Abstract: This short article provides an analysis of why reform is not advancing in Ukraine. It focuses on four explanations: oligarchs, economic policy, governance, and political parties. It is part of an occasional series of non-peer-reviewed articles designed to explain on-going current events.

Ukraine has been undergoing a “quadruple transition” of democratization, marketization, state- and nation-building during the last quarter century. In the course of a decade, in 2004 and 2014, Ukraine experienced two mass protests against election fraud (Orange Revolution) and in support of European integration and against President Viktor Yanukovych’s kleptocratic and violent regime (Revolution of Dignity more commonly known as the Euromaidan).

Although much has been accomplished during Ukraine’s “quadruple transition,” the structural impediments to reforms in Ukraine remains deeply entrenched. The factors underpinning these impediments have remained largely immune from reforms conducted during periodic spurts under Prime Minister Viktor Yushchenko in the early 2000s, and following the Orange Revolution and Euromaidan.

Ukraine’s oligarchs and shadow economy continue to remain stable and have been long-term facets of Ukrainian life for over two decades. Genuine political parties, in contrast to leader’s fan clubs or oligarch-funded election projects, have yet to emerge in Ukraine. Good governance remains a distant prospect as Ukraine’s ruling elites continue to be unaccountable for their actions, criminal prosecutions are non-existent, and high-level abuse of office continues unabated and unashamedly.

Tensions in Ukraine are palpable between a more politically mature

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Taras Kuzio is Senior Fellow at the Canadian Institute of Ukrainian Studies, University of Alberta. E-mail: kuziotaras@gmail.com.
civil society and citizens and a ruling elite that seeks to preserve what Joel S. Hellman described as the “partially reformed equilibrium.” Hellman argued that short-term winners gain considerable rents from distortions in partially reformed economies which creates considerable costs to the state and society. Short-term winners need to be restrained and integrated into the process for economic reforms to be instituted.

Without resolving the question of the winners, Ukraine will continue to be stuck in its “partially reformed equilibrium” and could be subjected to periodic cycles of revolution, domestic disillusionment, and fatigue abroad, followed by stagnation and counter revolution, as in 2010, or another democratic revolution. Corrupt post-communist states, such as Romania and Bulgaria, resolved their partially reformed equilibrium when they were offered membership by the European Union (EU). Ukraine’s Association Agreement and Deep and Comprehensive Free Trade Agreement (DCFTA) were fashioned under the Eastern Partnership as integration into Europe without a membership perspective. Enlargement-lite, as this has been termed, is premised on a naïve assumption that ruling elites in Ukraine and other Eastern Partnership members will change their short-term rent seeking horizons and undertake painful unpopular reforms that would benefit the country in the medium to long terms. But, Ukrainian and other kleptocratic elites have continued after the Euromaidan to prioritize rent seeking over their country’s national interests. This problem became evident with the scandal surrounding the leaking of information from the Panama documents about President Petro Poroshenko, who set up offshore accounts in Panama in 2014 as Ukraine was in the midst of a war with Russia.

This article analyzes four long-term structural obstacles to reforms that have created a weak democracy in Ukraine: oligarchs, economy, good governance and political parties.

**Oligarchs**

Anders Aslund points to Ukraine as a country where oligarchs have captured the state to a degree greater than in most countries. During the

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4 See the investigations by Ukrainian journalists into Poroshenko’s history of offshore bank accounts: https://www.youtube.com/watch?list=PLRVLFiynwHmES2Jh1_I997Qe1Vn-FA3zzN&time_continue=2&v=NCiKS1KYTQ and https://www.youtube.com/watch?v=4S4i5edPl&nohtml5=False.

1990s former state directors, Komsomol functionaries, and organized crime leaders transformed into tycoons and oligarchs with the patronage of President Leonid Kuchma. Their capture of the state has become more entrenched during each subsequent election cycle and democratic revolution.

Ukraine’s oligarchs impose a negative influence on Ukraine’s democratization in a multitude of ways. The economy is unable to fulfill its growth potential and Ukraine remains the only former Soviet republic that has yet to return to the GDP level it held in 1989, when the USSR went into recession. The size of Ukraine’s small and medium business sector remains small, especially in eastern and southern Ukraine, and yet it is this sector that drove economic growth and post-communist economic transformation in central Europe and is the basis of a country’s middle class.

Foreign capitalists are dissuaded from investing in Ukraine’s economy because higher profits can be maximized elsewhere in countries where there is the rule of law or fewer officials willing to play with the rules rather than by the rules. Ukraine has experienced relatively high levels of foreign investment only once, in 2005-2007, when it was driven by the foreign acquisition of Ukrainian banks and a consumer boom. Overall though, far more capital has fled Ukraine than has been invested in the country, with an average of $11.7 billion in untaxed revenues flowing to offshore tax havens each year (see Table 1). Between $117 (Global Financial Integrity) and 167 billion (Tax Justice Network) from Ukraine has been deposited in offshore tax havens. Since the 2008 global financial crisis, Ukraine has been in economic recession or stagnation and has required two IMF assistance packages.

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Table 1. Outflow from Ukraine to Offshore Zones (Billions of US dollars)


Economic and financial monopolization of power provides oligarchs with control over law enforcement and the political system. The Security Service of Ukraine (SBU) and prosecutor-general’s office fall under the authority of the president irrespective of whether Ukraine has been ruled by a presidential or parliamentary constitution. With massive financial resources, control over television stations and little competition from
a small number of ideologically driven political parties, oligarchs have been able to corrupt the political process and take control of parliament and the presidency. The power of Ukraine’s oligarchs is evident in their ability to elect their political allies after two popular revolutions: in 2004 Yushchenko who headed the National Bank when they emerged in the 1990s, and in 2014 oligarch Poroshenko who was a founding member of the Party of Regions and has had close relations with every Ukrainian president. Of the six political forces elected to parliament in 2014, at least 4 were oligarchic electoral projects.

With oligarchs remaining influential, there will continue to be a temptation for presidents, prime ministers, political leaders and election candidates to strike backroom opaque deals where immunity is offered in exchange for political benefits. In March 2014 in Vienna, Poroshenko, Vitalii Klitschko, gas mogul Dmytro Firtash, whom the U.S. seeks to extradite to stand trial for corruption,6 and Yanukovych’s former Chief of Staff Serhiy Lyovochkin negotiated such a deal. Poroshenko and Klitschko were elected president and Kyiv mayor respectively. Firtash, Lyovochkin and Yuriy Boyko, leaders of Ukraine’s infamous gas lobby, have never appeared on Interpol watch lists of Ukrainians and no criminal charges have been laid against them inside Ukraine. Boyko and Lyovochkin head the Opposition Bloc, the successor to the Party of Regions.

With no system of collecting party dues from members, party leaders seek funding for expensive election campaigns from oligarchs. Big business is the source for bribes, usually in the millions of dollars, paid in parliament for deputies to change factions. Oligarchs control Ukraine’s main television channels, which are the primary source of news for Ukrainian citizens. 1+1 channel is owned by Ihor Kolomoyskyy, Inter is owned by Firtash and Lyovochkin, and ICTV, Novyy Kanal and STB is owned by Viktor Pinchuk. Censorship of the news can both skew the information that citizens receive from their governments about reforms and influence voting patterns during election campaigns.

There have never been any attempts to imprison oligarchs in Ukraine. The idea of introducing a one-off tax levy on oligarchs and drawing a red line on their past, with a promise by them to play by the rules in the future, has remained confined to discussions among experts and has never been contemplated by policymakers. Re-nationalizing oligarch assets was raised by Prime Minister Yulia Tymoshenko after the Orange Revolution when it was loudly condemned in Ukraine and abroad as “populism.” Only one industrial plant, Kryvorizhstal, was re-nationalized from oligarchs Rinat Akhmetov and Pinchuk and resold to a foreign company for six times the price.

Economy and Taxes

Ukraine’s economy is skewed by the predominance of oligarch-controlled large enterprises that are based on old sector economies, such as coal, iron and steel, chemicals and machine building. Economic growth remains stagnant or sluggish and the small and medium business sector is less than half the size of the levels found in post-communist central Europe.

Persistently low levels of public trust in state institutions, governments and political leaders have contributed to the wide gulf between elites and citizens. Ukraine, even in comparison to Russia and Poland, has a lower level of tax compliance. A combination of a large shadow economy that has contributed half of GDP for two decades and billions of dollars of capital flight abroad to European countries and offshore tax havens is disastrous for the state budget. Ukrainian governments with limited budgetary means have been unable to provide sufficient levels of financing for social programs, can pay only low salaries for state officials (which encourages corruption), and have permitted the running down of the military and law enforcement, a problem that became critical in 2014 when Russia invaded Crimea and the eastern part of the country.

Budgetary crises caused by low domestic tax compliance and high capital outflows have forced Ukraine to seek 9 bailouts from the IMF since 1991. During the majority of the IMF bailouts, there has been a track record of Ukrainian failures to implement structural and macro reforms, leading to a renewed crisis down the road. Tim Ash, an investment banker and long-term observer of emerging markets and the Ukrainian economy, believes “the frustrating thing is that efforts to help Ukraine reform and to break out of the cycle of oligarchic capture and rent seeking have basically failed; 25 years after independence, per capita GDP is now down to USD2,000, which is the lowest in the region by some margin.”

Good Governance

Ukraine is the most corrupt country in Europe and this factor has not changed during the majority of the country’s modern history. In Transparency International’s 2015 Corruption Perceptions Index, of the 15 former Soviet republics only 3 - all in Central Asia - have lower rankings than Ukraine. Energy-rich Russia, Kazakhstan and Azerbaijan and authoritarian Belarus have lower levels of corruption than Ukraine.

Two democratic revolutions have not dislodged and reduced Ukraine’s deep levels of corruption and only in 2005, during Prime Minister Yulia Tymoshenko’s government, did levels temporarily fall. Her anti-oligarch and anti-corruption policies were thwarted by Poroshenko,
who was then the secretary of the National Security and Defense Council and by President Yushchenko. With the SBU and prosecutor-general’s office unreformed and Soviet in their operating culture, heavily overmanned and corrupt, there have been no state institutions, and no political will among Ukraine’s five presidents to reduce high-level corruption and seek criminal convictions for those who have abused their power. Ukraine has 18,000 prosecutors compared to only 8,000 in Britain’s three regional Criminal Prosecution Services, and the UK is a country with a much larger population. Ukraine’s Ministry of Interior employed 300,000 compared to Britain’s 120,000 police and prison officers.

Each Ukrainian president, including Yushchenko and Poroshenko who came to power on the back of pro-Western democratic revolutions, has continued to draw upon the SBU (which emerged from the Soviet Ukrainian KGB) and prosecutor general’s office. These two institutions continue to operate as in the Soviet Union; that is, to protect ruling elites rather than implement equality and accountability before the law.

Western pressure has led to the establishment of a National Anti-Corruption Bureau (NACB) which may over time change the culture of impunity and lack of accountability. The Soviet era militsiya in the Ministry of Interior are being transformed, with U.S. and Canadian assistance, into a European-style politsiya. But, it is still too early to ascertain if the NACB will be successful in a key area where the prosecutor-general’s office had nothing to do with the rule of law and Ukrainian experts believed was the biggest racket in the country.

Ukraine’s free media undertakes professional quality investigations and due diligence of high-level corruption leading to the exposure of corrupt politicians and state officials. But, this reporting generates widespread and deep-seated tension in society when state institutions fail to prosecute because they are controlled by political elites who use these state institutions to defend the status quo and protect those who hold power. As a consequence, no senior officials were criminally prosecuted after the Orange Revolution and Euromaidan whose protests were partially fuelled by public outrage at high-level abuse of office.

President Yanukovych and his entourage abused office and bankrupted the country, murdered over 100 unarmed protesters and betrayed their country by supporting the annexation of the Crimea and remaining neutral or backing pro-Russian separatists in the Donbas. More than two years on, not a single high-level official or politician has been criminally convicted in Ukraine. Oligarchs have been granted immunity or have been allowed to flee the country and Berkut riot officers implicated in the murders of protesters have been either forewarned of pending arrests or placed in house arrest, in both cases permitting them to go into hiding.¹

Political Parties

Although U.S. and European democracy promotion foundations have been active in Ukraine for two decades, Ukraine does not have a single genuine political party. The Ministry of Justice has registered over 200 political parties, but most of these exist mainly on paper with no regional structures or bona fide members. Although Western scholars have focused on extreme left and right parties, these are typically election projects or have been co-opted by oligarchs. The Communist Party of Ukraine ignored the toiling proletariat in favor of close cooperation and funding from the Party of Regions, the political force with the closest ties to tycoons, oligarchs and organized crime. Far right nationalist parties such as Svoboda (Freedom) have been funded by oligarchs and criminal elements.

Perhaps the closest Ukraine had to a political party, ironically, was the Party of Regions that elected three leaders over the course of its political life and won or received a plurality in four elections. The Party of Regions did not owe its success as a political machine to Western democracy-promoting foundations, but to high levels of oligarch funding and internal discipline, the latter usually lacking in democratic parties.

Political parties have been created for five reasons. They have been most often established around charismatic personalities, such as Tymoshenko and Yushchenko, and have risen and fallen in popularity depending on the ratings of their leaders and their success or failure in election campaigns. Our Ukraine disappeared after Yushchenko came fifth with only five percent of the vote in the 2010 elections.

Political parties in eastern Ukraine have often been created as kryshy (criminal slang for roof but here meaning protection) for oligarchic business empires and regional clans. The Party of Regions successfully united the Donetsk warring clans. Business leaders without regional clans have created their own amorphous parties that are used to advance their business interests. Poroshenko has created three parties entitled “Solidarity” that were donated to the inaugural congresses of the Party of Regions (2000) and Yushchenko’s failed presidential party, People’s Union-Our Ukraine (2005); the third became his 2014 election vehicle. In none of the three parties did Poroshenko invest time, capital and energy to create a genuine political party.

Oligarchs have created political parties as disposable (odnorazove) election projects. Pinchuk has invested in countless failed election projects and Kolomoyskyy more recently launched Ukrop, the slang term used...
by Russians to mock Ukrainian soldiers. Parties also can be created as
spoilers to take votes away from democratic parties. The Svoboda party
was funded by Party of Regions tycoons with the goal of taking votes
away from Tymoshenko’s Batkivshchina (Fatherland) party. Svoboda
would never receive support in Russophone eastern and southern Ukraine,
where the Party of Regions monopolized political life. The Radical party,
led by populist Oleh Lyashko, was initially funded by the gas lobby and
more recently by Akhmetov and Kolomoysky, who have together also
sought to take votes away from Batkivshchina and nationalist parties.
Similar funding patterns have been noticeable in presidential election
campaigns where the gas lobby has funded Arseniy Yatsenyuk in 2010 and
Poroshenko in 2014 to reduce Tymoshenko’s election chances.

Conclusion

Despite two democratic revolutions and mass protests, Ukraine’s quadruple
transition has been unable to break free of a partially reformed equilibrium
that came into being during Kuchma’s presidency. Two democratic revolu-
tions propelled by some of Europe’s largest and longest mass protests, an
active civil society and professional investigative journalists have failed to
dislodge this status quo. Ukrainians have been adept at building democratic
freedoms and holding free elections, but have failed to improve the rule of
law and reduce high levels of corruption.

The focus of Western assistance therefore should be on identifying
the structural obstacles to the success of reforms in Ukraine. These should
include improving the rule of law and supporting independent Ukrainian
efforts to institute criminal responsibility for major crimes. European inte-
gration will provide some impetus to breaking out of Ukraine’s partially
reformed equilibrium, but it cannot have the same impact as in post-com-
munist central Europe, where the membership carrot played a decisive
transformative role.