The Economic Policy of Ukraine after the Orange Revolution

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Abstract: A prominent specialist on economic transition in the former Soviet Union discusses changes in Ukraine's economic policy in the aftermath of Viktor Yushchenko's accession to that country's presidency in January 2005. The author relates his recent (through mid-June 2005) observations as co-chair of the UN's Blue Ribbon Commission for Ukraine. He analyzes the country's macroeconomic stability and growth since 2000, the regional divide, the winner's election program, the impact of the oligarchs, and the unexpected populism of the new government, which prompted re-privatization, price controls, and fiscal excesses. *Journal of Economic Literature*, Classification Numbers: E60, E63, F13, H20, H60. 1 figure, 6 tables, 62 references. Key words: Ukraine, Orange Revolution, macroeconomic stability, regional divide, oligarch, populism, re-privatization, oil prices, price controls, fiscal policy.

Ukraine went through the historic Orange Revolution during the course of the last two months of 2004. After falsifying the results of the second round of the presidential elections, the old regime proclaimed the victory of its favorite, Prime Minister Viktor Yanukovych. But massive protests and extensive international attention prompted the Supreme Court to decree a rerun of the second round, leaving the old regime no choice but to comply. As expected the former Ukrainian Prime Minister Viktor Yushchenko became the ultimate winner.[2]

In this paper, I discuss the economic policy that followed the Orange Revolution. Rather unexpectedly, this liberal revolution yielded an outburst of socialist populism. How could this happen? In the first part of the paper I address the question of why the revolution occurred by reviewing three standard factors of economic dissatisfaction, namely the macroeconomic situation, the political regional divide, and oligarchic influences in the Ukrainian state. The second part will cover the programmatic work undertaken before the new government ascended to power. Initially, the government's program aimed to establish a liberal market economy with some elements of populism. The surprise comes in the third part of the paper, devoted to the first policy steps of the new government, which turned out to be pretty socialist and populist. The three key topics discussed in some detail are re-privatization, fiscal policy, and control of prices.

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[2]For an analysis of the electoral geography of the 2004 presidential contests, see Clem and Craumer (2005, this issue).

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MACROECONOMIC STABILITY AND IMPRESSIVE GROWTH

In the 1990s, Ukraine suffered a depressing legacy of economic and social misery. During the decade from 1989 to 1999, the country's output declined by 54 percent. Official statistics exaggerate the fall, but it is likely to have been about half that size, still a very substantial record of the economy's contraction (Åslund, 2002, Table 4.2 and 4.9). The cause can be traced to the lack of economic policy and a nearly complete mismanagement of the economy in the early years of transition. State regulation and ownership dominated the economic environment longer than in most other former communist countries. Macroeconomic management also was thoroughly misguided, with inflation exceeding 10,000 percent in 1993. Soon enough, a number of emerging oligarchs figured out how to exploit the distortions, reaping enormous benefits from rent seeking. Until the year 2000, Ukraine was on the verge of external default with minimal external reserves (Åslund, 2000).

The year 2000 marked a pivotal change in Ukraine's economic history. At the end of 1999, the country was in a particularly precarious state, approaching external default. Frightened by the way Russian oligarchs had suffered in the aftermath of the financial crash of August 1998, the local oligarchs came to the conclusion that Ukraine's creditworthiness had to be restored. With time running out, they came together to promote Viktor Yushchenko, the only credible senior economic politician who had skillfully run the Central Bank for seven years, to the post of prime minister. Yushchenko did exactly what was required of him. In the course of four months, he restored Ukraine's creditworthiness, but did so with a vengeance directed against the oligarchs. Without much delay, he enacted a law that abolished 270 legal acts that sanctioned subsidies and privileges in the regulation or taxation of various business establishments. He rapidly rooted out barter and offsets, by demanding that all due payments to the state be made solely in cash. In the energy sphere, the gas trade with Russia was reformed, so that the oligarchs were forced to pay for their deliveries. A large number of big companies were privatized, many by sale to Russian businessmen, who were prepared to pay more than the homegrown Ukrainian oligarchs. Adding to the foregoing were the consequences of land reform, which dismantled the old collective and state farms and transferred the land to peasants.[3] By raising state revenues, Yushchenko turned a budget deficit of 1.5 percent of GDP in 1999 to a surplus of 0.6 percent in 2000, and reduced the foreign state debt from $9.3 to $8.0 billion. To an impressive degree, the playing field had been leveled and, as a consequence, the Ukrainian economy turned around (ICPS, 2005). After the oligarchs realized that Yushchenko had saved them, they unceremoniously dismissed him in April 2001. Yet, the clock could not be turned back, for Ukraine had changed, and the old rent-seeking system could not be restored. The successful oligarchs had been transformed from rent-seeking arbitrators to producers, notably of steel, while several energy traders vanished.

The Ukrainian economy took off, with growth of 5.9 percent in 2000, and even accelerated later. The Orange Revolution actually took place in the midst of an extraordinary economic boom. For the last five years, from 2000 to 2004, Ukraine's GDP has risen by a stunning annual average of 9 percent, and in 2004 it surged by no less than 12.1 percent (ICPS, 2005). The structure of the economic growth looked quite reassuring. It was primarily driven by industry, notably by steel production, food processing, and increasingly by machine building. The growth was export-driven, and in 2004 exports surged by an incredible

[3]For additional information on Ukraine's return to economic growth, see Åslund (2001).

Table 1. Main Economic Indicators, 1999-2004

Indicator	1999	2000	2001	2002	2003	2004
Production and investment[a]						
GDP	-0.2	5.9	9.2	5.2	9.4	12.1
Industrial output	4	13.2	14.2	7	15.8	12.5
Agricultural output	-6.9	9.8	10.2	1.2	-9.9	19.1
Capital investment	0.4	11.2	17.2	8.9	31.3	28
Foreign trade[b]						
Export of goods, FOB	-8.4	25.8	11.6	10.4	28.5	41.6
Import of goods, CIF	-20.5	15.4	13	7.6	35.6	26
Macroeconomic stability						
Consolidated budget balance[c]	-1.5	0.6	-0.3	0.7	-0.2	-3.1
Consumer price index[d]	19.2	25.8	6.1	-0.6	8.2	12.3

[a]Real cumulative change, expressed in percent of total.
[b]Change in percent.
[c]Consolidated budget indicators are calculated on the basis of methodology used by the Ministry of Finance of Ukraine. The balanceis expressed as a percentage of GDP.
[d] In percent.
Source: Compiled from data of Derzhkomstat (State Statistics Committee of Ukraine) and ICPS, 2005.

42 percent. Gross investment in fixed assets skyrocketed by more than 30 percent in both 2003 and 2004. Also, agriculture made an impressive recovery, as shown in Table 1. Thus when the Orange Revolution erupted, Ukraine enjoyed an extraordinary economic upswing, with the highest growth rate in Europe.

The country's macroeconomic indicators improved steadily. Inflation stayed in single digits from 2001 until the election campaign in 2004, and the state budget was more or less in balance. Ukraine ran up substantial trade and current account surpluses, and public debt fell to 25 percent of GDP. Economic results rarely look better than this, even if much of it may be seen as recovery growth (Gaidar, 2005). While massive economic recovery growth from the year 1999 characterized most of the states of the former Soviet Union, Ukraine, together with Kazakhstan and Armenia, were the leaders (EBRD, 2004).

Welfare is not necessarily shared equally, and the public perception was focused on the riches flowing to a few oligarchs. There is much to support this argument, but inequality rose sharply during the first years of postcommunist transition, and then leveled off at a plateau equivalent to the US level (Milanovich, 1998; World Bank, 2004). Social statistics are particularly unreliable in Ukraine, but all social indicators imply massive improvements from 2001 to 2004. Average wages and disposable household income rose much faster than GDP. In 2004, disposable household incomes escalated by 16.8 percent, and the average pretax wage by 23.8 percent, as shown in Table 2. In addition, personal income tax was reduced from the progressive tax peak of 40 percent to a flat tax of 13 percent.

Unemployment had also declined from 11.7 percent in 2000 to 7.8 percent in the third quarter of 2004.[4] Pension arrears were eliminated in 2000, and while wage arrears persisted,

[4]As measured in labor force surveys based on the International Labor Organization (ILO) methodology.

Table 2. Selected Social Indicators, 1999–2004

Year	Disposable income[a]	Average pretax wage[a]	Unemployment rate[b]
1999	—	–8.9	11.9
2000	—	0.9	11.7
2001	—	19.3	11.1
2002	18.0	18.2	10.1
2003	7.8	15.2	9.1
2004	16.8	23.8	8.6

[a]In real cumulative change expressed as a percentage of total.
[b]In percent of total.
Sources: Compiled from data in Derzhkomstat (State Statistics Committee of Ukraine) and ICPS, 2005.

they fell drastically from that year onward. Admittedly, living standards remained low; the average wage increased to $111 a month in 2004, i.e., to about one-half of the Russian level.

Although the standard of living rose at an ever increasing rate, people remained dissatisfied. As Alexis de Tocqueville pointed out about France before the revolution in 1789, the problem was not the efficiency of the old system, but that its injustices became less tolerable.[5] De Tocqueville's old dictum about the French Revolution appears applicable to another feature of Ukrainian society. The revolution happened not when things were getting worse, but when they were getting better.[6] To put it in Marxist terms, the high economic growth convinced people that the economic base had outgrown the political superstructure. And the rising welfare enhanced the self-confidence of the rising middle class.

UKRAINE'S REGIONAL DIVIDE

All Ukrainian elections have been characterized by a deep regional divide between the East and the West. As Sarah Birch (2000, p. 1017) observed, "residents of the industrialised and heavily Russian east of Ukraine have been found to be more left-wing and pro-Russian in their political orientations and voting proclivities, whereas those of the more agricultural and ethnic Ukrainian west tend to favour market reforms and closer ties with the [European] West." After a careful analysis of the elections prior to 1999, Birch drew the conclusion that the right-wing support in the West was determined by historical and cultural factors rather than economic conditions, because the West has been persistently more right-wing–oriented, even though official statistics indicate that it has been economically less well off. In turn, the left-wing orientation of the Eastern electorate could be explained in part by the predominance of blue-collar workers in the East's heavy industry (cf. O'Loughlin, 2001).

The East and the West of Ukraine have persistently and overwhelmingly supported opposing candidates, and as a consequence, the country's elections have been determined by

[5]In De Tocqueville's words ([1856], p. 87), "Although inequality of taxation prevailed all over Europe, there were few countries in which it had become so flagrant and so much detested as in France."

[6]Again, in De Tocqueville's words ([1856], p. 176), "…it was precisely in those parts of France where there had been most improvement that popular discontent ran highest."

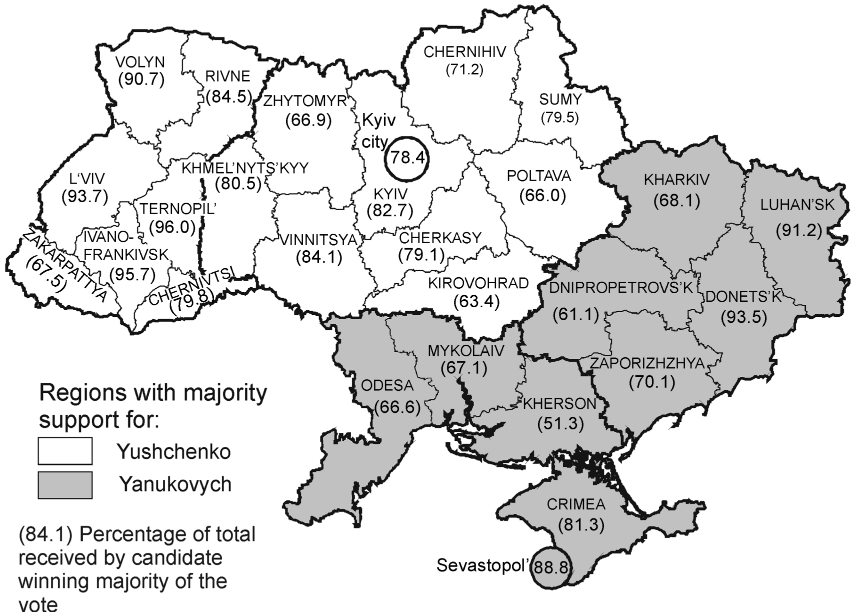

Fig 1. Maps showing regions in which Yushchenko and Yanukovych won majority of the vote in the December 26, 2004 second runoff election. Percentages of the total vote garnered by the winning candidate in each region are indicated in parentheses. *Source*: Ukraine, Central Electoral Commission [http://ww.ck.gov.ua].

Central Ukraine (Kuzio, 2005a). In the presidential elections of 2004, both leading presidential candidates appeared to adopt the same basic ideology, favoring a free market economy and large populist social expenditures. There were, however, two major differences. First, Yushchenko stood for Ukraine's European Choice, whereas Yanukovych advocated closer links with Russia. Second, it was a referendum on the previous regime, which Yushchenko characterized as criminal, corrupt, and oligarchic. It was thus not a choice between left and right but between liberal and oligarchic capitalism.

In the rerun of the second round of the elections, Yushchenko received 52 percent of the votes and Yanukovych 44 percent. The regional divide was quite conspicuous (Fig. 1). In the country's 17 Western and Central regions, Yushchenko received an average share of roughly 80 percent, whereas in the 10 Eastern and Southern regions he obtained an average of only ca. 20 percent (see Table 3).[7]

I will now attempt to enhance our understanding of the regional divide by reviewing a set of relevant statistics. In terms of GDP per capita, the East is 12 percent more affluent than the West (see Table 4, based on State, 2004, p. 423). Kyiv, however, where 78 percent of voters opted for Yushchenko, is about three times as wealthy as the national average. The country's three richest regions are Kyiv, Donets'k, and Dnipropetrovs'k—all seats of the dominant oligarchic conclaves.

A more relevant reflection of Ukraine's standard of living is per capita income, which is considerably more even among the country's different regions than the GDP per capita (see

[7]All averages are unweighted.

Table 3. Votes Cast for Yushchenko in the Presidential Election Rerun of December 26, 2004

Region	Percent of total vote	Region	Percent of total vote
West and Central		East and South	
Ternopil'	96.03	Kherson	43.80
Ivano-Frankivsk	95.72	Dnipropetrovs'k	32.01
L'viv	93.74	Mykolaiv	27.72
Volyn	90.71	Odesa	27.46
Rivne	84.52	Kharkiv	26.37
Vinnitsya	84.07	Zaporizhzhya	24.51
Kyiv (region)	82.70	Autonomous Republic	
Khmel'nyts'kyy	80.47	of Crimea	15.41
Chernivtsi	79.75	Sevastopol'	7.96
Sumy	79.45	Luhans'k	6.21
Cherkasy	79.10	Donets'k	4.21
Kyiv (city)	78.37		
Chernihiv	71.15		
Zakarpattya	67.45		
Zhytomyr	66.86		
Poltava	66.00		
Kirovohrad	63.40		

Source: Central Election Commission [http://www.cvk.gov.au/elect/wp301ept001f01=502rej=1].

Table 4). The difference in averages is relatively insignificant, being somewhat higher in the East than in the West. Moreover, leaving out the capital, the differences between all the regions are conspicuously small. It is noteworthy that rapid growth may generate tensions, and the population's overall income has skyrocketed by a staggering 36 percent from 2001 to 2003. But again the difference between the East and West is insignificant at 36.4 percent versus 34.6 percent, as shown in Table 4.

Election regressions have pinpointed urbanization as an important variable, and Table 5 clarifies this particular divide. On average, the urban population accounted for 55 percent of the West's population, and for 76 percent of that in the East (see Table 5, based on State, 2004, p. 238). Moreover, leaving Kyiv aside, all Eastern regions are more urbanized than all but two regions in the West. Characteristically, the two marginal regions in the elections, Kirovohrad and Kherson, also straddle the center with regard to urbanization. Another manifestation of conventional wisdom holds that the West is more hospitable to small enterprise. Table 5 shows the share of small-scale enterprise output in the country's total, highlighting the difference between East and West, due in part to the limited number of small enterprises in the big industrial cities of the East.

Social indicators do not offer striking contrasts. Unemployment is a bit higher in the West, in line with our indications of the slightly lower standard of living there, but unemployment is also high in Kherson, Luhansk, and Mykolaiv (State, 2004, p. 388). Infant

Table 4. Per Capita GDP and Income, 2001-2003[a]

Region	2002 GDP per capita[b]	2003 per capita income[c]	2001-2003 growth inpopulation income[d]
	West and Central		
Ternopil'	2,311	3,230	34.2
Ivano-Frankivsk	3,213	3,476	36.1
Lviv	3,292	4,058	35.8
Volyn	2,944	3,662	33.4
Rivne	2,960	3,823	37.4
Vinnitsya	3,015	3,861	35.0
Kyiv	3,771	4,499	26.0
Khmel'nyts'kyy	2,765	3,680	30.3
Chernivtsi	2,323	3,092	34.8
Sumy	3,381	4,026	31.0
Cherkasy	2,755	3,657	31.0
Kyiv	13,713	8,401	49.0
Chernihiv	3,103	3,941	29.0
Zakarpattya	2,559	3,243	41.2
Zhytomyr	2,555	3,765	39.7
Poltava	4,818	4,381	33.5
Kirovohrad	3,019	3,784	30.7
	South and East		
Kherson	2,784	3,425	34.8
Dnipropetrovs'k	5,071	4,796	32.5
Mykolaiv	3,723	4,079	36.2
Odesa	4,393	3,872	39.6
Kharkiv	4,075	4,541	37.2
Zaporizhzhya	4,478	4,820	31.6
Autonomuos Republic of Crimea	2,981	3,855	33.8
Sevastopol'	3,701	4,009	45.5
Luhans'k	3,374	3,956	36.5
Donets'k	5,240	4,651	36.7
17 region average (West and Central)	3,676	4,034	34.6
10 regions average (East and South)	4,115	4,200	36.0

aBased on population census of December 2001; for additional information, see Rowland, 2004.
bIn grivna at current prices.
cIn grivna.
[d]In percent.

Table 5. Urbanization and Small Business, 2003–2004 (in percent)

Region	Urban population[a]	Share of small enterprises in total output[b]	Region	Urban population[a]	Share of small enterprises in total output[b]
West and Central			East and South		
Ternopil’	42.8	16.4	Kherson	60.3	14.1
Ivano-Frankivsk	42.2	16.4	Dnipropetrovs’k	83.1	4.5
L’viv	59.7	10.9	Mykolaiv	66.6	11.1
Volyn	50.2	10.7	Odessa	65.9	9.1
Rivne	46.9	12.6	Kharkiv	78.8	10.6
Vinnitsya	46.9	10.3	Zaporizhzhya	75.8	5.2
Kyiv region	58.6	9.0			
Khmel’nyts’kyy	51.7	13.1			
Chernivtsi	40.8	21.0	Autonomous Republic of Crimea	62.8	13.7
Sumy	65.3	9.7	Sevastopol’	94.2	18.7
Cherkasy	54.2	10.7	Luhans’k	86.2	4.1
Kyiv city	100.0	8.1	Donets’k	90.2	4.0
Chernihiv	59.2	9.7			
Zakarpattya	37.0	18.8			
Zhytomyr	56.2	12.3			
Poltava	59.2	5.6			
Kirovohrad	60.6	13.6			
17-region average	54.8	12.3	10-region average	76.4	9.5

mortality stands out, because it is 12 percent higher in the East than in the West (State, 2004, p. 371).

It is difficult to make too much economic sense of this selection of regional data. The most evident difference can be attributed to the fact that the East is substantially more urbanized than the West. A second distinction is in the output of small-scale enterprises, which play a somewhat greater role in the West. A reflection of both is the domination of the East by a few large industrial cities with heavy industry and extensive working class populations. For the rest of Ukraine, the economic and social differences are strikingly limited.

What is likely to happen to these regional differences? An important indicator for the future is capital investment. It is heavily concentrated in Kyiv and its surrounding region, strong in the large industrial cities of the East, but remarkably limited in the Western, Southern, and Central regions, as shown in Table 6 (based on State, 2004, p. 220). While investment typically takes off first in metropolitan centers and then spreads out, the leading centers are likely to become more dominant in terms of attracting additional capital and migrants.

Little in these data suggest a major spurt in economic activity for the Western or Southern regions. However, over time a diffusion of economic development can be anticipated due to labor shortages in the big cities. If the largely closed western border were to open, it could rapidly stimulate the West. In addition, a far-reaching deregulation of the Ukrainian economy would revitalize the small-enterprise sector in the less affluent parts of the country.

Table 6. Fixed Capital Investment per Capita, 2000

Region	Grivna at current prices	Region	Grivna at current prices
West and Central		East and South	
Ternopil’	405	Kherson	476
Ivano-Frankivsk	808	Dnipropetrovs’k	1,208
L’viv	990	Mykolaiv	1,054
Volyn	693	Odessa	1,363
Rivne	925	Kharkiv	1,242
Vinnitsya	493	Zaporizhzhya	1,131
Kyiv region	1,613	Autonomous Republic of Crimea	955
Khmel’nyts’kyy	641	Sevastopol’	1,048
Chernivtsi	569	Luhans’k	765
Sumy	734	Donets’k	1,024
Cherkasy	703		
Kyiv city	3,276		
Chernihiv	683		
Zakarpattya	817		
Zhytomyr	445		
Poltava	1,356		
Kirovohrad	635		
17-region average	929	10-region average	1,026

A HIGHLY OLIGARCHIC REGIME[8]

At the outset of the Orange Revolution, Ukraine was ruled by a highly oligarchic regime, much more powerful and influential than the one in Russia. The regime was dominated by three wealthy regional oligarchic groups, which own large conglomerates: (1) Rinat Akhmetov’s System Capital Management (a very large metallurgical conglomerate based in Donets’k); (2) Viktor Pinchuk’s Interpipe (a company specializing in high-value added steel products, headquartered in Dnipropetrovs’k); and the amorphous group of Hrihoriy Surkis and Viktor Medvedchuk, based in Kyiv. The oligarchs maintained intimate connections with President Leonid Kuchma, directed large party factions in parliament, owned media empires, benefited from extensive government privileges, and controlled many important officials and branches of law enforcement.

Ukrainian oligarchs made most of their money in commodities, and more specifically in trading huge quantities of natural gas. As one of the oligarchs, Ihor Bakai, aptly observed:

[8]The popular meaning of “oligarch,” the same in Ukraine as in Russia, implies a very wealthy and politically well-connected businessman, a billionaire or near-billionaire, who is the principal owner of a conglomerate and has very close ties with the President. Joel Hellman (1998) has coined the phrase “state capture” to characterize the relationship between big businessmen and the state in a country such as Ukraine, because big businessmen used a variety of means to influence the governance of the state. For additional information, see two excellent studies of Russian oligarchs by Freeland (2000) and Hoffman (2002).

"All really rich people in Ukraine have made their money on gas" (Timoshenko, 1998). Generous revenue flows also came from oil trade, coal and other were subsidized state credits, as well as from agricultural, chemical, and steel exports. The year 2000, when a normal market economy with predominantly private ownership had at long last been established, marked the collapse of the old parasitic rent seeking and the demise of oligarchy. The growth of pluralism and competition that eventually prompted the retirement of the old regime can be attributed to five major causes.

First, President Kuchma played everyone against everybody, which applied to the oligarchs and law enforcement agencies as well. By assuming the role of arbiter, Kuchma tried to extend his power, but his efforts in this direction merely stimulated competition.

A second characteristic of the Kuchma regime was its covert and open disregard for law. Instead of seeking reform of Ukraine's defective legal system,[9] President Kuchma reverted to exploiting the lawlessness of the old communist system, which allowed him and his trusted retainees in the vast Presidential Administration to order any government official to break the law.[10]

A third feature was related to competition among the oligarchic groups, which grew ever more aggressive. A rapid structural modernization of business groups, privatization, deregulation, and the declining role of rent extraction served to enhance their economic independence from the state. With their newly won freedom, more businessmen felt secure enough to dare play a public political role. Most were motivated to enter politics in order to strengthen their weak property rights and also to appropriate additional state property as well as property owned by other individuals. This led to an almost unprecedented level of campaign financing. According to representatives of Yushchenko's campaign, Yanukovych planned to raise $600 million to finance his campaign[11] as early as September 2004. Half of that sum came from Russian enterprises and half from Ukrainian oligarchs, primarily from Rinat Akhmetov, and some informants talked about a campaign chest as large as $900 million.[12] David Zhvania, the chief fundraiser for the Yushchenko campaign, stated that his presidential campaign and public protests absorbed more than $150 million, provided by Ukrainian businessmen (Business, 2005). This means that the cost of the Ukrainian presidential elections exceeded one percent of GDP, or more than 100 times as much as the sums expended on the simultaneous presidential elections in the United States in relation to GDP.

A fourth hallmark of the old Ukrainian regime was division and competition among its branches of law enforcement, reflected in repeated leaks of important secret information. If someone had problems with one branch of law enforcement, he or she could turn to another for recourse, as illustrated by the legal tours in the Yulia Tymoshenko affair[13] or, indeed, by

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[9]Ukraine even lacks an elementary law on governing joint-stock companies.

[10]De Tocqueville described a similar state of affairs in France before the revolution: ". . . rigid rules, but flexibility, not to say laxity, in their application. . . . under the old régime everything was calculated to discourage the law-abiding instinct" ([1856], p. 67).

[11]Nearly as much as the cost of the second presidential campaign of George W. Bush in 2000.

[12] Information secured by the author in September 2004 from a senior functionary in the Yushchenko campaign.

[13]The main accusations were that Tymoshenko had evaded value-added tax on natural gas sales of $2.5 billion and bribed Prime Minister Pavlo Lazarenko with about $100 million. Tymoshenko retorted that here company was legally exempt from VAT, and that the payments to Lazarenko were dividends, as he was a co-owner of her corporation. She was arrested and incarcerated for slightly over one month in February–March 2001, but the case never went to court.

the quarrel over the validity of the presidential elections. Actual repression was limited in its severity, so that fear of the authorities was hardly a major factor.

Meanwhile, the power of the oligarchs appeared to grow. They dominated not only the presidency and media, but also the parliament (since March 2002) and the cabinet of ministers (since November 2002). Thus from 2002 to 2004, numerous large enterprises were sold in discretionary privatizations, benefitting most of the large oligarchic groupings. On the other hand, the oligarchs became increasingly exposed to public criticism. When their ownership of enterprises became official and their corporations more transparent, they actually became more vulnerable and disliked. Criticism of the three dominant oligarchic groups was reinforced by the aggressive behavior of their large corporate competitors.[14] These big challengers stayed neutral in the presidential election, while appearing to favor the opposition. Smaller businessmen who resented the preferences bestowed on the oligarchs and sought an end to lawlessness in Ukrainian society predominantly supported Yushchenko.

The Orange Revolution was thus the end result of the accumulating dissatisfaction with the lack of democracy, limited freedom, and fragile rule of law, and it was a challenge to pervasive corruption and oligarchic rule (Karatnycky, 2005; Kuzio, 2005a). It was a truly bourgeois revolution, and the country's oligarchs may be seen as its feudal lords. The support for Yanukovych in the East was to a large extent a reflection of the dominance of oligarchs in that region, although it was also in part a protest vote of Russian-speakers against Ukrainian nationalism in the West. To the extent that economics mattered, the steady high rate of growth emboldened the Ukrainian majority to demand a better life.

YUSHCHENKO'S ELECTION PROGRAM

As presidential candidate, Viktor Yushchenko presented his election program on July 9, 2004. Comprising only six pages in length, it was uncommonly unambiguous, substantive, and succinct.[15] The program's main points (Yushchenko, 2004) were: (1) create 5 million new jobs (abolish all obstacles to opening an enterprise); (2) secure priority financing for social programs (raise the minimum pension to subsistence level; guarantee all teachers no less than an average industrial wage); (3) reduce taxes (decrease payroll taxes in five years from 37.5 to 20 percent; liquidate the tax police; force oligarchs to pay taxes); (4) force the government to work for the population and fight corruption (dismiss corrupt officials; abolish unnecessary bureaucratic structures, detach business from government, raise public salaries); (5) create secure living conditions for the citizenry (fire corrupt policemen); (6) promote family values (increase social support for newborns by no less than 10 times; offer credits for the construction of housing); (7) cultivate spiritual and reinforce moral values; (8) support the development of Ukrainian villages (end speculative land sales by letting those who work it become its owners); (9) increase the country's military capability (reduce compulsory military service to 12 months in 2005 and abolish it in 2010); and (10) pursue a foreign policy that serves the interest of the Ukrainian people.

The program included promises to raise social expenditures, the most expensive of which was the highly popular commitment to raise the minimum pension. Higher salaries for teachers also were necessary, although the number of people employed in the educational

[14]In Dnipropetrovs'k, Interpipe was challenged by the even larger Privat Group, and in Donets'k, System Capital Management was threatened by a similar steel group, called the Industrial Union of Donbas.

[15]The program's opening words set the tone: "I see Ukraine as a just and rich European state, where every individual can realize his possibilities…" (Yushchenko, 2004).

system was excessive. The least expensive commitment was the promised increase in the state grant allocated to parents of newborn children. The remaining provisions of the fiscal section were typically liberal, emphasizing tax cuts, deregulation, and creation of a level playing field. Promises of credits did not suggest any form of subsidization. Basically, the focus of Yushchenko's program was on corruption and misuse of government power. The oligarchs were mentioned only twice, being admonished to pay a fair share of taxes and the full price for properties made available through privatizations. As noted above, Yushchenko unveiled a liberal market economic program with a social orientation. Since economic growth was abundant and macroeconomic stability reassuring, he barely mentioned these issues, while the speeches of his rival Yanukovych focused on the economy's achievements. Yushchenko's tone was moralistic, inveighing against theft and corruption.

It was evident that the outcome of Ukraine's presidential elections could create an opportunity for dramatic change in the way the country is governed. Anticipating such change, several organizations, notably the United Nations, the World Bank (Litwack and Wetzel, 2004), the OECD (2004), and the European Business Association (2004), proceeded to draft advisory economic programs for the future. Possibly, the most ambitious program was the one prepared by the Blue Ribbon Commission, sponsored by the United Nations.[16] While there were minor differences, the unusually high degree of consensus among all Ukrainian and international experts was evidenced in the uniform appeal to the new administration to undertake a sweeping "new wave" of reform to restructure relations between state and society and thus sustain the high rates of growth and broaden the reach of prosperity.

The report of the Blue Ribbon Commission (2005) identified five key areas in need of reform. First, and most urgent was the effort to reshape the political domain. The report concludes that the confidence of the citizenry in its state will depend on a fundamental change, with the state machinery being subject to real control by society and its laws.[17] Second, social transfers as well as health care and education need to be more effective so as to benefit the truly needy, rather than the affluent. Third, the tax system as well as legal foundations of the financial system need to be overhauled so that both work to stimulate economic growth. Fourth, a clear dividing line must be drawn between the state and private enterprise, so that property rights are fully protected. And fifth, integration with the world economy should be facilitated by efforts to join the World Trade Organization and eventually the European Union.

UNEXPECTED POPULISM OF THE NEW GOVERNMENT

After President Viktor Yushchenko was inaugurated on January 23, 2005, he appointed without delay a new government led by Yulia Tymoshenko, the former gas oligarch and one of the leaders of the Orange Revolution. Tymoshenko's government was overwhelmingly approved by the country's parliament, with 377 out of the total 450 votes cast. The composition of the new government appeared to be a positive sign. Most ministries were headed by politicians in their forties, young enough but sufficiently experienced; there were no holdovers from the old regime. At the same time, the parliament also approved the government's Action Program (Programma, 2005), which substantially concurred with Yushchenko's program as well as the report of the Blue Ribbon Commission. Ostensibly liberal, albeit without

[16]This author co-chaired the Blue Ribbon Commission for Ukraine together with Oleksandr Paskhaver.

[17]The persistent problem here, as well as in other post-communist countries, is the lingering notion that the state rules (rather than serves) its citizens.

a single number to substantiate its intentions, it said little about the future direction of the new government. Rather strangely, the Action Program has never been published, reinforcing this author's suspicion that it does not appear to have been used in any substantive way to guide government policy.

From the outset, Tymoshenko's government was focused on the parliamentary elections scheduled to take place in March 2006, when the Ukrainian party system is bound to undergo a complete metamorphosis. At this point in time, it is not entirely clear how this projected political transformation can ultimately materialize. The next parliament will be elected entirely according to the principle of proportional representation, which should weed out most businessmen, render the party factions more cohesive, and facilitate more orderly legislation. At present, the threshold for party representation in the new parliament is set at 3 percent of the votes cast. Major constitutional changes slated to reduce the power of the President are under way but none have been formalized or completed, and their legal status is in limbo. The approaching parliamentary elections preclude the adoption and implementation of difficult or complex reforms, so that all social reforms have been postponed.

Also from the beginning, the new government donned the mantle of populism, which it thought was a key to popularity. Its prime focus was on re-privatization, with vengeful pursuit of the oligarchs. A second characteristic was its emphasis on generous social expenditures and public wages, which required increases in tax revenues. The third effort was to meet the threat of rising prices by introducing price controls. These largely populist objectives took so much of the government's time and effort that liberal policies such as accession to the WTO, integration with the European Union, and deregulation were put on the back burner, while adoption of financial legislation appears to have been largely abandoned.

THE ORGANIZATIONAL CHANGE

The new government is well under way in its efforts to reform the state. Alas, extraordinary administrative chaos has erupted, with no less than 18,000 officials appointed within four months.[18] Meanwhile, substantial organizational changes have occurred, as evidenced by the large number of state agencies that were merged or altogether abolished. The average number of deputy ministers has been reduced from about 10 in each ministry to about three. As most deputy ministers formed the brain trust of the government, their exclusion or demotion weakened the government's intellectual base.

As Prime Minister in 2000, Yushchenko instituted four cabinet-level committees, each headed by one of the four Deputy Prime Ministers and designed to prepare all decisions to be made by the Cabinet of Ministers. He thus succeeded in reducing the average time of the previously long-winded, unfocused sessions of the Cabinet, concentrating the discussions on policy matters. But one of Prime Minister Tymoshenko's first acts was to abolish these committees, depriving the Deputy Ministers of most of their executive functions and staff, and concentrating additional power in her hands.[19]

The Presidential Administration was renamed and gradually reconstituted as the Secretariat of the President, headed by one of the revolutionary leaders, Oleksandr Zinchenko. Unlike the government, the Secretariat underwent a beneficial overhaul, recruiting educated

[18]Yushchenko quoted in *Ukrainskaya pravda* of May 13, 2005.

[19]Meetings of the Cabinet of Ministers reduced by Yushchenko to an average of two hours' duration, subsequently were convened two days each week, lasting at times up to eight hours.

outsiders, mostly from the academic community. While the formation of the Secretariat has taken time, it does appear to be quite competent and oriented toward reform.

In Ukraine, all regional governors are appointed, and rather easily replaced. In several instances, new governors appointed by Yushchenko were ousted almost immediately after their crimes were discovered and revealed in the media. The fate of the country's deposed governors underscores the difficulty in finding qualified and reasonably honest public servants in this pervasively corrupt post-communist state.

The work of the government was complicated by the breadth of the coalition that carried out the Orange Revolution. Prime Minister Tymoshenko formed an informal inner economic cabinet, comprising the Minister of Finance Viktor Pynzenyk and the Minister of Economy Serhyi Teriokhin, both seasoned liberals and loyalists of Yushchenko. The second most important group in the Cabinet was dominated by socialists, who secured four portfolios, including the State Property Fund (Valentyna Semeniuk), Ministry of Agricultural Policy (Aleksandr Baranivskiy), and the Ministry of Interior. A third group consisted of big businessmen allied with Yushchenko, including Petro Poroshenko, who became Secretary of the National Security and Defense Council; Yevhen Chervonenko (Ukraine's biggest trucker), who was appointed Minister of Communications and Transportation; and David Zhvanya, who was named Ukraine's Minister of Emergency Situations. A fourth group consisted of genuine Yushchenko loyalists, who focused mainly on foreign affairs. Its representatives were Deputy Prime Minister for European Integration Oleh Rybachuk, Minister for Foreign Affairs Borys Tarasiuk, and Minister of Justice Roman Zvarych. Finally, a sprinkling of industrialists, notably First Deputy Prime Minister Anatoly Kinakh, also was present in the corridors of state power.

While the government was excessively diverse and disorganized, the parliament was even worse. Until the fall of 2004, it supported Viktor Yanukovych. Now the Ukrainian parliament consists of about 13 loosely integrated party factions, trading a few parliamentarians almost every week. Reportedly, about two-thirds of the 450 deputies are dollar millionaires. Most parliamentarians are businessmen who transact and pursue their business objectives in the halls of the parliament. Such an amorphous institution riddled with conflicts of interest cannot be expected to seriously address reforms, so that politically sensitive legislation appears to be out of the question until the elections in March 2006.

THE DOMINANT RE-PRIVATIZATION

Re-privatization emerged as the dominant theme of the new government.[20] For months top Ukrainian officials have publicly discussed and enumerated the many flawed privatization deals that should be reversed. The emergence of this complex and contentious process was by no means a foregone conclusion. In his election program, Yushchenko (2004) only addressed re-privatization in passing: "I am against new redistribution of property, but the oligarchs are going to pay the real price for enterprises, which they are seizing for a trifle. . . ." The sentence appears to suggest that bygones be bygones, but that in the future the oligarchs would be forced to pay realistic prices for privatized properties.

The same approach even is evident in the election program of the socialist candidate, Oleksandr Moroz (2004). Yushchenko and Moroz, and Kinakh as well, all directed their

[20]Basically, re-privatization denotes the process of re-nationalization of previously privatized enterprises and their subsequent sale to new owners.

presidential election campaigns against the highly unpopular oligarchic clans. Demands for re-privatization were clearly voiced during the campaign, and Yushchenko himself named Kryvorizhstal, Ukraine's largest steel mill, as a possible target.[21] Kryvorizhstal had been brazenly privatized in June 2004 in a restricted auction won by a consortium controlled by Rinat Akhmetov and Viktor Pinchuk for the sum of $800 million. A much higher competing bid of $1.5 billion was disqualified on a formality, and some experts argued that the steel mill could have been sold for $2.5–3.0 billion (Varfolomeyev, 2005). The case became a symbol, to Ukraine, not unlike the loans-for-shares privatizations in 1995 became for Russia.

The Problems

The Government Action Program (Programma, 2005) includes an amorphous section on privatization, which ends with a sentence, "the Government shall ensure the revision of . . . privatization contests for certain properties where buyers fail to meet their undertakings . . . or where privatization procedures are not adhered to, particularly concerning the participation of other potential buyers. . . ." This somewhat intimidating phrase was balanced by a section on the safety of property rights, which reasoned: "the Government will undertake measures directed at the strict adherence to the provisions of the Constitution that guarantee state protection of rights of all owners, as well as equality of all subjects before the law." But in practice, the entire government action program became a dead letter.

Soon after Yushchenko's new government acceeded to power, all prominent members of the regime began to voice their indignation about illicit appropriation of valuable state assets and seek redress in the form of vigorous re-privatization. The time appeared to be ripe for revenge and repudiation of former guarantees given to stalwarts of the old regime. On February 10, Yushchenko proclaimed: "We will revoke every privatization case that was conducted in breach of law. Nothing will stop me." He added that the government would also re-privatize companies whose owners failed to meet their investment obligations (*The Dragon Daily* [Dragon Capital], February 11, 2005, p. 2). In fact, re-privatization was to dominate the government discourse for months. A large number of ministers have advocated re-privatization, but everybody seems to have had a different idea about which properties to re-privatize and how to accomplish the objective.

The first problematic issue was the selection of properties to re-privatize. Will there be a list of designated enterprises, or alternatively, a regulation based on more general criteria?[22] The government appears to have been divided into two major camps. President Yushchenko and First Deputy Prime Minister Anatoly Kinakh wanted a list with a limited number of enterprises, initially a few dozens but steadily shrinking to perhaps less than 10. The other camp, embracing Prime Minister Tymoshenko and the socialists (notably Semeniuk) was opposed to the limitation imposed by a predetermined list, preferring certain criteria such as sale of an enterprise below its market value or due to improper procedures. The latter approach could precipitate a fundamental revision of the entire process of Ukrainian privatization. Early on, Tymoshenko talked about investigating 3,000 instances of privatization occurring during the course of the last five years. Other slightly less aggressive proposals from her camp limited the revision to enterprises that had been sold in recent years without competitive bidding, or whose new owners failed to meet their pledges to invest (nearly 200

[21]Yushchenko also mentioned, albeit vaguely, some other objects of potential re-privatization.

[22]Re-privatization was the dominant theme of the media during the first half of 2005. Highly informative articles, providing the basis for this account, include Yatsenko (2005b, 2005d, and 2005e) and Kuzio (2005b).

according to Semeniuk as reported in *RFE/RL Newsline* of May 31, 2005). Recent direct sales of big production enterprises, mainly metallurgical companies and iron ore and coal mines, attracted more attention from both camps than other potential industrial objects.

The second problematic issue revolves around questions of how to re-privatize: by adopting a special law or by reliance on court proceedings? The Yushchenko-Kinakh camp preferred a law that would limit re-privatization procedures to specific enterprises. The Tymoshenko-Semeniuk camp, supported by law enforcement insiders, wanted to maximize re-privatization by prosecuting the criminals and taking all to court. Meanwhile, the law enforcement authorities proceeded to implement the more punitive policy without waiting for the outcome of the debate. The Prosecutor General declared in early March 2005 that he had initiated criminal proceedings against as many as 2,000 individuals for violating the law during the course of privatization (Genprokuratura, 2005).

The third problem is created by the inconclusive ideas about how to carry out the actual process of re-privatization. The two alternatives were expropriation of property followed by a new sale or an effort to collect from the current owner a premium in return for the state's commitment to leave the ownership intact. Tymoshenko and Semeniuk advocated that the state seize the properties and then proceed to resell them, arguing that some privatized enterprises should be re-nationalized. Semeniuk did not hesitate to ask publicly: "What is so bad about re-nationalization?," opining further that ". . . the revision of the results of privatization should be permanent" (Semeniuk, 2005). Yushchenko and Kinakh appeared to favor a process involving an offer to current owners to pay the government for the right to keep their enterprise. The question whether current owners would receive preferential discounts remained open.

A fourth query was how to arrive at a reasonable valuation. The standard proposal was to hold a new open auction and grant the current owner the right of first refusal. Alas, if such proposals were to materialize, many parties would have reasons to rig auctions by manipulating bid prices in either direction. Instead, the presidential economic advisor Oleksandr Paskhaver suggested that international investment banks should be recruited to appraise the values, because domestic assessors would be suspected of corruption (Yatsenko, 2005e).

The Consequences

The economic, moral, legal, and political repercussions of the re-privatization program would appear to be nearly disastrous, and most if not all qualified observers agree that this was the worst course of action the new government could undertake (Yatsenko, 2005e). Because the guarantee and protection of individual property rights is the hallmark of mature capitalism, to which Ukraine ostensibly aspires, the re-privatization drive began to resemble a form of economic anarchy (Yurchishin, 2005).

The economic effects of the re-privatization debate were immediate. Investment and construction plummeted, dragging down the country's economic growth. By April 2005, GDP growth had fallen to 3.9 percent relative to April 2004, compared with a staggering expansion of 12.1 percent for 2004 as a whole. Investment, which had increased by 28 percent in 2004, also followed the trend, by falling (ICPS, 2005). The reasons were readily apparent. First, no businessman would feel safe about investing in an old company, given the rapidly changing debate on re-privatization. Second, re-privatization could place a large number of attractive properties on the market, so that entrepreneurs would accumulate cash to keep it ready for unexpected opportunities. Most businessmen thus reverted to the "wait and see but do not invest" behavior prevailing during the early days of privatization when the economy was in a free fall.

Nor could the Ukrainian legal system handle re-privatization in a satisfactory manner. Ukrainian privatization legislation had been incredibly inconsistent, so that hardly any privatization could be unassailably legal. The administration and the courts were pervasively corrupt. But even if Ukrainian courts had been relied upon to function properly, they would quite likely be swamped by privatization cases.[23] Thus, recourse to courts needs to be minimized, and re-privatization, if any, primarily resolved through legislation. That said, however, it is doubtful that Ukraine's parliament will ever be in a position to adopt a sensible law on re-privatization,[24] given its domination by big businessmen.

The moral implications of re-privatization are at best dubious. The most successful businessmen would be punished and success in operating and developing former state enterprises would be penalized. On the other hand, people who literally stole properties or wasted their spoils would hardly suffer. Only very recent privatizations can be effectively reversed, because many properties have changed hands and were not properly recorded. Since many Ukrainian enterprises are owned by anonymous offshore companies, both the ownership and changes of title are very difficult to trace and establish. Re-privatization is forcing oligarchs to seek new protection, and thus engage more, rather than less, in politics. Poised to resist efforts to reduce their newly accumulated wealth, they are prompted to spend larger sums of money to win battles against the weak state. Business groups competing with the Kuchma oligarchs fiercely advocate re-privatization, hoping to recover their properties. Thus in Donets'k, the large Industrial Union of Donbas is interested in acquiring the metallurgical companies belonging to Rinat Akhmetov's System Capital Management, while in Dnipropetrovs'k, Privat Group wants to seize the properties of Viktor Pinchuk's Interpipe. Why should the state support such endeavors? Although directed against the highly unpopular Ukrainian oligarchs, it would likely repel reputable Westerners reluctant to cope with unrelenting corruption or seek redress in a legal quagmire. As a result, Russian oligarchs could, quite likely, replace the oligarchs of Ukraine.

If re-privatization were to take place, the government would face the choice of a slow process that would depress the economy for years, or of a rapid one that would be marred by legal battles. If a large number of enterprise auctions were to be organized in haste, prices would again likely be unreasonably low, so that the new privatization sales would become more controversial than the initial ones. Furthermore, case-by-case privatizations are rarely successful in weak postcommunist states, inasmuch as highly corrupt state administrations are not likely to become less corrupt when new opportunities to profit come their way. Most foreigners would hesitate to bid for confiscated enterprises belonging to ousted oligarchs, and a large number of enterprises would swamp the market at about the same time, while the amount of available cash to buy would be limited. After re-privatization, investment would remain low because many new domestic owners would have little cash to spare.[25] The forced change of ownership would most likely precipitate a massive economic shock. Even the most limited re-privatization that is currently discussed would involve 10 to 15 percent of GDP. Most enterprises that may be re-privatized are by now managed by able entrepreneurs, and

[23]For example, during the early days of privatization elsewhere, the unlimited legal pursuit of property rights through unreliable courts left millions of East German properties unused for years.

[24]Elsewhere, the Polish parliament has failed to do so, leaving large tracts of land, notably in the center of Warsaw, in legal limbo and thus without opportunity to attract investment.

[25]Foreign and perhaps even domestic banks would be reluctant to lend for investments in confiscated property.

new inexperienced owners are likely to inflict considerable economic damage. Hostile takeovers usually tend to be painful, costly, and exhausting, as the former owners sue to get their property back (see Paskhaver in Yatsenko, 2005e). The owners of Kryvorizhstal have already taken their case to the European Court of Justice, where proceedings are expected to last for a long time.

Meanwhile, the government is trying to recover many of its former enterprises through the country's courts. Some regional authorities have taken the law into their own hands and repossessed enterprises by force.[26] Various parcels of land that had been privatized illicitly have been re-nationalized. Also media reported how businessmen had forcibly taken over disputed enterprises. A fair measure of anarchy appears to be emerging in the process.

Public opinion, however, is becoming increasingly enchanted with the idea of re-privatization. In May 2005, no less than 71.3 percent of the population supported revision of the results of large state enterprise privatization, whereas only 10.9 percent considered it necessary to leave everything intact and declare amnesty for users of shadow capital (*Ukrainskaya pravda*, May 14, 2005). In the world at large, populism has long focused on macroeconomics,[27] but in Ukraine it is concentrating on property rights, posing a dangerous and long-lasting threat to the economy.

The official emphasis on re-privatization has had many other consequences. Effectively, Prime Minister Tymoshenko embraces state capitalism, stating, for example: "The biggest enterprises, which can easily be efficiently managed, must not be privatized, and they can give the state as their owner wonderful profits" (see Yatsenko, 2005c). She also favors partial state ownership of privatized enterprises. Rather than striving to reform state monopolies, Prime Minister Tymoshenko calls for their continuity and reinforcement, apparently viewing her job as manager of a holding company embracing large state enterprises. Meanwhile, President Yushchenko appears to be having second thoughts. In May 2005, he declared (not quite correctly), "From the first day I said that neither I nor my team has the goal of nationalization or re-privatization of any object of property" (Yushchenko, 2005b).

As a logical consequence of the re-privatization campaign, Ukraine has frozen its privatization program, although the state production sector remains substantial. Chairwoman of the State Property Fund Semeniuk clarified the state's holdings as follows: "I would like to say that the red line of economic security has been reached. The state retains only 22 percent of production companies. … So there is nothing left to sell" (ICTV, 2005).

Linked most strongly to the campaign for re-privatization is the drive against corruption, directed primarily against the oligarchs but not, as it also should be, against the state.[28] Deregulation, a potentially significant part of the debate, is in a state of benign neglect. However, the President seems to focus on the possible benefits, not unlike in the year 2000 when he was Prime Minister. Yushchenko wants to adopt a legal enactment to abolish 1,300 superfluous regulations. In 2000, he proceeded immediately, but by mid-June 2005 no such act had been passed and become state law. Yushchenko also wants to simplify procedures by introducing a single bureaucratic stop for both the establishment of a new firm and acquisition of property (Yushchenko, 2005a, 2005c, 2005d).

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[26]For example, the new governor of Sumy Oblast declared that he had transferred four or five dairies and other enterprises that his predecessor had privatized to fill his own pockets to new owners (U Shcherbana, 2005).

[27]E.g., see Dornbusch and Edwards (1991).

[28]The added contradiction here are findings that privatization tends to put a limit on corruption (see Kaufman and Siegelbaum, 1996).

On June 16, President Yushchenko attempted to put an end to the re-privatization debate, by compelling the Prime Minister and Parliament Speaker Volodymyr Lytvyn to sign a memorandum that guaranteed property rights. It asserted that changes in property rights could only occur if a court were to decide that laws had been violated during the course of privatization. The aforementioned proposals to compile a list of specific enterprises slated for privatization had been abandoned. Not unexpectedly, the socialists and communists took exception to this memorandum (Timoshenko, 2005). Although not quite obvious from the text, Yushchenko declared that the memorandum intended to state that re-privatization in Ukraine will not occur. At the same time, he promised that privatization would be reactivated (Yushchenko, 2005d). Possibly, the destructive re-privatization debate has ended without implementation of any actual measures, but the government has been diverted from the reforms it ought to have undertaken.

THE POPULIST FISCAL POLICY

Another great worry for Ukraine is the fiscal policy.[29] The departing government left behind a poison pill, when on September 1, 2004, Prime Minister Yanukovych doubled pensions, causing pension costs to rise from the internationally high level of 9 percent of GDP in 2004 to a staggering 16 percent in 2005—that is, the highest in the world.[30] Every aspect of that entitlement is flawed in the Ukrainian pension system. Half a million former government officials enjoy extraordinarily high pensions ranging up to $2,900 a month, whereas the average monthly wage in Ukraine was $111 in 2004. Ukraine has by far too many pensioners because the extremely low Soviet retirement age continues to be in force. Thus, for example, healthy 55-year-old women are entitled to receive full pensions, while continuing to work. The cost is exorbitant, but in an election year no Ukrainian politician is prepared to confront this fiscal abnormality. Admittedly, the new government has managed to reduce the total pension cost to 14.5 percent of GDP, but that level still remains the highest in the world.

The new government has also added substantial public expenditures, boosting pensions to the minimum subsistence level of $66 a month, and the monthly minimum wage to the same amount after August 2005. Furthermore, the government raised public wages by a staggering 57 percent, adding a variety of social benefits such as a lump-sum grant for the birth of each child. Altogether, the International Monetary Fund assesses that Ukraine's total public expenditures will increase by approximately 5 percent of GDP and reach about 44 percent of GDP, which approximates the level of a West European country. In order to accommodate the sizable expansion of social transfers and public wages, all other public expenditures, including health care, education and public investment, have been reduced.

A balanced budget, one of Yushchenko's electoral promises, found a dedicated advocate in Minister of Finance Pynzenyk, a fiscal conservative, who has tried to accomplish this objective. As a consequence, no tax or social reform can materialize this year. In early April, President Yushchenko spoke of the need to reduce payroll taxes from 37.5 to 20 percent and to combine them into a single social tax (Yushchenko, 2005e), but his speech on the subject appeared to reflect a certain detachment from current economic policy. The abolition of a range of tax exemptions increased the overall tax pressure significantly, although Yushchenko had promised to reduce taxes. All free economic zones, which were widely seen

[29]In addition to recent interviews in Kyiv, this section draws on material in Yatsenko (2005a), IER (2005) and IMF (2004).

[30]Western countries usually have public pension expenditures in the range of 6–10 percent of GDP.

as schemes for tax evasion, were closed down immediately, and all reductions in the profit tax for certain industries (such as automotive) were eliminated. One of the new government's first measures was a campaign against smuggling, which required the closing of customs and borders for about two weeks, but paid off in the form of increased revenue from customs tariffs. While these measures raised the tax pressure, they also leveled the playing field.

Of particular concern is the treatment of small entrepreneurs. A major cause of Ukraine's economic revival has been the introduction in 1998 of simplified tax schemes for small entrepreneurs, applicable to about 6 million people (Thiesen, 2001). They could pay either a fixed lump-sum tax or a share of their business turnover. At the end of March 2005, the government changed the scope of that tax arrangement, by enacting a punitive law on the revision of the budget for 2005. The law forced most small entrepreneurs to pay value-added taxes, and then also to keep accounts of income that had to be taxed. Moreover, the change in tax regulation was made retroactive to January 2005. Many had little choice but to go underground or close down their shops. Although Ministers of Finance Pynzenyk and of Economy Teriokhin insisted on the measure (seemingly for technocratic reasons) public outrage erupted with full force. First Deputy Prime Minister Kinakh together with various organizations representing small entrepreneurs led the protests. Due to the mounting opposition, the parliament reintroduced the simplified tax schemes for most of the deprived categories in June, and apparently succeeded in eliminating a potentially harmful policy change (Ukrainian, 2005).

In his pre-election program, Yushchenko demanded the abolition of the tax police, but the new regime insisted on more rigorous tax enforcement. Prime Minister Tymoshenko even declared that she would judge regional governors by the amount of their tax collection (Yatsenko, 2005c). One might thus interpret these acts to mean that the state was allowed to suppress Yushchenko's intent to vest its control in the hands of the citizenry.

The many radical changes render all forecasts for the state budget at best uncertain. Total state revenues are set to rise as a share of GDP, which the IMF forecasts at the level of 40 percent, leaving Ukraine with a significant but tolerable budget deficit of 4 percent of GDP in 2005. The Ukrainian government predicts, perhaps optimistically, a budget without deficit, and has produced a substantial cash surplus during the first four months of 2005. Even so, the combination of loose fiscal and monetary policy has increased inflation from 8.2 percent in 2003 to 15 percent by April 2005. The macroeconomic stability that looked so solid and prominent in early 2004 no longer inspires much confidence.

The country's fiscal policies are in a state of flux, and the new tax burden can hardly be maintained, because it is too high for a poor country such as Ukraine. Since no taxes have been reduced, hardly anyone appears to have benefitted when the many tax exemptions were abolished, and no one except the Ministry of Finance defends the changes. Most senior politicians, including the President, now scramble to propose tax exemptions for selected industries. The question is whether such exemptions will be reintroduced or whether significant reduction of overall tax levies will somehow materialize.

THE SOCIALIST ENERGY AND PRICE POLICY

The most strange, and socialist, policy of the new government has been applied to energy and energy prices. During April and May 2005, the Ukrainian government's public confrontation with Russian companies that supply the country's oil became even more acrimonious than its battle over re-privatization. In February, the Ukrainian government forced Russian companies to commit themselves to deliver oil for agricultural needs at lower than market prices during the sowing season. During the first half of 2005, the world market price of crude surged, and the oil companies demanded higher prices. At the end of March, the socialist Minister of Agricultural Policy, Aleksandr Baranivskiy, accused the oil refineries in Ukraine of collusion and price rigging, which the oil companies vehemently denied (Yeremenko, 2005).

As the public polemic rose to a crescendo, Prime Minister Tymoshenko took the lead by publicly scolding the Russian oil companies and accusing them (without evidence) of price rigging and formation of a monopolistic cartel. Ukrainian gasoline prices at the retail level were almost as low as in Moscow despite the fact that energy taxes in Ukraine were higher than in Russia. On April 14, the Ministry of Economy issued an order to set ceilings on both wholesale and retail prices of gasoline at about 10 percent below the market-clearing level. Exports of oil were also prohibited (Yeremenko, 2005).

Meanwhile, Tymoshenko developed an argument to justify extensive state manipulation of prices, proceeding to order the remaining Ukrainian state companies to supply gasoline at prices below the level of the market. Although less than half of the capacity of Ukraine's six refineries was utilized, Tymoshenko advocated the building of a new state-owned refinery. She also wanted the state oil company to borrow money to build 1,000 new gasoline stations and insisted on the need for large vertically integrated state companies in strategic industries. Seemingly unaware that the Soviet Union had failed to attain this socialist dream, her argument ran as follows: "the state will become a real owner, and the state as owner will work for the people. Then, our prices of petroleum products will never vacillate because we shall always have a stabilizer" (Yatsenko, 2005c).

Not surprisingly, two oil refineries that belonged to different private Russian oil companies closed for maintenance, prompting a decline in Russian oil deliveries to Ukraine. First, gasoline was sold at illicit surcharges, but soon massive shortages emerged and black market trade began to develop. The Ukrainian government created a serious oil supply crisis without reason or justification.

Finally, on May 19, President Yushchenko decided to put an end to the chaos. In front of the managers of oil companies operating in Ukraine, he apologized for the Ukrainian government's obstruction of their work (Mostovaya, 2005), promising to ". . . guarantee that the government will exclusively use market methods . . . on the marketing of meat, petroleum products and crude oil" (Yushchenko, 2005f).

Prime Minister Tymoshenko had adopted the same price control policy on meat. Meat prices rose sharply in early 2005, because the campaign against smuggling restricted imports, and the existing import tariff that had previously been ignored was prohibitively high (Giucci and Bilan, 2005). In early April, Tymoshenko declared at a televised cabinet meeting that "meat prices will be under my personal control," and after a meeting with major meat producers succeeded in forcing them to freeze prices on chicken. She stepped up her public campaign of blame, focusing on middlemen and promising to "do what it takes to combat the speculators." Tymoshenko insisted that the government had to influence the market by interventions, but the government offered prices that were too low to procure meat from producers. She then ordered the opening of market outlets for direct sale of meat by producers to consumers,[31] and next scolded the regional governors for failing to halt the rise of meat prices, ordering them to draw up plans to raise production (Prime Minister, 2005).

[31]Tymoshenko actually adopted the original concept of the Soviet *kolkhoz* market.

Tymoshenko seemed unaware that she was pursuing the failed Soviet meat policy, and no one but the Prime Minister appeared to indulge in this absurd economic intervention.

After the President upbraided Tymoshenko on May 19, the meat and gasoline markets were liberalized, and the entire policy of instituting price controls seemed to have disappeared. The government had wasted nearly two months on fruitless fights with seemingly decent businessmen.

A LIBERAL POLICY OF INTERNATIONAL INTEGRATION

The new government also has moved with great vigor in the arena of international integration, focusing on its two key goals, namely accession to the World Trade Organization in 2005 and accelerated integration with the European Union. Three top officials—President Yushchenko himself, Deputy Prime Minister Oleh Rybachuk, and Minister for Foreign Affairs Borys Tarasiuk—have enthusiastically engaged in these pursuits, producing very positive international responses. In particular, the attitudes of the European Union have improved beyond expectations, with Ukraine and the EU signing a substantive action plan, appearing entirely liberal in scope and design.

Alas, the required implementation did not follow. On May 20, President Yushchenko finally put his foot down, complaining about the government's inertia about joining the WTO, so that it had to rush to adopt a score of draft laws to be presented to the parliament. The United States is the critical stumbling block for Ukraine's accession to the WTO, with its key demand that the country adopt a law on protection of intellectual property rights. Ukraine's parliament finally came around to consider appropriate legislation on May 31, but in spite of two attempts the government failed to obtain a majority vote to support the law. Several members, even some belonging to Yushchenko's Our Ukraine faction, voted against it, even though there were no visible reasons to cater to the relatively uninfluential business groups engaged in piracy. By mid-June, numerous other draft laws needed for Ukraine's accession to the WTO either failed to reach the parliament or were altogether rejected by it. Hence, Ukraine is rather unlikely to be in a position to join the WTO in 2005. The government's failure to enact and see through the approval of key laws by a parliament that purportedly supports it is difficult for the outside world to comprehend. Nor has Ukraine succeeded in securing from the European Union or the United States the coveted status of a market economy.

EXPLAINING THE UKRAINIAN PARADOX

Many other developments have occurred in Ukraine's economic policy. Some import tariffs have been reduced, and currency regulations that severely impeded foreign investment have both come and gone. However, during the first half of the year that followed the Orange Revolution, the dominant economic policy issues have been re-privatization, fiscal populism, and regulation of prices. A seemingly splendid opportunity for a breakthrough in market reform has been missed, and the government is currently attempting to repair its own mistakes.

What appeared to be a liberal revolution suddenly turned into socialist populism. In particular, the Orange Revolution appears to have fueled passions for re-privatization. The contrast between the declarations of the Orange Revolution and the government's current policy could hardly be greater. As early as April 2005, the perceptive economic journalist Nataliya Yatsenko (2005b) summed up the trend as follows: "a planned backtracking from the principles of a liberal economy in the direction of a state-dominated economy is occurring in the country. A socialist at the head of the State Property Fund would have been just impossible a year or two ago . . . but now it appears a natural part of the new team in power." The above transformation appears to apply especially to Prime Minister Yulia Tymoshenko. How could this happen? Several explanations are possible, and presumably each has a measure of validity.

A fundamental explanation is that we have indeed witnessed a revolution, and revolutions have rules. One rule is radicalization. Revolutionaries are convinced that they are right, and are not prone to seek advice, so that radicalization typically proceeds further than the population is prepared to tolerate. Tymoshenko appears a natural Jacobine, emotionally riding the crest of the revolution, and she was in large company. Another characteristic of revolutions is redistribution of property (e.g., Mau and Starodubrovskaya, 2001). Much in the same way as the French Revolution, also initially a liberal revolution, the Orange Revolution was captured by radicals who focused on oligarchs rather than on the corrupt state. Since no pact was concluded with the old Kuchma regime, and the country's constitution was in the midst of reform, few institutional barriers could impede radicalization.

Radicalization also had concrete causes. The government concentrated on the forthcoming parliamentary elections in March 2006, which motivated its leaders to be become (or sound like) populists, assuming that populism will strike a chord with the electorate. Another explanation is that the government has to fulfill its election promises to the electorate, but that supposition appears to make less sense. Yushchenko's (2004) program did not hang together, as pre-election programs rarely do. The government had to choose which promise to fulfill—tax cuts or a rise in social expenditures—and it chose the latter. A third official explanation holds that the winning coalition in the Orange Revolution was very broad, including the Socialist Party, but why should a small and ideologically extreme party be allowed to dominate government policy?

The enthusiasm for re-privatization became increasingly stronger because it appealed to so many different interests. After the attempt to poison Yushchenko and all the dirty campaign tricks, a mood of revenge prevailed in the country. A logical conclusion might have been that the material base of the oligarchs should be eliminated, not unlike the broad international consensus after World War II that the feudal estates of Prussia must be nationalized. The socialists oppose the privatization of large private enterprises in general and clearly favor their nationalization. Boldly, the big businessmen, except for the few Kuchma-connected oligarchs, favored re-privatization, partly for the sake of revenge, and partly to partake of the potential benefits that could accrue to their commercial interests.

Not everyone in Ukraine was susceptible to radicalization. In an editorial on Yushchenko's first 100 days, the *Kyiv Post* pointed out that "while Yushchenko is making grand statements abroad, the rest of the government does not seem to follow his lead" (Sunden, 2005). Admittedly, Yushchenko himself had been carried away by revolutionary fervor in January and February, but by May he had sobered up, and a stark policy division between the President and the Prime Minister became apparent.

Finally, a vital explanation is to be found in Prime Minister Tymoshenko herself. Arguably, she was the most popular hero of the Orange Revolution, although her party received only seven percent of the votes cast in the parliamentary elections in March 2002. Tymoshenko benefitted from an enormous reservoir of good will, and as prime minister managed to concentrate considerable power in her hands. Ukraine had few checks and balances, and in the early post-revolutionary environment all institutions were up for grabs. Thus, she could take the country in any direction she pleased, and she proceeded to do so.

Tymoshenko's policies can be explained either by focusing on her intent or her limitations. Paradoxically, the new government policies were in many ways reminiscent of those pursued by Viktor Yanukovych. During his two years as prime minister, he toyed with price controls for gasoline and agricultural goods, promoted multiple state interventions, and doubled pensions. Although it puzzles observers why a new government would pursue the populist policies of its defeated opponent, Tymoshenko's populism might have been designed to capture some support from Yanukovych's electorate and from remaining segments of the electorate influenced by the oligarchs. Several businessmen in the parliament have recently joined the Tymoshenko faction, whereas others will most likely join the opposing side in an attempt to block her. Tymoshenko's policies can also be explained by her continued focus on the ideological spoils of the recent victory. Most notably, her price control policies and ambitious quest for strong state monopolies reflect the thinking of old-line communist directors.

Paradoxically, neither the main features nor the preferences of Yushchenko's electorate are reflected in the policies of the country's new government. While his electorate is mostly liberal and rural, Yushchenko agreed to prohibit trade in agricultural land until 2007 in order to win the support of the socialist leader Oleksandr Moroz. Another part of his electorate comprises small entrepreneurs, whose interests were not only neglected but who were hit hardest by the tax changes. One possible explanation is that Yushchenko's program fell on deaf ears because liberal ideology is inherently weak in Ukraine. After suffering for a decade under corrupt misuse of state power and very high taxes, the Ukrainians might have been expected to acquiesce, at the least, to an anti-state ideology, but for the time being popular sentiment seems to be focused on combating the rich.

The initial economic policy after the Orange Revolution is undergoing a far-reaching revision, and this trend is likely to continue, because the policy did not work. The reprivatization drive has already brought investment and construction to a painful halt. The exceedingly high tax burden harms business and investment, while rising costs neither stimulate enterprise nor calm the surging inflation. Despite high expectations, an economic policy that ignores the interests of business will not attract much foreign investment. The reinforced state sector is likely to function about as badly as in the past, and the new emphasis on state power will hardly reduce the high level of corruption. Lastly, the extraordinary boom in the steel industry appears to have faded, and Ukraine is not benefitting from access to any new markets. One may reasonably expect economic growth and welfare to fall steeply, enough to precipitate a sharp political reaction. The question is whether Ukraine's minds and institutions are strong enough to steer the country's newly born market economy away from chaos.

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