variants	answers distribution, %
Russia and Ukraine will unite	26
Russia and Ukraine will extend their ties but will not unite	44
The relations will remain unchanged	9
Ukraine will reduce its ties with Russia	2
Ukraine and Russia will choose entirely different ways	4

**In What Way Will Relations Between Ukraine and Europe Develop?**

answers variants	answers distribution, %
Ukraine will integrate into Europe	8
Ukraine will extend its ties with Europe, though gradually	49
The relations will remain unchanged	12
Ukraine will reduce its relations with Europe	3
Ukraine and Europe will take entirely different ways	6

The poll was conducted in April 1998 in all regions of Ukraine. The excerpt comprised 1200 respondents which according to their social-demographic characteristics (age, sex, education, type of settlement) represented the adult population of the country.

Source: *Monitoring Foreign and Security Policy of Ukraine. April-June 1998* (Kyiv: Ukrainian Center for Peace, Conversion and Conflict Resolution Studies, 1998), p.84.



**Table 5.8**

**Estimated Range of the Price Component of Implicit Russian Subsidies to Ukraine,  
1992-1995**

Year	Item	Total volume of imports (1)	World market price (2)	Average price of imports (3)	Max Russian subsidy (million \$) (4) (1)*((2)-(3))	Volume of imports from Turkmenistan (5)	Min price of Turkmen imports (6)	Max Turkmen subsidy (million \$) (7) =(5)*((2)-(6))	Max Russian subsidy (million \$) (8) =(4)-(7)
1992	Oil (m.tons)	34.1	\$119.40	\$42.20	2632.52	-	\$0.00	-	2632.52
	Gas (bn m3)	89.6	\$75.10	\$9.30	5895.68	14.25	\$10.00	927.44	4968.24
1993	Oil (m.tons)	19.6	\$105.70	\$80.00	503.72	-	\$0.00	-	503.72
	Gas (bn. m3)	79.8	\$83.50	\$49.80	2689.26	25.38	\$10.00	1865.17	824.09
1994	Gas (bn m3)	69.1	\$80.52	\$55.30	1742.70	12.00	\$10.00	846.24	896.46
1995	Gas (bn m3)	66.3	\$80.52	\$55.57	1654.19	12.10	\$10.00	853.29	800.89
Total Russian subsidy to Ukraine, 1992-95					15118.07				10625.93

Sources: 1992 and 1993 volume of imports, world market prices, average prices of imports: International Monetary Fund (1994), Table 44; 1994 and 1995 volume of imports: oral communication from World Bank staff; 1994 and 1995 world market price: United Nations (1994), Moldova.

Source: Gregory V. Krasnov and Josef C. Brada, "Implicit Subsidies in Russian-Ukrainian Energy Trade," *Europe-Asia Studies* vol.49, no.5, July 1997, p.830.

**Table 5.9**

**The Top Three Largest Recipients of Direct U.S. Government Aid in Millions of  
U.S. Dollars. Figures Don't Include Loans**

	1997*	1996	1995	1994
Israel	3.000.0	3.000.0	3.000.0	3.000.0
Egypt	2.116.0	2.116.0	2.275.0	1.902.0
Ukraine	225.0	228.2	154.5	211.0

\*Requested

Source: Matthew Brzezinski, "Ukraine's Bureaucrats Strymie U.S. Firms," *The Wall Street Journal*, 4 November 1996, p.A18.

## Chapter 6

### **Belarus - Explaining Pro-Russian Foreign Policy Shift**

In this chapter I conduct a case study of Belarus. My observations cover the period of 1991-1997. I follow the procedures developed for the case of Ukraine, assuring acquisition of comparable data from all three cases under consideration.

I start with the analysis of the initial foreign policy stance of Belarus towards Russia, immediately following independence, when the ruling elite was not concerned about its resource mobilization capacity. Then I test two major hypotheses: 1) if ruling elites are incapable or unwilling to pursue radical economic reforms, a strong pro-reform coalition is absent and elites do not have a high degree of legitimacy, the process of economic reforms will be slow and leaders, in order to secure their political survival, will be tempted to depart from initially independent foreign policy and move in a pro-Russian direction, expecting economic benefits in return; 2) by contrast, if elites are capable and willing to pursue radical economic reforms and they enjoy a high degree of legitimacy and outstanding support of a strong pro-reform coalition, the reforms are accelerated. As a result, the leaders may continuously pursue independent and, most likely, anti-Russian foreign policy.

I can list at least two factors that contributed to Belarus' initially independent and moderately pro-Russian foreign policy stance.

First of all, history mattered a great deal. Although Belarusians dominated the Grand Duchy of Lithuania until the late sixteenth century, Belarus did not have a

significant modern experience of independence. In comparison with any other major post-Soviet nationality, the Belarusians were exposed mostly to Russian cultural influences. In the absence of modern structure of the economy and society, which had to encourage the development of a strong Belarusian intelligentsia in the 19<sup>th</sup> and 20<sup>th</sup> centuries, the task of creating a full-fledged Belarusian culture, literature, and language was nearly impossible to accomplish.<sup>266</sup> As a result, Belarusian self-identification was intensively mixed with the Great Russian identity, and the Belarusians felt themselves as a part of some indivisible entity with Russia.<sup>267</sup> Only some nationalist sentiments existed in Belarus; as the short-lived cultural development of the 1920s illustrated, the Belarusians could make rapid developments in this field when official support and investment in native-language usage in schools and public life were provided.<sup>268</sup> So, the initial, moderately pro-Russian foreign policy reflected centuries of Belarusian history.

Second, the element of independence in Belarus' initial foreign policy stance may be attributed to the failure of the central Soviet authorities to address properly the needs of the republic. A particularly negative attitude toward the central government in Moscow grew after the Chernobyl disaster when Moscow took little action to address the problem - 70 percent of the fallout from Chernobyl landed on one-fifth of the republic's territory and threatened the lives of about 2.2 million people. The authorities suppressed the

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<sup>266</sup> Paul Kolstoe; with a contribution by Andrei Edemsky, *Russians in the Former Soviet Republics* (Bloomington: Indiana University Press, 1995), pp.166-170.

<sup>267</sup> Jan Zaprudnik, *Belarus: At a Crossroads in History* (Boulder, Colo: Westview Press, 1993). On the Soviet period, see Ivan S. Lubachko, *Belorussia Under Soviet Rule, 1917-1957* (Lexington: University of Kentucky Press, 1972).

<sup>268</sup> David R. Marples, *Belarus. From Soviet Rule to Nuclear Catastrophe* (New York: St. Martin's Press, 1996), pp.118-119.

information about the accident and allowed the everyday life in the highly contaminated area, where the concentration of radionuclides in locally raised meat, milk and vegetables exceeded permissible levels many times over.<sup>269</sup>

When the Soviet Union collapsed, Belarus, despite many commonalities with Russia such as closely related language, extensive integration under the Soviet Empire and common Soviet heritage, did not express its willingness to return back under Moscow's thumb. The ruling elite did not experience problems with the economy and could afford a foreign policy stance independent of Russia. In the long run, however, Belarus, that used to rely on Russia's energy supplies, raw materials, and export markets, had to make a strategic choice — whether to sustain its independence by improving its economy and reorienting it to Western markets or to return to Russia's orbit.

Pursuing moderately pro-Russian but nonetheless independent foreign policy, Belarus joined the International Monetary Fund (IMF), the World Bank, the European Bank for Reconstruction and Development, and became a member of the Conference on Security and Cooperation in Europe. Foreign Minister Piotr Krauchanka, referring to Belarus' cultural past and emphasizing its distinctiveness from the Russian culture, established a wide variety of bilateral ties with Western states. In its relations with Russia, Belarus successfully resisted Russian attempts to integrate Belarus into the CIS collective security arrangements and refused to sign the Tashkent Treaty in May 1992.

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<sup>269</sup> Jan Zaprudnik and Michael Urban, "Belarus: From Statehood to Empire?" In *New States, New Politics: Building the Post-Soviet Nations*, eds. Ian Bremmer and Ray Taras (Cambridge; New York: Cambridge University Press, 1997), p.288.

The Belarusian ruling elite believed that such a decision would not correspond the country's nonaligned and neutral status.

The pressure of domestic political economy worked against the Belarus' ability to pursue independent foreign policy. Once the trade among CMEA countries collapsed in 1991, followed by the collapse of trade among the republics of the former Soviet Union, Belarus, as a country with an extraordinary degree of specialization (its trade with other republics was more than 70 percent of the republic's net material product) had to find its way out. Belarus was almost fully dependent on Russia for the supply of energy resources: under the Soviet Empire, the Belorussian SSR was generously provided with the large volumes of inexpensive oil, natural gas, and electricity from the Russian Federation while its potential for renewable and non-traditional sources was capable of ensuring only about 5 percent of the country's energy needs. In 1992, for instance, Belarus imported about 75 percent of fuel and raw materials from NIS countries.<sup>270</sup>

Once the Soviet Union collapsed and Russian fuel prices approached the world levels, Belarusian industry had to be reformed because the whole design of the socialist economy did not provide any incentive to use fuels efficiently or modernize equipment. The ruling elite was unwilling to and incapable of introducing radical economic reforms. For example, Belarus had the biggest share of interrepublican trade in terms of GNP in 1988, but it did not benefit from it by introducing a liberal foreign trade regime. The state bodies continued to dominate in Belarusian foreign trade, the system of centralized

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<sup>270</sup> *Investment Guide for Belarus/ Centre for Co-operation with the Economies in Transition* (Paris: Organization for Economic Co-operation and Development, 1994), pp.30-32.

import and export of “sensitive” goods such as grains, sugar, and medicines was maintained, and various export quotas and licenses were imposed.

A price reform was introduced at the end of 1991, but the government imposed limits on the level of profits of monopolistic producers and in the trade sector. Moreover, when the first wave of liberalization was accomplished, prices for consumer goods were frozen. In 1994 when the state controlled about 5 to 7 percent of all retail prices of essential goods, the newly elected president Alyaksandr Lukashenka made further attempts to reverse the process of liberalization and by decree lowered the liberalized prices of consumer goods. In response to shortages in foodstuffs, the government raised prices for consumer goods to reduce the extent of state subsidies. Only in November 1994 did the government finally abolish the limits initially imposed on profit margins on wholesale and retail trade, as well as liberalize prices of foodstuffs along with prices of electricity and natural gas for industry and the agricultural sector.

The Law on Privatization of State Property which called for two-thirds of state enterprises to be privatized by the end of 2000 was approved by the Supreme Soviet in January 1993. Traditionally for the post-Soviet states, exemptions for privatization included defense industries, monopolies, and enterprises working with precious metals and gems. According to the law, every citizen was entitled to 20 property vouchers plus one voucher for each year worked. He or she could apply for privatization vouchers and open a voucher account at the Saving Bank. According to the privatization scheme, 50 percent of each entity slated for privatization had to be distributed to the population via vouchers, while the remaining 50 percent had to be sold for cash. The government, however, responding to strong pressure from state firms’ managers and politicians

opposing reforms, delayed privatization of large firms. According to some estimates, at best, 10 percent of state enterprises had been privatized by 1995.<sup>271</sup>

When the questions about the ruling elite's economic performance were raised, Belarusian Prime Minister Vyachaslau Kebich tried to explain the economic difficulties experienced by his country by referring to the severance of ties among the CIS states. The Belarusian authorities did not express any desire to launch a comprehensive reform program and emphasized an independent approach to the economy instead. As a part of these measures, the improvement of close relations with Russia was heavily advocated.

Vyachaslau Kebich, realizing that economic advantages from integration with Russia could be better achieved if a pro-Russian foreign policy shift was made, advocated the idea of a collective military-security defense union with Russia. Kebich emphasized that, given Western Europe's alliance policy, it was doubtful that Belarus could become a neutral state in reality. In 1993 the Kebich government proposed to join the Tashkent collective defense treaty signed by Russia, Armenia, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan. This proposal sparked heated debates in the Parliament and the opposition Belarusian Popular Front (BPF) strongly supported Belarusian neutrality. Although Speaker of the Supreme Soviet Stanislau Shushkevich tried to protect his state's declared neutrality by strongly opposing the idea of joining the Tashkent Treaty, he was forced to sign the collective security treaty. In February 1993 the Parliament ratified the Belarusian-Russian bilateral agreement on military co-operation together with the START Treaty, the Lisbon Protocol and the NPT.

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<sup>271</sup> Helen Fedor, ed. *Belarus and Moldova: Country Studies* (Washington, DC: Library of

The mood of the electorate, disturbed by the declining standard of living, favored the pro-Russian shift as well. The population exhibited clearly pro-Russian sentiments and significant segments supported the resurrection of the USSR. In a country where "sausage psychology," which connotes indifference to national cultural values, has come to dominate the public mentality, the only way to gain the wide public support of independence from Russia was to bring economic benefits of such re-orientation to ordinary people.<sup>272</sup> That is why the calls of the numerically small opposition for a return to Europe, a slogan supported by historical and cultural considerations, could hardly get outstanding public support. As a result, the government, relying on a strong ideological and cultural bias within the elite and majority of the population propelling them toward Russia, claimed that the improvement of contacts with the CIS would bring economic benefits far exceeding those of potential orientation of Belarus to the Western markets, where the country had little to offer.

Moreover, the Russian authorities exercised pressure on Belarus - - they did not want to continue fuel shipments to Belarus at a fraction of world prices, and on several occasions in 1993 and 1994 Russia suspended its shipments over unpaid fuel bills (when Russia first shut down the natural gas supply to Belarus in August 1993, the country accumulated a \$100 million debt). The Russian state gas company, Gazprom, tried to pressure the Belarusian authorities to sign an agreement providing Gazprom with an ownership of its Belarusian counterpart, Byeltransgaz, in exchange for resumption for gas

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Congress, 1995), p.47.

<sup>272</sup> Jan Zaprudnik, "Development of Belarusian National Identity and Its Influence on Belarus's Foreign Policy Orientation," in *National Identity and Ethnicity in Russia and the New States of Eurasia*, ed. Roman Szporluk, series: The International Politics of Eurasia



deliveries. Despite later payments to Russia in hard currency, consumer goods, and shares in Byeltransgaz, Belarus could not eliminate its debt, and by late November 1994 the debt stood at \$420 million.<sup>273</sup> The energy crisis led to a decline in every sector of Belarus' economy and demanded a political solution to be resolved properly.

Western resources could significantly assist in implementing economic reforms, re-orienting the economy and ultimately breaking Belarussian dependency on the former hegemon. Although Belarus secured a \$700 million credit pledge from the IMF, and the first installment of this credit, some \$98 million, was released in 1993, the ruling elite did not implement any significant reforms. Therefore, the second part of the IMF Systemic Transformation Facility loan, which was to be released in February 1995 was withheld.<sup>274</sup>

A pro-reform coalition capable of pushing the reform process was absent as well. The 1990 legislative elections in Belarus vividly showed that the share of pro-reform political forces was small. Although the Belarusian Popular Front (BPF) was formed during the perestroika to serve as an alternative voice to that of the Communist Party leadership, it could not find common ground with the Communists and incorporate a significant part of them into the movement. As a result, the Communist hierarchy withstood the initial shock and eventually regained its control over society. Although the

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(Armonk, NY: M.E. Sharpe 1994), vol.2, pp.142-147.

<sup>273</sup> Ustina Markus, "Still Coming to Terms with Independence," *Transition*, 15 February 1995, p.49.

<sup>274</sup> Ustina Markus, "Business as Usual with Lukashenka," *Transition*, 26 May 1995, p.61.

BPF collected enough signatures to demand new legislative elections in 1992, the Communist-dominated parliament rejected this request. In the absence of a strong democratic and pro-independence political movement pro-reform coalition hardly could emerge.

When Alyaksandr Lukashenka was elected president, he built a loyal bureaucratic apparatus which prevented the emergence of pro-reform coalition. He secured lawmakers' approval of his amendments to the law on local self-government. The law allowed the president to disband the councils in city districts, towns, and villages and place them under the supervision of local administrators which were appointed by the president. Although the local councils were provided with a veto power over the executives' nominees, the veto could only be used once. This meant that the executives' nominees could be forced on the council despite its disapproval. These amendments brought the entire Belarusian administration under Lukashenka's direct control.

The pro-Russian foreign policy shift which Belarus made in 1993-1994 was determined by the parameters of domestic political economy, though the speed and peculiar features of this process were influenced by President Alyaksandr Lukashenka. At the outset of his presidency in 1994, Lukashenka began to lash out at the reformers in the government. Since he campaigned for president on a platform of economic and political integration with Russia,<sup>275</sup> he made it clear that the further rapprochement with Russia would continue. He stressed particularly his intention to revitalize the military industrial

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<sup>275</sup> Stephen R. Burant, "Foreign Policy and National Identity: A Comparison of Ukraine

complex by gaining Russian orders, and declared his unwillingness to press for any pullout of the Russian strategic forces from Belarus.

The president and the ruling elite found an authoritative approach more attractive because they believed that it could help them to inch toward the overriding goal of reducing their insecurities. Moreover, a significant segment of the electorate was willing to back up administrative aggression, in this way identifying itself with the authorities, and providing for the foundations of new ruling elite's legitimization. This constituency perceived the uncertainty of social relationships and the situation of permanently making choices, typical of democracy, as threats to its authoritarian-paternalistic leanings.

Pursuing this approach and feeling that his power was not sufficient under the 1994 constitution, Lukashenka announced his intention to hold a national referendum to change the constitution. He forced the parliament to accept his decision to hold national referenda on the change of national symbols, particularly the replacement of the national flag with one similar to the former Soviet one, restoration of Russian as a state language, and providing the president with the powers to dissolve the parliament in cases of emergency.<sup>276</sup> To assure public support, Lukashenka issued a series of populist decrees increasing pensions, student stipends, aid to families with many children, and child support.<sup>277</sup>

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and Belarus," *Europe-Asia Studies*, vol.47, no.7 (1995), p.1136.

<sup>276</sup> David R. Marples, "Belarus: An Analysis of the Lukashenka Regime," *The Harriman Review*, vol.10, no.1 (Spring 1997), p.24.

<sup>277</sup> Ustina Markus, "A War of Referenda in Belarus," *Transition*, 13 December 1996, p.14.

On 24 November, 1996 the overwhelming majority of the Belarusian electorate supported Lukashenka's new constitution emasculating the legislature and overhauling the Constitutional Court, which had used its powers of veto to prevent some presidential decrees from being implemented.<sup>278</sup> In comparison with the 1994 Constitution, Lukashenka's powers were significantly broadened, and president's authority became virtually unrestricted.<sup>279</sup> Lukashenka extended his term in office from 5 to 7 years. In addition to this, the structure of the legislature was changed - the number of seats in the parliament was reduced from 260 to 110; an upper house, half of whose members were presidential appointees, emerged; and the president got the right to appoint half the members of the Constitutional Court.

The strategic pro-Russian shift in Belarus' foreign policy reflected domestic political economic conditions — when economic reforms were not implemented and the leadership experienced a need for economic resources, capable of assuring its domestic positions, pro-Russian policy could bring economic benefits from the former hegemon. Therefore, the first significant pro-Russia integrationist move had been made before Lukashenka took office. The Belarusian leadership was unable to find alternative supplies or to devise a plan and financing for restructuring the country's energy sector, therefore a political deal with Russia that would ensure cheap energy supplies was increasingly

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<sup>278</sup> Since the numerous violations of law and massive falsification of the vote count have been reported, the Presidium of the Supreme Soviet of the Republic of Belarus, the State Department of the United States, the Organization for Security and Cooperation in Europe and some other international organizations did not recognize the results of the referendum.

<sup>279</sup> Mikhail Pastukhov, *Human Rights in Belarus* (Minsk: Belarusian Helsinki Committee,

sought.<sup>280</sup> In April 1994, Russian Prime Minister Viktor Chernomyrdin and his Belarusian counterpart Vyacheslau Kebich signed the Agreement on Monetary Union. Starting from this document the provision for stationing Russian troops at Belarusian bases free-of-charge has appeared in all Russian-Belarusian integrationist agreements.<sup>281</sup> In return, Belarus was promised cheaper gas and oil from Russia.<sup>282</sup>

Although it was an important strategic incentive for Russia to cooperate, it was not enough to convince the Russian authorities to speed up the economic integration. On the one side, Russia embarked on economic reforms - prices on most consumer goods were freed, privatization of state enterprises was underway, and the inflation rate was minimized. On the other side, the Belarusian policy of printing money and issuing unbacked credits to subsidize agricultural sectors and pay wages represented an alternative, Soviet-type solution to economic problems facing both countries. In light of these differences, any practical implementation of this agreement could impose an unbearable burden on Russian economy, therefore it remained unfulfilled.

Under Lukashenka Belarus intensified its loyalty game: it became a permanent ally of Russia, always supporting Russia on all issues in the United Nations and other international organizations. Belarusian officials opposed NATO expansion because they believed that NATO membership for the Central European and Baltic states would

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1998), p.4.

<sup>280</sup> Ustina Markus, "Energy Crisis Spurs Ukraine and Belarus to Seek Help Abroad," *Transition*, 3 May 1996, p.15.

<sup>281</sup> Ustina Markus, "Russia and Belarus: Elusive Integration," *Problems of Post-Communism* (September/October 1997), p.56.

<sup>282</sup> Anatolii Rozanov, "Belarusian Perspectives on National Security and Belarusian Military Policy," in *State Building and Military Power in Russia and the New States of*

constitute a military threat to their country. This policy stance echoed the official Russian argument opposing NATO expansion.

Considering NATO's eastward expansion a threat to national security, the Belarusian authorities viewed a union with Russia as a countermeasure against it. Implementing this policy, Belarus intensified its military cooperation with Russia — the air-defense systems of Belarus and Russia were united, and the Russian armed forces enjoyed access to Belarusian military installations. For instance, the Russian military controlled the anti-missile warning installation stationed in Baranovichi as well as the Russian Navy's communication system in Vileyka. According to some estimates, the building of such installations in Russia would cost 7 trillion rubles plus some 10 trillion rubles for establishing Russian air defense alignment on its western border.<sup>283</sup>

Pursuing pro-Russian foreign policy, the Lukashenka administration often resorted to anti-Western rhetoric. Such rhetoric has been exploited, for instance, by Belarus' leadership in explaining its decision to stop destroying conventional weapons under the Conventional Forces in Europe treaty in 1994, despite the fact that the main reason behind this decision was the West's failure to provide aid quickly (\$1.3 billion has been allocated under the Nunn-Lugar program, but only \$150 million had been disbursed by early 1994, virtually all of it going to American contractors).<sup>284</sup>

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*Eurasia*, ed. Bruce Parrott (Armonk, NY: M.E.Sharpe, 1995), p.204.

<sup>283</sup> Serhiy Tolstov, "Ukrainian Foreign Policy Formation in the Context of NATO Enlargement," *The Ukrainian Review*, vol.44, no.2 (Summer 1997), p.13.

<sup>284</sup> Michael Mihalka, "Ukraine: Salvaging Nuclear Arms Control," *Transition*, 12 May 1995, p.35.

Lukashenka intensified his pro-Russian policy and in February 1995 Yeltsin and Lukashenka signed agreements on a customs union and on the defense of Belarusian borders. The first agreement discussed the issues of open borders and prospective alignment of tariff policies. A customs union with Russia improved the economic situation in Belarus: Belarusian products could be manufactured on a greater economic scale and sold on the huge Russian market. Also Belarus could purchase gas and crude oil at domestic Russian prices, or at 70-75 percent of world prices in September 1995.<sup>285</sup> In line with the second accord, both Belarusian and Russian border guards would carry out the defense of Belarus' borders with Poland, Latvia and Lithuania.

Lukashenka's populist policy (he generously distributed state funds in bonuses to the electorate) could not have been pursued in the absence of external economic assistance from Russia. Therefore, he exploited all available means to maximize the inflow of economic resources. For example, he tried to improve his relations with private Russian businessmen. In December 1994, he signed a deal with Lukoil and Rosneft, two of Russia's four largest oil companies. According to this agreement, each company was supposed to supply Belarus with 4 million tons of oil in exchange for shares in Belarusian oil refineries and petrochemical enterprises, once they were privatized.<sup>286</sup>

The next integrationist step was made on 1 January, 1996 when Lukashenka, trying to benefit from Yeltsin's vulnerability in an election year, after a telephone conversation with Yeltsin announced that he agreed with the Russian President on "zero

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<sup>285</sup> *Belarus: Prices, Markets and Enterprise Reform* (Washington: World Bank, 1997), p.40.

<sup>286</sup> Ustina Markus, "Heading Off an Energy Disaster," *Transition*, 14 April 1995, p.11.

option” standing for cancellation of their mutual debts. In February 1996 Lukashenka visited Russia, and signed a number of agreements with Boris Yeltsin,

“including the “zero option”, canceling Belarus’ \$1.27 billion debt to Russia for gas and credits in exchange for Belarus’ canceling Russia’s \$914 million debt for ecological damage caused by Russian troops in Belarus, troop stationing costs, and compensation for valuable materials in nuclear weapons removed from Belarus.”<sup>287</sup>

It helped Lukashenka to rescue the Belarusian economy: the lack of external finance, the persistent current-account deficit, and Belarus’ shrinking foreign exchange reserves (which fell from \$200 million to \$45 million from November 1995 to June 1996)<sup>288</sup> represented a potential threat to the ruling elite’s security.

Since the main part of the debt was owed to Gazprom, this Russian gas conglomerate acquired several concessions from the Belarusian government, such as the right to hold majority shares in Belarusian energy facilities.<sup>289</sup> Gazprom also acquired the majority of shares in the gas pipeline from Yamal in Northern Russia to Western Europe via Belarus.

Another agreement on the integration of Russia and Belarus, called the Treaty on the Formation of the Community, was signed on 2 April 1996. The agreement included plans for formation of a new Community that would unite several functions of government of these two states. Although the treaty outlined the creation of an economically and politically integrated community, the exact formula of integration was

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<sup>287</sup> Ustina Markus, “Belarus Chooses Dictatorship,” *Transition*, 7 February 1997, p.27.

<sup>288</sup> Natalia Gurushina, Michael Wyzan, and Ben Slav, “Mostly Stable in the CIS,” *Transition*, 7 February 1997, p.65.

<sup>289</sup> Ustina Markus, “Russia and Belarus: Elusive Integration,” *Problems of Post-*



quite unclear and the accord was no more than an expression of intent of both parties to integrate, that led eventually to mutual accusations and criticism for failing to implement the agreement.

In April 1997, Russian President Boris Yeltsin and his Belarusian counterpart Alyaksandr Lukashenka signed an agreement transforming the Community into the Union of Russia and Belarus.<sup>290</sup> Although these documents were worked out in secrecy and signed with great aplomb as “historic” documents, they did not produce any tangible results, with the exception of the creation of a couple of supranational bodies that had no real power.<sup>291</sup> The language of these agreements was vague and contradictory: they called for a single state with common leadership, emphasizing at the same time that Russia and Belarus will maintain national sovereignty.

The pro-Russian policy brought economic benefits for Belarus: in the first quarter of 1997, according to the report presented by the Ministry of Statistics, industrial production in Belarus increased 15 percent, only 32 percent in ferrous metallurgy. The GNP rose 10 percent in 1997, with a 17 percent increase in industrial production, and a 19 percent increase in investments. Since the World Bank experts did not find statistical juggling, this growth should be to a large degree explained by favorable relations with Russia. Instead of demanding hard currency payments for its energy resources, the Russian authorities agreed to accept the barter formula, and the significant part of

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*Communism* (September/October 1997), p.57.

<sup>290</sup> Natalya Ayrapetova, “Podpisan Prakticheski v Tom Vide, v Kotorom On Bul Gotov Esche ko 2 Aprelya,” *Nezavisimaya Gazeta* (Kyiv), 24 May 1997.

<sup>291</sup> Alyaksandr Lukashenka complained on several occasions about unsatisfactory slow dynamics of integrationist processes. Yuras Karmanov, “Moskva i Minsk Obmenyalis Ratifikazionnumi Gramotami,” *Nezavisimaya Gazeta* (Kyiv), 14 June 1997, p.3.

Belarus' export to Russia went as payment for cheap Russian power resources and gas.<sup>292</sup>

“The export of ferrous metals to Russia grew 40 percent in 1997, compared with that in 1996, export of tires increased in 2.5 times, tractor exports 42 percent, truck exports 84 percent, export metal-working machine-tools 57 percent, TV sets 27 percent, refrigerators and deep-freezers 45 percent, meats 47 percent, paper and cardboard 74 percent.”<sup>293</sup>

In January-September 1997 Russia accounted for 56.6 percent of total Belarus' trade volume compared with 52.7 percent in January-September 1996, Ukraine for 9.3 percent (10.1 percent), Germany 5.8 percent (6.1), Poland 3.3 percent (4.4), Lithuania 2.3 percent (2.5) and the USA 1.5 percent (1.7).<sup>294</sup> (see Tables 6.2 and 6.3).

The growth was also stimulated by the credit emissions to agriculture and housing construction sectors - the National Bank of Belarus was dependent on the President, and it had to follow the instructions issued by the Administration of President and the government. The artificially low prices for bread, milk and meat, benefiting Lukashenka's electorate, were compensated for by issuing excessive amounts of credit at very low rates and by providing subsidies, many of which went to the most inefficient enterprises experiencing the most serious financial problems.<sup>295</sup> Hard budget constraints were imposed on the enterprise level as well - - the credible threat of bankruptcy was

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<sup>292</sup> Azer Mursaliyev, “Reorganizaziya Obyedinennux Naziy,” *Kommersant* (Moscow) no.9, 11 March 1997, p.32.

<sup>293</sup> Olexander Potekhin, ed., *International Integration: Experience of the Republic of Belarus. Analytical Report* (Kyiv: Ukrainian Centre for Peace, Conversion and Conflict Resolution Studies, May 1998), p.7.

<sup>294</sup> “Belarus Nine-Month Foreign Trade up by One-Fifth,” *BBC*, November 1997, citing Belapan news agency, Minsk.

<sup>295</sup> *Belarus: Prices, Markets and Enterprise Reform* (Washington, DC: World Bank,

absent. Due to this peculiar administrative pattern of managing the economy, the Belarusian ruble collapsed in March 1998, when the difference between the official and unofficial exchange rates increased from 20-30 percent to 60 percent, a rate which was impossible to maintain.

On December 25, 1998, Russian President Boris Yeltsin and his Belarusian counterpart Alyaksandr Lukashenka signed a series of accords envisaging the unification of the two states, possibly as soon as mid-1999.<sup>296</sup> This accord appeared certain to show that the support for Russia's expanded effort to promote the reintegration of the former Soviet republics is rewarded by Russian authorities with economic benefits arising from closer integration. Belarus, giving up its economic sovereignty and insisting on further integration with Russia, returned to its former status of a Russian gubernia, "pursuing integration with Russia, Lukashenka tries to stave off total economic collapse and to improve the state of domestic affairs at the expense of the Russian economy."<sup>297</sup>

Although Russian politicians stood by the integrationist course, they were still concerned over the cost of such a union for Russia. As the lengthy negotiations on Belarus' energy debt illustrated, Russia was unwilling to assume the financial liabilities of Belarus and was unwilling to pay too high a price for any form of union. Since Belarus and Russia had different political and economic systems, the conflict of interests of various groups in the ruling elites of these states regarding the Russian-Belarusian

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1997), p.xix.

<sup>296</sup> Paul Goble, "A Divisive Call for Unity: the Russia-Belarus Merger," *The Ukrainian Weekly*, 10 January 1999, p.2.

<sup>297</sup> Jan Maksymiuk, "Gambling with Belarus's Sovereignty," *The Ukrainian Weekly*, 17 January 1999, p.2.

integration was unavoidable. Despite the strong and frequently-expressed wish of Russia to attach Belarus to itself as closely as possible, the Russian financial and industrial groups, unwilling to bear the high cost of this absorption, may exert appreciable influence on the policy of the Russian government. This has been reflected particularly in the conflict over the distribution of profits gained from the operational customs union.

**Table 6.1**

**Values of Independent, Intervening and Dependent Variables**

Period under consideration	Independent Variables				Intervening Variable	Dependent Variable
	Ruling Elite's Need in Economic Resources	Economic Strategy (willingness/unwillingness to adopt economic reforms)	Pro-reform Coalition	Ruling Elite's Legitimacy		
Belarus 1991	Low					Independent Moderately pro-Russian Foreign Policy
Belarus 1997	High	Unwilling	Absent	Low	Low	Change Pro-Russian Foreign Policy Shift

**Table 6.2**  
**Foreign Trade of Belarus with the CIS states in 1995**

CIS States	Export (thousands US dollars)	Import (thousands US dollars)
Azerbaijan	6250	4285
Armenia	2678	1038
Georgia	3565	2997
Kazakhstan	76462	55991
Kyrgyzstan	5918	2928
Moldova	70874	34987
Russia	2088919	2965022
Tajikistan	5280	2981
Turkmenistan	3240	812
Uzbekistan	59977	36730
Ukraine	607193	568964

Source: *Vneshniye Ekonomicheskiye Svyazi Respubliki Belarus v 1995 godu: Statisticheskii Sbornik* (Minsk: Ministerstvo Statistiki, 1996), pp.5-6.

**Table 6.3**  
**Balance of Merchandise Trade, 1992-1995, millions of US\$**

	1992	1993	1994	1995
Total foreign trade (turnover)	7,052	4,509	5,578	10,268
export	3,558	1,970	2,511	4,706
import	3,494	2,539	3,067	5,562
balance	64	-569	-556	-856
CIS countries (turnover)	5,015	2,601	3,571	6,606
export	2,364	1,181	1,479	2,930
import	2,651	1,420	2,092	3,676
balance	-287	-239	-613	-746
o/w Russia (turnover)	3,257	1,928	3,030	5,054
export	1,420	790	1,157	2,089
import	1,837	1,138	1,873	2,965
balance	-417	-348	-716	-876
ROW (turnover)	2,037	1,908	2,007	3,662
export	1,194	789	1,032	1,776
import	843	1,119	975	1,886
balance	351	-330	57	-110

Source: *Belarus. Prices, Markets and Enterprise Reform* (Washington, DC: World Bank, 1997), p.107.

## **Chapter 7**

### **Estonia - Explaining the Continuity in Foreign Policy Towards Russia**

As I have argued in previous chapters on Ukraine and Belarus, in order to assess the impact of developments in the domestic political economy on peripheral states' foreign policy towards Russia, the proper examination of initial sources of foreign policy in Estonia, immediately following independence, has to be conducted. At the beginning of the post-Soviet transition, peripheral ruling elites did not experience problems with mobilizing economic resources, therefore they could select independent foreign policy stance towards Russia. For the period when the ruling elite in Estonia started to experience problems with its resource mobilization capacities, I test two major hypotheses: 1) if ruling elites are incapable of/or unwilling to pursue radical economic reforms, elites do not have a high degree of legitimacy, and strong pro-reform coalition is absent, the process of economic reforms will be slow and leaders, in order to secure their political survival, will be tempted to depart from initially independent foreign policy and move in a pro-Russian direction, expecting economic benefits in return; 2) by contrast, if elites are capable of and willing to pursue radical economic reforms and they enjoy an outstanding support of a strong pro-reform coalition and high degree of legitimacy, the reforms are accelerated. As a result, leaders may continuously pursue independent and, most likely, anti-Russian foreign policy.

The experience of two decades of independence enjoyed by Estonia during the interwar period left a strong legacy of independent statehood that could not be erased by Soviet rule. As a result, Soviet citizens' lack of loyalty to the central authorities brought to the fore more nationalistic identifications in Estonia: long-suppressed national identities quickly emerged among the populations as well as in the Soviet elite - - even some Communists and Soviet officials aided and even joined national fronts. The drive for independence received considerable political support from the Russian-speaking population as well (see Table 7.4). The commonly shared desire to be liberated from Soviet domination and become free and independent was prominently manifested in August 23, 1989, when hundreds of thousands of people joined hands and formed a human chain from Vilnius to Tallinn.

Estonia's independence was declared in August 1991 after the failure of the coup in Moscow. All Estonian political forces regarded this event (77.8 percent of those voting chose to become independent<sup>298</sup>) not merely as the emergence of a successor state to the USSR but as the restoration of independence,<sup>299</sup> which could be preserved by pursuing an anti-Russian foreign policy stance.

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<sup>298</sup> David M. Crowe, *The Baltic States and the Great Powers. Foreign Relations, 1938-1940* (Boulder, Colo: Westview Press, 1993), p.181.

<sup>299</sup> Toivo U. Raun, "Estonia: Independence Redefined," in *New States, New Politics: Building the Post-Soviet Nations*, eds. Ian Bremmer and Ray Taras (Cambridge, New York: Cambridge University Press, 1997), p. 404.

I can list at least three main reasons that shaped the anti-Russian foreign policy stance of Estonia in 1991:

1) History mattered a great deal, and the historical experience of independence enjoyed by Estonia between the two world wars constituted a point of reference in foreign policy making. It was commonly believed that Estonia was occupied by the Soviet Union in 1940-91. Although the annexation of the Baltic states by the USSR was justified by the Soviet regime to the international community on the basis of a 1940 referendum, the fate of the Baltic states had been decided by Germany and the USSR in the Secret Protocol of the Soviet-German Non-Aggression Pact of 23 August 1939 as well as in the Secret Protocol of the Soviet-German Agreement on Friendship and Borders of 28 September 1939. By incorporating the Baltic states, the USSR separated them from the Western Europe and particularly from the Scandinavian countries.

2) The fact of occupation and the fears that Russians and other Russophone communities, accounting for one-third of the population in Estonia, might challenge the new leadership's statebuilding efforts, made the Estonian authorities extremely reluctant to grant citizenship to these minorities. Historical memories of Russian domination in the region as well as significant presence of Russian residents posed a threat to Estonian national identity. Many Estonians felt that their national identities were under threat because Russophone minorities could represent a political force capable of restoring Russian domination in the region.<sup>300</sup> Since the Estonian elites considered statebuilding as the restoration of the pre-1940 Republic of Estonia, they believed that the citizenship

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<sup>300</sup> David D. Laitin, *Identity in Formation: The Russian-Speaking Populations in the Near*



issues, affecting mostly a substantial Russian minority, should be resolved according to the international law covering occupation.

3) Outstanding Western support of Baltic independence and its diplomatic pressure on Russia strongly supported Estonia's anti-Russian policy in 1991. For instance, the West assisted in resolving the issue of Russian military withdrawal from Estonia, and in response to Baltic threats to blockade Russian military bases, a move which could have generated an endless series of clashes and tensions and could have ended up in large-scale violence, made clear to Moscow that retaining of military troops in the Baltic States would have negative diplomatic repercussions for Russia.

The main task of this project, however, is to explain the continuity in Estonia's anti-Russian foreign policy stance. As the case studies of Belarus and Ukraine clearly illustrated, these states started their post-Soviet transitions by adopting foreign policy stances clearly independent with regard to Russia's interests; however, the pressure of domestic politico-economic conditions necessitated the appropriate adjustments in their foreign policies. By contrast, in the case of Estonia domestic political and economic constraints made foreign policy adjustments unnecessary, and the leadership could maintain its initial anti-Russian policy stance.

The economy inherited by the Estonian leadership from Soviet times was inefficient. The smooth matching of consumers and producers - traditional in market economy - did not work, the quality of goods was poor and the whole economy was

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*Abroad.* (Ithaca and London: Cornell University Press, 1998).

based on corruption and nepotism.<sup>301</sup> The economic heritage included also huge structural distortions, resulting from administrative price regulation, centralized investment decisions, monopolization, and chronic deficits. Estonia, like other post-Soviet transitional states, faced adjustment problems dealing not only with the shedding of planned systems but also with a wide range of conjunctural difficulties such as severe macroeconomic imbalances, external indebtedness, and the desperate need to diversify economic ties away from an imperial center. The leadership was clearly willing and able to implement radical economic reforms. In its detailed reform program, the Estonian government focused on the following main elements:

- the creation of an independent banking system allowing the pursuit of financial policy independent of Moscow;
- the introduction of mechanisms to balance and regulate the consumer goods and labor markets;
- the reinstatement of the Estonian government's property rights to those objects that will not be privatized;
- the initiation of land reform;
- the balancing of foreign trade in hard currency;
- support for the 'crisis sector' (or key industries);
- improvement in accounting, both at the enterprise and national levels.<sup>302</sup>

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<sup>301</sup> Ingemar Stahl, "A Coasean Journey Through Estonia - A Study in Property Rights and Transaction Costs," in *The Political Economy of the Transition Process in Eastern Europe. Proceedings of the 13<sup>th</sup> Arne Ryde Symposium, Rungsted Kyst, 11-12 June 1992*, ed. Laszlo Somogyi (Aldershot, UK; Brookfield, Vt.: Edward Elgar, 1993), pp.312-325.

<sup>302</sup> Brian Van Arkadie and Mats Karlsson, *Economic Survey of the Baltic States. The*

Of key importance in Estonia's reform process was the reorientation of its trade. Before 1991, exports from the Estonian SSR to other Soviet Republics accounted for 95% of total trade and imports accounted for 87% of total trade. Due to such a close integration into the Soviet economy, Estonia could not compete effectively on the European markets with its inferior goods nor with its food products. A reorientation towards Western Europe demanded significant and unified efforts - heavy dependence on imported oil and raw materials, relatively low quality of manufactured goods, and tough competition in Europe were only some of the obstacles. Due to these hardships, in the two years immediately following independence, manufacturing production declined. Although the economic integration among the Baltic states partially addressed these limitations, it could not be considered self-sufficient,<sup>303</sup> therefore a comprehensive reform approach to changing the whole economy was introduced.

The formation of a strong pro-reform coalition, which plays a crucial role in assuring the success of the reform process, was facilitated by the emergence of political parties reflecting the political spectrum traditional for any Western democracy. This process preceded the formation of industrial lobbies and trade unions and limited their potentially negative impact on the reform process.<sup>304</sup> As a result, in September 1992 Estonian legislative elections produced a stable pro-reform majority coalition which

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*Reform Process in Estonia, Latvia and Lithuania* (Washington Square, NY: New York University Press, 1992), p.109.

<sup>303</sup> Priit Järve, "The Soviet Union and the Prospects of Baltic Cooperation: An Estonian View," in *The Changing Soviet Union in the New Europe*, ed. Jyrki Livonen (Aldershot, UK; Brookfield, Vt: Edward Elgar, 1991), pp.211-224.

<sup>304</sup> Ardo H. Hansson, "Kommentariy k Razdelu 5. Politiko-Ekonomicheskiy Analiz Makroekonomiki i Vneshnetorgovoy Politiki Estoniyi," in *Vneshnyaya Torgovlya v Novux Nezavisimux Gosudarstvax* (Washington, DC: World Bank, 1995), p.131.

clearly indicated the population's determination to accomplish radical economic and political reforms. Therefore the implementation of a reform package including among other a free trade regime, bankruptcy law, introduction of a new convertible currency, a balanced budget, and the elimination of various forms of subsidies was tremendously facilitated.

Since the leadership was clearly willing to and capable of pursuing radical economic reforms, and a strong pro-reform coalition supported these measures, Estonia was very successful in departing from the central planning and integrating into the world economy despite the fact that it inherited from Soviet times distorted production capabilities, a poorly developed infrastructure and high level of dependence on the former interrepublican trade. Estonia increased exposure of its domestic firms to international competition, developed infrastructure, and became a member of various international organizations facilitating transition to a market-based economy. The Estonian authorities eliminated virtually all export controls in 1992 and did not introduce any quantitative import restrictions. As a result, Estonia reoriented its trade from the CIS and obtained substantial aid and investments from the Western states. By 1994, exports to the CIS accounted for only 28% and imports for 21%.<sup>305</sup>

The Estonian leadership was quite successful in attracting foreign investors, offering not only good geographical location and comparatively cheap skilled labor, but also wise governmental policy including open free trade policies, customs regulations according to GATT/WTO guidelines, elimination of any forms of restrictions on the

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<sup>305</sup> Tony O'Rourke, *Baltic Republics in Transition: Study of the Transforming Economies*

repatriation of profits or foreign ownership of assets or currency movements, which attracted significant capital inflows (see Table 7.3). Estonia, by exiting rapidly from the ruble zone and establishing a currency pegged to the German mark, underpinned by gold reserves and hard currency, was able to reduce the inflation rate from 41% in 1994 to 30% in 1995. The removal of export and import barriers allowed Estonian domestic manufacturers access to imports at world market prices. The competition produced by these imports encouraged the rapid and extensive restructuring of the domestic economy.<sup>306</sup> As a result, exports of competitive on the world market Estonian goods and foreign tourism boomed, radically increasing the ruling elite's reserves of hard currency that allowed to overcome dependence on cheap Russian energy supplies, and pay the Russian energy bills in full (see Table 7.2).

By establishing market institutions and leaving the ruble zone, Estonia became capable of building its relations with Russia on free market principles. The task of breaking the existing dependency on the Russian markets and energy supplies was not so easy to accomplish -- once Russia increased the price for energy, and eliminated subsidies to the Baltic states withdrawing from the ruble zone and unwilling to join the CIS, the Baltic economies were seriously hit in 1992. Adopting a series of conservation measures as well as increasing the charges for domestic users, Estonia managed to survive the crisis. By 1994 Estonia broke its dependence on Russian energy supplies, except for

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*of Estonia, Latvia and Lithuania* (Edinburgh: Scottish Financial Enterprise, 1995), p.18.

<sup>306</sup> Graeme Herd with Ene Rongelep and Anton Surikov, "Crisis for Estonia? Russia, Estonia and a Post-Chechen Cold War," *London Defence Studies* 29 (September 1995), p.4.

gas.<sup>307</sup> It also drastically reduced its trade dependence on Russia and increased correspondingly its economic links with the West.

Such significant achievements in the way of economic reforms allowed the Estonian ruling elite to continuously pursue an anti-Russian foreign policy. When the Soviet Union collapsed and Gorbachev resigned in December 1991, at least 40,000 foreign troops (150,000 when family members were included) were stationed on Estonian soil.<sup>308</sup> Geopolitically, the Baltic states were considered by the Soviet authorities a sphere of primary strategic importance, therefore substantial military troops were located on the territories of these states. When Estonia got its independence, it did not want to agree to Russia's terms and demanded to have the Russian troops stationed on its territory removed by autumn 1992. The Russian officials did not agree to these conditions.<sup>309</sup> Moreover, the troops repositioned themselves and continued to hold artillery exercises on land and sea targets without approval from the local authorities. Only when the US aid to Russia (Freedom Support Act, 1992) was made conditional by the US Congress on the withdrawal of Russian troops from the Baltic states did the process of troop withdrawal and dismantling of the military infrastructure begin.

Another side of anti-Russian Estonian foreign policy dealt with border disputes. In resolving its border disputes with Russia, Estonia referred to the peace treaty concluded

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<sup>307</sup> *Baltic-Russian Relations in the New Geopolitical Framework. Novgorod, Russia, May 15-16, 1998* (Princeton, NJ: Project on Ethnic Relations, 1998), p.15.

<sup>308</sup> Rein Taagepera, *Estonia. Return to Independence* (Boulder: Westview Press, 1993), p.228.

<sup>309</sup> For a comprehensive analysis of the Baltic policy making in Russia, see Konstantin Voronov, "Baltiyskaya Politika Rosiyi: Poisk Strategiyi," *Mirovaya Ekonomika i Mezdunarodnyye Otnosheniya* (Moscow), no.12 (1998), pp.18-32.

with Russia in Tartu in 1920. On 12 September 1991, the Estonian Supreme Council declared invalid the border changes between Estonia and Russia that were initially decided in Moscow and approved by the puppet Supreme Soviet of the Estonian SSR in January 1945. Estonia established its claim at 2,300 square kilometers east of Narva and in southeastern Estonia, an issue which was supposed to be resolved through extensive negotiations with Russia. Obviously, these territorial claims to Russia could not be accepted by the Russian side. Both parties continued to support their claims: Estonia insisted that Russia recognize the Tartu Peace Treaty of 1920, in which Russia had agreed never to violate Estonia's borders before any border agreement could be signed, while Russia continued to argue that this treaty has never been violated and that Estonia willingly joined the USSR. The Estonian leadership went further and broadened the scope of its demands — accepting that Russia is the legal successor to the Soviet Union, it insisted that Russia should share responsibility for the consequences of the Soviet occupation.<sup>310</sup> Ironically, Estonia has given up its territorial claims on Russia not in response to Russia's pressure but rather as an important step toward membership in the EU. On 5 November 1996 the two foreign ministers approved a draft border agreement that avoided the major issue of contention.

Anti-Russian policy dominated in the security realm as well. Since the policy of neutrality at the end of the 1930s did not improve the national security of Estonia, such a policy option was rejected by the Estonian leaders.<sup>311</sup> It was clear, however, that Estonia

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<sup>310</sup> Andrus Park, "Russia and Estonian Security Dilemmas," *Europe-Asia Studies*, vol. 47, no.1 (1995), pp.30-35.

<sup>311</sup> Hugh I. Rodgers, *Search for Security. A Study in Baltic Diplomacy, 1920-1934*

would never have the weapons or manpower to seriously resist a determined Russian invasion (see Table 7.5). Therefore, the Estonian authorities pursued an anti-Russian foreign policy by adopting simultaneously multilateral and bilateral strategies aimed at building extensive economic, political and security ties with the West, which could constitute the only defense against Russian threats. A grand strategy of breaking all links with the former Soviet center and joining every Western institution became the major part of these efforts.

The willingness to become integrated into Europe produced a set of attempts to adopt unilaterally a set of norms associated with membership in European international organizations prior to actually being accorded full status in these organizations. Substantial progress was made in aligning local law with EU standards, including among other things the permission of foreign ownership of land. In June 1995 Estonia as well as other Baltic states signed the so-called European agreements, granting it the status of associate member of the European Union. By subscribing to a set of rules whose acceptance is necessary for inclusion into European Union, Estonia gave up the chance to insist on reciprocity and to demand benefits in exchange for her concessions.<sup>312</sup>

As a result of these efforts in 1997 the European Commission, the EU's executive body, expressing its official opinion, recommended Estonia for the first round of negotiations in early 1998. It was commonly accepted by the ruling elite as well as by the

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(Hamden, Conn.: Archon Books, 1975).

<sup>312</sup> Estonia's policy of integration into European Union is similar in many aspects to Eastern European approach. On international institutions, regimes and integration of Eastern European states into the western community, see Robert O. Keohane, Joseph S. Nye, and Stanley Hoffmann, eds. *After the Cold War. International Institutions and State Strategies in Europe, 1989-1991* (Cambridge, MA: Harvard University Press,



population at large that the fact of “rejoining the European family” could not only bolster national identity but also equalize European and Baltic interests, and hence protect the country from the alarming consistent rhetoric of certain Russian state elites advocating the need to maintain Russian influence in the “near abroad” and protect Russian minorities. According to a February 1997 study by the Tampere Peace Research Institute, “89 percent of the Estonian political elites surveyed were in favor of joining the EU and 65 percent considered it the only alternative for Estonia’s future; 91 percent considered it a means for ensuring security.”<sup>313</sup>

Although the possibility of direct and massive Russian military invasion could not be completely excluded, the main threats to Estonian security dealt with the unstable and unpredictable domestic situation in Russia which could bring radical political forces to power. Therefore Estonia continued to see membership in NATO as a potential guarantee against Russia and, despite the absence of explicit security guarantees for Estonia from NATO, it extended the scope of its cooperation — in December 1991 a political declaration envisaging joint activities between NATO and the Baltic states within the North Atlantic Cooperation Council (NACC) was signed in Brussels, and was followed by joining the NATO ‘Partnership for Peace’ plan in January 1994. Full membership of the Baltic states in NATO is unlikely in near future because, as U.S. Defense Secretary William Perry mentioned in September 1996, these countries still lack minimum defensive capabilities and were not sufficiently military compatible with other alliance members. Nonetheless, the growing number of contacts with NATO such as participation

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1993).

of NATO representatives in conferences on Baltic security-related issues, participation of Estonian troops in UN peacekeeping operations in the former Yugoslavia, and frequent visits of NATO officials contributed to intensification of Estonia - NATO ties.

Estonia also attempted to ensure that its defense force and command structures reached NATO inter-operability standards that would allow her to achieve membership in NATO at an early stage. This was a clear reflection of anti-Russian foreign policy: on the one side, NATO still could not find a new, persuasive and clear substitute for its anti-Russian rationale inherited from the Cold War times, on the other side, Russia was afraid of deployment of NATO troops on the territories of the Baltic states, posing a direct threat to its national security. Within this dualistic framework, Estonia's emphasis on NATO membership was equal to an anti-Russian foreign policy stance.

The unwillingness to accommodate Russia's interests was reflected in Estonia's domestic policy towards Russophone communities. Since the demographic situation in Estonia changed significantly during the Soviet period and the Russian-speaking population represented a significant share of the population, the Baltic authorities considered the presence of Russian minorities a threat to their domestic security. Due to centrally controlled economic growth which demanded the migration of workers, the Slavic workforce dominated large factories directed by Russians.<sup>313</sup> The political and economic orientation of the Russian-speaking population had been clearly manifested before the liberation of the Baltic states when workers' movements by the employees of

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<sup>313</sup> Joan Lofgren, "A Different Kind of Union," *Transitions*, vol. 4, no.6 (November 1997), p.48.

<sup>314</sup> Cynthia Kaplan, "Estonia: A Plural Society on the Road to Independence," in *Nation*

large enterprises, factories and mines subordinated to Moscow stated their goals — to protect socialism, to preserve the USSR and to guarantee equal human rights to everybody.

On 26 February 1992 the Estonian Supreme Council reinstated the citizenship law of 1938 which stated that Estonian citizenship is acquired either by birth or by further legal procedure such as naturalization.<sup>315</sup> The Estonian government, for instance, has given automatic citizenship only to citizens of the interwar Estonian Republic and their descendants. In other cases, all those willing to obtain citizenship had to apply for naturalization to the Ministry of the Interior. The Estonian citizenship law adopted in January 1995 stipulates a requirement of at least five years residence as well as passing exams demonstrating a basic knowledge of the Estonian language. As a result, “only 930,000, or 63 percent, of all residents of the country are citizens, of whom only 125,000 are not ethnic Estonians.”<sup>316</sup>

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*and Politics in the Soviet Successor States*, eds. Jan Bremmer and Ray Taras (Cambridge, New York: Cambridge University Press, 1993), p.208.

<sup>315</sup> Walter C. Clemens, Jr., “Baltic Identities in the 1990s. Renewed Fitness,” in *National Identity and Ethnicity in Russia and the New States of Eurasia*, ed. Roman Szporluk, series: The International Politics of Eurasia (Armonk, NY: M.E.Sharpe 1994), vol.2, p.197.

<sup>316</sup> Saulius Girnius, “Back in Europe, to Stay,” *Transition*, vol.3, no.4, 4 April 1997, p.8.

**Table 7.1****Values of Independent, Intervening and Dependent Variables**

Period under consideration	Independent Variables				Intervening Variable	Dependent Variable
	Ruling Elite's Need in Economic Resources	Economic Strategy (willingness/unwillingness to adopt economic reforms)	Pro-reform Coalition	Ruling Elite's Legitimacy	Progress of Economic Reforms	Continuity in Foreign Policy Towards Russia
Estonia 1991	Low					Anti-Russian Foreign Policy Stance
Estonia 1997	High	Willing	Present	High	High	Continuity anti-Russian Foreign Policy Stance

**Table 7.2**  
**Economies in Transition: Growth of Real GDP, 1992-97**  
**(annual percentage change\*)**

Country	1992	1993	1994	1995	1996**	1997***
Economies in Transition	-12.0	-7.1	-9.0	-1.8	-1.3	1.5
Central and Eastern Europe	-3.0	0.2	4.0	5.8	3.9	4.3
Albania	-6.0	11.0	7.4	6.0	6.5	6.0
Bulgaria	-5.7	-3.7	2.2	2.5	-4.0	0.0
Former Czechoslovakia	-6.4					
Czech Republic		-0.9	2.6	4.8	4.7	5.0
Slovakia		-4.1	4.8	7.3	6.0	5.0
Hungary	-3.0	-0.8	2.9	1.5	1.0	2.0
Poland	2.6	3.8	5.0	7.3	5.3	5.2
Romania	-8.8	-3.0	4.0	6.9	4.5	4.0
Baltic states	-31.6	-14.4	1.5	1.3	1.7	2.0
Estonia	-14.8	-7.8	4.0	3.0	3.3	3.0
Latvia	-34.9	-14.9	0.6	-1.6	1.5	1.8
Lithuania	-35.0	-17.0	1.0	2.7	1.0	1.5
Commonwealth of Independent States	-14.1	-9.6	-14.6	-5.7	-4.4	-0.3
Kazakhstan	-13.0	-12.9	-24.6	-8.9	0.7	1.5
Russia	-14.5	-8.7	-12.6	-4.0	-5.0	-1.0
Ukraine	-13.7	-14.2	-23.0	-11.8	-9.2	-2.3

\* Country group aggregates are averages weighted by GDP in 1988 dollars; for methodology, see World Economic Survey, 1992 (United Nations publication, Sales No. E 92.II.C.1 and corrigenda), annex, introductory text.

\*\* Partly estimated

\*\*\* Forecast, based in part on Project LINK.

Source: "The World Bank Streamlines Its Strategy for Transition Economies. Interview with Vice President Johannes F. Linn," *Transition*, vol. 8, no.1, February 1997.

Table 7.3

## Distribution of Foreign Investment by Branch in the First Half of 1994

<b>Branch</b>	<b>Investment (1000000 kroons)</b>	<b>Share (%)</b>
Industry	718	51
Retail and wholesale	568	41
Finance	53	4
Transport	23	2
Property and commercial services	20	1
Hotels and catering	7	0
Agriculture	2	0
Other	11	1
Total	1402	100

Kari Liuhto, "Foreign Investment in Estonia: A Statistical Approach," *Europe - Asia Studies*, vol.47, no.3, May 1995, p.515.

Table 7.4

## Preferences Concerning the Future Political Status of Estonia (%)

	Estonians				Non-Estonians			
	1989		1990		1989		1990	
	April	Sept.	Jan.	May	April	Sept.	Jan.	May
The maintenance of the status quo	2	2	0	0	54	37	20	21
Estonia must stay in a reformed Soviet Union (confederation)	39	31	15	2	25	47	52	46
Estonia should be an absolutely independent state	56	64	81	96	5	9	17	26
Unable to answer	3	3	4	2	16	7	1	7

Source: John Dunlop, "Russia: Confronting a Loss of Empire," in *Nation and Politics in the Soviet Successor States*, eds. Jan Bremmer and Ray Taras (Cambridge: Cambridge University Press, 1993), p.66.

**Table 7.5****Armed Forces Personnel**

	Army	Navy	Air Force	Border	Home Guard
Estonia	3,500	300	250	2,000	6,000
Latvia	3,000	350	280	3,400	16,500
Lithuania	4,500	500	600	4,000*	10,000

\*Lithuania's border guards are under the control of the Interior Ministry and are no longer considered part of armed forces.

Source: Saulius Girnius, "Tiny Armed Forces Need Allies' Aid," *Transition*, 1 December 1995, p.63.

## Chapter 8

### Conclusion

“By allowing habit rather than new strategic thinking to set the agenda, the governments miss much larger opportunities to advance a comprehensive agenda in which political, economic, social, ecological, and even psychological dimensions of national security loom larger than traditional military threats.”<sup>317</sup>

### Findings

The customary scholarly division of comparative politics, political economy, economics, international relations and security studies has generally prevented most social scientists from analyzing the hybrid character of relations among the post-Soviet states.<sup>318</sup> As this project clearly presents, international and domestic choices cannot be sharply separated, therefore transition in post-Soviet societies should be studied as a comprehensive, complex, and dynamic process in the context of the international environment.<sup>319</sup>

Unlike traditional approaches to foreign policy making which view the state's economic capabilities and the process of how these capabilities are transformed into

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<sup>317</sup> Graham Allison, Karl Kaiser, and Sergei Karaganov, “Toward a New Democratic Commonwealth,” *Transition*, 7 March 1997, p.40.

<sup>318</sup> An attempt to integrate comparative and international politics and provide cross-level integration has been made in James A. Caporaso, “Across the Great Divide: Integrating Comparative and International Politics,” *International Studies Quarterly* 41 (1997), pp.563-592.

<sup>319</sup> For the case of the USSR, see Rey Koslowski and Friedrich V. Kratochwil, “Understanding Change in International Politics: The Soviet Empire's Demise and the International System,” in *International Relations Theory and the End of the Cold War*, eds. Richard Ned Lebow and Thomas Risse-Kappen (New York: Columbia University Press, 1995), pp.127-165.



productive capacity as factors limiting the ability of any nation to realize its foreign policy goals,<sup>320</sup> this project reveals that post-Soviet ruling elites are even more concerned with economic, political and social domestic issues than with the goal of maximizing state power in the international system. I attempted to address this peculiarity and conceptualized domestic and international constraints along with the ruling elites' foreign policy strategies. I found that in those cases when the ruling elites did not experience problems with mobilizing economic resources, they tended to adopt foreign policy independent from Russia (Ukraine 1991, Belarus 1991, and Estonia 1991).

When the need for resources became high, the ruling elites' foreign policies were shaped by domestic political and economic constraints. In the case of Estonia (1997), where the ruling elite was capable of and willing to pursue radical economic reforms and it enjoyed a high degree of legitimacy and outstanding support of a strong pro-reform coalition, the reforms were implemented. As a result, the leaders could continuously pursue an anti-Russian foreign policy.

In contrast, the absence of economic reforms significantly limited the ability of post-Soviet leaders to maintain foreign policy independent from Russia and necessitated pro-Russian foreign policy shifts. Under conditions when the peripheral elites did not pursue radical economic reforms, Western economic credits and aid were unavailable, the leaders could not maintain the continuity in their initially independent foreign policy stance towards Russia. Such ruling elites tended to display their loyalty to the former hegemon, expecting economic benefits in return. In the case of Belarus (1997) the display

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<sup>320</sup> On the role of economic factor in Soviet foreign policy see Peter Zwick, *Soviet*

of loyalty went so far that we witnessed a transition from an independent state to a form of Russian gubernia.

The case of Ukraine (periods 1993, 1994 and 1997) presents slightly more complex dynamics: when some progress in the way of economic reforms was achieved, opening access to Western credits, aid and markets, the ruling elite could pursue foreign policy independent from Russia. When the reform process slowed down, the ruling elite usually made pro-Russian foreign policy shifts, expecting some sort of economic benefits in return.

The cases of Ukraine and Belarus indicate also that post-Soviet leaders are capable of learning about the most favorable linkages between initial conditions and final outcome. More specifically, the leaders of Ukraine and Belarus learned that they can display their loyalty to Russia and acquire some economic benefits in return. Although the displays of loyalty to superiors or the center in Moscow was a common resource maximization strategy under the Soviet Empire, the post-Soviet leaders, by learning through trial and error, modified the patterns of the loyalty game and adjusted them to new circumstances.<sup>321</sup> Once the leaders learned about the positive effects associated with the “old new” loyalty game, they played it more frequently.

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*Foreign Relations: Process and Policy* (Englewood Cliffs, NJ:Prentice Hall, 1990), pp.119-145.

<sup>321</sup> Janice Gross Stein, “Political Learning by Doing: Gorbachev as Uncommitted Thinker and Motivated Learner,” *International Organization*, vol.48, no.2 (Spring 1994), pp.155-183.

Table 8.1

## Summary Table

**Values of Independent, Intervening and Dependent Variables for all Periods under Consideration**

Period under consideration	Independent Variables				Intervening Variable	Dependent Variable
	Ruling Elite's Need in Economic Resources	Economic Strategy (willingness/unwillingness to adopt economic reforms)	Pro-reform Coalition	Ruling Elite's Legitimacy		
					Progress of Economic Reforms	Continuity in Foreign Policy Towards Russia
Ukraine 1991	Low					Continuity independent from Russia's interests foreign policy
Ukraine 1993	High	Unwilling	Absent	Medium	Low	Change pro-Russian foreign policy move
Ukraine 1994	High	Willing	Absent	Medium	Medium	Change Pro-Western and pro-Russian foreign policy pursued simultaneously
Ukraine 1997	High	Less Willing	Absent	Medium	Medium/Low	Change Pro-Russian Foreign Policy shift
Belarus 1991	Low					Independent Moderately pro-Russian Foreign Policy
Belarus 1997	High	Unwilling	Absent	Low	Low	Change Pro-Russian Foreign Policy Shift
Estonia 1991	Low					Anti-Russian Foreign Policy Stance
Estonia 1997	High	Willing	Present	High	High	Continuity anti-Russian Foreign Policy Stance

In this project I developed and tested a middle-range theory, which, unlike the grand theories attempting to explain international relations in an abstract and timeless fashion, concentrated in depth on a narrow topic of peripheral post-Soviet states' foreign policy making towards Russia in 1991-1997. Although this project organizes the post-

Soviet states according to their attributes and examines the resultant categorizations for identifiable patterns of foreign policy towards Russia, the middle range theory developed for the 1991-1997 time frame cannot be applied beyond 1997 without appropriate adjustment.

I assumed that the learning process of post-Soviet peripheral leaders on how to optimize the inflow of economic resources by exploiting foreign policy means relied on the legacies of the Soviet era. Therefore, I extensively analyzed the logic of political and economic relations between the imperial center and periphery longitudinally and tried to separate those elements of these relations that may have survived the imperial collapse and could constitute a reference point for post-Soviet leaders in making their foreign policy choices.

It might be reasonable to expect that the present peripheral leaders may learn how to learn – they may develop a new set of analytic techniques and decision making rules, improve the effectiveness of organizations involved in foreign policy-making and, what is more essential, they can reconsider their strategic assumptions and policy objectives and depart from linking strategies and the “loyalty game with Russia” developed by their predecessors.<sup>322</sup> Moreover, I expect that the interplay of politics and learning over time might make Russia reconsider its position towards the newly independent states as well. Although a future, fuller explanation of foreign policymaking towards Russia that invokes learning must be sought at different levels,<sup>323</sup> I can analytically distinguish two

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<sup>322</sup> Jack S. Levy, “Learning and Foreign Policy: Sweeping a Conceptual Minefield.” *International Organization*, vol.48, no.2 (Spring 1994), pp.279-312.

<sup>323</sup> William W. Jarosz with Joseph S. Nye, Jr. “The Shadow of the Past: Learning from

major scenarios of developments in Russia which may shape the foreign policy repertoire of peripheral post-Soviet leaders, particularly of Ukraine.

### Scenarios

#### 1. Optimistic

Although I focus in this project on the foreign policies of peripheral states towards Russia, it should be always kept in mind that this process is interactive and the final outcomes depend on developments within Russia as well — “Russia will focus most of its foreign policy energies on the near abroad, where it may well be as much a source of conflict as a contributor to conflict resolution.”<sup>324</sup> Although the economic and military dominance of Russia in the region cannot be seriously challenged, domestic political and economic developments may put in question about the high price paid for maintaining its leading position in the region.

The conflict of interests within Russia’s political and economic elite may lead to questioning the whole idea and principles of CIS integration policies where economic benefits are provided in exchange for some displays of loyalty. There are some signs supporting this possibility. For instance, with regard to the Belarusian-Russian integration things do not go as smoothly as might be expected: there was information in the Russian

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History in National Security Decision Making,” in *Behavior, Society, and International Conflict*, eds. Philip E. Tetlock, et al. (New York, Oxford: Oxford University Press, 1993), vol.3, p.179.

<sup>324</sup> Roger E. Kanet, “The Russian Federation,” in *Coping with Conflict after the Cold War*, eds. Edward A. Kolodziej and Roger E. Kanet (Baltimore and London: The Johns Hopkins University Press, 1996), p.81.

press that representatives of particular Russian interest groups tried to force Belarusian officials to share the profits of the customs union.<sup>325</sup>

## 2. Pessimistic

A small, well-organized coalition of economic interest groups, which has an economic stake in preserving good relations with the West, occupies a central role in the making of Russian foreign policy.<sup>326</sup> However, it can hardly guarantee continuity in Russian foreign policymaking in the long run. In the absence of a wide and strong pro-reform democratic coalition, the process of foreign policymaking continues to be chaotic and ambiguous, responding to short-term changes in the domestic and international arenas.

Given that the Russian ruling elite fails to establish democratic institutions and market mechanisms, the relations among newly independent states and Russia will become subject to a wide range of essentially noneconomic considerations. Although Russia may continue to hold elections and have legislature sessions, the sole purpose of “playing democracy” will be to assure the Western powers that the country remains on the right track. Aggressive and xenophobic rulers turning to great-power nationalism may attempt not only to reclaim the territories of the former USSR, but also to exploit

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<sup>325</sup> Olexander Potekhin, ed. *International Integration: Experience of the Republic of Belarus* (Kyiv: Ukrainian Centre for Peace, Conversion and Conflict Resolution Studies, May 1998), p.17.

<sup>326</sup> Michael McFaul, “A Precarious Peace. Domestic Politics in the Making of Russian Foreign Policy,” *International Security*, vol.22, no.3 (Winter 1997/98), p.27.

available political and economic mechanisms to ensure the compliance of former sister republics.

2.1 The temptation to resort to the language of imperial domination and to demand various forms of concessions from peripheral states, particularly from Ukraine, will be almost irresistible. “Compared to the United States, Russia may be a Third World state with nuclear arms; compared to its neighbors, Russia is a superpower.”<sup>327</sup> Russian authorities, in order to revive the empire, may be willing to force the Ukrainian leadership into a military-political alliance in exchange for trade regulations favorable to Ukraine. The growing sense of insecurity felt in Moscow, fueling the desire to restore the former empire, may be aggravated by fears of the consequences of exclusion from the orbit of Western institutions, such as the EU.

The absence of properly functioning democratic institutions combined with economic hardship in Ukraine may trigger the impulse for autocolonization or the emergence of the first signs of autocolonizing intent, when “peripheral elites seek or accept a diminution primarily of the state’s external authority and independence in return for assistance from the external power that may enhance domestic elite and/or state authority.”<sup>328</sup> This policy will seriously jeopardize regional security because the further exploitation of the “pro-Russian loyalty game” by the Ukrainian ruling elite, seeking

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<sup>327</sup> Alexander J. Motyl, “Why Empires Reemerge: Imperial Collapse and Imperial Revival in Comparative Perspective,” *Comparative Politics*, vol.31, no.2 (January 1999), p.139.

<sup>328</sup> Karen Dawisha, “Constructing and Deconstructing Empire in the Post-Soviet Space,” in *The End of Empire? The Transformation of the USSR in Comparative Perspective*, eds. Karen Dawisha and Bruce Parrott, series: The International Politics of Eurasia

immediate economic benefits, will ultimately lead to political breakdown within Ukraine. Moreover, Russia's extensive assistance to Ukraine may become not only a drain on Russia's economic resources but can also overburden the Russian state with a wide range of commitments that ultimately may bring down the Russian state itself.

2.2 If the Ukrainian ruling elite does not pursue radical economic reforms and abstain from displaying its loyalty to Russia, the threat of economic crisis (allowing the counter elites to recruit new followers) may drive the rulers to embark on legitimacy building efforts, emphasizing ethnic nationalism and blaming Russia for all social and economic difficulties in Ukraine. In this case the emergence of a hostile Russia may facilitate Ukraine's rapid integration into European security and economic structures, and Ukraine might become the recipient of large-scale Western military and economic assistance that would ensure, at least, its stability.<sup>329</sup>

The West, however, might be unwilling to bear significant costs associated with the incorporation of Ukraine into its economic and security spheres because of Ukraine's failure to reorient its economy towards the West and pursue full-fledged reforms. The West might find it more attractive to establish a new dividing line on the border of Poland, especially if Russia continues to insist on meeting the demands declared by Boris Yeltsin on 21 March 1997 in Helsinki, which include among others the condition that Russia will not sign any agreement with NATO if the Baltic states and Ukraine are admitted to NATO.

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(Armonk, NY: M.E.Sharpe, 1997), vol.9, p.345.

<sup>329</sup> Alexander J. Motyl, "Will Ukraine Survive 1994? In State Formation in Twentieth-Century Ukraine in Comparative Perspective. Papers from a Conference Held at Columbia University, December 10, 1993," *The Harriman Institute Forum*, vol.7, no.5



## **Policy Recommendations**

### **3.1 A Concerted Approach by International Actors is Needed**

In devising a cooperative security regime in the post-Soviet space, the nonmilitary threats to security must be taken into consideration. The West has to change its operational foreign policy to recognize this reality, and instead of reconfiguring models borrowed from the cold war times, articulate a policy that takes into consideration threats resulting from economic decline, collapsing central governments and all other factors contributing to adventurous foreign policy.

If organizational inertia and preoccupation with internal interests and developments continue to shape the agendas of various international institutions, this may produce misplaced preoccupation with old threats to national and regional security that are no longer important. The international organizations should clearly define new challenges to security and advance new arrangements capable of addressing them properly. This can be achieved through a cooperative effort of various international organizations, mobilizing various international instruments to monitor, preempt, or at least contain the negative consequences of domestic and international developments in the post-Soviet states.

If security strategists and economic development specialists discuss the policy packages towards the post-Soviet states more frequently, they may overcome the limitations of overly narrow specialization and develop a set of policy tools capable of

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(January 1994), p.4.

addressing the complex developments in the region. Although the concept of ‘interlocking institutions,’ improving the links of the OSCE with the United Nations, NATO, the EU, the WEU, as well as the international monetary institutions, was adopted at the 1992 CSCE Helsinki Summit and developed further at the 1994 Budapest Conference, these efforts should be intensified. Such efforts can help not only in avoiding duplication of these organizations’ activities, but also in assisting in adopting a comprehensive approach to regional security, taking into consideration the domestic threats to national and regional security.

In approaching the post-Soviet states the West should focus less on its own agenda: its security needs, its timetable for integration, its perceived financial limits and its general overarching model of the integration process. The West has to realize that by assisting Ukraine and other newly independent states, it is making a strategic investment in the future European security. Therefore, the attempts to deviate from universally accepted accession conditions in treating prospective EU members are inadvisable.<sup>330</sup> For instance, since the access of the most competitive Ukrainian goods to the Western markets is restricted due to the European Union’s Common Agriculture Policy and the “anti-dumping” measures on woven apparel imposed by the US, this may raise doubts in

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<sup>330</sup> In the criteria adopted at the 1993 European Council meeting, the European Union has left itself a high degree of flexibility in determining the timing of full integration of the Association Countries into the EU. To illustrate the vagueness of these criteria let me mention only some of them: stability of institutions guaranteeing democracy, the rule of law, human rights and protection of minorities; a functioning market economy; and the ability to cope with competitive pressures and market forces within the European Union and the capacity of the union to absorb new members.

Ukraine about the actual willingness of the West to integrate the country into its most important institutions.<sup>331</sup>

A trend of regress in relations of Ukraine with the European Union has dominated since 1996. The EU's goals with regard to Ukraine may be listed as follows: 1) to minimize the destructive effect of the Ukrainian crisis on Western and Eastern European countries; 2) to get access to the domestic market of Ukraine; 3) to exploit the raw materials and production sectors of Ukraine; 4) if internal political and economic stability is preserved and domestic economic competition is developed, a partial transfer of production cycles of particular branches to Ukraine is possible.<sup>332</sup> If this trend is not reversed and these objectives are not reexamined, the Ukrainian ruling elite may be encouraged to intensify the pro-Russian vector in foreign policy.

Such Western policy may encourage Ukraine and any other prospective member to give up the hope of EU integration and stimulate the CIS integration process. To offset such potentially dangerous developments, the EU must streamline the access of Ukrainian goods to EU markets, support Ukraine in her ambition to become a full-fledged GATT/WTO member, and speed up ratification by the national parliaments of EU member states of the Agreement on Partnership and Cooperation between Ukraine and the European Union. Ukraine's accession to GATT/WTO can facilitate trade and economic relations with the EU, assist in redirecting main foreign trade flows and

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<sup>331</sup> Alexander J. Motyl, "Ukraine: Politics, Economy, and Relations with the West," in *U.S. Relations with the Former Soviet States. Twenty-Third Conference April 17-21, 1998* (Washington, DC: The Aspen Institute, 1998), p.16.

<sup>332</sup> *Monitoring Foreign and Security Policy of Ukraine. April-June 1998* (Kyiv: Ukrainian Center for Peace, Conversion and Conflict Resolution Studies, 1998), p.66.

eventually contribute to the establishment of a healthy market economy and democratic society. In any case, defense and military cooperation with the West is less important for Ukraine than economic integration — as this project clearly presents, only radical economic reforms and eventual EU membership will radically transform Ukraine's security situation.

Within this broad "security-economic development" approach, conditionality should not only serve the interests of any organization in which the post-Soviet states seek membership but rather should provide a complex and carefully balanced approach incorporating security, economic, social and political dimensions. As the evidence of conditionality-applying donors suggests,

"conditionality does not meet its promise of greater aid effectiveness; it often does not achieve desired reductions in the demand for aid nor act as a substitute for borrower collateral by raising their future debt-servicing capabilities; over-reliance on conditionality leads to major misallocations of resources and large-scale waste of public monies."<sup>333</sup>

Donor countries and institutions should not have inflated expectations about the potential results of external conditionality because, most likely, their expectations in the post-Soviet space will not be met. In approaching post-Soviet ruling elites international organizations should keep in mind that Western models stand little chance of full-fledged successful adoption in most of the post-Soviet space; thus a more nuanced approach has to be found.<sup>334</sup> The adaptation of foreign concepts and institutions, which were

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<sup>333</sup> Tony Killick, "Principals, Agents and the Failings of Conditionality," *Journal of International Development*, vol.9, no.4 (1997), p.493.

<sup>334</sup> This point is extensively discussed in John Gray, "From Post-Communism to Civil Society: The Reemergence of History and the Decline of the Western Model," *Social*

developed initially for different social, economic, and political conditions, should be carefully modified to fit a different setting.

Since post-Soviet leaders, in the absence of economic reforms, may play “a loyalty to Russia game” to enhance their domestic standing, Western actors have to acknowledge the existence of this linking strategy and approach the security issues in the region keeping in mind that risky foreign policy moves and adventurous strategies can be avoided once democratic and free market institutions are established. It was quite correct to recommend in 1994 that “U.S. and Western policymakers should insist on a clear linkage between economic assistance and political support, on the one hand, and responsible conduct in the areas of security, arms control, weapons proliferation, and arms transfers, on the other.”<sup>335</sup> In the coming years the linkage has to be broadened and the call for rapid market-oriented reforms as a foundation of regional security should come from a wide variety of international as well as domestic sources, including among others the IMF, World Bank, UN, NATO and Western governments. Joint efforts aimed at institutionalizing conditions favorable for the emergence and maintenance of strong and viable pro-reform coalitions should be made. Once effective economic mechanisms are established, and a strong political force pushing the reform process through is institutionalized, the temptation of peripheral post-Soviet leaders to play the loyalty game towards Russia would significantly decrease.

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*Philosophy and Policy*, vol. 10, no.2 (Summer 1993), pp.26-50.

<sup>335</sup> Coit D. Blacker, “Emerging States and Military Legacies in the Former Soviet Union,” in *Global Engagement. Cooperation and Security in the 21<sup>st</sup> Century*, ed. Janne E. Nolan (Washington, DC: The Brookings Institution, 1994), p.384.

Therefore, the attempts by international players to prioritize geopolitical considerations over economic assistance are inadvisable. Such a move could jeopardize the long-term ruling elite's commitment to reforms as well as damage the credibility of the international institutions involved, because leaders may be tempted to tell international institutions what they have been instructed to say, while the international institutions, keeping in mind geopolitical considerations, may be willing to overlook the flaws of reforms and continue economic assistance.<sup>336</sup> In the absence of strong commitment to far-reaching reform, such a policy by international institutions may undermine public confidence in the necessity of reform measures. Simply stated, any aid package should be strictly conditional and instead of subsidizing the regime in power (economic or political structures) should stimulate radical economic transformation in all aspects and dimensions. If correctly stated and enforced, the conditions imposed by international actors may play the role of an exogenous shock that may precipitate a radical approach to economic reforms.

In order to ensure the successful implementation of reforms, international institutions may have to be more selective in lending and respond swiftly to breaches in compliance. A simple increase in the number of conditions disregarding the regional or country peculiarities "creates a vicious circle: weak compliance with conditions prompts donors to impose more conditions, increased conditions make it yet harder for the

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<sup>336</sup> For the context of economic reforms in Latin America and Africa, see Joan M. Nelson, "The Politics of Long-Haul Economic Reform," in *Fragile Coalitions: The Politics of Economic Adjustment*, Joan M. Nelson and contributors (New Brunswick, NJ: Transaction Books, 1989), p.20.

recipient to comply, thus increasing the incentive not to comply, and so on.”<sup>337</sup> In order to implement economic reforms successfully, economic logic, or the measures aimed at improving economic efficiency in both the domestic and international markets, and political logic, or the measures needed to assure domestic stability, have to positively reinforce each other.<sup>338</sup> In addition to economic and political issues, security aspects should be taken into consideration in framing donors’ policies towards the post-Soviet space. Also, traditional methods of external persuasion, support, and pressure aimed at strengthening the government’s commitment and capacity to implement economic reforms should be complemented by an emphasis on the potential security dangers associated with the absence of reforms.

Although there is a wide range of arguments why international organizations and bilateral aid agencies should not become involved in recipient nations’ political affairs, the monitoring and anticipation of political and administrative obstacles to reforms is essential in order to ensure the effective use of the resources provided. The negative outcome of reform attempts may create an atmosphere of cynicism and may produce unwillingness to make sacrifices and to devote resources to reform measures. Thus future attempts will necessarily require larger amounts of external economic assistance to accomplish economic reforms.

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<sup>337</sup> Carol Graham, “Foreign Aid,” *The Brookings Review* (Spring 1997), p.20.

<sup>338</sup> Thomas M. Callaghy, “Toward State Capability and Embedded Liberalism in the Third World: Lessons for Adjustment,” in *Fragile Coalitions: The Politics of Economic Adjustment*, Joan M. Nelson and contributors (New Brunswick, NJ: Transaction Books, 1989), p.115.

## **2.2 Ukraine and Stability in the Region - Domestic Political Economy and Regional Security**

As this project clearly presents, the nature of threats to security is multifaceted, where not only military, but also economic, political, social and ethnic issues are at stake. Although the Ukrainian academic and political decision-making communities define security broadly, the problem of how to translate this theoretical treatment into the state's ability to adapt to a changing environment, and to foresee potential security threats emanating from deteriorating economic and social conditions such as unemployment, inflation, and loss of a social safety net remains.

Although Western actors are capable of facilitating the newly independent states' transition to democratic and free market society, the actual success of transition depends mostly on domestic developments. In this project I operate under the assumption of ruling elites' self-interested behavior, prioritizing short-term goals of their political survival, and I reject the idea that the leadership in transitional post-Soviet context may behave as a benevolent social guardian, directing resources and activities to achieve a democratic and perfectly functioning market economy. There is always a probability, however, that as the transition proceeds, political leaders may learn that the sources of their revenue are finite and that their political stability may be achieved only when they enthusiastically embrace the idea of curbing bureaucratic rent seeking and achieve substantial progress in sustainable human development by introducing long-term oriented market reforms and by making efforts to democratize.

Although lobbies and interest groups may continue to use their influence to bring about the policy outcomes they want — outcomes that are usually inconsistent with an



efficient allocation of economic resources — the programs of economic reforms may be supported by various interest groups because these groups might realize that it would be more beneficial for them to sustain a systematic process of reforms that can ensure their stable access to national resources than by ransacking the economy in the short run. The emphasis on the positive security consequences of economic reforms may drastically expand a new coalition of beneficiaries by incorporating traditional losers of reforms.

Since national security has the properties of a public good for society as a whole, the problem of free riding is unavoidable. Security, as a public good, possesses two specific features - no member of the public at large can be denied access to consume the good, and if any individual consumes the good it does not reduce the quantity of the good to other members. Although everybody is interested in security, the fact that nobody can be excluded from consumption of this good prevents a rational actor from expending her resources to produce a security regime. Moreover, interest groups may attempt to acquire a disproportionate share of societal income for themselves that can lead to outcomes that are suboptimal for society at large, particularly with regard to national security. If, however, the individual's calculations of the benefits of participation and costs of shirking are altered, collective action can be achieved. This can be achieved when the costs of maintaining existing inefficient institutional arrangements are radically increased by emphasizing the high costs of long-term security threats. The recognition of the fact that the economic, political and security costs of failure to act are definitely greater than the costs of action may motivate not only the state elites but also the interest groups to become involved in strengthening long-term national security and political stability. Therefore, even though radical economic reforms are inconsistent with the interests of the

ruling elite and some interest groups, the actual or perceived threats to national security may at least partially eliminate existing incentives to defect in collective action and speed up the reform process.

In the absence of a pro-reform coalition capable of addressing the issues of security in connection with economic reforms, collective action might be initiated by the President who, regardless of his time horizon in office, can take initiatives in anticipation of obtaining the security and political benefits of radical economic reforms. As a political entrepreneur, the President may initiate the search for commonly acceptable solution, and reduce the costs of bargaining and monitoring associated with reaching and maintaining a new security order. In the absence of a strong dominant political coalition, the consensus over macroeconomic and to a large extent microeconomic policies can be achieved by negotiating social pacts involving the government, political parties, the Parliament, the trade unions and various economic interests.

As an external factor assuring the effectiveness of such policy discussions, international organizations dealing with economic and security issues may come up with a set of concerted measures advocating the need to acknowledge the importance of the security dimension in economic policy formulation. For example, negotiating the program of reforms, the IMF may consider consulting a wider circle of actors involved, where the nature of the program proposed and their possible economic and security implications may be presented in clear and simple form. This approach allows not only the expansion of the circle of those involved in the policy making process but also the creation of a set of new channels and ties that may improve the confidence of all social groups in their commitment to complex reform measures.

If the issue of security is incorporated into the program of economic reforms, the leadership can attempt to persuade the opposition to agree to reforms and gain public support.<sup>339</sup> Although the utility of persuasion is questioned by many economists, in the post-Soviet space, where the threats to security are high, the persuasion technique in managing political risk associated with economic reforms may be effective.

Although the durable and intense economic ties of some social groups to the ruling elite may weaken as reforms proceed, they may be substituted for by ties sharing the common security concerns. Preventive diplomacy by the UN, OSCE, and NATO, may play a particularly important role in this process by treating the economic factors as a potential source of conflict and by cooperating with the post-Soviet states in developing models of complex threats to national and regional security, peacemaking and peace enforcement. Once the long-term strategy of managing economy and security issues is adopted, actual policy implementation may be delegated to technocratic bureaucracy. The process of reforming the economy may eventually create a broad coalition of beneficiaries and establish a positive image of social pacts as a means of strategy making, contributing towards closer convergence of thinking among government, interest groups, labor and legislature about the positive relationship between national security and a viable market economy.

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<sup>339</sup> On techniques for managing political risk including partial compensation, persuasion, diversion or obfuscation, and containment, see Joan Nelson, "The Political Economy of Stabilization: Commitment, Capacity, and Public Response," in *Toward a Political Economy of Development. A Rational Choice Perspective*, ed. Robert H. Bates (Berkeley: University of California Press, 1988), pp.113-118.

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