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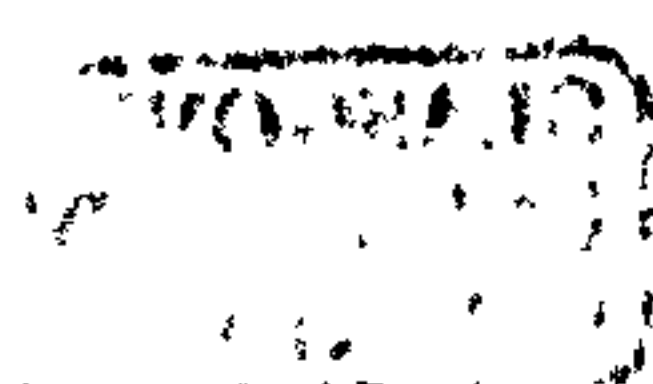
**Power to the Pragmatists: The Role of the Economic Elite in
Relations Between Russia and Ukraine.
1994-1998**

Thesis submitted in accordance with the requirements for the degree of Ph.D.

The University of Glasgow
Department of Russian and Eastern European Studies

December 2001

The candidate confirms that the work submitted is her own and that appropriate credit has
been given where reference has been made to the work of others



Abstract

This work discusses the role of the economic elites of Russia and Ukraine in the development of relations between the two countries in the period between 1994-1998. A “Pragmatist approach” to bilateral relations, that emerged in Kyiv and in Moscow in the mid-1990s, and the doctrine of CIS integration are identified as the ideological underpinnings for the participation of the economic elites in the process of foreign policy-making.

According to these approaches, economic elites in Russia and Ukraine share similar economic interests derived from the necessity to restore a post-Soviet common economic space. Convergent interests of the economic elites are assumed to be powerful incentives to increase bilateral co-operation and eventually foster economic and political reintegration between the two countries.

In an analysis based on the study of domestic sources of foreign policy, the author contests these approaches. This work argues that, contrary to expectations, the consolidation of nation-based economic elites led to the emergence of conflicting rather than convergent interests. The redistribution of national wealth, following the demise of the Soviet structure of state-ownership, sparked a struggle between domestic and economic elites for the control of economic resources. The penetration of external economic actors was viewed, in this perspective, as a factor that might upset the delicate balance of power between domestic institutions and economic agents. A nationalist vocabulary, resulting from a century-long struggle for independence, was used in Ukraine to express a protectionist mood against Russian competitors.

This research contributes to the debate on co-operation between states and the role that domestic factors play in encouraging or hindering such a process. In particular, this study supports the argument that recently established independent states are less prone to join co-operation schemes, especially when a process of redistribution of national resources follows

the demise of the previous regime. The economic elites may be identified in this process as active participants or even promoters of nationalist movements.

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LIST OF ABBREVIATIONS

AUB	Association of Ukrainian Banks
CBR	Central Bank of Russia
CIS	Commonwealth of Independent States
CMEA	Council of Mutual Economic Assistance
CPRF	Communist Party of the Russian Federation
CPSU	Communist Party of the Soviet Union
CPU	Communist Party of Ukraine
ECSC	European Coal and Steel Community
EU	European Union
FDI	Foreign Direct Investment
FIG	Financial-Industrial Group
FSU	Former Soviet Union
Gosbank	State Bank
Gosplan	State Planning Committee
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
LDPR	Liberal Democratic Party of Russia
MFA	Ministry of Foreign Affairs
NATO	North Atlantic Treaty Organisation
NDP	Party of Popular Democracy
OHR	Our Home is Russia
OSCE	Organisation of Security and Co-operation in Europe
OUN	Organisation of Ukrainian Nationalists
RSFSR	Russian Soviet Federative Socialist Republic
SDP	Social Democratic Party
SSR	Soviet Socialist Republic
START	Strategic Arms Reduction Treaty
TACIS	Technical Assistance for the CIS

TFIG	Transnational Financial-Industrial Group
UES	United Energy Systems
UGRC	Ukrainian Gas Resource Consortium
UN	United Nations
US	United States
USSR	Union of Soviet Socialist Republics

Note on Transliteration

In this work I have used a modified version of the Library of Congress transliteration scheme. The sounds ia and iu of the Library of Congress scheme have been transliterated as ya and yu. As I accessed Ukrainian material through Russian-language sources, I have chosen to use the Russian version of names, except when the Ukrainian version has become more commonly accepted, as for Kyiv (instead than Kiev), Kharkiv (instead than Kharkov), or Serhei Tihipko (rather than Sergei Tigipko). For titles of the Ukrainian language sources the Ukrainian Library of Congress transliteration scheme has been employed.

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The thesis is dedicated to my mother for her perseverance and to my father for his dedication.

INTRODUCTION

When Leonid Kuchma became President of Ukraine in July 1994, expectations for a radical change in bilateral relations between Russia and Ukraine rose markedly. In striking contrast to the Kravchuk presidency, which had conducted the process of nation-building on the basis of an aggressive rhetoric of anti-Russian sentiments, the Russian establishment saw in Kuchma a leader who would promote the reconciliation, if not the reunification, of the two brotherly countries.

The promised change in foreign policy strategy was strictly related to the different background that Kravchuk and Kuchma enjoyed, and the different constituencies and sets of interests that they represented. Leonid Kravchuk had presided over a coalition of *nomenklatura* and nationalist forces, whose differing positions towards economic and political reforms, coupled with a primary concern to preserve the Soviet-era networks of power within an independent Ukraine, led to stagnation. The political inactivity of the Kravchuk administration and the reluctance of its political allies to initiate any transformation of the centralised economic structure were finally responsible for the economic disaster that characterised the first years of independence.

In 1991, Kravchuk had been elected President with a large percentage of votes from the eastern and the southern regions of the country, but also in the conservative countryside outside the western territories, where he was rewarded for the role he and the “national communists” had played in achieving independence.¹ In his electoral campaign, Kravchuk had called for “statehood, democracy, prosperity, spirituality and trust”, stressing the economic benefits that would accrue to the Ukrainians from independence.² In the immediate post-Soviet years, Kravchuk struggled to define Ukrainian identity in opposition

¹ S. Birch (1995) “The Ukrainian Parliamentary And Presidential Elections of 1994” Electoral Studies, March, Vol.14, No.1, pp. 93-99

² A. Wilson (1997), “Ukraine: Two Presidents and their Power”, in *Postcommunist Presidents*, edited by R. Taras, (Cambridge: CUP), pp. 67-105

to Russia, and sought a new source of legitimacy in anti-Russian rhetoric to counter his rapidly declining popularity.

During the 1994 presidential elections, Kravchuk allied himself with the Ukrainian nationalists, aiming to win the vote in the western regions of the country. Annexation of these territories into Soviet Ukraine only at the end of the Second World War had produced strong national sentiments. To accommodate a western electorate, Leonid Kravchuk's campaign was fought on themes such as statehood, respect for the Ukrainian language and culture, independent foreign policy and close relations with Central-Eastern and Western Europe.³

Kravchuk's main opponent, Leonid Kuchma campaigned, instead, on a ticket of a closer relationship with Moscow, while stressing Ukraine's Eurasian identity. Kuchma, who had been director of the largest missile plant in Ukraine, Prime Minister in charge of economic reforms under Kravchuk, and finally, President of the Union of Industrialists, promised to place the solution of the Ukrainian economic crisis at the top of his political agenda. Improving relations with Russia, as Ukraine's main trading partner, was an integral part of a strategy that, Kuchma assured, would be founded on a concept of healthy pragmatism.

The electoral results showed that voting had mainly been shaped by the two candidates' views on the national issue. More than three-quarters of Ukrainian-speakers voted for Kravchuk, while a similar percentage of Russian-speakers' cast their votes for Kuchma. In the second round, Kuchma won every region in eastern and southern Ukraine, and the Left-Bank of the river Dnieper. Kravchuk earned the majority of votes in western Ukraine and in the Right-Bank regions.⁴ This significant shift of preferences seemed to herald a momentous turn also in relations between Russia and Ukraine, and many external observers thought that Ukraine would soon return to a Russian sphere of political influence.

³ *Ibid.*

⁴ *Ibid.*

Despite all expectations, however, relations between Russia and Ukraine did not evolve towards increased co-operation or economic and political reintegration. Kuchma's promises of a rapprochement with Russia were kept with the signature of the 1997 Friendship Agreement, which set relations between the two countries on a footing of equality. But the consolidation of Russia and Ukraine as two clearly separate political and economic entities and the emergence of distinctive national elites clearly hindered prospects of reintegration.⁵

In particular, the redistribution of economic resources, which followed the disintegration of the Soviet economy, sparked an acrimonious competition among domestic and foreign economic elites to gain control over national wealth. The development of divergent rather than convergent interests among economic elites in Russia and in Ukraine was an important factor in fostering a process of increasing diversification between the two countries.

In this work I look at relations between Russia and Ukraine in the years 1994-98, namely the period between the first election of Leonid Kuchma and the August economic crash in Russia, from the specific perspective of the foreign policy interests formulated by the economic elites of both countries.

The assumption is that, according to the pragmatist approach to Russian-Ukrainian relations and the doctrine of CIS integration (see below), the emergence of economic elites as powerful political actors should have represented the essential precondition to initiate a process of reintegration. The presumption of existing economic interrelations between the two countries, and consequential convergent interests among business elites in Russia and

⁵ In this work I understand elites as small and cohesive groups of strategic actors, who control administrative and economic resources and through them exercise substantial and regular influence on a country. I distinguish between a political and an economic elite, the first mainly in control of political resources (administration and policy-making), the second mainly in charge of economic resources (industrial and financial assets, media outlets). Political and economic elites may overlap; they may also be internally fragmented along fault lines determined by their interests. As elite groups react to the fluidity of the political and economic environment, coalitions among different subgroups emerge and break up when their interests change. Powerful economic actors who interact with the political institutions and establish with them a continued relation through which to pursue their own narrow interests are defined as oligarch. Finally, I call a "developmental elite" an elite whose social responsibility is seen as leading the country through a process of economic development.

Ukraine should have helped to overcome the “ideological” *empasse* induced by professional politicians.

Instead, the period 1994-1998 saw the stratification of economic elites and the establishment of an oligarchic or proto-oligarchic system in both Russia and Ukraine. The creation of mutually advantageous coalitions between political and economic power allowed economic actors to translate their policy preferences towards relations with the neighbouring country into implemented policies.

The redistribution of economic resources (primarily access to privatising assets) gave rise to a struggle for control over national wealth among domestic economic actors and against foreign competitors. Preoccupations among the Ukrainian economic elite that the richer and more experienced Russian business would dominate in the privatisation of large strategic assets found expression through a nationalist discourse. A rhetoric of “national bourgeoisie”, calling for the defence of “national capital” as the main instrument to preserve the newly acquired independence, was employed to articulate the Ukrainian protectionist mood.

On this basis, economic elites in Russia and Ukraine developed antagonistic interests and policy preferences that pulled towards the separation rather than the reintegration of the two countries. The process of economic liberalisation that followed the collapse of the centrally planned systems and the redistribution of economic resources impaired, then, the emergence of transnational coalitions supportive of acceleration in economic and political co-operation.

A Pragmatists Approach to Russo-Ukrainian Relations

In July 1994, the Ukrainian newspaper *Golos Ukrainy* published the story of Anatolii Gavrilenko, Director of a Kyiv industrial combine. In the previous four years, without ever changing its product specialisation, the enterprise had been transferred four times from the competence of one ministry to another and only in the last year it had been subordinated to the Ministry of Foreign Economic Relations. Gavrilenko also lamented that in the post-independence years the enterprise had hardly received spare parts from its partners in the CIS countries. Thus, in order to keep the business going, Gavrilenko had been forced to start to produce those parts within the Kyiv plant, finally becoming independent from the CIS suppliers.⁶

The story of enterprise director Gavrilenko was a little success. Gavrilenko had reacted to the severance of Soviet economic relations reconverting his enterprise to internal production, but still, he argued, the factory had lost a number of valuable trading partners located in the Russian regions. This vignette was not unique in the post-Soviet landscape, and both Ukrainian and Russian newspapers published in the post-independence years numerous stories, which highlighted the problems deriving from the rupture of the Soviet command economy.

A large number of Russian and Ukrainian enterprises remained linked to their traditional partners, even though with the drawing of the new national borders, they were now located abroad. Russian and Ukrainian enterprises experienced extraordinary hardship because of the introduction of diverging payment and tax systems, new currencies and custom tariffs. Amidst those who wanted to restore a fully-fledged union between the two countries, and those who wished to sever all bilateral connections, voices started to be heard both in Russia and in Ukraine, which advocated a more concrete approach to their common problems. Empty nationalistic claims, it was maintained, should be replaced by the

⁶ *Golos Ukrainy*, July 28, 1994, p. 6

recognition that the economic systems of the two countries were interdependent and would continue to be so even after the emergence of two separate states.

Arkadii Vol'skii, Chairman of the Russian Union of Industrialists became one of the most vociferous supporters of a foreign policy imbued with "constructive pragmatism".

"We have lived together for 300 years, [our economies] were built as a single large factory. Our links were so much intertwined that their interruption is blocking production on both sides of the frontier. I would very much like our leaders to understand this, because debates on who's feeding whom are of no use to anyone".⁷

Vol'skii argued that these sentiments reflected the common opinion of many enterprise directors on both side of the border. It was felt that, while for many politicians the establishment of good relations between Russia and Ukraine was a matter of "ideology", for the business community it was a matter of survival.⁸

Even after independence, Russia remained the primary provider of energy supplies for Ukraine, the main creditor and the single largest market. Ukraine imported from Russia almost 90% of its oil and more than 60% of its gas supplies every year. The remaining 15 to 20% of gas was imported from Turkmenistan and Uzbekistan, although for a period in 1997, the Turkmeni gas provider was controlled by Gazprom. In January 1997, Kyiv maintained an outstanding debt with Russia estimated by the Ukrainian Finance Minister Igor Mitiukov in \$ 8.8 billion. By March 1998, \$900 million of this amount were due only to Gazprom.⁹

Russia was also the main consumer of Ukrainian foodstuffs, wheat, meet, sugar, products that would hardly find a market in the European Union, given the poor standards of its commercialisation, and the persisting barriers for the protection of the European internal agricultural production. In the first half of 1996, Ukraine accounted for 52% of Russian imports from the CIS, and for 49% of Russian exports to the CIS. The total trade turnover

⁷ D. Ternovoi (1997), "Sinkhronnoe Lobbirovanie", Biznes, n. 20, 27 May, p. 11

⁸ Golos Ukrainy, August 27, 1994, p. 3

⁹ O. M. Smolansky, (1999), "Fuel, Credit, and Trade. Ukraine's Economic Dependence on Russia", Problems of Post-Communism, March/April, pp. 49-58

between the two countries amounted to \$17.7 billion in 1996, and to \$15.1 billion in 1997 (the drop was a result of the 1996 “trade war” initiated by the imposition of a 20% value-added tax on all Ukrainian goods exported to Russia).¹⁰

Such a close economic interdependence became for Moscow a bargaining chip over Ukraine, as economic leverage was used regularly to “guide” Kyiv into political decisions that would prove more favourable to Russian interests. Russia made no secret of its firm opposition to Ukrainian attempts to diversify its markets, a move that would ultimately alter the strategic balance between the two partners.

In the post-independence years, Ukraine was thus struggling to define its geopolitical location, gain international credibility and establish a set of strategic alliances. Kyiv was faced by the challenge of balancing an economic dependence on Russia, against the ambition to see its European identity recognised through admission to the institutions of Western security and co-operation. A “pragmatic” examination, however, suggested that Ukrainian foreign policy could not give exclusive preference to a potential friendship with the West, while disregarding relations with Russia.

As the Ukrainian economist Igor Burakovskii put it, there were three main reasons why Russia would remain a significant factor in Ukraine’s political choices, regardless of the foreign policy course ultimately adopted in Kyiv. First, Russia was at the same time the largest European country and a world power. Second, thanks to its extensive natural resources Russia could in the short-run recover its economic strength, and co-operation with its eastern neighbour would then become, once again, a necessary precondition for Ukrainian welfare. Finally, Ukrainian enterprises still maintained a high degree of interdependence with their Russian counterparts.¹¹ The Ukrainian economist Vladimir Gugel’ argued:

¹⁰ *Ibid.*

¹¹ I. V. Burakovskii, (1996) “Ukrainsko-rossiiskiye ekonomicheskkiye otnosheniya”, Occasional Paper on Changes in the Slavic-Eurasian world, Slavic Research Center, Hokkaido University, November 1996, Sapporo.

“The problem of economic relations with Russia, and with the other republics is often looked at in a propagandistic fashion, mixing together the analysis of economic interests with a strong anti-Russian syndrome. Ideology is tied up with a mythical matrix, which impregnates the evaluation of the real potential of the Ukrainian economy”.¹²

The “mythology” of Russo-Ukrainian relations, which Gugel’ referred to, was based on the “improper” assumption that the Ukrainian economy had been developed within the framework of the Soviet empire according to a colonial model, through which the Russians had plundered Ukraine’s wealth. From the assumption of Russian-imposed economic colonialism derived the conclusion that cutting off economic relations with Russia would promote the effective restructuring of the Ukrainian industrial system, and its consequential reorientation towards more profitable markets.

Integration with the countries of the former Soviet Union was viewed, then, by many as an obstacle to gaining access to the world economy, because of their technological underdevelopment. Preserving links with the backward former Soviet economies would automatically continue Ukraine’s economic backwardness. Conversely, the best prospect for a rapid development of the Ukrainian economy was viewed as tied to a quick rupture of economic relations with Russia, on the one side, and integration into the European environment, on the other.¹³

Integration into the European Union was certainly seen by Ukrainian observers as a very attractive prospect, but once again, appeals to a realist assessment of the Ukrainian economic situation invited to draw a more “pragmatic” foreign policy agenda. Quoting a World Bank report published in 1991, the Ukrainian economist Valentina Pisanskaya pointed out that, when the Soviet Union broke up, Ukraine was importing from Russia \$15 billion worth of oil, gas and wood every year. At the time, however, the subsidised price system meant that one could buy two tons of oil with one ton of grain. Ukraine would sell meat to Russia, but buy petrol. According to the coefficients of conversion in use then,

¹² *Golos Ukrainy*, August 27, 1994, p.3

¹³ *Ibid.*

Ukraine would get one dollar for every kilo of meat, but would pay only seven kopeks for a litre of petrol. Pisanskaya concluded:

“We would like very much to enter in a content and prosperous Europe, but the reality is that with our technology, and our non-competitive production we do not conform to their requirements and necessities. We are not needed by this Europe”.¹⁴

In 1994, Anatolii Zlenko, Ukrainian Minister for Foreign Affairs also noted that the European Common House was not ready yet to receive Ukraine.

“For a full integration of Ukraine into the world and European economic and political space we have to ask ourselves these questions: to which extent does the participation of Ukraine in this process correspond to its national interests? Does it guarantee its national security, and the vital and strategic interests of the country as an expression of sovereign will?”

Zlenko agreed that, given the close links and the dependence of Ukrainian vital activities on the former Soviet republics, and on Russia in particular, the economic crisis could be overcome only through restored co-operation with these countries.¹⁵

The key message of the Ukrainian pragmatists, then, was that European and world markets would be a fantastic mirage for the Ukrainian economy, and the harsh reality was the necessity to get back to business. Ukraine was faced with the urgent need to preserve and consolidate its only economically feasible trade and industrial links, namely those with the former Soviet Union and with Russia.

The Soviet economy had been built in seventy years, and – the pragmatists maintained - cross-border co-operation could not be severed overnight. This was especially true at a time of economic crisis, when resources for restructuring and reorientation were short for everybody. Vitol'd Pavlovich of the International Fund for Humanitarian and Economic Relations between Russia and Ukraine warned that:

¹⁴ Golos Ukrainy, August 18, 1994, p. 5

“The era of political romanticism is over, we are now facing the harsh necessity of a sensible pragmatism. Especially in the economic sphere. There is much talk about the country’s economic independence, but it is not clear to everybody that such independence requires stability for the manufacturers, [that is] stability in the legislation concerning their activity”.¹⁶

According to this idea of “sensible pragmatism”, political independence was to be viewed as an empty concept if it was not based on a sound economic system, which, in turn, could only exist on the basis of the former Soviet economy. Because of their efforts to create a system that was politically and economically insulated from Moscow, the Kravchuk administration was accused of lacking a clear awareness of the Ukrainian situation, and it was portrayed by the pragmatists as a group of “political romantics”. Trading the efficiency of the industrial sphere for an “idyllic” idea of independence, political circles in Kyiv had failed to understand that an agreement with Russia, even at the price of reduced sovereignty, might be what the country ultimately needed given its difficult financial circumstances.

Calling for the establishment of an economic Union between Russia and Ukraine, the group ‘Edinstvo’ (Unity), active in the Ukrainian border regions, put the reasons for the economic disorder in Ukraine down to the break up of the pre-existing economic relations. According to Edinstvo’s Vice President, in Donetsk, Dnipropetrovsk and Zaporizhzhia links at the inter-enterprise level had remained active, “not thanks to the state’s intervention, but despite the state’s intervention”.¹⁷

¹⁵ Golos Ukrainy, August 10, 1994, p. 5

¹⁶ Golos Ukrainy, September 1, 1994, p. 2

¹⁷ Golos Ukrainy, September 13, 1994, p. 2

Power to the Pragmatists

Pragmatism became the catch-phrase of Leonid Kuchma's electoral campaign in the spring of 1994, and during the first months of his presidential mandate. Kuchma's electoral commitment to improved relations with Russia, synthesised in the slogan 'less walls more bridges', was confirmed in his first presidential speech to the Verkhovna Rada.

"Our aim is not revolution, but a systematic, resolute, and consistent renewal of the economic and socio-political system in Ukraine. The main means to achieve this [objective] are realism and common sense in both domestic and foreign policy".¹⁸

Kuchma made it clear that he was particularly aware of the fact that nation-building purposes did not always coincide with the necessities of the Ukrainian industrial sector.

"The priorities of Ukraine's foreign policy should not be determined by ideology, but by the nation-wide interests of our state. In concrete terms this means that realism, specificity and pragmatism should replace political romanticism, euphoria, and a certain vagueness characteristic of the initial period of state-building".¹⁹

Both in Russia and in Ukraine, Kuchma's words were interpreted as a sign of Ukraine's acceptance of Russia's inevitable superiority.²⁰ Yet, Kuchma's speeches were only one of many expressions of a wider movement, which had surfaced among industrialists and business people in the former Soviet countries. A movement officially represented by the International Congress of Industrialists and Entrepreneurs, whose proclaimed aim was to exercise pressure over the political structures of the newly independent states, and have the economy and business put first in the battle against "romantic politics".

¹⁸ Kyiv Radio Ukraine World Service, July 19, 1994.

¹⁹ *Ibid.*

²⁰ Ukrainian nationalists criticised Kuchma's inaugural speech for endangering Ukraine's sovereignty. A document signed among others by members of the Rukh stated that "The Eurasian expanse where the President sees Ukraine playing a leading role is nothing other than the space that is economically and politically subordinate to Russia. [...] Ukrainian economic contacts with Russia are necessary, but they must be aimed at consolidating Ukrainian independence, not turning Ukraine into a neocolonial state". Segodnya,

“One of the main tasks of the International Congress of Industrialists and Entrepreneurs is to defend the interests of industrialists and entrepreneurs in government circles, and to lobby in the parliament for those interests. This is the only objective necessity - to represent the corporate interests of industrialists and entrepreneurs. [...] Sometimes good laws are written, but they do not correspond to our necessities. Legislative acts in the economic area have to converge. This is why economic sovereignty is not possible. Economics is international. Political sovereignty is essential, but it cannot leave citizens in the current situation”.²¹

The President of the Kyrgyz Union of Industrialists, for example, argued that politicians needed to be supported in their planning and decision-making by economic agents, who, having to deal with concrete issues, had a more pragmatic approach to the problems of transitional economies. The conditions of economic interrelation created in the Soviet era were looked at as the promising ground for a mutually beneficial diplomacy. Only economic co-operation, and cross-boarder exchange led by economic actors could overcome the reciprocal political incomprehension generated by the radicalism of the post-Soviet national movements.²²

The newly emerging pragmatist ideology seemed then to be based on the twin assumption that countries that are economically dependent on each other and are connected by trade and industrial exchanges do not go at war. And economic co-operation could switch attention away from the rhetoric of professional politicians, which was more likely to inflame rather than to pacify the sensitive relations of the post-Soviet arena.

The July 1994 meeting between Aleksander Moroz and Ivan Rybkin, speakers of the Ukrainian and the Russian Parliament, followed this line of bottom-up economic pragmatism as the chief ingredient for renewed co-operation. The two acknowledged that without waiting for any legislative initiative, the inhabitants of the two countries' border regions had already initiated an active collaboration.

July 27, 1994, p. 5

²¹ *Rossiskaya Gazeta* November 11, 1995

²² *Ibid.*

“One of the main tasks of the International Congress of Industrialists and Entrepreneurs is to defend the interests of industrialists and entrepreneurs in government circles, and to lobby in the parliament for those interests. This is the only objective necessity - to represent the corporate interests of industrialists and entrepreneurs. [...] Sometimes good laws are written, but they do not correspond to our necessities. Legislative acts in the economic area have to converge. This is why economic sovereignty is not possible. Economics is international. Political sovereignty is essential, but it cannot leave citizens in the current situation”.²¹

The President of the Kyrgyz Union of Industrialists, for example, argued that politicians needed to be supported in their planning and decision-making by economic agents, who, having to deal with concrete issues, had a more pragmatic approach to the problems of transitional economies. The conditions of economic interrelation created in the Soviet era were looked at as the promising ground for a mutually beneficial diplomacy. Only economic co-operation, and cross-boarder exchange led by economic actors could overcome the reciprocal political incomprehension generated by the radicalism of the post-Soviet national movements.²²

The newly emerging pragmatist ideology seemed then to be based on the twin assumption that countries that are economically dependent on each other and are connected by trade and industrial exchanges do not go at war. And economic co-operation could switch attention away from the rhetoric of professional politicians, which was more likely to inflame rather than to pacify the sensitive relations of the post-Soviet arena.

The July 1994 meeting between Aleksander Moroz and Ivan Rybkin, speakers of the Ukrainian and the Russian Parliament, followed this line of bottom-up economic pragmatism as the chief ingredient for renewed co-operation. The two acknowledged that without waiting for any legislative initiative, the inhabitants of the two countries' border regions had already initiated an active collaboration.

July 27, 1994, p. 5

²¹ Rossiskaya Gazeta November 11, 1995

²² *Ibid.*

If concrete experience had already preceded legislation, they added, legislators had now the responsibility for creating the right conditions for the efficient activity of Russian business in Ukraine and Ukrainian business in Russia. Enterprises should be allowed to open branches in the neighbouring country, and participate in the market of state orders. Financial-Industrial groups, transnational corporations, and joint banks should be established to revitalise the national economies.²³

The View from Moscow

The endorsement of the pragmatist approach in Kyiv was also matched by a remarkable change of attitudes in Moscow. At the end of Ukraine's third year of independence, Russia was forced to accept the reality that Ukraine was, indeed, developing into a fully sovereign country. Hopes to restore the neighbouring country to a subservient position with the election of the Russophile Leonid Kuchma were soon dashed. Upon reaching his presidential chair, Kuchma became a committed defendant of Ukraine's sovereignty, interested in remaining the president of an independent state, rather than becoming the governor of a Russian province.²⁴

It soon became clear that while Ukraine still represented an area of Russia's vital interests, those interests had to be fostered and preserved with different methods than the aggressive nationalism voiced by some political leaders. Russian initiatives had to become more positive and less threatening.

During his September 1994 visit to Kyiv, the Russian Foreign Minister Andrei Kozyrev stressed that there was no greater priority for Russian foreign policy than to normalise relations with Ukraine. The time had come, Kozyrev suggested, to abandon divisions between big brother and little brother, because the two countries were just "twins".²⁵

²³ *Golos Ukrainy*, July 30, 1994, p. 2

²⁴ This comment was made by Taras Kuzio in a conversation with the author, Kyiv, October 1998

²⁵ *Golos Ukrainy*, September 24, 1994, p. 6

The academic Arkadii Moshes argued that Russia had to learn to deal with a sovereign state, whose position in the world arena had significantly shifted in the last years. Ukraine had been admitted to the Council of Europe, it was working actively to establish bilateral relations with other CIS countries without Moscow's mediation, and also its relations with Russia had become more predictable. Ukraine was visibly trying to move away from the Russian sphere of influence.

The election of President Kuchma could be perceived as a guarantee that special relations between the two countries would be preserved, but also Moscow's attitude needed to undergo a radical re-evaluation. Russia had to establish "relations of stable, conflict-free, and mutually non-provocative co-operation", as an alternative to a "competitive partnership". The Russian foreign policy elite had to devise a new policy, asking themselves how it could be made possible for Russian private capital to become actively engaged in Ukraine, establishing fundamentally new economic ties.

From this perspective, Moshes questioned whether it was necessary to keep politically controversial issues such as the division of the Black Sea Fleet as a top priority on the agenda of relations between the two countries. What kind of positive motivation could Russia use to spark Ukraine's interest and slow its drift toward the West? What measures could Russia adopt if a crisis did eventually erupt?²⁶

The coming to power of the Russian oligarchs was not of secondary importance in this strategic turn. The rapid privatisation of state property created in Russia a strong, though not compact group, which proved able to introduce big business as another variable into the political equation. Talking about the responsibilities of Russian business in solving situations of crisis, and also justifying his political activity, Boris Berezovskii equated the well-being of Russia to the prosperity of his own business, and put forward a philosophy of self-interested business which works to the advantage of the community. "I am moved by pragmatism – Berezovskii said - a pragmatism based on my love for Russia. [...] I do not

²⁶ Segodnya, November 17, 1995,

want to seem an altruist. I defend the vital interests of Russian business, my own interests".²⁷

The approaching of the large-scale privatisation in Ukraine promised to open up favourable perspective for the penetration of Russian economic interests in the Ukrainian arena. Moscow strategy, or at least the strategy of a section of the Russian elite, seemed therefore to turn into what a Ukrainian scholar has termed a "creeping economic absorption".

In the case of relations with Ukraine, Volodymyr Sidenko argued, the variant of an "aggressive expansion", as the model of unification with Belarus, was probably to be discarded. The high costs the move would imply, in terms of levelling out wages, prices and writing off the Ukrainian debt would also make this strategy improbable. A "creeping absorption" would instead place the costs of the manoeuvre on the shoulders of the big financial-industrial groups and the transnational corporations, which would penetrate the Ukrainian market.

Sidenko painted a scenario in which economic re-annexation of Ukraine into Russia would take place in five successive stages. In the first stage, Russian investors would participate in the "big privatisation". Then, commercial credits would be granted by Russian corporations to Ukrainian enterprises. Russo-Ukrainian financial-industrial groups would be set up, controlled *de facto* by Russian capital. Inter-company agreements on market sharing, co-ordinated sales, and joint marketing, would be concluded, followed by mutual participation in each other's business activity. Finally, mergers and absorption would take place.²⁸

Big Russian companies would then become the major actors in bilateral relations between Russia and Ukraine, thus realising what a Russian observer had identified as their historical mission.

²⁷ A. Grishovets (1996), "Nado zaplatit'! i nikuda ne denesh'sya", *Kommersant*, n. 12, 12.11.1996, pp. 13-15

²⁸ V. Sidenko (1998), "Russia in the Ukrainian Policy of Socio-economic and Geoeconomic Transformation", *Political Thought* (Kyiv), n. 2, pp.161-175

“Lukoil, YUKOS, Rosneft, and Gazprom have long been paving the way for the restoration of a common economic space on the ruins of the former Soviet Union, showing in deed, not words, the advantages of developing such processes for the people and for the states. [...] And, who knows, perhaps not only in the economic but also the political significance of the role of these companies will be appreciated and their worth in the future of the CIS. There was a time when monuments were erected to Yermak and Khabarov. But they were conquerors in the direct meaning of the word. Perhaps a monument will some day be put up to Lukoil also as the embodiment of the peaceful economic rapprochement of the peoples and the states that fled the USSR”.²⁹

The CIS Model of Integration

Moscow’s new approach to relations with Ukraine was in a way an integral part of the doctrine of political and economic integration proposed for the reintegration of the Commonwealth of Independent States. Following a functionalist approach to European integration, it was envisaged that the construction of a new political and economic entity in the Eurasian space would take place at a dual level, involving simultaneously an inter-governmental, as well as an inter-enterprise level.

The role of the national governments would be to negotiate and sign bilateral or multilateral agreements, primarily aiming at restoring a common economic environment, and establishing a common legal framework. By doing so, they would express a *political will* in favour of economic integration. In order to obtain the broadest possible commitment from all actors, however, political will would have to be coupled with an *economic interest* at a grassroots level. The success of the process of integration could then be guaranteed only if integration proceeded *from above* and *from below* at the same time.³⁰

“The leading direction in the process of reintegration of the CIS countries consists in strengthening different forms of inter-governmental co-operation, and in promoting micro-level ties between market subjects.

²⁹ Rossiiskaya Gazeta August, 3 1996

³⁰ Memorandum Sovieta Glav Gosudarstv Sodruzhestva Nezavisimykh Gosudarstv, “Osnovnye napravleniya integratsionnogo razvitsiya Sodruzhestva Nezavisimykh Gosudarstv”, approved on October 21, 1995. Also Nikolai A. Cherkasov, Director of the Research Section of the CIS Interparliamentary Assembly, interview with the author, St. Petersburg, 27 March 1997.

Thereafter follows the need to preserve, develop, restructure and rationalise the existing relations among enterprises, which now happen to be across different borders. This means, in other words, creating different transnational industrial structures".³¹

Industrial enterprises across the borders were encouraged to re-establish industrial connections from the Soviet era. Economic subjects and transnational enterprises were to act as *transmission belts*, able to impose the impetus of integration to the political structures. The process, in the case of the CIS and of Russian-Ukrainian relations in particular, would be even easier than integration within the European space, because of the already existing network of economic co-operation, established in the Soviet period.³²

"The members of those structures would represent an industrial capital independent from its territorial location, and its forms of ownership. They will be naturally interested in setting up an optimal level of intersectorial, industrial and techno-scientific co-operation. The same consideration applies for the representatives of financial capital".³³

In a meeting with the Heads of State of the CIS countries in January 1996, President Yel'tsin also emphasised the importance of this dual approach. On the one side, he noticed, "It is not serious to talk about integration without having a clear-cut organisational structure", such as the Custom Union, and the Interstate Economic Committee, which were designed to become the "integration headquarters". Within this framework, member states had to "discuss in principle the question of the nature and stages of economic transformations in the Commonwealth States", and "co-ordinate positions on the questions of forming a common capital market, as well as a rational system for the interstate division of labour".

³¹ S. Golubeeva (1996), "Transnationalisatsiya Rossiiskikh FPG", *Rossiiskii Ekonomicheskii Zhurnal*, n. 7, pp. 29-36

³² I. V. Vorob'eva and E. G. Efimova (1996), "Torgovo-ekonomicheskie Interessy Rossii", *Uchonye Zapiski, St. Petersburg State University*, vol. 32,

³³ S. Golubeeva (1996), *Op. Cit.*

On the other side – Yeltsin pointed out - “Joint investment programs should become an effective tool of structural policy. This should be primarily in those spheres of the national economy whose production is vitally important for the partners”.³⁴

Plan of the Thesis

The main trajectory for the development of bilateral relations between Russia and Ukraine in 1994 then seemed to be one of integration. Growing dissatisfaction against a nationalist rhetoric used to consolidate Ukraine’s newly established independence, but also believed to be responsible for the deterioration of the economic situation, ousted Kravchuk from power and replaced him with the more Moscow-friendly Leonid Kuchma. Economic arguments in favour of increased co-operation seemed to win the upper hand over the “political ideology” of independence. This change of spirit found fertile ground in the new foreign policy strategy developed in Moscow, which foresaw measures of economic expansion gaining preference over political absorption, and major economic actors earning a definite space in the centres of Russian political power.

Were these factors the necessary preconditions for the emergence of transnational coalitions? Did they correspond to the grassroots level of co-operation foreseen by the CIS doctrine of integration? In this work I will argue that these conditions were in fact insufficient to foster increased co-operation between the two neighbouring countries. The emergence of national economic elites, which based their political prestige on the acquisition of property, represented one of the strongest obstacles towards the political and economic reintegration between Russia and Ukraine.

In particular, the consolidation of an economic elite in Ukraine and its ambition to increase its power through control over Ukrainian national resources reduced the prospects for the foreign expansion of Russian business. On the Ukrainian side, the rhetoric of a national bourgeoisie, based on the need to protect “national capital”, in order to create a fully

³⁴ Rossiiskie Vesti, January 20, 1996

developed economy, clearly contrasted with the lexicon of international economic interest heard in the Russian quarters.

As a nationalist discourse was used to oppose the expansion of Russian business in Ukraine, my conclusion is that nationalist sentiments may play an important role in countries such as Ukraine, that had only recently become independent. The coincidence of economic interests and nationalist aspirations may enhance the role of business elites in the struggle for independence and the process of nation-building. Economic elites may ultimately promote nationalist movements to be allowed to maintain control over the redistribution of national wealth.

Consequently, the pragmatists' suggestion that political interests rather than economic interests would be factors of secondary importance in bilateral relations between Russia and Ukraine appears unfounded. Economic elites did not express exclusively economic preferences, but by stepping onto the political scene they became political agents, especially at a time of deep instability, when access to politics was clearly the key to enhance and protect economic well-being.

The argument will be made following these points. In chapter one, I will outline a theoretical framework based on pluralist theories of international relations. I will stress that, in order to understand the process of rapprochement between Russia and Ukraine the study of transnational coalitions and international organisations is not sufficient, but attention must be devoted to the domestic level of politics. Following the tradition of the "second image", I will stress the importance of analysing elements such as the role of specific actors and their preferences, the ways in which coalitions are built and economic interests are translated into political actions.³⁵

³⁵ International studies classify the constraints and opportunities that the international system places on the foreign policy decisions of individual countries as the "third image" and the economic social and political characteristics of states as the "second image". K. Waltz (1954), *Man, the State, and War* (New York: Columbia University Press)

On the basis of this theoretical framework, in chapter two, I will provide an historical account of relations between Russia and Ukraine. The focus will be upon seeking to explore the “bargaining space” defined by the socio-economic systems shaped by the two countries’ common past. I will discuss whether relations between Russia and Ukraine were historically those of a colonial model of political repression and economic exploitation.

I will suggest that the past of bilateral relations between the two Slavic countries cannot be defined unidimensionally, and even if coercion was exercised by Russia against Ukraine, the role of the Ukrainian elites in the process cannot be overlooked. I will conclude that the various interpretations of the common Russian-Ukrainian history provide arguments both to support and to dismiss possibilities of post-Soviet co-operation between the two countries.

In chapter three, I will turn to the making of foreign policy in Russia and Ukraine, considering the opportunities and the restraints that the external political and economic situation imposed on the two countries in the period between 1994-98. I will interpret policy choices as a reaction to a combination of international as well as domestic events.

In the case of Russia, the emergence of a pragmatist nationalist foreign policy will be identified as a result of three factors. First, disillusion with the Western-oriented foreign policy of the early 1990s and the Russian post-imperial crisis of identity. Second, the severe economic decline. And third, the perception of risks deriving from the emancipation of the CIS countries from a Russian sphere of influence. I will argue that the emergence of a consensus around pragmatist nationalist strategies coincided with the rise of the oligarchs, and their interest in expanding their business activities abroad.

In the case of Ukraine, I will consider the “two-track foreign policy” inaugurated by Kuchma and aimed at achieving equally constructive relations with the West and with Russia. Kuchma’s foreign policy course was dictated by Ukraine’s position of weakness in the international arena. So that, if on the one side Kuchma aimed at Ukraine’s integration in the Western structures of security and co-operation, on the other side, economic

dependence on Russia forced the country's foreign policy community to seek the stabilisation of relations with its eastern neighbour.

Ukraine's international weakness failed to provide the domestic economic elite with the institutional protection and support that they required, on the other hand, however, the Ukrainian business elite lacked the capacity and resources to play a significant role in foreign markets. This is why foreign policy issues, apart from the demand for protection of the internal market, did not appear on the agenda of the economic elite.

In chapter four I will examine the emergence of the economic elite as a political actor in Russia. I will explore the relations between business and politics in Yel'tsin's regime, and the role that privatisation played in the aggregation of economic interests around political groups. I will then consider the interests and policy preferences of the major Russian companies abroad and in Ukraine. I will conclude that both the interests and the mode of Russian expansion in Ukraine highlighted not only divergent but even contrasting interests vis-à-vis the Ukrainian economic elite.

The interests and policy preferences of the Ukrainian economic elite will be examined in chapter five. I will outline the emergence of an ideology in support of the creation of a "national bourgeoisie" within which the wealth of the economic elite was equated to the well-being of the country. I will consider the political interconnections between politics and business, which were consolidated during the first term in office of Leonid Kuchma.

Finally, I will outline the spread of a protectionist mood in Ukraine in the form of an institutionally sanctioned policy of defence of "national capital". I will conclude that the very emergence of an Ukrainian economic elite, territorially limited to the Ukrainian space, relatively weaker than their Russian counterpart and equally interested in the privatisation of strategic assets, set relations between the Russian and the Ukrainian business community on a footing of competition.

In the conclusions I will discuss how, in the period between 1994-98, different models of business-politics interrelation and an instrumental use of nationalist arguments intertwined in contravening the pragmatist approach to relations between Russia and Ukraine. The interaction between economic liberalisation, elite consolidation and nationalism is considered as a powerful obstacle to processes of integration between newly independent countries.

CHAPTER ONE

Theoretical Background

Pluralist theories of International Relations provide a comprehensive framework through which to understand relations between Russia and Ukraine in the period 1994-98, in particular to identify the critical role played by the economic elites of the two countries in the tentative process of rapprochement. Why do pluralist theories provide a more parsimonious account of Russian-Ukrainian relations rather than a realist theory of co-operation?

The statist approach to foreign policy, on which realism is based, has two crucial assumptions. First, that the state is an autonomous (unified) actor, and, second, that the objectives pursued by the state correspond to the national interest. According to Stephen Krasner's definition, the state is "a set of roles and institutions [a set of "central decision-making institutions"] having peculiar drives, compulsions, and aims of their own that are separate and distinct from the interests of any particular societal group". It is precisely thanks to this isolation from societal pressures and particularistic interests that the state is capable of identifying the national interest as the supreme expression of "general material objectives or [...] ambitious ideological goals related to the beliefs about how society should be ordered".¹

Both these assumptions appear inadequate to depict post-Soviet polities, in which pluralistic societies and a fragmented perception of the national interest have replaced the apparent cohesiveness of the Soviet years. Despite the pledge that "the interests of the people and the interests of the Party are one," the definition of national interests appeared

¹ S. D. Krasner (1978), *Defending the National Interest. Raw Materials Investments and U.S. Foreign Policy*, (Princeton: Princeton University Press), p. 10

controversial even in the Soviet period, given the systemic competition between different branches of the Soviet elite for the allocation of resources.²

To a degree, the advent of *perestroika* provided only formal sanction for the emergence of pluralistic elements in society, and for the expression of a multiplicity of often-contrasting interests. Since the early 1990s, the processes of political and economic liberalisation have further multiplied the number of actors engaged on the domestic as well as on the international scene. The state itself has become another actor in the struggle for power, often the hostage of powerful interest groups.

The unitary perception of national interests, as forged in the Soviet era, has crumbled in a plethora of alternative preferences, with different segments of the elite arising on the political scene to spell out their personal concept of national interest. The resulting picture is best framed in Rober Keohane and Joseph Nye's words: "the state may prove to be multifaceted, even schizophrenic, [...] national interests will be defined differently on different issues, at different times and by different governmental units."³

In this study it will be argued that liberal theories best account for the emergence and failure of the loose set of ideas categorised as 'the pragmatist approach' to relations between Russia and Ukraine (see Introduction). The pragmatist approach as emerged in the years between 1994-98, was based upon a variety of assumptions about the key factors determining the relationship between the two countries:

- (i) That political and economic interests are distinct from each other and often contradictory.
- (ii) That the politicians' view of co-operation is generally determined by 'ideological' aims, often masking the goal of retaining or expanding political power

² For a detailed account on the evolving perception of interests under Gorbachev see L. D. Nelson and I. Y. Kuzes, (1998), "Russian Economic Reforms and the Restructuring of Interests", *Demokratisatsiya*, Vol. 6, n. 3, pp 480-503

³ R. O. Kohane and J. S. Nye (1977), *Power and Interdependence*, Little, (Boston: Brown and Company), p. 16

(defending independence in the case of Ukrainian politicians and asserting control over Ukraine in the case of Russian politicians).

- (iii) That the business communities' view of co-operation is generally determined by a more 'pragmatic' understanding of bilateral relations, where increased co-operation is considered an instrument to overcome the countries' economic crisis, improve production and generate shared wealth for the population.
- (iv) That the appointment of representatives from the two countries' business communities to leading policy making positions can foster co-operation by virtue of their common views and interests.

Pluralist theories dissect societies into their component parts, investigate the different preferences held by societal groups, the ways in which these groups organise politically and gain representation for their preferences, and the ways that interests between cross-border communities promote or hinder co-operation. Here it will be argued that the emergence of the 'pragmatist' approach in the two countries stemmed from the capture of key state institutions by particular domestic interest groups. While the failure of this approach to provide the foundations for co-operation was the result of the competing preferences of these particularistic groups.

Below I will outline in more detail the application of pluralist theories of international relations to the case of Russian-Ukrainian relations. In particular, I will examine the role that these theories identify for national and transnational elites in the process of co-operation. I will start by providing a definition of co-operation and integration, and a classification of liberal theories.

Co-operation and Integration

The realist approach to international relations sees co-operation between two states as an attempt to balance the power of or the threat from a third country.⁴ Conversely, in liberal theories, co-operation happens as the result of a recognised commonality of interests between states, which are oriented towards the maximisation of their individual gains, and are ready to engage in a bargaining process with the final aim of achieving co-ordinated policies. On the basis of shared interests in specific areas, individual nation-states agree to negotiate a single approach to the solution of existing or foreseen problems. As Robert Keohane puts it, during co-operation “actors adjust their behaviour to the actual or anticipated preferences of the other, through a process of co-ordination”.⁵

The motivation that sparks states’ efforts is the perspective of future gains arising from co-ordinated policies, even though, as Helen Milner points out, gains may not be the same for all the actors.⁶ Differences in rewards stem also from patterns of “asymmetrical interdependence” existing between the partners, according to which the less dependent partner is bound to face limited costs following changes in the relationship. Keohane and Nye distinguish between *sensitivity* and *vulnerability* as the two dimensions of asymmetrical interdependence. Sensitivity implies “liability to costly effects imposed from outside before policies are altered to try to change the situation”, whereas vulnerability can be defined as “an actor’s liability to suffer costs imposed by external events even after policies have been changed”.⁷

Co-operation is a “process of exchange”, resulting from the accommodation of nations’ policies. It arises through a process of bargaining, which does not require initial agreement or the absence of discord. Discord and conflicts are instead channelled, leading to common

⁴ For an example of realist theories of co-operation see K. N. Waltz (1979), *Theory of International Politics*, (New York: McGraw-Hill); and J. Grieco (1990), *Co-operation Among Nations: Europe, America, and Non-Tariff Barriers to Trade*, (Ithaca: Cornell University Press)

⁵ R. O. Keohane (1984), *After Hegemony*, (Princeton: Princeton University Press), pp. 51-52

⁶ H. V. Milner (1997), *Interests, Institutions and Information. Domestic Politics and International Relations*, (Princeton: Princeton University Press), pp. 7-8

understanding and a way to achieve common advantages. Co-operation can be achieved through a variety of political processes. It can be tacit and occur without communication or explicit agreement, or can be imposed to the weaker by the stronger part.

In such a relation a hegemonic actor can serve as the functional equivalent of a common authority in international politics.⁸ Hegemonic stability theories have argued that a concentration of power resources in a single state leads to stability and openness in the international economic system.⁹ Alternative studies have, instead, concentrated on explaining the conditions for co-operation in a situation of international anarchy.¹⁰

Stanley Fischer identifies co-operation as a progressive (or incremental) phenomenon moving through four levels:

- *Exchange of information* to facilitate tacit policy co-ordination,
- Negotiation of specific *policy deals* on a one-time basis,
- Establishment of a *set of rules* guiding policy choice,
- *Surrender* of national policy instruments to form a larger policy community (Union/integration).¹¹

Co-operation and integration stand in an inverse relationship. If integration requires co-operation, co-operation is not necessarily aimed at achieving integration. As opposite to co-operation, integration will ultimately lead to the creation of a new community, whose degree of interaction, centralisation, and transfer of power from the national to the supranational level is established by the state-members within the framework of agreements and common institutions.

⁷ R. O. Keohane and J. S. Nye (1977), *Op. Cit.*, p. 13

⁸ J. Gowa (1986), "Anarchy Egoism and Third Images: The Evolution of Co-operation and International Relations", *International Organization*, Vol. 40, Winter, p. 174.

⁹ S. Krasner (1976), "State Power and the Structure of International Trade", *World Politics*, Vol. 28, n. 3, April, pp.317-347

¹⁰ R. O. Keohane (1988), *After Hegemony: Co-operation and Discord in the World Political Economy*, (Princeton: Princeton University Press.), and R. O. Keohane (1988), "International Institutions: Two Approaches", *International Studies Quarterly*, Vol.32, December, pp.379-396; K. A. Oye (editor) (1986), "Co-operation under Anarchy", (Princeton: Princeton University Press)

¹¹ S. Fischer (1988), "International Macroeconomic Co-ordination", in *International Economic Co-operation*, edited by M. Feldstein (Chicago: Chicago University Press), pp.35-38

In the process of integration two or more countries agree to give up, partially or totally, their sovereignty. They will adopt common decisions in one, several or all areas of interaction, ranging from trade, currency or economic policy, to social policy or foreign policy and defence. Common decision-making will take place within a set of supranational institutions that might, in time, replace the pre-existing national ones. Political and economic power may ultimately shift from the national to the supranational level, giving rise to a new polity.

Despite the commonality of elements outlined so far, pluralist theories present different approaches as to how co-operation (or integration) can be brought about and on the role and importance of different actors in the process. On this basis I will divide pluralist theories of co-operation into three broad groups:

- (i) Institutional theories, which emphasise the role of *ad hoc* institutions;
- (ii) Transnationalist theories, which emphasise the role of transnational communities;
- (iii) Theories of domestic politics, which concentrate on the domestic balance of power as a factor hindering or fostering co-operation.

It is important to point out, however, that this classification is not rigid, as different approaches and authors generally employ overlapping understandings of the elements of co-operation.

Institutionalist Theories

With the term ‘institutionalism’ I refer to those theories that see *ad hoc* functional institutions as the core factor for successful co-operation. David Mitrany is often identified as the early father of this functionalist theory with his utopian proposals to replace nation-states with international functional agencies. In Mitrany’s view, the continuous transfer of functions and authority from national institutions to international functional agencies provides an appropriate mechanism to implement co-operation.

Behind Mitrany’s vision, formulated in the aftermath of the Second World War, lies the conviction that “politics is evil”, and nationalism is the destructive force responsible for the horrors of the war. Administration, instead, with its primary concern for the rational allocation of resources, is the positive value that can motivate individuals to co-operate.¹²

In spite of being deeply rooted in a realist view of the state, Mitrany’s theory aims at ultimately dismantling the state structure, replacing it with a network of supranational functional institutions, able to solve enduring conflicts and allow even countries that are ideologically distant to co-operate.¹³ The reason why functional institutions are more likely to lead to co-operation and eventually to integration is that they are de-politicised, and offer the opportunity to address the concrete problems arising from the complexity of the modern world.¹⁴ Mitrany wrote:

“The new problems are leading [...] not to create sovereignty but to deny it, not to exclusive political integration, but to collective functional integration”.¹⁵

¹² D. Mitrany (1968), “The Functional Approach to World Organisation”, in *World Politics*, edited by A. Lijphart (Boston: Allyn and Bacon, Inc.), pp. 314-326.

¹³ *Ibid.*

¹⁴ D. Mitrany (1943), *A Working Peace System: an Argument for the Functional Development of International Organisation*, (London: RIIA) pp. 92-93

¹⁵ D. Mitrany (1975), “A Political Theory for the New Society”, in *Functionalism: Theory and Practice in International Relations*, edited by A. J. R Groom. and P. Taylor (London: University of London Press), p. 30

A network of functional institutions can be established by virtue of “an index of common needs” existing among modern states.¹⁶ Such institutions would be delegated specific functional tasks and transcend national boundaries. They would have a limited existence, and their structure, and power would be as well defined by the extension of the task. They would be made up of technical bureaucrats able to propose impartial solutions to technical problems.¹⁷

Functional agencies promise to start in the individuals an incremental process of transfer of loyalty that will ultimately lead to total supranational co-operation. Once they realise that functional institutions provide better satisfaction to their needs than single nations do, individuals will be ready to shift their loyalty to the new institutions. Political loyalty is not, therefore, an indivisible good, but a “fractionated one” and can be gained by supranational agencies proceeding from function to function, as the individuals experience satisfaction of their needs.¹⁸

Mitrany’s functionalism found an institutional application in the creation of the European Coal and Steel Community (ECSC), with the Treaty of Paris in 1951. Jean Monnet conceived the new institution as a program for economic expansion, able to promote political reform, as well as economic progress. Its task was to co-ordinate the industrial policies of the six member countries and restrict the powers of private industry.¹⁹

The Schumann plan, which produced ultimately the ECSC, was the first of a series of documents constructed to overcome the many constraints to international co-operation raised by established national economic interests. The plan was built on the assumption

¹⁶ “The functionalist approach emphasises the common index of need. Very many such needs cut across national boundaries, not a few are universal, and an effective beginning for building up an international community of interest could be made by setting up joint agencies for dealing with these common needs”. D. Mitrany (1948), “The Functionalist Approach To World Organisation”, *International Affairs*, Vol. 24, pp. 350-361

¹⁷ D. Mitrany (1943), *Op. Cit.*, pp. 72-73 and 92-93

¹⁸ D. Mitrany (1975), *Op. Cit.*, p. 31

¹⁹ J. Gillingham (1991), “Jean Monnet and the European Coal and Steel Community”, in *Jean Monnet: The Path to the European Unity*, edited by D. Brienkley and C. Hockett (London: McMillan), pp. 129-162

that a modest surrender of national sovereignty over the control of some commodities was an acceptable price for the economic and political welfare that would follow co-operation. In the 1955 Messina Conference, the European partners committed themselves to the “establishment of a United Europe by the development of common institutions, the progressive fusion of national economies, the creation of a common market and the progressive harmonisation of national policies”.²⁰

The approach followed by the European architects at this stage was based on the principle of *spill-over* or *chain reaction* effects. According to it, integration would proceed gradually, starting from an initial stage of sectoral co-operation (trade, currency or economic co-operation), later expanding co-operation in scope (to a related sector), or in level (within the same sector but to a deeper extent). Economic co-operation conducted through common institutions would automatically implant political values and habits best suited for political integration.

The ECSC represented an important experience on the path toward European integration. An observer characterised it, as “a school in which the six learned to work together”, so that “when the day of the Common market dawned they were ready to continue their collaboration in much a wider area than coal and steel”.²¹ Walter Hallstein, collaborator of President Adenauer and President of the European Economic Commission between 1958-1967 expressed the hope that “the forces released for the creation of the common market will inevitably take Europe first to the economic union and then to the political union”.²²

A more modern group of institutional theories focuses on the study of international regimes. Regimes are identified as a set of rules and agreements that govern state actions in issue-specific areas (as, for example, transportation or environmental policies). Research in this area is concerned with the need to clarify the conditions under which regimes

²⁰ Quoted in M. O’Neil, (1996), “The Politics of European Integration: A Reader”, (London: Routledge), p. 35

²¹ R. Marjolin (1991), “What type of Europe?”, in *Jean Monnet: The Path to the European Unity*, edited by D. Brienkley and C. Hockett (London: McMillan), pp. 181

²² Quoted in R. Marjolin (1991), *Op. Cit.*

emerge, evolve and collapse.²³ Regimes are perceived as a valuable instrument for international co-operation as they reduce the degree of uncertainty and distrust among states, and the fear that a partner can defect. By providing a constant flow of information, and a forum for negotiations, international regimes make international actors' decisions more predictable, and lower transaction costs. Regimes are seen as an important locus of international learning, which can help producing convergent state policies.²⁴

Transnational Theories

Theories of transnationalism concentrate on the increase in international exchanges and observe the transformation that such an event has imposed to international relations. Individuals and groups become the main actors of co-operation. Robert Keohane presents co-operation as a necessity in a world characterised at the same time by the decline of a hegemonic power and the increase of interdependence among single countries.

In a realist view of the world, co-operation is both made possible and promoted by the emergence of a world hegemon. The concept of "hegemonic stability" implies that order on the world scene is created and maintained by a single power, which, "possessing superiority of economic and military resources, [implements] a plan for international order based on its interests and its vision of the world".²⁵

Increased economic interdependence on the international arena forces individual countries to abandon their restricted vision of self-interest and engage in a continuous search for co-

²³ S. Krasner (editor) (1983), *International Regimes*, (Ithaca, N. Y.: Cornell University Press)

²⁴ P. M. Haas (1989), "Do Regimes Matter? Epistemic Communities and Mediterranean Pollution Control", *International Organization*, Vol. 43, n. 3, Summer, pp.377-403; see also E. B. Haas (1980), "Why Collaborate? Issue-Linkage and International Regimes", *World Politics*, Vol. 32, April, pp. 357-405; O. Young (1986), "International Regimes: Towards a New Theory of Institutions", *World Politics*, Vol. 30, October, pp. 115-117; S. Haggard and B. A. Simmons (1987), "Theories of International Regimes", *International Organization*, Vol. 41, Summer, pp. 491-517

operation in disparate sectors of interaction. To use John Burton's analogy, the "billiard ball model" of a world where nation-states are seen as coherent, sovereign and independent entities, applies no longer. The modern world is better understood as a "cobweb model", a system of "complex interdependencies".²⁶

In a world of complex interdependence "actors other than states participate directly in world politics, [...] a clear hierarchy of issues does not exist, and [...] force is an ineffective instrument of policy".²⁷ Military concerns have shifted down from the top ranks of foreign policy agenda, and economic and environmental problems have become of crucial concern. The number of issues on the table of international negotiations has expanded as a result of this increased interaction. "International relations conducted by governments have been supplemented by relations among private individuals, groups, and societies, that can, and do have, important consequences for the course of events".²⁸

Societies are connected through a network of multiple channels among governmental elites, non-governmental elites, and transnational organisations (multinational banks and corporations). Every individual and every segment of society becomes a potential actor on the international scene. As Burton puts it,

"there is a system of states, and there are also transactions between businessmen, traders, research workers, television stations, drug peddlers, students and others. There are systems or linkages such as those created by amateur radio enthusiasts, by people with the same ideological or religious outlooks, by scientists exchanging papers and meeting together, by people behaving in different ways".²⁹

The emergence of powerful economic subjects, with cross-border interests, broadens the scope of the government's domestic activities and blurs the line between domestic and foreign policy. In this context economic elites and transnational corporations act as

²⁵ R. Keohane (1984) *Op. Cit.*, pp. 9, 31 and 32-33. For a classical statement of hegemonic stability see C. P. Kindleberg (1973), *The World in Depression, 1929-1939*, (Berkeley: University of California Press). For a more recent interpretation see J. Gowa (1986), *Op. Cit.*

²⁶ J. W. Burton (1972), *World Society*, (Cambridge: CUP), pp. 28-32 and pp. 35-45

²⁷ R. O. Keohane and J. S. Nye (1977), *Op. Cit.*

²⁸ J. N. Rosenau (1980), *The Study of Global Interdependence: Essays on the Transnationalisation of World Affairs*, (New York: Nichols), p. 1

“*transmission belts*, making government policies in various countries more sensitive to one another”.³⁰

The literature on transnationalism has two important precedents in the 1950s, represented by Karl Deutsch’s study of “security communities”, and Ernst Haas’ research on European integration. Deutsch argues that the high intensity of communications and transactions between countries makes them less inclined to resolve their conflicts through resorting to large-scale physical force.³¹

Security communities arise when “a group of people has become integrated”, namely when a “we-feeling”, a “common culture based on intense interactions and communications between all levels of society” has emerged.³² In this view integration and international security are equivalent, and integration is depicted as a set of Chinese boxes where “no-war communities”, represent the lowest degree of integration, and “amalgamated communities” the highest.³³

Ernst Haas defines political integration as “the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the pre-existing national states. The end result of a process of political integration is a new political community, superimposed over the pre-existing ones”.³⁴

In his seminal work on the establishment of a European Community, “The Uniting of Europe”, Haas applies a concept of “pluralism of groups, values, and institutions” as the main characteristic of European political life. Through these lenses, Haas examines the attitudes of different segments of European societies towards economic and political

²⁹ J. W. Burton (1972), *Op. Cit.*, p. 36

³⁰ R. O. Keohane and J. S. Nye (1977), *Op. Cit.*, pp. 25-29

³¹ K. W. Deutsch et al. (1957), *Political Community and the North Atlantic Area. International Organisations in the Light of Historical Experience*, (Princeton: Princeton University Press), p. 3

³² *Ibid.*, pp. 17-18

³³ K. W. Deutsch (1954) *Political Community at the International level – Problems of Measurement and Definition*, (Garden City N. Y.: Doubleday), p. 34, and K. W. Deutsch et al. (1957) *Op. Cit.*, p. 6.

³⁴ E. B. Haas (1958), *The Uniting of Europe*, (Stanford: Stanford University Press), First Edition, p. 16

unification, and concludes that the development of the process of integration hinges upon the perception of interests and values of all the actors who participate in the process.

“Major interest groups as well as politicians determine their support of, or opposition to, new central institutions and policies on the basis of a calculation of advantage. The ‘good Europeans’ are not the main creators of the regional community that is growing up; the process of community formation is dominated by nationally constituted groups with specific interests and aims, willing and able to adjust their aspirations by turning to supranational means when this course appears profitable”.³⁵

The consequence is that, if a group perceives integration as being beneficial for the development of their individual or group interests, they will be willing to “shift their loyalty” from their national community towards a “new political community”. As a result “a larger political community can be developed if the crucial expectations, ideologies, and behavioural patterns of certain key groups can be successfully refocused on a new set of central symbols and institutions”.³⁶

Haas identifies the positions of the key interest groups, the political parties and the governments towards concrete steps on the path toward integration, and their “economic expectations”, their “political fears or hopes”, “their ideologies or their notion of the national interest”.³⁷ Different groups are seen reaching “identity of aspirations”, when they share basic values and adopt a similar concept of interest; or “convergence of interests”, when they agree on the final objectives of integration, but their basic values are different. Groups may also be opposed to integration, for identical or converging reasons.

Following the same path, Leon Lindberg and Stuart Scheingold recognise the opportunity for integration to occur when coalitions having identical or converging demands and interests emerge. Coalitions may be created by four types of mechanism, of which “functional spill-over” and “actor socialisation” appear the most important ones. In particular, functional spillover takes place when actors decide to co-operate because they realise that a number of tasks are functionally related to one another. Thanks to actor

³⁵ E. B. Haas (1968), *The Uniting of Europe*, (Stanford: Stanford University Press), Second Edition, pp. 34-35,

³⁶ *Ibid.*, pp. 34-35

socialisation individuals involved in an ongoing decision-making process, which might well be extended over a period of many years, come into close and frequent contact. They are involved in a process of problem-solving and policy-generating.

Commonality of problems and tasks gives rise to a common view of the world among bureaucratic elites, that, for this reason perform an especially important role in fostering integration. Echoing Haas' distinction in "dramatic-political" and "incremental-economic" aims of integration, Lindberg and Scheingold maintain that "Elites (or actors) with dramatic-political aims are those who are concerned with 'high politics', with 'deep ideological or philosophical commitment', with national self-assertion, prestige and grandeur, power in the world. Elites with incremental-economic aims devote themselves to the maximisation of their daily-life welfare concerns and have 'abandoned an interest in high politics'" ³⁸.

If transnational bureaucrats are likely to become agents of integration because of the common set of perceptions and interests they have developed, epistemic communities too provide an important contribution to international co-operation, because of the causal knowledge that they share on specific issues. Peter Haas defines an epistemic community as "a network of professionals with recognised expertise in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area".³⁹ An epistemic community is, therefore, a group of scientists or technical experts that have a shared set of causal and principles beliefs, a consensual knowledge base and a common policy enterprise.

Epistemic communities emerge as important actors on the international arena, as a response to the complexity of the technical questions that professional policy-makers increasingly face. Social or physical processes and their interrelation with other phenomena require

³⁷ *Ibid.*, p. 15

³⁸ L. N. Lindberg and S. A. Scheingold (1970), *Europe's Would-Be Policy. Patterns of Change in the European Community*, (Englewood Cliffs: Prentice-Hall), p. 123

³⁹ P. M. Haas (1992), "Introduction: Epistemic Communities and International Policy Co-ordination", *International Organization*, Vol. 46, n. 1, Knowledge, Power, and International Policy Co-ordination, Winter, p.3

considerable scientific and technical expertise. Economic interdependence and a globalised economy require policy co-ordination, as international and domestic agenda become increasingly intertwined.

Uncertainty about the best path to follow in policy-making or the consequences of alternative policies gives rise to increasing demands for the information that epistemic communities can provide. Epistemic communities, then, illustrate causal relations and provide advice on the possible results of alternative courses of action, explain the complexity of interrelated issues, define (or help defining) the self-interest of a state, and help to formulate policies.⁴⁰

Epistemic communities are not necessarily transnational, but they can become transnational thanks to the diffusion of community ideas in international conferences, journals, and research collaborations or within international organisations. Scholars see epistemic communities behind the introduction of new consensus on questions like nuclear arms control, or environmental threats, and the rise of international regimes.⁴¹

⁴⁰ Ibid., p.15

⁴¹ See for example E. Adler (1992), "The Emergence of Co-operation: National Epistemic Communities and the International Evolution of the Idea of Nuclear Arms Control", *International Organization*, Vol. 46, n. 1, Knowledge, Power, and International Policy Co-ordination, Winter, pp.101-145; C. Enloe (1975), *The Politics of Pollution in a Comparative Perspective*, (New York: David McKay) P. M. Haas (1990), *Saving the Mediterranean: The Politics of International Environmental Co-operation*, (New York: Columbia University Press); K Sebenius (1981), "The Computer as a Mediator: Law of the Sea and Beyond", *Journal of Policy Analysis and Management*, Vol. 1, pp. 77-95

Theories of Domestic Politics

Theories of domestic politics are characterised by a common concern with the domestic political and economic structure as the factor determining co-operation and integration. These theories are devoted to an examination of the components that constitute the domestic political arena and to the role that these components play in defining the international scene.

Theories of domestic politics move from the assumption that the structure of domestic politics does not only affect but determines the outcomes of foreign policy.⁴² The interrelation between domestic and international politics is manifest in both directions. Thus, on the one side, a country's position on the international arena influences its domestic political and economic situation, while, on the other side its domestic structure shapes its behaviour in foreign relations.⁴³ In the words of Andrew Moravcsik:

"State-society relations – the relationship of states to the domestic and transnational social context in which they are embedded – have a fundamental impact on state behaviour in world politics. Societal ideas, interests, and institutions influence state behaviour by shaping state preferences".⁴⁴

American literature has been particularly prolific on the analysis of the influence exerted by domestic factors on foreign policy. Following Peter Gourevitch's notion of "the second image reversed", scholars have demonstrated that the structure of domestic power has been historically one of the key factors behind US military intervention abroad.⁴⁵ The contrast between domestically or internationally oriented banks and multinational enterprises and

⁴² H. Milner (1998), "Rationalising Politics: The Emerging Synthesis of International, American and Comparative Politics", *International Organization*, Vol. 52, n.3, Autumn, pp. 759-786

⁴³ for example, H. V. Milner (1997), *Interests, Institutions and Information: Domestic Politics and International Relations*, (Princeton: Princeton University Press)

⁴⁴ A. Moravcsik (1997), "Taking Preferences Seriously: A Liberal Theory of International Politics", *International Organization*, Vol. 51, n. 4, Autumn, p. 513

⁴⁵ J. Gowa (1998), "Politics at the Water's Edge: Parties, Voters, and the Use of Force Abroad", *International Organization*, Vol. 52, n. 2, Spring, pp. 307-324; P. A. Gourevitch (1978), "The Second Image Reversed: the International Sources of Domestic Politics", *International Organization*, Vol. 32, n. 4, Autumn, p.904.

their representatives in the Senate are believed to have dictated US foreign policy in the Cold War era.⁴⁶ Domestic motivations are recognised behind states' decisions to adopt costly international moral actions, and states' inclination towards conflict or peace.⁴⁷ Finally, foreign economic policies are seen as the reflection of the "stress and contradiction in domestic structures", the product of the struggle between export-oriented, technologically advanced industries and import-competing, technologically backward ones, between industry and finance, and between organised labour and business.⁴⁸

According to Gourevitch, theories that explain international co-operation as the outcome of domestic policies can be divided into two broad categories: preference-driven and institution-driven. In preference-driven theories, foreign policy is the result of ideology, economic context, self-interest and other factors related to domestic agents. Decision-makers have to take into account the preferences of state actors in order to retain their offices. Domestic agents can make their voices heard either thanks to functional power (strikes and capital flight) or political power (elections). Institution-driven models, on the contrary, define foreign policy as the result of a process conducted by political institutions; the way in which preferences are aggregated, that is the way institutions work, influences the final results of foreign policy.⁴⁹

Theorists of domestic politics aim to draw attention from the international to the domestic level of diplomacy. The domestic level, Gourevitch argues, is of extreme importance for the achievement of co-operation: "co-operation will in either case require domestic concordances". "Co-operators' in each country will have to find common ground with

⁴⁶ B. O. Fordham (1998), "Economic Interests, Party, and Ideology in Early Cold War Era US Foreign Policy", *International Organization*, Vol. 52, n. 2, Spring, pp. 359-396

⁴⁷ C. D. Kaufman and R. A. Pape (1999), "Explaining Costly International Moral Action: Britain's Sixty-year Campaign Against the Atlantic Slave Trade", *International Organization*, Vol. 53, n. 4, Autumn, pp. 631-668; D. P. Auerswald (1999), "Inward Bound: Domestic Institutions and Military Conflicts", *International Organization*, Vol. 53, n. 3, Summer, pp. 469-504; M. R. Gordon (1974), "Domestic Conflict and the Origins of the First World War: The British and the German Case", *Journal of Modern History*, Vol. 46, n. 2, June, pp. 191-226

⁴⁸ P. J. Katzenstein (1977), "Conclusion: Domestic Structures and Strategies of Foreign Economic Policy", *International Organization*, Vol. 31, n. 4, Autumn, Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States, p. 917

⁴⁹ P. A. Gourevitch (1996), "Squaring the Circle: the Domestic Sources of International Co-operation", *International Organization*, Vol. 50, n. 2, Spring, pp. 349-73

their allies in other countries, constructing a regime that is able to provide enough benefits for the winners to overcome the losers in each country seeking to overthrow the regime”.⁵⁰

Robert Putnam’s two-level game model arises precisely from the consideration that, in order to understand the outcome of international negotiations, the domestic as well as the international level must be taken into account simultaneously. As Putnam says, a national negotiator is engaged in an international as well as a domestic action, exposed to pressures from the domestic and the international negotiating table.

“Across the international table sits his foreign counterparts, and at his elbow sit diplomats and other international advisors. Around the domestic table behind him sit party and parliamentary figures, spokespersons for domestic agencies, representatives of key interest groups, and the leader’s own political advisors”.⁵¹

At the national level, then, domestic groups pursue their interests by pressurising the government to adopt favourable policies, while for politicians support of coalitions is vital to retain their power. At the international level, national governments seek to maximise their own ability to satisfy domestic pressures, while minimising the adverse consequences of foreign developments.

On the basis of this assumption international conflict and co-operation can be modelled as processes that take place in two stages. In the first stage governments define the set of domestic interests. At the second stage, they bargain among themselves in an effort to realise those interests. The configuration of domestically determined national preferences defines a “bargaining space” of potentially viable agreements, each of which generates gains for one or more participants. “Negotiation is – therefore - the process of collective choice through which conflicting interests are reconciled”.⁵²

⁵⁰ *Ibid.*, p.362

⁵¹ R. D. Putnam (1988), “Diplomacy and Domestic Politics: the Logic of Two-Level Games”, International Organization, Vol. 42, n. 3, Summer, p. 434

⁵² A. Moravcsik (1993), “Preferences and Power in the European Community: A Liberal Intergovernmentalist Approach”, Journal of Common Market Studies, Vol. 31, n. 4, December, p.497

While theorists have agreed about the necessity of considering the interrelationship between the domestic and international level, the elements that constitute this interrelationship have proved more contentious. The realist assumption of a unitary national interest ignores the existence of multiple preferences within a polity, and with it the process whereby preferences are aggregated.⁵³ Theories of domestic politics, instead, assume the centrality of individuals and interest groups in the political process. Actors are rational and risk-adverse and organise their collective action aiming at the maximisation of their profit within the boundaries set by factors like “material scarcity, conflicting values and variations in social influence”.⁵⁴ This is what Milner calls a “poliarchy”.

In poliarchy “actors domestically have distinct preferences, and fashioning some single national preference is dependent on the resources the actors possess and the institutions in which they operate”. According to this picture, national interest becomes a “contested term”, the result of strategic games among all the internal actors (decision-makers, legislatures, bureaucracies and other domestic groups).⁵⁵

The definition of the national interest is the result of a complex process in which many factors intervene. The country’s major interests groups, their position in the domestic political and economic structure, their relations to the world system and the possible outcomes of a change of conditions on the international arena, the commonality of interests that prompts different groups to establish coalitions, all these factors play a significant role. In Jeff Frieden’s words:

“The national interest is not a blank slate upon which the international system writes at will; it is internally determined by the socio-economic evolution of the nation in question. [...] These goals are set by the

⁵³ Milner hypothesises that preference aggregation in a realist perspective must respond to one of the following conditions: (1) One domestic actor (one individual or group) has control foreign policy, and its preferences are elected to the level of national interest. (2) On a particular issue all members of the community share the same vision and preferences (e.g. the national survival. (3) All national politics is summarised in one utility function that does not correspond to the interests of one specific group or individual, but represents the results of the domestic political game. H. Milner (1998), *Op. Cit.*

⁵⁴ A. Moravcsik (1997), *Op. Cit.*, p. 516

⁵⁵ H. Milner (1998), *Op. Cit.*, p. 772

constraints and opportunities that various domestic economic interests face in the world arena and by the underlying strength of the various socio-economic groups”.⁵⁶

This consideration has two major implications. One, that preferences (actors’ preferences and groups’ preferences) are key in the process of foreign policy-making. Government policy is “constrained by the underlying identities, interests, and power of individuals and groups who constantly pressure the central decision-makers to pursue policies consistent with their preferences”.⁵⁷ Two, that the concept of national interest appears nothing more than the screen behind which private interests of powerful domestic groups or bureaucracies are concealed.

“States (or other political institutions) represent some subsets of domestic society, on the basis of whose interests state officials define state preferences and act purposively in world politics”. The state is not an actor *per se*, but a “representative institution constantly subject to capture and recapture, construction and reconstruction by coalitions of social actors”.⁵⁸

Policy preferences are then characterised as “a set of fundamental interests defined across ‘states of the world’; [they are] causally independent of the strategies of other actors and, therefore, prior to specific interstate political interactions, including external threats, incentives, manipulations of information, or other tactics”.⁵⁹ As preferences of societal actors are determined by the actors’ position in the international and domestic economy, societal actors apply pressures on the governments, and “form coalitions, involving bargaining and tradeoffs, to mobilise the consent they need to prevail”.⁶⁰

The structure of policy preferences of domestic actors determines, consequently, a country and its elites’ inclination towards international co-operation. As Helen Milner points out:

⁵⁶ J. Frieden (1988), “Sectoral Conflict and Foreign Economic Policy, 1914-1940”, International Organization, Vol. 42, n. 1, Winter, The State and American Foreign Economic Policy, pp. 88-89

⁵⁷ A. Moravcsik (1997), *Op. Cit.*, p. 518

⁵⁸ *Ibid.* p. 518

⁵⁹ *Ibid.*, p. 519

⁶⁰ P. Gourevitch (1986), *Politics in Hard Times. Comparative Responses to International Economic Crises*, (Ithaca: Cornell University Press), p. 55

“Co-operation among nations is affected less by fears of other countries’ relative gains than it is by the domestic distributional consequences of co-operative endeavours. Co-operative agreements create winners and losers domestically; therefore they generate supporters and opponents. The internal struggle between these two groups shapes the possibility and nature of international co-operative agreements”.⁶¹

Domestic coalitions are constructed precisely as a result of this dynamic reaction between winners and losers of externally induced actions (what Moravcsik calls “domestic distributional conflict”).⁶² Ronald Rogowski relates the emergence and realignment of domestic coalitions to the distinctive factor endowment of each country and to shifts in international trade flows. Following the assumptions of the Stoper-Samuelson theorem of international trade, Rogowski highlights the divergent effects that the introduction of protectionist measures produce on different economic actors, motivating them to political mobilisation in pursue of protectionist measures.

Protectionism benefits owners of factors in which, relatively to the rest of the world, the country is poorly endowed, while it penalises owners of factors which, relatively to the rest of the world the country is richly endowed (or producers who use those locally abundant factors intensively). As a result, those who benefit from the change in trading patterns will try to continue accelerating change, while those who suffer from it will try to retard or halt change. Economic wealth is rapidly translated into political capital and an expansion in influence on (or within) policy-making institutions.⁶³ Coalitions can also be based on sectors, rather than on factors of production, or they can emerge on the convergence of firm’s interests.⁶⁴

The effects of variations in international conditions on the domestic scene become more intense in a world exposed to increasing internationalisation. Helen Milner and Robert

⁶¹ H. V. Milner (1997), *Op. Cit.*, pp. 9-10.

⁶² A. Moravcsik (1997), *Op. Cit.*, p. 529

⁶³ R. Rogowski (1989), *Commerce and Coalitions: How Trade Affects Domestic Political Alignments*, (Princeton: Princeton University Press), Chapter 1, pp. 3-20

⁶⁴ P. Gourevitch (1986), *Op. Cit.*,

Keohane define internationalisation as the “processes generated by underlying shifts in transaction costs that produce observable flows of goods, services and capital”.

Internationalisation is seen to affect domestic politics in two ways. Firstly, by modifying the opportunities and constraints facing social and economic actors, internationalisation influences the policy preferences of actors, that is their choices about which policies will be more effective to achieve their goals. Secondly, internationalisation produces effects on the aggregate welfare of countries, increasing their sensitivity and vulnerability to external changes, and, therefore, the constraints and opportunities that their governments face.⁶⁵

From an analytical perspective the concepts of coalitions and preferences become important tools to decode the policy process. In order to understand the policy choices adopted by a government, Gourevitch suggests the analysis to be focused on the coalitions that were formed in connection with alternative policy packages, on the assumption that choices made by politicians are constrained by “the need to mobilise or retain support”.

“To understand a country’s policy choice requires us to do some mapping of the country’s production profile: the situation of the societal actors in the international economy, the actor’s policy preferences, their potential bases of alliance or conflict with other forces, and the coalitions that emerge. When countries converge (or diverge) on economic policy, they are likely to do so because of the similarity (or difference) in the pattern of preferences among societal actors.”⁶⁶

While the concept of coalitions provides an important link between the domestic and international political levels, bureaucratic politics too offers a critical element. In theories of domestic politics the state is depicted as neither the only significant actor, nor necessarily the most important one. The state does not always act as a rational unified entity. State officials become themselves part of the preference-game using their unique

⁶⁵ H. V. Milner and R. O. Keohane (1996), “Internationalisation and Domestic Politics: An Introduction”, in *Internationalisation and Domestic Politics*, edited by H. V. Milner and R. O. Keohane (Cambridge: CUP), p. 4; see also J. Frieden and R. Rogowskii, (1996), “The Impact of the International Economy on national Policies: An Analytical Overview”, in *Internationalisation and Domestic Politics*, edited by H. V. Milner and R. O. Keohane (Cambridge: CUP), pp. 25-47

⁶⁶ P. Gourevitch (1986), *Op. Cit.*, p. 59

position to enter into transnational coalitions and alter the stakes and outcome of political debates.

Thanks to the administrative resources they manage, bureaucrats can mobilise otherwise inactive societal groups to counterbalance the political weight of their adversaries.

Moreover, they can modify the state institutions and utilise their position as the principal makers of foreign policy.⁶⁷ This is a situation in which, in the words of Henry Kissinger, “the staff on which modern executives come to depend develop a momentum on their own. What starts out as an aid to decision-makers often turns into a practically autonomous organisation whose internal problems structure and sometimes compound the issues which it was originally designed to solve.”⁶⁸

The study of bureaucratic politics originated as a result of the considerable growth of bureaucracies as complex and independent structures:

“The size of this bureaucracy and the scale of its operations have become so large that they lead to a lack of control by central foreign policy decision-makers. Informal networks and alliances, reinforced by the idiosyncratic factors tied to the character and position of particular individuals, work in the same direction”.⁶⁹

In their classical analysis of the American security system, Graham Allison and Morton Halperin provide a framework of interpretation, which intends to disprove the traditional assumption of “purposive unitary nations”. On the basis of this assumption the actions of international actors are understood as the behaviour of unified national governments, and the analysis of international politics focuses on “the interests and goals of a nation, the alternative courses of actions available, and the costs and benefits of each alternative”.

⁶⁷ G. J. Ikenberry et al. (1988), “Introduction: Approaches to Explaining American Foreign Economic Policy”, *International Organization*, Vol. 42, n. 1, The State and American Foreign Economic Policy, Winter, p. 10

⁶⁸ H. A. Kissinger (1977), *American Foreign Policy*, (New York: W. W. Norton & Company), Third Edition, , p. 20

⁶⁹ P. J. Katzenstein (1977), “Introduction: Domestic and International Forces and Strategies of Foreign Economic Policy”, *International Organization*, Vol. 31, n. 4, Autumn, Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States, pp. 598.

On the contrary, bureaucratic politics values the fact that the bureaucracy, in its capacity as concrete maker of the government's policy, is not "one calculating decision-maker, but rather a conglomerate of large organisations and political actors, who differ substantially about what their government should do [...], and who compete in attempting to affect both governmental decisions and the actions of their government".⁷⁰

In a different study on the American decision to deploy a ballistic missile defence system in the late 1960s, Halperin follows the same methodology and dissects the main actors involved in the decision-making process (the Army, the Directorate of Defence, Research and Engineering). To understand the final resolution, he argues, it is important to identify interests and preferences of the main actors. "When individuals in the American government consider a proposed change in the American foreign policy, they often see and emphasise quite different things and reach different conclusions". A foreign policy decision then never appears as the outcome of a unitary will, but rather as the result of the "pulling and hauling of many different players with different interests".⁷¹

Finally, the role of institutions needs to be considered in the relationship between domestic and international politics. Theories of domestic politics can be divided in two sub-groups depending on whether they emphasise the role of societal actors (society-based theories) or the role of state institutions (institution-based theories) in the process of determining preferences.

Society-centred approaches (especially those studying American economic foreign policy making) have been accused of devoting scarce attention to the contribution and the mediating role exercised by government institutions. Institution-based theorists lament that in society-based approaches government institutions are seen as providing only an arena for group competition while having no significant impact on resulting decisions. This is why, it is remarked, society-centred approaches risk overlooking the "critical intervening role

⁷⁰ G. T. Allison and M. H. Halperin (1972), "Bureaucratic Politics: A Paradigm and some Policy Implications", *World Politics*, 24, Supplement, pp. 40-72

⁷¹ M. H. Halperin (1972), "The Decision to Deploy the ABM: Bureaucratic and Domestic Politics in the Johnson Administration", *International Organization*, Vol. 25, n. 1, October, pp. 65, 90

that state actors and institutions may play in shaping the constellation and impact of interest groups in the policy process”.⁷²

In institution-centred approaches institutions are presented as a filter that selects and channels societal pressures. “By setting down the rules of the game, institutions reward or punish specific groups, interests, visions, persons”. The importance of institutions lies “in the way a given structure at specific historic moments helps one set of opinions prevail over another”.⁷³ Milner defines institutions as “socially accepted constraints or rules that shape human interactions”. In particular, political institutions “shape the process by which preferences are aggregated”.

There are four crucial powers that confer domestic actors authority in the process of aggregating preferences:

- (i) Initiating and setting the agenda
- (ii) Amending proposed policies
- (iii) Ratifying or vetoing policies
- (iv) Proposing public referenda.⁷⁴

Institutions and preferences interact according to a ‘spill-over’ schema. Policies influence the structure of society, so that uncompetitive actors are eliminated from it, while strong actors prosper. Gradually interests are altered and reshaped, and with them preferences. Groups develop an interest in the policy of the supranational state and in its institutions. The institutions produce, then, their own constituencies, which have a stake in the perpetuation and growth of the system. “Politicians judge the domestic political costs of honouring the commitments, and voters and interest groups judge the effects of those

⁷² G. J. Ikenberry et al., (1988), *Op. Cit.*, p. 9

⁷³ P. A. Gourevitch (1978), “The Second Image Reversed: the International Sources of Domestic Politics”, *International Organization*, Vol. 32, n. 4, Autumn, p. 904

⁷⁴ H. V. Milner (1997), *Op. Cit.*, p. 18

policies on their welfare. Institutions alter these strategic judgements, but one of the variables at play is the durability of the institutions themselves”.⁷⁵

The different response that institutions give to societal pressures is the result of historical factors that characterised the development of the state. Scholars distinguish between weak states, which have fragmented political institutions and are, therefore, open to pressures from interest groups and parties, and strong states, which consist of centralised political institutions with strong bureaucracies and are, therefore, able to preserve a higher degree of autonomy vis-à-vis society.⁷⁶

The nature of the state (weak vs. strong state) is determined by a number of factors, of which difference in models of economic growth is probably the most important one. Gerschenkron’s theory on the sequence of industrialisation shows that late modernisers (France, Germany, Japan, and Russia) required a massive intervention of the state to support a rapid rate of growth and the development of economic sectors that required a heavy injection of capital. As Krasner summarises it, “the state played a direct role in moving the economy from a mercantile and agricultural base to an industrial one, particularly by mobilising resources and dispensing investment funds”.⁷⁷

Also Katzenstein stresses the influence exercised by historical factors, such as “the elimination of feudalism, the unfolding of the industrial revolution, the building of a modern state” on the current shape of contemporary states. Katzenstein distinguishes between countries with a democratic past that experienced the industrial revolution earlier (Anglo-Saxon model), and favoured a liberal approach to international political economy; and countries with an authoritarian past, which experienced industrial revolution later (Japan, “state capitalism model”) and were supportive of mercantilist strategies.⁷⁸

⁷⁵ P. A. Gourevitch (1996), *Op. Cit.*, p.364

⁷⁶ T. Risse-Kappen (1991), “Public Opinion, Domestic Structure, and Foreign Policy in Liberal Democracies”, *International Organization*, Vol. 53, N. 4, July, p. 484 and 495

⁷⁷ S. D. Krasner (1978), *Op. Cit.*, p. 68

Both democratic institutions and coalition-building interact heavily to construct a model of foreign policy decision-making that is specific for each individual state. “State structures do not determine the specific content of direction of policies”, and coalition-building takes place in the framework of political and societal institutions. The structures of the society and the political system determine the size and strength of policy coalitions needed to create the support basis for specific policies.⁷⁹

Arguments Against Institutional and Transnational Theories

In the case of co-operation between Russia and Ukraine, the institutional and transnationalist theories outlined in the previous sections contain two sets of problems that together render them insufficient to explain relations between the two countries.

First, these approaches take the concept of interest for granted, so ignoring the domestic scene through which these interests are defined, the agents that participate in the definition of interest, and the possible changes in this definition that can occur through time. This argument is important in the case of Russo-Ukrainian relations because of the special position that powerful interest groups occupy in the process of interest-definition and in setting the agenda pro or against co-operation.

The second problem is related to what Ernst Haas calls “the end of ideology” and David Mitrany emphasises in the triumph of administration. Ideology and nationalism (be it genuine or an artificial construction) are factors that have become an integral part of the political discourse in post-Soviet Russia and Ukraine, intensified by the complexity of their common history and interrelation, and still weight heavily on the course of their bilateral relations.

⁷⁸ P. J. Katzenstein (1977), “Conclusion: Domestic Structures and Strategies of Foreign Economic Policy”, *International Organization*, Vol. 31, n. 4, Autumn, Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States, pp. 907-908

When they talk about interests, institutional and transnational theorists present an immutable concept of interests, consistent in time and irrespective of different contingent situations. Even if they do not presume complete harmony within the same society, institutionalists and transnationalists do not explain how interests are aggregated, how they are represented within the governmental institutions, how they come to be put forward and defended as the national interest.

Deutsch's notion of "mutual responsiveness" is an example of this shortcoming. By establishing mutual transactions, based on the exchange of mail, visits, and other sorts of information, single individuals, he maintains, become the primary protagonists of the integration process. They contribute to the construction of a "we-feeling" and a "special relationship" that make violence an inconceivable instrument for the solution of conflicts.

Yet, shall we assume that individuals share the same vision of the world? Will they have the same interests irrespectively of their class, ethnic, gender, religious, or geographical belonging?⁸⁰ Increased communication does not imply automatic commonality of interests. This seems particularly true in the case of Russian and Ukrainian economic elites, which are indeed competing for control over markets and limited resources. In this case, some sections of the economic elites become a barrier to rather than a "transmission belt" for co-operation.

Furthermore, when the international dimension is introduced into the political game, neither Deutsch nor his fellow transnationalists conduct a systematic analysis of the repercussions that the international level produces on the domestic one.⁸¹ They seem to ignore effects of economic fluctuations on domestic economic agents, political pressures imposed by international organisations on internal governments, or even effects of changes in domestic regulations as a result of international agreements.

⁷⁹ T. Risse-Kappen (1991), *Op. Cit.*, p. 485

⁸⁰ For a critical interpretation of Deutsch's work, and, in particular, of the contradictions inherent in the concept of transactions see J. K. De Vree (1972), *Political Integration: The Formation of Theory and its Problems*, (The Hague: Mouton), chapter 4.

By ignoring this interrelation, transnationalist views fails to capture the dynamic dimension of politics and societies. Interests may change over time, even within the same elite group, and coalitions may converge in a certain period or diverge in another, as a consequence of alterations in the domestic as well as in the international arena. Elite groups may be satisfied with a limited form of integration (or co-operation) in one period, and lobby for more integration (or co-operation) in another period.⁸²

Only an accurate analysis of the domestic structures, the weight of institutional and non-institutional actors on the decision-making process, the groups' preferences and the effects that on these preferences external factors produce can help understanding the alternate course of relations between Russia and Ukraine, and the possibility of changes in a future course.

Mitrany's presumption of a bloc of "needs", common to the whole society, recognised and attended by a bureaucratic elite not only presents an immobile vision of society, but involves inherent risks of authoritarian degeneration. In Mitrany's explanation, needs are given, and factors like ideology or non-rational behaviour play no role in their determination. Few individuals (without any specification of how those individuals should be selected) are allowed to participate in the administration, but not in the definition of needs, which is a role reserved to the bureaucrats.

The assumption that the bureaucracy acts as an impartial interpreter of societal interests presents problems. How do bureaucrats understand societal interests? Do not technocrats have their own values? Is not technocracy an ideology it itself? Ideas like welfare, one of the principal needs identified by Mitrany, is not a universal concept, and different countries, differing in size, natural resource endowment, level of economic and social development and ideological orientation, may not share the same interests.

⁸¹ H. V. Milner and R. O. Keohane (1996), *Op. Cit.*,

⁸² The fluctuation of interests and the lack of immobility in elite coalitions are often brought in to explain, for example, the stop-and-go pattern of European integration. On this point see W. Sandholtz and L. Zysman (1989), "1992: Recasting the European Bargain", *World Politics*, Vol. 42, n. 1, October, pp. 95-128.

Centralisation and bureaucratisation can easily lead to a world where control and administration are completely taken over by a class of bureaucrats and technocrats. The ultimate possible consequence is an oligarchic or totalitarian structure, where, in the name of efficiency, political debate and ideological disputes are reduced or banned. Who can decide when activities are “inherently controversial”, and must then be subjected to political discussions, or are “inherently non-controversial” and belong, to the realm of technical evaluations?

Also the architects of the European integration, together with Ernest Haas’ theory of convergent cross-border coalitions, believed in the existence of a non-ideological approach based on procedural consensus, where the individual’s choices are made on the basis of pure self-interest. If, on the one side, this perspective appears fascinating for its efficiency-boosting approach, on the other side depicting political controversies as a surmountable inconvenient, rarely corresponds to reality.

In the case of relations between Russia and Ukraine this perspective ignores three main aspects. Firstly, the significance that post-Soviet Ukraine attaches to its sovereignty. Secondly the fact that in Russia and Ukraine politics and economics are not two divorced aspects of life. Thirdly that segments of society, which might be conducive of increased co-operation, are part of a finely tuned balance of institutional and societal forces that may construct significant opposition on an issue as sensitive as bilateral relations. I shall return on these points after another examination of Ernst Haas’ theory of transnational coalitions.

In the first edition of his work on European integration Ernst Haas prophesised that post-war Europe was ready to give up national sovereignty and ideological confrontation, as nationalism and ideology were phenomena that belonged to the past. The end of ideology was, Haas argued, the cornerstone on which European integration would be built. The stalling of the integration process, instead, brought about mainly by the leadership of General De Gaulle and his policy of *grandeur*, contradicted severely this belief.⁸³

⁸³ The whole section is based on E. B. Haas (1968), *Op. Cit.*, the Author’s Preface, pp. XI-XXX

With the insight of ten years of history, Haas admits in a further edition of his book, the limitations of his theory and reassesses it, pointing out a number of alternative factors to the “end of ideology”, that took Europe to a consolidation of its mutual interrelation. Haas provides a new definition of nationalism and an analysis of the conditions that at the end of the Second World War, convinced European countries to relegate nationalistic forces to the margin of the political panorama.

Haas distinguishes between three key concepts. First, an *ideology of nationalism*, which presents “positive values with respect to one’s own nation and less positive ones for the outsiders”. Second, a *national consciousness*, which corresponds to the feeling of belonging of the inhabitants of the state, and finally a *national situation*, which is a “condition in time and space describing the power, freedom of manoeuvre and ranks of one’s nation vis-à-vis others”.

Haas argues that, in the aftermath of the Second World War, the European nations shared a very pessimistic view of their *national situation*, regarding themselves as either defeated or dependant countries, faced with the gigantic task of post-war reconstruction. The *national consciousness* reflected this negative perception, and, as a result, the *ideologies of nationalism* were “far from ebullient, self-confident, assertive and hostile”. This whole condition provided the perfect ground for the demise of a discredited national power in favour of a more reliable supranational institution, which would guarantee “security and welfare, peace and plenty without repeating the nationalist mistakes of an earlier generation of statesmen”.

This functionalist approach was seen as the winning attitude in the process of European integration, because the process itself was set in motion to “safeguard an existing way of life”. The establishment of a “welfare state”, with its subordination of “world commitments and an independent foreign policy to the economic and fiscal demands of domestic welfare”, became a crucial task of the European countries’ policies. On this basis, politics developed as an instrument to achieve economic aims. The early architects of European integration “had decided to leave the game of high politics and devote themselves

to the building of Europe, to achieve more modest aims". By doing so they provided the "shelter" needed by the economic technicians to enhance their project.

In the years to come, however, functionalism proved a short-lived framework, unable to respond elastically to a change in the international system. When the depressing perspectives of the post-war years gave way to the resurgence of the national state, the defence of its alternative interests vis-à-vis the supranational structure appeared again to be of primary importance. Haas recognises the shortcomings of his theory as formulated in 1958 in not having foreseen the emergence of a figure like General de Gaulle, who gave back his country the vision of a positive *national situation*, and restored politics in its traditional position of pre-eminence vis-à-vis economics. With the advent of General de Gaulle the process of European integration came to a halt.

The reliance of the process of integration exclusively on the pursuit of welfare is what Haas defines one of its "built-in limits". The primary shortcoming of this approach is precisely what was originally seen as its strong point: the absence of ideology. "Pragmatic interests, because they are pragmatic and not reinforced with deep ideological or philosophical commitment are ephemeral". They are fragile and can easily be relegated to a marginal position, when the general circumstances change. The consequence is that "a political process that is built and projected from pragmatist interests is bound to be a frail process susceptible to reversal. And so integration can turn into disintegration".

The theory of integration promoted by Ernst Haas is given particular consideration here because it corresponds very closely to the theory of co-operation put forward by pragmatists in Russia and Ukraine, and to the CIS doctrine of integration. The shortcomings illustrated by Haas are thus relevant also in the post-Soviet case. There are four points particularly worth raising.

First, the Ukrainian "national situation" in the period between 1994-1998 did not seem conducive of integration with Russia. The defence of a newly acquired sovereignty was high on the agenda of political forces and still enjoyed wide support among the population.

The signature of a comprehensive Treaty of Friendship and Co-operation in May 1997, repeated efforts to re-orient energy supply markets to curb the dependence on Russia, and improved links with Western partners were evidence of an attempt to place relations with Russia on an equal footing. The recognition and safeguard of Ukraine's autonomy and sovereignty were key aspects of this policy.

Second, both in Russia and Ukraine there was no separation between politics and economics, even though technocratic arguments acquired a wide audience. In the period under examination, on the contrary, the economy and politics were strongly intertwined. When members of the economic elite joined together they made a political statement. When they became engaged in political activities they had an interest, often a private interest, in claiming special conditions for their business or for their sector. In Russia and Ukraine access to the political sphere enabled access to restricted markets, the creation of monopolies, the allocation of budget resources, and the acquisition of privatised assets.

Third, Haas' approach ignores the combination of the social and political forces in Russia and Ukraine; the relative force of the economic elite vis-à-vis the other groups, the institutional settings and the permeability of institutions to societal factors, the power of the economic elite within the institutions.

All these elements lead to the conclusion that a broad societal perspective cannot be overlooked in the process of rapprochement between the two Slavic neighbours. Even if the forces that intended to promote the process enjoyed transnational connections, if they had no considerable influence on the social and the institutional level, the process was bound to failure. Control of (or influence over) the institutional level allowed preferences towards integration and co-operation to find a space on the political agenda.

Conversely, opposition to integration and co-operation among segments of the elite that enjoyed direct access to policy-making represented a severe impediment to a policy of rapprochement. Finally, the intense fragmentation in the Ukrainian polity along institutional (executive vs. legislative), geographic (East vs. West), ideological

(Russophiles vs. Russophobes), and economic (privatised vs. state economy) cleavages made it difficult for one section of society to appropriate the discourse over co-operation and to advance it in the face of opposing domestic voices.

Arguments in Favour of Theories of Domestic Politics

For the reasons discussed above, institutional and transnational theories of international relations are insufficient to provide a comprehensive understanding of relations between Russia and Ukraine. Instead, I propose to supplement them with theories of domestic politics as they are better equipped to account for relations between the two countries, in particular their dynamic character.

The concept of social identity, for example, is of central importance for post-Soviet Russia and Ukraine as it defines the “bargaining space” within which concessions can be made and a rapprochement can be negotiated. Andrew Moravcsik defines social identity as “the set of preferences shared by individuals concerning the proper scope and nature of public goods provision, which, in turn, specifies the nature of legitimate domestic order by stipulating which social actors belong to the polity and what is owed them”.

Social perceptions of “legitimate borders, political institutions, and modes of socio-economic regulation” set the ground for a discussion on the terms of the bilateral relations and inform the foreign policy of the two countries. The hypothesis being, to put it again in Moravcsik’s words, that if national claims can be made more compatible by reciprocal policy adjustment, co-operation is likely. Whereas, if social identities are incompatible and create significant negative externalities, tension and zero-sum conflict are more likely.⁸⁴

Furthermore, because Ukraine, and in a different way Russia, are both weak states it is important to define the set of actors at play and their distinct preferences in order to understand the process of foreign policy-making. In a weak state, “political power is

⁸⁴ A. Moravcsik (1997), *Op. Cit.*, p. 525

fragmented and dispersed. There are many points of access to the decision-making process. Political leaders must struggle to maintain control when they confront opposition from large private corporations".⁸⁵ Post-Soviet societies have witnessed the fragmentation of the state, increased factionalisation within the polity, and the inter-penetration of powerful private interests with state institutions.

Although currently weak, Russia and Ukraine have emerged from a historical form of development that gave primacy to a strong state. Within the Russian Empire and the Soviet Union state institutions performed an entrepreneurial role in the process of industrialisation and economic growth. This understanding of the correct role of the state still informs the political culture of the region and makes mercantilist and protectionist options not only legitimate but a defining activity of the state. In the period 1994-98 this conception of the essential role of the state, with its mercantilist and protectionist assumptions and arguments of economic nationalism, served to justify the emergence of coalitions forged from political and economic actors in favour of narrow economic interests.

The definition of policy objectives, therefore, reflected the preferences and material interests of the ruling coalition, which combined political and economic forces often placed in "institutions a step removed from electoral".⁸⁶ The structure of the domestic political system acquired then a special importance, as the conditions of domestic political representation determined whose social preferences were institutionally privileged. As Moravcsik has noted "When political representation is biased in favour of particularistic groups, they tend to 'capture' government institutions and employ them for their needs alone, systematically passing on the costs and risks to others. The precise policy of governments depends on which domestic groups are represented".⁸⁷

A final element that requires consideration is the degree of interrelation between elements of the domestic economy with world markets, and the degree to which domestic agents are exposed to fluctuations in the international system. In countries like Ukraine and Russia,

⁸⁵ S. D. Krasner (1978), *Op. Cit.*, p. 18

⁸⁶ P. J. Katzenstein (1977), *Op. Cit.*, p. 892

which are economically unstable and institutionally weak, internationalisation increased the vulnerability of internal markets vis-à-vis world markets. In the early phase of transition, economic shocks from abroad were more fully and quickly translated into the domestic economy.

At the same time, the autonomy of the governments' macroeconomic policies was severely restricted by internationalisation, while weak domestic institutions were incapable or unwilling to make appropriate but unpopular responses. This phenomenon was reflected in the emergence of ephemeral political-economic coalitions exposed to and affected by international fluctuations, in which mobile capital, with its increased opportunities for exit, easily translated its economic influence into political power.⁸⁸

Conclusions

The pluralist theories of international relations outlined above contribute important insights into the nature of relations between Russia and Ukraine in the period 1994-98.

Institutionalist and transnationalist theories, in particular, with the emphasis they place on supranational institutions and transnational coalitions as agents of co-operation, recall the Russo-Ukrainian pragmatist approach and the CIS doctrine of integration. These two approaches fail, however, to account for the fluid and unstable situation that developed in relations between the post-Soviet states. To understand the reality of the bilateral relations and the possible changes of course in the future, the domestic balance of power is a factor that cannot be overlooked.

Economic actors alone cannot be automatically expected to establish cross-border coalitions, and join in transnational corporations to foster co-operation, in virtue of a commonality of interests that goes back in time to the Soviet era. Since independence the

⁸⁷ A. Moravcsik (1997), *Op. Cit.*, p. 530

⁸⁸ H. V. Milner and R. O. Keohane (1996), *Op. Cit.*, p. 4; see also J. Frieden and R. Rogowskii (1996), *Op. Cit.*,

domestic arena in both countries has become much more diversified. Economic actors have not only developed interests that conflict with their neighbouring counterparts, but also acquired political positions that allow them to transform their individual preferences into foreign policy measures. While the interests of the Russian economic elite were defined primarily by the aim of gaining access to the Ukrainian market through acquisition of major industrial plants, the Ukrainian economic elite, endowed with more limited resources, saw its interest in raising institutional barriers to resist Russian penetration and to guarantee their own survival.

Furthermore, factors like the two countries' institutional setting, the access they granted to business representation, and the importance that the Ukrainian public ascribed to the newly acquired sovereignty, must be included in a comprehensive analysis. Theories of domestic politics allow one to take all these contradictory elements into account and to map a dynamic picture, considering the nature of coalitions and the networks linking state and society, the form of political institutions and the degree of their centralisation, and the structure of the economy and its sensitivity to international fluctuations.

Chapter Two

Historical Background

As highlighted in the previous chapter, pluralist theories of International Relations stress the importance of such factors as social identity, perception of legitimacy of borders, political institutions and socio-economic models. Such elements mould the definition of preferences and outline the “bargaining space” within which each country can make policy concessions to its international partners and accept conditions of co-operation.

Some authors, in particular, have studied the connection between identity formation and foreign policy outcomes, concluding that external relations often become an instrument in the process of shaping new national identities. Foreign states and foreign groups can be used as a “reference group”, against which the collective identity is defined. The political implication of this process is that preferences towards integration or closer co-operation will emerge with countries whose populations are seen as culturally similar, while more distant relations will be demanded with countries that are seen culturally different.¹

In this chapter, I turn to the historical background of relations between Russia and Ukraine, investigating the elements that define their mutual “bargaining space”, and asking whether national claims are more or less compatible to mutual policy concessions. My conclusion is that the common history of Russia and Ukraine does not automatically guarantee improved relations, nor does it provide a clear source of conflict in the post-Soviet years. The shared past of these two countries offers arguments both to those who oppose co-operation, fearing renewed domination by Russia, and to those who support a strengthening of political and economic ties, in the

¹ This tendency could lead to the extreme situation in which “In states whose ethnic groups perceive substantial cultural distance among themselves and disagree over which foreign states serve as positive and negative reference groups, there will be conflict over foreign policy. This is because any given pattern of ties with foreign reference groups will strengthen one ethnic identity over others and elevate its position in the contest over which ethnic identity, if any, is to form the core of the national identity”. S. Shulman (1998), “National Integration and Foreign Policy in Multiethnic States”, Nationalism and Ethnic Politics, Vol. 4, n. 4, pp. 119-120

name of a common identity and the survival of economic links inherited from the USSR.

Relations between Russia and Ukraine are not the 'ordinary' relations between two neighbouring countries. The two Slavic neighbours have been part of each other's history, identity and self-perception for centuries. Russia and Ukraine have very close languages and cultures, there are high levels of intermarriage and important diaspora communities exist on each other's territory. The two countries find it hard to perceive each other as foreigners, and all the more as enemies. As some authors have appropriately pointed out, relations between Russia and Ukraine must be looked at from, at least, two different angles: as inter-state relations and as relations between the populations who inhabit the two countries.² It is true that inter-state relations have been even in post-Soviet days harsh and confrontational, but it is also true that they have never degenerated into open hostility because of the cultural and historical proximity of the peoples.

This notwithstanding, the history of relations between Russia and Ukraine is a history of colonial rule. The common past of relations between Russia and Ukraine is heavily weighted down by the autocratic and imperial power of Russia over the smaller and often politically unaware Ukraine. Several times through the centuries Ukraine was deprived of the right to use its own language, promote its own separate culture and experiment with self-rule for protracted periods. The legacy of this past influences current inter-state relations, determines the scope for a policy of rapprochement and justifies Ukrainian reluctance to join any political or economic scheme that might imply a renewed subordination to Russia.

Bohdan Krawchenko has defined relations between Russia and Ukraine in terms of "European colonialism". "Ukraine – he writes - was not a colony in the traditional sense of the word. It was a colony of the European type; that is one with an highly advanced economy whose development was distorted by having to meet the priorities

² A. Lieven (1999), *Ukraine and Russia, a Fraternal Rivalry*, (Washington D. C: United States Institute of Peace Press), and E. Golovakha and N. Panina, (1997) "Rossisko-Ukrainskie otnosheniya v obshestvennom mnenii Ukrainy i Rossii", in *Ukraina i Rossiya: Obshchestva i Gosudarstva*, edited by D. E. Furman, (Moscow: Izdatelstvo Prava Cheloveka), pp. 259-277

established by the Russian state.”³ This reference to colonialism, or internal colonialism, as other authors have pointed out, identifies only some of the aspects of the complex relationship between Russia and Ukraine, while it fails to explain and it misrepresents other aspects.⁴ It overlooks the fact that the nature of this relationship has significantly altered not only in the transition from the Russian Empire to the Soviet Union, but also throughout the Soviet period itself. Different patterns of interrelation can be identified during the post-World War I phase and the Stalinist period, under the political and economic reforms conducted by Khrushchev and in Brezhnev’s years of stagnation.

Secondly the question whether the Soviet Union was an empire or not is still to this day object of heated controversy, with Russians vehemently objecting to the idea that, being the centre of the Empire, they profited from the exploitation of the peripheral provinces. Russian authors note that “Russian imperialism [was] peculiar in that the metropole failed to generate economic gains by exploiting the periphery”.⁵

The problem of the role of the national elites and their “collaboration” with the colonial regime must also be addressed. Furthermore, the idea of economic exploitation and the

³ B. Krawchenko (1985), *Social Change And National Consciousness In Twentieth-Century Ukraine*, (London: Macmillan), , p. 185

⁴ This definition is very close to the definition of “internal colonialism” used by some scholars to explain relations, within the same state, between a dominant centre and a dependent periphery. According to this theory, internal colonial structures are established to extract wealth from less privileged areas of the country (or social groups) to promote economic and social development to the advantage of the centre (or the dominant social group). This concept encapsulates the essence of forced collectivisation under Stalin. In the process of collectivisation, indeed, countryside was called upon to support the industrialisation effort of the entire society and promote “socialist accumulation”. For an example of two separate historical cases of internal colonialism see A. W. Gouldner (1977), “Stalinism, a Study of Internal Colonialism”, *Telos*, Vol. 34, Winter, pp. 13-25, and M. Hetcher (1975), *Internal Colonialism: the Celtic Fringe in British National Development, 1536-1966*, (London: Routledge and Kegan). For a cross-disciplinary overview of internal colonialism see: R. J. Hind (1984), “The Internal Colonialism Concept”, *Comparative Studies in Society and History*, Vol. 26 pp 543-568, J. L. Love (1989); “Modelling Internal Colonialism – History and Prospects”, *World Development*, June, Vol. 17, n. 6, pp. 905-922; S. M. Di Giacomo (1997), “The New Internal Colonialism”, *Critique of Anthropology*, March, Vol. 17, n. 1, pp. 91-97.

⁵ M. A. Molchanov (2000), “Post-communist Nationalism as a Power Resource: a Russia-Ukraine Comparison”, *Nationalities Papers*, Vol. 28, n. 2, pp. 263-288 (quotation p. 266). Molchanov maintains also that Russians were discriminated against within the Soviet Union in terms of representation in the organs of Soviet power and access to intellectual professions. (p. 270) On the debate about whether the Soviet Union was indeed an empire see also: D. Lieven (1995), “The Russian Empire and the Soviet Union as Imperial Politics”, *Journal of Contemporary History*, Vol. 30, pp. 607-636; K. Dawisha and B. Parrott (Eds.) (1997), *The End of the Empire? The Transformation of the USSR in Comparative*

imposition of a set of centrally developed political priorities must be considered within the particular framework of the ideological nature of the Soviet Union. In the USSR a sense of collective mission was imposed onto the whole polity (including the Russian majority).

Finally, in its unequal relationship with Moscow Ukraine was, nevertheless, one step up from other regions of the USSR, for example Central Asia. In the latter territories, the scale of natural resources extraction and ecological disasters caused by the model of development imposed by the centre fully justify the use of the term colonialism.⁶ All of these aspects will be considered in this chapter, in particular the burden that they placed on the development of relations between Russia and Ukraine in the post-Soviet period will be discussed. I will start with a review of mutual perceptions and policy views in the two countries.

Russian Attitudes towards Ukraine

Defining relations between Russia and Ukraine in terms of colonial rule is a controversial issue. From the Moscow point of view, Russian rule was never perceived as colonial or as control exercised on a foreign land. Ukraine was, and still is, recognised as an integral part of Russia itself and Kyiv as the “Mother of all cities of Rus’”. In the words of the Russian historian Dmitrii Likhachev, even after the split of Kievan Rus’ “into two entities, Russia and Ukraine formed not only a political but also a culturally dualistic unity: Russian culture is meaningless without Ukraine, as Ukrainian is without Russian”.⁷

Even advocates of a more “civilised” relationship between the two countries, in which Russia should allow Ukraine to assert its identity and provide it with whatever assistance is possible, did not fail to emphasise their shared destiny. “Kiev is our

Perspective, (Armok: M. E. Sharpe,); R. L. Rudolph and D. F. Good, (Eds.) (1992), *Nationalism and Empire: The Habsburg Monarchy and the Soviet Union*, (New York: St. Martin Press),

⁶ B. Z. Rumer (1989), *Soviet Central Asia: a Tragic Experiment*, (Boston: Unwin); R. S. Clem (1992), “The Frontier and Colonialism in Russian and Soviet Central Asia”, in *Geographic Perspectives on Soviet Central Asia*, edited by R. A. Lewis, (London: Routledge), pp. 19-36

⁷ D. Likhachev (1991), *Reflections on Russia*, (Boulder: Press), p. 74

common home, the source of our common language, common religion, and common culture. We share a common value system".⁸

A number of surveys conducted in Russia and in Ukraine confirm the closeness between Russians and Ukrainians.⁹ Yet, Russian scholars admit that, even after Ukrainian independence in 1991, relations between the two countries are still based on the trite rhetoric of the younger and older brother. "Russians and Ukrainians are too close in terms of language and culture, to perceive each other as 'definitively different' peoples, as 'totally different' or 'definitively different' are, for example, in the case of Armenians or Estonians". Because of this similarity, Russians have often failed to take Ukrainians seriously, and have adopted an attitude of

"[...] Categorical rejection that this is a specific people, and not an ethnographic group of Russians, that the Ukrainian language is a language and not the southern-Russian dialect of a simple people, and that the Ukrainian national movement is a 'serious' movement, and not an artificial construction or a Bulgakov-style 'operetta'".¹⁰

This widespread lack of proper consideration has inevitably sparked bitter resentment in Ukrainian quarters, where officials have lamented that Ukraine has been relegated by Russia to the role of "a satellite or a diplomatic junior partner".¹¹

Across the political spectrum Russian political approaches toward Ukraine appear vitiated by what Roman Solchanik calls "Russia's Ukrainian complex". For Solchanik Russians' understanding of Ukrainian identity not only precludes the notion of an independent Ukraine, but also makes an "historical absurdity" the very existence of

⁸ N. Travkin (1994), "Russia, Ukraine and Eastern Europe", in *Rethinking Russia's National Interests*, edited by S. Sestyanovich, (Washington D. C.: Centre for Strategic And International Studies), pp. 33-41

⁹ In a poll conducted in July 1996, 29% of Russian respondents characterised relations with Ukraine as "friendly", and 38% as "partner-like". In 1997, on the eve of President Yel'tsin's visit to Kyiv, 35% of the Russians interviewed stated their preference for Ukraine as Russia's main partner within the CIS. Similar perceptions can be found across the border. In a 1993 survey, 50% of the answers revealed that Ukrainians consider Russia as their most important partner. Ukrainians would like to see relations with their neighbour develop either within the framework of the CIS (34% of preferences in a 1993 survey and 24% in 1997), or within an Eastern Slavic bloc (10% in 1993, and 24% in 1997). E. Golovakha and N. Panina (1997), "Rossisko-Ukrainskie otnosheniya v obshchestvennom mnenii Ukrainy i Rossii", in *Ukraina i Rossiya: Obshchestva I Gosudarstva*, edited by D. E. Furman, (Moscow: Izdatel'stvo Prava Chelaveka), pp. 259-277

¹⁰ D. Furman (1995), "Ukraina i My", *Svobodnaya Mysl'*, n. 1, , pp. 69-83

Russia without Ukraine.¹² From the democrats to the ultra-nationalists, Russian political figures voiced their disconcert towards Ukrainian sovereign existence, while often articulating an incoherent and contradictory political line.¹³

The more verbally aggressive, but politically powerless attitude of the parliament was often contrasted by a more verbally cautious but politically effective strategy endorsed by the Presidency, the Foreign Ministry and the government all together. Thus, on the one side, Russian officials asserted that Russia had no territorial claims on Ukraine¹⁴, and urged members of the parliament to “get used to the fact that Ukraine is a sovereign country and it is entitled to decide its internal issues independently”.¹⁵ Yet, on the other side, President Yel'tsin repeatedly succeeded in irritating his Ukrainian counterpart by advocating for Russia a UN endorsed “special authority as guarantor of peace and stability in the [CIS] region”,¹⁶ and blaming the Ukrainian side for the failure of the Black Sea Fleet negotiations.¹⁷

In the period following Ukrainian independence in 1991 to 1998 Russian views toward their western neighbour could be broadly divided into three categories. The common element of these views was the perception, expressed in either belligerent or restrained tones, that the privileged relation between Russia and Ukraine must be preserved.¹⁸

¹¹ D. Vydrin (1994), “Ukraine and Russia”, in *Damage Limitation or Crisis?*, edited by R. D. Blackwill and S. A. Karaganov, CSIA Studies in International Security, n. 5, (Washington and London: Brassey's), pp. 123-137

¹² R. Solchanik (1993), “Russia, Ukraine and the Imperial Legacy”, *Post-Soviet Affairs*, Vol. 9, n. 4, pp. 337-365

¹³ On Russian political attitudes towards Ukraine see: S. W. Garnett (1994), “The Ukrainian Question and the Future of Russia”, *Politichna Dumka/Political Thought*, n. 4, pp. 169-177, R. Solchanik (1993), “Russia, Ukraine and the Imperial Legacy”, *Post-Soviet Affairs*, Vol. 9, n. 4, pp. 337-365, J. Lester (1994), “Russian Attitudes to Ukrainian Independence”, *Journal of Communist Studies and Transition Politics*, June, Vol. 10, n. 2, pp. 193-233, and Ukrainian Centre for Independent Political Research (1997), *Russia That We...*, (Kyiv: UCIPR)

¹⁴ *SIT-30*, May 4, 1995

¹⁵ *SIT-30*, October, 261994

¹⁶ *Ukrainian News Bulletin*, March, 281993

¹⁷ *UTN*, April 18, 1995. In the same tone, Russian members of government protested that decisions on IMF provision of financial aid to Ukraine should not be made without the participation of Russia. *SIT-30*, October 26, 1994

¹⁸ The results of a survey conducted by a Ukrainian research institute on a sample of deputies of the Russian State Duma seem to confirm this cross-party orientation. The sample included 55 deputies and represented 10 factions. Asked what in their opinion should be the Ukrainian policy line towards Russia, 41.5% of those interviewed responded that Ukraine should aim at the restoration of a federal state with Russia. 43.4% recognised that Ukraine should move towards the creation of an economic, political and military union with Russia, while preserving its sovereignty. 20.8% were in favour of the formation of an equal partnership with Russia in the political and economic but not military sphere. 11.3% wanted the formation of a mutually beneficial partnership only in the economic sphere. Asked what should be the

Drawing on an “historic notion of Russia”, that included Great Russia, Little Russia and White Russia, patriots argued in favour of the reunification of Russia and Ukraine in a restored Soviet Union or in another unitary political entity.¹⁹ The collapse of the Soviet Union was branded as “neither natural nor unavoidable”,²⁰ and a line of historical continuity was called upon to justify Russian imperialism. In the words of the Communist Party Duma deputy Albert Makashov, “We remain Slavs used to living in a great state. For me Kyievan Rus’, the Moscow Empire and the USSR are notions on the same level”.²¹

Patriots encompassed political orientations ranging from the National Salvation Front,²² to the CPRF, to Vladimir Zhirinovskii’s Liberal Democrats,²³ to Aleksandr Rutskoi’s Derzhava.²⁴ Even moderate democrats were not immune from nostalgia towards a unitary state including Ukraine. State Duma deputy Boris Fedorov, leader of the “Forward Russia” movement, called for amendments to the constitution, to express “the will for reunification with Ukraine, Belarus and Kazakhstan [...] as an official policy of Russia”.²⁵

ultimate goal of Russia in relations with Ukraine 50.9 % of the deputies interviewed said that they wanted to see the restoration of an economic and military union with Ukraine. 23.6% wanted to preserve mutually beneficial partnership without emphasis on its special importance, while another 23.6% supported the establishment of a real strategic partnership. Ukrainian Centre of Conflict Studies and Ukrainian Centre for International Security Studies (1998), “Ukrainian-Russian Relations and the prospects of the CIS from the State Duma of Russian Federation Deputies Point of View”, Occasional Paper

¹⁹ N. Bindyukov (1995), *Dumskii vestnik*, n. 2 (7), pp. 33-34

²⁰ N. Rizhkov (1995), *Ya iz politicheskoi partii nazvan Rossiya*, (Moscow: Information-Analytical Agency Obozrevatel’), , p. 174

²¹ *Vseukrainskie Vedomosti*, July 18, 1995

²² In his speech at the front’s Foundation Congress in October 1992, Ilya Kostantinov stated that “We will never recognise independence of regimes in Ukraine and Belarus. Our attitude to the regimes in Ukraine and Belarus is defined not by international law, but by the norms of the [Russian] criminal code”. *Izvestiya*, October 27, 1992

²³ LDPR protested against what they called “the anti-Russian hysteria in Ukraine”, and accused the press, “managed predominantly by people from Lviv, Ternopil and Ivano-Frankivsk” (the areas where Ukrainian nationalism is traditionally rooted), of staging an “anti-Russian campaign”. They also supported Russian nationalists in Crimea, questioning the legitimacy of the region’s transfer to Ukraine. “Crimea is our territory, Russian [territory]”, State Duma deputy Aleksei Zviagin claimed. “Zhirinovskii and the LDPR faction in the State Duma”, *Information Bulletin*, n. 5, May 1995, pp. 21-23

²⁴ Rutskoi proposed to “encourage the process of state re-integration of Russia Ukraine and Belarus as the first step towards the elimination of the disastrous aftermath of the liquidation of the Soviet Union” A. Rutskoi (1995), *Obretenie very*, (Moscow: Sanktpeterburskaya Tipografiya n. 6), pp. 16-17

²⁵ B. Fedorov (1995), *One Hundred Questions to Boris Fedorov About ‘Forward, Russia’ Movement and the Liberal-Democratic Fund* (Moscow: mimeo), p. 12

Patriots' claims generated alarm in Ukrainian political circles. The Ukrainian leadership was in the difficult position of having to appear determined in the defence of the country's independence, while, at the same time, finding a diplomatic approach to solve incomprehension with the powerful neighbour. There was a common understanding within political circles in Kyiv that Ukrainian internal stability depended a great deal on Russia, and to preserve it Ukrainian authorities adopted a dual strategy. Russian attempts to "increase the tension" in bilateral relations, "interfere with the process of normalising" these relations and "disrupt negotiations" for the co-operation treaty were harshly criticised.²⁶ On the other side, however, a conciliatory tone was adopted and guarantees were provided that Ukraine would not take radical actions "except for the cases when certain politicians come to Ukraine from Russia to conduct propagandistic and political activities".²⁷

Given the strategic superiority of their eastern neighbour, Ukrainian policy-makers had to make an effort and discriminate between the boisterous positions of the Russian parliament, blamed for its "overt interference with Ukraine's internal affairs", and the will of the Russian people, "who stand for peace and friendly relations with Ukraine".²⁸ Ukraine, however, had its own patriots too, represented by the Communist Party of Ukraine and the Agrarian Party of Ukraine, who repelled the Belavezha Agreement and the dissolution of the Soviet Union, and supported the recreation of a unitary state with Russia.²⁹

Russian moderates occupied the portion of the political spectrum between the patriots and the economic pragmatists. The moderates called for a more careful attitude in the international arena and relations with the CIS countries (and Ukraine), in order to obtain

²⁶ UTN, January 14, 1995. Preoccupation with Russian imperialism increased also as a result of the first Chechen campaign in 1995. Public opinion started to fear that if Russia had used tanks against one of its own regions, it could easily march against Ukraine. The press service of President Kuchma issued a statement on the events in Chechnya calling for "self-control, consistent striving for peaceful resolution of the conflict, observation of human rights, first and foremost the right to live", UTN, January 5, 1995. On Ukrainian reactions to the war in Chechnya see also T. Kuzio (1995), "The Chechnya Crisis and the 'Near Abroad'", Central Asian Survey, Vol. 14, n. 4, pp. 553-572

²⁷ Kievskie Novosti, April 14, 1995

²⁸ Ukrainian News Bulletin, July 12, 1993

²⁹ OMRI Daily Digest, October 19, 1995. As late as March 2001 Gennadii Zyuganov and Petr Simonenko, leaders of the Communist parties of Russia and Ukraine, announced their intention to work more closely together, blaming the Ukrainian institutional crisis on the "pro-Western direction [in Ukrainian] foreign policy and the complete dependence of Ukraine [...] especially in economics on the financial structures of the West RFE/RL Newslines, March 26, 2001

a reorientation of resources previously directed to foreign policy to internal economic development and improvement of living standards for the Russian population.

“National egoism” was presented as the criterion that must shape Russian international strategy.³⁰ In this perspective also policy towards Ukraine had to switch onto an equal footing, transforming relations between the two countries into relations between “allies”. Russia must not deem itself responsible anymore for supporting Ukraine’s economy or bankrolling its reforms.³¹

Moderate attitudes included also the “wait and see” strategy advocated by former presidential advisor Andranik Migranyan, according to which Ukraine was worth no diplomatic efforts and political campaigns. Migranyan predicted that, being an “artificial, heterogeneous, and bland institutional figure”, Ukraine would collapse as a result of the deteriorating economic and social situation. Energy crisis, financial instability, the inexperience of the national elite and interethnic conflicts would destroy Ukraine’s dream of independence, without the need for Russia to intervene. Ukraine would then fall into Russia’s sphere of influence again, and thereby be forced to accept political, economic, and military co-operation with Russia and with the CIS, or crumble into a potentially disastrous ethnic war.³²

The approach that in Kyiv corresponded to Russian moderate attitudes was a renewed emphasis on the Ukrainian ability to survive and prosper without Russian help. Especially from the nationalist quarters it was often claimed that Ukraine had to diversify its trade activities, reorient towards Western allies and adopt the economic model of its Eastern European neighbours. Ukrainian academics close to the President portrayed a model of Ukraine as “the bastion of European peace, fortress of European values and mentality” that would unfold in three stages along a path of “normal European development”. Stage one would involve the strengthening of economic

³⁰ “To be engaged in the development of other nations means to commit crimes against the Russian people. It deprives them at a crucial moment of means that could promote their development into a vital and energetic nation. We are now national egoists: all our actions must benefit the Russian nation. It was this very national egoism that produced a great power”. A. Mitrofanov (1998), “Russia’s New Geopolitics”, Harvard University, JFK School of Government, Strengthening Democratic Institutions Project, July, p. 7

³¹ Council on Foreign and Defence Policy (1997), “Will the Union be Reborn? The Future of the Post-Soviet Region”, Harvard University, JFK School of Government, Strengthening Democratic Institutions Project, June, p. 19

³² “Russia’s Foreign Policy with Ukraine”, in Current Digest of the Post-Soviet Press, n. 7, 1994, pp. 6-7

relations with Poland and, through it, with Germany. Stage two would foresee the creation of a Baltic-Black Sea economic alliance. In stage three Ukraine would join Nato.³³

The perspectives of Economic Pragmatists was shaped by a recognition of economic inter-dependence between the two countries, and called for a more effective bilateral co-operation. In the words of Nikolai Gonchar, Chairman of the Budget Committee of the Russian Council of the Federation: "If we want to have an industrial economy, we should recognise that it is impossible without Ukraine, as well as without Belarus and Kazakhstan". In this view, economic necessities would drive individual countries to a closer interrelation without impinging on national sovereignty.³⁴ Economic pragmatism was the spirit that animated bilateral relations between the Russian and the Ukrainian Union of Industrialists, and inspired governors of 13 border regions to lobby for special legislation regulating their economic interaction. Economic pragmatism was advocated by Russian as well as Ukrainian political forces as a means to normalise relations:

"[...] Deeper economic ties between Russia and Ukraine may assist to neutralise political tension [...] [the level of] industrial co-operation between Ukraine and Russia is extremely high [...] the deeper the economic ties, the better they can neutralise political tension."³⁵

³³ Oleh Soskin, Advisor to the President of Ukraine on economic issues, Director of the Institute of Society Transformation, interview with the author, Kyiv, 27 November 1998.

³⁴ *Vechirniy Kyiv*, July 29, 1993

³⁵ Prime minister Marchuk in an interview with Washington Post reported in *UTN*, 28 September 1995

The Weight of History

Russian failure to recognise Ukrainian diversity is deeply rooted in the historical myths that have been constructed to justify Ukrainian submission to Russia. Contrasting interpretations of crucial events punctuate the history of the Russian-Ukrainian encounter, and history has become, in the words of a Western historian, another “battleground”.³⁶ Competing versions of history correspond to contrasting visions of identity, and are advocated to substantiate territorial claims or pretensions of political legitimacy.³⁷ To assert a political pre-eminence or reject the colonial power.³⁸

The common origin of Russia and Ukraine goes back to the year 882 A. D., when Prince Oleh established his capital in Kyiv, thus giving rise to the political entity known as Kievan Rus'. Kievan Rus' was a feudal, decentralised kingdom, that at the height of its power stretched from the Carpathian mountains, in the south, to Novgorod, in the North, comprising territories that belong today to Belarus, Ukraine and are part of Northern Russia. Located on the trade route from the Baltic Sea to Constantinople, Kievan Rus' prospered to become a vibrant centre of cultural and religious civilisation, until 1240, when Kyiv was sacked by the Mongols and Rus' disintegrated into several rival principalities.

Both Soviet/Russian and Ukrainian historians have claimed continuity between Kievan Rus' and the successive state organisations that developed on their respective territories. In the Ukrainian version of history, a separate ethnic group, which had existed in the territories around Kyiv, was the rightful creator of the medieval kingdom, while the

³⁶ Z. E. Kohut (1994), “History as a Battleground. Russian-Ukrainian Relations and Historical Consciousness in Contemporary Ukraine”, in *The Legacy of History in Russia and the New States of Eurasia*, edited by S. F. Starr, (Armok: M. E. Sharpe,), pp. 123-145. See also G. Smith et al. (1998), *Nation Building in the Post-Soviet Borderlands: The Politics of National Identities*, (Cambridge: CUP) chapter 2, pp. 23-48

³⁷ Andrew Wilson has demonstrated how two parallel but contradictory visions of the process of the population of the Donbass justify both Russian and Ukrainian pretensions for the region to be historically part of ethnic Ukraine and, at the same time, of ethnic Russia. A. Wilson, The Donbass between Ukraine and Russia: The Use of History in Political Disputes, *Journal of Contemporary History*, Vol. 30, (1995), pp. 265-289

³⁸ History – or a carefully edited version of history - is used as an instrument to consolidate the new Ukrainian state and provide ideological support to the process of nation-building. “The post-colonial reality, distorted by the corrupting influences of colonisers, is to be brought in line with the idealised image of nationhood. In order to restore the lost purity the nation-building elites total differences, which

Russians, descending from more northern tribes, only played a minor role in the Kievan state.³⁹ In the Russian version, following the sack of Kyiv by the Mongols, the political and cultural heritage of Rus' was preserved in the territories of Muscovy. Massive migrations brought populations once living in the core of the proto-state to Russian lands. New populations from the Carpathian region settled in what is today Ukraine, establishing the roots of the Ukrainian language and culture, as a corrupted version of the original Kievan identity. According to the Russian version of history, Kievan Rus' was the common cradle of the Slavic civilisation, with Russians (*Great Russians*), Ukrainian (*Little Russians*) and Belorussians (*White Russians*) representing a single united people, differentiated only as a result of successive historical events. The Ukrainian historian Yuriy Badz'o has highlighted effectively the paradox of this interpretation.

"...From the ninth to the thirteenth century, the Eastern Slavs constituted one people, one ethnos, which, of course, was Russian: the Ukrainians and the Belarussian appeared only in the fourteenth-fifteenth centuries. They appeared for no other purpose than to 'dream' about 'reunification' with Russia. All peoples of the world aspired, and still aspire, toward national independence. Only the Ukrainians and the Belarussians are an exception: their dream was to 'reunite' with Russia".⁴⁰

Perfectly in line with this explanation, the Russian version of the 1654 Treaty of Pereislav celebrates the "reunion" of the two "brotherly" peoples. In 1648, a large-scale rebellion started in the Ukrainian territories transferred to the Polish rule by the 1559 Union of Lublin. The rebellion was headed by the Cossack Hetman Bohdan Khmel'nitskii. Khmel'nitskii succeeded in establishing an embryonic Cossack-Orthodox state on both the left and the right bank of the Dnieper for the first time since the thirteenth century. Exposed to military pressures on three fronts (from the Poles, the Tatars and the Russians), Khmel'nitskii forged an alliance with Moscow that was formalised with the Treaty of Pereislav.

are portrayed as irreconcilable". K. Wolczuk (2000), "History, Europe, and the 'National Idea': the 'Official' Narrative of National Identity in Ukraine", *Nationality Papers*, Vol. 28, n. 4, pp. 671-694

³⁹ For a summary of competing interpretations of Ukrainian history see P. R. Magocsi (1996), *A History of Ukraine*, (Toronto: University of Toronto Press), Chapter 2

⁴⁰ Quoted in Ivan L. Rudnytsky (1987a), "Pereislav: History and Myth", in *Essays in Modern Ukrainian History*, edited by Peter L. Rudnytsky, (Edmonton: Canadian Institute of Ukrainian Studies, University of Alberta), pp. 77-89

In the Ukrainian version of the story, the Treaty was an agreement binding both signatories to a military alliance in the form of a personal union and protectorate. In the Russian version, the Treaty was portrayed as an act of submission to the Tsar's authority and provided the first step of the incorporation of the Cossack Hetmanate into what was to become the Russian Empire. The process of Ukrainian submission was completed only with the 1709 defeat in Poltava of the forces headed by King Charles XII of Sweden and the Hetman Ivan Mazepa. Ukraine was incorporated into the Russian imperial system, and its status was lowered to that of a subordinate entity within the framework of the Russian Empire. In this way what has been called the "Myth of Pereislav" was born, with the agreement serving to legitimise the annexation of Ukraine by the Russian Empire. Ukrainian historians object:

"About one century after the event, what in fact had been a bilateral, negotiated settlement, a treaty, had assumed the character of a unilateral, and therefore revocable, act of tsarist munificence".⁴¹

Roman Szporluk has criticised the Russian attempt to "shape the historical consciousness of the Ukrainians" and has equated this attitude to a form of cultural colonialism.

"To deprive a people of its past may thus be a colonialism more destructive and more vicious than the one that expropriates a nation's mineral resources, imposes discriminatory terms of trade, disbands its army and civil service, or puts foreigners in all official positions".⁴²

The legacy of the past is a key factor in determining the present and the future of relations between Russia and Ukraine. A past of deceit, broken promises and violated national identity is used by some authors to explain Ukraine's long time reluctance to sign any sort of agreement with Russia, be it bilateral or within the framework of the Commonwealth of Independent States.⁴³ Political, cultural and economic repression imposed on the Ukrainian population under tsarist as well as under Soviet rule is viewed as the basis for Ukraine's mistrust towards its eastern neighbour. This past of

⁴¹ Ivan L. Rudnytsky (1987a), *Op. Cit.*

⁴² R. Szporluk (1986), "The Ukraine and Russia", in *The Last Empire: Nationality and the Soviet Future*, edited by R. Conquest, (Stanford: Hoover Institution Press), p. 155

⁴³ J. Morrison(1993), "Pereislav and After", *International Affairs*, Vol. 69, 4, pp. 677-703

repression is also the most significant impediment on the path towards improved relations in the post-Soviet years.

Political Rule

From Peter I onwards, centralisation and the construction of a strong bureaucratic and administrative state apparatus on the Ukrainian territories were the most common aspects of the Russian imperial rule. Under Catherine II, in particular, the office of Hetman was permanently abolished (1764), enserfment of the peasantry was introduced, and the first wave of Russification took place. The Ukrainian population living on territories controlled by the Russian Empire (close to 85% of the total), was deprived of territorial autonomy and administered by regional governors, appointed by the tsar and responsible directly to St. Petersburg.⁴⁴

Between 1917 and 1920 Ukraine experienced a brief season as an independent state, ruled by the Central Rada, until April 1918, a restored Hetmanate under German influence (April to December 1918), and finally a Directory, until the final eruption of the Civil War and the establishment of the Bolshevik regime. The Ukrainian government in Kyiv strove to set relations with Russia on an equal basis, proclaiming Ukraine an autonomous land within a federated Russia, and urging the formation of Ukrainian national units within the former Imperial Russian army. The government represented a moderate socialist orientation and was opposed to the Bolshevik turn that the revolution had taken in Petrograd. In December 1917 a first Soviet state was set up in Kharkiv (Respublyka Rad Ukrainy), headed by a government composed of only Bolshevik ministers, and subordinated to the Bolshevik government in Petrograd.

With the end of the Civil War and the final demise of the ephemeral Ukrainian National Republic, Soviet Ukraine was established as an apparently independent state, linked to Soviet Russia only by a treaty of alliance concluded in December 1920. In fact, Ukrainian military and economic decisions were subjected to decisions made in Moscow, and diplomatic prerogatives were delegated to the Russian capital. In December 1922, the Union of Socialist Soviet Republics was formed by the Russian, the Ukrainian, the Belorussian and the Transcaucasian Soviet Federative Socialist

Republics. The Treaty of the Union established the Ukrainian Soviet Socialist Republic as a sovereign state, federated as an equal entity with Russia and the other Soviet republics. Despite Ukraine's constitutionally recognised right of secession from the Union, however, Ukrainian historians have branded Ukrainian statehood "a sheer myth manipulated to the advantage of the rulers".⁴⁵

The 1924 Soviet Constitution stripped Ukraine, and the other constituent republics, of any independent power, investing the central authorities with decisions related to education, justice and health, exploitation of natural resources, and foreign affairs, plus the power to annul decisions taken by the union republics.⁴⁶ The application of the principle of "democratic centralism" constructed a rigid power structure that ensured the swift implementation of centrally produced directives. In February 1944, the constituent Soviet republics were given back the pre-1923 right to engage in direct relations with foreign countries. Soviet Ukraine and Soviet Belorussia were allowed to establish their own foreign ministries, and by April 1945 they were admitted as constituent members of the United Nations.

Cultural Repression

The 1863 Valuev Decree, and the 1876 Ems Ukaze codified the subordination of the Ukrainian to Russian culture and language. The publication of religious and educational books in Ukrainian was banned, as was their importation from abroad. Ukrainian lyrics to musical compositions were outlawed. Ukrainian organisations and newspapers were closed. Ukrainian teachers were removed from office. With the development of a standard literary Russian, in the early 19th century, Ukrainian was increasingly associated with peasantry and localism, while Russian was viewed as a vehicle to access culture and achieve upward social mobility. Also Ukrainian writers chose to write in Russian rather than in Ukrainian to broaden their audience.

⁴⁴ P. R. Magocsi (1996), *A History of Ukraine*, (Toronto: University of Toronto Press), p. 305.

⁴⁵ Ivan L. Rudnytsky (1987b), "Soviet Ukraine in Historical Perspective", in *Essays in Modern Ukrainian History*, edited by Peter L. Rudnytsky, (Edmonton: Canadian Institute of Ukrainian Studies, University of Alberta), pp. 463-473

⁴⁶ P. R. Magocsi (1996), *Op. Cit.*, p. 528.

The years following the end of the First World War and the establishment of the Soviet Union were characterised by a relaxation of linguistic repression in Ukraine. A first wave of Ukrainisation, introduced by the Communist Party of Ukraine in 1923, accompanied the New Economic Policy. With the beginning of the political purges in the 1930s, however, any appearance of cultural independence for Ukraine vanished and Ukrainisation was reversed. In 1933 the alphabet and the language reforms approved in 1928 were abolished, and decrees were passed requiring that the Ukrainian alphabet, language and grammar were brought closer to Russian. By 1938 the use of Russian had been made obligatory in all non-Russian schools throughout the Soviet Union. The Khrushchev's school reform of 1958-59 further undermined the status of the Ukrainian language, by removing it as an obligatory subject of study. A new wave of Russification followed the dismissal in 1972 of the Ukrainian Communist Party First Secretary Petro Shelest, who had been an advocate of Ukrainian language and of Ukrainian autonomy. For his stance Shelest was accused of "local patriotism".⁴⁷

Russification policies had the result of undermining the use of Ukrainian as a scientific and academic language. In the mid-1960s only 62% of the Ukrainian school children (a proportion significantly lower than the Ukrainian population living in the Ukrainian SSR) were taught Ukrainian in school. By 1987 the percentage had dropped to 50.5%. The total number of books published in Ukrainian was only 22.1% in 1987, while only 16.3% of the academic journals published in Ukraine in 1989 were in Ukrainian.⁴⁸

Language policies and repression of cultural debates were used as a common instrument to suppress Ukrainian sense of identity. As one author has pointed out, "Ukrainians as a method of asserting their non-Russian identity, waged their campaign for national survival in terms of their right to speak Ukrainian, rather than Russian".⁴⁹

⁴⁷ Shelest's defence of Ukraine was epitomised in his book "Our Soviet Ukraine". See O. Subtelny (1994), *Ukraine: A History*, (Toronto: University of Toronto Press), second edition, p. 512

⁴⁸ R. Solchanyk (1990), "Ukraine, Belorussia and Moldova: Imperial Integration, Russification and the Struggle for National Survival", in *The Nationalities Factor in Soviet Politics and Society*, edited by L. Hajda and M. Bessinger, (Boulder: Westview Press), pp. 175-203

⁴⁹ B. Krawchenko (1985), *Social Change and National Consciousness in Twentieth-Century Ukraine*, (London: St. Antony/Mcmillan), p. 198. On the political significance of cultural debates R. Solchanyk (1983), "Politics and the National Question in the post-Shelest Period", in *Ukraine after Shelest*, edited by B. Krawchenko, (Edmonton: Canadian Institute of Ukrainian Studies, University of Alberta); and B. Lewytskyj (1984), *Politics and Society in Soviet Ukraine, 1953-1980*, (Edmonton Canadian Institute of Ukrainian Studies, University of Alberta), chapters 4 and 5. For the Ukrainian perspective on Russian colonialism see Anti-Bolshevik Bloc of Nations (1969), *Revolutionary Voices: Ukrainian Political Prisoners Condemn Russian Colonialism*, (Munich: Press Bureau of the Anti-Bolshevik Bloc of Nations), especially I. Dzyuba, "Internationalism or Russification", pp. 37-55

Religious autonomy was also considered by the Russian authorities breeding ground for the growth of Ukrainian nationalism. As a result also the Uniate Church and the Ukrainian Autocephalous Church were repressed. The first was ejected from eastern Ukraine after the Treaty of Pereislav, allowing for the official Orthodox Church, subject to the Moscow authority, to regain control of the region. The second was suppressed by Stalin in 1929 and its hierarchy was liquidated. More than 3 thousand churches were transferred to the Orthodox faith.⁵⁰

Repression of the population was a common characteristic in the Soviet totalitarian state. In the Stalinist period political opponents were purged and entire populations were forced to collective migration from their land of origin. In the Brezhnevite years gulags and working camps in inhospitable areas of the country were crowded with political dissidents. Despite the widespread and quasi-indiscriminate repression of large strata of the Soviet population, there are, however, episodes that in the collective memory of the Ukrainian people have gone down as acts of specific persecution. The Great Famine, for example, whose occurrence was consistently denied by Stalinist historians, has assumed the same proportions as the Holocaust for the Jews and the 1915 genocide for the Armenians. Ukrainian nationalist writers have hypothesised that the event was a carefully staged state-massacre to eliminate the Ukrainian people.⁵¹ Incompetence in the organisation of collective farms, the duress of the forced collectivisation, and indiscriminate confiscation of agricultural production to support the industrial effort triggered the famine. In the winter and spring of 1933, at least 4.8 million people, equal to 15% of the Ukrainian population at the time were killed for starvation or diseases.⁵²

⁵⁰ The Uniate Church emerged as a result of the Union of Brest (1596). It is Catholic in essence, as it accepts the authority of the Pontiff, but Byzantine in rite. The Ukrainian Autocephalous Orthodox Church came into being in October 1921, by declaring its independence from Moscow, seen as an instrument of Russian domination. With the synod of L'viv in 1946, organised by Stalin with the support of the Russian Orthodox Church, the Autocephalous Church rejoined the Moscow authority. D. Little (1991), *Ukraine. The Legacy of Intolerance*, (Washington D.C.: United States Institute of Peace Press), especially chapter 2

⁵¹ Y. Bilinsky (1994), "Basic Factors in the Foreign Policy of Ukraine. The Impact of the Soviet Experience", in *The Legacy of History in Russia and the New States of Eurasia*, edited by S. Frederick Starr, (Armonk: M. E. Sharpe), pp.171-191

⁵² O. Subtelny (1994), *Op. Cit.*, p. 413

The interpretation of a voluntary policy of annihilation pursued by the Soviet authorities against the Ukrainian seems upheld by the revelation, made by Khrushchev in his speech at the 20th Party Conference, that Stalin had probably in store mass deportations for them. "The Ukrainians – Khrushchev said - avoided meeting this fate because there were too many of them, and there was no place to deport them".⁵³

Encouraged immigration of Russians in regions with a strong Ukrainian tradition was another instrument used to diminish the power of the Ukrainian population. This happened especially in the Western regions of the country which had become part of the Soviet Union only after the second World war. Russians were called there to occupy key political and economic positions.⁵⁴ In the face of a more advantaged Russian minority, Ukrainian representation in party leadership, scientific personnel and student population in institutions of higher education was reported considerably lower than the percentage of Ukrainian population in the Ukrainian SSR.⁵⁵

The Role of National Elites

Throughout the Russian Empire and the Soviet Union Ukrainian national elites were progressively assimilated into Russian culture, with only a limited minority preserving a distinct Ukrainian national identity (more on Ukrainian nationalism below). The reign of Catherine, in particular, inaugurated a practice re-proposed also in the Soviet era, whereby the Cossack aristocracy was promised equality to the Russian aristocracy if they proved loyal to the Russian Empire and committed to its grandeur. Equally, in the Soviet Union, individuals devoted to the common cause of socialism and affiliated to the right patronage lines were admitted to join the *nomenklatura*, often with little regard for their ethnic belonging.

⁵³ Quoted in G. P. Holman, Jr. (1994), "Russo-Ukrainian Relations: the Containment Legacy", in *Ethnic Nationalism and Regional Conflict: The Former Soviet Union and Yugoslavia*, edited by W. R. Duncan and G. P. Holman Jr., (Boulder: Westview Press), p. 84

⁵⁴ The western regions of Ukraine, which had never been part of the Russian Empire or the Soviet Union, were exposed to a rapid process of integration into the Soviet environment, with forced collectivisation between 1948 and 1951, the introduction of heavy industry, and the exploitation of natural resources. The Russian population in the region increased substantially (with a total of more than 300 thousand Russian immigrants in the region, primarily involved in activities in the Party and the emerging heavy industries). This occurred against the backdrop of a remarkable exodus of Ukrainians to Poland. P. R. Magocsi (1996), *Op. Cit.*, pp. 648-49. For a more general overview on internal migration patterns see Krawchenko (1985) *Op. Cit.*

⁵⁵ R. Solchanyk (1990), *Op. Cit.*

The social and economic privileges it was afforded and the political power it administered ensured that the Soviet elite developed into a cohesive stratum, with common values and prepared to defend its class interests.⁵⁶ Data collected by Evan Mawdsley and Stephen White show that from 1961 to 1986, the representation of Ukrainians in the Central Committee was second only to the Russians, with a proportion between 17 and 12% (against a proportion between 56 and 71% for the Russians).⁵⁷

This notwithstanding, an embryonic national elite started to appear as a result of the consolidation of the Ukrainian Communist party in the aftermath of World War Two, and the economic reforms pushed through by Khrushchev. The increased powers awarded to the Republic at the end of the war reinforced a mood of self-confidence within the Ukrainian leadership, which had fought to defend its territory in the face of the rapid German advance. At the 18th Congress of the CPSU a new Ukrainian political generation emerged, the first one to hold the majority of key posts in the republic. Following its important role in support of Khrushchev's leadership bid, the Ukrainian party leadership began to demand a greater role in managing the republic.

The question was posed with more urgency after Khrushchev's reform of the economic administration, when it became evident that the majority of the staff to the eleven *sovnarkhozy* created in Ukraine were sent from Moscow; from the former union ministries. "A new Ukrainian political elite comprised of individuals with modern skills had come into being and found itself frustrated politically and economically by a hyper-centralised system, which refused to recognise it as a force, or share power with it".⁵⁸

In the light of increased republican economic autonomy, members of the party elite, who were close to the central party institutions (high level ministerial bureaucrats and Gosplan officials), tried to limit the number of emerging economic regions, in order to ensure their control on economic institutions. Members of the regional administrations

⁵⁶ On the structure of the Soviet elite M. M. Voslenskii (1984), *Nomenklatura: Anatomy of the Soviet Ruling Class*, (London: The Bodley Head), especially chapter 5. On the shared values of the Soviet elite J. Klugman (1989), *The New Soviet Elite. How They Think and What They Want*, (New York: Praeger)

⁵⁷ E. Mawdsley and S. White (2000), *The Soviet Elite from Lenin to Gorbachev*, (Oxford: OUP), p. 175

⁵⁸ B. Krawchenko (1985), *Op. Cit.*, p. 249

supported instead the reforms, hoping to increase their authority on the economic process.⁵⁹

The removal in 1972 of Petro Shelest, the vocal First Secretary, who in more than one case had advocated Ukrainisation and increased economic powers to the republican leadership, was read as a manoeuvre of the Brezhnev era leadership in the direction of a new centralist initiative.⁶⁰ During the Brezhnevite regime pressure on intellectuals increased and restrictions on national cultures and political dissent were re-introduced. The Ukrainian national elite that had emerged in the previous decades was again silenced, while the loyalist, pro-Moscow leadership, represented by first secretary Volodymir Sherbitskyi, re-occupied the Republic's top positions.

The Path of Economic Development

The process of economic development pursued in the Soviet era highlights the contradiction of the central planning system. On the one side, industrial growth was promoted on a scale that would have been difficult to realise without the massive investment allocated from Moscow. Yet, on the other side, central planning imposed a line of development that was instrumental to the interests of the whole Soviet Union, as perceived by the central authorities.

Within the framework of the First Five Year Plan, republican commissariats were made subordinate to the central commissariat for agriculture, and all heavy industry and forestry were separated from the republic's control. Schools and public health facilities were also subjected to the central structures, as were the new economic regions established on the territory of Ukraine.⁶¹ Within the socialist power system, the priorities and directions of growth were established by the Central Committee and the Gosplan. Within the comprehensive plan for the development of the Soviet Union, Ukraine was assigned the role of producing raw materials (metallurgy, coal and agricultural products), while the production of finished goods, especially consumer goods, was concentrated in Russia.

⁵⁹ B. Lewytskyj, (1984), *Op. Cit.*, p. 74

⁶⁰ B. Krawchenko (1985), *Op. Cit.*, p. 249

⁶¹ P. R. Magocsi (1996), *Op. Cit.*, p. 557

The First Five Years Plan brought the development of heavy industry and transformed Ukraine into the leading industrial centre for coal extraction and metallurgy, as well as a primary source of grain and sugar provisions. Ukraine received 20% of the total Soviet investment, and 400 of the 1500 plants planned for the whole Soviet Union were placed on Ukrainian territory. Smaller investments were allocated to Ukraine during the Second and Third plan, but the country's newly acquired industrial base was nonetheless strengthened. By the 1970s-80s, however, as a result of the ageing and inefficiency of the industries located in Ukraine and the failure to implement new technologies, the country's growth rate dropped. Between 1981 and 1985, Ukraine's performance in terms of technological progress had slipped to ninth place vis-à-vis the other republics' economy, and productivity was below the union average.⁶² Ukraine's agricultural sector, though, was still very active, providing the Soviet Union with more than 23% of its total production (against only 19% of the total population).

By the 1980s, investment in the Ukrainian economy had fallen dramatically and Ukraine's share of total USSR investment appeared consistently below its population's percentage. It was as low as 13.6% in 1982 against a population that was 19% of the total Soviet population (compared to the 60.8% of investment and 53.8% of population in Russia, and 6.2% of investment and 5.4% of population in Khazakhstan).⁶³ The eminent Canadian-Ukrainian economist Ivan Koropecykj has rejected the theory that the drop in investment, coupled with unrequited transfers of national income, were all part of a strategy to exploit Ukraine to the advantage of other regions of Russia and the Soviet Union. Geopolitical considerations, rather than national considerations, he believes, were at work in defining the priorities for regional development in the post-war years.⁶⁴

⁶² I. S. Koropecykj (1992), "Introduction", in *The Ukrainian Economy*, edited by I. S. Koropecykj, (Cambridge, Massachusetts: Harvard University Press.), pp. 6-7

⁶³ I. S. Koropecykj (1990), *Development in the Shadow: Studies in Ukrainian Economics*, (Edmonton: Canadian Institute of Ukrainian Studies press, University of Alberta), p. 51

⁶⁴ After the war, it was considered strategically important to develop the huge areas east of the Urals. Defence and political criteria were key determinants in this decision. Moscow aims were: 1. To shift economic activity from West to East, disperse territorially industry, strengthen regions bordering with China, and the exploitation of resources in the Asiatic regions. The Ukrainian economy was never attractive for these purposes, but was relegated to be the "resource base" for the development of other more strategically important regions. I. S. Koropecykj (1970), "Industrial Location policy in the USSR during the Post War Period", in *Economic Performance and the Military Burden in the Soviet Union*, Joint Economic Committee (Washington: US Government Printing Office).

It is undisputed, however, that the development of the Ukrainian economy was distorted to meet the political and economic priorities identified by the central planners. The chronic shortages of consumer goods in the late Soviet years, for example, have been explained as a consequence of an investment policy that, giving preference to the growth of the heavy industry to the disadvantage of the light industry, directed two thirds of scientific resources only to the defence industry.⁶⁵ The inefficient structure of the Ukrainian economy (too high a share of agricultural production, raw and industrial materials, against too low a share of industrial production) was also dictated by the orientation towards the CMEA markets. Within Soviet foreign policy strategy, the Ukrainian economy was locked into a plan that saw it supporting the alliance with the Eastern European countries, through a system of preferential trade. This subordinated the possibility of correcting its structural unbalances to a radical change in Soviet foreign policy priorities.⁶⁶

The energy system provided a further distortion of the Ukrainian economy. As a consequence of short-sighted policies of energy intensive development, the republic's energy situation deteriorated in less than two decades, from enjoying a small energy surplus to a 42% overall net energy deficit. In 1970 Ukraine met 100% of its energy needs, 98% in 1980 and only 58% in 1985.⁶⁷

An accurate calculation of who won and who lost from the game of transfers in the Soviet economy has proved difficult. Estimates produced by the nationalist party Rukh present a catalogue of centrally imposed distortions to the disadvantage of the Ukrainian economy. During the Soviet years, it is argued, "some 113 billion rubles were taken from Ukraine to the centre annually, thorough taxation and profits". Prices imposed on Ukrainian products were highly discriminatory (48 rubles per tonne of sugar paid to

⁶⁵ I. Lukinov (1992), "Radical Reconstruction of the Ukrainian Economy: Reasons, Reforms, Outlook", in *The Ukrainian Economy*, edited by I. S. Koropecykj (Cambridge, Massachusetts: Harvard University Press), , pp. 21-43

⁶⁶ "As long as the Moscow leadership has the ambition and power to dominate the COMECON countries economically, substantial structural changes in Ukrainian trade with other countries are unlikely. Domestically, since the role of Ukraine in attaining Moscow's geopolitical goals is supportive, there is no chance for structural change in Ukrainian trade within the USSR either". I. S. Koropecykj (1990), *Op. Cit.*, p. 37

⁶⁷ L. Dienes (1992), "Energy, Minerals and Economic Policy, in *The Ukrainian Economy*, edited by I. S. Koropecykj, (Cambridge, Massachusetts: Harvard University Press), pp. 123-147

Ukraine, against 73 paid in Russia), and expenditures on the development of basic science research per capita in Ukraine was only 6.3 rubles, against the 25.5 rubles per capita in Russia.⁶⁸

A comparative analysis of direct (fiscal and budget expenses) and indirect (inter-republican trade) transfers, conducted by western researchers, however, suggests that the argument of Ukrainian economic exploitation needs reconsideration. Trade flows and artificially inflated or decreased prices, vis-à-vis world prices, were used by the central authorities to subsidise some regions. In particular, the strongly underpriced trade in oil and gas was matched by overpriced trade in the light and food industries. As a result of these unbalances, in 1990 Russia and Turkmenistan appeared to be the only two republics in a position of net donors to the federal budget. In fact, Ukraine received net transfers equal to 3.61% of its GDP, thanks to the flow of subsidised oil and gas products from Russia.⁶⁹

Was Russia a Colonial Power?

A German historian has defined colonialism as

“A relationship of domination between an indigenous (or forcibly imported) majority and a minority of foreign invaders. The fundamental decisions affecting the lives of the colonised people are made and implemented by the colonial rules in pursuit of interests that are often defined in a distant metropolis. Rejecting cultural compromises with the colonised population, the colonisers are convinced of their own superiority and their ordained mandate to rule”.⁷⁰

To which extent does this definition of colonialism apply to the relations between Russia and Ukraine? Can Russia be defined *tout-court* a colonial power? How do

⁶⁸ Report of the First Rukh Congress, quoted in B. Krawchenko (1993), “Ukraine: the Politics of Independence”, in *Nations and Politics in the Soviet Successor States*, edited by I. Bremmer and R. Taras, (Cambridge: CUP) pp. 75-98, (quotation p. 87)

⁶⁹ L. T. Orlowski (1993), “Indirect Transfers in Trade among Former Soviet Union Republics: Sources, Patterns and Policy Responses in the Post-Soviet Period”, *Europe-Asia Studies*, Vol. 45, n. 6, pp. 1001, 1024. See also S. S. Brown and M. V. Belkindas (1993), “Who’s Feeding Whom? An Analysis of Soviet Interrepublican Trade”, in *The Former Soviet Union in Transition*, edited by R. F. Kaufman and J. P. Hardt, (Armok: M. E. Sharpe), pp. 163-183

⁷⁰ J. Osterhammel (1997), *Colonialism. A Theoretical Overview*, (Princeton: Markus Wiener Publishers), pp. 16-17

historical relations affect the future development of bilateral relations and the perspectives of improved co-operation?

Both the Russian Empire first and the Soviet Union indeed established a “relation of domination” over Ukraine, in the sense that they dismantled any vestige of a self-ruled state structure on the Ukrainian territory. The authorities in Russia imposed a highly centralised form of state that was administered by a governor sent in and subjected to the government in the capital, thus leaving little space for local powers to grow. Yet, with the creation of the Ukrainian SSR, the Soviet government unintentionally laid the foundations of the independent state that was to emerge more than seventy years later. Soviet policies not only set up the bureaucratic system that would provide the skeleton for sovereign Ukraine; but also created a national elite that, through the decades, acquired an interest and the confidence to administer the country.⁷¹

The policy of *korenizatsiya* (or “indigenisation”), promoted by the party in the 1920s, was the first step towards the “indigenisation of the local political leadership” and the consolidation of the local intelligentsia.⁷² The decentralisation of economic power during the Khrushchev years represented another stage in this process. As a result, by the time that *perestroika* started, “practically, everyone who is active in politics, including the Communist Party of Ukraine, was a nationalist in the sense of being an advocate of the primacy of the republic’s rights over those of the Centre. Practically everyone was in favour of a Ukrainian cultural rebirth”.⁷³

It is, therefore, difficult to say that the monopoly of power was detained in the exclusive hands of Russians as the “external colonisers”. During the Russian Empire, Ukrainian elites were Russified and absorbed into the Russian table of ranks. Also in the Soviet Union, part of the Ukrainian elite accepted, on ideological grounds, or in the hope to share the advantages afforded to the elite, the prominence of the Soviet state. These members of the elite became the “agents of mediation” between local society and

⁷¹ Some authors argue that the existence of a bureaucratic structure was the factor that determined the failure of the 1918 Ukrainian National Republic and the success of the 1991 movement towards independence. A. J. Motyl (1993), *Dilemmas of Independence: Ukraine after Totalitarianism*, (New York: Council of Foreign Relations, p. 35

⁷² G. Smith et al. (1998), *Op. Cit.*, p. 6

⁷³ B. Harasymiw (1992), “Ukrainian Nationalism and the Future”, in *Nationalism and the Break-up of an Empire: Russia and its Periphery*, edited by M. Rezun, (Westport, Connecticut: Praeger), pp. 57-69

central power, recruited with the twin purpose of promoting “modernisation and imperial control”.⁷⁴ They were “collaborators”, who experienced what a scholar of colonialism has called a “convergence of interests” between their own aspirations and the objectives of the colonial state.⁷⁵

Elevating to the level of ideology the historical mission of the empire, Russia offered Ukraine and its elites a partnership (Ukraine was to become the “second among equals”, as Khrushchev put it) that exempted them from being treated as a simple colony. In the Russian iconography, Ukraine was portrayed as the “younger brother” to be protected and looked after by the “older brother”. The Russian Empire and the Soviet Union were presented as an historical opportunity for the Slavic peoples to be finally reunited within the successor of the Kievan kingdom.

In this perspective, the national interests of Ukraine were certainly defined by the centre (as were the interests of any other Soviet Republic, including the RSFSR), but such a process would take place in the light of the historical mission of the Soviet Union. With this aim in sight, other elements (such as political opposition of the Ukrainian people and their yearning to preserve their cultural identity or exercise political autonomy) were viewed as perfectly expendable elements: either an instrument to achieve the final purpose of the empire, or an obstacle to be eliminated. In an undoubted colonial attitude, Russia proceeded in a move of systematic denial of the Ukrainian diversity, either in linguistic, cultural or historical terms, because the recognition of such a difference would most probably undermine the empire’s mission of civilisation.

Russian chauvinism became one of the ideological pillars of the empire, and institutionalised the preponderance of the Russians over the Ukrainians and other minorities in the Empire. Thus, if it is true, as Alexandr Motyl points out, that “life in the totalitarian Soviet Empire was difficult for everyone”, it is also true that “Russian elites enjoyed the prerequisites of imperial authority, and Russians in general had the

⁷⁴ M. R. Bessinger (1992), “Elites and Ethnic Identities in Soviet and Post-Soviet Politics”, in *The Post-Soviet Nations: Perspectives on the Demise of the USSR*, edited by A. J. Motyl, (New York: Columbia University Press), p. 150

⁷⁵ J. Osterhammel (1997), *Op. Cit.*, pp. 16-17

satisfaction of being masters, even if decidedly impoverished ones, of an empire, in which their language, culture, symbols and values reigned supreme”.⁷⁶

Because of all these contradictions (structure of the state, role of the elites, use of historical myths, cultural repression, submission of the local interests to centrally identified objectives) the relation between Russia and Ukraine is best described in terms of what Graham Smith and others have defined as “federal colonialism”. Relations between Russia and Ukraine within the Imperial and Soviet framework were therefore “neither wholly ‘federal’ nor ‘colonial’, but [contained] elements of both systems”.⁷⁷ In relation to our analysis it must be asked whether this form of partial, or collaborative colonialism has left permanent scars in the collective political conscience of the Ukrainian population and its elite. In particular, whether the history of this complex relationship would constitute an element strong enough to inhibit a post-Soviet rapprochement.

Ukrainian Nationalism and Independence

The Ukrainian reply to the constraints of “federal colonialism” was the emergence of a national movement that initially flourished within the wave of national resurgence that shook Europe in the second half of the 19th century.⁷⁸ Starting from the 1820s, a process of “ethnisation of the enlightened elites” occurred. Local elites became aware of the history of their national community, promoted research into their local folklore and expressed “emotional attachment” to the homeland. This process was followed by a stage of “patriotic agitation”, in which the elite attempted an organised reaction to their state of subordination.

The Elite’s reaction to the Russian pre-eminence was motivated by the awareness that, in order to achieve upward mobility, they were forced to accept a process of cultural assimilation. A “reactive ethnicity”, thus, developed as a result of growing perceptions

⁷⁶ A. J. Motyl (1993), *Op. Cit.*, p. 34

⁷⁷ G. Smith et al (1998), *Op. Cit.*, p. 4

⁷⁸ For an historical background on Ukrainian nationalism see J. Armstrong (1963), *Ukrainian Nationalism*, (New York: Columbia University Press)

of “relative deprivation”.⁷⁹ The sacred Brotherhood of Sts. Cyril and Methodius, attended by figures like the historian Mikola Kostmarov and the poet Taras Shevchenko, was the first organised Ukrainian national group.⁸⁰ The Ukrainian national movement was not, however, a powerful and widespread movement. Mainly limited to the western and central regions of the country, the nationalists had to compete with the prevailing “Little Russian” identity and Russophile doctrines.⁸¹ After centuries of Russian cultural assimilation and political domination, Ukrainian national identity was weakened, relegated to the countryside and heavily discredited.⁸²

In the Soviet period Ukrainian nationalism was revived in the OUN (Organisation of Ukrainian Nationalists), radical right-wing partisan groups that during the Second World War fought the Soviets, either allied with the German invading troops or independently. It was only with the advent of de-Stalinisation, however, that renewed enthusiasm for the Ukrainian cause gave rise to a new national movement led by members of the Soviet Ukrainian intelligentsia (the *shestidesyatikh*). Poets, like Ivan Drach, and writers, like Vasyl’ Symonenko, initiated a campaign for the defence of Ukrainian linguistic and cultural prerogatives, promoted an open critique of Russian power, and claimed political autonomy for Ukraine.

Repression of dissent from the 1960s to the 1980s drew the Ukrainian nationalistic movement underground, prompted the diffusion of illegal publications (*samydav*), and filled Soviet prison camps of Ukrainian activists. Ukrainian nationalism acquired the character of a movement for the defence of democracy and human rights (epitomised in the establishment of the Ukrainian Helsinki Group, called to monitor the Helsinki

⁷⁹ R. J. Kaiser (1994), *The Geography of Nationalism in Russia and the USSR*, (Princeton: Princeton University Press), pp.36-41

⁸⁰ A. Wilson (1997), *Ukrainian Nationalism in the 1990s: A Minority Faith*, (Cambridge: CUP), p. 28

⁸¹ *Ibid.*, chapters 2 and 5.

⁸² A passage of General Petro Grigorenko’s autobiography gives a sense of these feelings. “Mass terror campaigns were carried out against the Ukrainian population together with a cruel system of serf exploitation. As a result, in one century a country of universal literacy was transformed into a dark and forgotten province. [...] During the centuries they spent in the Russian imperial state, the Ukrainian began to forget their national name and became accustomed to the name their colonisers had bestowed on them – the *Malorosii*, or Little Russians; or the *Kholkhi* or Topknots”. P. Grigorenko (1983), *Memoirs*, (London: Harvill Press), p. 345

Accord).⁸³ In the Ukrainian experience the democratic movement and national movement coincided.⁸⁴

Despite such a relentless tradition, fuelled also by an active diaspora, nationalism, and with it the national movement, was only one of the forces that brought Ukraine to independence. The influence of mass mobilisation was indisputably large, but nationalist and democratic groups were obviously not strong enough to bring about, on their own, independence and the demise of the Soviet Union.⁸⁵ In the words of Aleksandr Motyl, "Nationalists pushed the process along - and they certainly chronicled it - but without the decay of totalitarianism and the collapse of the Soviet empire their efforts could not have transformed Ukraine from a colonial territory into an independent polity".⁸⁶ A nationalist discourse was adopted by the former communist leadership to legitimise its permanence in power and to substantiate the successive process of state-building. The realignment of the national elites was certainly one of the most important forces behind the achievement of independence.

Towards the end of the 1980s the Soviet Union had lost its appeal for citizens of the non-Russian republics. Shaken by an economic crisis that the central leadership appeared incapable of controlling, impaired by political anarchy, diminished in its international prestige, "Moscow had nothing to offer - it was neither a source of technological know-how, nor an international financial centre. It was merely an apparatus of repression and control".⁸⁷ The central bureaucracy was perceived as an obstacle to economic progress, while it seemed that local economies would become

⁸³ A. Wilson (1997), *Op. Cit.*, chapter 2

⁸⁴ B. Krawchenko (1993), "Ukraine: the Politics of Independence", in *Nations and Politics in the Soviet Successor States*, edited by I. Bremmer and R. Taras, (Cambridge: CUP), p. 86

⁸⁵ A number of "informal groups" emerged between 1987 and 1988. Among these the Ukrainian Helsinki group, the Ukrainian Association of Independent creative Intelligentsiya, the Culturological Club, the Student Organisation Hromada and the Ecological organisation Zelenyi Svit ("Green World"). Themes addressed by these groups were the abolition of party privileges, opposition to the construction of new nuclear plants, economic sovereignty, Ukranisation policies, and even the formation of a Ukrainian army. The Chernobyl catastrophe in 1986, in particular, had represented an occasion of massive political mobilisation and open critique of Soviet power. Defence of the environment became a synonym for defence of national interests as differentiated from Soviet interests. On informal groups T. Kuzio (1992), "Restructuring from Below: Informal Groups in Ukraine under Gorbachev, 1985-89", in *Ukrainian Past, Ukrainian Present*, edited by B. Krawchenko, (New York: St. Martin Press), pp.107-123. On the role of Eco-nationalism J. I. Dawson (1996), *Eco-nationalism: Antinuclear Activism and National Identity in Russia, Lithuania and Ukraine*, (Durham N.C.: Duke University Press)

⁸⁶ A. J. Motyl (1993), *Op. Cit.*, p. 23

⁸⁷ B. Krawchenko (1993), *Op. Cit.*, p. 84

more effective and prosper under the management of local elites.⁸⁸ Hopes for social and economic improvement in a state ruled from Kyiv, rather than national awareness, motivated popular support for independence in some parts of the population (especially in the central and the eastern regions of the country).⁸⁹

The increasing mobilisation of the population along a nationalistic strategy induced part of the local elites to build its authority within this framework. In January 1990 a human chain of nearly one million people joined L'viv and Kyiv, in commemoration of the 1918 declaration of independence. In the 1990 parliamentary elections the pro-independence party Rukh (the "Popular Movement of Ukraine for Restructuring") won one fourth of the seats in the Verkhovna Rada, three regional governments in Galicia, and city, municipal and rural Soviets (among them also the city of Kyiv). By mid-1990, the Rukh claimed to have a membership of half a million people. Students and workers went on hunger strikes demanding more democratisation and national autonomy. The Declaration of Sovereignty was approved by the Verkhovna Rada on 16 June 1990 in this exhilarated climate in an attempt to moderate pressures from below.⁹⁰

Between January and March 1991, the Communist Party of Ukraine (CPU) split. A "national communist" section, headed by former ideology secretary and Speaker of the Verkhovna Rada Leonid Kravchuk, emerged in opposition to a group loyal to Moscow and headed by the first Secretary Stanislav Hurenko. The nationalistic argument was hijacked by the national communists and absorbed into their political program. To which extent the conversion from communism to nationalism corresponded to a genuine ideological transformation or a "marriage of interest" is disputable. There were certainly reasons to justify the local elites' disaffection towards the central structures and their demands for direct political and economic power. Yet, it is a fact that the

⁸⁸ A 1990 report sponsored by the Deutsche Bank increased confidence that Ukraine was in a better shape than Russia to face the economic transition and it would be better off by severing its economic connections with it. J. Corret and A. Gummich (1990), *The Soviet Union at the Crossroad: Fact and Figures on the Soviet Republics*, (Frankfurt: Deutsche Bank)

⁸⁹ B. Krawchenko (1993), *Op. Cit.*

⁹⁰ P. Kubicek (1996), "Dynamics of Contemporary Ukrainian Nationalism: Empire-Breaking to State-Building", *Canadian Review of Studies on Nationalism*, Vol. 23, n. 1-2, , p. 40

defence of the national cause proved fruitful for Kravchuk, whose rating rose remarkably from November 1990 to June 1991.⁹¹

By embracing the nationalist cause, the local elites had an opportunity to re-gain their breathing space against the interference of the centre. In the Gorbachev years local elites had been blamed for the failure of the reforms, while, at the same time, the provision of those resources that could have made reforms possible was severely curtailed. Nationalism was for these elites the opportunity to "secure themselves from any attack from the centre" while "distancing themselves from Russia".⁹² A nationalist discourse gave national elites the opportunity to redistribute local resources excluding central elites. That fraction of the political and economic elite that had learnt to administer power during the Khrushchev period, and had seen their hopes frustrated in the Brezhnev years by a renewed centralisation, looked at the emancipation from Moscow as an opportunity to gain real political power. This is the process described by Mark Beissinger.

"[The] indigenisation of administration [had] made possible the penetration of nationalism into local elites and the co-option of administration by local structures. At times, native elites ostensibly recruited to mediate imperial domination over indigenous society instead defended the interests of indigenous society before the centre, even seeking to build authority on the basis of such an appeal".⁹³

This interpretation would be substantiated by the claim made by Ukrainian émigrés in the 1960s that nationalism was at its peak in the republican economic structures where frustration for Moscow's bureaucratic inefficiency was coupled with a sense of injustice for the oppressive nature of central planning.⁹⁴ The other face of this same coin was that a nationalistic cover allowed elites already in power not to be displaced by an incoming elite rooted in the national and democratic movement. Staying in power, the national communist elites could consolidate the networks of patronage that had been active in the Soviet days, keeping control over the resources that they had been

⁹¹ A survey conducted in Kyiv in November 1990 failed to include Kravchuk in a list of the twenty most popular politicians. In June 1991 he was considered the favoured candidate to the Presidency by 54% of the respondents of another survey. Quoted in B. Krawchenko (1993), *Op. Cit.*, p. 81

⁹² M. A. Molchanov (2000), *Op. Cit.*, p. 278

⁹³ M. R. Bessinger (1992), *Op. Cit.*, p.153

⁹⁴ I. S. Koropecjy (1990), *Op. Cit.*, chapter 5

“authorised to manage on behalf of the centre”.⁹⁵ As a result, a nationalistic approach pervaded the process of state-building in the post-independence years and characterised the strained relations with Moscow during Kravchuk’s presidency.

The Kravchuk Presidency

In the first years of independence, the political debate in Ukraine was characterised by a strong nationalist rhetoric, and relations with Russia were marked by the post-colonial urge to defend the newly acquired independence even with aggressive tones.

Nationalism was used as “spiritual cement” to unify society.⁹⁶ The inclusive character of Ukrainian nationalism, however, and the fact that it did not define the nation along ethnic lines, but in terms of “territorial patriotism”, allowed non-ethnic Ukrainians (Russian, Poles, Jews) to feel part of the emerging state.⁹⁷ Citizenship and language policies were liberal and contrasted strikingly with those adopted in other post-Soviet countries.⁹⁸ On the other side, however, attitudes towards Russia were inspired by the need to establish a clear-cut separation between the two countries. Because of Russia’s difficulty in accepting an independent Ukraine, and because of Ukraine’s antagonistic tones, the relationship reached breaking-point several times during Leonid Kravchuk’s presidency.

An eloquent example of such strategy of “separation” implemented during the Kravchuk years was the “Fundamentals of National Economic Policy”. Launched in March 1992, the plan envisaged the introduction of the Ukrainian national currency by November of the same year. As a reaction to price liberalisation and a tightening of monetary policy in Russia, Ukraine decided to leave the ruble zone, in order to avoid a “price competition with Russia, which is moving toward hyperinflation”⁹⁹.

The introduction of the hryvna was expected to produce a rapid reduction of imports from Russia and a reorientation of trade towards Western markets and the other

⁹⁵ M. A. Molchanov (2000), *Op. Cit.*, p. 279

⁹⁶ P. Kubicek (1996), *Op. Cit.*, p. 42

⁹⁷ Wilson (1997), *Op. Cit.*, p. 148 and Motyl (1993), *Op. Cit.*, p. 47

⁹⁸ For a comparative view on nationality policies in the post-Soviet arena see N. Melvin (1995), *Russians Beyond Russia: The Politics of National Identity*, (London: RIIA)

⁹⁹ *Komsomolskaya Pravda*, March 26, 1992

countries of the former Soviet Union. By pushing through a monetary reform without co-ordination with its economic partners, it was argued, Russia had provided a clear signal that it intended to decide alone the pace of economic reforms, ignoring potential consequences for the economies of the other former republics.

The Ukrainian economic program, however, did not contain a clear framework for reform and seemed to be motivated primarily by nationalist aims, while the leadership was coming under increasing popular pressures.¹⁰⁰ Western observers judged the move a "nasty response" to the Russian liberalisation of prices, and warned on the adverse effects that "isolationist policies" could produce on the Ukrainian economy".¹⁰¹

Economic confrontation was not the only issue between Russia and Ukraine, and the number of pending issues was multifaceted. A sizeable Russian diaspora lived on Ukrainian territory, and regions with a Russian majority population, like Crimea and the Donbass, made no secret of their hostility towards a Ukrainian state disconnected from Russia.

From 1992, in the Crimea hostility degenerated into an open challenge to Kyiv, fuelled by the support provided by some Russian political forces. The Russian parliament decided to address the question directly, and political figures like Speaker of the Parliament Aleksander Rutskoi, presidential advisor Stanislav Stankevich, and General Gromov travelled to the Crimea claiming that the region was an integral part of Russia. After the May 1992 declaration of independence by the Crimean parliament, and the response of the Verkhovana Rada of the declaration's unconstitutionality, the crisis subsided until the election in January 1994 of a new Crimean president.¹⁰²

In the question of Crimea, Russia and Ukraine were tied to the power struggle taking place in Moscow between the President and the parliament. The factor that prevented

¹⁰⁰ Leonid Kravchuk justified the decision as follows. "Now, when Ukraine becomes an independent state, and when the Union has ceased to exist, our economy continues to be managed from the outside, but now through financial, monetary and price policy. For all practical purposes, Ukraine has not made and could not make any serious independent decision on economic questions". *Komsomolskaya Pravda*, March 26, 1992. See also *RFE/RL Research Report*, October 30, 1992

¹⁰¹ A. Sekarev (1992) "Ukraine's Policy Structure", *RFE/RL Research Report*, Vol. 1, n. 32, August 14, pp.60-63. Also *Journal of Commerce*, August 7, 1992, p. 5

¹⁰² For a more detailed analysis of the Crimean issue see D. R. Marple and d. F. Duke (1995), "Ukraine, Russia and the Question of Crimea", *Nationalities Papers*, Vol. 23, n. 2, , pp. 261-280

the deterioration of the crisis was Yel'tsin's refusal to support the independence movement, as he realised that Crimea would constitute a precedent for separatist movements in non-Russian regions within the Russian Federation (Chechnya, Ingushetiya, and Tatarstan). By not addressing the Crimean question in the agreements signed with Kravchuk in June and August 1992, Yel'tsin signalled that Crimea was an exclusively Ukrainian internal question.

The alarm caused in Kyiv by the Crimean crisis and the ambiguous attitude of the Russian establishment towards the question of Ukrainian borders, however, combined with the perception of risk caused by the presence of 700,000 Soviet soldiers stationed on Ukrainian territory. The presence of these troops convinced Ukraine of the need to build its own army. The army was designed to be smaller than the Soviet army in Ukraine, and it was to be composed of the Ukrainian share of the Soviet forces (with the rest of the army to be withdrawn). Between January and March 1992, 500,000 troops and half of the officers of the Black Sea Fleet swore loyalty to Ukraine. Ukraine agreed to surrender strategic and tactical nuclear weapons and claimed neutrality.

Inevitably, Kyiv's decision sparked new controversies with Russia. First of all around the question of the Black Sea Fleet. Ukraine initially claimed the totality of the Fleet, reducing its demands to 30% at a later stage. Yet, the Fleet was still based in the Crimean port of Sevastopol, and Ukrainian requests were perceived by Russian nationalists as a challenge also to the status of the city, traditionally viewed as Russian land, and the glory and pride of Russian maritime history. The September 1993 Massandra Agreement temporarily resolved the issue by placing the fleet under a joint Ukrainian and Russian command for a period of three years, after which the question would be permanently settled.

The second controversial question related to the Ukrainian decision to create its own army was that it forced Russia to establish a separate Ministry of Defence and a Russian army, against previous expectations that military issues would be dealt with within the Commonwealth of Independent States.¹⁰³ This appeared to be the first blow against the Russian strategy towards the former Soviet space, and demonstrated the different

understanding that Russia and Ukraine had of the CIS. Ukraine perceived the Commonwealth as a loose association of fully independent states, with no common monetary and economic policy and no common army. The CIS was for Kyiv an organisation aimed at providing a “civilised divorce” from the USSR, while the country was waiting to join European structures.¹⁰⁴ Russia, on the other hand, saw the CIS as a federation, within which some powers (especially economic and military) would be managed by the centre, giving ground to Ukraine’s fears that the CIS would become an instrument to preserve the Russian pre-eminence in the region.

Not surprisingly, the Belavezha Pushcha Agreement, which set up the CIS, was rejected by the Ukrainian nationalists as a betrayal of the national interest, and a threat to the country’s sovereignty. Ukraine appeared to be the most reluctant member of the organisation, especially between 1992-93. After that first year, though, the grip of the economic crisis and the energy dependence on Russia forced Kyiv to a more accommodating approach towards the CIS and even convinced Kravchuk to sign the Agreement for the Economic Union.

Negotiations with Moscow on energy imports had indeed revealed the virtues of Russian “energy diplomacy”, and led the Ukrainian leadership to believe that the Russians were using the “oil whip” on Kyiv.¹⁰⁵ On more than one occasion, it appeared that Ukraine’s vulnerability to threats or actual reductions in energy provisions made the country’s leadership more “inclined” to compromise on other important bilateral issues.

Aware of what Prime Minister Kuchma acknowledged to be “total dependence on Russia”, Ukrainian energy strategy in the first years of independence was to diversify its markets, reaching agreements on the importation of energy supplies from Turkmenistan,

¹⁰³ In January 1992, Russia, Ukraine and other states of the former Soviet Union sign an agreement that placed USSR strategic forces under a CIS command.

¹⁰⁴ The CIS was also considered a framework to solve the issues related to the succession of the USSR. The 1991 Minsk and Alma Aty agreements recognised Moscow as the successor of the USSR only in the United Nations Security Council. Instead, Russia assumed the prerogatives of the successor state in many different aspects: debt repayment, disarmament, Soviet property (including hard currency and gold reserves, and all USSR embassies and consulates). After successive negotiations Russia agreed to transfer to Ukraine 16.37% of Soviet assets (including property overseas).

¹⁰⁵ O. M. Smolansky (1995), “Ukraine’s Quest for Independence: the Fuel Factor”, *Europe-Asia Studies*, Vol. 47, n. 1, p. 75

Uzbekistan, Kazakhstan and Oman. The construction of a tanker fleet was planned to import oil from countries other than Russia. Yet, given its limited extraction capabilities (Ukraine could meet only 15-20% of its annual gas and only 8% of its oil requirements), and the high rate of energy imports, mainly from Russia (90% of the gas consumed was Russian), diversification proved a difficult task.¹⁰⁶

Withdrawal from the ruble zone meant also that, from February 1993, energy deliveries had to be paid in hard currency. As a result, prices increased suddenly by ten times, but provisions of Russian energy resources at prices below the world market continued to take place occasionally in exchange for cheap Ukrainian foodstuff. Reductions in Russian supply, motivated by the Ukrainian increasing difficulty in paying, were reciprocated by Ukrainian diversions for its own use of Russian gas passing through its territory en-route to European markets.

By late 1993 Ukrainian energy debt with Russia had reached the sum of \$2.5 billion. The country was subjected to recurrent power cuts, and the economy as a whole had plunged into a climate of stagnation (inflation in 1993 was reported at 4,735% a year). The crisis convinced Ukraine to reconsider its policy towards Russia.¹⁰⁷ The "Concept of Economic Union", signed in September 1993, was seen as an instrument to stabilise trade relations with Russia, restoring historical trade patterns and even obtaining favourable energy prices. The agreement envisaged the free circulation of goods, capital and labour, the co-ordination of fiscal policies, trade policies with third countries, and the harmonisation of monetary policies within a sort of monetary union.

¹⁰⁶ E. Whitlock (1993), "Ukrainian-Russian Trade: the Economics of Dependency", RFE/RL Research Report, Vol. 2, n. 43, 29 October, pp. 38-42

¹⁰⁷ World Economic Outlook, May 1996

The Kuchma Presidency

The election of Leonid Kuchma to the Ukrainian presidency in July 1994 marked a radical change in relations with Russia. Kuchma had been particularly critical of Kravchuk's foreign policy line, his isolationism from Russia and the CIS and his unrealistic plans of a reorientation towards Western markets. He conducted his campaign on a pro-Russian, pro-economic reform ticket, reminding the population that "the West has no need for us on account of our low level of technology, and besides 80% of our production depends on Russia's supply of raw materials".¹⁰⁸ Kuchma promised an economic policy that would give priority to those sectors whose production cycles involved Russia, but reassured his audience that Ukraine intended to build equally good relations with Asian as well as European countries, becoming a "bridge between Russia and the technologically developed West".¹⁰⁹

Kuchma's first term in office was characterised by a more constructive approach to Russia, as many of the issues stemming from independence were finally resolved. The President's greatest achievement was the 1997 Treaty of Friendship, Co-operation and Partnership, which provided Russia and Ukraine with an entirely new framework for bilateral relations. The agreement had taken two years of preparatory work. President Yel'tsin's visit to Kyiv had been scheduled six times, but had always been postponed because of new obstacles emerged in the negotiations.¹¹⁰ The importance of the Treaty and its urgency for the Ukrainian part lay mainly in the fact that it set relations between the two countries on an equal footing. In the agreement Russia and Ukraine were defined "friendly, equal and sovereign states", committed to base their relations on "mutual respect and trust, strategic partnership and co-operation". The countries' territorial integrity and the immutability of the borders between them were confirmed.¹¹¹

For Ukraine the Treaty meant that Russia's territorial claims on Ukraine, and especially on Crimea and Sevastopol, were to cease. To indicate the importance they attached to

¹⁰⁸ *Nezavisimaya gazeta*, June 18, 1994

¹⁰⁹ *Ibid.*, and *Izvestiya* July 13, 1994

¹¹⁰ For more details on the history of the failed visits to Kyiv see "Istoricheskii put' B. N. El'tsina na Ukrainu", *Kommersant*, n. 20 (226), 3, June 1997, pp. 23-24

¹¹¹ For an English version of the Treaty see *SWB SU/2934*, S1, June 2, 1997

the treaty, the Ukrainian parliament ratified it on its first reading,¹¹² as opposite to the Russian Parliament which took more than one year to finally approve the Treaty.¹¹³ Demonstrating that the significance of the Treaty was measured on different scales in Moscow and Kyiv, after the Duma's ratification Russian Deputy Foreign Minister Ivanov commented that the treaty "will become a step towards the unification of the three Slavic nations".¹¹⁴

Despite rumours that his presidential bid had been heavily sponsored by Moscow, Kuchma turned out to be a more cautious and less obedient leader than the Russians had hoped for. Once he had acquired the presidency, Kuchma proved to be highly interested in preserving the sovereignty of his country. In the face of continuous pressure from Russian nationalists and Ukrainian populists, Kuchma firmly and repeatedly denied any opportunity for the establishment of a three-way union with Russia and Belarus, which from Minsk President Lukashenka considered "inevitable".¹¹⁵ The Crimean crisis became, in this respect, one of the most difficult testing grounds of Kuchma's response to Russian nationalism.

After almost two years of quite, tension erupted again in Sevastopol in August 1994, when the city council proclaimed the Russian status of the city. A decision subsequently upheld by the regional parliament. The Verkhovna Rada annulled the City Council's decision, the Crimean constitution and its presidency, and threatened to disband the regional legislature if it did not refrain from separatist tendencies. The

¹¹² More details on the ratification in Kompanyon n. 42, January 1998, pp. 8-9 and Kievskie Vedomosti, January 15, 1998

¹¹³ Primakov intervened to the Council of the Federation discussion on the ratification of the treaty of friendship. Urging the senators to vote in favour of ratification he said: "Do we like everything in our relations with Ukraine? No this is absolutely clear. Where should we go? Should we boost our contradictions or smooth them down. Should we draw closer to the fraternal nation on the issues of strategic importance or should we push it away?" He suggested that the decision stipulated that the treaty would come into force when the Verkhovna Rada had ratified the three agreements on the Fleet. The Council of the Federation finally approved the treaty on February 17, 1999, with a 106-25 majority. V. Musatov (1999), "Russian-Ukrainian Treaty Ratified", International Affairs (Moscow), Vol. 45, Part 2, p. 160

¹¹⁴ RFE/RL Newslines, December 28, 1998

¹¹⁵ Pressing for a Duma ratification of the friendship Treaty, Ukrainian parliamentary speaker Oleksandr Tkachenko visited the Duma and spoke in favour of working out a common defence doctrine and a common Russian-Ukrainian position towards Nato enlargement, merging the Russian and Black sea Fleets, creating a common currency, a common economic space, and a common broadcasting space. In Kyiv Rukh leaders pointed out that Tkachenko's proposal had not been authorised by the parliament. Kuchma's representative in the parliament suggested that Tkachenko had probably started his own

region was placed under direct presidential rule until a new constitution, more favourable to Kyiv, but still respectful of regional autonomy and cultural identity was passed.¹¹⁶ Even though the Russian government had reassured Kyiv that Russia had no intention of interfering in Ukraine's internal affairs and respected the country's territorial integrity, an appeal of members of the Crimean parliament to the Russian parliament attracted Moscow's attention to the peninsula once again.¹¹⁷

By April 1995 the relations between Russia and Ukraine had become so tense that Yel'tsin announced he would not sign the Friendship Treaty, which had already been initialled by the two Prime Ministers, unless the Crimean question was resolved.¹¹⁸ In December 1996 the Russian Council of the Federation adopted a statement calling Sevastopol a "part of Russia's territory", and urging the observance of Russia's territorial integrity.¹¹⁹

Even after the signature of the Treaty of Friendship, which Russian nationalists condemned as recognition of Ukrainian right on Sevastopol, protests over the status of the city and the peninsula did not diminish. Moscow mayor Yuri Luzhkov demanded again that the city be placed under Russian jurisdiction, denounced the "forced Ukrainisation" of ethnic Russians and warned that relations between Russia and Ukraine will never be transparent or sincerely fraternal if injustice towards Sevastopol and Crimea continues.¹²⁰

personal campaign as a leftist candidate to the post of president. Jamestown Monitor December 19, 12 1998. RFE/RL Newsline September 30, 1998, and RFE/RL NewsLine August 4, 1998

¹¹⁶ The 1995 constitution still recognised the autonomous status of the region, and it allowed it to maintain foreign economic relations and special economic co-operation with Moscow. The official language of the region was established as Ukrainian, but citizens are authorised to use their own national language (Russian or Crimean Tatar) for education culture or in the administrative sphere.

¹¹⁷ Head of the State Duma Committee on CIS Affairs, Konstantin Zatulin, called for sanctions to be considered against Ukraine, state visits to be cancelled, trade agreements suspended and immediate repayment of Ukrainian debt demanded. (OMRI Daily Digest, March 29, 1995). First deputy Prime Minister Oleg Soskovets was accused by the Duma of having betrayed the interests of Russia and Russians living abroad in his negotiations with Ukraine. Nine Duma factions (including the Agrarian party, The Communist Party, The Liberal Democratic party, the Democratic Party of Russia and Yabloko) appealed for a special session to discuss Russia's relations with Ukraine (OMRI Daily Digest, March 27, 1995). A Duma deputy, member of the right-wing National Republican Party, reacted by tearing up a Ukrainian flag in the parliament. He was reprimanded by the speaker. (OMRI Daily Digest, April 10, 1995).

¹¹⁸ OMRI Daily Digest, April 18, 1995

¹¹⁹ Jamestown Monitoring, December 6, 1996

¹²⁰ RFE/RL NewsLine, February 21, 1998

The Crimean question was naturally intertwined with the problem of the division of the Black Sea Fleet, and the city's vociferous campaign was largely motivated by the preoccupation with losing the high income and status deriving from being home port to the Fleet.¹²¹ Russian nationalists had not accepted yet the idea of conceding sovereignty over a land that, in Luzhkov's words, was "packed with Russian bones".¹²² At the same time, Ukrainian concerns were justified by the presence of a considerable Russian military contingent on Ukrainian territory, which could diminish the country's sovereignty and undermine its security. As Kuchma put it, Ukraine's opposition to the Russian plans was a matter of territory, not ships.¹²³

A final agreement on the division of the fleet was reached only on the eve of Ye'tsin's visit to Kyiv, under the pressure of the need to sign the Friendship Treaty. The agreement stipulated that the Russian part of the fleet (4/5 of the total, 338 ships, 106 planes and up to 25 thousand men) would be stationed in Sevastopol, in the Yuzhnyy bay, while the Ukrainian part would be stationed in the Streletskaya bay and Karantiya bay would be demilitarised. The right of the Russian fleet to use Gvardieysk airport, and Yalta military sanatorium was also recognised.¹²⁴ Russia would lease Sevastopol for 20 years, after which, by common agreement of the two parties, the lease could be renewed for a further five years. Russia would also participate in the development of the infrastructure of the base, and it would guarantee not to deploy nuclear weapons in the area.¹²⁵ The price of the lease was agreed at \$2,5 billion, to be detracted from the Ukrainian outstanding debt towards Russia.¹²⁶

The agreement was heavily criticised on both sides of the border by nationalist forces, but it was welcomed by moderates as the first step towards improved co-operation.¹²⁷

¹²¹ After Crimea was transferred to Ukraine in 1954, the city started to receive money from the Ukrainian budget, as well as from the USSR Ministry of Defence as the main Black Sea naval base. Defence enterprises of Union jurisdiction also invested in city development. V. Musatov (1999), *Op. Cit.*

¹²² RFE/RL NewsLine, February 21, 1998

¹²³ OMRI Daily Digest, April 26, 1995

¹²⁴ Vseukrainskie Vedomosti, June 8, 1997

¹²⁵ Den', May 29, 1997

¹²⁶ The agreement was also motivated by also another economic reason, the recognition that Ukraine would not be able to support the repair of the fleet on its own. Over 70% of the vessels of the Fleet were in disrepair. There was no procedure to pay for maintenance work, and no contracts had been signed with Russian enterprises to carry on the work, as the fleet still had to pay \$ 2.65 million debt for past repairs. OMRI Daily Digest, October 24, 1995

¹²⁷ The leader of the CPRF Gennadii Ziuganov said that the agreement meant "the destruction of the Black Sea Fleet". Rukh leader Vyacheslav Chornovil called the agreement a "big surrender on the

The unresolved question of the Black Sea Fleet had been indeed the main obstacle to the long-awaited Friendship Treaty.

Russia's attitude towards Ukraine also changed in the years 1994-98 with the emergence of a pragmatist approach to foreign policy. The Russian establishment switched from a more openly confrontational relationship, to one based on an increased use of extra-political leverages (trade wars, debt repayment, energy deliveries) to achieve political objectives. The final accord on the Friendship Treaty was attributed by Ukrainian sources to the use of economic pressures based on inaccurate calculations of the Ukrainian debt to Russia.¹²⁸ In September 1996 Russia introduced a 10% VAT on goods imported from Ukraine. The move caused a loss of \$300 million to Kyiv as a result of the drop in price competitiveness. Ukrainian Prime Minister Pavlo Lazarenko tried to play down the asymmetrical taxation problems denying any trade war and attributing them to the fact that the two countries' tax policies were "just uncoordinated".¹²⁹

In May 1997 a 25% tariff on the import of Ukrainian sugar was introduced. The intention was to support the growth of Russian sugar production, but the result was a severe blow to Ukrainian producers who enjoyed a position of quasi-monopoly on the Russian market.¹³⁰ Even President Yel'tsin acknowledged that economic pressure had been used as an instrument to force Ukraine into positions more favourable to Moscow. At the press conference following the signature of the Friendship Treaty he said:

Ukrainian side". The leader of the parliamentary fraction of the Republican party of Crimea Sergei Tsekov defined the agreement as a "betrayal of the interests of Russia and of those Russians who live abroad [...] the Russian in Crimea are in a state of semi-shock for the signature of the agreement". (Den', May 31, 1997) While Arkadii Vol'skii, President of the Russian Union of Industrialists and Entrepreneurs commented that "it was about time" to conclude the negotiations, as the uncertainty was slowing down the process of "further economic integration and friendly political relations". (Den', May 31, 1997)

¹²⁸ Leading the Russian delegation which preceded Yel'tsin's visit to Kyiv, Viktor Chernomyrdin commented that the Ukrainian debt towards Ukraine was in the range of \$4.5 billion and Kyiv would not be able to pay that sum even in a hundred years. Ukrainian deputies protested that the debt was "increased and created artificially", as Russian estimates voluntarily excluded money owed by Russia to Ukrainian enterprises. Den', May 31, 1997

¹²⁹ O. Medvedev (1996), "There will be no Trade War", Business in Russia, 22 December, pp. 46-47

¹³⁰ A. Pyatnitskii (1997), "Chem bagaty, to i v Radu", Kommersant', n. 20 (226), 3 June, pp. 20-22. In 1997 Ukraine exported to Russia only 600 thousand tones of sugar against the usual 1.1/1.3 million tons per year. (RFE/RL Newslines, September 17, 1997). In November the parties agreed to remove VAT on each other's products (RFE/RL NewsLine, November 17, 1997)

“We [Russia and Ukraine] are blood brothers. But now we are arguing all the time, either [on] this subject or that. If transit goods cannot pass [through Ukraine], let’s either cut off gas or double VAT on all Ukrainian goods coming to Russia. What robbery! Of course this happens not on the instructions of the presidents, but someone does this. This is inadmissible. This is inadmissible towards any state, let alone Ukraine.”¹³¹

Despite the more favourable climate between the two countries, Russia still maintained an obvious position of superiority, on the economically unstable and heavily indebted Ukraine. The signature of the February 1998 Programme of Economic Co-operation until the year 2007, which promised Russian investors favourable conditions to participate in Ukrainian large-scale privatisation, was interpreted as a way to secure Moscow’s favour.

By inviting Russian capital into the Ukrainian game, Kuchma closed the circle with Russia. In his first term in office the Ukrainian President had certainly established that bilateral relations with the powerful neighbour should be set on the principle of the inviolable sovereignty of the two countries. But Kuchma had also created the conditions to strengthen the special relationship with the powerful neighbour on terms that, in the era of economic pragmatism, were well accepted in Moscow.

Conclusions

In this chapter I have identified the impact of history on the development of the relationship between Russia and Ukraine. In Andrew Moravcsik’s terms, this meant outlining the “social identity” of the two partners and the resulting “bargaining space” that could promote, or hinder, the move towards co-operation. The numerous factors that defined the relationship between Russia and Ukraine were not automatically conducive to a climate of co-operation or conflict.

The closeness of this relationship based on the similarity of language and mentality, the high degree of inter-marriage between the populations, feelings of mutual belonging, and the level of economic interdependence, were all elements that gave support to the rhetoric a renewed Slavic Union. On the contrary, memories of political and cultural

¹³¹ SWB SU/2934 S1/9, June 2 1997. I grateful to Graeme Herd for this reference

repression during the Russian empire, first, and the Soviet Union later, together with the Russian hostility to recognise Ukrainian sovereignty suggest that there would be resistance towards increased co-operation with Russia.

Which of these two interpretations of history prevailed depended mainly on what Ernst Haas calls the “national situation”, that is the self-perception of Ukrainians in a specific historical moment and in their relation of power with Russia and with other international partners. Factors such as changes on the international arena, fluctuations in the foreign market conditions, competitiveness of the country’s economic actors abroad, the standard of living of the population vis-à-vis their neighbours, had important consequences on Ukraine’s decisions to preserve its independence no matter the costs, or abdicate to some sort of Russian protection.

The role of domestic institutions and of domestic actors (such as members of the economic elites) was no less important. Such actors could contribute by influencing popular perception and modifying the national situation as a result of specific interests, as President Kuchma’s ambivalent attitudes towards Moscow showed. Domestic forces then could use the historical background of relations between Russia and Ukraine instrumentally, to defend their own political or economic position. The influence of international and domestic forces will be examined in more detail in the next chapters.

CHAPTER THREE

The Development of Foreign Policy in Russia and Ukraine

In order to understand the policy preferences of economic elites in Russia and Ukraine and choices vis-à-vis co-operation or even reintegration between their two countries it is important to define the domestic and the international scene on which they operate. The purpose of this chapter is to outline the space for action afforded to the economic elites, highlighting the constraints, the opportunities and the incentives that the international environment imposed on them.

In the case of the Russian foreign policy, the emergence of what can be termed as a pragmatist approach signalled the achievement of a temporary consensus between parts of the foreign policy establishment and the rising oligarchic powers. In the years between 1994 and 1998, a reaction to the victimisation of Russian national pride combined with deteriorating economic conditions and the perceived risks to Russian national security deriving from the independence of the former Soviet republics. The interaction of these three factors fostered a change in foreign policy priorities, with a shift from a post-imperial approach to a less ideological attitude, in which economic interests took central stage.

The sense that Russia was missing out on significant economic opportunities in the former Soviet space, while foreign companies were gradually eroding what had traditionally been Russian markets was key in convincing Moscow of the need to moderate the terms of its foreign policy. As Paul Goble points out, this implied a major shift for the Russian leadership, moving away from the concept of “a mission oriented foreign policy to an interest-driven one”. For perhaps the first time in its millennial history, Russia had been left with no special mission in the world, no third Rome to build, or Marxist gospel to

spread.¹ Russia was confronted with a situation in which issues of domestic economic, social and political development had become compelling and had come to determine the foreign policy agenda.

This change provided a particularly convenient setting for economic actors to promote their interests on the international scene. The pragmatist doctrine of foreign policy, assimilated also in a number of official documents summarising the medium-term objectives of Russian foreign policy, provided an institutional mandate for big companies. Groups like Gazprom, Lukoil, Yuksi and Alfa Capital engaged in expansionary operations on the territories of the former Soviet Union, and came to be seen as the most powerful ambassadors for Moscow, while their prosperity was increasingly equated to the national interest and the well-being of the whole country.

Ukrainian foreign policy also went through a major transformation in the period between 1994-98. After the election of President Leonid Kuchma, Kyiv moved from the vehemently anti-Russian policy adopted under Leonid Kravchuk's presidency, to a "multivectorial strategy". Within this line, the new president defined Ukraine's priority as developing simultaneously good relations with Russia, as well as with Western Europe and the United States. Kuchma's ultimate foreign policy aim was the acceptance of Ukraine into the European and North Atlantic structures of economic, political and military co-operation. At the same time, however, an improvement in relations with Moscow was viewed as the inevitable precondition for stability on the internal scene.

Political uncertainty in Ukraine, and the country's fragmentation along geographical, political and socio-economic faults was reflected in the President's attempts to seek a counterbalancing support abroad. The deteriorating economic situation, with Ukraine's acute energy dependence on Russia, and the rapidly changing international environment in the post-cold war world contributed to sharpening Kyiv's urgency in defining its strategic position. Kuchma's ambivalent policy towards Russia and the West was, therefore,

¹ P. A. Goble (1994), "Russia as and Eurasian Power: Moscow and the Post-Soviet Successor States", in *Rethinking Russia's National Interests*, edited by S. Sestyanovich, (Washington D. C.: Centre for Strategic

dictated by the stringent necessity to obtain political as well as financial aid, turning to one bloc when the other appeared less inclined to compromise. The President tried to use a geographical position that would have otherwise condemned Ukraine to the role of buffer state between Russia and Europe to his country's advantage.

In this general perspective, the Ukrainian economic elite found fertile ground in an already active debate which focused on defending the country's newly acquired sovereignty. The question whether an autarchic economic system or balanced economic relations with Russia and the West would provide the most effective guarantee to Ukrainian independence became central in this debate. The weakness of the Ukrainian economic elite, however, and its inability to engage in foreign markets limited their business interests to the domestic arena.

Foreign policy issues, other than the demand for protection of the internal market did not appear on the agenda of the Ukrainian rising oligarchs, and economic actors played very little role in defining Ukrainian foreign policy. Yet, as it will be seen in chapter five, the economic elite's quest to exclude Russian competitors from ownership of strategic assets became an integral part of a nationalist strategy to reject Moscow's attempts at reasserting political and economic control over the newly independent state.

The chapter is divided in two halves in which I examine the Russian foreign policy first and then the Ukrainian foreign policy. The identity crisis that derived from the loss of Russia's imperial status is discussed in section one. In section two and three I look at the Russian economic crisis and the increasing independence of the former Soviet republics as elements that caused a shift towards a pragmatist nationalist approach to Russian foreign policy. The emergence of Pragmatist nationalism is discussed in the following section.

From section five I turn to the Ukrainian foreign policy, examining its nationalist character. In the following sections I consider the Ukrainian economic decline and the unfolding of regional co-operation blocs as the two major constraints to Ukraine's foreign policy. The

adoption of a “two-track foreign policy”, designed to balance the country’s domestic and international weakness is analysed in section eight. Some conclusions sum up my argument.

Russian Identity Crisis

Pragmatist Nationalism emerged in Russia as a reaction to Foreign Minister Andrei Kozyrev’s foreign policy line, which by the beginning of 1993 was perceived to be too submissive towards Western interests. The years between 1991-1993 were characterised by a sense of bewilderment amongst a section of the Russian foreign policy elite on the interpretation of national interests and the understanding of national identity in the aftermath of the dissolution of the Soviet Union. The rise of a pragmatist foreign policy represented, on the contrary, an advance from this state of confusion and testified of the achievement of a wider foreign policy consensus on the role for Russia to play in a post-Cold War world.

Andrei Kozyrev had worked to change the image of Russia as a closed and predominantly aggressive country, having realised that military confrontation was moving off the foreign policy agenda. The foreign policy course was to be forged so as to correspond to the priorities of domestic reforms. In the Foreign Minister’s vision, the fact that military threats from Western powers had indeed evaporated reduced the need for ideology and militarism. Russia, he believed, had to be established as a “normal state”, a democratic market economy. An “imperial syndrome” had to be abandoned, while other sorts of considerations, such as the country’s position in the world economy, in science, in culture, and the living standards of its population, had to become priority issues in the process of foreign policy-making.

Kozyrev placed on top of his strategic task-list the urgent need for Russia to attract foreign capital for industrial modernisation, to access the most sophisticated modern technology, and to expand the market for its products. The Foreign Minister presented the opportunity

for economic co-operation with neighbouring and Western countries as the most effective tactics to preserve national security. "Buffer zones" or "zones of Russian priority interests" could also be turned into areas of economic integration.

This switch from a strategy of military domination to one of economic influence, Kozyrev maintained, would serve a twin purpose. It would challenge the traditional mistrust and seclusion that the capitalist world had imposed on Russia during the Soviet era, while, at the same time, it would liberate Russia from the economic burden of supporting a "confrontational climate". The preservation of the country's military arsenal and the establishment of a new *cordon sanitair* with the West were a price too high for Russia to pay.²

The foreign policy strategy that was adopted as a result of these considerations was blamed, in the nationalistic circles, as the embodiment of a defeatist spirit. Nationalists suggested that Russia, having lost the Cold War was now forced into an isolationist, inward looking policy. Many democratically oriented scholars and politicians maintained, indeed, that, as Japan and Germany had done after World War II, Russia had to concentrate on its internal situation, promote economic and political reforms, and thus recover its international prestige. A report published by the Academy of Science in 1995 articulated this perception.

"Given the conditions of its socio-economic development, Russia cannot be a superpower. At the present stage it does not need that status, which is beyond its capabilities. Even with the role of great power Russia is currently encountering huge difficulties, since it lacks the political, economic, and military resources necessary to perform this role. Russia is not in the position to carry on a global foreign policy similar to that of the former Soviet Union, and bear responsibility for global international security".³

Along the same lines, Yabloko's Deputy President Vladimir Lukin noted that

² A. Kozyrev (1995), *Preobrazhenie*, (Moscow: Mezhdunarodnie Otnoshenie), pp. 35-48

³ S. Kolchin (1995), "Rossiya- blizhnyeye zarubez'ye: vzaimothosheniya, interessy, tseli politiki", *Mirovaya ekonomika i mezhdunarodnie otnosheniya*, n. 4, pp. 47-56

“Our top priority is putting our own civilised home in order gradually, displaying every skill we are capable of, weighting our strengths, and the price we must pay for whatever moves we are taking, to heal our wounds and to draw plans for the future”.⁴

With the collapse of the Soviet Union and the loss of control over the former republics, it had become particularly difficult for Russians to agree on the best foreign policy line to pursue in the years of transition. Many, however, did share the view that “the starting point of any discussion about the interests of Russia has to be a discussion about Russia itself. What kind of country are we are talking about – territorially, politically and ideologically?”. Finding an accord on the very essence of the Russian identity and its foreign policy implications turned out to be a much more troublesome task to address.⁵

Russia had undergone an epochal shock, even more severe than it had been for the other former republics. In most of these states a distinct national identity had endured persecution and repression under the Russian and the Soviet empires. Independence had coincided with the triumph of the nation-state, when an historical opportunity of self-rule along nationalist or ethnic lines was finally afforded. Being the centre of the empire, the focus from which political and economic decisions departed, Russia had instead failed to develop its identity as a distinct nation-state. For many Russians, the establishment of the new polity in December 1991 meant only the shrinking of the Russian borders, not the enhancement of the Russian State.

Throughout much of its history Russian statehood had grown simultaneously with the empire: “We cannot separate the Russian Republic from the centre - the literary critic Yurii Burtin remarked - we look back in history, and the centre is somehow ourselves”.⁶ Russian identity had then been defined by the common history of the components of the empire.

⁴ *International Affairs* (Moscow) (1995), “Election 1995. Parties’ Foreign Policy Views”, n. 11-12, special issue

⁵ V. P. Lukin (1994), “Russia and its Interests”, in *Rethinking Russia’s National Interests*, edited by S. Sestyanovich, (Washington D. C.: Centre for Strategic and International Studies), pp. 106-115

⁶ V. Tolz and E. Teague (1992), “Russian Intellectuals Adjust to Loss of Empire”, *RFE/RL Research Report*, Vol. 1, n. 8, 21 February, pp. 4-8

Ninth century Kievan Rus' represented the root of the modern Russian state, while Moscow had emerged as a separate political entity only in the fourteenth century. For Russians it was difficult to accept that Ukraine was now an independent country separated by an international border: "millions of Russians are convinced that without Ukraine, it is impossible to speak not only of a great Russia, but of any kind of Russia at all".⁷ As political commentator Sergei Kortunov summarised, "Russians are defined more by their geopolitical location than by blood. [...] [They] never equated the nation to the state".⁸

Shrunk frontiers made Russians question who they really were (Asians? Europeans? Eurasians?), and who their friends, and who their enemies. "It is important to determine who we are, where we are going, what kind of brains we have in our heads". The confidence of the past had crumbled. "In what borders do we exist? What relations should we have with our neighbours, who just recently were part of a single state? [...] What is in store for twenty five million Russians who have found themselves abroad?"⁹

The loss of the Empire had happened so abruptly that Russians had not had the time yet to develop an extra imperial identity. Russian nationalists, like Aleksandr Tsipko, argued that decisions over the future of the Soviet state had been made by a small number of ambitious politicians, over the head of the population. This represented a *de facto* usurping of "the power to speak in the name of Russian history and the Russian Empire".¹⁰

The inability to come to terms with this new, reduced identity explains the difficulties in defining a foreign policy concept for independent Russia. The foreign policy elite agreed only as far as outlining a set of "fundamental interests", survival, prosperity, and security. The country's geography, history, culture, ethnic composition and political tradition defined the implications of these "immutable" interests and the way they would be implemented. Yet, a further layer of national interests, reflecting the "national idea", the

⁷ *Ibid.*

⁸ S. Kortunov (1998), *Russia's National Identity in a New Era*, J. F. Kennedy School of Governance, Harvard University, Strengthening Democratic Institutions Project, September, p. 8

⁹ S. Kondrakov (1996), "National Interests in Russian Foreign Policy", *International Affairs* (Moscow), n. 2, pp. 1-24

¹⁰ *Ibid.*

“nation’s self-identity”, the country’s “visualisations of the national past and the national future”, presented more serious problems of identification.¹¹ Political opinions on the essence of national interests diverged widely, ranging from “Liberal-Westernisers” to “National Patriots” (see table 3.1).¹²

Michael McFaul has argued that the prevalence of a strategy of liberal foreign policy, in the immediate post-Soviet years, was the result of the polarisation of ideology occurred in the late Soviet era. Then, in order to propose themselves as the only viable ideological alternative to the communists, the democrats were forced to adopt even more radical positions than Gorbachev. The rejection of liberal policy and the renewed pre-eminence of nationalism once power was safely in the hands of Yel’tsin’s democrats, represented, in this context, the return to a natural state of things. Russia was a great power, had traditionally harboured a vision of itself as a great power, and it was only natural for it to go back to a policy of a great power on the international arena.¹³

After the inauguration of *Glasnost*, Russians had endured almost a decade of “self-flagellation”. They were faced with revelations that pricked their national pride: the scale of the horrors perpetrated in the Stalinist period, the devastation of the environment, the rise of crime, the decay of traditional social values, the condemnation of Russian colonial exploitation of the other Soviet Republics. This was combined with a “feeling of victimisation” that had been present in the Russian conscience since the Soviet era.

Then, the “practice of damning Russian imperialism”, along with the perception that large resources were being transferred out of Russia to promote social and economic

¹¹ S. B. Stankevich, (1994)., “Towards a New ‘National Idea’”, in *Rethinking Russia’s National Interests*, edited by S. Sestyanovich, (Washington D. C.: Centre for Strategic and International Studies), pp. 24-32

¹² For an accurate account of the debate on the definition of the national interests see M. Light(1996)., “Foreign Policy Thinking”, in *Internal Factors in Russian Foreign Policy*, edited by N. Malcolm et al., (Oxford: OUP), pp. 33-101; J. Valdez (1995), “The Near Abroad, the West, and National Identity in Russian Foreign Policy”, in *The Making of Foreign Policy in Russia and the New States of Eurasia*, edited by A. Dawisha and K. Dawisha (New York: M. E. Sharpe), pp. 84-109; L. Aron (1998), “The Foreign Policy Doctrine of Post-Communist Russia and Its Domestic Context”, in *The New Russian Foreign Policy*, edited by M. Mandelbaum, (New York: A Council of Foreign Relations Book), pp. 23-63

development in the non-Russian republics, had contributed to the spread of the feeling that Russia was indeed feeding the empire while being blamed for keeping it together.¹⁴ There was only that much that Russians could take before “the reaction of a proud people began to set in”. The wave of renewed nationalism that shook Moscow’s political circles in the second part of Kozyrev’s office came as a “direct response” to the loss of this pride and national self-assuredness.¹⁵

¹³ M. McFaul (1995a), “Revolutionary Ideas, State Interests and Russian Foreign Policy”, in *Political Culture and Civil Society in Russia and the New States of Eurasia*, edited by V. Tismaneanu, (Armonk: M. E. Sharp), pp. 27-54

¹⁴ I. Prizel (1998), *National Identity and Foreign Policy: Nationalism and Leadership in Poland, Russia and Ukraine*, (Cambridge: CUP), pp. 180-238. An example of this attitude can be found in the June 1997 Statement by the Council on Foreign and Defence Policy. “In most of the republics, the document says, there was a widely current myth that Russia was “robbing” them, whereas in fact Russia was providing for them”. Council on Foreign and Defence Policy (1997), *Will the Union be Reborn?*, J. F. Kennedy School of Government, Harvard University, Strengthening Democratic Institutions Project, June, p. 3

¹⁵ G. Guroff and A. Guroff (1995), “The Paradox of Russian National Identity”, in *National Identity and Ethnicity in Russia and the New States of Eurasia*, edited by R. Szporluk, (New York: M. E. Sharpe), pp. 78-100

Table 3.1. Political Orientations in the Foreign Policy Debate, 1991-1993

	LIBERAL WESTERNISERS	PRAGMATIC NATIONALISTS	FUNDAMENTAL NATIONALISTS
KEY FIGURES	Foreign Minister Andrei Kozyrev before 1993	Yabloko Deputy President Vladimir Lukin, Prime Minister Viktor Chernomyrdin, Foreign Minister Evgenii Primakov, Foreign Minister Andrei Kozyrev after 1993	Speaker of Parliament until 1993 Aleksandr Rutskoi, Secretary of the CPRF Gennadii Zyuganov, Leader of LDPR Vladimir Zhirinovskii
AREAS OF RUSSIA'S PRIORITY INTEREST	Europe, United States, Japan	Countries of the Former Soviet Union	Eurasian continent, from Turkey to Afghanistan
VIEW ON THE ECONOMY	In favour of market reforms	In favour of cautious economic reforms, with large controls on part of the state	Reject economic liberalism and individualism. Favoured corporatism.
VIEW ON RELATIONS WITH THE WEST	Pro-Western orientation. Partnership with the West	More sceptical towards the West. In relations with the West Russian National Interest must be defended	Extreme nationalism. Mistrust towards the West. American plot to create a world government absorbing also Russia.
VIEW ON RELATIONS FSU	Independence of the FSU countries is accepted. They are likely to be a burden to Russia for their economic backwardness. Co-ordination with CIS rather than integration.	Independence of FSU countries is accepted. Strengthen economic and military co-operation within the framework of the CIS. Russia should be the unifying force.	FSU belong to the sphere of Russian interests. The URSS should be restored.

Source: M. Light(1996),, "Foreign Policy Thinking", in *Internal Factors in Russian Foreign Policy*, edited by N. Malcolm et al., (Oxford: OUP), pp. 33-101

Economic Deterioration

Another factor that affected the change in direction of foreign policy was the deepening of the economic crisis. The further deterioration of the economic situation from 1993 on increased the identity crisis and the difficulty of identification in the reduced political entity that had replaced the Soviet Union. The failure of a pro-Western foreign policy to stabilise the economy, and the general perception that economic welfare and living standards, as low as they might have been, were guaranteed in the Soviet Union, contributed to strengthen a sentiment of nostalgia for the USSR. This mood translated into the conviction that economic interests and relations with the former republics had to be restored to a central position in the Russian foreign policy strategy.

In 1993 real GDP fell by a further 12 % in comparison to the previous year, after a drop of 13 % in 1991 and 19 % in 1992. Inflation reached an annual rate of 915.3 % after having peaked at 1,353 % in 1992.¹⁶ The economic crisis was steadily getting worse. After years of unsatisfactory economic reforms, of steep decline in living standards and in industrial production and of deterioration in the patterns of trade, there was a widespread awareness that the threats this never-ending crisis posed were real.

Perceptions that the internal stability was at stake were so high that economic commentators posed the issue in terms of the country's "economic security". The chaotic and under-regulated environment resulting from the rapid pace of economic liberalisation, added with the economic degradation and structural deformities of the years of stagnation created a dangerous combination, which could explode into social and political unrest at any time.¹⁷

¹⁶ International Monetary Fund (1994), *World Economic Outlook*, October

¹⁷ On economic security see the two special issues of *Voprosy Ekonomiki* devoted to the topic. n. 12/1994, and n. 1/1995. Articles published in these issues had the distinctive feature of a "call-up" to all the relevant institutions to take part in joint efforts and confront the seemingly irreversible deterioration of the social and economic environment. Economic threats were presented as the consequences of internal instability, rather

In his 1995 speech on the State of the Nation, President Yel'tsin also recognised that: "Russia will not have reliable guarantees of sovereignty, independence and territorial integrity until it overcomes the economic crisis".¹⁸ Russian academics raised the alarm. Comparing Russian economic indicators to economic indicators that in the West signalled a situation of risk, they pointed out that Russia was already beyond the minimal levels (see table 3.2). They warned that, in halting the structural deterioration of the country, timing was essential. National authorities were urged to act while resources and reserves were still available, the human capital was still highly qualified, and a reorganisation of the industrial base was still possible.¹⁹

Table 3.2. Indicators of Economic Security in 1994

INDICATORS	CRITICAL LEVEL IN THE WESTERN ECONOMIES	1994 LEVELS IN THE RF	POSSIBLE CONSEQUENCES AT A SOCIO-POLITICAL AND ECONOMIC LEVEL
FALL IN GNP	30-40 %	50 %	De-industrialisation of the economy
PERCENTAGE OF FOODSTUFF IMPORTED	30 %	40 %	Strategic dependency of the country on vital imports
PERCENTAGE OF INDUSTRIAL EXPORTS	40 %	12 %	Colonial structure of the economy
PERCENTAGE OF HIGH- TECHNOLOGY EXPORTED	10-15 %	1 %	Technological lag
PERCENTAGE OF STATE-FUNDED R&D EXPENDITURES	2 %	0.32 %	Destruction of intellectual capital

Source: Vladimir Medvedev (1997), "Problemy ekonomicheskoi bezopasnosti", *Voprosy Ekonomiki*, n. 3, p. 114

than as the effects of an unfriendly international environment. The irrevocability of market reforms was never questioned, but a substantial adjustment in the state's role as the major economic actor was urged.

¹⁸ *Rossiiskiy Vestnik*, February 17, 1995, pp. 1, 3-7

¹⁹ L. Abalkin (1994), "Ekonomicheskaya bezopasnost' Rossii: ugrozy i ikh otrazhenie", *Voprosy Ekonomiki*, n. 12, pp. 4-13

The striking contrasts of the model of development pursued in the post-independence years was condemning Russia to a “structural trap”, typical of developing countries. In the face of a general decline in industrial production, the raw material sector appeared to be the only profitable industry, and capable of generating hard currency revenues. Raw materials production had maintained almost the same level as in the pre-crisis years. In 1995 output was 70 % of the 1990 level, with maximum rates in the gas industry (93 %), oil (56 %), and rolled iron (61 %). Given the large reserves and the low salary rates, Russian natural resources were the only competitive goods on the world markets. In 1995 raw materials accounted for 80 % of Russian exports, equal to 20 % of the GNP.²⁰

On the other side, however, the scientific potential of the country was exposed to a rapid and apparently inexorable decline. As a result of sharp cuts in the budget, expenditures for research and development fell to 0.32 % of the GNP in 1993. The number of scientists and researchers also dropped, and the number of research institutes attached to enterprises diminished from a total of 400 in 1990 to 276 in 1994. A massive migration of science workers, either towards foreign countries, or towards more profitable and prestigious positions outside research, contributed heavily to the decline of the country’s scientific potential.

Russia had slipped into a situation of economic insecurity. According to the description provided by a Russian author, internal and external factors [were] disturbing the normal functioning of social reproduction, destroying the living standard of the population, and, at the same time, provoking a rise in social tension. This condition had come to threaten the very existence of the state itself.²¹ The risks that the Russian population was facing - famine, cold, and epidemics - were as concrete as in a war-like situation. These problems

²⁰ V. Medvedev (1997), “Problemy ekonomicheskoi bezopasnosti”, *Voprosy Ekonomiki*, n. 3, pp. 11-127

²¹ Institut Mirovoi Ekonomiki i Mezhdunarodnykh Otnoshenii RAN (1994), *Aktualnye problemy vneshneekonomicheskoi bezopasnosti Rossii*, (Moscow: RAN), p. 14

were coupled with the deterioration of the transport and information network, the energy system and the technological and scientific potential of the country.²²

In concrete political terms these considerations were translated into the urge to establish dignified living conditions for the population, secure social and political security and foster the emergence of a stable system of national values and interests.²³ In order to do this, the state was required to perform a number of tasks to stimulate competitiveness within national industry, provide all the possible guarantees for private economic activity, and establish a climate favourable to innovation, investment and modernisation of the country.²⁴

In the international arena, foreign policy institutions were called upon to avoid the danger of economic dependence on foreign countries, which could, in turn, induce risks of political dependence.²⁵ The urgent rapprochement with the countries of the former Soviet Union was perceived as instrumental to counter increasing economic decline.

Emancipation of the Former Soviet-Republics

One of the strongest accusations that critics aimed at Kozyrev's foreign policy was that, in its urge to strengthen relations with the Western countries, it had overlooked the newly independent states. It is a telling fact that a department in charge of relations with the countries of the Commonwealth of Independent States was established only six months into Kozyrev's mandate. By 1994 it had not been decided yet whether the issue of relations with the FSU countries belonged to the realm of foreign or internal affairs. A ministry for CIS Co-operation was set up only at a later stage.²⁶ A further clear sign of Kozyrev's underestimation of the former Soviet republics' importance was the fact that he undertook

²² K. Samsonov (1994), "Elementy kontsepsii ekonomicheskoi bezopasnosti", *Voprosy Ekonomiki*, n. 12, pp. 14-12

²³ S. Lykshin and A. Svinarenko (1994), "Razvitie ekonomiki Rossii i ee restrukturizatsiya kak garantiya ekonomicheskoi bezopasnosti", *Voprosy ekonomiki*, n. 12, pp. 115-125

²⁴ L. Abalkin (1994), *Op. Cit.*

²⁵ O. Bogomolov (1996), "National Interests in Russian Foreign Policy", *International Affairs* (Moscow), n. 2, pp. 1-24

²⁶ R. de Nevers (1994), "Russia's Strategic Renovation", *Adelphi Papers*, n. 289, July

his first tour in the region only at the end of 1992, after he had already visited Scandinavia and a group of African countries.

With the continuing deterioration of the internal economic situation, however, the argument that improvement of the domestic economic and political situation of Russia could not be separated from a course of reintegration with the countries of the near abroad gained momentum. There was already a shared understanding among foreign policy students and practitioners that the country's foreign policy course and the definition of its national interests must take into account components like its "geographic position, the kind of countries surrounding it, their traditional policy and civilisation orientation".²⁷

The lack of success of policies oriented towards the West, though, reinforced considerations on the role of CIS co-operation in preserving acceptable rates of growth and stability for the Russian economy. Countries of the former Soviet Union provided Russia with a space in which national producers enjoyed guaranteed access to raw materials, unrestricted entrance to their markets, and unlimited possibilities of co-operation with related enterprises.²⁸ The loss of these markets, as a result of possible geopolitical reorientation of the neighbouring countries, started to be perceived in Russia as a renewed threat to its economic security.

A Russian-based survey published in 1994 demonstrated that, in the hypothetical event of a total break down of economic links with the former Republics, Russia would be the post-Soviet state most capable of achieving self-sufficiency. Should the new independent states resort to an autarkic regime, Russia would still be able to guarantee 65 % of its production, while only 27 % of the Kazakh, 15 % of the Ukrainian, and 4 % of the Belarusian output would be maintained.²⁹ The survey was obviously designed to demonstrate Russia's superiority in the post-Soviet environment, but it inevitably emphasised also the country's dependence on its neighbours.

²⁷ N. Narochinskaya (1992), "Russia's National Interests", *International Affairs* (Moscow), n. 8, pp.134-143

²⁸ I. Faminski (1994), "Otkritaya ekonomika i vneshneekonomicheskaya bezopasnost'", *Voprosy Ekonomiki*, n. 12, pp. 65-78

The break up of the Soviet Union had induced catastrophic effects for all the national economies; Russia had certainly the most solid economic structure in the region, but consequences of the abrupt dislocation were nonetheless felt there as well. Russian observers listed the following as the most critical consequences of the collapse of the USSR:

- Disintegration of the economic potential;
- Diminished economic space;
- Diminished access to foreign economic infrastructure, loss of ports and individual types of raw materials;
- Increased transportation costs;
- Threat of losing traditional markets for the sale of Russian machine-building products (for which it was difficult to find alternatives under the existing conditions);
- Direct loss of a number of markets for military-technical products, and for consumer goods.³⁰

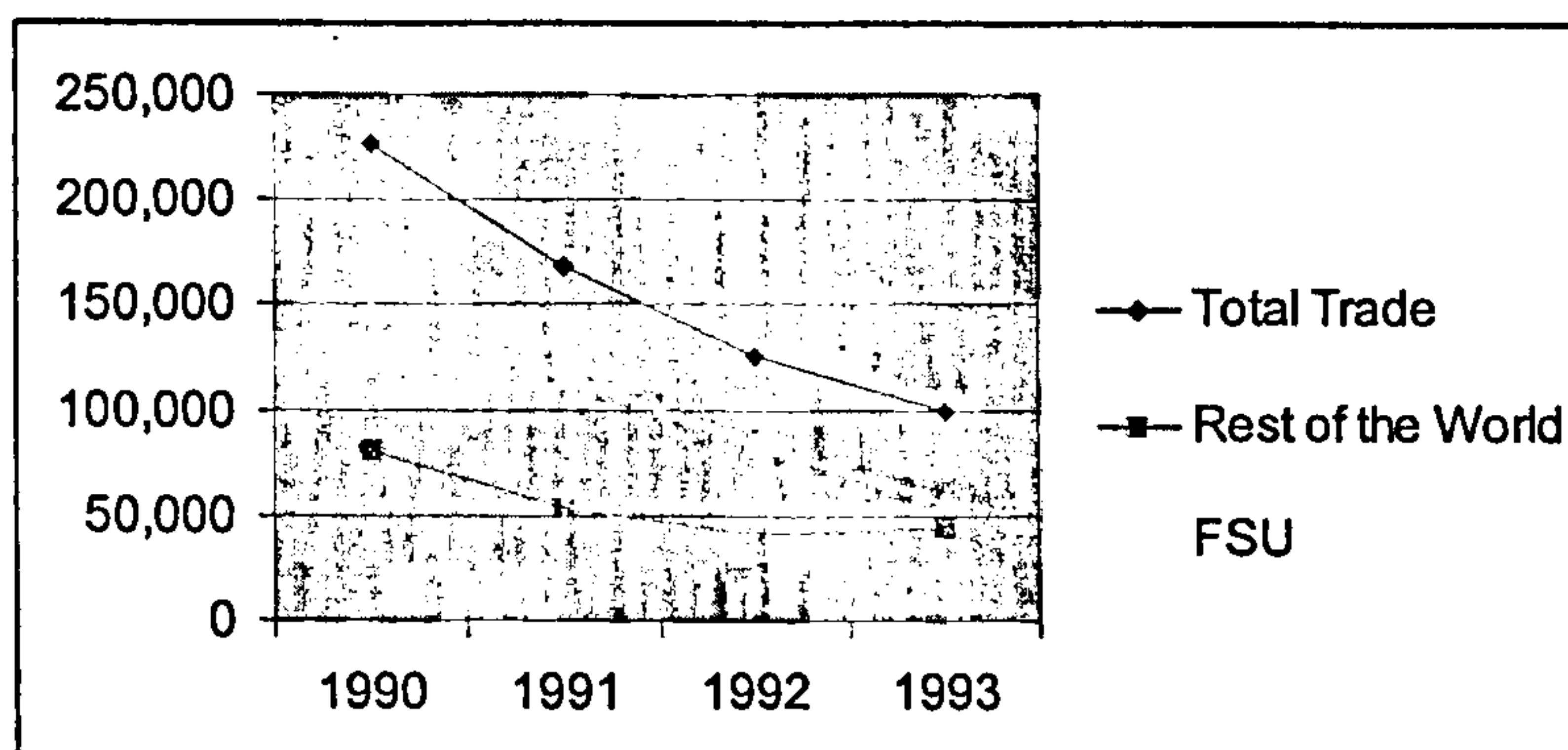
As a direct result of the highly ineffective trade arrangements put in place in the post-Soviet times among the former Soviet Republics (bilateral agreements and barter trade), the shift to world prices starting from 1992, the collapse of the ruble zone, and attempts at trade reorientation of the former Soviet partners, trade flows decreased steeply. In the period January-June 1992, the overall Russian trade turnover was down 30 % in comparison with the same period of the previous year, with export cut by 35 % and imports by 24 %.³¹ As Figures 3.1 and 3.2 show, trade with the former Soviet republics was the most severely affected.

²⁹ Quoted in V. Savin (1995), "Torgovlye otnosheniya i vnesheekonomicheskaya politika", Vneshnyaya Torgovlya, n. 5, pp 13-15

³⁰ V. Sil'vestrov and S. Filatov (1994) "Vneshneekonomicheskaya politika i sistemniy vzgliad", Rossiiski Ekonomicheski Zhurnal, n. 10, pp. 46-58

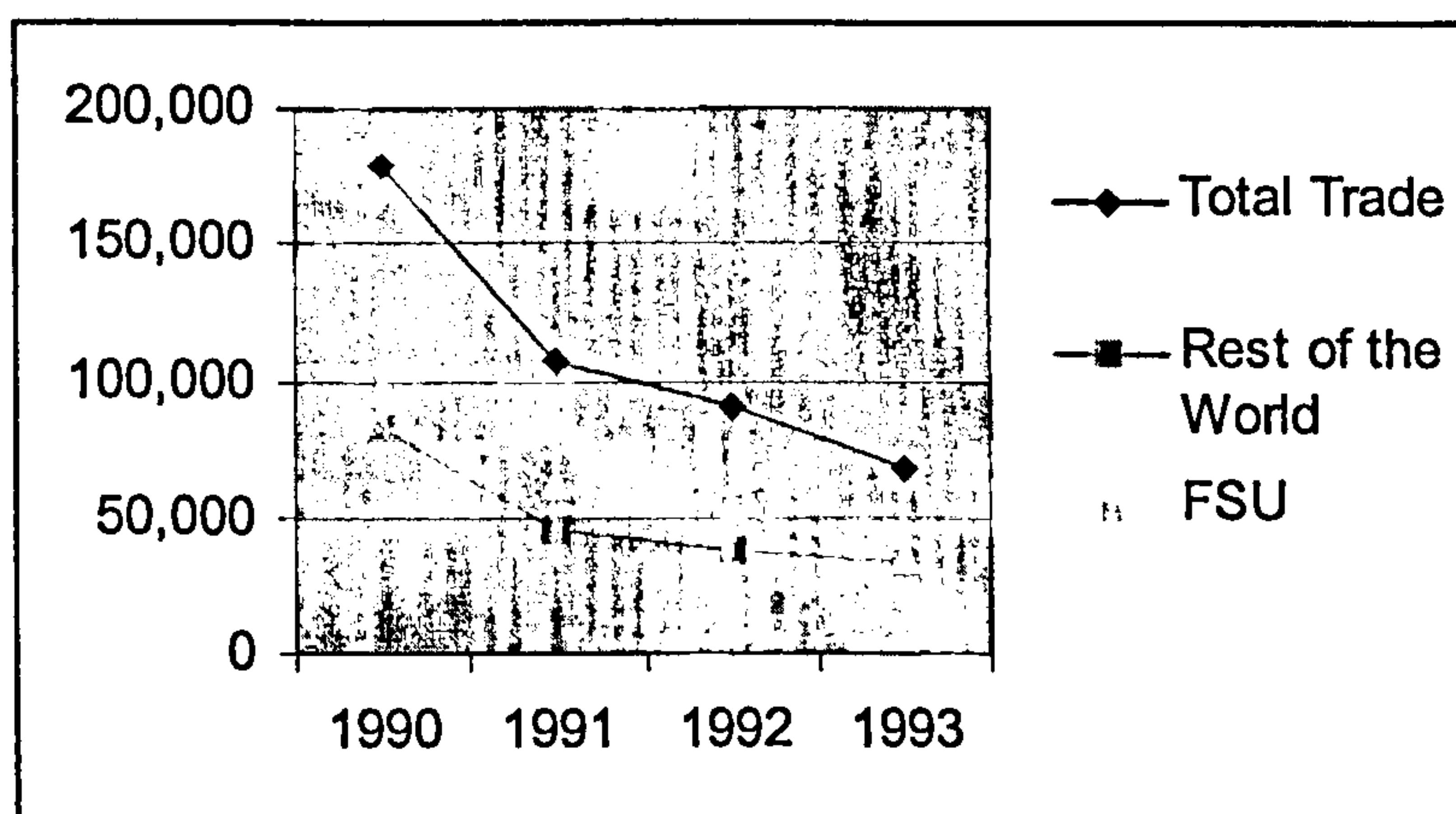
³¹ J. H. Noren and R. Watson (1992), "Interrepublican Economic Relations After the Disintegration of the USSR". Soviet Economy, Vol. 8, n, 2, pp. 89-129

Figure 3.1. Russian Exports in the Period 1990-1993
(Millions of current US dollars)



Source: C. Michalopoulos and D. G. Tarr (1994), *Trade in the New Independent States*, (Washington D. C.: The World Bank), pp. 3-5

Figure 3.2. Russian Imports in the Period 1990-1993
(Millions of current US dollars)



Source: C. Michalopoulos and D. G. Tarr (1994), *Trade in the New Independent States*, (Washington D. C.: The World Bank), pp. 3-5

According to data provided by the World Bank, over the period 1990-1993 trade among the newly independent states decreased by more than 60 percent. Exports to the rest of the world dropped from \$105 billion in 1990 to \$58 billion in 1993, equal to 46 % of the initial figure. Imports fell even more from \$121 billion to \$45 billion, equal to 63 % of the initial

figure. Interstate trade shrank more than trade with the rest of the world; the total was estimated to be 65 % over three years.³²

These figures notwithstanding, interdependence among the former republics remained high. In the Soviet years individual republics had become monopolist manufacturers of specific components and technological equipment, or exclusive producers of specific raw materials and semi-finished products. Now the failure of Russian enterprises to penetrate international markets, as obsolete production and non-competitive prices contributed to make their merchandise less appealing for Western buyers, was matched by the conviction that the sheltered environment of the CIS would provide in any case an alternative output market.³³

In addition to this direct influence over the Russian economy, CIS countries played a significant role in controlling, indirectly, Russia's routes to the Western markets. After the collapse of the Soviet Union, the majority of the westward Soviet rail and track routes, pipelines, and seaports had been inherited by Ukraine, Belarus and the Baltic States. Russia had been left either with no control over vital transportation lines, or with infrastructures able to provide services below international standards.

Russian ports could satisfy only 60 % of the capacity required. Of the gas shipped to Europe 94 % went through pipelines on Ukrainian territory, 3 % through Belarusian territory. The gas pipeline Druzhba, for example, crossed Ukrainian territory on its way to the European markets, and Ukraine inevitably used its control over it to increase its bargaining power vis-à-vis Russia. Ukraine's allegedly arbitrary use of these transport

³² C. Michalopoulos and D. G. Tarr (1994), *Trade in the New Independent States*, (Washington D. C.: The World Bank), pp. 3-5

³³ An example of the high degree of interdependence was the machine-building sector. According to data published in 1998, in the aircraft industry about 100 Russian enterprises received up to 130 components or semi-finished products from Ukraine. More than 80 % of these products were provided by 8 Ukrainian monopolistic enterprises in the aircraft sector. One sixth of the Russian aircraft market was occupied by the Zaporizhe enterprise. The car industry proved unable to work without the industrial co-operation of the CIS countries, where the thousand of enterprises that provided Russian companies with the semi-finished products were located. *Finansovye Izvestiya*, n. 6, 29 January 1998, see also S. Kolchin (1995), "Rossiya-blizhe zarubezh'e: vzaimotnosheniya, interessy, tseli politiki", *Mirovaya ekonomika i mezhdunarodnie otnosheniya*, n. 4, pp. 47-56.

facilities was blamed for causing severe damage to Russian exports (see Box 3.1), giving rise to prolonged tension between the two Slavic neighbours.³⁴

The gravity of the transit problem forced Moscow to look into alternative solutions, leading to the identification of two viable options. Either Russian companies assumed control over strategic plants on the former Soviet territories, by acquiring the controlling shares of privatised assets. Or exit routes to foreign markets needed to be diversified. With the privatisation process in the neighbouring countries still lengthy and controversial, the second option was often considered to be the most effective solution.³⁵

Because of the irreplaceable role played by the CIS countries in the Russian economy, the establishment of mutually advantageous relations came to be indicated as the top priority for the Russian survival strategy. These relations were seen as the “minimum compensation for the loss of the Soviet Union”. Normalisation of economic and trade relations, and the development of industrial, technical and scientific ties with the former republics were presented, by Russian scholars, as absolutely essential conditions to guarantee the healthy state of the Russian economy in the short-run. In the future these relations would preserve and extend existing positions in the CIS emerging markets, and would help Russia to earn its fully-fledged membership of the international community.³⁶

From 1993 onwards, however, it became evident that hopes to revive the former Soviet economy within the artificial boundaries of the Commonwealth would not be automatically successful, as had initially been hoped.³⁷ Frustrated by the inefficiency of the CIS and

³⁴ Institut Mirovoi Ekonomiki i Mezhdunarodnykh Otnoshenii RAN (1994), *Aktualnye problemy vneshneekonomicheskoi bezopaznosti Rossii*, (Moscow: RAN), p. 61

³⁵ This is how the ambitious projects for the Yamal, and the Blue Flow pipeline were born. The first one shipping Russian gas through the Polish territory to Germany, is expected to carry 65.7 billion cubic metres per year by the year 2010. The second one runs from Tyumen across Russian and Turkish territories, bypassing the North and the South Caucasus, and avoiding Ukraine, Romania and Bulgaria, with whom the bitterest disputes had taken place. In 2010 the pipeline is expected to reach its full capacity and annual deliveries should increase fivefold the current gas flow to 16 billion cubic metres. *Moscow News*, February 5-11, 1998, p. 8

³⁶ S. Kirichenko (1994) “Evolutsiya i perspektivy ekonomicheskikh otnoshenii Rossii so stranami SNG”, *Svobodnaya Mysl'*, n. 9, pp. 3-14

³⁷ For an overall evaluation of the CIS see R. Sakwa and M. Webber (1999), “The Commonwealth of Independent States, 1991-1998: Stagnation and Survival”, *Europe-Asia Studies*, Vol. 51, n. 3, pp. 379-415

afraid to compromise their newly acquired sovereignty, the partners started to shift away from Moscow's sphere of influence by diversifying their diplomatic efforts.

The Commonwealth of Independent States had been created to provide a safety net for the state-members, to help them integrating gradually into the world economy. Among the former Soviet republics there had been a shared belief that they should back each other, and offer protection against the unsustainable competition of the world market. Still in 1992, while listing the advantages of a common approach to the international markets, Stanislav Shuskevich, Chairman of the Belarusian Supreme Soviet urged: "There will be no miracle with the world market [...] If they divide us up, we will loose everything [...] They are dividing us up and fleecing us. We must unite in our poverty".³⁸ Also Kazakh President Nursultan Nazarbayev noted "Except for ourselves no one in the world has any use for our products".³⁹

A few years later the former Soviet republics started to develop an intricate network of strategic alliances and preferential trade blocks, using these alternative groups as a powerful counterbalance to Russia's overwhelming influence (see table 3.3).

Table 3.3. Co-operation and Trade Blocks in the FSU

ORGANISATION	WHEN ESTABLISHED	MEMBERS	OBJECTIVES AND ACHIEVEMENTS
BLACK SEA ECONOMIC CO-OPERATION	June 1992	11 countries: all littoral states plus Albania, Armenia, Azerbaijan and Greece	Examine potential for regional integration Projects in banking, finance, environment, trade industry, infrastructure, and the development of the private sector
ECONOMIC CO-OPERATION ORGANISATION	1970	Established by Turkey, Iran and Pakistan expanded to Kazakhstan, Uzbekistan, Turkmenistan,	Increase economic co-operation, facilitate flows of aid. 10percent decrease of preferential tariffs among

³⁸ *Izvestiya*, December 14, 1992, p. 1

³⁹ *Segodnya*, December 15, 1994, p. 2

		Kyrgyzstan, Tajikistan and Azerbaijan in November 1992	members included in March 1992. Projects of regional investment and development bank initiated in November 1992
CASPIAN SEA CO-OPERATION ZONE	February 1992	Iran, Azerbaijan, Russia, Kazakhstan and Turkmenistan	Increase co-operation in the fields of shipping, fisheries, and the exploitation of oil and gas.
CENTRAL ASIA	January 1993	Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan	Create a common market. In January 1994 Kazakhstan, Uzbekistan, and Kyrgyzstan decided to establish a custom union and explore the potential for multilateral co-ordination of monetary and fiscal policies.
GUAM (GUUAM FROM 1998)	1997	Georgia, Ukraine, Armenia, Moldova, and in 1998 Uzbekistan	Combating internal separatism, promoting integration into European and Euro-Atlantic structures Oil extraction and transportation (ship energy resources from Azerbaijan to the West through the Ukrainian and the Moldovan territory)

Sources: M. Nicholls and H. Potter, "Regional Initiatives in the Former Soviet Block: A Review of Multi-country Trade Groups, Environment Initiatives and Infrastructure Projects", Communist Economies & Economic Transformation, Vol. 6, N. 3, 1994, pp. 315-340; Rossiiskaya Gazeta, December 2, 1997, p. 7

Pragmatic Nationalism in Foreign Policy

Pragmatist Nationalism emerged in the period 1994-1998 in response to the sense that Russia had been victimised, the deterioration of the internal economic situation and the perceived risks deriving from the breaking away of the former Soviet republics. The unexpected electoral victory of Vladimir Zhirinovskii's Liberal Democratic Party (LDPR) in 1993 and of the Communist Party in 1995 gave a further impulse to nationalist claims.

This political change translated into concrete demands raised by representatives of diverse political orientations for a radical correction in the foreign policy course to give back to Russia its role as a great power. The aspect on which politicians of all parties seemed to agree was the rejection of Western attempts to reduce Russia to a regional power. Russia was still a Great Power, and its main strength was to be found in its Eurasian position, "the continent where the main sources of energy, the main areas of conflicts, and the main interests of other key actors on the world stage are located".⁴⁰

The question was, however, what sort of strategy should be adopted to regain central stage in the Eurasian arena, as geo-political and geo-economic interpretations of the country's national interests were perceived as intrinsically contradictory. A view of international relations as based on the rivalry among alternative centres of military, political and economic power was opposed to the idea that the country's position in the world scene depended on the well-being and stability of its economy.

Advocates of a geo-political approach argued that manifestation of the Great Power status coincided with the country's ability to exert political and military influence over as large an area of foreign territories as possible. Supporters of geo-economic approaches, instead,

⁴⁰ A. Pushkov (1996), "National Interests in Russian Foreign Policy", *International Affairs* (Moscow), n. 2, pp. 1-24

emphasised that factors like the country's share in the world economy, the flow of foreign investment, and technological capability were more telling indicators.⁴¹

From the beginning of 1994 relations with the former Soviet republics were restored in a central position within the Russian foreign policy agenda. This move had its official endorsement in the words of Foreign Minister Kozyrev, who recognised that “the CIS and the Baltics are regions where Russian vital interests are concentrated”.⁴² In February 1993 President Yel'tsin had already required the United Nations and other international organisations to grant Russia a mandate to act on the territories of the newly independent states to protect its interests. Russian intervention would include humanitarian and peacekeeping operations, political mediation in the region, and defence of the interests of ethnic Russians living in the “Near Abroad”.⁴³

Two different and contrasting approaches towards relations with the post-Soviet countries appeared evident at this stage: imperial and ideological, the first, and post-colonial and economic, the second. In the version formulated by Andranik Migranyan, the Monroe Doctrine claimed for Russia a “special role in the entire geopolitical space of the former USSR”.⁴⁴ Politicians like Speaker of the Supreme Soviet Aleksandr Rutskoi, LDPR leader Vladimir Zhirinovskii and, at a later stage, Moscow mayor Yurii Luzhkov, underlined this claim with controversial trips to areas of contested sovereignty, like the Crimea.

The LDPR included in its 1995 electoral manifesto objectives such as the restoration of “Russia's strategic boundaries and its historical and geo-political space”, primarily by “bringing Ukraine and Belarus back into the single Russian state”. Russia's role as a world super power was seen as part of its “geopolitical predestination”.⁴⁵ The State Duma's refusal in March 1996 to ratify the Belovezha Agreements, which had marked the

⁴¹ A. Torkunov (1996), “National Interests in Russian Foreign Policy”, *International Affairs* (Moscow), n. 2, pp. 1-24

⁴² *Rossiiskaya Gazeta*, January 19, 1994, p. 1

⁴³ This request was later backed by the November 1993 military doctrine, which recognised the geopolitical space of the former Soviet Union (excluding the Baltic States) as an “area of Russian vital interests and primary responsibility”. S. Kolchin (1995), *Op. Cit.*

⁴⁴ *Rossiiskaya Gazeta*, August 14, 1992, p. 7

⁴⁵ , *International Affairs* (Moscow) (1995), *Op. Cit.*

dissolution of the Soviet Union, was also part of this same strategy. Nationalist political forces aimed at rejecting the break up of the Soviet Union (in its extreme form) and re-imposing a stricter control over the new independent states (in its milder form).

On the opposite side of the political spectrum, acknowledging the importance of the CIS for Russian economic and political interests, "Pragmatic Nationalism" warned of the dangers and costs of a policy that used military instruments and imperial arguments. Outlining some of the problems connected with the Russian Monroe Doctrine, Aleksei Arbatov presented three of the main elements of the Pragmatist concept.

First, by embracing a Monroe Doctrine, Russia would give up its option to exercise an *ad hoc* "rational and pragmatic" distinction between situations in which Russia's intervention would indeed protect the country's interests, and situations in which Russia's interests would be best served by a non-interventionist attitude. Second, the price of an involvement in the domestic problems of the CIS countries could be too high. Russia would probably be sucked into ethnic wars causing heavy casualties, massive flows of refugees and possible retaliatory attacks to Russian interests abroad. Third, a militarist course would impinge on the continuation of democratic reforms, producing, most likely, "the revival of an authoritarian, besieged, militarised state, with a large degree of central economic planning, and the reintroduction of rationing".⁴⁶

In contrast to an approach that stressed military supremacy, Pragmatic Nationalists proposed a strategy that endorsed "leadership rather than control, economic dominance rather than political responsibility". Any project for the restoration of the Soviet Union was rejected as "pure utopian fantasy". A pragmatic nationalist policy towards the "Near Abroad" was to be based on a strategy that

"Would be aimed at alleviating the negative consequences of disintegration for Russians especially, that would be relatively cost-effective and stable, that would reduce the likelihood of conflict, and [...] that would

⁴⁶ A. G. Arbatov (1994), "Russian National Interests", in *Damage Limitation or Crisis? Russia and the Outside World*, edited by R. D. Blackwill and S. A. Karaganov (Washington: Brassey's, INC), pp. 61-62

conform to the main strategic goal of bringing about the economic, political and spiritual rebirth and ascendancy of Russia".⁴⁷

Rebuffing more militant claims on territories now located within the boundaries of the new independent states, Nikolai Travkin recognised that:

"What is needed now is not the reconstruction of the Soviet Union, but, instead, the restoration of some of those beneficial ties. Integration cannot be forced on the countries of the former Soviet Union. Only a rational assessment of and respect for, the needs of each country can lead to the reintegration of the region".⁴⁸

The aspects of economic security and consolidation of the Russian positions in the "Near Abroad" become intertwined in the pragmatist vision. A survey conducted in the aftermath of the 1996 presidential elections confirmed that an orientation towards a foreign policy aimed at protecting Russian economic interests and restoring relations with the countries of the former Soviet Union was widespread.

Of respondents in a general public survey 94 % mentioned defence of national economic interests as the top priority for Russian foreign policy. The percentage rose to 95 % when the interviews were conducted among members of the foreign policy elite. 67 % of the general public considered development of relations with the 'Near Abroad' the most important issue. 83 % of the foreign policy elite shared the same position. While 93 % of the general public and 97 % of the foreign policy elite shared the belief that Russia's internal situation was indeed affecting the country's foreign policy goals.⁴⁹

By the time this survey was conducted pragmatic nationalism had penetrated the official circles of foreign policy-making. A number of documents approved by President Yel'tsin in this period reflected this general mood. From the "Basic Provisions of the Russian

⁴⁷ Council on Foreign and Defence Policy (1997), *Op, Cit.*

⁴⁸ N. Travkin (1994), "Russia, Ukraine and Eastern Europe", in *Rethinking Russia's National Interests*, edited by S. Sestyanovich, (Washington D. C.: Centre for Strategic and International Studies), pp. 33-41

⁴⁹ Elena Bashkirova (1998), "Democracy, Foreign Policy and the Media in the Russian Federation", final report drawn under Nato Democratic Institution Fellowship, <http://www.nato.int/acad/fellow/96-98/bashkirova.pdf>. The elite sample included members of the foreign policy committees of the Duma, editors and foreign policy commentators in the media, senior staff officers, major figures at foreign policy-related institutes, and persons in economic ministries and privatised enterprises that had foreign trade components.

Federation Foreign Policy Concept”, to the “Strategic Course of Russia with the State-Members of the CIS”, to the “Concept of National Security”, the importance of domestic and economic issues in setting the agenda for foreign relations was spelled out clearly (see Box 3.2).

An indissoluble link was established between the country’s economic well-being and the conditions met by Russian agents on the world markets. The government was required to play a more active role in protecting Russian enterprises that were facing at the same time a hostile environment on the international arena and the “unscrupulous” competition of Western corporations on its internal markets (in these documents CIS markets were considered internal).

Russian companies were presented as the agents capable of bridging the gap that ideology had created between Russia and its CIS neighbours. Boris Nemtsov, then governor of Nizhnii Novgorod, suggested that in order to solve the Crimean crisis Russian business ought to be encouraged to buy up property and business in Sevastopol, thus “restoring historical justice by capitalist means”.⁵⁰ “If enterprises, hotels, restaurants and cafes are bought by Russian banks, then wages and salaries will be paid in rubles - he argued - This, in fact will make Sevastopol a *de facto* Russian town”.⁵¹

Other prominent political advisers were impressed with this new role identified for the Russian enterprises. In the words of Mikhail Delyagin, of the Russian Federation President’s Analytical Centre:

“The force that has the greatest stake in uniting democracy and patriotism is national capital, as it moves out into world markets. It needs a powerful Russia capable of supporting it on an interstate level. It needs a free Russia that does not threaten it with nationalisation or terror”.⁵²

⁵⁰ OMRI Daily Digest, February 20, 1997

⁵¹ C. Caryl (1998), “Who Makes Russia’s Foreign Policy Anyway?” *World Report*, February 16,

⁵² *Izvestiya*, January 6, 1995, p 3

In the pragmatist doctrine the conquest of new markets under the standard of Russian capital was viewed as a peaceful invasion that would make Russia's name great again. At a time when Russia felt its grip on the countries of the Near Abroad loosening, the rhetoric of national capital gradually replaced the traditionally aggressive nationalistic slogans. This new, civilised Russian nationalism appeared no longer interested in the political domination of the countries of the Near Abroad. Political or military domination would imply additional costs that Russia was no longer in the position to afford.

The viable alternative proposed by the theorists of national capital was then to gain access to the natural resources and the strategic infrastructure of the newly independent states via economic means. Prosperity of Russian business was equated to the prosperity of the country, and economic losses for national companies, caused by the "invasion of foreign investors", were presented as a threat to the country's national security. "We cannot allow", the Concept of National Security read, "foreign companies to seize control over strategically relevant economic sectors, the military industry, and the natural monopolies".

The strongest supporter of this political trend was Our Home is Russia (OHR), the then "party of power". "Expansion of the exports and reasonable protectionism" was one of the slogans echoed in the OHR Party Conference in July 1995.⁵³ The party's electoral platform made clear that Our Home is Russia considered the raw materials sector and the industries engaged in processing raw materials as the primary sources of economic growth, at least in the short run. The financial basis for those companies would come from the rapidly growing large banks. The state's role would be, in their view, to secure favourable conditions for those companies which proved able to accumulate the necessary capital to initiate a process of growth.⁵⁴

The party was to seek a "steady economic development on the basis of national capital".⁵⁵ Finding inspiration in the principle "a mighty state means a clear economy" it proclaimed

⁵³ *Rossiia*, n. 23, July 26-31, 1995, p. 3

⁵⁴ *Segodnya*, December 6, 1995, p. 5

⁵⁵ *Segodnya*, July 21, 1995, p. 2

the abandonment of liberal policies.⁵⁶ “The liberal stage of reforming the economy, which prepared the way for the modernisation of the country’s economy is already coming to an end, and therefore a fundamental change of direction is needed. Instead of financial stabilisation at any price, a new core of reforms providing incentives for the accumulation of national capital is being built”.⁵⁷

“Social state liberalism” was the solution to Russian problems also on the world arena. Sergei Belaev, First Deputy Chairman of OHR explained the party’s foreign policy aims as trying to “provide the most favourable international setting in which this country feels absolutely secure, with its hands free to proceed with economic and social reforms”.⁵⁸ In the promotion of national capital, the party of government coincided with the less belligerent positions of the national patriots, who urged the return of a great Russia, armed, this time, with the more powerful weapons of the market economy. In the fragmented political space of Russia in this period the unifying idea of national capital found fertile ground.

“The idea of a great Russia expresses something more - a need to create a new national ideology that would reflect both the corporate interests of the Russian political leadership and the growing power of Russian national capital.”⁵⁹

It would be misleading, however, to think that the policy of protecting national capital in the name of the country’s common good was free from controversies. A voice of dissent was raised by those economic sectors, which felt not only that they were misrepresented by the official government line, but also that government policy was harming their growth. Russian companies were certainly not all in the same situation, as their performance on the world markets diverged widely. On the basis of their interests and foreign policy preferences, Prime Minister Chernomyrdin divided them in three categories:

⁵⁶ *Rossiia*, n. 23, July 26-31, 1995, p. 3

⁵⁷ *Kommersant’ Daily*, August 15, 1995, p.1

⁵⁸ *International Affairs* (Moscow) (1995), *Op. Cit.*

⁵⁹ *Nezavisimaya Gazeta*, November 16, 1995, p. 16

1. Export-oriented sectors with a high price margin, including producers of natural gas, oil, power station coal, and non-ferrous metal.
2. Industries oriented towards the internal market, including natural monopolies, ferrous metallurgy, instrument and motor vehicle manufacturers, consumer goods, food and medical products. Industries in this sector did not have an open interest in foreign policy orientations, but tended to assume pro-protectionist positions.
3. Old and inefficient industries, which did not fit the international or the internal market, and had practically no buyers.⁶⁰

According to the Prime Minister's interpretation there was a sharp divide between productive and unproductive enterprises, between those who could face the capitalistic challenge and those who were being defeated by it. Representatives of those sectors that appeared the weakest shared the same impression that there was indeed a rigid fracture between enterprises' performance on the foreign markets. Yet, they blamed the government and its policies for creating that divide.

Yurii Skokov and Sergei Glaz'ev of the Congress of Russian Communities, for example, ascribed the responsibility for the industrial crisis to the nasty alliance between business and politics. The protection granted to the most powerful sectors and enterprises, in their view, was seriously undermining the entire Russian economy, while considerably benefiting only a small group of people.⁶¹

"Economic Policy is being conducted in the interests of the comprador bourgeoisie, foreign capital, the bigwigs of speculative business and organised criminal groups. Its continuation over the next several months will lead to profound and irreversible destruction of the scientific and industrial potential, the final loss of the country's independence, and the loss to Russia's producers not only of the foreign markets but also of the domestic market".⁶²

⁶⁰ Y. Fedorov (1998), "Interest Groups and Russia's Foreign Policy", *International Affairs* (Moscow), Vol. 44, n. 6, pp. 173-183. See also S. A. Karaganov (1994), "Russia's Elites", in *Damage Limitation or Crisis. Russia and the Outside World*, edited by R. D. Blackwill and S. A. Karaganov (Washington: Brassey's, Inc.), pp. 41-53

⁶¹ *Nezavisimaya Gazeta*, Oct 19, 1995, p. 2

⁶² *Nezavisimaya Gazeta*, Sept 22, 1994, pp. 1-2

A document published on the eve of the 1995 Duma elections by the Defence Research Institute pointed out at the “New Russians” as the only social group that was in fact benefiting from this situation. The Russian elite, and Russian business, especially those sectors engaged in banking, finance and export-oriented activities, had signed a Faustian pact with the West. They had traded the degradation of the country’s economic potential and the elimination of the single market with the former Soviet republics for the largest stake in the exploitation of the national wealth.

The existing economic model, based on the export of raw material, had practically been imposed on Russia to the advantage of the West. Over-reliance on the primary sector, it was argued, would impede the modernisation of national manufacturing industry and agriculture, the conversion and maintenance of the military-industrial complex’s high technological capability, and the preservation of the Armed Forces’ fighting strength. The inevitable consequence would be the permanent relegation of Russia to the status of a second grade power.⁶³

Other commentators highlighted the paradox that the business elite, the very same people who had worked to demolish the state in the late Soviet days, were now committed to building it up again, reviving a “state power ideology”. Corporate structures and specific individuals had already seized the key seats in politics, economics, and finance, and, as a result, decisions were being made on the basis of the interests of specific groups, restricted to members of the elite or individuals in proximity of it.⁶⁴

In the years after the collapse of the Soviet Union, Russia went through an identity crisis caused by the loss of its imperial status. The need to accept a “reduced identity” was coupled with the deterioration of the economic situation and the perception that also independence of the former Soviet republics was now imposing severe risks to Russian national security. This sense of drift prompted a significant change in the Russian foreign policy course.

⁶³ Segodnya, October 20, 1995, p. 3

From 1994 onwards a growing consensus emerged among the Russian foreign policy elite that the country's great power status was to be re-established on the basis of economic rather than military power. A course of pragmatic nationalism demanded that also relations with the CIS countries were reoriented, moving away from a strategy aimed at imposing on them the Russian political hegemony. Following the consolidation of the newly independent states, policies towards the CIS were now to be inspired to the principles of profit and were to be aimed at increasing economic power through the acquisition of strategic assets and access to foreign markets. This ideological background provided a favourable situation for the expansion abroad of Russian economic actors, whose interests were associated to the national interest of Russia.

What was instead the relationship between foreign policy and interests of the economic elite in Ukraine? The inherent weakness of the Ukrainian economic elite meant that their interests were limited to the national territory, and their foreign policy preferences amounted to nothing more than the protection of the domestic market against foreign competition. Instability of the Ukrainian economy, and the country's dependence on foreign aid, however, implied that foreign policy institutions could not fully satisfy the economic elite's demands for protection, as a balance had to be maintained between international organisations and foreign donors' pressures to liberalise the economy.

Yet, a foreign policy debate centred on the need to preserve the country's sovereignty provided the Ukrainian economic elite with a powerful nationalist vocabulary to articulate its interests (see chapter 5). In the remaining of this chapter I will outline the main aspects of the foreign policy adopted by presidents Kravchuk and Kuchma.

⁶⁴ A. Tret'yakov (1996), "Growing support for New Foreign Policy in Russia", International Affairs (Moscow), n. 5-6, pp. 15-31

Ukrainian Nationalism and Foreign Policy

After four hundred years as part of the Russian Empire first and then of the USSR, post-Soviet Ukraine faced the challenge to establish its own independent state. Such a long time spent as a province, had significantly weakened the sense of a Ukrainian statehood. As its national identity needed to be vigorously re-asserted within the domestic as well as the international arena, Ukraine went through a phase of intense nation-building, which was inevitably reflected also in the foreign policy course adopted by the country's leadership.

While under Kravchuk's presidency Ukrainian foreign policy was inspired to a nationalist anti-Russian rhetoric, the advent to power of Leonid Kuchma marked the beginning of a "multivectorial strategy". From 1994 onwards, the aim to establish equally beneficial relations with the West as well as with Russia served the need to consolidate the newly acquired sovereignty.

The task of nation-building implied that not only state institutions had to be established, but "a new sense of history and new symbols" had to be provided as unifying elements for the whole population.⁶⁵ The lack of a common national mythology emerged as a result of the national struggle, the virtual divide between Ukrainian-speaking and Russian-speaking regions within the country, and the weakness of nationalist sentiments in the largest part of the population further complicated the efforts of national development.⁶⁶

The process of nation-building had to operate simultaneously at two levels. Kyiv was in the situation of having to justify its own existence to the external world, build credibility for itself and demonstrate that its independence would not be an ephemeral phenomenon. Nonetheless, trust and credibility had to be established also within the boundaries of the new country. A distinctive social identity with which the whole population could recognise

⁶⁵ I. Prizel (1994), "The Influence of Ethnicity on Foreign Policy. The Case of Ukraine", in *National Identity and Ethnicity in Russia and the New States of Eurasia*, edited by R. Szporluk, (Armonk: M. E. Sharpe), pp. 103-128

⁶⁶ I. Prizel (1998), *Op. Cit.*, pp. 372-373

themselves had to be outlined. This needed to be a social identity that was inclusive of all the ethnic minorities living on Ukrainian territory and yet strong enough to convince its citizens to shift their loyalty from the old Soviet to the new Ukrainian state.

Struggling to assert its independence, Ukraine's strategy followed closely a post-colonial pattern in which "the growth of positive sovereignty through state and nation-building is often conducted [...] by distancing to the maximum the newly independent state from the former imperial metropolis".⁶⁷ Under these circumstances it is not surprising that from the outset Ukrainian independence came to be defined not in absolute terms, but in relative terms: as independence from Russia.⁶⁸

The preservation of the newly acquired sovereignty came to be seen as a crucial matter of survival for the Ukrainian civilisation after past traumatic experiences. "For Ukraine, independence is not a luxury but the only means for survival in the face of both physical and cultural genocide" – was the justification provided by a Ukrainian-American author.⁶⁹

The importance that the Ukrainian leadership ascribed to the need to create international underpinnings to safeguard the newly-acquired independence was reflected in the documents issued in the early 1990s to outline the country's foreign policy priorities. The 1990 Declaration of Independence, for example, identified as the primary national interest the attainment of international recognition for the country's sovereignty. Ukraine's neutrality was also proclaimed as an additional guarantee to its independence. A Ukrainian analyst commented:

⁶⁷ T. Kuzio (1998), "The Domestic Sources of Ukrainian Security Policy", *The Journal of Strategic Studies*, Vol. 21, n. 4, p. 19

⁶⁸ A. Moshes (1999), "Ukraine and Russia: A Chronic Crisis", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann, et al., (Bern: Peter Lang), p. 258

⁶⁹ Y. Bilinsky (1994), "Basic Factors in the Foreign Policy of Ukraine", in *The Legacy of History in Russia and the New States of Eurasia*, edited by S. F. Starr, (Armonk, New York: M. E. Sharpe), p. 187

“Ukraine does not need neutrality for the sake of neutrality, but as a means to achieve its main national interest: absolute sovereignty and independence, consolidation of statehood, provision of territorial integrity and inviolability of borders, political stability and economic prosperity”.⁷⁰

The 1993 Main Directions of Ukrainian Foreign Policy, defined security in terms of national sovereignty and state independence, territorial integrity, ethnic minorities’ rights, the economic situation, ecology and information. Most importantly, however, the Main Directions strove to find a geopolitical location for Ukraine that was more appropriate to its ambition for a European identity. Thus, while the document pledged that Ukraine would enhance bilateral relations and deepen the special partnership with Russia, it also expressed willingness to participate in regional co-operation (the OSCE, European Security structures, the UN), seek active co-operation with NATO and ultimately the country’s full membership in the European Union.

CIS co-operation was to be improved, but the Commonwealth was inevitably classified as a mechanism of multilateral consultations to manage the “peaceful divorce” within the former Soviet area. The development of bilateral relations was to be given priority to multilateral co-operation within the CIS. Finally bilateral relations with neighbouring states, geographically close countries and NATO and EU structures were to be developed.⁷¹

Confronted with the urgent task of finding a unifying element for an otherwise divided population, and lacking a strong political legitimisation, the post-Soviet Ukrainian leadership used nationalism and foreign policy as instruments of nation-building. Nationalism became the main framework to read Ukrainian current events, to make decisions on the country’s place on the international arena, to establish alliances and to identify enemies.⁷² President Kravchuk used strong foreign policy statements and a

⁷⁰ N. A. Kulinich (1995), “Ukraine in the New Geopolitical Environment. Issues of Regional and Subregional Security”, in *The Making of Foreign Policy in Russia and the New States of Eurasia*, edited by A. Dawisha and K. Dawisha, (Armonk, New York: M. E. Sharpe), pp.113-139

⁷¹ O. Alexandrova (1999), “The Premises of Ukrainian Foreign and Security Policy”, in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann et al., (Bern: Peter Lang), pp. 31-52

⁷² Discussing the role of nationalism in foreign policy, Charles Furtado notes that nationalism provides “a belief system that consciously or unconsciously structures the perception of the world. Through its identification with the nation, the ideology establishes moral, pragmatic, and cognitive priorities that aid its

nationalist rhetoric, especially against Russia, to make up an international role for the newly independent state and thus define the contents of its national identity.⁷³

In the early 1990s Ukrainian foreign and security policy was centred on the assumption of potential threats from Moscow. Threats were identified in the form of Russian interference in Ukraine's internal affairs, territorial and other claims on state sovereignty, political and military instability and violent conflicts in neighbouring states, and in separatist tendencies in some regions of the country fomented by Russian forces.⁷⁴ Moscow became the main target of Ukrainian criticism. Kravchuk, for instance, blamed the Russians for the Great Famine and presented it as an episode of planned genocide against the Ukrainian population, hinting that in the 1990s as in the 1930s Ukraine should not trust Russian motives.

"[The Great Famine] was an action planned by the state and by the Communist Party authorities. One in five Ukrainians starved to death. This was genocide against one's own people on the basis of instructions issued from outside. The dreadful pressure put on Ukraine was based on striving to uproot the entire Ukrainian soul. Unacceptable living conditions were created to destroy a nation".⁷⁵

At the same time, however, the Ukrainian president pushed through what two Ukrainian economists have defined as "an economic policy destructive and absurd from the standpoint of general national interests", dictated more by a nationalistic agenda than by objective economic concerns (more details on Kravchuk's economic nationalism in chapter two).⁷⁶

adherents in distinguishing which beliefs are indisputable and which intolerable, which actions acceptable and which unacceptable, which course is true and wholesome and which is false and baleful, and where lies security and danger. As it filters experience, nationalism automatically heightens the salience of certain events, while downplaying the importance of others". C. F. Furtado (1994), "Nationalism and Foreign Policy in Ukraine", *Political Science Quarterly*, pp. 81-104 (quotation p. 85)

⁷³ Lowell Dittmer and Samuel Kim argue that the behaviour of a nation-state in the international arena contributes to the overall content of its national identity. A state can be defined by what it does. "What the state does is engage in various exploits on behalf of the nation it represents, most visibly in foreign policy. These actions make up a role, and the accumulated roles constitute an identity". Quoted in S. Shulman (1998), "National Integration and Foreign Policy in Multiethnic States", *Nationalism and Ethnic Politics*, Vol. 4, n. 4, p. 115

⁷⁴ O. Alexandrova (1999), "The Premises of Ukrainian Foreign and Security Policy", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann, (Bern: Peter Lang), pp. 31-52

⁷⁵ Y. Bilinsky (1994), *Op. Cit.*, p. 179

⁷⁶ Y. Pogorelova and V. Samborsky (1995), "On Ukraine's Export Potential", *Political Thought*, n. 1, p. 157

In opposition to its stated intentions, Kravchuk's assertive nationalism and anti-Russian spirit burdened Ukraine with a negative international reputation that his successor managed only partly to amend. By creating Ukraine's armed forces, issuing the Ukrainian national currency and obstructing CIS co-operation, Ukraine appeared to the West as unpredictable and unreasonable a subject to be kept at bay rather than welcomed as a partner. Kravchuk's reinterpretation of Ukrainian obligations under the START 1 and Lisbon Protocols gave Western countries the impression that Ukraine was trying to use the country's control over nuclear weapons as an instrument to pressurise the international community into providing additional financial aid.

The deteriorating economic conditions and a rapidly changing regional scenario convinced Leonid Kuchma that Ukraine's foreign policy strategy was in need of a radical reassessment in which relations with the West and with the East were to be given equal priority.

Economic Decline

Despite the most optimistic expectations of the pre-independence period, Ukraine was severely hit by the economic consequences of the dissolution of the Soviet Union. The rapid economic decline that accompanied the early years of independence was probably the single most important factor that convinced Kuchma's administration to re-orient Ukrainian foreign policy.

In view of the heavy economic interdependence with Russia, and of the urgent necessity to reform the industrial system, the country's leadership decided that the only possibility for Ukraine to recover would be to seek simultaneously economic co-operation with the East and financial support from the West. Conversion of economic sectors connected to the Soviet industrial infrastructure and restructuring of sectors dependent on Russian supplies appeared, in fact, desperate tasks that Ukraine could not face without external help.

Ukraine's dependence on Russian energy deliveries was a particular problem. According to data published in the mid-1990s, Kyiv relied on Russia for 90% of its oil imports, while it managed to produce internally about 20% of the gas it required. Turkmenistan could provide an alternative supply of gas for another 20%. Ukraine's five nuclear stations produced about one-third of the country's total electricity needs, but Ukraine's potential for energy output was much larger, thanks to the Donbass coal-mining industry and the many rivers that could be dammed to produce hydroelectric power.

Since independence Ukraine had nonetheless been under extreme pressure for energy deliveries. It was threatened by continuous cuts in supplies caused not only by its growing indebtedness with its Russian providers, but also by internal instability on the Russian market. For example, the March 1994 strikes by gas workers in Siberia.⁷⁷

Kyiv tried repeatedly to restructure its energy sector and find alternative energy suppliers. In early 1994 an energy plan promised to make Ukraine independent by 2010. The plan foresaw an increase of nuclear energy supplies to 40% of the total electric consumption. Domestic gas and oil production was expected to double, reaching 7.5 million tons of oil and 35 billion cubic meters of gas annually. The gas and oil reserves off the country's Black Sea coast and the 87 oil fields already active would be pivotal in this strategy. The G7 agreed to provide an aid package to build alternative power stations to replace the Chernobyl nuclear plant. The lack of progress in addressing effectively the country's energy problems, however, appeared as one of the many consequences of the Ukrainian unsuccessful economic reforms.⁷⁸

It was estimated that 60% of Ukraine's coal resources were unexploited, but the obsolescence of the plants and dangerous state of repair (the Donbass mines had the highest rate of accident related deaths in the world) made the full use of Ukrainian coal an

⁷⁷ U. Markus (1996), "Energy Crisis Spurs Ukraine and Belarus to Seek Help Abroad", Transition, 3 May 1996, pp. 14-18

⁷⁸ *Ibid.*

extremely hazardous operation.⁷⁹ Co-operation with external partners was indispensable for an effective closure of the mines.

The military-industrial complex was another sector of the Ukrainian economy to be severely hit by the disruption of industrial co-operation in the Former Soviet Union. The military industry located on Ukrainian territory represented almost 30% of the former Soviet defence industry, with hundreds of large defence-related companies and 1.45 million people directly employed. According to 1992 data, 1,870 enterprises, scientific research institutes, and construction offices, with a total of three million employees, were involved in the defence industry. Of these enterprises, about 700 employed one million people. In total 60% of the Ukrainian industries worked in defence.⁸⁰

In the USSR Ukraine was the leading producer of military ships, space-rockets, and ballistic missiles, air defence and air-to-air missiles, tanks, advanced radar, laser and optical equipment, and aircraft avionics. Even in the post-Soviet period, the defence industry could still sell \$ 8-10 billion per year. The industry, however, required substantial upgrading amounting to approximately \$ 28 billion, which the government could not provide. Ukraine was ranked among the top ten arms exporters in the world. Yet the country's sale potential was hampered by the fact that only few complete competitive arms production cycles were located on the territory of the newly independent state, while a large part of production was still oriented towards Russia and thus dependent on Russian co-operation.⁸¹

The energy sector and the military-industrial complex were only two of the industries that were affected by the break up of the Soviet Union and by the economic mismanagement that followed independence. Yet, the whole Ukrainian economy was badly hit by the crisis. In the five years up to 1995, total production in the state sector fell by more than a half, manufacturing declined by slightly less than half, agriculture by 35% and consumer goods

⁷⁹ *Ibid.*

⁸⁰ N. A. Kulinich (1995), *Op. Cit.*

production by 56%.⁸² The economic slowdown reverberated immediately onto the living standards of the population.

Table 3.4. Ukrainian Main Economic Indicators, 1991-1996

	1991	1992	1993	1994	1995	1996
REAL GDP	-8.7	-9.9	-14.2	-23	-11.8	-10
CAPITAL INVESTMENT	-7.1	-36.8	-10.5	-22.8	-35	-20.1
INFLATION *	39	210	10255	501	282	139.7
PRODUCTIVITY OF LABOUR	-7.3	-8.1	-12	-20	-4.8	n. a.

*Consumer Price index, December to December of previous year

Source: UNDP (1996), *Ukraine Human Development Report. Beyond the Triple Transition*, (Kyiv: UNDP), p. 11 and UNDP (1997), *Ukraine Human Development Report*, (Kyiv: UNDP), p. 15

In 1996 employment of the working age population was as low as 77.6%, namely 8% less than in 1990. On the contrary, employment in agriculture grew from 19.5% in 1990 to 21.8% reflecting the increasing number of people working their personal land plots to provide foodstuff that low salaries and the growing inflation could not afford. Throughout 1996 real wages decreased by 14%, while during the previous five years the decline in wages had been fourfold. From January 1995 to June 1997, wage arrears rose 16 times; throughout 1996 the sum of back wages rose by another 7 times. In January 1995 wage arrears were equal to 7% of the aggregate payroll fund, two years later this indicator rose to 19% at all enterprises

As a consequence of the difficult economic situation the level of nutrition of the population worsened. The portion of income spent on food went up to 57% in 1996, and the dietary composition deteriorated, with an increase in the consumption of corn products and a decrease in the consumption of meat products. In 1996 meat consumption was down by

⁸¹ A. Grytsenko (1999), "Ukraine's Defence Sector in Transition: Impacts on Foreign and Security Policy, in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann et al., (Bern: Peter Lang), pp. 95-120

⁸² UNDP (1996), *Ukraine Human Development Report: Beyond the Triple Transition*, (Kyiv: UNDP), p. 11

46.2% compared to 1990, while consumption of milk and dairy products dropped by 38.4%, fruit by 21.9%, and of eggs by 40%.⁸³

Inevitably, the population's trust in the national economy and the government's ability to solve the crisis fell sharply, and Ukrainians manifested their lack of confidence in the country's financial institutions preferring to save in dollars rather than in hryvnas or investing in the country's failing industrial system. According to the National Bank of Ukraine, the equivalent of US\$1.2 billion were spent in 1995 buying foreign currency, thirteen times more than in 1994, leaving the country heavily dependent on foreign government and international organisations to support its economic and social policy.⁸⁴

Opinion polls reflected effectively the gloomy perceptions of the population. According to a survey conducted in 1997 by the Democratic Initiative Foundation and National Academy of Sciences, the percentage of those who considered the economic situation in Ukraine very bad rose from 38.4% in 1994 to 43.3% in 1997. 11.3 % of the population rated their own family's material situation very bad in 1994, while a similar perception was shared by 18.8% of the respondents in 1997. The vast majority of people interviewed in 1997 (38%) confessed to be willing to return to a pre-*Perestroika* situation (the percentage was 30.9% in 1994). Only 20.3% agreed that a complete transition to the market was required (29.6% in 1994).⁸⁵

It has been argued that the loyalty of some parts of Ukraine, especially the eastern regions, to the new state entity was tightly tied to the central authorities' ability to deliver satisfactory economic conditions. In 1991 and 1994 the Russified areas of the country had voted for the candidate who seemed to guarantee an improvement in their economic situation. In the same way, the deterioration of the economic conditions in Ukraine, against the backdrop of a stable or improving economy in neighbouring Russia could convince

⁸³ UNDP (1997), *Ukraine Human Development Report*, (Kyiv: UNDP), pp. 23-38

⁸⁴ UNDP (1996), *Op. Cit.*, pp. 11, 12, 15

⁸⁵ Democratic Initiative Foundation and National Academy of Sciences (1998), *Ukrainian Society: 1994-97*, (mimeo: Kyiv)

Eastern Ukrainian electors to shift their support from Kyiv to Moscow.⁸⁶ In this perspective, a falling economy would pose serious risks for the credibility of the new Ukrainian state and endangered its very existence.

Public polls confirmed this tendency. In a 1997 national survey, approximately one third of the respondents declared that for them the country's sovereignty was of little or no importance at all. One fifth of the population was unable to remember exactly how they voted in the 1991 referendum on independence, and 52% declared that should the referendum take place again, they would support Ukraine's independence within a Union of Soviet Sovereign States. 23% would be completely against independence.⁸⁷ In a second survey conducted in 1997, 33% of the respondents revealed their support for a reunification with Russia, while 34% were in favour of a balanced development of Ukrainian relations both with Russia and the West.⁸⁸

The perception of the threats to the stability and unity of the country deriving from the economic uncertainty were so acute that even the 1997 Concept of National Security of Ukraine defined the national interests in terms of:

- Elevating living standards,
- Improving social security,
- Reforming the national economy,
- Enhancing the efficiency of government structures, strengthening civil society,
- Fighting corruption,
- Protecting national resources.

In particular, in the economic sphere elements such as:

⁸⁶ J. E. Mroz and O. Pavliuk (1996), "Ukraine: Europe's Linchpin", *Foreign Affairs*, Vol. 75, n. 3, May/June 1996, pp. 52-62

⁸⁷ Monitoring Foreign and Security Policy (1997b) "Sovereignty and Reforms in Ukraine: Public Opinion", *Occasional Paper* n. 19, <http://www.cpcfpu.org>

⁸⁸ Monitoring Foreign and Security Policy, (1997c) "Foreign Policy, Electoral and Political Attitudes: Public Opinion in Ukraine", *Occasional Paper* n. 37, <http://www.cpcfpu.org>

- The inefficiency of the state management of the economy,
- The persistence of monopolies,
- The economic and technological dependency on other countries,
- The economic isolation from international institutions,
- The lack of control on the drain of intellectual, material and financial resources,
- Crime and the shadow economy

were indicated as factors of risk for Ukraine's security.⁸⁹ Such alarming economic and social indicators provided the background for the launch by Kuchma's administration of a "multivectored" foreign policy strategy. This coincided with a momentous reconsideration of the regional geopolitical balance in the Eurasian continent by both Western governments and international organisations.

Regional Co-operation

The international arena in which the young Ukrainian state was taking its first diplomatic steps was characterised by two parallel phenomena. On the one side the post-communist set of alliances was disappearing, leaving space for an unsteady Commonwealth of Independent States on the territories of the Former Soviet Union and to a Central and Eastern European region eager to find a more "appropriate" geopolitical orientation. On the other side European unification was proceeding fast, raising hopes for its Eastern neighbours to be admitted in a promised land of political stability and economic prosperity. Also the Ukrainian leadership was confronted with the inevitable dilemma:

"Either enter the civilised area of geopolitically integrated Europe, confirming and installing Ukraine's historic place in it, or be reintegrated into the Eurasian geopolitical environment constituted by the post-Soviet states, with Russia as the neutral nucleus of integration".⁹⁰

⁸⁹ Kontsepsiya (Osnovy gosudarstvennoi politiki) natsionalnoi bezopasnosti Ukrainy, Decree of the Supreme Rada of Ukraine n. 3/97, 16 January 1997

⁹⁰ N. A. Kulinich (1995), *Op. Cit.*, p. 126

Integration in European structures, however, was not a real option and co-operation with Western governments proceeded erratically and with difficulty while Leonid Kravchuk retained the Ukrainian presidency, the Ukrainian nuclear problem was unsolved, and the West feared that their close relations with Ukraine would hinder relations with Russia. A number of events contributed subsequently to a significant shift of European and US diplomacy. The war and interethnic strife in Yugoslavia, the 1993 bombing of the Russian Parliament and the electoral success of Vladimir Zhirinovskii's extremism in Russia raised Ukraine's strategic profile on the international scene.

Given its multiethnic composition, Ukraine came to be seen as a potential source of "soft security risks"; the possibility of its "Yugoslavisation", the explosion of an ethnic conflict and the consequent migration flows from the country were rated as a large threat on the European borders.⁹¹ Moreover, Ukraine's geographical position between East and West made it a natural buffer against the re-emergence of an internationally assertive Russia.⁹² At the same time, the Ukrainian ratification of the START1 treaty, the trilateral agreement between the United States, Russia and Ukraine on Ukrainian nuclear disarmament, and launching of the economic reform in October 1994 gave Western partners the impression that Ukraine's policies were becoming more reliable.⁹³

In view of Ukraine's strategic importance for the continent's security, political commentators, both in Ukraine and in the West, argued vehemently in favour of a more active participation of the country in the European structures.

"Ukraine is crucial for the stability of the continent, and uncertainty there would reverberate throughout Europe. An independent, democratic, and reform-oriented Ukraine can provide a model for Russia's development, prevent the emergence of the Commonwealth of Independent States as a political and military alliance under Moscow's control, and promote stability in Central and Eastern Europe".⁹⁴

⁹¹ *Izvestiya*, 8 February 1994

⁹² I. Kempe (1999), "The European Union and Ukraine: Interests and Strategies", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, K. R. Spillmann et al., (Bern: Peter Lang), pp. 167-184

⁹³ O. Alexandrova (1998), *Op. Cit.*

Not only could Ukraine provide a model for Russian civilised development, but Russian political and military power appeared significantly curbed by the very existence of an independent Ukrainian state. Ukraine represented a guarantee of security for Poland, Romania and Turkey, which could also infuse a new spirit of co-operation in the CIS to contrast the design of a centrally integrated community envisaged by Russia.⁹⁵

An intense shuttle diplomacy between Kyiv and the European capitals in the autumn of 1993 (Chancellor Kohl visited Ukraine for the first time) marked the change of direction in relations between Ukraine and the European Union. Already in 1993 negotiations began over a Partnership and Co-operation Agreement between Ukraine and the European Union, that was finally signed in May 1994. The Agreement provided a framework for political dialogue, promised to promote trade, investment and economic co-operation and to support Ukraine's efforts to promote democracy.⁹⁶ Equally, in November 1994 the Council of Europe emphasised the need for a strong political relationship with Ukraine, support for the country's independence and territorial integrity, backing for political and economic reforms, improvement of nuclear safety and integration into the world economy.⁹⁷

Ukraine's decision to comply with the START 1 and the Nuclear Non-Proliferation Treaty, followed by the election of President Kuchma represented a turning point also in relations between Ukraine and the United States. The Clinton Administration proclaimed 1994 the "Year of Ukraine". In November, for the first time, a Ukrainian president was invited to a state visit in Washington.⁹⁸ During the visit a Charter of Ukrainian-American Partnership, Friendship and Co-operation was signed.⁹⁹

⁹⁴ J. E. Mroz and O. Pavliuk (1996), *Op. Cit.*, p. 52

⁹⁵ Z. Brzezinski (1998), "Ukraine's Critical Role in Post-Soviet Space", in *Ukraine in the World. Studies in the International Relations and Security Structure of a New Independent State*, edited by L. A. Haida, (Cambridge, Massachusetts: Harvard University Press), pp. 3-8

⁹⁶ O. Alexandrova (1998), *Op. Cit.*

⁹⁷ J. Sherr (2001), "A Failing Partnership? Ukraine and the West", *Conflict Studies Research Centre*, G89, p. 8

⁹⁸ A. Moshes (1996), "Politika zapada v otnoshenii Ukrainy", *Mirovaya ekonomika i mezhdunarodnie otnosheniya*, n. 2, pp. 90-98

⁹⁹ For the text of the Charter see *Golos Ukrainy*, November 20, 1994, p. 3

The Clinton administration also promoted the creation of a bilateral commission headed by the Ukrainian President Leonid Kuchma and the American Vice-President Al Gore to keep under permanent scrutiny foreign policy, security and economic issues. Ukraine became the third largest recipient of US foreign assistance. In an attempt to deflate the risks of a possible conflict between the two countries, Washington provided mediation in the Russian-Ukrainian energy debt crisis,¹⁰⁰ while condemning the Russian parliament's denunciation of the Belovezha Agreements as an "irresponsible step".¹⁰¹ Finally, in October 1996, the United States and Ukraine declared their relationship a "strategic partnership".¹⁰²

In February 1994 Ukraine joined the NATO Partnership for Peace program. Following the 1996 decision of the Russian parliament to revoke the Belavezha Agreement, President Kuchma and Foreign Minister Hennadii Udovenko signalled Ukraine's eagerness to expand ties with NATO. In July 1997 a Distinctive Partnership between NATO and Ukraine was initialled, according to which NATO members pledged to "support Ukraine in its efforts to protect its sovereignty, political independence, territorial integrity and inviolability of frontiers, promote its democratic development and economic prosperity".¹⁰³

From late 1993 then, the European and United States governments' approach to Ukraine changed radically, establishing a pattern of active engagement in the region. The West agreed to provide financial and technical assistance to prevent the deterioration of the country's economic and political situation, and opened the institutions of European political and security co-operation to Ukraine. From within an international framework, it was argued, Europe could more successfully control and manage Ukraine's soft security

¹⁰⁰ The US mediation rose harsh criticism in Moscow, where the intervention was judged the "pointless and inappropriate". *Golos Ukrainy*, February 1, 1995

¹⁰¹ *Segodnya*, March 21, 1996

¹⁰² S. Garnett (1998), "U.S.-Ukrainian Relations: Past, Present and Future, in *Ukraine in the World: Studies in the International Relations and Security Structure of a Newly Independent State*, edited by L. A. Hajda (Cambridge, Massachusetts: Harvard University Press), pp. 103-124

¹⁰³ O. Potekhin (1999), "The NATO-Ukraine Partnership: Problems, Achievements and Perspectives", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann et al., (Bern: Peter Lang), p. 146

risks.¹⁰⁴ Visiting Ukraine in February 1995, the American Ambassador Thomas Simons stressed that it was the responsibility of the international community to support political and economic reforms in the country, and indicated that the United States and the international financial organisations wanted to play a significant role in the process.¹⁰⁵

According to European governments' estimates, in 1994 Ukraine was granted \$367 million credit, while international organisations provided \$472.6 million. In 1995 the figures were respectively \$207 million and \$1746.3 million. A 1995 IMF stand-by-credit gave Ukraine \$801 million to guarantee the stabilisation of the national currency, balance of payments, and payment of crucial imports (energy). In the period 1991-96 Ukraine secured a total of \$1.6 billion from European institutions to strengthen the country's reserve position and to support restructuring of the economy. In 1996 seven credit lines were operating, allocating Ukraine a total of \$1050 million, five times more than the previous year. Between 1991-96 the United States granted Ukraine \$ 2 billion.¹⁰⁶

On top of financial assistance, Western governments and international organisations provided Ukraine with technical support for the industrial conversion of the country and the modernisation of its infrastructure. The introduction of energy and resource-saving technologies, the development of the fuel and energy complex, of the medical and microbiological industry, support to ship-building, aircraft building, transport and communication infrastructure were rated as absolute priorities to enhance Ukraine's economic independence. Environmental and natural resources protection, development of the privatisation program, support of small and medium-sized enterprises and social protection of the population were also targeted. Total international technical assistance amounted to \$369.9 million in 1995, and \$467.3 million in 1996.¹⁰⁷

¹⁰⁴ I. Kempe (1999), "The European Union and Ukraine: Interests and Strategies", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, K. R. Spillmann et al., (Bern: Peter Lang), pp. 167-184

¹⁰⁵ *Golos Ukrainy*, February 8, 1995

¹⁰⁶ Monitoring Foreign and Security Policy of Ukraine (1997a), "Financial and Technical Assistance to Ukraine", *Occasional Paper* n. 6, <http://www.cpcfpu.org>

¹⁰⁷ Monitoring Foreign and Security Policy of Ukraine (1997), *Op. Cit.*

Table 3.5. Official External Debt, 1995-1998 (In million US dollars, end of period)

	1995	1996
TOTAL OFFICIAL DEBT	8,142	9,170
RUSSIA, BALTICS AND OTHER FSU COUNTRIES	4,913	4,400
RUSSIA	4,185	3,690
TURKMENISTAN	710	710
REST OF THE WORLD	3,229	4,770
GERMANY	753	704
UNITED STATES	157	302
EUROPEAN UNION	110	235
IMF	1,590	2,368
WORLD BANK	499	905
EBRD	7	30

Source: IMF (1999), *Ukraine Country Report*, p. 128

The increased engagement of Western governments and international organisations in Ukraine was certainly the result of a changed geopolitical situation on the European continent. Nonetheless, the more active foreign policy of President Kuchma played an indisputable role in attracting the European countries' attention to Ukraine.

Two-Track Foreign Policy

The appearance on the Ukrainian political scene of Leonid Kuchma determined a significant reconsideration of the Ukrainian foreign policy. Kuchma inaugurated what he called a "two-track" policy line aimed at overcoming his predecessor's antagonism to Russia, while, at the same time, fostering a more effective partnership with the West. Kuchma refused to look at the choice of a Ukrainian foreign policy in terms of mutually exclusive options. Instead the President stressed that a well-balanced relation with Russia and the CIS as well as with the EU, the US and the Central and Eastern European neighbours met Ukraine's natural vocation as *trait-d'union* on the European continent.

“We have to move towards Europe, without moving away and cutting ourselves off from Russia, but we have to do this with Russia, we have to gather all the forces for the consolidation of the Euro-Atlantic environment, fulfilling an integrating role at the core of the European region”.¹⁰⁸

In the president’s perception, both orientations presented their advantages. Ukraine shared not only a “civilisation” and common interests with Europe, which could provide “the valuable experience of rights and means, the standard of a modern state”. As for Russia, the relation between the two Slavic neighbours needed to be based on “brotherly” co-operation.¹⁰⁹

An active foreign policy agenda confirmed Kuchma’s multivector foreign policy strategy. In November 1994 the Verkhovna Rada approved the Nuclear Non-Proliferation Treaty, following which Ukraine became an active member of the NATO Partnership for Peace Program. In November 1995 Ukraine was accepted as a fully-fledged member of the Council of Europe. In June 1996 Ukraine and Poland declared their relationship a “strategic partnership”, and in October 1996, also US-Ukraine relations were defined as a “strategic partnership”. In May 1997 the Polish and the Ukrainian Presidents signed a Joint Statement on Mutual Reconciliation between the two countries. In May 1997 the Treaty of Friendship, Co-operation and Partnership with Russia was signed, and in June of the same year the Treaty on Good Neighbourly Relations and Co-operation with Rumania was finalised. In July 1997 the Charter on a Distinctive Partnership between the North Atlantic Organisation and Ukraine was initialled. In February 1998 the Ten Years Agreement on Economic Co-operation between Russia and Ukraine was signed, while in March the Partnership and Co-operation Agreement between the EU and Ukraine came into force.

Kuchma’s views on the need to achieve a balanced relationship both with the East and with the West reflected a widespread perception in Kyiv. It was believed that, given the extension of the borderline between Russia and Ukraine, the many economic and technological connections and the long common history, Moscow could not be ignored in

¹⁰⁸ L. Kuchma (1999), *O samom glavnom*, (Kyiv: USPP), p. 330

¹⁰⁹ *Ibid.*, p. 309-332

developing a long-term foreign policy strategy. Relations between the two countries had to be founded on principles of mutual benefit and friendship.

Nonetheless, because of Russia's difficulty in establishing an equal relationship with Ukraine, the country needed to diversify its co-operation plans, embracing the EU, the CIS and Central and Eastern European countries, as well as the United States. The creation of a suitable "vital space" for Ukraine was viewed as the only way to guarantee the proper development of its population.¹¹⁰ Ukrainian commentators presented the country's geopolitical choice in terms of an alternative between socialism and the East or the market and the West.¹¹¹

Finding the right balance, however, was the object of a long and complex process, in which different political forces and segments of the state administration were revealed to be harbouring very different understandings of the country's geopolitical priorities (see table 3.6).¹¹² A real foreign policy consensus was never fully achieved and dramatic splits remained within the political elite on crucial issues such as Ukraine's approach to NATO.

In 1998, for example, 69% of foreign policy-makers indicated themselves in favour of co-operation with NATO. Yet, opinions on the role of the North-Atlantic organisation in Eastern Europe appeared sharply divided. According to another survey conducted in 1998, 32% of ordinary citizens considered NATO a defence alliance, while 11% saw it as a peace-making organisation and 22% feared it as an aggressive military bloc. 25% of those interviewed expected Ukraine would join NATO in the future, and 40% revealed a positive attitude towards the alliance. Interestingly, the percentage of those who declared support for a closer relationship with NATO was 30% among ordinary citizens, and twice as many among members of the political elite.¹¹³

¹¹⁰ *Golos Ukrainy*, February 16, 1995, p. 14, and 17 February 1995, p. 5

¹¹¹ *Golos Ukrainy*, February 21, 1995, p. 2

¹¹² *Golos Ukrainy*, February 16, 1995, p. 14, and 17 February 1995, p. 5

¹¹³ O. Potekhin (1999), "The NATO-Ukraine Partnership: Problems, Achievements and Perspectives", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann et al., (Bern: Peter Lang), pp. 145-165

Table 3.6. Foreign Policy Orientation of Main Ukrainian Political Parties, 1998

PARTY	% OF VOTES (*)	N. OF SEATS (**)	ORIENTATION TOWARDS CIS/RUSSIA	ORIENTATION TOWARDS NATO/WEST
COMMUNIST PARTY OF UKRAINE	24.65	120	Voluntary union of fraternal peoples.	Away from NATO and the West.
RUKH	9.4	50	Withdrawal of foreign troops from Ukraine, mutual beneficial relations with all countries.	Economic, political and military integration into Europe
SOCIALIST PARTY OF UKRAINE AND PEASANT PARTY	8.5	30	Fraternal economic and political relations with the Slavic world.	Rejection of dictates of international organisations.
PEOPLE'S DEMOCRATIC PARTY	5.01	72	Priority to friendly relations with neighbours	Gradual integration in European structures and world community
HROMADA	4.6	41	Renovation of lost markets in the CIS. Friendly relations with CIS/Russia	Integration into world economy, strategic partnership with USA
GREEN PARTY	5.4	25	Ukraine should be non-aligned country	
SOCIAL DEMOCRATIC PARTY	4	30	Priority to domestic manufacturers, protection of domestic markets, lower dependence on foreign energy sources	
PROGRESSIVE SOCIALIST PARTY OF UKRAINE	4	16	Protectionism in foreign economic relations. Russia and Belarus strategic allies	Denunciation of IMF agreements, and NATO partnership. Proscription of Western advisors.
REFORMS AND ORDER	3.13	4	Co-operation with CIS countries.	Role in the EU, joining US security Council. Co-operation with regional collective security structures.

Source: O. Dergachev and O. Potekhin (1998), "Parliamentary Elections and Foreign Policy in Ukraine", Monitoring Foreign and security Policy of Ukraine, Occasional Paper n. 11, <http://www.cpcfpr.org>

(*) Percentage of votes received at the 1998 parliamentary elections in multi-mandate districts

(**) General number of mandates out of 413 total number of seats

Relations with the European Union were a less controversial issue, and a large part of the foreign policy community seemed to agree that a common European identity had to shape Ukraine's foreign policy orientations.

"Ukraine should 'return' to Europe, to the family of civilised nations. Ukraine must do so independently, and not 'at the tail of the Moscow fleet', moving towards an integrated Europe. This does not mean that Ukraine should neglect its interests in the East. Normal interaction with Russia and the CIS states is one of the preconditions of Ukrainian integration into Europe".¹¹⁴

To testify Ukraine's commitment to joining the European Union, in 1998 President Kuchma passed a decree "On Endorsing the Strategy of Ukraine's Integration into the European Union". The document outlined a ten year program to meet the preconditions required for associate membership, promising radical transformations in areas as different as legislation, economy and trade, security, political consolidation and strengthening of democracy, social policy, culture, education, science, technology, regional co-operation and the environment.¹¹⁵ Ukraine's eagerness to be accepted into the EU, however, was matched by a more cautious approach within the European institutions, where the possibility of European enlargement to include Ukraine was excluded for the foreseeable future.¹¹⁶

The Kuchma administration was, therefore, left to voice the country's frustration and disappointment at the pace of its relations with Brussels. Foreign Minister Borys Tarasyuk noted in front of an audience of Western diplomats:

"There is a wide consensus in the country that Ukraine's return to Europe is beneficial for all – for ourselves, for our neighbours, for Europe itself. But this consensus is seriously damaged by procrastination of time and lack of adequate reaction. Discreditation of Ukraine's European integration policy may trigger a chain of unpredictable and dangerous geopolitical changes which shall know no borders indeed."¹¹⁷

¹¹⁴ N. A. Kulinich (1995), *Op. Cit.*, p. 131

¹¹⁵ Embassy of Ukraine to the United States, Press Release (1998), "Ukraine Marks the 7th Anniversary of its Independence" 18 August 1998, <http://www.brama.com/ukraine-embassy/pre0818.html>

¹¹⁶ Kilian Strauss, EU Economic Affairs Officer, , interview with the author, Kyiv, 7 June 1997

¹¹⁷ B. Tarasyuk (1998), "Borderline Case Europe: Chances and Risks of the New Neighbourhood", Statement pronounced at the International Bertelsman Forum, Berlin July 4th, 1998, as reprinted in <http://www.brama.com/ukraine-embassy/pre0704.html>

Economic pressures and the awareness that the perspective of European integration would not provide a short-term solution for Ukraine's problems forced Kuchma to balance carefully between Ukraine's Western and Eastern neighbours. In the face of the international agencies' threat to cut aid to Ukraine as a result of unsatisfactory economic reforms, the lack of internal resources to support the economy, and the outflow of foreign investment, Kuchma turned for help to Russia once again. Complaining that Russian investment in Ukraine was as low as Russian investment in Cyprus, Kuchma promised to open the doors of the Ukrainian economy to Russian capital.¹¹⁸ The February 1998 Programme of Economic Co-operation until the year 2007, initialled by Prime Ministers Pustoyvotenko and Chernomyrdin was meant to provide the legal framework for Russian investment in Ukraine. After the drop experienced in the previous years the programme was expected to more than double bilateral trade in the decade ahead, counterbalancing previous anticipations of increased exchanges with Europe.¹¹⁹

Conclusions

The collapse of the Soviet Union affected the foreign policy of Russia and Ukraine in two different ways. Russia's identity crisis following the loss of an imperial status was coupled with a serious economic decline and the perception that increasing consolidation of the new independent states would impose risks to Russia's security. From 1994 onwards the preoccupation that the foreign policy course adopted under Andrei Kozyrev's direction had failed to understand and address these problems translated into a growing consensus around "pragmatic nationalist" positions.

Moving away from a conception that equated state power to military power, pragmatic nationalists suggested Russia should aim to re-acquire its influence over its neighbouring

¹¹⁸ RFE/RL Newslines, February 25, 1998

¹¹⁹ RFE/RL Newslines February 23, 1998. In 1995-96 Russia's share in Ukraine's foreign trade was 47%, in 1997 40%, and in 1998 33%. This decline was mainly due to the Russian perception that Ukraine was an unreliable partner, unwilling to pay for goods and services it receives. V. Musatov (1999), *Op. Cit.*

countries through economic rather than political means. Expansion on external markets and control over foreign assets were indicated as a more effective path to win back Russia's pride and improve the population's living standards.

Against this background, big Russian companies were viewed as the most effective representatives of Russian interests abroad, as their prosperity was increasingly equated to the country's prosperity. Foreign policy documents published in the period 1994-98 presented the protection of big companies' activity as an inherent part of the Russian national interest, and through pragmatist nationalism Russian financial-industrial groups received the state endorsement to pursue their individual interests on foreign markets.

The foreign policy setting did not provide an equally favorable environment for the Ukrainian economic elite, as the country's economic situation was not stable enough to allow the foreign policy institutions to implement self-sustaining policies. Ukraine was faced by the urgent necessity to attract Western financial and technical aid to conduct a programs of structural transformation, while, at the same time it needed to secure credits and energy supplies from Russia.

This double constraint imposed on the Ukrainian leadership the choice of an ambivalent policy of balanced relations with both its Eastern and Western neighbours. The interests of the economic elite did not find an explicit articulation in this context. As a result of the Ukrainian economic elite's lack of sufficient resources and experience to engage on foreign markets Ukrainian economic actors failed to formulate a set of foreign policy interests other than demands for domestic protectionism.

The background of a foreign policy aimed at consolidating Ukraine's statehood, however, provided the economic elite with a valuable nationalist vocabulary. In chapter five it will be shown that economic actors succeeded in articulating their policy preferences within the framework of a foreign policy discourse that prioritised the preservation of the country's independence and the establishment of sufficient guarantees against Russian attempts of re-establishing conditions of political or economic subordination.

The fragmentation of Russia and Ukraine's economic elites along lines that represented their economic resources, their political power and their foreign policy interests translated into conflicting policy preferences. In order to understand what influence economic actors could exercise on the structure of relations between Russia and Ukraine two elements need to be kept into account. The first element is the political authority that certain segments of the economic elite enjoyed and their access to policy-making institutions. The second element is the specific set of preferences of these segments towards the neighbouring country. This analysis will be the object of the next two chapters.

CHAPTER FOUR

The Russian Economic Elite

Foreign policy preferences of individual social groups stem from the perceived benefits or damages that individual foreign policy decisions can pose on the interest of the group. Policy preferences can then be translated into foreign political decisions depending on the degree of influence and control that that specific group exercises over the state institutions.¹ The convergence of interests and policy preferences among social groups in two or more countries fosters a process of co-operation, which may ultimately lead to economic or political integration. In Ernst Haas' account of early integration within the European community (see chapter 1), the perception that integration could be beneficial for the development of individual or group interests convinced social groups to shift loyalty and support to the creation of a new transnational entity.

Similarly, the approach to co-operation within the Commonwealth of Independent States assumes the existence of convergent economic interests among business elites across the territory of the Former Soviet Union. It was argued that the urgency to re-start industrial relations interrupted by the collapse of the USSR, and to invert the catastrophic economic decay experienced within the former Soviet space created the conditions for a pragmatic view of business interests common to all economic actors in the CIS. "Economic pragmatism", as opposed to "political romanticism", was presented as the approach able to overcome nationalistic preconceptions against co-operation. In this view, economic actors were to become the very agents of economic and possibly political reintegration in the post-Soviet arena.

In this chapter I turn to the domestic level of foreign policy, exploring first the structure of the Russian economic elite and its access to political power. I will then identify the interests of the Russian economic elite towards Ukraine, illustrating how in the period

1994-98, the interests and attitudes of the Russian economic elite were in fact not only divergent but antagonistic vis-à-vis the interests of the Ukrainian economic elite. The predatory character of the Russian economic elite and its anxiety to secure property rather than foster a process of economic development, based on joint medium-to-long-term investment programmes, were the main factors of this antagonism.

The intertwining of economic and political power allowed the Russian business elite to translate their policy preferences into political decisions. Since the first years of *perestroika*, distinctive economic actors had emerged in the shadow of the *nomenklatura*, as a result of a process of converting political authority into economic power. In the mid-1990s, large-scale Russian capital consolidated into financial-industrial groups. The combination of the economic resources of these conglomerates and the increasing weakness of the Yel'tsin's presidency were the two main conditions through which the business elite gained direct access to policy-making.

The presence of representatives of the economic elite in the centres of decision-making allowed economic interests to be articulated also in the foreign policy arena. The interests of big business were absorbed into and presented as state interests in the Concept of National Security and a string of other foreign policy documents published during Yel'tsin's presidency (see chapter 3). Business elite interests, however, did not necessarily correspond to Russia's foreign policy interests and, as a result, the Russian economic elite never performed the role of agent of integration in the CIS or defender of the Russian national interests abroad.

The business elite was not a compact stratum and the interests of specific groups were often contradictory and in conflict with the interests of other economic sectors, regional groups or state institutions. Furthermore, the attitude Russian business adopted towards Ukraine showed that the economic elite considered participation in the local markets as a chance to expand their own power-base, after privatisation opportunities dried up in Russia.

¹ H. V. Milner (1997), *Interests, Institutions and Information. Domestic Politics and International Relations*, (Princeton: Princeton University Press), pp. 9-10

As the establishment of strategies of co-operation with Ukrainian economic elites did not seem to be on the agenda of the most visible Russian businessmen, penetration of Russian capital in Ukraine was perceived by local elites as a zero-sum game. Finally, the 1998 economic crash interrupted most plans for economic expansion abroad. As Russian financial institutions became more vulnerable and unstable, and many were forced to close or merge, a strategy of survival replaced a strategy of expansion.

The substantial failure of the state-sponsored project to establish Transnational Financial-Industrial Groups (TFIGs) as an instrument to foster bilateral economic co-operation indicated a clear lack of common interests between business groups in Russia and in Ukraine.

Business and Politics

Contiguity to the political and administrative power was the key factor for the Russian economic elite's ability to establish their business activities in the late Soviet years. A Russian author has called the special relation forged between political and economic agents in that period "bureaucratic and social capital".² Bureaucratic capital allowed future entrepreneurs to capitalise on the Communist Party's assets, drawing from CPSU funds or making use of the Party's structures. A large segment of that early economic elite has been identified as the "Komsomolers", precisely because, as former officers of the Komsomol', many individuals started their new economic activities under the auspices of the Youth Organisation or other related structures.³

²N. Shmatko (1995), "Stanovlenie Rossiiskogo patronata i biurokraticheskii kapital", *Sotsiologicheskie Issledovaniia*, n. 6, pp. 24-36

³I. Kukolev (1996), "Formirovanie biznes-elity", *Obshchestvennye nauki i sovremennost'*, n. 2, pp. 12-23. On this point also O. Kryshtanovskaya and S. White (1996), "From Soviet Nomenklatura to Russian Elite", *Europe-Asia Studies*, Vol. 48, n. 5, pp. 711-733, and D. M. Kotz (1997), *Revolution from Above*, (London: Routledge), pp. 120-121

Significantly, Russian sociologists have confirmed that a large part of the economic elite originated in the Soviet *nomenklatura*. According to a survey conducted in 1994 among business people, 44% of the respondents were revealed to have been previously employed in *nomenklatura*-related positions (see table 4.1).⁴

There was, however, another group, called by Olga Kryshtanovskaya the *nomenklatura*'s "fiduciary agents", who, despite the fact that they were not themselves part of the *nomenklatura*, was, nonetheless, "authorised" by the *nomenklatura* to engage in profitable economic activities. Thanks to the persisting disparities between internal and international prices and official and black market exchange rates, foreign trade and financial speculation became a secure path toward wealth and success.⁵

⁴ A. B. Babaeva and A. E. Chirikova (1996), "Lidery biznesa o sebe i ob obshchestve", in *Rossiskaya Elita: opyt sotsiologicheskogo analiza* (part II), (Moscow: Nauka), p. 17. The dispute over the origin of the economic elite is only part of the controversial debate among students of Russian politics on the reproduction or circulation of the Soviet elite. For a view upholding the thesis of circulation, D. Lane and C. Ross (1997), "Russian Political Elites, 1991-1995: Recruitment and Renewal", *International Politics*, Vol. 34, pp. 169-192 and D. Lane and C. Ross (1999) *The Transition from Communism to Capitalism. Ruling Elites from Gorbachev to Yeltsin*, (New York: St. Martin's Press). For a study focussing on the top political elites, T. H. Rigby (1999), "New Top Elites for Old in Russian Politics", *British Journal of Political Science*, Vol. 29, pp. 323-343. For a regional perspective, J. Hughes (1997), "Sub-National Elites and Post-Communist Transformation in Russia: A Reply to Kryshtanovskaya and White", *Europe-Asia Studies*, Vol. 49, n. 6, pp. 1017-1036, and S. Werning Rivera (2000), "Elites in Post-Communist Russia: A Changing of the Guard?", *Europe-Asia Studies*, Vol. 52, n. 3, pp. 413-432

⁵ O. Kryshtanovskaya (1996), "Post-Soviet Elites: Parlaying Power into Property", *Izvestiya*, January 10, 1996, as reported in *Current Digest of the Post-Soviet Press*, Vol. 48, n. 4, February 21, pp. 1-5. See also A. Aslund (1999), "Russia's Collapse", *Foreign Affairs*, September/October, pp. 64-77. For an anthropological portrait of the emerging economic elite see O. V. Perepelkin (1995), "Rossiiskii predprinimatel': shtrikhi k sotsialnomu portretu", *Sotsiologicheskkiye Issledovaniya*, n. 2, pp. 35-40; A. B. Babaeva and A. E. Chirikova (1996), *Op. Cit.*; R. Medvedev (1997), "Novy klass rossiiskogo obshestva", *Svobodnaya Mysl'*, n. 8, pp. 58-71. For a review in English, B. Silverman and M. Yanovich (1997), *New Rich, New Poor, New Russia*, (Armonk: M. E. Shape), chapter 6

Table 4.1. Background Of The Economic Elite, By Type Of Enterprises And Geographical Location

	NOMENKLATURA OR POLITICAL ELITE POSITIONS (%)	“SELF-MADE MEN” (%)	PREVIOUS JOB NOT DECLARED (%)
TOTAL IN 1994	44.2	55.8	0
TOTAL IN 1995	26.2	49.7	24.1
BANKS	31.3	39.1	29.7
STOCK-COMPANIES IN THE REGIONS	33.3	51.3	15.4
STOCK-COMPANIES IN MOSCOW	16	72	12
FIRMS IN THE REGIONS	16.7	33.3	50
FIRMS IN MOSCOW	0	81.8	18.2

Source: A. B. Babaeva and A. E. Chirikova (1996), “Lidery biznesa o sebe i ob obshchestve”, in *Rossiskaya Elita: opyt sotsiologicheskogo analiza* (part II) (Moscow Nauka), p. 66

With the break up of the command economy in 1987-88 and the weakening of state control over the means of production, the Party *nomenklatura* promoted a process aimed at the conversion of power into property.⁶ In his book “The State and Evolution”, Egor Gaidar maintains that the Soviet *nomenklatura* had not only been in favour but strongly supportive of initiating economic reforms in the late 1980s. Convinced that under capitalism they would still be in charge of the political and economic system, members of the *nomenklatura* pushed towards a process that Gaidar calls “privatisation of power”, finally establishing a “*nomenklatura* capitalism”.⁷

“Spontaneous privatisation” ensured that the direction of state properties was gradually transferred to the state property’s administrators, at least four years before the outset of the official privatisation in 1991-92. Michael McFaul argues that “during the Soviet era enterprise directors had *de facto* seized many of the rights associated with ownership of property”, as a result of the state’s weakened ability to control the performance and

⁶ N. Ryabotyzhev (1998), “K voprosu o ginezise i sushnosti nomenklaturnogo kapitala”, *Mirovaya ekonomika i mezhdunorodnie otnosheniya*, n. 2, pp. 38-51

⁷ Quoted in L. D. Nelson and I. Y. Kuzes (1998), “Russian Economic Reform and the Restructuring of Interests”, *Demokratisatsiya*, Vol. 6, n. 3, pp. 480-503

behaviour of directors.⁸ Spontaneous privatisation gave the economic elite an advantage over ordinary citizens and allowed them to realise a “primary accumulation of capital” in anticipation of official privatisation.⁹ According to a survey conducted by Joseph Blasi and others, in 1996 58% of Russian enterprises were owned by insiders. Of this percentage, 18% of shares was owned by the enterprises’ management.¹⁰

The 1992-94 liberal reforms represented a further development of this tendency, as they favoured the establishment of a property class within a general environment, in which small-scale ownership had been severely curtailed. Some Russian scholars have seen a deliberate plan behind the 1992 price liberalisation, and have stressed the role that the consequent hyperinflation played as a “confiscation measure”. By wiping out of the market many of the small enterprises and co-operatives that had emerged in the late 1980s, hyperinflation removed potential competitors for the more established entrepreneurs. While, by eroding deposits of small and medium savers, price growth ensured that, when privatisation started, small potential buyers lacked the resources to take part in the auctions.¹¹

The *nomenklatura* was also the main beneficiary of the restructuring of the sectoral ministries as concerns and associations, as former ministers or their deputies were absorbed into the management structures of the new companies and became their majority shareholders. Gazprom (gas extracting industry with control over the pipelines), Rostekstil’ (textile industry), Lesprom (timber industry), and Roslegprom (light industries) were all established by dismantling the relevant ministries, and creating shareholding companies, involving a mixed ownership structure consisting of state, workers and outsiders.

Proximity to the centre of policy-making, then, allowed a section of the Soviet *nomenklatura* to turn into a “property class”. Yet, if in the first stage of reforms it was

⁸ M. McFaul (1995b), “State Power, Institutional Change and the Politics of Privatization in Russia”, *World Politics*, Vol. 47, n. 2, p. 211, and M. McFaul (1996) “The Allocation of Property Rights in Russia: The First Round”, *Communist and Post-Communist Studies*, Vol. 29, n. 3, pp. 287-308

⁹ N. Shmatko (1995), *Op. Cit.*

¹⁰ J. R. Blasi et al. (1997), *Kremlin Capitalism*, (Ithaca: Cornell University Press), table 4, p. 193

¹¹ N. Ryabotyazhev (1998), *Op. Cit.*

access to political power that guaranteed the new entrepreneurs control over economic resources, with the consolidation of the economic empires, that relationship was inverted and economic capital proved an important instrument to gain access and to keep control over politics.

Economic actors became increasingly engaged in the political sphere to preserve and expand their recently acquired property rights. In an environment in which economic transformations did not look irreversible, and control over property was perceived as the distinctive trait of the economic elite's authority, fears that a sudden change in the political landscape would challenge their ownership prompted the new entrepreneurs to take direct political action. This process generated a circular flow of power at the top of the Russian leadership, whereby economic power was employed to acquire political influence, which, in turn, generated further economic advantages.¹²

The Oligarchic Regime

The relationship between political and economic power that developed in the years of the Yel'tsin's presidency goes beyond the traditional pattern of lobbying for the allocation of better economic conditions (budget subsidies, quotas and licences, tax exemptions).¹³ The rapacious attitude of the economic elite, the often-illegal character of their operations, and the scandals that punctuated the second stage of privatisation gained them the title of "robber barons" and the system they created the name of "*kleptocracy*".

The distinguishing attribute of this business elite was its parasitic nature; as Louise Shelley puts it, "[the economic elite] does not trade in goods or produce anything of value. Instead,

¹² N. Shmatko (1995), *Op. Cit.*

¹³ For an overview of lobbying, S. Peregudov and I. Semenenko (1996), "Lobbying Business Interests in Russia", *Democratization*, Vol. 3, n. 2, p. 115-139; for a comparative view of lobbying in Russia and Ukraine see P. Kubicek (1996), "Variations on a Corporatist Theme: Interest Associations in Post-Soviet Ukraine and Russia", *Europe-Asia Studies*, Vol.48, n. 1, pp. 27-46

it merely drains the state”.¹⁴ In draining the state, the oligarchs became co-responsible for the emergence of the “virtual economy” that burst with the 1998 financial meltdown. Up to then the Russian economy had been governed under the “illusion” that it was larger than it really was, “producing larger governments and budgets than Russia could really afford”.¹⁵

From a political point of view, the oligarchic regime contributed to discrediting the state institutions and further alienated civil society, by *de facto* limiting free elections, workers rights and freedom of the press. From an economic point of view the oligarchs became engaged “in heavy predation and capital flight” resulting in “an industrial waste land specked with islands of speculative financial prosperity”.¹⁶

The oligarchic regime that emerged in the years between 1995 and 1998 was the product of the alliance between the economic elite and the Yel'tsin's presidency. This was a relation based on mutual advantage and mutual need, generated by a situation in which the ailing presidential power, finding itself isolated from the parliament and society at large, sought the support of forces external to the institutional arena. The presidential administration traded access to the oligarchs' economic resources, needed to pay for the 1996 electoral campaign, against guaranteed access to privatising assets, and increased political influence.

The character of the presidential system created by Yel'tsin became key for the consolidation of the oligarchs' power. Scholars have disputed at length whether a presidential or a parliamentary system would be best suited for a transitional democracy.¹⁷ In Guillermo O'Donnell's model of “delegative democracy”, a presidential system is seen as conflicting with the very purpose of institution-building and democratisation. Presidents

¹⁴ L. I. Shelley (1997), “Stealing the Russian State”, *Demokratizatsiya*, Vol. 3, n. 2, pp. 115-139 (quotation p. 482)

¹⁵ C. G. Gaddy and Barry W. Ickes (1998), “Beyond Bailout: Time to Face Reality About Russia's ‘Virtual Economy’”, <http://www.brookings.org/fp/w-papers/gaddy/gaddick1.htm>

¹⁶ S. Hedlund (1999), *Russia's “Market” Economy. A Bad Case of Predatory Capitalism*, (London: UCL Press), p. 261

¹⁷ J. J. Linz (1990), “The Perils of Presidentialism”, *The Journal of Democracy*, Vol. 1, n. 1 pp. 51-69, S. Mainwaring (1993), “Presidentialism, Multipartyism and Democracy: the Difficult Combination”, *Comparative Political Studies*, Vol. 26, n. 2, pp. 198-228, A. Stepan and C. Skach (1993), “Constitutional Framework and Democratic Consolidation: Parliamentarism versus Presidentialism”, *World Politics*, Vol. 46, October, pp. 1-22

present themselves as being “above parties”, while institutions such as the parliament and the judiciary are viewed as a “nuisance”, and accountability to them is considered by the president an unnecessary impediment. In this framework, the president and his staff become “the alpha and the omega of politics”, as the president insulates himself from most existing political institutions and organised interaction, becoming the sole agency responsible for his policies.¹⁸

So designed, a presidential system increases the risks of polarisation as elections and conflict between political groups and institutional branches are perceived as a zero-sum game, in which the winner takes all.¹⁹ The Yel'tsin presidency was not an exception to this general rule. Having failed to carry on fundamental political reforms, disbanding the Supreme Soviet and calling for elections before a course of economic transformations was initiated, the presidency became locked in a constant struggle for power with a conservative parliament.

The reformist governments of Egor Gaidar and later Anatolii Chubais faced repeated opposition by the legislature trying to impose fiscal austerity, reform the tax system, and resist the pressure for subsidies to loss-making enterprises. In their efforts to implement a policy of de-regulation, the “reformers” sought the support of prominent figures in the fuel and energy complex, the banking sector and financial industrial groups, who had a personal interest in replacing the withdrawing state institutions in the economic management of the country.

Yet, the support that the oligarchs could provide was not only in the area of economic policy. Throughout his two terms in office, Yel'tsin maintained a confrontational relation with the parliament. This resulted in the 1993 bombing of the White House, the centralisation of powers in his hands, stipulated by the new constitution, and the emergence of an illiberal political system based on a strategy of *divide et impera*. As Stefan Hedlund

¹⁸ Quoted in A. Stepan and C. Skach (1993), “Constitutional Framework and Democratic Consolidation: Parliamentarism versus Presidentialism”, *World Politics*, Vol. 46, October, pp. 1-22 (quotation pp. 19-20)

¹⁹ J. J. Linz (1990), “The Perils of Presidentialism”, *The Journal of Democracy*, Vol. 1, n. 1 pp. 51-69

has pointed out, the contest between the executive and the legislative was increasingly fought “with weapons out of the democratic arsenal.”²⁰

Frequent government re-shuffles and the tendency to refuse responsibility for political and economic mistakes transformed Yel'tsin into a figure who resembled more a medieval prince than a modern president. The institutionalised fora of decision-making were progressively undermined, while the political system came to be built on the president's personal charisma.

The discrediting of parties and social movements reinforced a pattern according to which policy-making took place increasingly outside political institutions and within the inner circle of the president's loyal entourage; the “family”. The system turned into what George Breslauer calls “patriarchalism”. Yel'tsin, the “patriarch”, treated “his political dependants as his extended family, within which he demands obedience and dispenses absolution to those who have ‘sinned’”; the Russian government became “his patrimony, within which he dispenses both challenges and rewards”.²¹

In this charged climate, presidential elections still remained the only legitimate and recognised instrument to change the system and replace the leadership. In the wake of the 1996 presidential election, facing the perspective of a rising communist electorate, the interests of the presidential administration and of the nascent oligarchs came to coincide.

In fear of a classical “winner-takes-all” scenario, in which the victory of a communist president would result in the ousting from power of political and economic figures close to Yel'tsin, the presidency revealed its need for the oligarchs' support. Financial backing from the large financial-industrial groups allowed to conduct an effective electoral campaign, and control over the media helped to win back the popular favour. The electoral

²⁰ S. Hedlund (1999), *Op. Cit.*, quotation p. 325

²¹ G. W. Breslauer (1999), “Boris Yel'tsin as Patriarch”, *Post-Soviet Affairs*, Vol. 15, n. 2, p. 188. For a first assessment of the Yel'tsin era D. Glinksi and P. Reddaway (1998) “The Yeltsin Era in the Light of Russian History: Reform or Reaction?”, *Demokratizatsiya*, Vol. 6, n. 3, pp. 518-534

victory marked the institutionalisation of the presence of business interests within the political sphere, which lasted intermittently until the end of the Yel'tsin's presidency.

What the oligarchs had to offer were the advantages of the economic wealth they had accumulated since the late 1980s; what they required in exchange was the government's endorsement to expand further that wealth through a system of "personalised political redistribution".²² The "blender of power and property" that the oligarchs' political rise fostered has been effectively framed in Stefan Hedlund's words:

"Present day boyar capitalists have become dependant on straight links to the government for their own enrichment [...]. The boyars lack real security of tenure: both accumulating and holding onto wealth is conditional upon service and loyalty to the tsar. [...] The modern day boyars have been rewarded for their services and loyalty in monetary terms [...], a siphoning off of money from the federal budget and [...] a transfer of wealth out of the government's hands."²³

The perception of the financial-industrial groups' economic strength in an economy afflicted by de-monetisation and disinvestment put the oligarchs in a position of quasi-equal partners with the President and his administration.²⁴

²² D. Treisman (1995), "The Politics of Soft Credit in Post-Soviet Russia", Europe-Asia Studies, Vol. 47, n. 6, p. 967

²³ S. Hedlund (1999), *Op. Cit.*, pp. 252-253

²⁴ For an overview of the Russian economy M. Ellman (2000), "The Russian Economy under El'tsin", Europe-Asia Studies, Vol. 52, n. 8, pp. 1417-1432 and P. Hanson (1997), "What Sort of Capitalism is Developing in Russia?", Communist Economies and Economic Transformation, Vol. 9, n. 1, pp. 27-42

The Emergence of “Big Capital”

There are two paradoxes related to the appearance of financial-industrial groups (FIGs) on the Russian scene. The first is that even though FIGs were originally designed as an instrument for a statist industrial policy, their project was successively adopted by the emerging economic elite and turned into an opportunity to pursue their economic interests.

The second paradox consists in the fact that, despite the allegations of great financial power attached to those groups and to the banks that presided over them, the economic empires emerged in the mid-1990s were in fact considerably small. It has been estimated, for example, that before the 1998 crisis Vladimir Potanin's Oneksimbank would not rank among the top 100 US banks.²⁵ The implications of the oligarchs' financial weakness was that, as their wealth was large only in relative terms, in order to prosper further and to keep their grip on the privatised assets, oligarchs needed the protection of the government and the President.

The project of financial-industrial groups was originally part of a state-led industrial and investment policy to counter the devastating post-Soviet industrial collapse, designed on the model of the Korean Chaebol and the Japanese Zaibatsu.²⁶ Through the FIGs the Russian leadership intended to reaffirm its leading role as a developmental state, assuming the task to identify priority sectors in the national economy and establish a stimulating (or protecting) environment for them.

²⁵ C. G. Gaddy and B. W. Ickes (1998), *Op. Cit.*

²⁶ S. Mizobata (1998), “Financial Relations in the Russian Financial-Industrial Groups: A Comparison of Russia and Japan”, Kyoto Institute of Economic Research, Discussion Paper n. 480. For an overview of FIGs, their functions and structure, J. Johnson (1997), “Russia's Emerging Financial-Industrial Groups”, Post-Soviet Affairs, Vol. 3, n. 4, pp.333-365, L. Gorbatova,(1995), “Formation of Connections Between Finance and Industry in Russia: Basic Stages and Forms”, Communist Economies and Economic Transformation, Vol. 7, n. 1, pp. 21-34, L. Freinkman (1995), “Financial-Industrial Groups in Russia: Emergence of Large Diversified Private Companies”, Communist Economies and Economic Transformation, Vol. 7, n. 1, pp. 51-66, I. Starodubrovskaya (1995), “Financial-Industrial Groups: Illusion and Reality”, Communist Economies and Economic Transformation, Vol. 7, n. 1, pp. 5-19, J. E. Prokop (1995), “Industrial Conglomerates, Risk Spreading and the Transition in Russia”, Communist Economies and Economic Transformation, Vol. 7, n. 1, pp. 35-50

The state would supplement private initiative in those sectors where risks were perceived to be too high and revenue too low to invest in production.²⁷ FIGs would restore the interrupted productive chain, and would constitute the “nucleus to revitalise relations among the different economic spheres”, restoring the contradiction between the shortage of investment capital in industry and the excessive resources within the financial sector.²⁸

Legislation established that groups could be created by the autonomous initiative of members or by state intervention. The state would step in to fill the gap in spontaneous entrepreneurship, “supporting the process of de-monopolisation and industrial restructuring” and orienting dynamic market forces towards the “restoration of the export of technical and scientific potential of the Russian industry”. The purpose was to form a new system of industrial investment and integrated structures, capable of self-development in a market environment. A framework of preferential conditions, tax privileges, and state guarantees, was initially set up to boost the creation of those groups whose investment projects and economic programs met objectives and priorities of the socio-economic policy.²⁹

The original plan foresaw the creation of FIGs as vertically and horizontally integrated institutions, linking a number of industrial, trade and service structures with, generally, a bank at its core to guarantee the financial stability of the group and attract potential investors. Thanks to this structure, FIGs would then produce virtuous economies of scale, pooling resources together to implement joint research and development investment, and to upgrade the technological assets of individual enterprises.³⁰

²⁷ A. Seleznev (1997), “Bankovskaya sistema - yadro infrastruktury finansovogo rynka”, *Ekonomist*, n. 7, pp. 29-38

²⁸ V. V. Bolotin (1995), “Finansovo-Promyshlennye Gruppy: vozmozhnosti, realnost' i normativnost'”, *Finansy*, n. 7, pp.8-12

²⁹ The first piece of legislation on financial-industrial groups was in fact enacted only in December 1993 (Presidential decree no. 2096, 5.12.1993, “On the creation of Financial-Industrial Groups in the Russian Federation”), and it was then followed by the Government's Program (decree no. 48, 16.01.1995), the Federal Law on “Financial-Industrial Groups” (November 1995), and the Presidential Decree “On measures to stimulate the creation and the activity of Financial-Industrial Groups” (no. 433, 01.04.1996).

³⁰ Yu. Vinslav and E. Guskov (1996), “Faktozy i put' effektivnosti raboty otechstvennykh finansovo-promyshlennykh grup”, *Rossiiskii Ekonomicheskii Zhurnal*, n. 7, pp. 20-25

It was believed that the existence of large conglomerates would positively affect also macroeconomic stabilisation, slowing inflation by means of a voluntary price regulation, implemented through cartel agreements.³¹ FIGs would as well lower the risks for enterprise restructuring, by building up a portfolio of different business units, which would cope with shifts in competitive advantage and insure strategic planning.³² Product diversification would also soften the ups and downs of the economic cycle, by allowing swift capital transfers from a temporary stagnant sector to a more productive one.³³

Despite the original statist design, however, it soon became clear that the model of financial-industrial groups had also been adopted by default by the private sector, outside the government's official developmental framework. FIGs suited, for different reasons, the interests of both industrial enterprises and commercial banks. Strangled by the payments crisis and the lack of funds for structural investments and every day spending, enterprises hoped to find a preferential source of credit to foster their development or, at least, guarantee their survival.³⁴ Endangered by the increasing number of insolvent clients, banks hoped to exert a more effective control over enterprises, and guarantee their short- and medium- term investment.

A year after the law on financial-industrial groups had come into force a report of the Inter-ministerial Analytical Centre emphasised the success of spontaneous FIGs, which had indeed outnumbered the groups created by direct state intervention. Only five groups were registered in the first months of 1995.³⁵ By January 1996, the figure had reached 28. They consisted of 326 enterprises and 74 financial institutions, employing an average of 2 million people. The consolidated capital of these groups amounted to about 2 trillion roubles, while the annual volume of production was more than 3 trillion roubles.

³¹ I. Starodubrovskaya (1995), *Op. Cit.*

³² J. E. Prokop (1995) *Op. Cit.*

³³ Yu. Vinslav and E. Guskov (1996), *Op. Cit.*

³⁴ Starodubrovskaya differentiates between groups for development, "oriented to finding the most effective market strategy and exploiting the most profitable opportunities presented by the market environment", and groups for survival, aiming at "maximum isolation from the market by means of closed economic links within the group". I. Starodubrovskaya (1995), *Op. Cit.*

³⁵ S. Batchikov, Y. Petrov (1995), "Formirovanie FPG i Gosudarstvo", *Rossiiskii Ekonomicheskii Zhurnal*, no. 2, pp 3-10

A mere 10.2% of the FIGs members were state-owned enterprises. The sources of investment were 55.3% funds belonging to the group itself, 42.2% external funds attracted by the group's investment policy, and 2.5% funds coming from the central budget.³⁶ Ten more groups were reported to be operating without formal registration.³⁷ A total amount of 50 FIGs was estimated to be active throughout the Russian Federation.³⁸ Among these, the so-called bank-led FIGs, which had emerged when the large-scale accumulation of financial capital from the late 1980s had been injected into the 1992-93 process of voucher privatisation.

Even in the Soviet period trade, and especially foreign trade, had traditionally been considered a highly profitable activity. In the late 1980s access to foreign trade was monopolised, but internal prices failed to equalise quickly to world market prices, generating large financial capitals, which were successively put into circulation through a rapidly expanding banking and financial system. Cheap state credits issued in the face of rapidly rising inflation also contributed to the creation of this initial capital.³⁹

The patchy and contradictory legislation regulating financial activities made it easy to enter the banking system. The 1990 "war of banks" between the Soviet Gosbank and the Russian Central Bank (CBR), allowed, for example, a relaxation in the regulatory requirements of commercial banks, since both CBR and Gosbank tried to offer convenient deals to attract banks to register with them. About 750 banks were then created from the different branches of the Soviet specialised banks.⁴⁰

³⁶ Y. Vinslav (1996), "Rossiiskie FPG proidennyi put' i imperativy rosta", Rossiiskii Ekonomicheskii Zhurnal, n. 5-6, pp 29-39

³⁷ A. Kulikov, A. Svortsov (1997), "Mesto Finansovo-promyshlennykh grupp v ekonomike", Ekonomist n. 3, pp 53-59

³⁸ A. Seleznev (1997), "Bankovskaya sistema – yadro infrastruktury finansogo rynka", Ekonomist, n. 7, pp.32-38

³⁹ A. Aslund (1999), "Russia's Collapse", Foreign Affairs, September/October, pp. 64-77, and H. Schroder (1999), "El'tsin and the Oligarchs: the Role of Financial Groups in Russian Politics between 1993 and July 1998", Europe-Asia Studies, Vol. 51, No. 6, pp. 957-988

⁴⁰ J. Johnson (1996), "Banking in Russia. Shadows of the Past", Problems of Post-Communism, May/June, pp 49-59

Thanks to low interest rates and low capital requirements, commercial banks were set up also by industrial enterprises, (the so called “pocket banks”), with the purpose of providing preferential credits to the parent enterprise. When the liberalisation of banking activity started in 1989, state-owned industrial enterprises had a considerable amount of capital available, thanks to easy centralised credit. Enterprises became at the same time shareholders and clients of the new financial institutions.

With the liberalisation of prices, however, the consequent inflation, and the payment crisis in 1992, the relationship reversed. By performing currency operations, commercial banks had raised their profits and accumulated adequate resources for short and medium- term investment funds. Industrial enterprises became increasingly dependent on them. Affected by an unreliable payment system, the lack of market discipline, and bad debts, commercial banks “found themselves in a situation where they had to take final responsibility for the whole chain of debts between enterprises”.⁴¹

In 1993, and then in 1994 the CBR increased the minimum capital requirement for commercial banks and financial institutions, leading to a massive concentration of banking operations in a rather limited number of large banks. According to data published at the end of 1993, “only 6% of banks had capital exceeding 200 million roubles, in particular sixty banks had capital worth 1 to 5 billion roubles, nine banks over 5 billion roubles and only a handful of banks had 15 to 20 billion roubles”⁴².

When privatisation started in 1993, however, only few banks took an active role in it. The lack of opportunity to acquire a controlling block of shares and secure an influencing position on the enterprise’s policy deterred most of them. In a survey conducted in 1994 only 20% of the banks questioned revealed their intention to take part in the privatisation

⁴¹ E. Zhuravskaya (1995), “The first stage of banking reform in Russia is completed what lies ahead?”, in *Banking Reform in Central Europe and the Former Soviet Union*, edited by J. Rostowski., (Budapest: Central European University Press), pp. 166-182. (p. 170)

⁴² E. Zhuravskaya (1995), “The first stage of banking reform in Russia is completed what lies ahead?”, in *Banking Reform in Central Europe and the Former Soviet Union*, edited by J Rostowski., (Budapest: Central European University Press), pp. 166-182.

process, while the rest of them considered privatisation a not sufficiently attractive investment.⁴³

Yet, some banks acted from the very beginning with the clear intention of establishing their own industrial conglomerates. The major Moscow-based banks, such as MENATEP and Russian Credit, played the most active role.⁴⁴ As involuntary groups emerged around a large commercial bank, the most popular strategies to accumulate shares in the enterprises' business were threefold. A bank would buy enterprises' shares with the intent to re-sell them at a profit later, it would then grant investment credits to the enterprise, or it would buy shares of its debt. From this original nucleus gigantic FIGs developed.

During the voucher privatisation, banks did not seem to have a coherent strategy, as shares were bought almost indiscriminately, on the basis of the perception that assets were sold at underestimated prices, and the share prices would certainly increase at a later stage.⁴⁵ By the second stage of privatisation based on monetary rather than voucher investments, opportunities for banks to acquire the controlling block of enterprises' shares increased even further. Thanks to this process, banks with large cash resources and powerful political connections gained the opportunity to grow rapidly.⁴⁶ Six of the notorious "Big Seven" groups that went on to dominate Russian politics after the 1996 presidential elections, grew out of this model of involuntary financial-industrial groups, with a large commercial bank as the core of the operations (see table 4.2).

⁴³ L. Gorbatova (1995), *Op. Cit.*

⁴⁴ *Ibid.*

⁴⁵ L. Freinkman (1995), *Op. Cit.*

⁴⁶ A. K. Kuz'min (1995), "Rol' banka v protsesse formirovaniya i razvitiya Finansovo-Promyshlennykh Grupp", *Finansy*, no.1, pp 25-28

Table 4.2. The “Big Seven”

NAME OF THE GROUP	NAME OF THE LEADER	ORIGIN	CAPITAL (AT 1 JULY 1997), IN MN RB	KEY HOLDINGS	POLITICAL NETWORK
ALFA	Mikhail Fridman, Petr Aven	Trading company established in 1987. Connections with the Ministry of Foreign Economic Relations	9,891,903	Alfa Bank, Alfa Capital, Alfa Cement, part of consortium than owns 38% of ORT	Anatolii Chubais, Egor Gaidar
INKOMBANK	Vladimir Vinogradov	Bank established in 1988 to service Komsomol' commercial activities	22,232,134	Inkom capital, Samara Aluminium, controls 15% of the Russian confectionery market	Aleksandr Lebed
LOGOVAZ	Boris Berezovskii	First Russian car dealership established in 1989	Information not available	Avtovaz Bank, Obedinionnyi Bank, Sibneft oil, Aeroflot, ORT (8% and control over executives), Nezavisimaya Gazeta, Ogonyok	Pyotr Aven, Egor Gaidar, Aleksandr Korzhakov, Tatyana Dyachenko
MENATEP	Mikhail Khodorkovskii Aleksandr Zhubarov	1987 Youth Scientific Technical Creativity Centre in Frunze's Moscow district	12, 229,470	Alliance-Menatop Investment Bank, Trading Company, Yukos, Russkii Tekstil', ORT (part of a 38% shares consortium)	Oleg Soskovets, Aleksandr Korzhakov, Yurii Shafranik, Ruslan Khasbulatov

MOST	Vladimir Gusinskii, Boris Khat	Bank established in 1989 to finance restructuring office buildings business	11,013,431	Media Most, Most Investment, NTV (70%), Ekho-Moskvy (controlling packet), Segodnya, Obshchaya Gazeta, Itogi	Yurii Luzhkov, Egor Gaidar, Yavlinskii, Anatolii Chubais, Viktor Chenomyrdin
ONEKSIMBANK	Vladimir Potanin, Mikhail Prokhorov	Trading firm established in the 1990s on a USSR Ministry of Foreign Economic Relations \$10th loan	20,559,345	International Finance Corporation, Renaissance Capital, Norilsk Nickel (51%), Sidanko oil (81%), Szyazinvest (25%), Komsomol'ska ya Pravda, Izvestiya	Anatolii Chubais, Oleg Soskovets, Aleksandr Korzhakov
SBS-AGRO	Aleksandr Smolenskii	Party and Government financial resources	13,860,459	Finance Oil Company, ORT (38%), Kommersant's Daily, Kommersant's Weekly	Opposed to Chubais, supports conservative political forces

Source: D. N. Jensen (1998), "Russia's Financial Empires", <http://www.rferl.org/nca/special/rufinance/index.html>

Vladimir Potanin's Oneksimbank-Interros was one of the most typical informal financial-industrial groups. The group was established around Oneksimbank, heir of the Soviet Foreign Trade Bank, which expanded and diversified its financial interests during the monetary stage of privatisation. In June 1998 the bank was ranked third among Russian banks for net assets (23 138 860 thousand rubles), and third for capital stock (5 740 204 thousand rubles).⁴⁷

The group accounted for a total of \$10 billion, Oneksimbank and Mezhdunarodnaya Finansovaya Kompaniya (MFK), controlled Sidanko, Russia's fifth-largest oil company,

⁴⁷ "300 krupneishikh bankov Rossii", *Profil* n. 22 (102), June 15, 1998, special issue

Noril'skii Nikel' one of the country's biggest metals conglomerates and the world's largest producer of nickel, Svyazinvest, the communication giant, Permskiye Motory, and its subsidiary Aviadvigatel', one of Russia's biggest aircraft engine manufacturers, and three of the country's largest newspapers, Komsomol'skaya Pravda, Izvestiya, and Russkii Telegraf.

Each of these companies, in turn, was on the top of a pyramid of smaller enterprises, and had a complex management structure. The giant Noril'skii Nikel', for example, producer of 99.8% of Russia's platinum metals (40% of the total world output), included six enterprises and had an authorised capital exceeding 31 billion rubles.⁴⁸

In the shares for loans programme (detail on the programme below) Oneksimbank acquired 38% of the company's authorised capital, accounting for 51% of the voting stock, as collateral to a \$170 million credit to the federal authorities. The results of the auction were, however, challenged by the company's management in the first instance, and by the unsuccessful contenders in the second instance, causing one of the most bitter conflicts in the entire process of Russian privatisation.

Sidanko was a vertically integrated oil company, controlling a total of 2.19 billion tons of oil reserves.⁴⁹ This was another one of the companies that Oneksimbank acquired through the shares for loans scheme. On that occasion, the bank was accused of having prevented Russkii Kredit from taking part in the auction, firstly by impeding representatives of the competing bank from entering the building where the bids were being accepted, then by refusing the bank's offer.⁵⁰

Another characteristic of the financial-industrial groups that enhanced the political power of the oligarchs was the use they made of the media as an instrument to fight their campaigns, prompting concerns that a new form of censorship (the "big capital's

⁴⁸ *Nezavisimaya Gazeta*, Jan. 25, 1996, p. 4

⁴⁹ B: Arsen'yev, "Banki byutcy ob zaklad", *Kommersant*, n. 37, 1996, pp. 44-45

⁵⁰ *Segodnya*, December 6, 1995, p. 1

censorship”) would soon silence any dissent.⁵¹ Oneksimbank and Potanin were slower than others in understanding the importance of the media in the struggle for political influence, but the group recovered rapidly acquiring control of Komsomolskaya Pravda and Izvestiya, and founding in September 1997 Russkii Telegraf.

As opposite to Oneksimbank-Interros, Boris Berezovskii’s LogoVAZ did not develop from a bank. The conglomerate emerged around LogoVAZ, the car-dealing company established by Berezovskii in 1989, on the basis of an agreement he had struck with Togliatti AvtoVAZ plant director Vladimir Kadannikov. According to this agreement LogoVAZ would buy AvtoVAZ cars at internal subsidised prices, and would sell them on the internal Russian market at full market prices. LogoVAZ grew to become one of the leaders in the Russian car business, and in 1993 its turnover exceeded 250 million dollars. The business was so successful that after four years LogoVAZ accounted for more than 10% of AvtoVAZ Russian market.⁵²

The group included other valuable assets such as the TV channel ORT (Berezovskii controlled only a small fraction of its shares, but had influential relations with the TV station executives), the oil company Sibneft, Aeroflot, and the newspaper Nezavisimaya Gazeta. Connections between the different enterprises, however, were remarkably loose, and a co-ordinated policy between them was not evident. Moreover, Berezovskii’s business appeared more shaky and vulnerable than other conglomerates, as he did not own the controlling shares of many of the enterprises that were part of his empire. It was probably this instability that prompted Berezovskii to become the most politically active of the oligarchs, lobbying for political favours and involving himself in backroom conspiracies, necessary to consolidate his wealth.

⁵¹ “Today money is playing the role that used to be played by the CPSU Central Committee’s regional committees, and its propaganda department, and the myth of an independent press seems to be fading once again” (*Obshchaya Gazeta*, n. 15, April 17-23, 1997, p. 2). “The time of journalist romanticism in Russia has passed. [...] A covert bureaucratic coup has taken place in Russia. And the massive buying up of newspapers is the final stage of that coup. We have fumbled away not only freedom of the press, but freedom altogether. Russia is entering a new political era that is in some ways similar to the stagnation of the Brezhnev period. Everything will be decided by the interests of the financial-bureaucratic oligarchy”. (*Novaya Gazeta*, n. 15, Apr. 14-20, 1997, p. 4)

⁵² R. Wright et al. (1998), “Nine lives of Berezovsky”, *The European*, 25-31 May, pp. 8-12

More than for their real financial weight, however, the big seven gained renown as informal networks of alliances and political clans, which included not only prominent figures from industrial and financial structures, but also politicians, representatives of the media, and members of the security forces. The forming and dissolving of these alliances characterised political life under Yel'tsin's second presidency.

Oligarchic Politics

Members of the economic elite emerged as strong political actors in the mid-1990s, following a process of rapid capital accumulation. Thanks to previous connections with the structures of political power, leading business figures had acquired large financial resources through foreign currency speculation, foreign trade operations and banking activities. During the process of privatisation, financial capital was invested in industrial enterprises, giving rise to financial-industrial groups.

The relative wealth of these groups and the weakness of the presidential structure emerged under Yel'tsin allowed prominent economic leaders to infiltrate the state apparatus and establish an oligarchic system. Under this oligarchic regime the power and prestige of financial figures was defined by the property they owned. A struggle for ownership, fought through legal and illegal means, rather than investment in productive activities became the distinguishing feature of the Russian business elite.

A number of attempts at providing institutional representation to economic interests were made already in the early 1990s, with the creation of business associations first, and later through parties like Kostantin Borovoi's Party of Economic Freedom or Arkadii Volskii's Civic Union.⁵³ The establishment, during the 1995 Duma elections, of Our Home is Russia

⁵³ P. Rutland (1992), *Business Elites and Russian Economic Policy*, (London: Royal Institute of International Affairs); on the position and role of Civic Union, J. Lester (1995), *Modern Tsars and Princes. The Struggle for Hegemony in Russia*, (London: Verso), chapter 5, and M. McFaul (1993) "Russian Centrism and Revolutionary Transitions", *Post-Soviet Affairs*, Vol. 9, n. 3, pp. 196-222

(OHR) provided the privatised state-sector and, in particular, the raw-materials complex, an opportunity to defend their sectoral interests in areas such as the extraction and redistribution of natural resources.⁵⁴ Divergence of interest with those sectors, however, and their relative position of strength convinced the oligarchs to by-pass parliamentary representation and aim directly at the presidential administration. This move reflected also the shift in the balance of power that had followed the introduction of the 1993 Constitution.

After the power struggle with the Supreme Soviet, the President had become head of State, chief of the armed forces, and head of the Security Council. Yel'tsin was now directly responsible for the internal as well as the foreign policy of the country. He appointed the Prime Minister, the Vice Prime Ministers and other ministers suggested by the Prime Minister, the Chairman of the Central Bank, the General Prosecutor, members of the Constitutional Court, the Supreme Court, and the Court of Arbitration. He was personally in charge of the strategic ministries (Defence, Internal and Foreign Affairs). He could rule by decree, and in certain areas of decision-making considered the President's exclusive domain, the Parliament's checking authority was severely restricted.⁵⁵

The economic elite had obviously sensed the change of direction. Already in a 1993 survey of Moscow entrepreneurs, 53% of the respondents admitted that for the defence of their interests they preferred to lobby the Presidential Central apparatus rather than the members of parliament.⁵⁶ While the presidential structures were not accessible to the majority of the entrepreneurs, from the summer of 1995, however, their doors opened to a conspicuous circle of bankers and financiers.

It was the disastrous condition of the state budget, the immediate need for it to be replenished with fresh cash flows, and the relative power of the big banks that gave the oligarchs-to-be the opportunity to enter the presidential circle. Already in August 1995 the

⁵⁴ *Moskovskie Novosti*, n. 50, July 23-30, 1995, p. 6

⁵⁵ For a review of the Russian presidentialism S. White, (1997), "Russia: Presidential Leadership under Yeltsin", in *Postcommunist Presidents*, edited by R. Taras (Cambridge: CUP), pp. 38-66

money-based privatisation displayed signs of its substantial failure. Only 5% of the properties planned for sale by the end of the year had actually been purchased. Lagging behind with the payment of wages and salaries, the government signalled its readiness to strike a deal with the banking elite.

With the shares for loan scheme a group of powerful entrepreneurs gained a distinctive image in Russian politics, appearing as a more or less cohesive syndicate, able to deal with the state structures on an equal footing. The bankers were no longer a lobby alongside other sectoral lobbies; they were in the unique position of proposing a business agreement to the state institutions, negotiating it, and profiting from it.

“Big capital” had already made its first public political appearance on the eve of the 1995 parliamentary election, when an alliance including LogoVAZ, Gazprom, Mikrofin, MENATEP bank, National Credit, Alfa Bank, Imperial Bank, and the Capital City Savings Bank had called for the elections to be postponed. It was maintained that, in a situation of heated controversy, where political struggle could provoke a “cataclysm”, electoral competition needed to be scaled down.. To guarantee social and political stability big business representatives wanted the electoral contest to take place only after the privatisation of the large state enterprises, the redistribution of property, and the consolidation of a middle class had been accomplished.⁵⁷

As one of its representatives explained, the authority of the group derived from their economic wealth, in the name of which they were reclaiming their rightful political status.

“[The “big eight” league] ...includes the structures that are the most influential in terms of many parameters and that [...] recognise each other as leaders of the business world. [...] We certainly think alike on many

⁵⁶ A. Zudin (1996), “Rossiya: biznes i politika”, *Mirovaya Ekonomika i Mezhdunarodniye Otnosheniya*, n. 4, pp. 17- 27

⁵⁷ *Kommersant-Daily*, March 14, 1995, p. 3. Aleksander Smolenskii, President of the Capital City Savings Bank, remarked: “From the time of the first Congress of USSR People's Deputies [in 1989] to the present day, I have seen the quality of our parliamentarians diminish. I think fearfully: What are we going to elect for ourselves at the end of the year? [...] I am deeply convinced that if a new corps of Deputies comes in, there will just be another division of the spoils. We won't survive that...” *Moskovskiye Novosti*, No. 19, March 19-26, 1995, p. 4

questions, because we have common class interests and, by definition, cannot have serious political disagreements. Before, we were not sufficiently aware of what we had in common – there simply was no time to think about that – but now we have all become a little more aware and have started being more tolerant toward one another and trying to take some joint actions.”⁵⁸

The proposal for the shares for loans scheme came into the debate on how to realise the money-based stage of privatisation. The problem was to reconcile two divergent sets of priorities voiced within the government. On the one side, the function-based ministries favoured an approach focused on the enterprises, aiming at attracting private investment, to restructure the enterprises’ debts, and to promote efficiency in production. On the other side, the economic-branch departments promoted an approach, which aimed to produce substantial revenues for the state budget to be used to settle the pensions and wages arrears.⁵⁹

The approval of the shares for loans meant the prevalence of the budget-oriented approach. The Consortium of seven banks that proposed the deal emphasised that a number of large and potentially rich companies could hardly be sold, given the underdevelopment of the Russian financial market, and the poor financial state of the companies themselves. Putting the state’s block of shares from these enterprises into a trust with the consortium was to be the solution to square the circle. The banks would provide credit to the state budget while, at the same time, they would restructure the enterprises to sell them later to strategic investors.⁶⁰

The plan spurred immediate controversies. Neither the number of the banks actually taking part in the project, nor the amount of credit to be provided to the budget was clarified at an initial stage.⁶¹ An early figure of 9 billion rubles was mentioned, but it later slipped into a

⁵⁸ *Obshchaya Gazeta* No. 12, March 23-29, 1995, p. 8.

⁵⁹ *Segodnya*, March 31, 1995, p. 1.

⁶⁰ *Segodnya*, March 31, 1995, p. 1.

⁶¹ Avtovaz bank was the eighth bank to join in, so the final list included: AvtoVAZ Bank, Alfa-Bank, Menatep, MFK, Oneksimbank, Renaissance, Rossiiskii Kredit, and Stolichnii Savings Bank. After participating in the first stages of the negotiations over the agreement, Imperial and Inkombank withdrew from the project. *Moscow News*, n. 36, Sept. 15-21, 1995, p. 9

vague “several trillion rubles”.⁶² After the agreement came into effect, unofficial sources quoted figures between \$800 million and \$1 billion, while Alfred Kokh, Chairman of the State Property Committee estimated a total of 3 billion rubles.⁶³

Critics also contested that the banks could not possibly have enough money to finance the plan. It was calculated that the total assets of Oneksimbank, Inkombank, Menatep and the Capital City Savings Bank barely reached 45-50 trillion rubles, but the proportion of liquid assets in that sum was significantly smaller. The possibility that, in the short-term the banks could induce substantial changes in the structure of their assets to make sure they would be able to provide the agreed credits looked improbable.⁶⁴ It was instead considered more likely that the scheme would be used to legalise cases of spontaneous privatisation: the enterprises would put into circulation part of their unreported profits, channelling the money through the banks and receiving, in return, the right to manage the shadowy resources.⁶⁵

The banks were denounced for trying to set up a conveniently competition-free environment, where they would be able to seize ownership of the country's most prestigious companies at discount prizes.⁶⁶ But most of all there were allegations that the relationship between the banks and the government would inevitably change from an “amorphous co-operation without hard and fast rules to an extremely formalised co-operation: political and economic loyalty in exchange for priority access to blue chips”.⁶⁷ Observers wittingly equated the consortium to a “Ministry of Banks”.⁶⁸

The scheme envisaged two long-term stages. In the first stage, the State Property Committee would select a list of state enterprises to be proposed as collateral to the banks'

⁶² *Segodnya*, April 4, 1995, p. 1

⁶³ *Moscow News*, n. 36, September 15-21, 1995, p. 9

⁶⁴ *Segodnya*, April 4, 1995, p. 11

⁶⁵ *Segodnya*, May 18, 1995, p. 1

⁶⁶ *Segodnya*, April 4, 1995, p. 11

⁶⁷ *Kommersant'-Daily*, March 31, 1995, p. 1

⁶⁸ The Consortium declared its objectives as: (1) co-ordinating contacts between the bankers and state agencies; (2) settling disputes among the founding banks; and (3) mediating between the state and structures that have not joined the consortium. *Kommersant'-Daily*, April 5, 1995, p. 5.

loan. Then the consortium would invite tenders for the right to participate in the fiduciary management of the companies' shares. Tenders indicating the amount of credit the banks were willing to provide would be submitted both by consortium members and by non-members. Conditions of the loan would be negotiated separately in each case, although a framework agreement would be concluded on general terms for the management of the shares transferred to the consortium.⁶⁹

Upon the expiration of the credit terms, on 1 September 1996, the state and the banks would arrange for the competitive sale of the shares, which would be open, also to foreigners. The banks that had managed in trust the packets of shares could not take part in the bids. Yet, if the banks had managed successfully the enterprise, and had increased its initial value, they were entitled to collect 30% of the difference between the basic price of stock and the final price of it.⁷⁰ Between the first and the second term of the shares for loan scheme, however, the 1996 presidential elections intervened, changing remarkably the Russian political landscape.

In the well-known letter "Get out of the *empasse*" addressed to the two presidential contenders, thirteen oligarchs expressed their concern that the "ideologisation" of the electoral campaign could open an irremediable divide in society. Taking a "patriotic" stance, they launched an appeal to all the forces involved in the campaign for a political compromise, to avoid the risk of conflict threatening the interests and the very existence of the country. The primary fear was that a communist victory could spur an "ideological revenge", and induce changes that would be "final and vitally important" for the whole society.⁷¹

At the international economic Forum in Davos seven bankers and energy industrialists, headed by Boris Berezovskii, promised to offer their financial and media services to

⁶⁹ *Kommersant'-Daily*, April 5, 1995, p. 5

⁷⁰ *Moscow News*, n. 26, July 7-13, 1996, p. 9

⁷¹ *Kommersant'-Daily*, April 27, 1996, p. 1.

Yel'tsin.⁷² After the electoral victory had been secured most of them were duly compensated. Vladimir Potanin was appointed Economic Minister, and Boris Berezovskii first deputy secretary of the Security Council. According to journalistic reports, Vladimir Gusinskii was granted a personal conversation with the President, in which the composition of the first post-electoral government was discussed. The Minister of Defence Igor Radionov held consultations with some commercial banks before drafting a plan to restructure the Army, and Prime Minister Viktor Chernomyrdin appealed to representatives of the largest banks to buy 15 billion rubles worth of state obligations.⁷³ Yet, most importantly, the consolidated group of oligarchs was in the position of insiders when the terms of the shares for loan arrangement expired.

What followed was an internecine struggle for the control of the Russian blue chips, Noril'sk Nickel, Rosprom, Svyazinvest. The battle was fought through legal and illegal instruments, openly in the media or in backroom plots involving all the key figures of the political and economic clans. The scandal over the Svyazinvest privatisation, in September 1997, was probably the most clamorous one and it eventually broke the unsteady equilibrium set by the "Davos pact".

Not only the bankers, who the year before had arranged a truce to guarantee President Yel'tsin's re-election, sided again one against the other. But also, the silent agreement between the bankers and the reformist wing in the government was shattered by accusations of illegal deals in support of the privatisation bid by Oneksimbank, Interrosbank and Deutsche Bank group against the Alfa Group, Telefonica de Espana, Credit Swiss First Boston, LogoVAZ alliance.

In the media war that ensued, deputy prime minister Anatolii Chubais, who had endorsed the deal, was characterised as an "authoritarian and unscrupulous politician", who "belongs to a very dangerous category - that of the cynical fanatic". An article signed by

⁷² The "big seven", uniting in what has come to be known as the "Davos Pact", included: Boris Berezovskii, Vladimir Potanin, Vladimir Gusinskii, Mikhail Khodorkovsky, Petr Aven, Rem Vyakhirev, and Vagit Alekperov.

Berezovskii, accused Chubais of deliberately strengthening an oligarchic tendency rather than promoting a democratic development, creating a “superoligarchy”, a *de facto* “gentle dictatorship”.⁷⁴

The scandals, which closed the first stage of relations between the presidency and the economic elite, gave Yel'tsin the opportunity to curb the political influence of the oligarchs. Feeling that the financial situation of the country had stabilised, the reforms were proceeding steadily, and the credibility of the country had been endorsed by Russia's acceptance in the Paris Club, Yel'tsin decided that the government was no more in need of the bankers' support. In an address to the Council of the Federation the President warned:

“The state will not tolerate any attempt to influence [the political course] on the part of representatives of business and banks. They have to serve society, and act for the good of the Russians”.⁷⁵

The tense political climate of the years between 1995-1998, the corruption of business power and its rapacious attitude towards ownership gave Russia's neighbours a flavour of the business style that the oligarchs might be willing to export to their neighbouring countries.

The Foreign Policy of Russian Business

Having acquired a degree of political representation within the domestic institutions, economic agents aimed at gaining access also to foreign policy-making. Engaged in an expansion on foreign markets, Russian companies developed distinctive and at times contrasting foreign policy agendas, which often conflicted also with the definition of national interest promoted by foreign policy institutions. Russian business' bid to gain institutional support on foreign markets was facilitated by the high degree of permeability of the Russian foreign policy machinery. Fluidity in post-Soviet institutions and a state of

⁷³ Ya. Skvortsov (1997), “Politicheskii kapital vykhodit na chistuyu pribyl'”, *Kommersant*, n. 9, March 11, 1997, pp. 17-18.

⁷⁴ *Nezavisimaya Gazeta*, Sept. 13, 1997, pp 1,6

⁷⁵ S. Viktorov (1997), “Kapital za bortom”, *Kommersant*, n. 35 (241), Sept. 30, 1997, pp. 11.14

“anarchy” in the foreign policy-making process made the system easily accessible, generating situations in which “several foreign policies” were conducted at the same time.⁷⁶

The gradual erosion of the state’s authority, in a context in which market mechanisms and business representation were poorly regulated, failed to give full and equal expression to individual interests. Corporate interests prospered, often turning the state’s policies to their private benefit.⁷⁷ Under Yel’tsin’s presidency, figures like Gennadii Burbulis, Mikhail Poltoranin, Aleksandr Korzhakov, and, at a later stage, Boris Berezovskii (and with them the set of alternative policy preferences they supported) gained large but ephemeral political powers. “Owing to their close association with the president some of them [acquired] a significance in society in general and foreign affairs that [was] incommensurate with their human dimension”.⁷⁸

A striking concentration of powers in the hands of the President was matched by fragmentation and rivalry among other foreign policy agencies. In the dim-light of the presidential authority, the various institutions involved in foreign policy (for a summary of their powers and activities see table 4.3) were often engaged in “a fierce and at times violent political struggle”.⁷⁹ Their roles were defined more by the balance of power prevailing at the moment than by a set of codified rules. Shifts of power and alliances caused abrupt changes in the policy line and institutional hierarchies.⁸⁰

⁷⁶ N. A. Simonia (1995), “Priorities of Russia’s Foreign Policy and the Way it Works”, in *The Making of Foreign Policy in Russia and the New States of Eurasia*, edited by A. Dawisha and K. Dawisha, (Armonk: M. E. Sharpe), pp. 17-41

⁷⁷ V. Sokolov, (1996) “Natsionalniye ekonomicheskkiye interesy: vyrabotka konsensusa”, *Mirovaya Ekonomika i mezhdunarodniye otnosheniya*, n. 3, pp. 5-18

⁷⁸ N. A. Simonia (1995), *Op. Cit.*

⁷⁹ N. Malcom, “Foreign Policy Making” (1996), in *Internal Factors in Russian Foreign Policy*, edited by N. Malcom et al., (Oxford: OUP), pp. 101-167

⁸⁰ Under Kozyrev, the Ministry of Foreign Affairs (MFA), which was, *de jure*, the institution in charge of implementing the policies designed by the President, was often overshadowed by the Security Council and its Secretary. The Foreign Ministry was itself shaken by ferocious inter-departmental struggles, prompting observers to comment that “what appears to be Russian policy is often either the result of *ad hoc* decision-making in response to the pressure of international events, or simply the free-lancing by various elements of the Russian bureaucracy”. Only Evgenii Primakov’s appointment in January 1996 resored credit and primacy to the MFA. S. Parish (1996), “Chaos in Foreign Policy Decision-Making”, *Transitions*, 17 May, pp. 30-33, p. 32

Table 4.3. Foreign Policy Institutions, 1994-1998

INSTITUTION	CHARACTERISTICS	FUNCTIONS
PRESIDENT	The presidential administration contained 1500 members, with several departments in charge of foreign policy	Negotiated and signed treaties, accredited foreign diplomats, appointed Russian diplomats after consultation with Federal Assembly and head of Security Council, appointed members of the cabinet without consulting the parliament. Regulated foreign policy issues by decree.
DUMA	Not officially involved in foreign policy making, had influence over foreign policy though foreign policy and defence policy committees	Ratified and denounced international treaties, approved the presidential appointment of ambassadors.
MINISTRY OF FOREIGN AFFAIRS	Overstaffed with Soviet era bureaucrats in Kozyrev time, prone to interdepartmental conflicts.	Officially responsible for implementing the policies set by the president. Co-ordinated and monitored work by other ministries, committees and departments to ensure a unified political line.
SECURITY COUNCIL	Established in 1992, on the model of the US National Security council. Most important members: President, Prime Minister, Council's Secretary. Ministers of Defence, Foreign Affairs and Interior are non-voting members.	Consultative body, made recommendations and proposals, and prepares decisions for the President on security matters that he would implement by decree. It covered internal and external security matters.
MINISTRY OF FOREIGN ECONOMIC RELATIONS	Established in February 1992	Supervised the remnants of the Soviet system of monopoly of Foreign Trade organisations, promoted exports, set tariffs and import controls, negotiated international trade agreements.

**MINISTRY OF RELATIONS
WITH CIS**

Established in 1994 after
having been a committee
within the government

Overlooked and co-ordinated
policy towards the CIS states

Sources: Richard Sakwa (1996), *Russian Politics and Society*, (London: Routledge, Second edition), pp. 281-285

The appointment of Evgenii Primakov as Foreign Minister in January 1996 marked a turning point in relations between foreign policy institutions and big business. Russian media branded Primakov a “moderate reformer” and a “pragmatist”, and economic circles hoped they could finally look at the Ministry of Foreign Affairs (MFA) as a supportive partner for their activities abroad.⁸¹ In an interview two months after his appointment, Primakov identified the creation of “more favourable conditions for economic development within our country” as one of Russian foreign policy top priorities.⁸²

The practice that followed, however, revealed the difficulty to reconcile the foreign policy preferences of big companies with the official foreign policy line. The multifirmity of potential economic subjects interested in foreign policy outcomes, and the discrepancy between private interests of individual companies and what were perceived to be Russian vital interests made the co-ordination of foreign policy agendas an almost impossible task. The result was a free-for-all strategy, in which the most powerful companies tended to set their own foreign policy agenda, irrespective of directions and instructions issued by foreign policy agencies.

Primakov was accused of resorting to Soviet-style policies using economic power as an instrument to achieve foreign policy aims, rather than foreign policy as an instrument to achieve economic power. The outcome was not only economically damaging, but also strategically embarrassing.⁸³ Gazprom Chairman, Rem Vyakhirev called “madness” the MFA directive that commercial agreements between Gazprom and Iran for the exploitation

⁸¹ *Izvestiya*, 15 May 1996, p. 6

⁸² *Izvestiya*, 6 March 1996, p. 3

⁸³ Energy diplomacy was used to try and deter Poland and the Czech Republic from joining NATO, but, contrary to expectations, the two countries succeeded in diversifying their supply sources, by switching to a

of South Caspian deposits were to be frozen until the United Nations sanctions towards Iran had been lifted.⁸⁴

While the number of companies with foreign policy interests was potentially large, only a few companies were in a position to play an effective role on the international arena. The economic wealth of the company, its ability to generate badly needed hard currency, and its consequential political connections were the main determinant of a company's foreign policy authority. Thus, the energy sector, which accounted for 45 % of total Russian exports, and had representatives well positioned in political circles, appeared in the mid-1990s as the main lobbyist in Russian foreign policy.

The individual policies of Lukoil and Gazprom were perceived to be part of official Russian policy towards foreign countries. While, on the other side, Lukoil and Gazprom were powerful enough to by-pass foreign policy institutions. The fact that Rem Vyakhirev, whom the Ukrainian press nicknamed "the Godfather of Gazprom", would accompany Prime Minister Chernomyrdin on his most important visits abroad was seen as a clear indicator of Gazprom's preferential position.⁸⁵ As for Lukoil, its economic power allowed it to conduct a foreign policy strategy at times in open contrast with the Foreign Ministry, lobbying directly with the Prime Minister and the President to be allowed to participate in foreign projects.⁸⁶

The common interest of energy companies was to promote international expansion, but geographical interests were widely different. As European markets were Gazprom's main areas of expansion, preserving good relations with Western Europe was on the top of Gazprom foreign policy agenda. A deterioration in relations between Russia and its

Norwegian oil provider. G. Sysoev and A. Shumilin (1997), "Ministerstvo Strannikh Del", *Kommersant*, n. 44 (250), 2 December, pp. 39-40

⁸⁴ Vyakhirev clarified that Gazprom would not comply with the Foreign Ministry decision. *RFE/RL Newswire*, 7 October 1997

⁸⁵ A. Eremenko (1998a), "Presidenty i Argumenty", *Zerkalo Nedelii*, N. 5 (174), 31 January

⁸⁶ In 1994-96 the Foreign Ministry forbade Russian companies from participating in projects for the excavation of the Caspian Sea basin until the legal status of the Caspian had been defined. Yakov Pappe (1997), "Neftyanaya i gazovaya diplomatiya Rossii", *Pro et Contra*, Vol. 2, Summer, pp. 55-72

Western partners and the extreme case of a Western embargo against Russia would cause an extraordinary damage to Gazprom exports.⁸⁷

Conversely, Lukoil was not interested in establishing a special relation with Western Europe, but was rather concerned to improve relations with the Baltic States, which represented 40 % of its market.⁸⁸ Both Gazprom and Lukoil shared interests in restoring good relations with Ukraine, Moldova and Belarus, where strategic oil refineries and gas pipelines were located. Gazprom was particularly active in promoting the establishment of a Union between Russia and Belarus.⁸⁹

After the energy sector, the arms trade was the industry in which the contradictions between Russian national interest and interests of the business companies appeared most striking. As foreign trade was the only means of support, the military-industrial complex was naturally oriented towards external markets.⁹⁰ Minatom (the Ministry for Atomic Energy), for example, was animated by an “ideology of export”, ready to sell abroad nuclear technologies and fuel services in order to obtain the hard currency needed to sustain and modernise its infrastructure.

Trade agreements were negotiated with China, Cuba, India and Iran for the construction or completion of nuclear power reactors and for the provision of training and fuel services. In 1995, a \$800 million contract was signed with the Atomic Energy Organisation of Iran to complete a nuclear reactor.⁹¹ The training of specialists and the provision of nuclear-fuel services included in the contract were offered to Iran without previous consultations with

⁸⁷ *Ibid.*

⁸⁸ *Ibid.*

⁸⁹ Upon the inauguration of works of the Belarusian stretch of the Yamal-Hamburg pipeline, Rem Vyakhirev praised Lukashenka for being the “leading integrator in the CIS”, and stressed the implications of the project, which would provide a “political link between Russia and Belarus”. *Jamestown Monitor*, 24 October 1996, see also A. Serov (1997), “Gazprom uber alles”, *Itogi*, 8 April, pp. 13-14

⁹⁰ While the only possible domestic buyer, the Ministry of Defence lacked resources to purchase new weaponry; it has been estimated that international arms trade financed more than 50 % of all weapons production by Russian enterprises. *Izvestiya*, September 19, 1996, p. 2

⁹¹ *Izvestiya*, April 8, 1998, p. 1

the MFA and stirred tension with the United States.⁹² Agreements between individual arms companies and China were equally disruptive, and inflicted a serious damage to Russian security interests.⁹³

The majority of Russian companies were pursuing a conventional program of expansion to foreign markets, aiming at increasing the export of their products abroad. But, in the second half of the 1990s, a small number of Russian economic actors became increasingly attracted by the opportunities offered by the upcoming privatisation of strategic assets in the former Soviet countries. Seeking to earn an insider position to influence the process of privatisation, Russian oligarchs tried to establish preferential relations with the presidential administrations of the neighbouring countries, acquiring an institutional basis from which to conduct their campaign.

In Ukraine, in particular, large-scale privatisation, which had been repeatedly delayed by the national parliament, was expected to begin towards the end of 1997, at the time when the Russian oligarchs had reached the peak of their political and economic power. The fact that the tactics experimented with during the Russian privatisation had proved

⁹² J. C. Baker (1997), "Non-Proliferation Incentives for Russia and Ukraine", *Adelphi Paper* 309, pp. 55-79. In July 1998 the Iranians tested successfully a medium range ballistic missile, the Shahab 3, considered capable of delivering nuclear warheads. According to Russian and American estimates, thanks to Russian nuclear co-operation, Iran could be in a position to produce its own bomb within 5-8 years. Consequently, Americans increased pressure on Moscow to freeze projects involving the transfer of dual-use technologies to Iran. (*Segodnya*, July 25, 1998, p. 3). This free-rider approach on the side of Russian arms companies has created tension with Washington on sale of military technology more than once. In July 1998 the US authorities compiled a blacklist of seven Russian companies considered responsible of transferring illegally missile technology to Iran, Libya, and South Korea. Imports of the seven companies to the US were prohibited, and American firms and American government agencies were barred from providing the Russian companies with financial or technological assistance. The accident raised the issue of imposing a firmer control on Russian companies trading in hot spot region, or facing the possibility of a prolonged friction with Washington, at a stage when Russia was in need of international loans. (*Izvestiya*, July 30, 1998, p. 1)

⁹³ In 1995, for example, the Sukhoi Special Design Bureau in Khabarovskii krai sold to China a license to produce the warplane SU 27. Damages were of a commercial as well as of a strategic nature. The agreement had not only meant the loss of a further \$1.2 billion worth of commission to Russian enterprises, and the rise of a potential competitor for the Russian aviation industry on the Asian market, but it also provided for additional weaponry to one of Russia's traditional military adversaries. Russian observers stressed the risks that the operation involved for Russian security. The Chinese military doctrine calls Russia an "unquestionable enemy" and a "belligerent force". More than 60 percent of Chinese combat-ready forces are intended to repel a threat from Russia. This notwithstanding, Russia has been active building up China's military power, by selling it new weaponry: four S-300 surface to air missile systems; a submarine originally ordered by the Russian navy, later unable to pay for it; 10 IL-76 military cargo planes; a number of T-80

successful for some, led to the belief that a vicious privatisation struggle might be in store also for Ukraine if Russian enterprises were allowed to dictate the rules.

The Oligarchs and Ukraine

In his capacity as first deputy secretary of the Security Council, and then executive secretary of the CIS, Boris Berezovskii presented himself as the official representative of Russian business abroad. Following a self-styled pragmatist policy, Berezovskii made business interests and “economic pacifism” the pillars of his foreign policy strategy. As Deputy Secretary of the Security Council he conducted ceaseless operations in Chechnya, finally negotiating a peace agreement.⁹⁴ His diplomatic skills, but most of all, the promise of credit and financial opportunities, managed to win over the natural distrust of the Chechen leadership.⁹⁵ In his attempt at proving that in the Russian business community laid the primary responsibility to secure internal stability, Berezovskii emphasised the link between the peace needs of the country and the interests of the economic elite.⁹⁶

Berezovskii’s pragmatism was welcomed with enthusiasm by the CIS heads of state, which put forward his candidature for the position of executive secretary of the CIS. Ukrainian commentators were positively impressed by the “inhuman energy” he had displayed in his express tour of the CIS.⁹⁷ Allegedly, Uzbekistan moved from a position of critical opposition to Russia, to a position of strategic partnership during the very Moscow summit in which Berezovskii was appointed. Convinced by Berezovskii’s proposals to promote economic co-operation, no more than a week later, in an official visit to the Russian capital, President Karimov offered Russian business a full packet of economic projects.⁹⁸

tanks. (*Kommersant*’-Daily, May 25, 1996, p.2 , *Kommersant*’ Daily, July 18, 1996, p. 2, *Nezavisimoe Voennoe Oboozrenie*, July 25, 1996, pp. 1-2)

⁹⁴ A. Grishkovets (1996a), “Berezovsky otkryl v Chechnye vtoroi front”, *Kommersant*, n. 42, November 12, , pp. 11-12

⁹⁵ *Moskovskie Novosti*, No. 47, Nov. 24-Dec. 1, 1996, p. 8.

⁹⁶ A. Grishovets (1996c), “Boris Berezovsky: ‘Nado zaplatit’! i nikuda ne denesh’cya’”, *Kommersant*’, n. 42, November 12, pp. 13-15

⁹⁷ V. Portnikov (1998), “Sig’or Truffal’dino”, *Zerkalo Nedelii*, n. 18-19, 7-15 May, pp.1, 4

⁹⁸ A. Pivovarov et al. “AOZT ‘Sodruzhestvo Nezavisimykh Gosudarstv’”, *Kommersant*’ Vlast’, n. 16-17 (268-269), May 12, 1998, pp. 24-25

According to more caustic observers, however, it was not Berezovskii's energy that had attracted favours within the top echelons of the CIS. His control of media outlets active also on the CIS territories, the approach of new presidential elections in the neighbouring countries, and his comment that "the CIS needs continuity of power" had most probably convinced the Commonwealth leaders of the advantages that Berezovskii would bring to the Eurasian space.⁹⁹ Leonid Kuchma hailed him as a "new type of politician" and an "intelligent man", while local observers commented that Berezovskii would seek in Ukraine what he had sought in Chechnya; "money, capital, property".¹⁰⁰ The quick success he had obtained with the Ukrainian president was seen as a sign that Berezovskii had already worked his way through the presidential circle and had found somebody close to the president who would lobby for his interests.¹⁰¹

As Executive Secretary of the Commonwealth of Independent States, Berezovskii vowed to bring economic pragmatism to Russian foreign policy. He professed the use of "economic pacifism" as an instrument to resolve conflicts and incomprehension within the CIS.¹⁰² Characterising his task as "building a real Commonwealth", Berezovskii confirmed that "private capital is the only force capable of consolidating the CIS".¹⁰³

"Representatives of private business know in depth the problems on the way of economic co-operation with the CIS countries, and know also the instruments for their solution".¹⁰⁴

A successive proposal of a debt relief scheme modelled on the Russian debt for shares program raised questions that Berezovskii was indeed planning to export to the CIS privatisation strategies that had poisoned the Russian process. The project was aimed at settling the \$8 billion energy debt of CIS countries towards Russia (of which \$2.7 billion from Ukraine, \$1.3 billion from Kazakhstan and \$500 million from Belarus). According to

⁹⁹ *Kommersant' Daily*, 30 April 1998

¹⁰⁰ V. Denisenko (1998), "Nakanune", *Kompan'yon*, n. 21, pp. 14-15

¹⁰¹ V. Portnikov (1998), "Sig'or Truffal'dino", *Zerkalo Nedelii*, n. 18-19, 7-15 May, pp.1, 4

¹⁰² A. Pivovarov et al. "AOZT (1998), 'Sodruzhestvo Nezavisimyykh Gosudarstv'", *Kommersant' Vlast'*, n. 16-17 (268-269), May 12, pp. 24-25

¹⁰³ *Kommersant'-Daily*, April 30, 1998, p. 1

¹⁰⁴ A. Ryagov, "SNG na Troikh", *Kommersant' Vlast'*, n. 15 (267), 28.04.1998, pp. 50-51

the plan, Russian banks would pay back to Russia the total amount of the foreign debt, receiving in exchange Russia's creditor rights to cash in the debt. Russian banks would thus acquire from the debtor countries industrial facilities and infrastructures considered more valuable than the actual debt.¹⁰⁵

While a number of Russian companies expressed interest in the programme, options were restricted by the fact that only Kyrgyzstan actively endorsed the debt-for-property scheme, and put forward a list of facilities it was willing to entrust to Russian banks.¹⁰⁶ A difficult balance between internal and external interests in the other countries and the explosion of the August crisis halted Berezovskii's belligerent plans.

The impending mass privatisation process and the nature of the assets that would pass from state to private property attracted the attention of the oligarchs to Ukraine. Gazprom was claiming gas fields in the Carpathian region, compression plants and gas pipelines. Sibirskii Aluminium offered to become a strategic partner of the Ukrainian aluminium complex, investing in local enterprises \$200 million, while hoping to acquire ownership of the Nikolaevsk aluminium combine.¹⁰⁷ Oneximbank expressed interest for Ukrtelekom, while Yukos and Lukoil were competing for the Lisichansk (Linos), and the Odessa oil refineries.¹⁰⁸ The space and aeronautical complexes in Kyiv and Dnipropetrovsk, and the export military productions in Dnipropetrovsk or Kharkiv figured among the most attractive investment opportunities on the privatisation agenda.

The fact that Ukrainian enterprises were at least three times cheaper than Russian enterprises, while having a similar rate of capital productivity led many to believe that Russian investors would be exceptionally active in the process.¹⁰⁹ Aware of the stir that the presence of Russian capital would cause in Ukraine, Vladimir Vinogradov of Inkombank tried to smooth difficulties. "We would like to be considered not as rivals in the struggle

¹⁰⁵ V. Bardin, K. Levin (1998), "Kak Berezovskiy potrysaet mir", *Kommersant' Vlast'*, n. 18 (270), pp. 17-19

¹⁰⁶ *Ibid.*

¹⁰⁷ *Nezavisimaya Gazeta*, 29 October 1998, p.5, *Kievskie Vedomosti*, 29 October 1998, p. 2

¹⁰⁸ *Kievskie Vedomosti*, 14 April 1998, p. 10

¹⁰⁹ K. Razumovskii (1998), "Bol'shaya privatizatsiya na Ukraine nachalas'", *Ekspert*, n. 14, pp. 68-69

for ownership on the Ukrainian territory, but as partners in the development of our countries.”¹¹⁰

Russian companies had already tried to enter the Ukrainian market, but with scarce success. Distrusting the Ukrainian nationalist leadership control over transformation and transportation facilities vital for its activity, Gazprom had traditionally aimed at acquiring the ownership of Ukrainian strategic assets. In 1995 it had put forward the names of fifteen enterprises, including ferrous alloy plants and gas storage and transportation facilities, claiming a 30-50% share as partial payment for Ukraine’s \$1.5 billion debt.¹¹¹ But Ukrainian nationalists’ preoccupation that the acquisition of Ukrainian assets by Russian investors would result in a loss of political independence had blocked the plan and made it difficult to implement any other related project.

The urgency of external financing for the state budget, however, and the increasing opposition of international lenders to cover the Ukrainian deficit, gave Russian companies the hope that the Ukrainian authorities would be more forthcoming this time. The “big privatisation” could become for Kyiv an opportunity to replenish their budget. Already \$600 million out of the \$11 billion projected 1998 budget income had been set to come from privatisation.¹¹² While it was estimated that Russian investors could bring to the Ukrainian economy a profit in the range of \$1 billion.¹¹³

The February 1998 ten-year Agreement on Economic Co-operation between Russia and Ukraine officially opened Ukrainian privatisation to Russian investors. In the meeting that accompanied the signature of the treaty Kuchma and Yel’tsin spoke in favour of Russian and Ukrainian businesses having free access to each other’s market, stepping up investment policies on a mutually beneficial basis and creating international financial and industrial groups. The fuel and energy complex, the space sector, nuclear power engineering,

¹¹⁰ O. Dnestryan, (1998), “Iskusstvo prodavat’sya”, Biznes, n. 14, p.5

¹¹¹ OMRI Daily Digest, 14 March 1995

¹¹² P. Aleksandrov (1998), “Leonid Kuchma is Pleased with Even Politically Suspect Investment”, Business in Russia, n. 87, March-April, pp. 46-49

¹¹³ Kievskie Vedomosti, 14 April 1998, p.10

electronics aircraft building, transport and agriculture were cited as the primary areas of co-operation.¹¹⁴

Significantly, Kuchma's visit to Moscow was preceded by talks in Kyiv with a delegation of Russian entrepreneurs, including Vladimir Gusinskii (Media-Most) and Mikhail Khodorkovskii (Yuksi), to discuss the investment opportunities in Ukraine.¹¹⁵ Among the issues on the table there was the possibility for Russian capital to participate in the privatisation of oil and gas enterprises in exchange of a guarantee of energy deliveries to Ukraine.¹¹⁶ In particular, Russian investors were promised the right to subscribe to the sale of 45% of the Linos oil refinery on condition that they would re-pay the enterprise's debts and regularly deliver no less than \$6 million tons of oil a year.¹¹⁷ Renewed opposition by the Verkhovna Rada, which had already blocked a November 1997 presidential decree allowing international tenders for a number of blue chip enterprises, led Russian observers' to believe that the agreement would never be implemented.¹¹⁸

Large-scale privatisation represented the first real opportunity for the penetration of Russian capital in Ukraine, because despite all the protests and concern expressed by the nationalists, Russian investment had been up to then barely significant. Trying to reassure those who accused him of having sold Ukraine to the Russians, President Kuchma produced a figure of \$150 million of Russian investment over a total of \$2 billion foreign direct investment since independence. "It is ridiculous to say that Russian capital will eat up Ukraine! There is not enough Russian capital even in Russia, even for Russia"- Kuchma exclaimed.¹¹⁹

¹¹⁴ Novie Izvestiya, 28 February 1998, pp.1-2

¹¹⁵ RFE/RL Newslines 25 February 1998

¹¹⁶ Kommersant' Daily, 28 February 1998, p. 2

¹¹⁷ P. Aleksandrov (1998), "Leonid Kuchma is Pleased with Even Politically Suspect Investment", Business in Russia, n. 87, March-April, pp. 46-49

¹¹⁸ Kommersant' Daily, 28 February 1998, p. 2. The Russian academic Arkadii Moshes defines the 1998 Treaty of Economic Co-operation as "a rather empty document, a political declaration, which requires a lot of additional agreements in at least 14 fields, according to the text to become a really comprehensive legal base of bilateral relations". A. Moshes (1999), "Ukraine and Russia: A Chronic Crisis", in *Between Russia and the West: Foreign and Security Policy in Independent Ukraine*, edited by K. R. Spillmann, (Bern: Peter Lang), p. 264).

Official statistics painted an even grimmer picture. In 1997 the total amount of investment from the CIS and the Baltic States in Ukraine was \$67.7 million, 40% less than in 1996.¹²⁰ Investment from Russia had remained constant through the years since 1995, with an exceptional rise in 1996 when a \$2 billion capital flow (invested primarily in bonds) was registered in association with the uncertainty of the Russian presidential elections.¹²¹ In 1994 and 1995 the proportion of Russian investment to Ukraine had been only 4 and 5% of the total (against 20 and 22% of the US and 21 and 17% of Germany). This figure was below the share of investment from Cyprus (6% and 5%), where Ukrainian and Russian illegal capital was often laundered.¹²²

Admittedly, the data above do not provide the full picture of Russian investment in Ukraine for the period under investigation, as a number of Russian businesses were involved in the neighbouring country through affiliated resident companies or puppet companies legally registered in the West. The practice allowed Russians to by-pass Ukrainian regulation, which, for example, restricted some type of business – as gas supply – only to Ukrainian residents. Also, the Western flag afforded Russian business an aura of credibility and prestige that made it more palatable to independence conscious Ukrainians.¹²³

Participation in a Ukrainian bank, or the opening of a branch in Ukraine was key in the Russian banks' strategy of expansion. According to figures published in 1997, out of the 200 commercial banks operating at the time in Ukraine, six were representatives of Russian banks (Onexsimbank, Rossiiskii Kredit, National Reserve Bank, Inkombank, Kreditimpeks, and Mezhhkombank).¹²⁴ Twelve Ukrainian banks registered the participation of Russian capital; among these Lukoil Imperial Bank, active in Bank Ukraina, the agricultural sector

¹¹⁹ *Fakty*, 4 March 1998

¹²⁰ A. Eremenko (1998b), "Ukrainskie investitsii v Rossii: legche naiti chernuyu koshku v temnoi komnate", *Zerkalo Nedeli*, n. 13, 28 March, p. 9

¹²¹ *OMRI Daily Digest*, 8 July 1996

¹²² B. Gubskii (1998), "Investitsionnie gorizonty ukrainskoi ekonomiki", *Zerkalo Nedeli*, n. 6, 7 February, p. 8

¹²³ P. Aleksandrov (1998), *Op. Cit.*

¹²⁴ V. Kobzar (1997), "Pervie shagi rossiskikh bankov v Ukraine", *Mirovaya ekonomika i mezhdunarodnie otnosheniya*, pp. 134-138

authorised bank, and Oneksimbank, which had become a shareholder to save the Ukrainian Yuneks Bank from bankruptcy.¹²⁵

Russian banks were engaged in the trade of the \$1.4 billion government obligation issued in 1995 by the Ukrainian Ministry of Finance to cover the energy debt with Gazprom. The largest investor in the sector was the National Reserve Bank, which owned a \$850 million packet.¹²⁶ In addition to that, Russian banks in Ukraine performed the role of intermediary between enterprises across the border, especially in the metal and aviation-building sector, served Russian enterprises involved in projected transnational financial-industrial groups, and functioned as clearing-houses for bilateral trade.¹²⁷

Alongside banks, Russian brokering houses (such as Alfa Capital) had made their appearance in Ukraine, issuing and circulating securities on the Ukrainian stock market, and working on corporate and state securities on the secondary market. Capitalising on their experience in Russian privatisation, Russian brokering houses were actively involved in the Ukrainian privatisation process, buying shares at auctions and investment tenders. Russian investors in Ukraine displayed a considerable interest in short-term speculative activities, trading in state bonds (OVSGZ), treasury bills, eurobonds, and trade equities. In 1997 the Ukrainian stock market generated profits in the range of 62% of the initial investment, raising expectations that after the Russian boom (the Russian market provided in 1997 120% profits on the initial investment), Ukraine would be the “next Russia”. The small size of the Ukrainian market and its low level of liquidity, however, proved a distinctive obstacle to this expansion.¹²⁸

So much activity on the Russian side, however, was met by a more than cautious attitude in Ukraine. The Ukrainian reluctance to initiate the process of mass privatisation, the approaching of the presidential election, and the political uncertainty associated to it slowed

¹²⁵ Editor (1998), “Iz ‘Oneksima’ vozroditsya ‘Yuneks’”, *Kompan’yon*, n. 16, 16 April 1998, pp. 22-23

¹²⁶ Y. Korven (1998), “Fortochka na vostok”, *Biznes*, n. 6, 16 February, p. 23

¹²⁷ V. Kobzar (1997), “Pervie shagi rossiskikh bankov vUkraine”, *Mirovaya ekonomika i mezhdunarodnie otnosheniya*, pp. 134-138

¹²⁸ Mikhail Karpilovsky, Vice-president of Alfa Capital, interview with the author, Kyiv, 30 October 1998

down significantly Russian oligarchs' plans to expand in Ukraine. But what definitively froze any movement in this direction was the eruption of the 1998 financial crash.

The deterioration of the Asian crisis and fears that the financial instability would also infect Russia convinced President Yel'tsin and the oligarchs to seek again an accord. In an attempt to institutionalise their political rule in a "virtual second government", with the creation of a permanent council of experts for the president, the powerful economic actors granted their approval to Sergei Kirienko's cabinet, and promised to support the effort at economic stabilisation. Their pledge to refrain from "political games", however, was not sufficient to halt the wave of investor panic that on 17 August burst the bubble of the Russian economy.¹²⁹

The decision of the Russian government simultaneously to devalue the rouble, default on foreign debt and introduce capital controls imposed a suspension of activity on the financial market, a drop in the volume of transactions on the currency, inter-bank and security markets. Most Russian banks became illiquid, and especially those with foreign debts became unable to service them. While economic activity decreased rapidly inflation rose to 43% in the first weeks of September.¹³⁰

As a result of the crisis, a number of banks, among which Aleksand Smolenskii's SBS-Agro and Vladimir Vinogradov's Inkombank went bankrupt. Alfa Bank survived thanks to its limited involvement in the short-term security market, Potanin's Oneksimbank was forced to reduce its activities, while other groups like Gazprom and Lukoil considered a merge. Groups engaged in natural-resources extraction, like Menatep and LogoVAZ (Yuksi) were relatively unhurt.¹³¹

¹²⁹ *Nezavisimaya Gazeta*, 6 June 1998, p. 3, *Nezavisimaya Gazeta*, 18 June 1998, pp. 1,3, *Kommersant' Daily*, 20 June 1998, p. 1, A. Bagrov (1998), "Snova v stroyu", *Kommersant' Vlast'*, n. 22, 16 July 1998, pp. 28-29

¹³⁰ P. Hanson (1999), "The Russian Economic Crisis", *Europe-Asia Studies*, Vol. 51, n. 7, pp. 1141-1166

¹³¹ P. Rutland (1998) "How Russia is Ruled, 1998", *Radio Free Europe/Radio*, <http://www.rferl.org/nca/special/ruwhorules/index.html>

Strangled by a liquidity crisis Russian businesses in Ukraine were forced to downsize or to withdraw all together. Fears that Russian capital would buy up the Ukrainian economy subsided, while the drop in asset prices opened windows of opportunity to investors who had an interest in more long-term rather than speculative engagement. Russian and Ukrainian policy-makers had pointed to the transnational financial industrial group as an instrument to further bilateral co-operation. Could TFIGs provide a framework for mutually beneficial economic interaction?

Transnational FIGs

Plans to establish transnational financial-industrial groups (TFIGs) as an instrument to foster economic co-operation between Russia and Ukraine were largely unsuccessful. The slowness in overcoming the technical obstacles to the effective operation of the groups or the resistance to the idea of TFIGs can be interpreted as a further testimony of the lack of a widespread convergence of interests between economic actors in Russia and in Ukraine.

TFIGs were conceived as “locomotives of integration” in the former Soviet space, able to promote gradual economic integration, combining international co-operation and the concrete interests of banks and enterprises in the region.¹³² Within their framework, industrial enterprises were encouraged to re-establish Soviet-era industrial connections that would revitalise grassroot interest towards co-operation within the CIS. Members of the structure would represent an “industrial capital” independent from territorial location, naturally interested in setting up an optimal level of inter-sectoral, industrial and techno-scientific co-operation.¹³³ Their capacity to satisfy common economic necessities was viewed as an opportunity to counterbalance the rise of nationalism in the countries of the former Soviet Union and defuse ideological conflicts and incomprehension.

¹³² *Nezavisimaya Gazeta*, 27 August 1994, p. 1-2

¹³³ S. Golubeva (1996), “Transnatsionalizatsiya Rossiiskikh FPG”, *Rossiskii Ekonomicheskii Zhurnal*, n. 7, pp. 29-36

As with many other CIS agreements and projects, however, transnational groups were also affected by the same problems that multilateral interaction experienced in the post-Soviet arena. Firstly, a formal commitment to co-operation was often met by the difficulty to harmonise increasingly divergent national legislation and economic practices. Secondly, the particular activism of Russian enterprises and the relative weakness of their counterparts in the former Soviet space raised concerns among non-Russian actors that TFIGs would become an instrument to reassert Russian economic and eventually political supremacy over them.

The idea of TFIGs appeared for the first time in the December 1993 “Agreement for the Creation of an Economic Union”, in which the parties agreed to “promote the creation of joint transnational industrial entrepreneurial unions, and a net of commercial and credit-financial institutions and organisations”. To encourage the emergence of transnational structures, enterprises were promised breaks in export duties, taxes, and trade restrictions, and were guaranteed the right to open accounts in local banks.¹³⁴

In the 1994 agreement on “Intervention for the Creation and Development of Industrial Associations”, CIS members reaffirmed their commitment to this approach. They vowed to provide “support for the development of effective forms of industrial, techno-scientific, investment, insurance, commercial joint activities, and to co-ordinate their actions to support the establishment and the development of transnational associations”. In particular it was agreed to establish convenient conditions for:

- the co-operation of enterprises basing their activities on close technological ties,
- the specialisation and co-operation in production,
- the realisation of inter-state programs, industrial and economic projects,
- the creation of joint trade organisations aiming at the utmost development of direct trade-economic ties between economic subjects,

¹³⁴ For a collection of the documents that underpinned the development of transnational financial-industrial groups, Yu. B. Vinslav and S. S. Golubeva (ed.), *Reintegratsiya postsoyusnogo ekonomicheskogo prostranstva i stanovlenie transnatsional'nykh finansog-promyshlennykh grupp v Rossi*, (Moscow: REZh), Appendix 1, pp. 139-175

- the guarantee of effective credit-financial services of enterprises taking part in the transnational associations
- the issue and distribution of shares and other bonds belonging to the transnational associations,
- the participation in joint investment projects, the establishment of joint insurance companies.

Transnational associations would be established on the basis of inter-state agreements, or through spontaneous agreements between economic subjects. Yet, the fact that the group's activities were expected to be regulated by the legislation of the country where the association was located represented one of the most difficult obstacles for its effective operation. Groups were subjected to widespread variations in investment conditions and difficulties in co-ordinating their activity with the parent company, which, if located in a different country, would be exposed to different regulation.

Harmonisation in areas like tax, customs and financial legislation, reciprocal bank accounts and relations between banks and other financial and credit institutions, property, investment and profit sharing regulation was advocated as a means to speed up management bottlenecks.¹³⁵ Efforts made in this sense by the inter-factional groups in the Russian, Ukrainian, Belarusian and Kazakh parliaments since 1994 registered scarce success.¹³⁶

In a seminar held by the Commercial-Industrial Chambers of the Russian Federation, with the economic committee of the Economic Union and the Association of Russian FIGs, in the spring of 1997, representatives pointed out the lack of implementation of transnational groups. The existing tax systems, the payments crisis, the unstable social and political situation, the insufficient degree of preparation of cadres were blamed as the most

¹³⁵ Yu. Belaev (1997), "Finansovo-promyshlennykh grupp: opyt i problemy", *Finansy*, n. 5, p. 58

¹³⁶ Promoted in the Russian Duma by Nikolay Gonchar, at the time Chairman of the Council of the Federation's Budget and Finance Committee, the aim of the groups was to "bring about the economic reintegration of the countries of the former Soviet Union "from the bottom", by forming transnational FIG". The groups across the borders would therefore draft parallel laws on FIGs and get them enacted by their legislative bodies (*Nezavisimaya Gazeta* 7.10.1994, p. 1).

significant impediments to the establishment and development of transnational FIGs, which remained “at the stage of projects and good will agreements”.¹³⁷

In addition to the technical problems, transnational groups often experienced fierce hostility within hosting countries. Ukrainian observers were concerned that Russia would establish transnational groups under its auspices to renew “the tradition of colonial exploitation threatening national security”.¹³⁸ TFIGs would become a mechanism to exert Russian influence on other CIS countries through firm control over the neighbours’ economics sectors. The economic supremacy of Russian investors and the relative inexperience of their Ukrainian counterparts would inevitably create an unbalanced relation within the framework of the TFIGs.

Taking advantage of their weak and incomplete legislation, Russian enterprises would acquire the lion’s share of profits deriving from their joint activity. Russian capital would be able to dictate law in the division of labour between partner enterprises, diminishing Ukrainian companies to the role of providing cheap manpower, raw material, and semi-finished products. In the long-run this strategy would weaken Ukrainian companies’ competitiveness, restrict their access to the market, and exacerbate their economic dependence on Moscow.¹³⁹

The result of the combined effects of divergent legislation and nationalistic opposition to the TFIGs project meant that, despite the frequent statements by Commonwealth leaders on the creation of hundreds of groups, the practice saw very few examples of implementation. In the case of Russia and Ukraine, for example, press reports announced that in 1995 only, one hundred transnational FIGs would be established¹⁴⁰.

¹³⁷ Yu. Belaev (1997), “Finansovo-promyshlennykh grupp: opyt i problemy”, *Finansy*, n. 5, p. 58

¹³⁸ Oleg Soskin, Advisor to the President of Ukraine on economic issues, Director of the Institute of Society Transformation, , interview with the author, Kyiv, 27 November 1998

¹³⁹ V. Koval, (1996) “Problemi Stvorennia Finansovo-Promislovikh Grup v Ukraini”, *Ekonomika Ukrainy*, October, pp. 39-44

¹⁴⁰ *Ekonomicheskie Novosti Rossii i Sodruzhestva*, no.20, October 1995

Up to 1998, however, there was incontrovertible information regarding the activity of only one group, the Ukrtatneft financial industrial corporation established between Ukraine and Tatarstan to refine Tatar oil in the Keremenchuk oil refinery in Poltava.¹⁴¹ A number of other partnerships, however, like Mezhdunarodnie Aviamotory, responsible for the AN- 40 Russian-Ukrainian project, preferred to work under the juridical form of “associations”, avoiding the red tape that could arise from official registration.¹⁴²

As in the case of Russian financial industrial groups, there was a further possibility for the expansion of transnational FIGs. This would be attached to the emergence of spontaneous groups, born out of the acquisition of enterprises’ shares by a powerful bank (most probably a Russian bank). Both Inkombank and Alfa Capital were moving along that route.

Inkombank, which was technically a Ukrainian bank, with 100% of Russian capital, was engaged in a project to extend the number of subsidiary structures, especially in the agro-industrial sector, where Agroinkom and Inkomleasing were working. As a result of this strategy, Inkombank created a sort of very loose financial industrial group, without direct connections between the enterprises, and with the bank on top of the structure.¹⁴³

Alfa Capital, which was a subsidiary of Alfa Bank and Alfa Capital in Moscow, was similarly establishing an informal financial-industrial group, and already owned shares in pharmaceutical, gas and computer companies. As opposite to what happened to other groups, Alfa Capital encountered a more favourable environment for the creation of its TFIG after the August 1998 crisis.

Following the financial melt-down, the structure shifted from a brokerage service to a strategic partnership plan, promoting the development of the investment banking sector. Lower prices of Ukrainian enterprises convinced the management of the company to buy

¹⁴¹ OMRI Daily Digest, 12 July 1998

¹⁴² Ivan Byk, first vice Director of the State Economic Division, Ministry of Industrial Policy, interview with the author, Kyiv, 24 November 1998

shares. Yet, the short time frame of economic plans and the possibility that more convenient investment could arise, prompting the company to sell and “move on”, made Alfa Capital a particularly fluid and speculation-prone group.¹⁴⁴

Given the technical and ideological problems that state-led transnational financial industrial groups presented, especially in relation to Russia and Ukraine, bank-led spontaneous financial industrial groups seemed to provide the most likely opportunity for Russian investment in Ukraine. There were, however, two problems connected with them.

First, experience demonstrated that Russian companies establishing their TFIGs in Ukraine were primarily moved by speculative motives, aiming at maximising revenues in the shortest possible time, ready to leave the enterprises they had bought up if expectations of revenues fell. Investment strategies appeared therefore defined in a short-term frame, confirming the Ukrainian nationalists’ stereotype of Russian capital. Second, the expansion of these groups was inevitably dependent on the wealth and economic stability of the parent company. As the financial crash in the summer of 1998 demonstrated, a drop in liquidity and a climate of general uncertainty convinced most of the parent companies to quickly withdraw investments from Ukraine.

Conclusions

In this chapter I have provided a portrait of the Russian economic elite and its relation to political power. I have also identified the main foreign policy interests of the Russian economic elite and outlined their strategy of expansion in Ukraine. I have focused on a relatively small segment of the Russian economic elite: the oligarchs. The Russian economic elite was certainly a more widely diversified social group, with different and conflicting interests across sectoral and regional dimensions. Beyond the plans of expansion of the oligarchs in Ukraine, there were also examples of successful joint-

¹⁴³ Gennadii Trofimenko, Head of the Press-Services, Inkombank Ukraine, interview with the author, Kyiv 6 November 1998

¹⁴⁴ Mikhail Karpilovsky, interview with the author *Op. Cit.*

ventures between Russian and Ukrainian enterprises. Russian capital was certainly looked at as a life-saving investment opportunity in some areas and sectors in Ukraine.

There are, however, two reasons that make it worthwhile to concentrate on the activities of the Russian conglomerates. Firstly, the fact that the oligarchs had successfully worked their way into the corridors of political power in Moscow gave their strategies an institutional endorsement. Thanks to their connections to the government, Gazprom's interests were de facto identified with the national interest of Russia. When Boris Berezovskii travelled to the CIS in his capacity as executive secretary of the Commonwealth, he sought to establish relations and push through decisions that would benefit also his business interests.

Secondly, the scandals and the illegal practices that accompanied the second stage of Russian privatisation gave the oligarchs wide notoriety and made their strategies representative of the approach that the whole Russian business community would have adopted if allowed to penetrate the CIS markets. Russian capital in Ukraine was perceived as a speculative, short-term profit oriented business. The emphasis on ownership rather than long-term development became a major deterrent for Ukrainian entrepreneurs. The dirty tricks that had characterised the Russian privatisation, the pervasive corruption and the large-scale embezzlement that had enriched the Russian oligarchs raised fears that the same methods could be adopted in Ukraine had the Russian elite gained an insider position to control the whole process.

The primary concern of the just emerging Ukrainian economic elite, however, was that they would not be able to compete against the relatively large Russian financial empires. The aggressive business style of the Russian conglomerates, then, gave Ukrainian entrepreneurs the opportunity to justify their claims for protectionism as an instrument to defend the economic and political independence of the country. Fears of being dwarfed in and ejected from their own market prompted the Ukrainian elite to regroup in support of a strategy aimed at defending "national capital" as an instrument to preserve the country's newly acquired sovereignty.

CHAPTER FIVE

The Ukrainian Economic Elite

The increasing influence of the Russian oligarchs on their domestic arena, and plans to expand their power-base to neighbouring countries during the forthcoming process of privatisation were met in Ukraine by calls for the protection of the domestic market expressed through a nationalist rhetoric. With Ukrainian strategic assets, crucial for the development of Russian companies (pipelines and refineries) expected to be sold at prices significantly lower than in Russia, the approaching large-scale privatisation was viewed by Russian entrepreneurs as an unmissable opportunity. The fact that the Ukrainian presidency, under Leonid Kuchma, appeared to be more favourably inclined towards Russia than it had been under his predecessor, led the Russian oligarchs to believe that all the right conditions were in place to consolidate “economic co-operation” between Russia and Ukraine. There were, however, a number of factors that had not been taken into account.

The election of Leonid Kuchma to the Ukrainian presidency, in 1994, was read by many as a sign that aspirations towards increasingly close economic, and possibly political co-operation between Russia and Ukraine would find expression in the country’s foreign policy course. Kuchma was elected on a programme that rejected much of the Kravchuk era nationalism and instead proposed closer links to Russia and a restoration of the cultural pre-eminence of the Russian-speaking population of Ukraine. Instead, however, of a union with Moscow and expansion of economic links to the east, the first Kuchma presidency was characterised by the emergence and consolidation of a national economic elite, which acted to resist the penetration of external actors into key economic sectors.

In the period between 1994-1998, Kuchma and key business actors developed an ideology for the protection of the national economy encapsulated in the concept of ‘national

bourgeoisie'. Ukraine, it was maintained, could only develop through the creation of an indigenous class of property owners. This class would provide the foundations for the consolidation of national independence, promote democratisation and further stimulate economic growth. In this view, the national bourgeoisie would serve as the locomotive of development and would foster an improvement in living standards for the whole population.

Expectations of co-operation and economic integration between Russia and Ukraine, then, failed to materialise mainly because of the emergence of a more powerful idea of national economic development for Ukraine, which generated competing rather than convergent policy preferences between business actors in Ukraine and Russia. At the heart of this antagonism was the set of interests produced by the structure of economic liberalisation in both post-Soviet states. In both Russia and Ukraine, economic liberalisation created a business class with strong interests in ownership rather than production. Economic instability, an uncertain rule of law and the lack of significant investment capital channelled business actors toward rent seeking activity rather than production as a source of wealth generation.

By the mid-1990s liberalisation in Ukraine was at a far earlier stage than in Russia, while the country lacked the large business groups that dominated economic life in Moscow. Through Kuchma and with the rhetoric of fostering a national bourgeoisie, the Ukrainian business elite sought to consolidate its limited power, and to translate its relative economic wealth into political capital. Gradual and partial privatisation, coupled with the development of business practices strongly dependent on political favours, strengthened the position of a rent-seeking business elite, which made use of its proximity to political power to assure and expand its control over the national wealth.

With the 1998 parliamentary elections and the campaign preceding the 1999 presidential elections, the economic elite gained an opportunity to establish control over the economic policy-making process. This happened at a time when vital decisions relating to business

legislation and the relaxation of privatisation regulations were expected. Through Kuchma's first term in office, the presidential patronage network, which had emerged around a regional clan structure, evolved into a rudimentary party system. A more formalised regime of mutual support between business and the presidential apparatus was then established in the form of "holdings". An embryonic oligarchy had taken root, affecting also relations with Russia.

In this chapter I will examine the emergence of a Ukrainian economic elite, its closeness to the political power and its policy preferences towards Russia. I will start by analysing the emergence of an ideology of "national bourgeoisie" as the instrument to provide political legitimisation to a set of business actors close to the Kuchma administration. In the section on the political economy of reforms, I will look at how a diversification between business and politics never took place in Ukraine, and how a favourable relationship with political leaders helped economic actors to steer the direction of reforms.

In the following two sections, I will consider the evolution of relations between politics and business within the two main centres of policy-making, the Parliament and the Presidential Administration. In particular, I will argue that relations between the economic elite and the presidential administration consolidated through the formation of regional political-economic clans, president-sponsored parliamentary fractions, and finally, business "holdings". I will maintain that the Kuchma administration made use of administrative resources, for instance, the transfer of state-owned shares into private trusts, as an instrument of coalition and support building within economic circles. The energy sector will be presented as an example of this attitude.

Finally, I will discuss the spreading of a protectionist mood articulated in the nationalist vocabulary of the necessity to defend the "national capital". Preoccupations that a Russian economic expansion would wipe out of the market weaker Ukrainian business were stronger in sectors that felt particularly exposed. In the last section I will show how the lack of security from external competition made the banking and financial sector prone to

support the idea of “national capital”.

Kuchma and the Idea of a “National Bourgeoisie”

The 1994 presidential campaign was conducted by Leonid Kuchma in the name of economic pragmatism, and on a ticket of improved relations with Russia. Kuchma pledged that, in defining his policy towards Moscow, he would take into account the objective economic interests of industrial enterprises on both sides of the border, rather than the nationalistic stances that had informed his predecessor’s presidency. Representing the interests of those enterprise directors, whose business activities had been disrupted by the collapse of the Soviet common economic space, mainly located in the south-eastern regions of the country, Kuchma gave voice to their requests for co-ordinated trade, payment and economic policies between the two countries.

Despite Kuchma’s repeated dismissal of projects for a common Eurasian space or a Slavic Union together with Russia and Belarus, voters voted for him in anticipation of a rapprochement with Russia. Expectations were that a policy based on improved economic co-operation would eventually lead to an economic reintegration.¹ On these grounds, Kuchma received significant support also in Russian political circles. Indeed rumours circulated that Kuchma’s final electoral victory was secured thanks to financial help from the big Russian financial-industrial groups. In the wake of the privatisation of large Ukrainian strategic plants, representatives of the “Russian big capital” appeared only too eager to make sure that their projects for future expansion into Ukrainian markets would win a powerful ally in Kyiv’s political quarters.

Contrary to expectations, however, Kuchma’s first term in office was characterised by the emergence of an ideology centred on the concept of a ‘national bourgeoisie’ as the prime engine of political and economic change rather than integration. According to this view,

¹ The idea of establishing an economic union between Russia and Ukraine had been central of Kuchma’s electoral campaign. It was hoped that within an economic union Ukraine would obtain economic privileges, such as special prices for energy resources. *Nezavisimaya Gazeta*, July 12, 1994, p.1

privatisation, land reform, foreign trade and price liberalisation would initiate widespread economic growth. This would in turn generate an economic elite, a class of proprietors, personally interested in the course of reforms, in the progressive opening up of the economy, and in the preservation of the new status quo. A developmental economic elite would guarantee the stability of a democratic political system, and would set the preconditions for the emergence of a wealthier society altogether.²

In the rhetoric of the ‘national bourgeoisie’, entrepreneurs were presented by the president as part of a “new wave” (“*novaya volna*”): new political and business actors conscious of their social responsibility, and actively involved in economic activities for the common good of the country.

“Entrepreneurs are people who realise their connection with the country, who understand that fabulous profits sometimes are a loss for them, as they are a loss for the country. Earning money by pumping out blood from the country is stupid. What is more profitable now are revenues that are modest in speculative terms, but are rooted in the development of the enterprises, not in their fall.”³

Kuchma outlined also the responsibilities that the government had towards the entrepreneurial class.

“The government must give to the reforms a social direction, defending not only those who have little [...], but also all those who can create national wealth. The government must create jobs, give people the possibility to earn”.⁴

Approaching the end of his first term in office, Kuchma suggested that his economic policies were already showing signs of success. The process of reforms was indeed creating an open economy and the emerging class of entrepreneurs was playing an increasingly tangible role in the economic, political, and human development of the country.

² T. Kuzio (1999), *Ukraine: State and Nation-Building*, (London: Routledge), p. 26, and P. D’Anieri et al. (1999), *Politics and Society in Ukraine*, (Boulder, Colorado: Westview Series on the Post-Soviet Republics), p. 137

³ L. Kuchma (1999), *O samom glavnom*, (Kyiv: USPP), p. 145

“The middle class gathers social significance, a large layer of shareowners consolidates. On the basis of this changing social psychology economic freedom is indeed strengthening”.⁵

The idea of a developmental economic elite, charged with the responsibility for helping to establish and defend a liberal political and economic structure, was not new in political terms. The classical study of Barrington Moore on the causes of democracy draws a line of inevitable dependence between the development of democratic conditions and the emergence of a class which has a personal stake in the preservation of economic and political freedom. The equation ‘no bourgeoisie, no democracy’ has ever since been viewed by many as the secret of successful democratic transitions.⁶

Seymour Martin Lipset’s conclusion that “the more well-to-do a nation, the greater the chances are that it will sustain democracy” has important implications for the social engineering of post-authoritarian societies.⁷ As does Larry Diamond’s consideration that values such as “moderation, tolerance and democracy” are naturally embedded in the middle-class.⁸ The assumption underpinning these theories is that the bourgeoisie will invest in the political sphere the power they acquired in economic terms, automatically restraining the authority of the state and reducing the possibilities for authoritarian regimes to be re-established.

After the wave of military coups in the 1960s and 1970s, and the successive return to democracy in the 1980s and 1990s, Latin America became the traditional testing ground for this interpretation. Local economic elites were often exhorted to “assume the role of agent of national development with responsibility and vision”, and to “commit [themselves] to

⁴ *Ibid.*, p. 238

⁵ Uryadovyi Kur'er, November 22, 1998, pp. 1-4. I am grateful to Taras Kuzio for this reference.

⁶ B. Moore Jr. (1969), *The Social Origins of Dictatorship and Democracy: Lord and Peasants in the Making of the Modern World*, (Harmondsworth: Penguin), p. 418.

⁷ S. M. Lipset (1959), “Some Social Requisites of Democracy: Economic Development and Political Legitimacy”, *American Political Science Review*, March, p. 75

⁸ L. Diamond (1999), *Developing Democracy: Towards Consolidation*, (Baltimore: Johns Hopkins University Press)

the task of expanding the social basis of the economy, enlarging the market, generating more employment, and multiplying the wealth of the country”.⁹

In Ukraine, the concept of a developmental economic elite was supported with equal enthusiasm in different political circles. Even figures more normally critical of presidential activities went as far as advocating the establishment of nothing less than an oligarchic system. Blaming the then Ukrainian crisis on the lack of an oligarchy, a political commentator argued that in a transitional country an oligarchic structure presents the advantage of supplementing the incomplete institutions of civil society. Oligarchs can, for example, provide the parliament with a professional and civilised system of lobbying. In filling the gaps of civil society, oligarchy erects a barrier to the recurrence of totalitarian powers, as “the presence of numerous ambitions neutralises the rise of one individuality”.¹⁰

In more openly nationalistic quarters the appearance of an economic elite, defined by a “distinctive national character” and the “understanding of the country’s purposes” was hailed as an example of “positive nationalism”, as opposed to the cosmopolitan attitudes imposed by the Soviet state.¹¹ The emergence of an ideology of ‘national bourgeoisie’ was indeed instrumental in maintaining a relation of mutual dependence between political and economic actors, and was the result of two crucial circumstances. First, the need to provide social legitimisation to the emerging economic elites, and second, the need to sustain the strategic alliance concluded between the latter and the President in the wake of the 1999 presidential elections.

⁹ G. M. Rocha (1994), “Redefining the Role of the Bourgeoisie in Dependant Capitalist Development”, *Latin American Perspectives*, Vol. 80, n. 1, p. 72. On competing interpretations of the role of the economic elites in the process of democratisation in Latin America see also G. O'Donnell (1973), *Modernisation and Bureaucratic-Authoritarianism*, (Berkley: University of California Press); F. H. Cardoso (1986), “Entrepreneurs and the Transition Process: The Brazilian Case”, in *Transitions from Authoritarian Rule. Comparative Perspectives*, edited by G. O'Donnell et al. (Baltimore: The John Hopkins University Press,) pp. 137-153; and E. Bartell and L. Payne (Eds). (1995), *Business and Democracy in Latin America*, (Pittsburgh: University of Pittsburgh Press).

¹⁰ O. Dashko (1998), “Tak li strashen chert?”. *Kompanyon*, n. 32, pp. 11-15

¹¹ Oleg Soskin, Advisor to the President of Ukraine on economic issues, Director of the Institute of Society Transformation, interview with the author, Kyiv, 27 November 1998

In a country that still harboured a distinctive dose of suspicion towards private business, it seemed important to provide an official endorsement to an economic elite that was becoming increasingly visible and active also in the political arena. According to a 1997 survey conducted by the Democratic Initiative Foundation and the National Academy of Sciences, 49% of the 1800 people interviewed declared to have a rather negative attitude towards the privatisation of large enterprises, while 22% were still opposed to the privatisation of small enterprises. While 25% of respondents recognised that businessmen played a powerful role in shaping the Ukrainian state, more than 50% confessed some sort of distrust towards private entrepreneurs, and more than 53% expressed mistrust towards large state enterprise managers.¹²

The President of the Ukrainian Union of Industrialists and Entrepreneurs, and Prime Minister since 2001, Anatolii Kinakh, tried to present the business elite as the prime group responsible for an effective strategy of economic development and job-creation in the country. In the general context of popular disapproval towards powerful economic actors, Kinakh's words marked an important step towards the political legitimisation of the country's economic elite.

"In the course of structural reforms now under way in Ukraine, millions of people lose their jobs [...] a chance of creating new jobs for them is connected with the formation of a small and medium-sized business sector. [...] It is the small and medium sector that is the main foundation upon which the middle class is built, and the middle class is a guarantor of democracy and of the irreversible character of the market-oriented reforms".¹³

Political legitimisation in the form of an ideology of national bourgeoisie was also needed to sanction the tactical agreement concluded between the economic elites and the presidency. On the one side, the president gained in the new entrepreneurs a

¹² Democratic Initiative Foundation and National Academy of Sciences (1998), *Ukrainian Society 1994-1998*, mimeo

¹³ A. Shestakov (1998), "Ukraine Is To Be Developed By Ukrainians", *Welcome to Ukraine*, n. 1, pp. 30-31. This interview with Kinakh was published in a magazine destined for foreign investors whose primary aim was to support the idea that "Ukraine is committed to reforms, and the new – new for Ukraine – class of businessmen and entrepreneurs are all for reforms. These people are the force that can set Ukraine onto the course of steady economic development".

counterbalancing support against the *appartachiki* and the “red directors”, who had monopolised the agenda of reforms from independence to the adoption of the new Constitution in 1996. It was not accidental, indeed, that the inner circle around Kuchma consolidated in the year preceding the 1999 presidential elections (on this point more below). On the other side, however, with presidential support, the economic elite received an official endorsement to grow and prosper “for the good of the country”.

Inside observers confirmed that the idea of a national bourgeoisie originated from within the presidential administration, at the hands of a group of economic figures well aware that the political survival of President Kuchma was of vital importance for the preservation of their positions of power. The widespread preoccupation within this circle was that an abrupt change of the guard, and a possible return of the Communists to power, could endanger the gains they had made since 1994, and prejudice the chances to acquire the ownership of attractive business assets.¹⁴

Following a pattern of behaviour that has been wittily termed “the Vyakhirev syndrome”, members of the economic elite realised that vicinity to the loci of decision-making would guarantee them favourable results in business terms. Exemptions from the anti-monopoly legislation, privileged access to privatisation, budget subsidies, quotas and licences on the import-export of oil, gas, wheat, vodka, and tobacco would be awarded according to the balance of power established within the presidential patronage networks.¹⁵

The most tangible result of President Kuchma’s economic policies, thus, was not the creation of an economic elite, but its “*ierarkhizatsiya*”. The President’s intervention drew a distinction within the business elites, and placed on a hierarchy of influence those who were granted access to budget resources, those who enjoyed political connections, and those who were altogether banned from the circles of power.¹⁶

¹⁴ Aleksander Goncharenko, Chief Department of National and International Security, National Security and Defence Council of Ukraine interview with the author, Kyiv, 10 November 1998

¹⁵ Ivan Lozowy, Director of the Institute of Statehood and Democracy, interview with the author, Kyiv, 12 November 1998

¹⁶ Oleksandr Shnypko, Vice Chairman of the Ukrainian Union of Industrialists and Entrepreneurs, interview with the author, Kyiv, 1 December 1998

Critics argued that if the President had genuinely intended to establish a developmental middle class, whose personal interest would coincide with the country's interest, the first priority of the reforms should have been the creation of a stable and predictable economic environment. "Equally applied rules of economic activity", would have led, after a conspicuous length of time, to the consolidation of an economic elite distinguished from "the gamblers and the speculators".¹⁷

Instead the unstable, corrupted, and physically dangerous business climate in Ukraine appeared most unsuited for long-term investment. Small and medium business was pushed into the shadows, and forced to find a political *krysha* (protection) to resist a punitive tax system, unpredictable legislation and a corrupted administration. Western investors repeatedly signalled their uneasiness in committing resources under these conditions, and foreign donors often imposed conditionality on the release of financial aid requiring the introduction of guarantees for the stability of business regulations.¹⁸

Kuchma's advocates were quick to relieve him of any responsibility for the system of "clan capitalism, state capitalism, monopolistic capitalism" that had emerged during his first term. As the President could only give policy directions and intervene in the political arena by means of laws and decrees, the finger was pointed against the Cabinet of Ministers, which was still "what it used to be, Soviet, socialist, based on clans".¹⁹ According to this view, the split between the President's '*zhelanie*' (will), and the actual power of the Cabinet

¹⁷ Igor Burakovskii Associate Professor, Department of Economic Theory, Kyiv- Mohila Academy, interview with the author, Kyiv, 12 October 1998

¹⁸ In 1997 the US Congress conditioned further financial support on the introduction of measures to fight corruption in the state apparatus. In his meeting with President Kuchma in Washington in May of that year, President Clinton also voiced the dissatisfaction of the American investors in Ukraine. "Soobshcheniya o korruptsii, meshayushchei deyatel'nosti amerikanskikh firm, mogut oslozhnits' vizit Prezidenta Kuchmy v SshA", (translation of an article published in the Washington Post, 10 May, 1997), *Delovaya Nedeliya*, n. 3, 1997, p. 5. The low inflow of foreign direct investment into Ukraine compared to other Eastern European countries is also an illustration of the distrust of foreign investors. In the period between 1992-97 FDI in Ukraine were \$1742 million; in the period between 1989-97 FDI were \$15403 million in Hungary, \$7473 million in the Czech Republic, \$ 8442 million in Poland. United Nations (1998), *Economic Survey of Europe*, n. 1 and European Bank for Reconstruction and Development (1998), *Transition Report Update* (London: EBRD)

¹⁹ Oleg Soskin, interview with the author, *Op. cit.*

had then caused the expansion of an inner circle of big enterprises managers gathered around the administration to be “fed with the allocation of privileges”.²⁰

Political Economy of Reforms

Politics and business never became separated in post-Soviet Ukraine. As a result, the special relationship that representatives of the economic circles enjoyed in the political sphere crucially informed the course of economic reforms. The economic elite systematically pushed through measures that would help to preserve their status, while obstructed policies that would endanger their interests.²¹

The consequence was the reinforcement of a rent-seeking system in which economic advantages were afforded only to those close to the administration, while excluding those who were not part of it. As administrative resources became a source of income for the bureaucracy, the bureaucrats became themselves an obstacle to economic reforms, preventing changes that would unsettle their power and revenues.²²

In such a system wealth was generated by special exemptions from economic regulations, rather than by the development of a productive activity, by the expansion of ownership over existing assets rather than by new investments and developmental projects. The burden placed on the economic system and the state budget by rent-seeking activity was most certainly one of the factors preventing consistent economic growth.

As politics and business largely failed to separate, a clear distinction between the economic and the political elite in Ukraine did not materialise. Olga Kryshchanovskaya and Stephen

²⁰ Oleg Soskin, interview with the author, *Op. cit.*

²¹ A. J. Motyl (1997), “Structural Constraints and Starting Points. The Logic of Systemic Change in Ukraine and Russia”, *Comparative Politics*, July, pp. 433-447

²² A. Aslund (1999a), *Problems with Economic transformation in Ukraine*, Paper presented at the Fifth Dubrovnik Conference on Transition Economies, June 23-25, 1999, in <http://wwwceip.org/files/Publications/webnotel0.asp?from=pubproject> . Cfr. on the emergence of the Russian economic elite A. Aslund (1999b), “Russia’s Collapse”, *Foreign Affairs*, September/October, pp. 64-77

White identify a Russian economic elite, which emerged, in the early years of liberalisation, as a result of the “bifurcation” of the Soviet *nomenklatura* into a political elite and an economic elite. The picture painted by Kryshchanovskaya and White characterises the political elite as a group competing for the political power and the economic elite as a group whose power and social rank was based upon its control of capital.²³ In Ukraine this diversification did not take place in the late *perestroika* years, and well into the post-Soviet period the economic elite was still identified with the state apparatus.

In Ukraine, as in Russia, an economic elite appeared as a result of the late 1980s economic reforms, when “miraculous economic exchanges” took place, and “real billions of dollars were made”.²⁴ Wealth was accumulated through four main channels. First, through the trade of metals and chemicals bought in Ukraine at state-regulated prices (equal to 10% of the world prices) and sold abroad at full market prices. Second, through the trade of products (like Russian gas) imported at subsidised exchange rates and sold in hard currency. Third, through subsidised credits issued at a 20% interest a year when inflation was running at 10,155%. Fourth, through budget subsidies (equal to 8.1% of GDP in 1992 and 10.8% in 1993) concentrated mainly in the agricultural sector, and in the gas and the coal industry.²⁵

Insider privatisation (or *nomenklatura* privatisation) provided another opportunity for the consolidation of the economic elites, turning state enterprise directors into a property class. Given the lack of a comprehensive programme of privatisation, enterprise managers attained *de facto* the property rights of the state enterprises they directed. By mid-1997, 85% of all shares allocated had been acquired by incumbent managers and working collectives.²⁶

²³ O. Kryshchanovskaya and S. White (1996), “From Soviet Nomenklatura to Russian Elite”, *Europe-Asia Studies*, Vol. 48, n. 5, pp. 711-733. For a list of materials on the debate on the structure of post-Soviet elites, see footnote 4, chapter 4.

²⁴ Oleksandr Shnyepko, interview with the author, *Op. cit.*

²⁵ A. Aslund (1999a), *Op. Cit.*

²⁶ P. D’Anieri et al. (1999), *Politics and Society in Ukraine*, (Boulder, Colorado: Westview Series on the Post-Soviet Republics), p. 184

Because of their previous affiliation to the CPSU in their capacity as managers of state enterprises, 'red directors' gained parliamentary representation through seats won within the ranks of the Communist Party. This situation gave rise to the paradox of an embryonic capitalist class (the 'red directors') that was bound at the same time by party discipline to an anti-capitalist ideology and by their own private interests to the development of a market economy.²⁷

The faltering pace of privatisation and the way the process was conducted are the most striking examples of how *nomenklatura* and bureaucratic interests intertwined in setting the course of reforms. Initiated in 1992, privatisation was repeatedly halted by the Parliament, which was dominated by a lobby for the red directors. In 1996, a resolution exempting more than 6000 state enterprises, especially in the gas and oil sector, which were considered of strategic importance, brought the large-scale privatisation to a standstill. Small-scale privatisation was substantially completed by mid-1997, but enterprises, which had been acquired by existing managers and employee groups, totalled only 2% of the official industrial output. The great bulk of Ukrainian production remained instead concentrated in large enterprises, more resistant to privatisation and often successful in lobbying for exemptions to antimonopoly regulation.²⁸

The system of "rent with buy out", according to which enterprises had to submit a privatisation application to local bureaucrats before being authorised to initiate the privatisation procedures, gave rise to widespread forms of bribery and corruption.²⁹ Finally, a process of substantial restructuring was obstructed as privatisation largely benefited insiders, and discouraged foreigners and external investors, leaving state enterprises producing at a loss and begging for state subsidies.

²⁷ Aleksandr Goncharenko, interview with the author, *Op. cit.*

²⁸ Paul D'Anieri et al. (1999), *Politics and Society in Ukraine*, (Boulder, Colorado: Westview Series on the Post-Soviet Republics), pp. 184-186

²⁹ For an overview of the privatisation program I. Filatotchev et al. (1996), "Privatisation and Industrial Restructuring in Ukraine", *Communist Economies and Economic Transformation*, Vol. 8, n. 2, pp. 185-203

A similar pattern of administrative favouritism appeared in the foreign trade regime, where liberalisation took place only at a formal level, while in fact new regulations were introduced, increasing opportunities for corruption.³⁰

Asymmetrical control over the political institutions drew a line of divergent interests and possibilities between big and small-medium businesses. Political power allowed representatives of big businesses to shape the rules of the market to fit their own preferences, defending their newly acquired property rights and preserving their privileges on the market. Small and medium businesses, on the contrary, were generally divorced from political power, and were therefore exposed to the full force of market fluctuations, and to the unpredictability of the economic environment.

As a business consultant admitted, in Ukraine “nobody plans long into the future, you do not sit down and draw a business plan to produce something, put together a marketing plan, where your product is going to be sold and under what label. Nobody does that because it is too long range”. As events often demonstrated, a businessman’s fortune could change abruptly “not because of the business cycles, but because of the government’s action, or inaction”.³¹

Continuous revisions of business legislation led economic subjects to develop an attitude of distrust towards the state. “You can start [by] playing chess, then you find, in the middle of the game, that you are playing basketball, or soccer”. With rules being so uncertain, the economic environment was characterised by a permanent search for ways to survive and shortcuts to reach the heart of the system. “People try to steal. You can take anybody, and there is something he disobeyed in the law, because laws and regulations can be in the way,

³⁰ In the autumn of 1994, for example, the Kuchma administration abolished export quotas and licences, replacing them with a registration and certification scheme, requiring traded goods to comply with Ukrainian standards. Economist Intelligence Unit (1995), *Ukraine Country Profile*, Second Quarter 1995. See also A. Aslund (1999a), *Op. Cit.*

³¹ Ivan Lozowy, Director of the Institute of Statehood and Democracy, close to the Rukh

and you have to overcome any barrier. It is not always intentional, but there are some gaps in the system which allow people to escape or by-pass the laws”.³²

Excessive bureaucratic requirements, the arbitrariness of business regulations and a punitive tax system pushed business to face the alternative between exit (capital flight, migration or withdrawal into the shadow economy), and voice (choosing a political affiliation). While capital flight in Ukraine up to the late 1990s, has been estimated in the region of \$25-50 billion,³³ an increasing number of leading businessmen chose to emigrate, fearing “to be caught in a civil war, to become victim of crime, or to be kidnapped”.³⁴ Among these was Vadim Rabinovich, President of the Ukrainian Jewish community, media magnate, and Israeli citizen.

Capital export and emigration, however, were an option open only to big business, as small and medium business were left with only the option of illegality. Anatoliy Kinakh admitted:

“The problem of the shadow economy is a result of the lack of trust from the entrepreneurs toward state power. It manifests a problem of stability, quality and transparency in the legislation that regulates the economic and business activity, it is a problem of civilised relations between the state and the business sector”.³⁵

Two surveys conducted among managers of privatised large and medium-sized enterprises in 1998 confirmed this picture. The overall economic situation in Ukraine was described as very bad by 69% of those interviewed, while a total of 89% considered the country a negative environment for the development of private entrepreneurship. When asked to name the most critical problems for their enterprise, 80% did not hesitate to identify oppressive taxation, and 27% blamed constantly changing rules and regulations. The main

³² Anatoli Grytsenko, Head of the Analytical Centre, National Security and Defence Council of Ukraine, interview with the author, Kyiv, 17 November 1998

³³ Paul D'Anieri et al. (1999), *Politics and Society in Ukraine*, (Boulder, Colorado: Westview Series on the Post-Soviet Republics), p. 175

³⁴ Ivan Lozowy, interview with the author, *Op. Cit.*

³⁵ T. Ivzhenko (1999), “President USPP Anatoliy Kinakh: ekonomicheskie problemy Ukrainy mozhet reshit' tol'ko komanda professionalov u vlasti”, *Kompanyon* n. 4, pp. 18-20

reason why business stagnated in Ukraine was identified by 96% as high taxes, and 75% put the reason down to corruption by national government officials.³⁶ Reflecting this spirit of pessimism, in November 1998 a business magazine speculated whether the government would soon introduce a tax on breathing air.³⁷

According to data provided by the Kharkhiv-based TACIS Enterprise Assistance Centre, a typical owner of a small business spent annually 4,200 hryvnas (about 1100 dollars) in fines paid to local or national authorities.³⁸ While the 'unofficial price-list' for services granted by the local authorities to enterprises was publicly known.³⁹

Small business representatives called insistently for the establishment of a system, which would allow the entrepreneur to "work normally". If business were administered effectively, it was argued, the state would benefit from it, at least tax revenues would increase. On the contrary, in an unstable and corrupted environment, unprotected small business was 'forced' to illegality. As Lyudmila Yakovleva, Director of the Agency for the Development of Business Enterprises put it, "I will cheat, I will start producing in the shadow, I will earn money on which I will not pay taxes, I will cheat on custom duties".⁴⁰

Under conditions of lawlessness, the choice between the state and the parallel criminal structures became in Ukraine a rational economic calculation. Political observers calculated that if the tax load for a legal business could reach up to two thirds of a businessman's income, the racket required only between 10 and 30% of it.⁴¹

³⁶ G. Anderson and Company/The PBN/ USAID (1998), *Ukrainian Medium and Large Enterprises Manager Survey*, (Kyiv: mimeo), and Ukrainian Market Reform Education Program (1998), *A National Survey of 441 Managers of Privatised Enterprises in Ukraine*, (Kyiv: mimeo)

³⁷ *Biznes*, n 47, 1998, p. 25

³⁸ R. Vysitskiy (1998), "When Small is Big", *Eastern Economist*, Vol. 5, n. 44, p.14

³⁹ A Ukrainian magazine listed that the registration of an enterprise costs "unofficially" \$176 dollars, the visit of the health or fire security inspection \$42, a visit of the tax inspection \$87. To have a telephone connection an enterprise pays \$894, \$123 to obtain an export licence, \$278 for an import licence. O. El'tsov (1998), "Nomenklatura kak vetv' vlasti", *Kompanyon*, n. 33, pp.10-12

⁴⁰ Lyudmila Yakovleva, Director of the Agency for Development of Business Enterprises, interview with the author, Kyiv, 24 November 1998

⁴¹ O. Turchynov (1996), "The Shadow Economy and Shadow Politics", *Politichna Dumka*, n. 3-4, pp. 75-87

Business associations, which could play a crucial role in mediating between the state and entrepreneurs, were weak, very numerous, and scarcely significant on the political scene. Paul Kubicek characterises them as “infiltrated by and subservient to the communist party”; they were “intertwined with state structures and dependent heavily upon state sponsorship and recognition for their present power”.⁴² A line of financial dependence was created between the Ukrainian Union of Industrialists and Entrepreneurs and the state in the form of state subsidies paid to the enterprises constituting the organisation.⁴³ When asked why his organisation was not taking up a more critical attitude towards the presidency, the Vice-Chairman of the Union of Industrialists and Entrepreneurs admitted: “You cannot bite the hand that feeds you”.⁴⁴

Polling among entrepreneurs confirmed that “lobbying the Government is not seen yet as a way to advocate the interests of enterprises before local and national government officials, at least partly because existing lobbying organisations are not seen as effective”. In the above mentioned survey, 73% of respondents recognised that, should they need to defend their interests in the political sphere, they would resort to personal contacts. Only 11% of entrepreneurs said that they would rely on business associations.⁴⁵

Rent-seeking was essentially an economic activity that afforded members of the elite privileges and means that they would not earn through productive activities. Engagement with political power was a constituent part of this system. A high degree of interlocking between political and economic positions blurred even further the distinction between politics and business, and led observers to believe that “the economic elite controls the state by bringing in its own members, through direct connections, without even the need to camouflage them”.⁴⁶

⁴² P. Kubicek (1997), “Post-Soviet Ukraine: In Search of a Constituency for Reform”, *Journal of Communist Studies and Transition Politics*, Vol. 13, No. 3, pp. 103-126 (quotation p. 112)

⁴³ P. Kubicek (2000), *Unbroken Ties. The State, Interest Associations and Corporatism in Post-Soviet Ukraine*, (The University of Michigan Press), p. 91

⁴⁴ Oleksandr Shnyenko, interview with the author, *Op. cit.*

⁴⁵ Ukrainian Market Reform Education Program (1998), *A National Survey of 441 Managers of Privatised Enterprises in Ukraine*, (Kyiv: mimeo), p. 10.

⁴⁶ Oleksandr Shnyenko, interview with the author, *Op. cit.*

The list of representatives of business interests in key political position was significant. A few example will suffice to indicate the trend. Serhei Tihipko, for example, Deputy Prime Minister in Valerii Pustovoytenko's government had been from 1991 to 1992 vice Director of the Dnipro Commercial Bank. He then became director of the Dnirpopetrovsk branch of Privatbank, the second largest bank in Ukraine, before being appointed in 1997 to the position of Deputy Prime Minister in charge of the economic reforms.⁴⁷

Oleksandr Tkachenko, Speaker of the Parliament from 1998, was the Chairman of the agriculture-based financial-industrial group Zemlya i Lyudi. Oleg Ishchenko, Chairman of the Ol-bank, Mikhail Brodskii Chairman of the concern Dendi, Leonid Chernovetskii, Chairman of Praveksbank, Grigoryi Surkis, President of the Dynamo Kyiv, were only few of the conspicuous wave of entrepreneurs who entered the Parliament following the March 1998 election.

In the following two sections I will turn to the structure of relations between business and political power in the two most important centres of Ukrainian policy-making, the Parliament and the presidential administration.

Business and the Verkhovna Rada

In post-independence Ukraine, the Parliament became the main channel for the former *nomenklatura* to defend their positions, lobby for state subsidies, obstruct reforms, and acquire personal immunity. In the March 1994 elections, enterprise directors (including farm directors) were the third largest individual group in the parliament, following high governmental officials and professionals. The July 1994 moratorium on privatisation (lifted the following December) was arguably the most remarkable success in the strategy of business leaders to halt economic reforms, but throughout its entire legislative mandate the conservative majority voted consistently to grant subsidies to unprofitable enterprises. Red directors and Party *nomenklatura* strongly opposed President Kuchma's efforts of

⁴⁷ G. Andrushchak et al. (1997), *Khto e khto v Ukraini*, (Kyiv: KIS), various entries

economic restructuring and finally provoked a conflict between the executive and the legislative that eventually resulted in the weakening of the parliament.⁴⁸

The April 1998 elections marked a significant turn in business representation within the Ukrainian political institutions, as a large number of entrepreneurs (mostly representative of the sectors that had prospered in the post-Soviet arena) ran for and won seats in parliament. As many as 127 representatives of business, equal to 28% of the total number of legislators were finally elected.⁴⁹ While the energy sector was most successful in gaining representation, electing 15 deputies, the banking sector was the most active. 49 bankers ran under different party tickets, while a few dozens campaigned in single mandate constituencies, and Privatbank even established its own party. 14 representatives of the banking community were finally elected. The Sixth Congress of the Association of Commercial Banks, held the previous February, had signalled a general consensus in the sector on the necessity to establish a banking lobby in Parliament.⁵⁰

⁴⁸ S. Birch (1997), "*Nomenklatura* Democratisation: Electoral Clientelism in Post-Soviet Ukraine", *Democratization*, Vol. 4, n. 4, pp. 40-62

⁴⁹ For a more general analysis of the 1998 elections, A. Wilson and S. Birch (1999), "Voting Stability, Political Gridlock: Ukraine's 1998 Parliamentary Elections", *Europe-Asia Studies*, Vol. 51, n. 6, pp. 1039-1068

⁵⁰ A. Kovtun (1998), "Banki uzhe vzyali", *Zerkalo Nedelii*, n. 7, 14-21 February, p. 1

Table 5.1. Composition of the Verkhovna Rada, by Profession

PROFESSION	NUMBER OF DEPUTIES	%
Entrepreneurs	127	28.0
Former deputies	118	26.0
State officers	77	17.0
Party officers	26	5.7
Academics	23	5.1
Trade unionists	18	4.0
Journalists	12	2.6
Researchers	11	2.4
Factory workers	9	2.0
Others	33	7.3
Total	454	100

Source: Delovaya Nedelya, 6 April, 1998, pp. 6-8

Table 5.2. Economic Elite in the Verkhovna Rada, by Profession

POSITION	DEPUTIES	%
Chairmen of Enterprises/Board of Directors	88	69.3
Deputy Chairmen	10	7.9
Managers	10	7.9
ex Chairmen	7	5.5
Presidents of Business Associations	5	3.9
Other	4	3.1
Financial advisors	3	2.4
Total	127	100

Source: Delovaya Nedelya, 6 April, 1998, pp. 6-8

Table 5.3. Economic Elite in the Verkhovna Rada, by Fraction

PARLIAMENTARY FRACTION	TOTAL NUMBER OF DEPUTIES (1)	ECONOMIC ELITE DEPUTIES	
		1998 (2)	2000 (3)
People’s Democratic Party	28	31 (4)	8
Green Party of Ukraine	19	11	6
Social Democratic Party of Ukraine (united)	17	10	10
Rukh	46	3	2
Hromada	26	2	0
Reforms and Order	3	1	1
Regional Revival	2	0	14
Working Ukraine	1	0	11
Fatherland	0	0	3
Solidarity	0	0	4
Independents	5 (5)	5	unknown
Deputies elected in Single mandate Constituencies	unknown		2

Sources: Inna Pidluska and Svitlana Kononchuk (2000), *Dilova elita Ukrainy*, Part 1, Parliament, (Kyiv: UNTsPD), pp. 264-266, Andrew Wilson and Sarah Birch (1999), “Voting Stability, Political Gridlock: Ukraine’s 1998 Parliamentary Elections”, *Europe-Asia Studies*, Vol. 51, n. 6, p. 1040

- (1) Total number of deputies initially registered in the fraction (1998-99)
- (2) Number of deputies from the economic elite initially registered in the fraction (1998-99)
- (3) Number of deputies from the economic elite registered in the fraction after a number of defections(1999-2000)
- (4) 28 deputies elected , three joined the party in the following months
- (5) Number of deputies registered as independent as march 2000, according to Pidluska and Kononchuk (2000)

Table 5.4. Economic Elite in the Verkhovna Rada, by Sector

SECTOR	NUMBER OF DEPUTIES
Energy	15
Banking	14
Agro-industry	12
FIGs	5
Media	5
Trade	3
Other	8

Source: Delovaya Nedelya, 6 April, 1998, pp. 6-8

Political observers remarked that it was the first time that representatives of business structures had taken such a bold position, announcing publicly their plans to influence the decision-making process from inside.⁵¹ Others reckoned that the decision to enter *en masse* the parliament reflected six years of frustration in economic circles due to legislative inactivity.⁵²

The urge of “business promotion” had in most cases motivated the economic elite in their quest for a parliamentary seat. Disparate political quarters reflected, however, the hope that, by default, the presence in parliament of representatives of business would produce positive consequences for the economic community at large. “They cannot establish rules only for themselves, and if they push on legislation that cuts down taxes everybody will benefit, if they adopt more liberal economic rules everybody will benefit, even though they are mainly guided by their own interests”.⁵³

While representatives of small-enterprises appeared more sceptical of the advantages that the presence of big business in Parliament would bring to the general economic

⁵¹ Inna Pidluska, Director of the Ukrainian Centre for Independent Political Research, Kyiv, 31 October 1998

⁵² Igor Buryakovski, interview with the author, *Op. cit.*

⁵³ Inna Pidluska, interview with the author, *Op. cit.*

environment,⁵⁴ members of the banking community welcomed the event as a “natural phenomenon” that reflected the more active presence of business in society.⁵⁵ It was argued that the economic elite could make a real difference in the law-making process by virtue of their awareness of the real conditions of business, contrasting with the “political decisions” adopted by members of the political elite.⁵⁶ With the presence of economic actors, the Verkhovna Rada looked finally “more professional”, but still, it was lamented, the number of representatives of the banking sector was not sufficient.⁵⁷

“Business promotion” or obtaining a political affiliation prompted candidates to pay as much as 1 million dollars in a single mandate district to obtain a parliamentary seat.⁵⁸ “In order to defend his own business every businessman looks for a *krysha*, including a political one, against the state”, commented the former Speaker of the Rada Ivan Plyuch.⁵⁹ But, what concrete advantages could a parliamentary seat offer to the new economic elite?

The 1995 Power Bill had been the first step towards the shift of decision-making powers from the parliament to the President, which had then been confirmed with the approval of the 1996 Constitution. Even though the president had been awarded considerable powers to conduct political and economic reforms, the parliament had nonetheless been left with significant authority in the economic area, which made it the key player in the privatisation process.⁶⁰ In fact, the parliament was not only put in charge of “approving the list of state-owned objectives which [would] not be made subject to privatisation, determining the legal

⁵⁴ Lyudmila Yakovleva, interview with the author, *Op. cit.*

⁵⁵ Valeryi Suskin, Director of Privatbank Kyiv, interview with the author, Kyiv, 10 November 1998

⁵⁶ These opinions were expressed both by Stanislav Arzhevitin, Chairman of the Board of Aggio Bank and Deputy Chairman of the Association of Ukrainian Commercial Banks, interview with the author, Kyiv, 13 November 1998, and Evgenyi Zel'ster, interview with the author, Vice Director of the Investment Division, Bank Ukraina, interview with the author, Kyiv, 13 November 1998

⁵⁷ Aleksei Pavlov, Director of Public Relations, Bank Ukraina interview with the author, Kyiv, 13 November 1998

⁵⁸ M. Tomenko (1998), *Returns of the Recent Parliamentary Elections in Ukraine*, *Politichna Dumka* (Kyiv), n. 2, pp. 113-126

⁵⁹ “Pochemu predpriminatelei idut v politicu?”, *Kompanyon*, n. 47, 1998, pp. 8-9

⁶⁰ On the establishment of a presidential system in Ukraine A. Wilson (1997), “Ukraine: Two Presidents and Their Powers”, in *Postcommunist Presidents*, edited by R. Taras (Cambridge: CUP), pp. 67-106

principles for appropriating privately owned objectives”, but it also received control over the State Property Fund, which supervised privatisation.⁶¹

By virtue of these powers, a parliamentary seat still presented remarkable advantages to representatives of the economic elite. Firstly, the deadline on the freezing on the sale of thirty-two large enterprises (especially in the energy sector) was due to expire during the lifetime of the 1998 parliament, and regulation for their privatisation would be issued by the legislature.⁶² Secondly, legislation on economic activity (as for example regarding the new tax code) was still expected to be debated and adopted within the Parliament. Finally, the parliament could guarantee immunity from criminal charges to perspective deputies who had been caught up in corruption scandals.

Bidding for immunity was arguably one of the most powerful motivations for candidates to run in the elections. “Business in Ukraine if it is not entirely criminal is semi-criminal. The status of Deputy gives [the businessman] more or less four years to cover and to solve the problems of his business”, commented a member of the presidential administration.⁶³ Statistics seemed to prove him right, as between 1990 and 1994 over 500 deputies were not committed for trial because either a local council or the Verkhovna Rada had failed to grant approval.⁶⁴ Louise Shelley has estimated that following the 1998 parliamentary elections more than 20 members of the parliament faced criminal prosecution if they were stripped of their parliamentary immunity, while forty-four legislators elected to local political bodies also had criminal backgrounds.⁶⁵

⁶¹ In December 1996 the Parliament amended the existing legislation and made the Fund accountable to the Parliament. Kuchma vetoed the amended law and made the Fund responsible to the President through the Cabinet of Ministers. The final law approved by the Parliament placed the fund “under operative subordination” of the Cabinet and made it accountable to the Parliament. Charles R. Wise, Trevor L. Brown (1999), “The Separation of Powers in Ukraine”, *Communist and Post-Communist Studies* Vol. 32, pp. 23-44 (p. 40), and Charles R. Wise and Trevor L. Brown (1998), “The Consolidation of Democracy in Ukraine”, *Democratisation*, Vol. 5, n. 1, pp. 116-137,

⁶² I. Maskalevich (1998), “Privatizatsiya energetiki: Iskusstvo petch bliny”, *Zerkalo Nedelii*, n. 6, 7 February, p. 9

⁶³ *Kompanyon* (1998b), *Op. Cit.*

⁶⁴ O. Turchynov (1996), “The Shadow Economy and Shadow Politics”, *Politichna Dumka* (Kyiv), n. 3-4, pp. 75-87.

Many prominent figures elected to the Parliament did indeed have a remarkable past of relations with the justice. A typical example was Oleksandr Tkachenko, President of the agro-industrial concern 'Zemlya i Lyudi', then Speaker of the 1998 Rada. At the time of his election, a lengthy investigation was pending against him. Tkachenko had been accused of illegal transactions committed by Zemlya i Lyudi, together with the American wheat dealer Zeneka Incorporated, on the basis of a 500 million dollar credit line provided by the American government. The operation, which had cost the Ukrainian budget more than 30 million dollars, and Ukrainian exporters a temporary freeze on their corresponding accounts in Ukreximbank, had also prompted an US investigation. Once Tkachenko was elected, however, all accusations were miraculously dropped. Allegedly, the President had helped by "smoothing" the process, judging it safer, in view of the upcoming presidential elections, to have a loyal ally in charge of the often-vociferous Parliament.⁶⁶

The 1998 elections demonstrated that by dispensing favours to business structures, and by granting protection to figures like Tkachenko, the President and his administration were trying to expand their control over legislative power. Support to individual businessmen, parties entering parliament for the first time, or coalitions established around business interests were all part of the complex strategy adopted by the presidential circles in anticipation of the 1999 electoral campaign.

⁶⁵ L. I. Shelley (1998), "Organised Crime and Corruption in Ukraine: Impediments to the Development of a Free Market Economy", Demokratisatsiya – The Journal of Post-Soviet Democratisation, Fall, pp. 648-663

⁶⁶ Information on the Zemlya and Zemeka case was provided off the record by an official of the Procuror's office. Mikhail Brodskii was another deputy who ran seeking immunity. Brodskii had been the founder and the President of the concern 'Dendi', a *de facto* financial-industrial group established around the Dendi bank. The concern comprised 28 enterprises engaged in disparate activities, among which also the popular newspaper 'Kievskie Vedomosti'. After having been charged for money laundering and having been exposed to lengthy administrative controls, in 1997 the bank virtually collapsed, overwhelmed by debts of approximately 4 million dollars. Brodskii accused the Ministry of Internal Affairs of having staged a campaign against him with the real intent of silencing Kievskie Vedomosti, which had been in the past critical of the Ministry's activities. Brodskii was then jailed for financial irregularities in the buying and selling of apartments, and eventually released in April 1998, after having been elected a deputy. Through the pages of his newspaper, Brodskii managed to fight his electoral campaign as a self-styled hero, raising an inflamed debate within public opinion on his controversial figure. A. Sakhno and V. Gonchar (1997), "Kak Dendi londonskiy odet", V. Gonchar (1997), "Ya ne poydu igrat' s gosudarsvom v kakie-libo igri", N. Rodina and Yu. Shiblovskaya (1997), "Vozmozhniye versii politicheskikh al'yansov Brodskogo", Kompanyon, n. 14, 1997, pp. 32-43. A. Sakhno (1998), "Mikhail Brodskiy: Ya svoi dengi zaberu iz banka Dendi poslednim", Kompanyon, n. 6, 1998, pp. 18-21. Pochemu predpriminatelei idut v politiku?, Kompanyon, n. 47, 1998, pp. 8-9, and "V chem fenomen Brodskogo?", Kompanyon, n. 15, 1998, p. 5

Business and the Presidential Administration

In the years of the first Kuchma's presidency a "capitalist class" emerged and consolidated thanks to the special privileges awarded by the President and his administration to the members of his inner circle. The President's patronage network set relations between political power and business on new foundations. Closeness to the president guaranteed access to the administration, redistribution and utilisation of state financial or administrative resources ("a property nobody knows whom it belongs to"), creating large and unexpected fortunes.⁶⁷ As an observer commented,

"The formula 'capital forms power', traditional in all developed market economies has been completely inverted into its opposite – 'power forms capital'. Those who have power can also have capital, while the power of an owner disloyal to the authorities could, at any moment be alienated, and on quite legal grounds".⁶⁸

Kuchma's patronage networks developed along three lines. The regional clan of Dnipropetrovsk constituted the President's primary power-base, which fragmented and evolved, at the time of the 1998 parliamentary elections, into an embryonic party-system. The alliance between business and politics consolidated then in a more stable form centred around "holdings".

With President Kuchma not only the economic elite, but first and foremost his 'Dnipropetrovsk family' went to power. It has been estimated that in the months following Kuchma's election in 1994, something like 206 *apparatchiki* moved from Dnipropetrovsk to Kyiv to occupy key positions in the state administration, and control the process of resource allocation. The core of the clan was composed of some 200 individuals, among whom were figures like the future Prime Minister Valeryi Pustoyvotenko, Volodymir Horbulin, secretary of the National Security and Defence Council, and Serhey Tihipko, first

⁶⁷ S. Belashko (1998c), *Osnovnymi pretendentami na vlast' ostayutsya "Partii Vlasti"*, *Kompanyon*, n. 1-2, 6-7

⁶⁸ O. Turchynov (1996), *Op. Cit.*

Vice Prime Minister in charge for the economic reforms.⁶⁹ In 1997 Ukrainian media sources counted five “*Dnipropetrovtsy*” among the members of the Presidential administration, and 20 in the government’s apparatus.⁷⁰

The structure of regional clans in the Ukrainian political landscape dated back to the Stalinist years, when, in the attempt to resist the persecution of the political police, communist activists joined forces in tight and exclusive regional teams. Regional clans were formed according to the country’s division of labour. If Donetsk was the core of the mining area and of the metallurgical industry, and Kharkiv the centre of the machine-building sector, Dnipropetrovsk’s strength lay in its high level of industrialisation and the consequent importance of its party organisation. Thanks to the high concentration of enterprises of the military-industrial sector, Dnipropetrovsk was also one of the most strategically important regions in the Soviet Union. These factors put the region in the position to place its own political representatives in key positions of the Soviet apparatus.⁷¹

The secretive nature of the clan and the mutual support (financial and administrative) it provided to its members characterised the clan structure also in the years of the Kuchma presidency. The Dnipropetrovsk clan could draw from and administer a large pool of resources. The top managers of two of the largest Ukrainian banks, Mikhaïlo Bairaka, Deputy Chairman of the Board of Directors of Bank Ukraina, and Volodymyr Matvienko,

⁶⁹ D. Voloshin (1997), “*Legendy i byli Dnepropetrovskogo klana*”, *Delovaya Nedelya*, n. 5, p. 9

⁷⁰ Ukrainian Centre for Independent Political Research, *The Dnipropetrovsk Family*, 1997 (Kyiv: UCIPR), p. 21

⁷¹ The father of the Dnipropetrovsk family was Leonid Brezhnev, himself politically brought up in Dnipropetrovsk and graduated of the Dnipropetrovsk Metallurgical Institute, which, for the large number of cadres it provided to the USSR has been ironically compared to Yale, Harvard and Princeton. With Brezhnev the structure of the regional clan acquired a double significance. For regional elites, it became an instrument to press for participation in the management of the country, while for the General Secretary it was a means to consolidate his power base. In his 18 years at the top of the Soviet state Brezhnev used his native region as a “private patronage reserve”. By pooling in the capital cadres from Dnipropetrovsk he wanted to ensure himself support for his policy initiatives within the bureaucracies responsible to implement them, and at the same time, counterbalance the influence of his political opponents. Evidence of his strategy lies in the fact that the number of Central Committee members coming from the region increased from 2 in 1956 to 13 in 1976. As predictable as the strength of the military-industrial region was, its position was also amplified in the internal balance of power in Ukraine. As was revealed in a 1990 report of the CPSU Central Committee, 53% of the Ukrainian executive officials were originally from Dnipropetrovsk. J. C. Moses (1976), “Regional Cohorts and Political Mobility in the USSR: The case of Dnepropetrovsk”, *Soviet Union/Union Sovietique*, Vol. 3, part 1, pp. 63-89, and Ukrainian Centre for Independent Political Research (1997), *Op. Cit.* p. 3

Chairman of the Board of Directors of Prominvestbank, were recognised members of the clan.⁷²

Solidarity between members of the clan often proved a useful asset to escape critical situations. In March 1995, Yuliya Timoshenko was arrested at the Zaporizhzhia airport on charges of attempted smuggling of \$ 26 million to Moscow. Examination of the case was moved from Zaporizhzhia to Dnipropetrovsk, where Pavlo Lazarenko was Speaker of the regional parliament and head of the regional administration. The regional procurator was conveniently promoted to general procurator in Kyiv, allegedly on an expressed request of Lazarenko. The case against Timoshenko was subsequently dropped, and the documents related to it were made inaccessible.⁷³

With the appointment of Pavlo Lazarenko to the position of Prime Minister in the Autumn of 1996, the Dnipropetrovsk clan consolidated its position. For the first time the group gained, as one observer put it, the “controlling packet of shares” in the country, achieving the position of President and Prime Minister at the same time.⁷⁴

Kuchma and Lazarenko, however, represented the two conflicting souls of the clan: the Soviet military-industrial complex, the former, the agrarian sector the latter. Lazarenko was probably instrumental in Kuchma’s 1994 victory, bringing with him the votes of the rural areas of the region, and with his appointment to the Premiership he was rewarded for his loyalty. But Lazarenko’s presidential ambitions and growing charges of corruption surrounding him caused the two groups to split.

In July 1997 Lazarenko was forced to step down. His resignation represented the open fracturing of the clan, and the politicisation of conflict. Lazarenko established the main opposition party, Hromada, and became its leader. Kuchma found support in the newly established Party of Popular Democracy (NDP in its Ukrainian acronym), immediately

⁷² *Ibid.*, pp. 212-214

⁷³ T. Ivzhenko (1997), *Ne Nashe "Delo"*, *Kompanyon*, n. 24, pp. 11-12

⁷⁴ D. Voloshin (1997), *Op. Cit.*

titled the 'party of power'. The NDP, in turn, derived from the bloc of Constitutional Centre, which had supported Kuchma in the 1994 presidential campaign.

The conflict between Kuchma and Lazarenko produced, paradoxically, a positive outcome for the Ukrainian political system, as the structure of regional clans seemed to evolve into a system of political parties, albeit no less conflictual and personalised. Observers believed that the main reason for the transformation was that the structure of regional clans could not be preserved any longer in the same form as it effectively operated under Brezhnev. While under the command-administrative system, it had been possible to retain the monopoly in managing economic resources, in post-Soviet Ukrainian society a plurality of contrasting political and economic actors had emerged. In this complex arena, the new leader would have to demonstrate his ability to play all the conflicting forces to his advantage.⁷⁵

The creation of the NDP as the backbone of the presidential administration could then be read as a shift from a policy of cadres based on their regional origin, to a policy of cadres based on political (or party) belonging. Kuchma's supporters hoped that the NDP, being economically based on the large resources of the energy sector, could channel and actually expand the President's political support beyond the borders of Dnipropetrovsk. At the same time, with its roots in the government (the party included the then Prime Minister Pustoyvotenko as its leader and a large number of ministries), the NDP could increase presidential control over administrative power.

The 1998 electoral campaign showed that political forces had started to look at entrepreneurs as an important part of their constituency. Just before the elections took place, the president issued a decree on the development of entrepreneurial activities, setting the ground for a sweeping collection of reforms in the tax, trade and financial sector. Also the parliament passed a decree that allowed enterprises to pay a single flat-rate tax.⁷⁶ It was, however, only when the new parliament first sat that the full extent of business interests involved in legislative power became finally evident. Political parties appeared,

⁷⁵ Aleksandr Goncharenko, *Op. cit.*

⁷⁶ A. Gromov (1998), "Borba za kormil'tsev", *Kompanyon*, n. 10, pp. 19-20

for the first time, as institutionalised channels to lobby for specific business interests. Political alliances were forged on the basis of common interests, and political splits followed as a result of these same interests.

The Green party was the big winner of the 1998 elections, as after more than ten years of battles following the Chernobyl disaster, it succeeded in overcoming for the first time the 5% barrier, to gain a total of nineteen seats. Financial support and the direct participation of big business, with the consequential shift towards pro-presidential positions, explain part of their success. The Greens were viewed as a new party in the Ukrainian lifeless political landscape, able to appeal to a larger audience by virtue of their high moral reputation. The party also organised an effective advertising campaign. Slogans like “It is ecology rather than politics that primarily matters” allowed the Greens to break through with a political electorate disillusioned with traditional politics. The success of the Green party proved, however, a temporary phenomenon, as fractions soon emerged within the party. Regrouping took place around different economic interests.

One of the architects of the operation was Vadim Rabinovich, President of the Jewish Community. Nicknamed the ‘Ukrainian little Berezovskii’, Rabinovich was at the time in control of the TV channel ‘1+1’. Among the eleven deputies initially elected through the Greens (five later defected to other fractions), the most well-known were Irina Shevchenko (Commercial Director of the Media Company Prioritet, controlled by Rabinovich), Vasili Khmel’nitskiy and Sergey Pavlenko (both Chairmen of Real Group), and Sergei Rys’ (Chairman of the oil company Shelton).

The People’s Democratic Party (NDP) was by far the most successful party, initially gaining a total of twenty-eight deputies, all of whom came from an economic background. The party was immediately dubbed “the party of power”. Political commentators noted it had been formed on the model of Our Home is Russia, with the aim to channel economic interests in support of the President in preparation of the next presidential elections. Anatolii Kinakh was one of the deputies of the fraction. The group, representing primarily

energy interests, proved, however, very unstable. Controversies over the redistribution of gas contracts led twenty-three of its deputies to abandon the fraction at different stages.⁷⁷ Seven of them established subsequently the group 'Working Ukraine', while eleven moved to reinforce the Party of Regional Revival.⁷⁸

The second pillar in the administration's strategy to create parliamentary support for the president was the Social Democratic Party (SDP), which, because of its ten deputies elected among the ranks of the business elite, was considered the party of the big monopolies. It included representatives of economic empires like Bogdan Gubskii Chairman of the Slavutich Board of Directors, and Grigoryi Surkis, Chairman of Dynamo Kyiv. The "diversification" of Kuchma's support was interpreted as an attempt to send a signal to the business community that, in advance of the presidential campaign, they could look for the President's favour regardless of their party belonging.⁷⁹

The rise of the SDP contrasted sharply with the decline of Hromada, which local commentators identified as "the party of the power that was".⁸⁰ Hromada had been created by Lazarenko to gather support in his struggle against the President. Ideologically it occupied the position of "authentic social democrats, with Christian values", and called for the protection of Ukrainian national capital, threatened, in their view, by the uncontrolled influx of foreign companies.⁸¹ Contrary to this image, however, Hromada was suspected of entertaining close financial relations with foreign markets, especially the United Kingdom and Cyprus, thanks to expatriated Ukrainian entrepreneurs. Hromada's financial power put the party in the position of owning a bank and establishing a financial-industrial group.⁸²

The party won twenty-six parliamentary seats, of these eight went to business representatives, among whom were Yuliya Timoshenko (former Chairman of the United

⁷⁷ S. Belashko (1998a), *Partiya, Vlast' i Biznes*, *Kompanyon*, n. 48, pp. 8-11

⁷⁸ I. Pidluska and S. Kononchuk (2000), *Dilova elita Ukrainy*, Part 1, Parliament, (Kyiv: UNTsPD), pp. 264-266

⁷⁹ T. Ivzhenko (1998b), "Klubok Interesov", *Kompanyon*, n. 48, pp. 14-16

⁸⁰ Inna Pidluska, interview with the author, *Op. cit.*

⁸¹ Oleg Bilorus, Deputy for the Hromada Party and former Ukrainian Ambassador to Washington, interview with the author, Kyiv, 20 November 1998

⁸² Nataliya Zinets, Reuters correspondent in Kyiv, interview with the author, Kyiv 27 October 1998

Energy Systems), Aleksandr Ryanchenko (Chairman of the Kredit-Dnepr), and Sergei Chukmasov (former Chairman of Ukrzoloto). Contrasts between Lazarenko and Timoshenko, and the December 1998 arrest of Lazarenko in Switzerland on charges of money laundering, caused the party to split into two groups: 'Fatherland', headed by Timoshenko, and 'Solidarity'.⁸³

With the 1998 elections the Parliament gained importance in the estimation of the economic elite as a place to present and advocate business interests. Political tactics and the significance of decisions adopted meant, however, that effective lobbying in the Verkhovna Rada required coalition-building and inter-fraction co-operation. The presidential administration remained still the focus of business lobbying, thanks to its ability to provide protection for individual interests.

The party structure appeared to rest on a complex and unstable network of five or six economic clans that enjoyed a close relationship with the president, supported his electoral campaign and secured for themselves political revenues thanks to this privileged position. The presidential electoral campaign was inevitably perceived as a delicate phase for the economic groups' precarious cohesion. One commentator anticipated that this would be a "time of divisions and redistribution, St. George's Days and Bartholomew's nights, expropriation of someone else's capital and in that process earning new capital".⁸⁴

The economic groups that were assembled in anticipation of the electoral campaign were called by Ukrainian analysts "holdings", even though they resembled more political coalitions built upon financial capital. Holdings were created from the confluence of a number of relatively small business empires, whose owners realised that it would be impossible for them to reach political power on their own. As in business, they negotiated, concluded agreements, and made mutual concessions within their political alliances.

⁸³ O. Yarmo (1998), "Hromada Rukhnula?", *Kompanyon*, n. 36, pp. 10-12

⁸⁴ *Zerkalo Nedelii*, n. 43, 24 October 1998, p. 4

Contrary to the Russian oligarchy, however, because of their limited scale and capital, Ukrainian holdings were forced to work out co-operative strategies.⁸⁵

The possible emergence of conflicting interests made holdings unstable affiliations, likely to break when one set of preferences overlapped with the interests of another holding, as happened, for example, to the short-lived alliance between Rabinovich and Surkis. When Rabinovich lost influence over the state TV channel '1+1', the coalition with Surkis also collapsed. Ukrainian journalists speculated that as Rabinovich was of no more use to the president because he no longer controlled one of the most popular TV stations, he would most likely see his access to the president curtailed and his business activity endangered.⁸⁶

The Rabinovich case was not, however, an isolated one. Other examples of the poisonous atmosphere that existed within in the presidential circles and which led to instability in parties and holdings can also be found. In October 1998, the Government transferred the controlling packet of shares of the 'Oriana' chemical concern (50% plus 1 share) from the state property fund to the management of 'Shelton', whose president was a deputy for the Green Party. Igor' Nasalyk, Chairman of the competing 'Tekhnotsentr' and NDP deputy, frustrated in his aspiration to gain control of the same packet of shares, left the parliamentary fraction, contributing in the split that led to the creation of 'Working Ukraine'. Similar episodes involving behind the scenes agreements between the presidential administration and leading entrepreneurs took place in relation to the enterprise 'South-Pipe in Nikopol', which had recently been included in the list of assets undergoing privatisation, and the Nikolaevsk refinery.⁸⁷

In anticipation of the presidential elections, Ukrainian observers agreed that the electoral campaign would work as a catalyst for the different and contrasting interests of the economic holdings. There were expectations that during the political process, more stable coalitions would be created, even though they would only have a temporary character. Building up alliances with political forces would arguably increase the financial power of

⁸⁵ T. Ivzhenko (1998a), "Nasha Marka", *Kompanyon*, n. 44, pp. 10-12

⁸⁶ *Kyiv Post*, 30 October 1998, pp 1-2, and T. Ivzhenko (1998b), *Op. Cit.*

the holdings.⁸⁸ Commentators bitterly remarked that Ukrainian political institutions existed only as a mechanism to legalise decisions made by economic organisations which enjoyed direct access to power. If an oligarchy had not materialised yet in Ukraine, this was only a matter of time: the process of consolidation was still at an early stage.⁸⁹

The Energy Sector as an Administrative Resource

So far I have examined the consolidation of the relation between business and politics in the Parliament and the presidential administration, especially following the 1998 parliamentary elections and in anticipation of the 1999 presidential election. I have outlined a system of rent-seeking based on the mutual dependence between political institutions and leading economic actors. In this system, access to the redistribution of economic benefits was employed by political figures, notably the President and his administration, as a currency to secure political support from powerful business people. The clearest example of how the presidential circles made use of economic and administrative resources as an instrument of coalition-building is the energy sector.

Pavlo Lazarenko was the first to set up a structure designed to maximise revenue extraction from the gas sector for himself and for his party. In his capacity as Prime Minister, Lazarenko took advantage of the move towards the de-monopolisation of the gas trade with Russia and Turkmenistan, which had previously been administered by Ukgazprom (the Ukrainian gas monopoly).

The alternative proposal to establish a system where gas was bought with private capital by a network of gas-trading companies emerged between the end of 1995 and the beginning of 1996. Initially six companies had managed gas trading, but with the territorial demarcation introduced in January 1996, the number of importers dropped, limiting the number of gas importing companies to just two: United Energy Systems (UES) (chaired by Yuliya

⁸⁷ S. Belashko (1998a) *Op. Cit.*

⁸⁸ T. Ivzhenko (1998b), *Op. Cit.*

⁸⁹ N. Kononenko and V. Denisenko (1998), "Vliyaem, kak mozhem", *Kompanyon* n. 51-52, pp. 10-11

Timoshenko), and Itera (belonging to the Russian Gazpom). While Lazarenko maintained the position of Prime Minister, he made sure that the largest part of state contracts were granted to his business associates in UES, sweeping from the market politically unconnected competitors.⁹⁰

Industrialnyi Soyuz Donbassa (ISD), for example, was considered to be a possible third contender, but after Donbass governor Vladimir Sherbaniya was dismissed, the position of ISD weakened considerably and in 1997 the company failed to obtain supplies to place on the Ukrainian market. Intergaz was another victim of the territorial demarcation. In 1996 the company not only had its quota of gas import curtailed, but the volume of actual Russian gas deliveries was also drastically reduced.

A similar fate befell Oleg Ishchenko, chairman of Ol-Bank and Ol-House concern. Before Lazarenko became Prime Minister, Ishchenko controlled about 25% of the market for the import of natural gas to Ukraine, earning an estimated \$10 million per year. The appearance of United Energy Systems cut his business turnover dramatically and his company collapsed. Political disgrace followed his economic crash. Assessing the chances that a draft law presented by Ischenko, who had subsequently been elected deputy, could receive presidential approval, one of his fellow deputies commented: "Today Ishchenko is bankrupted and his law will not be approved".⁹¹

Towards the end of 1996 the Ukrainian government decided to establish a consortium, the Ukrainian Gas Resources Consortium (UGRC), including also UES, to stabilise the situation on the energy market. Following a December 1996 decree, the market was divided so that UGRC became the leading company. 18.7% of its quota was given to UES. In addition, UES was the only company to be granted the privilege of a 100% state budget payment for supplies to the population and state organisations, while other state companies involved in the gas distribution business were paid no more than 40% of their fees.⁹²

⁹⁰ *Kyiv Post*, November 10, 1998, p. 10

⁹¹ S. Belashko (1998b), *Op. Cit.*

In the spring of 1997 the Council of Security and Defence (and through it most probably the president) denounced the “clan-administrative” system of gas supply in Ukraine. A Temporary Special Committee of the Parliament established to create a national market for gas transport reported that private companies were responsible for financial breaches, and had tendencies to monopolise the gas market. The Committee recommended the development of a concept for the reform of the energy sector based upon the establishment of an exchange on which energy resources would be traded.

As a result, a proposal was formulated to set up a gas resources consortium, in which the big companies would define common conditions for the definition of prices and supply of gas. Yuliya Timoshenko proposed that the consortium be awarded the right to function as the sole gas importer in the country. Commentators remarked that UES was trying to get a status of “official monopolist” in the gas sector. But other companies such as Itera and Intergaz (believed to be close to President Kuchma) contested the UES position. Since all the companies failed to find a compromise, the idea of the Consortium was temporarily discarded.

Approximately at the same time, however, Mikhail Kovalko, a figure close to the president and member of the People’s Democratic Party, was appointed President of Gazneftegazprom, the Ukrainian gas and oil concern. Kovalko announced the decision to create a number of gas trading companies (“*gaztreidery*”, as they became known in the Ukrainian political jargon). The companies, he said, would be set up on different conditions to guarantee “healthy competition”.⁹³

A number of deputies, not related to the gas industry but believed to be close to the president, addressed a letter to Kuchma urging that he stop the dissolution of Ukrgazprom, which controlled the whole gas infrastructure, and was vital for the defence of Ukrainian interests. Ukrgazprom in fact administered more than 34 thousand kilometres of gas pipelines, through which every year ran more than 240 billion cubic metres of gas, of which

⁹² M. Zaplavskaya (1997), “Pavel Lazarenko I ‘ego’ Ukraina”, *Kompanyon*, n. 10, pp.18-21

⁹³ T. Nezhenko (1997), “Truba khvostom”, *Kompanyon*, n. 11, pp. 19-21

120 billion cubic metres was Russian gas en route to European markets. The letter written by the Ukrainian deputies called for Ukgazprom to be guaranteed a privileged position on the Ukrainian market and in the import of Russian gas, in virtue of its strategically important role.⁹⁴

The fragmentation of the gas market and the political decline of Lazarenko and UES had a major influence on the political arena and on the emergence of a group of *gaztreidery*, actively engaged in politics, lobbying against the creation of energy monopolies.⁹⁵

Gaztreidery initially sided with Kuchma, on the expectation that the political defeat of Lazarenko would mean a more equitable distribution of the gas market for them.

The creation of the gas monopoly 'Neftegaz Ukraina' in February 1998, however, sparked immediate protests against the president and his administration. The company, established to "increase the degree of energy security of the country", pooled all the state-owned shares in energy enterprises that were exempted from privatisation. Neftegaz Ukraina was designed to perform activities that were previously distributed among a number of separate enterprises, like transit, formerly managed by Ukgazprom and regional distribution of gas, previously supervised by Ukgaz. The purpose of the company, whose institutional capital was fixed at \$650 millions, was defined as "conducting an effective state policy in the energy sector through the establishment of a vertically integrated company with the functions of a financial holding".⁹⁶ In their trade relations with Moscow, single agents were forced to use Neftegaz as an intermediary, and, as a result, their authority on the energy market was severely curtailed.

Hromada, and Yuliya Timoshenko called upon parliament to impeach the president (the proposal had no follow up) on the grounds that the decree for the establishment of Neftegaz

⁹⁴ *Ibid.*

⁹⁵ G. Lyuta (1998a), "V 'Ukgazprom' uvereniy: zabotoi NAKa dolzhny byt' raschety za energonosoteli, a ne ikh transit", *Zerkalo Nedelii*, n. 21, 23 May, p. 9

⁹⁶ G. Lyuta (1998c) "Vernut'sya k prezhnei modeli rynka gaza...nevozmozhno", *Zerkalo Nedelii*, n. 44, 31 October 1998, p. 9, G. Lyuta (1998b), "Igor' Bakai: 'U NAKa est' bozmozhnosti, kotorykh ni u kogo prezhde ne bylo", *Zerkalo Nedelii*, n. 31, 1 August, p. 5

posed the risk of a gradual loss of strategically important energy enterprises.⁹⁷ But, on June 24 1998, the Parliament voted 239 to 34 a law forbidding the government to transfer shares of state-owned energy companies to Neftegaz. The law equally forbade the government to re-organise energy enterprises which were exempted from privatisation into share-holding companies, which would be, in the words of one of the promoters of the law, the first step towards open privatisation.⁹⁸

The draft law was presented by the Rukh deputy Oleg Ishchenko, who accused the President and the Cabinet of violating the constitution and the legislation on privatisation, as Neftegaz was *de facto* being established as a monopolist in the oil and gas market.⁹⁹ Commenting on the fact that the law would most probably be vetoed by the President, Ishchenko said: “When there is the opportunity to privatise for 10 billion hryvnas something that is worth ten times more, who will give up on it?”¹⁰⁰

In November 1998, the presidential administration was forced to partially give in, accepting that Neftegaz would control only 85% of the gas market. The event, however, provided the opportunity to reward other political allies for their support. The shares of three state-owned energy enterprises were transferred to the management of the Ukrainian Credit Bank, considered close to Gregoryi Surkis’ business empire. While it was expected that Surkis’ energy enterprises, together with Interpipe chaired by the recently elected deputy Viktor Pinchuk, would be among those benefiting from the redistribution of the remaining 15% of the gas market.¹⁰¹

Read in political terms, the *verticalisation* of the gas sector, and its submission to a single authority, loyal to the president (NDP Igor’ Bakai was appointed Chairman of the concern) seemed designed to strengthen the president’s control over the energy sector. As Bakai would be the only person to decide about gas deliveries, gas traders could be required to pay different prices, reflecting “objective and subjective” conditions. *Gaztreidery* not

⁹⁷ L. Krinichna (1998), “Dubl’ Dva”, *Kompanyon*, n. 11, pp. 12-13

⁹⁸ Yu. Mostovaya (1998), “Neftegaz prikryt: nadolgo li?”, *Zerkalo Nedelii*, n. 30, 25 June, p. 2

⁹⁹ *Ibid.*

¹⁰⁰ N. Burlyuk (1998), “Parlament ‘nazhal’ na ‘Neftegaz’”, *Kompanyon*, n. 34, pp. 28-29

sufficiently loyal to the executive power and political opponents could have their access to the market denied or curtailed, as it happened to UES, which was fined 1.4 billion hryvnas (about \$ 450 million), for a violation of the Neftegaz monopoly.¹⁰²

Finally, no one made a mystery of the plan to channel the vast financial resources generated in the gas sector into the presidential race. “We will buy gas at 36 dollars, and sell it twice as much. We will transfer money from one pocket to the other, and the difference will go to the electoral campaign”, confirmed a source close to Neftegaz.¹⁰³

Defence of ‘National Capital’

The system of rent-seeking and network patronage, which consolidated in Ukraine during President Kuchma’s first term, provided very little room, if any, for co-operation with Russia on the basis of a convergence of economic interests. The Ukrainian economic and political environment appeared designed to exclude (or significantly limit) the intervention of outsiders, who might upset the precarious balance of forces that existed between the presidential administration, the Parliament and the different groups of the economic elite. Russian investors, in particular, were deemed the greatest threat to the expansion on wealth and property of the Ukrainian economic elite.

More affluent than their Ukrainian counterparts, Russian financial conglomerates had an advantage over other potential foreign investors in view of the cultural proximity between the two countries. An understanding of the risks inherent in the Ukrainian economic environment made the Russians more resilient than Western investors, while the common historical background made it possible for the Ukrainians to characterise Russian business interests as attacks on Ukrainian newly acquired sovereignty. An ideology of protection of ‘national capital’ was, therefore, forged as an instrument to defend the Ukrainian system, and preserve the existing balance of force among insider actors.

¹⁰¹ N. Kononenko and V. Denisenko (1998), *Op. Cit.*

¹⁰² S. Belashko (1998b), *Op. Cit.*

¹⁰³ *Ibid.*

National capital, the argument went, was more attached to the country than foreign capital. While the former was there to stay, despite the fluctuations of the market and the instability of the political environment, the latter would be ready to leave at the first signs of social and political unrest. The former was interested in the economic development of the country and would reinvest profits on the national soil. The latter, instead, had primarily a speculative intention, and once it had exploited the resources of the host country, it would repatriate its revenues, leaving the region poorer than before. Finally, national capital had a natural right and a patriotic duty to administer the country's wealth, because it had at heart the good of the nation, while foreign investors concealed expansionistic and imperialistic attitudes behind business interests, and plans to exert political control through economic means.¹⁰⁴

'National capital' arguments were voiced in different quarters of the Ukrainian political arena and to different degrees. The President urged to "buy Ukrainian!", and Oleksander Moroz's Socialist Party demanded the development of national capital and called for the support of national production.¹⁰⁵ Lamenting the massive penetration of low-quality products, especially in the food industry, some advocated the introduction of "flexible protectionist measures" to defend the quality of products and give national industry an opportunity to grow.¹⁰⁶ At the same time, Ukrainian entrepreneurs complained that because of the high tax rating and complicated foreign trade regulations, Ukrainian production was disadvantaged vis-à-vis foreign production, and export had become for them highly unprofitable.¹⁰⁷

As a representative of the banking community pointed out, "everybody thinks [that national capital must be defended to allow its development], because without national capital it is difficult to manage the economy".¹⁰⁸ Oleg Bilorus, deputy of Hromada, and one of the most vociferous supporters of a policy to defend national entrepreneurs, confirmed: "In the

¹⁰⁴ Stanislav Arzhevitin, interview with the author, *Op. cit.*

¹⁰⁵ L. Kuchma (2000), *Op. Cit.*, p. 242

¹⁰⁶ Anatolii Gritsenko, interview with the author, *Op. cit.*

¹⁰⁷ Yu. Kornev (1998), "Ne vygodno", *Biznes*, n. 46, pp. 14-15

national interest only national capital can be the real locomotive of transformation and development. It would be the real security and guarantee for that. National capital is [...] not ethnic but political. National in the sense that it was produced here, and that it was invested here”.¹⁰⁹

On the concept of ‘National Capital’ the interests of the economic elite were seen to coincide with the nationalist striving to preserve an independent Ukraine. Arguments for moderate protectionism gained praise also in liberal-oriented nationalist circles, where, it was suggested, specific group interests could be channelled to foster the process of nation-building.¹¹⁰ As the interest of the economic elite was primarily in “establishing control over the national wealth”, they acquired a patriotic character by default.¹¹¹ Only the consolidation of Ukraine as a “strong nation” would rebuff the dangers of re-assimilation that the Russian capital would present in the case that the plan of an economic or political union between the two countries was implemented.

The Ukrainian economic elite was well aware that their resources were limited in comparison with their Russian or Western counterparts, and their production was largely unable to face competition on foreign markets. Ukrainian economic actors realised that their activity was inevitably territorially limited to Ukraine, their fortunes irremediably “linked to the Ukrainian soil”. The defence of the Ukrainian nation, then, became for the Ukrainian business a matter of survival.¹¹²

The policy preferences of small entrepreneurs, however, seemed to make no difference between foreign and national capital. Concerned with the stagnation of the Ukrainian economy, representatives of small business viewed the influx of any sort of foreign investment as an indispensable contribution to a strategy of growth.¹¹³

¹⁰⁸ Valerii Suskin, interview with the author, *Op. cit.*

¹⁰⁹ Oleg Bilorus, interview with the author, *Op. cit.*

¹¹⁰ Aleksandr Goncharenko, interview with the author, *Op. cit.*

¹¹¹ Oleksandr Shnytko, interview with the author, *Op. cit.*

¹¹² Igor’ Burakovskii, interview with the author, *Op. cit.*

The idea of national capital found fertile ground on the widespread preoccupation, primarily supported in nationalistic (Rukh) as well as liberal (presidential administration) quarters, that Russia was using economic levers to achieve its political aims. Although many agreed that the threat of a massive invasion of Russian capital had never really existed, there was, however, general apprehension about the aggressive character of Russian investors.¹¹⁴ Western investors were moved only by business reasons, it was argued, exclusively aiming at maximising their profits, whereas Russian investors masked their imperial appetites beyond business projects, which aimed to thus reinforce Ukraine's political dependence through economic means.¹¹⁵

As Oleg Bilorus pointed out, Russian business involved in Ukraine had a dual objective: “the first basic, very pragmatic, business, economic co-operation in spite of all, and the second integration with Ukraine. [...] They discussed all of the time the so-called ‘strategy of fragmentation’ of Ukraine, fragmentation in all senses, disintegration, reduction of trade and so on”.¹¹⁶

At the same time, Russian capital was viewed as “dirty capital”, speculative and criminal capital which would introduce in Ukraine the devious Russian business practices. Oleg Soskin, presidential advisor on economic issues was adamant on this point:

“As Ukrainian capital also the Russian capital is a new capital, originated from the shadow economy, it is a criminal capital. This is why it should not be allowed in Ukraine. Russian capital is oriented towards making their profits under monopoly conditions. We should not allow a capital that burns all the bridges behind, that gathers as much as it can and then leaves”.

¹¹³ Nataliya Koshevina, President of the small-business organisation “Yednannya”, interview with the author, Kyiv, 12 November 1998

¹¹⁴ Officials in Bank Ukraina reported an influx of Russian capital into the bank, as well as another Ukrainian bank, in coincidence with the 1996 Russian Presidential elections. The risk of a massive influx of Russian capital was, however, dismissed, given the rigid controls imposed on the Ukrainian banking system by the National Bank. This control also reduced the opportunities to establish transnational financial-industrial groups. This information was provided by Aleksei Pavlov and Evgenyi Zel'tser, interviews with the author, *Op. cit.*

¹¹⁵ Oleg Soskin, interview with the author, *Op. cit.*

¹¹⁶ Oleg Bilorus, interview with the author, *Op. cit.*

In the most moderate form, protection of national capital focused on defence against Russian penetration, while it hailed Western investment and the consequent exchange of technology as a route towards economic recovery and scientific progress. The option of an autarchic economy was completely dismissed; it was viewed as being the source of further corruption and economic degradation, while an export-oriented strategy was indicated as the optimum alternative. As in the countries of East Asia, an active engagement with Western companies was felt to bring the advantages of new technology and consistent investment capital. Ukraine would then become the next “economic tiger”. “We should not defend our capital, creating for it artificial support, we have only to establish the right conditions for it to work. The same conditions must be applied to foreign capital”.¹¹⁷

The appeal for Western economic involvement in Ukraine derived also from the view that Western investment would counterbalance the Russian presence in the country, especially in the energy sector. Ukrainian commentators welcomed the idea that Western companies would be attracted to finance repairs to the Ukrainian gas transportation system in exchange for concessions.¹¹⁸ As part of its “geopolitical project”, Gazprom, it was feared, would not be satisfied with generic concessions. In the view of Ukrainian commentators, Gazprom’s exclusive aim was to obtain ownership over the Ukrainian system, increasing the country’s debt up to 50% of the value of the transportation facilities. This would then put the company in a position to reclaim property legally, or take long-term control over these objects.¹¹⁹

In more radical forms, however, the ideology that claimed the protection of national capital portrayed any foreign intervention as an instrument of political and economic domination.

¹¹⁷ Oleg Soskin, interview with the author, *Op. cit.*

¹¹⁸ More than 30% of the gas used in Europe travelled through Ukrainian pipelines. Europeans were concerned about the state of the system and feared that a break down may result in vast losses. Royal Dutch Shell proposed that the Ukrainian government participate in the management and upgrading of the pipeline system. One of the forms of co-operation put forward by them was the creation of a joint enterprise with Ukrgazprom. Shell would hold 49% of the shares and leave to the Ukrainian government control over the infrastructure. Shell would participate with \$1, 5 billion investment in the operation. L. Krinichna (1998), *Op. Cit.*, and A. Volnenko (1998), “Iskusstvo igry na trube”, *Biznes* n. 13, 6 April, pp.35-36

¹¹⁹ V. Granovskii, M. Karizhskii (1998) “Komplementarnaya politika reformirovaniya gazovogo sektora”, *Kompanyon*, n. 17, p. 9

This was the position taken by Lazarenko and Hromada who used this rhetoric to launch their political challenge against the president and his administration.

According to Lazarenko, the gradual opening up of the Ukrainian economy and its consequential pauperisation had been part of a well-designed strategy to diminish the country's sovereignty, make way to the "Foreign Investor", obtain foreign financial aid and force the government to issue state obligations.¹²⁰ The intervention of foreign advisers and the policies of stabilisation imposed by international organisations had resulted in the "*deindustrializatsiya, deinttelektualizatsiya, dekul'turalisatsiya*" of the country.

Consequently, Ukraine had become "an economic and intellectual donor for developed countries. From [Ukraine] they extract tens of billion dollars every year". In particular, the liberalisation of foreign trade had caused a massive loss of national wealth to foreign countries. "The people of Ukraine have become an investor for the 'world society', every year we invest billion of dollars in the development of the economy of other economies, but not the other way round".¹²¹

Lazarenko characterised the relationship between Ukraine and other foreign countries in terms of "neo-imperialism" and "neo-colonialism". Thus, "the most important condition for Ukraine to realise its own national interests in the economic sphere was to guarantee the development of the country's economic system, preserving its management and integrity".¹²² Russian capital, however, represented, in Lazarenko's view, the most serious threat to Ukraine's economic development. Russian companies would not invest in industry, he accused, and would not resist the "temptation of buying some Ukrainian sectors at dumping prices".¹²³

The protectionist mood, echoed by the 'national capital' arguments and often disguised behind patriotic professions, appeared typical of a country approaching the international economy and concerned by foreign competition. As Oleg Bilorus put it:

¹²⁰ T. Nezhenko (1998), "Pavel Lazarenko: Ya ponimayu chto mne v blizhaishee vremiya ne dadut spokoino raportat", *Kompanyon*, n. 21, pp.19.20

¹²¹ P. Lazarenko (1998) *Ukraina poslennii shans: strategiya natsionalnogo spaseniya* (Kyiv: Hromada)

¹²² *Ibid.*

“Our strategy of open economic borders is not working. This strategy would be very good if we were stronger, the strongest economy in the region, then we could open the economic system. But if we are weak, if we are in a process of transformation, in crisis, if we change social political formation – from pseudo-socialism to pseudo capitalism, if we are changing the economic system, if we are trying to change the economic structure of national economy, we should follow first the strategy of self-reliance, as China does, and we should follow the strategy of economic [isolationism]. All governments of Ukraine starting from 1992 never understood this. They for sure thought that all other countries are brothers and sisters, they come bringing investments. They have never understood what international economic competition is, and they have never understood that every country has its own national interests.”¹²⁴

Commercial Banks and National Capital

The banking sector was perceived as the most seriously at risk from foreign competition, given the delay it had experienced in liberalisation and in the emergence of a stable private entrepreneurship. Hyperinflation in the early 1990s had led to a massive flight from money and a consequent return to barter relations, both at the level of consumption and at the level of industrial exchange. Burning up savings and long-run investment perspectives, hyperinflation had obstructed the growth of an independent and solid banking system.

In 1995, 92 of the then registered 208 commercial banks (42% of the total amount of capital) had a statutory fund of not more than 10.5 billion karbovanets. Given the rate of currency depreciation and inflation, the National Bank of Ukraine (NBU) itself defined that amount “insufficient for the sound functioning and for the development of commercial banks”.¹²⁵

The central bank remained firmly in control of the commercial banks (130 registered in 1998), regulating their activity and restricting their possibilities for investment. Directly responsible to the government, the NBU was for the best part of the 1990s forced to support the executive’s policies and finance its extra-budget credits, and

¹²³ T. Nezhenko (1998), *Op. Cit.*

¹²⁴ Oleg Bilorus, interview with the author, *Op. cit.*

was thereby unable to provide liquidity appropriate for the investment purposes of the financial institutions.¹²⁶

As was the case with Russia, many Ukrainian banks had been created in the early 1990s to address the financial needs of particular businesses, industrial or administrative institutions, and they had emerged on the basis of often very limited investments.¹²⁷ One third of the banks registered in 1997 was believed to have an authorised capital below the ECU 1 m or \$ 1.3m minimum set by the NBU.¹²⁸ It was estimated that in terms of the amount of capital, the largest Ukrainian bank would not be included among the top 10 Russian banks, and only two Ukrainian banks would make it into a list of the 100 largest banks in the CIS.¹²⁹

In the autumn of 1998 commercial banks were in revolt against the NBU and the restriction imposed by the central institution to their activities. At the Congress of the Association of Commercial Banks in February of the same year, representatives of the commercial banks had demanded that the NBU lower the percentage for mandatory reserves. The high debt of state enterprises (totalling more than \$ 13 million) and the consequent restriction on the capitals available were already strangling the banks' commercial possibilities. It was feared that a further reduction in liquidity funds would severely hamper business activities in the financial sector.¹³⁰

As a consequence of the steady and automatic subsidies made to loss-making state-enterprises, commercial banks suffered an endemic bad-debt problem. The low quality of

¹²⁵ National Bank of Ukraine (1994), *Annual Report*, (Kyiv: mimeo), p. 16

¹²⁶ In 1994 according to the NBU annual report, total credits granted to the Ministry of Finance amounted to Kb 140 trillion. They were granted to cover the inter year gap between budget revenue and expenditures, but they were systematically transformed into budget subsidiary funds. Given the fact that commitment to the government absorbed much of the central bank's resources, the NBU claimed that it could not fulfil its plan to direct 10% of the primary credit emission to crediting commercial banks for their transactions.

¹²⁷ Five of the existing banks derive from the local branches of the Soviet Gosbank's sectoral banks, one is a savings bank (Oschadbank), three are specialised lending banks (industrial investment, agricultural and social development) and one is the Export-Import Bank of Ukraine. A. R. Latter (1995) "Banking reform in Ukraine", in *Banking Reform in Central Europe and the Former Soviet Union*, edited by J. Rostowski, (Budapest: Central European University Press), pp 183-96.

¹²⁸ *Golos Ukrainy*, March 22, 1997, p.2

¹²⁹ *Rossiskaya Gazeta*, March, 30 1996, p 10

assets appeared to be the most widespread issue. In January 1997, about 22% of the credit and investment portfolio of all Ukrainian banks was defined as “problematic”.¹³¹ As a result of the drop in industrial (-1.8%) and agricultural production (-1.9%) in 1997, the banking system had registered losses between 7-8.5%.¹³² Since the creation of the Ukrainian system of commercial banks sixty-three banks had faced financial difficulties, forty of them had already been liquidated and twenty-three were in a regime of sanitation whereby their activities were supervised by the central bank.¹³³

Two more circumstances intervened in 1998 to weaken the position of commercial banks and to make them fear for their survival. The National Bank imposed a requirement that banks raise their statutory fund to ECU3 million from January 1999. The move, designed to guarantee stability in the system, would have had in fact the result to cut off the so-called pocket banks and reducing drastically the overall number of active banks. The president of the Banks Association in Odessa estimated that 80% of the banks in his region would be forced to close.¹³⁴

The second blow against commercial banks was the National Bank’s decision to reduce the number of authorised banks from eighteen to six. Serving as an authorised bank had been for many financial institutions an opportunity to increase liquidity, through the management of budget resources. Having their liquidity reduced and the number of customers severely curtailed, banks would be forced to make more frequent use of inter-banking credits. Privatbank and Praveksbank were among the institutions affected.¹³⁵

Feeling squeezed by market restrictions, representatives of the banking community, more than other sectors, went on the offensive. The president of the Association of Ukrainian Banks (AUB) Aleksandr Sugonyako accused the legislature of seeming to introduce into the capital market regulations that limited the participation of national capital and favoured

¹³⁰ A. Kovtun (1998), *Op. Cit.*

¹³¹ M. Bogomazov (1997), “Kolichestvennie podkhody k problemam kachestva”, *Biznes*, n. 19, 20 May, pp. 20-21

¹³² A. Potokov (1998), “Bolshaya ten’ na bankovskii pleten”, *Biznes*, n. 6, 16 February, pp 15-16

¹³³ A. Kovtun (1998), “Banki uzhe vzyali”, *Zerkalo Nedelii*, n. 7, 14-21 February, p. 1

¹³⁴ A. Potokov (1998), “Bolshaya ten’ na bankovskii pleten”, *Biznes*, n. 6 (265), 16 February, pp 15-16

the accumulation of foreign capital. In particular, he said, tax provisions for state obligations (OVGZ) discriminated against domestic investors, while allowing foreigners to escape taxation. Foreign investors were guaranteed 21% revenue on medium-term obligations (allegedly three times higher than on the world market). Commercial banks at large advocated the introduction of protectionist measures that would allow them to accumulate enough capital to face, at a later stage, foreign competition.¹³⁶

Stanislav Arzhevitin, president of Aggio Bank, and Vice-President of the AUB called for the introduction of a central planning system of foreign investment based on the “careful consideration of the country’s aims, possibilities and financial requirements”. The government would be called upon to decide the proportions and the modality for foreign economic participation. Foreign investment, he maintained, should never exceed a level beyond which foreigners could claim control over the political situation of the country, demanding representation in the government and the parliament.¹³⁷

Concerns over the predominance of foreign capital in the Ukrainian financial system appeared to be widely shared beyond the commercial banks. Domestic legislation had indeed created conditions that offered vast protection to the national financial institutions and had repeatedly attracted criticism for the use of double standards for foreign and national investors.¹³⁸ Despite the fact that Ukrainian legislation applied to enterprises with foreign capital the same regulation that applied to enterprises with only Ukrainian capital, observers stressed the wide discrepancy existing between the law and practice, which, in fact, imposed severe limitations to the establishment and the activity of foreign banks.

There was the perception that, for example, since the quality and quantity of services offered by foreign banks was higher than the services offered by Ukrainian banks, the penetration of foreign banks should be somehow limited, to discourage potential competitors. The procedures to open a bank with foreign capital were made artificially

¹³⁵ E. Pototskaya (1998), “Byudzheth pokinul banki”, *Biznes*, n. 10, 16 March, p. 22

¹³⁶ A. Potokov (1998), *Op. Cit.*

¹³⁷ Stanislav Arzhevitin, interview with the author, *Op. cit.*

¹³⁸ A. Potokov (1998), *Op. Cit.*

long, expensive and complex. But, most of all they were subjected to the arbitrary decisions of the NBU, which had to provide authorisation for the creation of the bank. Foreign banks were obliged to undergo a compulsory examination of the Antimonopoly Committee, while the same rule did not apply to domestic banks.¹³⁹

Conclusions

During his first term in office President Kuchma succeeded in stabilising relations with Russia, and solving most of the disputes that had been left open in the post-independence period. To Leonid Kuchma and his administration went the credit for having negotiated and signed the long-awaited Friendship Agreement between the two neighbouring countries that, for the first time after the dissolution of the Soviet Union, set relations between Russia and Ukraine on an equal footing. Ukrainian sovereignty was formally acknowledged, and the mutual inviolability of borders sanctioned. During Kuchma's presidency the practice of anti-Russian nationalism followed by Leonid Kravchuk was finally abandoned.

The stabilisation of relations with Russia did not open, however, the path to the much-anticipated Slavic union. Expectations that with the election of President Kuchma a process of political integration, preceded by economic integration, would take place were disappointed. The Ukrainian economic elites, together with their Russian counterparts, were supposed to lead the rapprochement based upon a presumed commonality of business interests.

Yet, in the period between 1994-98 it became evident that in fact precisely these economic elites had become aware of the antagonism of their group interests, and had started to articulate a militant nationalist agenda. In the wake of the privatisation of large strategic plants, nationalistic politics was designed to keep the Russian economic elites out of the process that would redistribute the national wealth. The fact that nationalism had been used as a state-building platform in the post-independence years and that an active nationalist

¹³⁹ M. Yanevich (1997), "Inostrannye banki i butylki", *Kompanyon*, n. 4, pp. 14-15

movement existed at the grassroots level allowed the Ukrainian economic elite to use nationalist arguments to maintain their grip on the national wealth. That is, concepts such as 'national bourgeoisie' and 'national capital' were used instrumentally as a tool of resource mobilisation.¹⁴⁰

The system of rent-seeking and patronage network that had emerged as a result of the process of reforms and incipient liberalisation and had consolidated around the figure of President Kuchma left little space to the participation of external economic agents. In the period between 1994-98 the economic structure seemed to maintain a precarious balance of forces between the Presidential administration, the Parliament and the different sections of the economic elite, which traded political support for control over parts of the national wealth. In anticipation of the 1999 presidential election, privatisation of strategic plants and allocation of subsidies and exemptions were used as resources to support the President's second electoral bid.

Russian capital, more than any other foreign capital, was ready and experienced in playing the game by the same rules. Being more powerful and better experienced in privatisation deals than its Ukrainian counterpart, Russian business could be depicted as the real threat to Ukrainian economic independence. The aggressive character Russian oligarchs had displayed in their domestic transactions justified fears of defeat and re-annexation. On the economic grounds of co-operation between Russia and Ukraine, as a result, the policy preferences of a vulnerable and slowly consolidating Ukrainian elite clashed with the predatory attitudes of the Russian elite, thereby undermining the basis for economic co-operation between Russia and Ukraine.

The set of economic and political interests that developed within Russia and Ukraine in the period between 1994 and 1998 provided, then, little in the way of a foundation for a presumed communality of economic interests. The very emergence of national economic elites, concerned with extending their control over national wealth, set the relationship

¹⁴⁰ M. A. Molchanov (2000), "Post-Communist Nationalism as a Power Resource: A Russia-Ukraine Comparison", *Nationality Papers*, Vol.28, n. 2, pp. 263-288

between the two countries on a competitive rather than co-operative basis, with control over property interpreted as a zero-sum game.

CONCLUSIONS

In the period between 1994-1998 relations between Russia and Ukraine underwent a dramatic transition, moving away from the narrow nationalistic approach that had characterised the first years of independence. On the one side, the Ukrainian leadership abandoned the aggressive anti-Russian tones that had been an integral part of Kravchuk's strategy of nation-building. On the other side, the prevalence of pragmatic nationalist arguments in the Russian foreign policy circles also meant that boisterous imperialistic plans of political reintegration on the post-Soviet arena were replaced by a less threatening rhetoric of economic co-operation.

The election in Ukraine of a moderate President as Leonid Kuchma was interpreted by many as a sign that a rapprochement between Moscow and Kyiv would follow soon. With a background as director of an industrial plant located in one of the Russian-speaking regions of Ukraine, Kuchma presented himself as the best representative of a pragmatist foreign policy approach. In the president's view, a pragmatist strategy would restore the priority of economic interests over ideology as the crucial factor in defining relations between Russia and Ukraine.

The emergence of a powerful economic elite in Moscow, which soon acquired control over domestic and foreign policy-making institutions led to believe that all the conditions were in place for a renewed relation. Old imperialistic ambitions would be discarded in the name of a mutually beneficial economic co-operation. Following a functionalist approach to economic integration in the CIS, economic actors in Russia and in Ukraine were expected to play a leading role in an increased economic and possibly political interaction between the two countries.

In practice, however, economic and political reintegration did not take place. The economic elites of the two states, with their divergent rather than convergent interests played a crucial role in this process. Russia and Ukraine consolidated as two separate entities, and relations between the two countries evolved towards a civilised coexistence

based on the mutual acceptance of their independent statehood rather than towards political or economic re-absorption.

In this work I have sought to explain why increased economic and political co-operation between Russia and Ukraine failed to happen. This question is important also in terms of the study of international relations, as the relationship between Russia and Ukraine provides an interesting testing case for co-operation and integration theories.

The transnationalist and institutionalist theories outlined in chapter one present important insight to understand some aspects of the unfolding of events between Russia and Ukraine. In particular they are useful tools to depict fragmented polities, to which a unitary concept of national interests and foreign policy agency is not appropriate. These theories, however, fail to catch the complexity of the Russo-Ukrainian relationship and its dynamic evolution.

Transnationalist theories of integration, for example, would lead to believe that the difficulties derived from the disintegration of the Soviet common environment would be a sufficient motivation for economic elites in both Russia and Ukraine to lobby for the recreation of the common market. Institutional theories would maintain that the formal existence of institutions such as the CIS Economic Union and extensive legislation regulating TFIGs should automatically convince economic actors to shift their loyalty from the national to the transnational level.

This research has shown, instead, that only a comprehensive examination of the domestic level of politics provides a parsimonious analysis of relations between Russia and Ukraine. The interests of domestic actors, their aggregation into political coalitions, the role played by the state institutions in representing these interests, and the influence and conditions provided by the international environment are all elements that must be taken into account. The discussion presented in this work has then been framed within a domestic perspective of international relations and has been developed in two levels. The first level is the interrelation of domestic and international factors in the shaping of interests and policy preferences of political actors. The second level is the influence that the interests of

individual groups exercise over the sanction or re-direction of a determined foreign policy course.

This bifocal approach stems from the conviction that “the relationship between a weak and unstable domestic institutional context, ideas as a source of legitimacy in competition for political power, and the weight of the international environment in activating interests and influencing policy choice” are powerful instruments to understand post-Soviet foreign policy.¹ This is particularly true when issues like state-building, nationalism, economic liberalisation and the consequent redistribution of economic resources overlap, as they did in post-Soviet Russia and Ukraine.

Moving away from an issue-based analysis of Russian-Ukrainian relations in the post-Soviet arena, I have then adopted an actor-based perspective grounded on the assumption that in countries undergoing a process of political and economic liberalisation, like Russia and Ukraine, social interests are fragmented and widely diversified. Political representation of interests is achieved by the group(s) that succeeds in “capturing” the state institutions and in translating its preferences into implemented policies.

The choice to concentrate on the economic elites in Russia and Ukraine derives from two considerations. First, the Russian economic elite successfully “captured” the Russian state institutions in the period between 1995-98. Thanks to the special relationship established between Yel'tsin's administration and the oligarchs, not only domestic, but also foreign policy interests of the top echelons of the Russian business community found expression in the centre of Russian political power.

In Ukraine the consolidation process of business interests around state institutions was somehow slower, but by 1998 the Ukrainian big business had managed to gain representation both in the legislative and the executive branches of power. Ukrainian oligarchs, to different degrees, were thus in a position to influence or determine Ukrainian

¹ C. A. Wallander (1996), “Ideas, Interests, and Institutions in Russian Foreign Policy”, in *The Sources of Russian Foreign Policy After the Cold War*, edited by C. A. Wallander (Boulder: Westview), 207-218 (quotation p. 207)

domestic policies. The weakness of the Ukrainian business at the international level meant, however that the Ukrainian economic elite was not ready to formulate a set of foreign policy preferences other than the request for protection on the domestic market.

The second consideration is that, both the doctrine of CIS integration and the pragmatist approach to Russian-Ukrainian relations (outlined in the introduction) assumed the existence of convergent interests between the economic elites of the two countries as the precondition for a possible bilateral reintegration. If the two theories had any foundation, the period between 1994-98 should have witnessed acceleration in bilateral co-operation and possibly in economic and political reintegration, as the economic elites were in a ruling position in both countries.

Contrary to expectations, however, during this period Russia and Ukraine experienced a process of consolidation as independent political and economic entities. The nature of economic transformations in these countries played a critical role in the pattern of national formation that emerged.

This, however, is not to say that President Kuchma repudiated the policy of pragmatism that brought him to office, but he reoriented it substantially. Leonid Kuchma's electoral promise of a political rapprochement with Russia was indeed achieved with great success. The signature of the 1997 Friendship Agreement marked the end of the post-Soviet contention between Russia and Ukraine. Territorial claims were dropped. State borders were indisputably defined. Any ground for Moscow's direct intervention in Ukrainian domestic politics was removed. Russia and Ukraine agreed to relate one to the other as two legitimately sovereign countries.

Kuchma's pragmatism, however, suggested that, in order to maintain Ukraine's balance of power, the president needed to appease both the domestic business community and the Russian partners. The former would provide Kuchma with vital support in his internal political struggles, while the latter could impinge upon Ukrainian stability through their control over energy supplies, the Ukrainian debt, and bilateral trade policy.

Following unsatisfactory results in economic and administrative reforms, international organisations and Western governments threatened to curtail their contributions to Ukraine. Exposed to external pressures and to the urgent necessity to secure Russian help in the 1999 presidential elections, Kuchma made concessions to Russian interests with the 1998 Treaty of Economic Co-operation. Yet, the guarantee that the agreement would encounter substantial parliamentary opposition to its ratification, and would be unlikely to be implemented, put the Ukrainian president in the position to lend a friendly hand to Moscow, while at the same time still enjoying the support of domestic economic actors.

Kuchma never gave the signal that he would move relations between Russia and Ukraine along the same path of integration that Belarus was following. The President's main constituency in the 1994 elections had been the industrialists from the southern and eastern regions of the country, who identified their primary economic interests as the restoration of Soviet-era industrial and trade relations with Russia. Then two conditions changed.

During the four years of his first term in office, Kuchma broadened his electoral support. On the one side he portrayed himself as the defender and the promoter of the whole Ukrainian business sector. On the other side, however, he sought the backing of the business community to crush political opposition. Pressures on the privatisation of strategic assets and the relative wealth of their Russian counterpart convinced the Ukrainian business community that their interests were in fact very much different from the Russians'. The Ukrainian "national bourgeoisie" defined then its agenda in terms of defending "national capital" as an instrument to foster the country's development.

The emergence of a protectionist mood in Ukraine, articulated through the nationalist vocabulary of patriotic concerns, challenged then the *a priori* assumption of common economic interests between members of the Russian and the Ukrainian elite. In fact, it highlighted the existence of antagonistic interests dictated by the very emergence of a nation-based economic elite.

The process of economic liberalisation, in particular privatisation, with the emphasis placed on ownership rather than investment, brought to the fore the close interdependence between political circles and the business community. The rent-seeking nature of the business elite in both countries made it heavily dependent on political power. At the same time, unstable administrations employed the distribution of economic privileges (access to privatisation, management of profitable enterprises, granting of state subsidies) as an instrument to guarantee the support of powerful economic actors.

An important aspect of the alliance between business and politics was that such an alliance was very much country-based. The intervention of external agents was hardly foreseeable in a situation where newcomers could upset the delicate balance of forces defined between the executive, the legislative, different sectoral economic interests, and the oligarchs. The perception of the process of privatisation as a zero-sum game also left little or no room for outsiders' participation. A Russian strategy based on economic expansion, then, contrasted a Ukrainian strategy based on withdrawal within domestic boundaries and protection of the internal market. Economic and political re-integration dropped from the agenda of bilateral relations.

Theorists of nation-building would interpret the failed reintegration between Russia and Ukraine as an example of the consolidation of statehood in the two countries. While not denying this interpretation, my research shows that economic interests and economic elites also played an important role in the process of achieving and preserving independence. Three conclusions then follow.

First, the very emergence of national economic elites created conflicting economic interests opposed to political and economic integration. Second, the process of liberalisation and, in particular, the redistribution of resources initiated a struggle among domestic and foreign actors to acquire control over the national wealth. Third, asymmetrical wealth and authority between national economic elites and consequent preoccupations that the richer country may take over economic resources belonging to the poorer country found expression in a nationalist rhetoric in Ukraine.

The structure of relations between business and the state institutions accounted for the degree of vulnerability perceived by domestic economic actors and for the concrete possibilities they had to articulate their group's interests. Before going on to explore in more detail the interrelation between nationalism and economic elites, it is worthwhile summarising the patterns of business-politics relations established in Russia and in Ukraine in the period 1994-98.

Models of Interrelations between Business and Politics

In post-Soviet Russia and Ukraine proximity between economic and political power proved a distinctive feature of political life, allowing the business elites the opportunity to translate their political preferences into concrete policy agendas. The weight and influence of the business elite appeared substantially different in the two countries, expressed in different forms and modulated by the importance of a number of political and economic factors at work in the period between 1994 and 1998.

In the second half of the 1990s, Russia and Ukraine could be characterised as forms of *weak states*, where "political power is fragmented and dispersed, [and] there are many points of access to the decision-making process".² Fragmented political institutions were open to pressures by societal interests, and in particular to the influence of "big business". Consequently, the ability of the state institutions to impose policies and decisions or to extract resources from societal groups appeared significantly impaired.

The Russian and the Ukrainian political structures were distinguished by the interweaving of three elements that determined the different character and development of the systems. The first element was the mutual dependence between business structures and executive power, caused by the authoritarian/illiberal degeneration of the political regimes. The second element was the pace and extension of the economic reforms together with the

² S. D. Krasner (1978), "Defending the National Interest. Raw Materials Investments and U.S. Foreign Policy", Princeton University Press (Princeton, New Jersey)

resource-endowment of the national economies. The third element was the division of competence between the executive and the legislative in relation to economic issues.

Both the Russian and the Ukrainian political systems evolved in the post-Soviet period towards forms of authoritarianism (or illiberalism), in which power was largely concentrated in the hands of the executive.³ This generated the need for extraordinary support provided by powerful agents, who had a stake in the maintenance of the newly acquired political status quo, but were formally external to the political struggle and institutions.

The Russian system generated an ambivalent relationship between the executive (the presidential administration and the government) and the economic elite, in which episodes of intense collaboration were replaced by attempts by the executive at restraining the cumbersome influence of the business partners. The concentration of economic power, the narrowness of the circle of power around the president and the high degree of penetration into state institutions achieved by representatives of the economic elite were, then, the distinguishing features of the Russian system.

The 1996 Presidential elections provided the most vivid examples of how this ambivalent relationship functioned. Some authors concur in saying that, even if Russia had substantially moved towards forms of authoritarianism, the importance played by elections in maintaining the stability of the system and the balance among political forces was still significant. As one observer noted, “the Russian state and democracy might be weak, but the balance of weak forces in them has so far been sufficiently strong to deter an attempt at a coup d’etat”.⁴ The only way to subvert the Russian regime, then, was through an “electoral transfer of power”.⁵ Facing the risk of a Communist revival in the 1996 presidential elections, the interests of the economic elite and of the presidency coincided, and the two groups joined forces. The economic elite’s support for Yel’tsin’s presidential

³ P. G. Roeder (1994), “Varieties of Post-Soviet Authoritarian Regimes”, Post Soviet Affairs, Vol. 10, No. 1, pp. 61-101

⁴ N. Robinson (2000), “The Economy and the Prospects for Anti-democratic Development in Russia”, Europe-Asia Studies, Vol. 52, No. 8, pp. 1391-1416

campaign was used as currency to acquire a right to participate in the design of the future economic reforms.

Conversely, the Ukrainian system allowed for a more continuous, even if no less pervasive, presence of the economic elite, not only in the presidential circles, but also within the parliament. This relationship between business and politics was formalised in a corporative structure.⁶ The diffusion of economic power, consequent fragmentation of the economic elites, and sectoral lobbying appeared as the primary components of this system. Also, the presence and the influence of external elements (for example pressures from the international community, or from Russia) seemed at times to contain the power of local economic elites.

Furthermore, in Ukraine the general instability of the political and economic system, coupled with the relentless struggle for power between the executive and the legislative forced the president to pull business forces originally exogenous to the political system, into the state institutions. Redistribution of resources, promises of privileged access to the privatisation of strategic assets and management of profitable state enterprises were all used as instruments to reward loyal supporters and punish those who challenged presidential authority.

The political backing of the economic elite was initially channelled through business associations or councils for the support of the entrepreneurship established under the auspices of the president. At a later stage, parliamentary fractions, party organisations and economic “holdings” provided an institutional structure for the alliance between business and the presidential administration.

The second element that determined the distinct character of business-politics relations in Russia and Ukraine was the different pace and extent of economic reforms adopted in the two countries. In Ukraine, export quotas and licensing arrangements on foreign and

⁵ *Ibid.*

⁶ P. Kubicek (2000), *Unbroken Ties. The State, Interest Associations and Corporatism in Post-Soviet Ukraine*, (Ann Arbor, Michigan.: The University of Michigan Press)

commodity trade were formally abolished only in December 1994. As a result of the long restricted access to these activities, foreign and commodity trade failed to generate the same extent of private wealth that emerged in Russia.

Moreover, a rich raw material endowment in Russia allowed individuals who succeeded in appropriating state resources to trade even in the absence of a well-developed industrial infrastructure. Ukrainian energy dependence on Russia and the country's decaying industrial system also explain the different outcomes of capital accumulation in Russia and Ukraine.

A further element in this equation is the late development of the Ukrainian banking system. As opposite to Russia, the Ukrainian financial market remained firmly centralised, with remarkable degrees of controls available to the National Bank until the late 1990s. Hyperinflation led in Ukraine to a massive flight from money and a consequent return to barter relations, both at the level of consumers and enterprises level. Uncontrolled price rises burned up savings and impaired any long-run investment perspective.

This poorly developed banking system lacked the appropriate financial and management resources to face the challenge of privatisation. On the other side, however, Ukrainian privatisation, obstructed by the ideological opposition of a left-wing parliament, started much later than in Russia, proceeded in a sporadic fashion and did not concern, at least until the late 1990s, large or strategic plants.

As a result of inconsistent economic reforms and a poorer natural resources endowment, the Ukrainian business elite was significantly weaker than its Russian counterpart; it was equally dependent on state munificence, but because of its more limited wealth enjoyed less negotiating power towards state institutions. Yet, relations between "big business" and political power underwent a substantial evolution during the four years of President Kuchma's first term.

In the period between 1994-98, the economic elite provided generic political support to the president in the parliament, voting in favour of presidential-sponsored decisions and against a *nomenklatura*-bureaucratic opposition. The rewards that the administration granted in exchange were along the traditional patronage lines and rent-seeking, such as export licences and subsidies to loss-making enterprises. From the 1998 parliamentary elections, however, the system started to evolve towards a more sophisticated exchange between the presidency and the economic elite in anticipation of the privatisation of large enterprises from the energy sector and the 1999 presidential campaign.

Following a more rapid process of economic liberalisation, wealth in Russia was larger and more concentrated than in Ukraine, and the political weight of the Russian economic elite was more pervasive and sophisticated than in the neighbouring country. In Russia, commodity exports, subsidised credits and food-import subsidies generated since the early 1990s large patrimonies, that were later employed in the establishment of a private banking system and a financial-industrial structure.

A substantial diversification in the economic arena took place, with a state system largely dependent on budget subsidies and a dynamic private sector ready to exploit its vicinity to political power to increase its economic weight. On the basis of a mutually advantageous exchange, the relationship between the new Russian entrepreneurship and the presidential administration was set on conditions of equality.

The Russian economic elite was in a situation to provide substantial financial help to the 1996 presidential campaign, bail-out for the indebtedness of the state (the share-for-loans scheme revenues was used to pay salary and pension arrears), and promises of “responsible behaviour” in the wake of the 1998 economic crash. In exchange, the Russian economic elite was rewarded with the guarantee that the post-Soviet status quo would be preserved and privatisation would not be overturned. The endorsement to carry out privatisation deals to the advantage of a restricted group of oligarchs was part of the advantages acquired through bargaining with the institutions.

The final element that distinguished business-politics relations in Russia and Ukraine was the different division of powers between the executive and the legislative in the management of economic issues. The conflict between the executive and the legislative was solved in Russia much earlier than in Ukraine. The 1993 constitution assigned to the president exclusive powers and control over the government, while the legislature's authority to check and balance the president was severely restricted. Privatisation was strictly controlled by the executive through the State Property Fund, and decisions relative to the share-for-loans scheme were made by the government. Also decisions relative to state subsidies were made by presidential decree, and were subject to the ratification of the parliament. Because of the extensive powers the president and his administration were afforded in the economic area, for the Russian economic elite it was most profitable to nurture connections with the executive.

In Ukraine, the conflict between the executive and the legislative was resolved only with the approval of the 1995 Power bill and the 1996 Constitution, which concentrated broad powers in the hands of the president, but allowed the parliament authority in some economic decisions, mainly in relation to privatisation. For the economic elite, proximity to the president proved an important element of stability, but the parliament, alongside the presidential administration, retained its importance as a body involved in the definition of strategic economic issues.

To sum up, different patterns of interrelation between business and politics in Russia and Ukraine were determined by the intertwining of three factors: the emergence of illiberal regimes, the shaping of different economic structures, and the establishment of a different balance of power between the executive and the legislative in the regulation of economic issues.

The distinctive combination of these three elements gave rise to a Russian oligarchic system characterised by close connections to the presidential administration and large financial capital. Once the possibilities of expansion within the territory of the Russian

Federation seemed to be exhausted, the Russian economic elite turned to Ukraine as a possible area of further economic acquisition.

On the other side, the Ukrainian economic elite was characterised by a more dispersed model of political representation, with connections both to the legislative and the executive branches of power. The limited nature of their resource forced the Ukrainian oligarchs to an inward oriented economic strategy aimed at preserving the only areas over which they could exercise their control. The exclusion of the more powerful Russian competitors from the process of resource redistribution became an integral part of the Ukrainian elite's strategy of self-preservation.

Nationalism as a Political Resource

Nationalism and patriotic sentiments provided both the Russian and the Ukrainian economic elites with an arena on which to articulate their interests and policy preferences. A distinction between benign and hegemonic forms of nationalism helps to clarify this point. A benign national mission is characterised by a defensive attitude towards outsiders and focuses on "improving collective welfare, maintaining the status quo, and strengthening internal cohesion and unity". Conversely, a hegemonic national mission has an "imperialistic and messianic" character, ultimately leading to expansive and aggressive policies pursued in the name of the nation.⁷

Following the collapse of the Soviet Union, both Russia and Ukraine went through a process of vast readjustment. Nationalism and identity played the important role of "holding society together", while the two countries were undergoing the strains of political and economic transformations.⁸

⁷ A. S. Tuminez (1996), "Russian Nationalism and the National Interest in Russian Foreign Policy", in *The Sources of Russian Foreign Policy After the Cold War*, edited by C. A. Wallander (Boulder: Westview), pp. 41-68

⁸ E. B. Haas (1986), "What is Nationalism and Why Should We Study it?", *International Organization*, VO. 40, n. 3, p. 710

Ukraine embarked on a process of nation-building, facing the challenge of having to justify and legitimise the very existence of the new state entity not only to the international community, but also to some parts of its population. Exposed to financial (energy dependence on Russia, external debt, and industrial restructuring) and political pressures (democratisation, institution-building, ethnic and citizenship policies), the young Ukrainian state appeared to the outside world permanently on the brink of fragmentation and civil war. One of the most important tasks for post-independence Ukraine was then to demonstrate that the Ukrainian state would be able to consolidate internally and satisfy its external obligations.

Russia also was severely hit by a post-Soviet crisis. Russian identity had overlapped with imperial identity for centuries. After independence, Russians struggled to accept a reduced role within the restricted boundaries of the Russian Federation. With the consolidation of post-Soviet governments in the former Soviet republics, Russians were forced to acknowledge that the possibility of the restoration of Russian authority in the region was not only politically impossible, but also economically unfeasible.

Yet, as James Richter summarises it, “elites in Russia [agreed] that Russia is the successor to a truncated empire and that Russia should regain its dominant influence over the territory of the former Soviet Union”.⁹ For pragmatic nationalists, economic expansionism became a substitute for political or military control to satisfy Russian hegemonic ambitions.

Ukraine’s “benign national mission”, dictated by internal instability and external insecurity translated into a nationalistic rhetoric centred around ideas of protection of the recently-acquired sovereignty and defence against risks of creeping re-absorption within a newly fashioned Soviet Union. Concepts such as “national bourgeoisie and “national capital” provided the economically weak Ukrainian oligarchs with a convenient vocabulary through which to express their expectations of economic protection. In contrast, Russia’s “hegemonic nationalism”, a heritage from the Tsarist and Soviet imperial past, provided

⁹ J. Richter (1996), “Russian Foreign Policy and the Politics of National Identity”, in *The Sources of Russian Foreign Policy After the Cold War*, edited by C. A. Wallander (Boulder: Westview), p. 75

Russian oligarchs with an ideological background against which an economic re-conquest of the Soviet space was viewed as a return to the traditional Russian grandeur.

In accordance to a constructivist model of nationalism, the Ukrainian economic elite employed nationalistic sentiments for two main purposes: to legitimise their public role, and to justify their protectionist claims. Nationalism provided Ukrainian economic actors with a channel of political mobilisation justified on the grounds of a past of political, cultural and religious repression suffered by Ukraine at the hands of Russian imperial institutions.¹⁰

In this respect, post-independence Ukraine followed the pattern of a post-colonial society, in which the belief that “only the nation, organised not merely as a community in arms but as a territorial economy, can redress the wrongs of economic exploitation” found wide intellectual currency.¹¹ As in many post-colonial societies, in Ukraine the existence of a middle class was viewed as a prerequisite for social stability and democratic politics.

The creation of a middle-class, supported through state financial resources, was portrayed as a necessary investment to establish a stable and sovereign state. The most significant aspect of this rhetoric was that solely the economic elite was on the receiving end of the “tangible benefits” (income, property rights) deriving from the use of nationalistic

¹⁰ Theorists of nationalism categorise theories of ethnic and national politics into three groups. A primordialist approach presents ethnicity as a “natural inherent attitude, as inescapable as a genetic property”. An instrumentalist approach sees ethnicity and nationhood as “fabricated, ideological categories” used by the local elites to manipulate public opinion and advance particular agendas. A constructivist approach understands ethnicity as an ongoing social process of “construction and deconstruction” in which ethnicity represents a “social identity that groups incorporate and internalise, largely as a collective response to discrimination, domination and exclusion”. Instrumentalist and constructivist theories agree in viewing nationalism as a “political myth”, that is “consciously created, propagated, and manipulated by the elites, or proto-elites seeking power, material advantages, or both”. Within this framework social identities are believed to develop as a result of “the recognition and articulation of a shared experience of discrimination, subjugation and subordination”. B. Anderson (1983), *Imagined Communities*, (London: Verso) and L. Walker (1996), “Nationalism and Ethnic Conflict in the Post-Soviet Transition”, in *Ethnic Conflict in the Post-Soviet World: Case Studies and Analysis*, edited by L. Drobizheva et al. (Armonk: M. E. Sharpe), pp. 3-13

¹¹ J. Mayall (1990), *Nationalism and International Society*, (Cambridge: CUP), p. 71

sentiments. While the country at large benefited only of the “psychic satisfaction” accruing from the “gratification of the taste of nationalism”.¹²

There is, however, one important issue that sets apart the process of nation-building in post-Soviet Ukraine from many post-colonial countries. The transition in Ukraine took place on the background of a process of liberalisation of the economy and privatisation of the state ownership. In many post-colonial countries, instead, the consolidation of the newly acquired sovereignty was carried on within the framework of a Marxist ideology that called for the nationalisation of the economic resources.

Economic liberalisation imposed special pressures to newly independent Ukraine in the definition of its foreign policy agenda and on its perspectives to join post-Soviet projects of integration. Conclusions deriving from the Ukrainian case can be tentatively extended to post-communist countries as well as post-colonial countries that face processes of state-building and economic liberalisation simultaneously.

The redistribution of resources that follows the dissolution of colonial institutions or the liberalisation of previously centralised economies sparks a struggle for power among domestic economic actors and against possible foreign competitors. Domestic actors are given the opportunity to acquire unprecedented control over national resources. In an initial phase of internal consolidation, actors struggle to achieve permanent control over national assets and state institutions. As the economic arena is fluid, the intervention of stronger foreign actors is perceived as a threat, and the vulnerability of domestic economic elites prompts them to raise demands for protection. The anxiety of the economic elite to gain access to property may find expression through a nationalist rhetoric. This is especially true if the history of relations between the two engaging countries is characterised by a past of cultural and political repression or economic exploitation.

¹² For a definition of economic nationalism in post-colonial countries see H. G. Johnson (1965), “A Theoretical Model of Economic Nationalism in New and Developing States”, Political Science Quarterly, Vol. 80, June, n. 2, pp. 169-185

Domestic actors might be available to move away from their narrow territorial base at a further stage of their development, when they perceive that the process of resource accumulation and power consolidation is accomplished, and they have gained control over a sufficient amount of resources to guarantee their stability. In this context, economic elites may be instrumental in the emergence of nationalistic movements, as they elect to use a nationalist rhetoric to preserve control over national resources. Arguably, economic actors may be behind the promotion of nationalist movements. Their need for stability finds expression through a patriotic vocabulary that is still part of the country's common heritage, following the recent struggle for independence.

As Celeste Wallander explains,

“Legitimacy, authority, and elite coalition building centered on issues of nationalism because these ideas served as focal points for political competition and provided information that both the elites and the public need in order to stake out political positions and to offer policies that would serve their interests”.¹³

The redistribution of economic resources may then become a catalyst for the mobilisation of the economic elite. But the coincidence between economic interests and nationalistic sentiments may be characteristic only of an initial stage of nation-building, when property is up for grabs, and the economic power of the local elite is not yet consolidated.

At a later stage, when political and economic power has stratified and roles and prerogatives of domestic groups vis-à-vis foreign groups have been defined, the struggle for resources may be fought using weapons other than nationalism. Domestic economic actors may then accept possibilities of “internationalisation”, signalling their availability to compete on external markets and opening up the domestic economy to foreign investors.

Further research is needed to show whether the significance of the business elite in national movements and the repercussion of economic liberalisation on political agendas are a case isolated to Ukraine or whether they have correspondence in other post-Soviet states. The

¹³ C. A. Wallander (1996), “Ideas, Interests, and Institutions in Russian Foreign Policy”, in *The Sources of Russian Foreign Policy After the Cold War*, edited by C. A. Wallander (Boulder: Westview), p. 213

emergence of Transnistrian nationalism in the Republic of Moldova, for example, seems to point to a movement generated within the local economic elite as an instrument to maintain ownership of the region's assets against the risk of a take-over from the Moldovan elites.¹⁴

There is, however, a contradiction between processes of globalisation and internationalisation going on in the outside world and the consolidation of a national elite through redistribution of national wealth.

Anthony Smith observes that:

“With the demise of the national state, regional-continental federation is the political form that best expresses and serves the economics of the great transnational companies and the societies of a ‘post-national’ era. [...] The national state can no longer serve the needs and interests of business and the market economy of advanced capitalism. [...] The regional-continental federation, which is best suited to the needs of transnational capitalism and as the locus of sovereignty, is especially appropriate for those populations who share a close historical bond and cultural heritage”.¹⁵

The results of my research dispute that countries like Ukraine and Russia can be considered part of this general trend of “post-nationalism”, in which political and economic issues become clearly separated. In the period between 1994-98, Ukraine and Russia appeared exposed to the contradictory pressures of globalisation and internal consolidation. Thus, while international organisations and foreign governments were providing financial support and technical assistance for the transition, they also imposed conditions for their assistance, which contrasted with the interests of the local elites.

In particular, calls for a larger participation by the indigenous elites in the economic activities of the country conflicted with the country's dependence on the external economy and the need to initiate technological modernisation through the support of international organisations and foreign governments. Autarchic or rigidly protectionist policies that characterised economic nationalist movements in the 1970s were difficult to implement,

¹⁴ I owe this insight into Transnistrian nationalism to Neil Melvin

¹⁵ A. D. Smith (1995), *Nations and Nationalism in a Global Era*, (Cambridge: Polity Press), p. 117

because the state lacked the resources needed for the restructuring and modernisation of the economic infrastructure. This unbalance explains why Ukrainian “economic nationalism” had to be selective, calling for protection against Russian competition, while, at the same time, trying to attract foreign investments and financial assistance from international organisations.

The failure of Russia and Ukraine to establish a close pattern of economic and political integration in the period between 1994-98 supports James Mayall’s observation that:

“When governments have newly acquired sovereignty and/or are primarily concerned with their political and economic vulnerability, they generally show a marked reluctance to create such institutions [supra-national institutions with the power and authority to redistribute income within the new entity]”.¹⁶

A newly independent country’s hesitancy in joining schemes of international co-operation has its roots in the delicate balance of forces established within the domestic political and economic arena.

¹⁶ J. Mayall (1990), *Nationalism and International Society*, (Cambridge: CUP), p. 94

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