

The State and Economic Reform in Ukraine

VOLODYMYR ZVIGLYANICH

The program of economic reform in Ukraine presupposes a drastic reconsideration of the role of the state in the intended transition from an administrative to a market economy.” That was a motto of Leonid Kuchma during his election campaign in the summer of 1994. This idea has gained further momentum since Kuchma’s election on 10 July 1994. According to Kuchma, the previous administration headed by Kravchuk misunderstood the role of the state in the process of economic transformation.

The core of the Kuchma program adopted by the International Monetary Fund (IMF) and the World Bank makes the state the centerpiece of radical economic change. It signifies a reevaluation of the idea of Ukrainian statehood. The patriotic model of statehood advocated by Kravchuk and by intellectuals from the national-democratic camp, especially from Rukh, the Ukrainian Republican Party (URP), the Democratic Party of Ukraine (DPU), and the Ukrainian National Assembly (UNA) was based on the supposition that building a state would be a relatively long process. It also embodied the belief that people should tolerate their hardships in order to have independence and develop their civil rights.

The instrumental pragmatic model of the state championed by Kuchma emphasizes the fact that the state is firmly established and presumes that one should use it to create a socially oriented market economy. According to the first idea of statehood, economic benefits would eventually be attained through the development of the norms and values of civil society. The second perspective sees economic prosperity as something that can best be attained by emphasizing a pragmatic rather than value-oriented model of statehood. Each of these views of the state’s relationship to economic reforms has its advantages and disadvantages. One should search for common ground rather than simply choosing one or the other view.

The pages to follow demonstrate the importance of both perspectives by examining the three ideas of statehood and economic change in Ukraine since its independence. The main emphasis will be put on the lengthy plan of radical economic reform that President Kuchma presented to the parliament on 11 October 1994. This plan, which numbered ninety-six pages, was prepared by a group of experts headed by the presidential adviser on macroeconomics, Anatoly Halchynsky. The rest of the group included Kuchma’s senior aide, Olexander Razumkov, academician Yuri Pakhomov, and first deputy prime minister Volodymyr Pynzenyk. After outlining the main ideas of Kuchma’s program, this article will discuss the public’s perception of the plan, as well as Friedrich Hayek’s views concerning the state and freedom in economic transformation. The essay concludes with a discussion of these views and their significance for the accomplishment of the proposed pragmatic concept of economic transformation in Ukraine.

Volodymyr Zvigliyanich, a former senior fellow at the Institute of Philosophy (Kiev), is an adjunct professor and research associate at the Elliott School of International Affairs, Institute for European, Russian and Eurasian Studies, the George Washington University, Washington, D.C. He is co-editor of the forthcoming book *Ukraine in a Post-Soviet World: Building a State* to be published by the Central European Press.

The Patriotic Model of Statehood and Its Economic Implications

The first concept of statehood may be referred to as the "patriotic model." A brief account of it was given in Kuchma's inauguration speech on 19 July 1994. In his speech Kuchma mentioned that after achieving independence Ukrainian statehood was seen as an end in itself. He disagreed with this idea, saying that "the Ukrainian state is not an icon to be prayed for."¹ The "patriotic model" in Ukraine was initiated by the Ukrainian dissident movement in the 1960s. It was further developed by the People's Movement for Perestroika, or Rukh, and supported by members of the Ukrainian *nomenklatura*, headed by former President Kravchuk. The "patriotic model" was presented at the Fourth All-Ukrainian Congress of Rukh on 4-6 December 1992 as a program of state-building in Ukraine. It consists of several major components including law and state building, economic reform, national security, health care, and the development of culture, education, and science.² The program hoped to achieve economic prosperity through the development

"The program hoped to achieve economic prosperity through the development of the ideals and values of civil society."

of the ideals and values of civil society. The state, according to this idea, is understood as an instrument of societal self-regulation and an agglomerate of the institutions of public power.³ The state cannot be placed above society or even be equal to it. Rather, it serves society. The program proclaimed the law-based state a societal necessity.⁴

Rukh's program planned to combine state building with the revival of the values and ideals of national culture. The revival of traditional culture and craftsmanship, the protection of cultural values and historical surroundings, the return of Ukraine's cultural heritage, and the renaissance of the Ukrainian language were among the basic points of this program.⁵ In their patriotic zeal they even proposed a bill on languages, an alternative to the one officially adopted in 1989, with administrative and criminal punishment for state officials and citizens for its "violation."⁶ However, this law has never been elaborated and concrete details of its enactment are unknown. The program's preoccupation with ideals of the past and its stress on revival of the ethnographic and linguistic features of patriotism did not bring the expected economic benefits to the population.

The economic part of the Rukh's program was oriented toward the model of a mixed, socially oriented market economy. It stated that the "mixed" character of the economy referred to the types of property and the correlation of market mechanisms with state regulation.⁷ The authors of the program tended to combine the liberalized version of the market economy with the paradigm of a "socially oriented" welfare state. However, the latter idea in the Rukh's interpretation did not go further than the recognition of the necessity of periodically changing minimum wages and providing help to the low income strata of the population. The stable prices and incomes were considered to be the basis of the well-being of the population. The "liberal" part of the economic model contained measures aimed at stabilizing the economy through liberalizing prices, developing free competition, and demonopolizing industries. These measures targeted the creation of an entrepreneurial class whose interaction on the market would lead to the stabilization and gradual reduction of prices.

The demonopolization process was scheduled to come before price liberalization. The state was supposed to create the necessary conditions for competition to dismantle the monopolies and establish new enterprises in the monopolized branches of industry, and to open, rather than protect, the monopolized sectors to international competition.⁸ The role of the state was crucial in the jump-start of reforms and in the creation of new entrepreneurs. Soon after, state influence on the market was limited to taxation policy and to planning and financing the restructuring of industry.⁹ Thus, the Value Added Tax (VAT), was to be reduced from 28 percent to 20 percent, an income tax was to be abolished, and a 10-35 percent tax on profit was to be introduced.

There was nothing in the program that provided for the creation of additional jobs for state bureaucrats. Therefore, it did not have a chance for success in 1992 or 1993 when the number of branch ministries supervising the economic reform increased. The program also undermined the positions of the “red directors” with its declared intent to open their principalities to foreign

“After more than three years since the official declaration of Ukrainian independence, there is still little public confidence in its sustainability.”

competition. The planned introduction of private agricultural property and the creation of a land market with the free buying and selling of plots met fervent resistance from *kolkhoz* directors.

The economic rationale of the “patriotic model” thus remained unnoticed at the time of its presentation in December of 1992. Instead, its value-oriented issues came to the forefront. The former Communist *nomenklatura* in Ukraine have adopted the aspirations of the “patriotic model” and used them to their benefit in the wake of the aborted coup of August 1991 in Moscow. The shift from complete dependence on Moscow to the proclamation of Ukraine’s secession immediately turned the provincial Ukrainian elite into major political players in the state and in the world. The shift in the habitual societal roles of former party apparatchiks caused reevaluations of their traditional friends and foes. Moscow became a foe overnight, whereas “bourgeois nationalism,” a target of incessant party and KGB activities, turned into a means of state building. Such a shift was supported by national-democrats, because it was the only way to get rid of Moscow’s influence and eventually share power with the former Communist elite.

In the sphere of popular economic *Weltanschauung*, the idea of Ukraine’s independence brought about a belief that as soon as Ukraine stopped transferring food and goods to Russia, it would be the richest republic of the former Soviet Union. The popular assurance that Ukraine was feeding Russia had become an archetype of the collective unconscious. This archetype was reinforced by an erroneous evaluation of the market capacities of the Ukrainian economy by the Deutsche Bank in 1990. Ukraine was placed first among the former Soviet republics with 83 points (out of a possible 100). The Baltic states received 77 points, and Russia received only 72. The calculations of the Deutsche Bank did not take into account Ukraine’s complete dependence of on Russia for its energy supply, or that 70 percent of the Ukrainian industrial output was brought to other republics of the former USSR, primarily to Russia, for final assembling.¹⁰ These miscalculations fueled the impression that economic prosperity would follow independence almost automatically, without any changes in the traditional Soviet framework of political and

economic decisionmaking. After more than three years since the official declaration of Ukrainian independence, there is still little public confidence in its sustainability. The “patriotic model” is on the defensive. This attitude was emphasized by the creation of the all-Ukrainian public association “Understanding” in January 1995, headed by former President Kravchuk. The preface to the Declaration of this organization states that Ukraine has now entered the phase of greatest difficulties on the path to consolidating independence. Internal and external forces have come into being that openly call for the restoration of the USSR, the changing of the symbols of the state, and the establishment of official bilingualism. Tendencies toward transforming the CIS into a *de facto* state organization have grown stronger, as shown by recently signed documents such as the Agreement on Creating an Interstate Economic Committee (MEK), and the Memorandum and the Long-Term Plan for the Integrated Development of the CIS, “which provides for the creation of supranational structures in virtually all spheres of social life.”

The association “Understanding” states that its strategic goals are the consolidation of Ukraine’s patriotic community, counteracting any attempt to transform the CIS into a new state organization, strengthening the army and the nuclear power industry, and the struggle against separatism, federalization, and splitting Ukraine along linguistic and cultural lines.¹¹

The National-Protectionist Model of Statehood, and Its Economic Program

The liberal economic program of the “patriotic model” of statehood was never fulfilled, nor even discussed. The real power of political and economic decisionmaking belonged to the older generation of post-Communist *nomenklatura* who were in their late fifties or sixties and came to power on the independence ticket. The implementation of a liberalized version of market reforms openly threatened their social position and personal well-being, and so they chose to follow the National-Protectionist Model (NPM) of statehood.

According to experts, this model had two stages. The first one was from August 1991 to October 1992, when Kuchma became the prime minister. The second stage began in May 1993 when the parliament refused to extend Kuchma’s extraordinary power and ended in July 1994 with the election of Kuchma as president.

During the first stage, “the political leadership of the country adopted the course of *de facto* removal of the state from the regulation of evolutionary market (*evolutsiinykh rynkovykh*) economic transformation.”¹² This step resulted in a sweeping criminalization of the economy. The Ukrainian media published astounding facts concerning broad-scale official distortions of real data on import-export operations. The Ukrainian economist Ivan Lukinov compared Ukrainian data on export-import operations with those published by the European Center on Macroeconomic Analysis, shown in Table 1.

According to the official statistics, the volume of Ukrainian exports in 1993 was \$310.4 million, and the volume of imports \$394.5 million, with a negative balance of \$84.1 million. According to the data of the European Center, the volume of Ukraine’s general exports in 1993 was \$10,841 million, and of imports \$12,669 million, with a negative balance of \$1,828 million.¹³ The difference between the Ukrainian and foreign statistics speaks of the real—and hidden—volume of trade operations, the accumulation of hard currency revenues in foreign banks, tax evasion, and mistrust of state policy by Ukrainian entrepreneurs.

TABLE 1
 Ukrainian Data on Exports and Imports in 1993
 and Statistical Data of Its Partners (in millions of U.S. dollars)

	Exports			Imports		
	Ukr. data	Partners	Difference	Ukr. data	Partners	Diff.
Germany	172	247	1.44	462	930	2.01
France	29	162	5.58	157	172	1.1
Italy	141	505	3.58	96	257	2.68
UK	36	19	0.53	53	110	2.07
Spain	13	53	4.08	4	25	6.25
EU	624	1099	1.76	946	1739	1.83

During the second stage, the administrative methods of regulating Ukrainian entrepreneurs and the economy were restored, because the political ambitions of some parliamentary leaders during Kuchma's term as prime minister blocked liberalization efforts.¹⁴

The *de facto* removal of the state from market transformation in Ukraine in 1991-92 would have signified that Ukraine had chosen the IMF-Gaidar plan for macroeconomic stabilization, with price liberalization as its main component. Meanwhile, the key principles of the National-Protectionist Model which were proclaimed by Kravchuk at a closed session of parliament on 24 March 1992, and published on 1 May 1992, were as follows:

- (1) The introduction of the Ukrainian currency (the hryvnya) and, as a preliminary counterweight to the Russian ruble, the reusable coupon;
- (2) The introduction of hard currency only trade with the former Soviet republics and a tariff on imports from them, with the introduction of VAT on exports to them;
- (3) The establishment of customs posts at all borders, especially with Russia; and
- (4) The encouragement of foreign investors, allowing them to buy property and land.¹⁵

In contrast to Gaidar's plan of economic recovery through the introduction of free prices and the removal of the state from the transition process, Ukrainian leaders chose a version of an administratively backed transition to a market economy. The idea of Ukraine's own currency, the key element of this program, bound the political rush to complete economic independence with the hope for achieving the internal and external convertibility of the hryvnya, thus creating the stimuli for increasing industrial output. The introduction of free prices based on both a supply-demand process and a system of relative prices was not initially planned in the Ukrainian economic model. From the outset, Ukraine tried to cope with the economic crisis in a traditional, protectionist way via the introduction of its own currency (a step without any economic backing) and the erection of semi-transparent customs barriers. Gaidar's reforms took Ukraine by surprise, and it was compelled to introduce so-called "free prices," which meant administratively raising prices overnight by anywhere from 100 to 200 times.

The introduction of a reusable coupon, the karbovanets, was the only real undertaking of the NPM. Attempts to reach independence in one leap were undermined by a number of factors, including the preservation of two parallel currencies, the ruble and the karbovanets;

the complete dependence on Russia and Turkmenistan for oil and gas; and the misunderstanding by both Vitaly Masol and Vitold Fokin, former top party apparatchiks who served as prime misisters before Kuchma, of how the market functions, especially in the area of credit-tax policy.

The official use of two currencies caused the creation of the ruble "black market," alongside the official market for the dollar. It also confused industrial structures, as no one bank would accept all the coupons. Stimuli for the increase in production output thus were seriously undermined. According to a report by the Ukrainian Ministry of Statistics, by the end of the first quarter of 1992 the fall of public production decreased somewhat, but the crisis continued. Compared to the corresponding period in 1991, GNP decreased by 18 percent; national income by 20 percent; and labor productivity by 19 percent. The decrease in basic branches of industry in Ukraine was about 20-25 percent. The biggest drops in production occurred in the food sector (30 percent), the petroleum refining sector (28 percent); the metallurgical sector (22 percent), and the chemical sector (18 percent). The production of almost all key industrial items declined.¹⁶

"A further threat to the Ukrainian plan to attain economic independence through the introduction of its currency was the decision of the IMF and the G7 countries to provide \$6 billion for the stabilization of the ruble."

Ukraine was always considered to be the "breadbasket" of Europe. Decades of devastation of Ukrainian agriculture by the *kolkhoz* system and the indecisiveness of the Fokin government in the field of land privatization caused a severe drop in production of basic food. During the first quarter of 1992 830,000 metric tons of meat were produced (26 percent less than in the corresponding period in 1991), 2.9 million metric tons of milk (24 percent less), and 2.1 billion eggs (14 percent less).¹⁷

The measures taken by Fokin's government tried to support Ukraine's independence economically, but the government was not prepared and created more problems than they resolved. One problem was related to the credit financing of enterprises, which was conducted exclusively on a ruble basis. Another problem was the oil and gas supply. Instead of the forty million metric tons needed by Ukraine annually, Russia provided only six to eight million tons and refused to accept the coupon as a means of payment. Ukraine was thus compelled to arrange barter deals for oil with Iran.

A further threat to the Ukrainian plan to attain economic independence through the introduction of its currency was the decision of the IMF and the G7 countries to provide \$6 billion for the stabilization of the ruble. Although it was not implemented, that measure nevertheless seriously undermined Ukraine's attempts to have a reliable monetary unit and raise the attractiveness of the coupon (or the hryvnya) in the eyes of potential economic partners. Within the framework of the NPM Ukraine also failed to create simple and stable stimuli for raising production and quality output.

Therefore, the reason for Ukraine's economic decline at the time, as implied by Kuchma, was not a lack of state influence on economics. The pattern of the state/economy relationship continued to be modeled on the former Soviet, pyramid-styled arrangement with all economic initiatives spreading from the state. Ukraine had simply chosen a *different* direction of economic change than Russia. The key element of the NPM, the

intended introduction of its currency rather than price liberalization, fulfilled several goals. It would have demonstrated visible implementation of the spirit of independence, and fortified support for Kravchuk as a "solid and sober-minded" defender of national sovereignty. Additional goals were of an intermediary character and aimed at the protection of the domestic market from "alien" (Russian) influences. Long-term goals included the establishment of state control over prices and wages and the restoration of a single "national-economic complex," which had been the cornerstone of the Stalin-Brezhnev-Ryzhkov economy.²⁰

A *partial* restoration of administrative control over some segments of the economy occurred during the second stage of the NPM, from October 1993 until July 1994. In particular, the export and re-export of raw materials was heavily regulated and a fixed karbovanets-dollar exchange rate was introduced. The latter measure led to unprecedented corruption in the upper echelons of the Ukrainian power structure. By that time, the national economy was in a free-fall. Therefore, a return to administrative control over the *whole* economy was impossible. It became obvious that the NPM did not achieve any of its goals, particularly the real independence of the state. In 1991, according to a group of Ukrainian and foreign economists including Anatoly Halchynsky, Olexander Razumkov, Yuri Pakhomov, Volodymyr Pynzenyk, Bohdan Havrylyshyn (Switzerland), and Anders Aslund (Sweden), who participated in the preparation and discussion for a plan of radical economic reforms, Ukraine had achieved only some attributes of a sovereign state. The hryvnya was never introduced. In 1991-93, domestic output declined 39.4 percent, more than the decline in U.S. output during the Great Depression (which did not exceed 25 percent) and in the Soviet Union during World War II (30 percent). Production in the first six months of 1994 declined 36 percent compared to the corresponding period in 1993.

Ukraine failed to establish a functional and efficient financial system, and came to lead the other countries of the world in the size of its budget deficit. In 1992, state budget expenditures took up 61.7 percent of national income; in 1993 they accounted for 73.2 percent. In 1994 they reached more than 85 percent, a sign of increased state control over the economy and bureaucratization. The funding of the state budget deficit in 1994 absorbed 85-95 percent of credit emissions, and reached almost 20 percent of the gross national product (GNP). The state collects only 50 percent or less in taxes.²¹

According to the Ukrainian experts, the reasons for these developments are as follows. First, it was strategically erroneous to attempt to assert Ukraine's statehood and economic independence by politically reorienting it from the East to the West.

Another strategical mistake was in removing the state from the process of regulating the transformation of the economy. A legal basis was created for the criminalization of the economy and the accumulation of capital in the "shadow" economy. From \$10 to \$20 billion belonging to Ukrainian citizens has been deposited in foreign banks, whereas there is only \$2 to \$4 billion in Ukraine.²²

There were other mistakes such as the introduction of the highest income tax in the world (90 percent), the collapse of reforms in agriculture, the artificial limitation of peoples' incomes, and the lack of influence of the National Bank of Ukraine on commercial banks.

Ukrainian economists believe that these mistakes were caused by the increasing level of administrative state control over the economy. The level of state controlled prices rose to 80 percent. According to World Bank experts, the index of administrative management of the Ukrainian economy in the summer of 1994 was 2.5 times greater than in the corresponding period in 1993. Meanwhile, the growth of administrative pressure on the

economy has diminished, and as Kuchma maintains, the real result of the state's control of the economy was its criminalization. Restoration of state management of the economy, without bureaucratic and administrative pressure, constitutes the strategy of intended economic reforms.

The Instrumental-Pragmatic Model of Statehood and the Economy

The essence of the latest Ukrainian economic model advocated by Kuchma is the goal of creating a "socially oriented market economy which in the end will subdue all the activity of its functional structures to the satisfaction of the material and spiritual needs of the individual."²³ This resembles a definition of the primary goals of the Soviet style five-year plans that always promised to satisfy the constantly growing needs of the Soviet people. This goal is to guide all efforts aimed at creation of a new society in Ukraine.

In particular, this model proposes: 1) to cut all state subsidies and conduct price liberalization together with financial and monetary stabilization; 2) to cut government spending and reduce the budget deficit through establishing limits: 8 percent of GNP in 1995, 6 percent in 1996, and 4 percent in 1997; and 3) to establish a state debt-servicing market, and issue state bonds, loans, and short-term treasury notes by the end of 1994.

The government will also develop a system to auction securities according to their real market value, taking inflation into account. Investors in state securities will receive tax breaks. A special financial body, the National Committee on the Open Market, will be established in 1995 to supervise the equity market.

The creation of new state bodies to supervise the process of marketization of the Ukrainian economy is foreseen in almost all of sectors. For instance, the government wants to create an Interdepartmental Consultative Council on Banks, which will include representatives from the National Bank of Ukraine, the parliament, the Cabinet of Ministers, and the Commercial Banks Association. This body is to regulate the activity of the commercial banks directly rather than through the National Bank of Ukraine.

To develop the stock market, the government will establish a special Commission on Securities to provide regulations, control, and protection of rights on the securities market. To promote the demonopolization of the economy, an Interdepartmental Demonopolization Committee will be established. In an obvious contradiction with this move, state controlled financial-industrial conglomerates (FICs) will be created. Their main task will be to re-establish ties between former Soviet enterprises.

Privatization, according to the Instrumental-Pragmatic Model of statehood, would also be regulated by the government. The new economic policy will promote a market economy featuring a mixed ownership system putting state-owned, private, and collective property ownership forms on an equal footing. That was one of the ideas advocated by Gorbachev before his resignation from the post of president of the USSR.

In the area of agricultural reform, the intended innovations imply an introduction of private property that is also under the control of the state. With this aim Kuchma will advocate an adoption of the State Program on Development of Land Reforms in Ukraine. According to this program, the land will be declared the property of the kolkhozi and sovkhozi, or as they are now called in Ukraine, "collective agricultural enterprises" (*kolektyvni silskohospodarski pidpryemstva*). Previously the land was only in the possession of the kolkhozi. Each member of the kolkhoz is to be given the right of property in the form of land plots (*pai*), the size of which depends on such factors as the number of members in a *kolkhoz*, its size, assets, etc. The six-year moratorium on buying and

selling plots imposed earlier by the parliament would be abolished. The implementation of this reform is made difficult by the social apathy of the rural population, which has lost the traditions of land management, and by the fact that the agricultural bureaucracy was in charge of land reform.

In the sphere of foreign trade, strategic priorities for the new economic program are the restoration of broken ties with Russia and other CIS countries, involvement in forming the structure of Ukraine's imports, and a policy of limited protectionism. A State Program for the Development of Export Potential of Ukraine will be elaborated.

In the sphere of social policies, the reform plan intends to ensure state support for the development of environmental protection, education, science, and culture. Education and health care will remain free of charge for most of the population.

To create appropriate means of attaining market reforms, as Yeltsin proposed in Russia, Kuchma has proposed that all parties and public movements should sign an act of national accord with the state. Kuchma also plans to propose a law on opposition to the state and to sign an agreement with trade unions declaring a six-month moratorium on strikes. In his 12 October 1994 speech at the parliament, Kuchma also warned all social forces in Ukraine that his decision to restore economic ties with Russia and other CIS countries is final and irrevocable.

The Public Perception of the Instrumental-Pragmatic Model

The recent program of reforms in Ukraine within the framework of economic and social pragmatism was well received by the Ukrainian public. The following is a description of the sociological and academic analyses of the Ukrainian perception of reform.

The sociological surveys of public opinion were conducted before and after the public was informed of the reform program. A nationwide survey, commissioned by USIA and fielded by the Kiev-based firm SOCIS-Gallup, was conducted between 10 October and 23 October 1994 on the basis of personal interviews with a nation-wide representative sample of 1,190 adults (18 years and older). The margin of error is plus or minus three percentage points.

The survey discovered that the reforms promised by the Kuchma government would be welcomed by the public, especially by young adults. It was shown that the public supported privatization and that they generally wanted the changes to be gradual. Among the young, an equal number wanted rapid privatization. More people favored a mixed economic system, rather than "mainly-state" or "mainly private" ownership. Most wanted land to be in private hands.²⁴

Only one in ten opposed the introduction of private enterprises in Ukraine, except among those 50 years and older. Overall, the public prefers gradual rather than rapid introduction of private enterprises, except for young adults (18-29 years of age). In this age group 46 percent were for rapid privatization, 45 percent were for more gradual privatization, and 4 percent were against any privatization. The other age groups expressed their opinion in a following way: 30-39 years of age—52 percent were for gradual privatization, 35 percent for rapid, and 7 percent were against any privatization; 40-49 years of age—46 percent were for gradual, 34 percent for rapid privatization, and 12 percent against any privatization; 50+ years—45 percent were for gradual, 13 percent for rapid, and 22 percent were against any privatization.²⁵

The survey discovered that support for privatization has been constant since first measured in November 1992, but opinion has shifted on the pace of reform. In the first year

of independence, 41 percent supported rapid privatization, whereas 40 percent were for more gradual privatization. In October 1994, just before public announcement of Kuchma's reform plan, 45 percent were for gradual and only 28 percent favored rapid privatization.²⁶ The public atmosphere in general was unfavorable to the program of radical economic reforms announced on 11 October 1994 which presupposed a mandatory privatization (*obovyazkova pryvatuzatsiya*) of 8,500 small and medium size enterprises in 1995.²⁷ The population wanted privatization but expressed its disappointment with previous unsuccessful privatization attempts.²⁸

The survey also found a muted reaction among the population regarding the type of economic system that should emerge in Ukraine. The majority favored a "mixed" economy. The following question was asked: "People have different views about economic matters. Please tell me which of the following views is closest to your own: (a) Most economic activities (enterprises, shops, and farms) should be privately owned; state ownership should be kept to a minimum. (b) Some economic activities (enterprises, shops, farms) should be privately owned and some should be owned by the state. (c) Most economic activities (enterprises, shops, farms) should be owned by the state, and private ownership should be kept to a minimum."²⁹ The results are shown in Table 2.

TABLE 2
Distribution of Privatization Survey

	Nationwide	(in percentages)			By Age	
		By Education			< 50	50+
		Prim.	Second.	Univ.		
Mainly private	23	14	27	35	33	12
Mixed ec. system	39	33	42	46	44	32
Mainly state ownership	31	40	27	16	21	45
N/A	7	13	4	3	2	11

Before introduction of the program of radical market reform in Ukraine, a majority those polled disagreed with the notion that "a market economy improves the standard of living of ordinary people" (61 percent disagree to 25 percent agree), a perception that prevails among all demographic groups, except among adults under 30 years of age. Along educational lines, the university-educated group is most optimistic that a market economy will improve the life of ordinary citizens (62 percent agree to 33 percent disagree), a perception shared by half of those with secondary education (52 percent to 42 percent), and rejected by those with primary or lesser education (35 percent agree to 52 percent disagree). A paradoxical situation arose: the population wanted reforms but did not connect a market economy with improvement of their life.

Another survey conducted by the International Foundation for Electoral Systems (IFES) sheds some light on this paradox. The survey was based on a nationally representative random-sample poll commissioned by the IFES and conducted by the Kiev International Institute of Sociology. In all, 1,201 face-to-face interviews were conducted

nationwide on 13-23 December 1994. The margin of error is +/- 2.2 percent at a 90 percent confidence level.

It appeared that the population simply was not informed about the essence of free-market reforms. The following question was asked: How much information do you feel you have about the free market reforms underway in Ukraine?

Great deal/fair amount	33.8%
Not very much/none at all	60.1%
DK/NA (Do not know/No answer)	6.1% ³⁰

Ukrainians have sharp differences in their attitudes toward and understanding of free-market reforms. They have little understanding of what such reforms mean or that certain groups are very supportive of a free market. However, the prevailing mood is for the return to state control.

In economic policy, should Ukraine—

Return to mostly state control?	45.6%(yes)
Reduce state's role?	31.0%(yes)
DK/NA	23.5%

The demographic analysis of this question reveals clear difference between groups. Males under 45 years old show overwhelming support for "reducing state control" while females over 45 show strong support for "return to a system where the state controls much of the economy."

	Males <45	Males 45+	Females <45	Females 45+
Reduce state's role	50	26	33	18
Return to state control	34	56	40	50
DK/NA	16	19	26	32

Besides the lack of basic information, a legacy of Soviet rule brings about the aforementioned paradox in which people want reform but do not expect improvement of their lives from the market system. This legacy refers to the role of the state in economic processes.

Is it the duty of government to guarantee people a job?

Agree	89.6%
Disagree	7.7%
DK/NA	2.7%

Even those who say they support free-market reforms believe that government should guarantee them a job. This suggests that citizens have little comprehension of the personal responsibility inherent in a free-market system and the necessity of painstaking labor to improve their lives. Remarkably enough, 75.7 percent chose Western democracies, including that of Japan, as models for Ukraine. This shows a continuing legacy of the old

Soviet dream: to live like those in the West and to work like in the socialist system, under strong state protection.

At the same time, 44.4 percent approve President Kuchma's performance, 28.2 percent disapprove, 27.4 percent DK/NA and 57.9 percent think that he needs more time to fulfill his promises (21.6 percent disagree and 20.5 percent have no answer).

This data show that there is no clear evi-

dence of strong public support for the radical market reforms. Public opinion is split regarding the role of the state in economic transformations. More than 91 percent of those polled (with 6.4 percent disagreeing) declared that they are dissatisfied with the situation in Ukraine today. Further deterioration of the population's living conditions could undermine any attempts at reform.

In academic literature, a discussion of the state's role in market reforms in has just begun in Ukraine. Two books worth mentioning were prepared by a team of researchers from the Institute of Economics of the National Academy of Sciences of Ukraine. The first book addressed the problems of the market and state regulation; the formation of a system of macroeconomic regulation; state enterprises and the stabilization of their activity in the market system; the development of the means of production and their regulation; and the formation of the state antimonopoly policy. The main themes of the book are that pure market economies do not exist in the world; that all functioning economic systems are mixed; that the state and the market correlate with each other; and the main problem is to find the proper level of cooperation. State regulation of the Ukrainian economy in transition should be different than that in countries that have stable, developed market economies. Along with monetary-credit policy, the Ukrainian economy needs long-term state programs with financial subsidies, state orders, antimonopoly regulation, and the regulation of prices.

The discussion of the long-term (sometimes were referred to as "complex goal-oriented programs") state programs in the Soviet plan economy started in the early 1970s in Novosibirsk, which was the center of dissident economic thought at the time. Examples of such programs that have never been accomplished are the State Program of Development of Non-Black Soil (*nechernozemie*) in Russia (1972-79) and the Food Program (*prodovolstvennyaya programma*, 1981-85). The state orders that the Gorbachev-Ryzhkov government used to try to dynamize the stilted Soviet economy were also unsuccessful. There is a need to intelligently analyze untraditional Soviet thinking about the development of market reforms and on the private property, its legal protection, and the creation of free subjects of market activity. "Economic determinism" is of little help in analyzing the problems of systemic societal transformations such as the introduction of market democracy in Ukraine.

The second book discusses strategies of social and economic development in Ukraine. The authors bitterly criticize the policies of "shock therapy" and "neomonetarism." They put forward three stages of a long-term economic strategy:

(1) Overcoming the economic crisis, stabilization of production, overcoming budget deficit, and creation of "qualitatively new owners and entrepreneurs;"

(2) Economic recovery, with economic growth, beginning at 2-3 percent and eventually at 5-7 percent. The program presupposes the state's involvement in social programs aimed at protection of the poorest strata of the population. The structural

"... data show that there is no clear evidence of a strong public support for the radical market reforms."

reconstruction of the economy will cost about \$200 billion and will last anywhere from seven to ten years depending on the rate of technological renovation of the production base; and

(3) A stable evolutionary economic growth that could last for decades.

The main points of the proposed programs, such as financial stabilization, introduction of a full-fledged convertible national currency, the cutting of state subsidies to ailing enterprises, and the step-by-step introduction of private property in agriculture, essentially coincided with the plan proposed by Kuchma on 11 October 1994. However, the Institute of Economy declared its disagreement with "shock therapy" methods such as price liberalization while 85 percent of Ukraine's enterprises were still owned by the state. The program also criticized the process of privatization. It held the state responsible for the final results of privatization and for the profitability of the privatized enterprises, stressing that this should be a long gradual process rather than a sweeping act. Therefore, it contradicted Kuchma's program of radical economic reforms, in which priority was given to price liberalization and mandatory (*obovyazkova*) privatization.

Sociological surveys and academic inquiries show that the public of Ukraine, upon the announcement and commencement of the program of radical market reforms, was more ready to accept a gradual path of reforms than revolutionary changes. This reflects popular disappointment in the policy of pseudoliberalization of prices that took effect in Ukraine on 5 January 1992 in the wake of the "shock therapy" of the Gaidar government in Moscow. Another attempt of reform was made in Ukraine on 21 October 1994 when, according to government edict No. 773, the subsidies on most goods were abolished. Prices skyrocketed going up by ten to twenty times overnight. In 1995 the government plans to raise prices further cutting subsidies for the development of science, medicine, education, culture, and community services, with the aim of attaining a budget deficit that is only 5 percent of the GNP. Currently, the deficit is at 8 percent.³¹ All of this could undermine the social basis for support of the reform process.

Therefore, the timing for starting a program based on economic radicalism could hardly be considered favorable. President Kuchma had at that time no freedom to maneuver politically because he was recently elected and had to prove his credibility to the electorate. The radicalism and instrumentalism of his program reflected the speed of its preparation within a short time-span from 19 July 1994 (the date of the inauguration speech of Leonid Kuchma) to 11 October 1994 (the time of the program's presentation at the parliament).

Kuchma's program is unacceptable to some influential political parties in the parliament, and they could suspend or block it. This is especially true with Kuchma's program of private land ownership. First deputy speaker Olexander Tkachenko, expressing the views of the powerful agrarian lobby in the parliament, vehemently rejected the possibility of land being privately owned. Speaking on the presidential edict on land reform, which foresaw the buying and selling of land, he stressed that "Ukraine cannot permit the buying and selling of land with its financial situation. The land will be given on lease only."³² On another occasion Tkachenko reiterated his understanding of private property. He claimed that "it is not true that private property always gives high labor productivity, material benefits, and progress. All of this depends on those who manage the property rather than on the form of the property."³³ Besides, Kuchma's edict on 10 November 1994, "On Extraordinary Measures in Enhancing the Land Reform in Agriculture,"

contradicted many articles and provisions of the acting Constitution and the laws of Ukraine, and this undermined prospects for its implementation by state bureaucrats.³⁴

The instrumental-pragmatic model of reform is also criticized on the liberal-minded side of the political spectrum. The deputy Olexandra Kuzhel, a member of the influential pro-reform faction Unity (*Yednist*), stressed the necessity to create an entrepreneurial climate in Ukraine, which could promote free competition in the market.³⁵

Economist Volodymyr Chernyak, one of the first advocates of market reform in Ukraine during the Communist regime, stated that the *Homo Sovieticus* mentality stipulates the quasi-market character of economic and political reforms in Ukraine.³⁶ Chernyak warned against the neo-liberal version of economic reform chosen by Kuchma, and advocated the neo-structural concept of regulation of structurally deformed markets, like in the countries of South Asia. He pointed out some of the more dangerous consequences of monetarism and price liberalization in Ukraine. Monetarism cannot be successful during continuous decreases of production, deep structural deformations, or in the absence of a capital market. Price liberalization without wage liberalization has resulted in a situation in which the prices on most products in Ukraine have reached (or even overstepped) the world level, and yet the average salary is between \$15 to 20 per month. All of this could undermine the social basis of reforms and threaten democracy.³⁷ One Ukrainian economist proposes getting rid of economic radicalism and struggling with inflation as an end in itself. He claims that the development of production in Ukraine should be a top priority, rather than price liberalization without competition and a market environment. Financial stabilization should have a solid base of industrial stabilization under it. The stimulation of production and capital investments should become the top priority of the state in conducting gradual economic reforms.³⁸

The instrumental-pragmatic model faces several other problems, besides the controversy between radicalism and gradualism. For instance, it claims to pursue the demonopolization of industry and at the same time it presupposes the creation of huge financial-industrial conglomerates (FICs). In post-Soviet conditions these would be the centers of new monopolies. One can imagine the following scenario: an enterprise that is privatized by its former managers creates its own bank and calls this amalgamation an FIC. It then receives credits from the National Bank of Ukraine, divides the market, and establishes monopoly prices. Evidence of the likelihood of this was given in the presidential edict of 27 January 1995 on the creation of FICs. It foresees the provision under which "the Antimonopoly Committee of Ukraine, upon agreement with the Cabinet of Ministers, could give an FIC the status of an authorized monopolist (*dozvoleno ho monopolista*) if it meets conditions and terms of performance consistent with the program of the development of key sectors of Ukraine's."³⁹

An authorized monopolist is an FIC that is given the exclusive right to fulfill a certain kind of industrial, scientific, or commercial activity. The main aim in creating the FICs is to unite property belonging to the enterprises and banks and to create the centralized management of scientific, financial, and commercial activity.⁴⁰ Having such "authorized monopolists" under centralized control could lead to reestablishment of the Soviet model of economy, or to the institution of quasi-market interactions of oligarchic cartels, accompanied by corruption, protectionism, and nepotism.

A modern market system presupposes a high level of social mobility of the workforce. How Ukraine would create such mobility with the *propiska* and with the lack of a developed housing market is unclear. The *propiska*, or obligatory residence permit, is a

legacy of the Soviet regime. It presupposes citizens' registration with the police. It means that citizens cannot freely choose their living place, and the *propiska* seal in their internal passports is a precondition of getting a job. Therefore, the instrumental-pragmatic model faces the necessity of creating a civil society for its implementation.

Market Reform and Civil Society

Post-colonial societies in third world countries have been transformed to democracies and market economies with the help of former centers of empires and with the help of international financial institutions. In the Ukrainian case there is no mother country whose democratic system of government the former colony could adopt. There aren't the solid preconditions for a market economy that could make the methods of shock therapy, or of John Keynes, applicable. The IMF's and World Bank's recommendations are designed for the improvement of, rather than the creation of, market systems. Certain experts, such as James Millar, have argued that Ukraine's case demands a different approach. According to their view, the obvious failure of the IMF's efforts in Russia and in the CIS draws attention to key principles of the Marshall Plan that could be useful in shaping U.S. policy toward political and economic stabilization in the CIS. The Marshall Plan was designed to achieve political stabilization in post-war Europe by achieving economic stabilization, and the success of the countries that applied it is obvious. Millar notes that there were three guidelines for the use of Marshall Plan funds. The monies were to be used (1) to restore and expand production; (2) to integrate economies by relaxing trade barriers; and (3) to achieve macroeconomic stabilization.⁴¹ These are exactly the stages and goals that Ukraine should reach for on its road to the world community. One cannot delude oneself with the idea of the success of rapid or "radical" economic reform. A successful economic program should be more pragmatic, less romantic, and, alas, slow.

The shift from the "utopian capitalism" the IMF favors to the more pragmatic Marshall Plan guidelines presupposes restoration (as in the case of post-war Europe) or a civil society (as in the case of the CIS countries). The views of Friedrich Hayek (1899-1992), Austrian economist, Nobel Prize winner (1974), and ardent supporter of economic and political liberalism, could help revise Ukraine's recent economic program, with its stress on radicalism and the role of the state in the transition to a market economy.

“. . . all post-Soviet attempts to introduce a state-controlled market economy have stimulated corruption as the only logical means of officials' motivation.”

Opposing government intervention in the market, Hayek stressed in the 1940s that the sum of knowledge available in an economy never exists in a concentrated or integrated form, but exists solely as the dispersed bits of incomplete and frequently contradictory knowledge possessed by separate individuals. What Hayek meant is that subjects *A* and *B* (and the managers of private sector companies) know more about their conditions and wishes than could ever be acquired by a state or any central authority. Even if we imagine the impossible, namely that governments could obtain and process all of the information dispersed in a market economy, their knowledge would still not be enough to make the "right" decisions. This is because we do not know in advance what knowledge will be relevant to our decisions; we thus could not keep government officials fully informed even if this were our goal.

Decentralized markets will outperform state bureaucrats for two reasons. First, they provide access to far more relevant information (in terms both of personal involvement and technological options). Second, they provide strong incentives (in the shape of profit opportunities) for using the information efficiently. Even if governments can somehow discover what to do, officials usually lack appropriate incentives. Therefore, all post-Soviet attempts to introduce a state-controlled market economy have stimulated corruption as the only logical means of officials' motivation. The principal task of government should thus be to eliminate the obstacles that prevent markets from operating smoothly. As Hayek maintained, speaking on the role of the state in economic performance, "to create conditions in which competition will be as effective as possible, to supplement it where it cannot be made effective, to provide the services which, in the words of Adam Smith, though they may be in the highest degree advantageous to a great society, are, however, of such a nature, that the profit could never repay the expense to any individual or small number of individuals—these tasks provide . . . a wide and unquestioned field for state activity."⁴²

It is crucial that individuals and companies (both foreign and domestic) always be allowed to enter existing markets and compete for profits with established companies. With free entry, entrepreneurial competition creates an upward spiral leading to ever higher standards of living. It is obvious that Hayek's vision of the route to economic prosperity essentially differs from that of "the pragmatic model." It puts the main emphasis on the creation of free competition in a free market rather than on the establishment of governmental bodies to supervise it.

Conclusions

The new economic program is the best that Ukrainians have had. Nevertheless, in its pursuit of pragmatism in terms of the economy and the building of the state it leaves unanswered the problem of the gradual creation of civil society—the only milieu in which a market economy functions. This leads it to principal radicalism both in economy and in state building.

Economic radicalism was reflected even in the title of the program. On 2 December 1994 Kuchma signed a Constitutional Bill on Power (a Small Constitution), virtually depriving the parliament of any legislative power as an independent branch. As Hayek predicted, the paradigmatic figure of an "economic dictator" results from the statement: "We are living in economic chaos and we cannot get out of it except under some kind of dictatorial leadership."⁴³ The combination of *pragmatism* and *radicalism* is guided by a vision of economic development under which some "bad guys" are in charge of economic chaos. One should remove them and then ask the "good guys" from the government to restore order and to provide universal protection.

The stress on the values of civil society leads to *pragmatic conservatism* rather than radicalism. It highlights a different version of reforms, the creation of conditions under which everybody can protect him or herself rather than being protected by the "nanny state." Private property has worth only if it is protected legally. Paraphrasing Kuchma, one could say that civil society is not an icon, but an instrument of the individual's protection from encroachments on private property.

Real market reform in Ukraine should:

- (1) Encourage free competition by allowing entrepreneurship;
- (2) Conduct real privatization to make everybody a proprietor who wishes to be;
- (3) Create a legal framework (civil code) for the protection of free competition and

private property;

(4) Establish a limit on state control over the national income so that it does not exceed 50 percent; and

(5) Adopt a constitution based on the values of civil society.

This program is aimed at the creation of a real rather than imagined middle class in Ukraine. Its members would increase public well-being by freely pursuing their individual interests, by creating political parties and a system of representative democracy. The idea of the “nanny state,” even a pragmatic and radical one would thus wither away.

Notes

1. *Holos Ukrainy*, 21 July 1994, 2.
2. *Kontseptsiya derzhavotvorenniya v Ukraini* (The Concept of State-Building in Ukraine), Kiev, 4-6 December, 1992.
3. *Ibid.*, 3.
4. *Ibid.*
5. *Ibid.*, 22.
6. *Ibid.*
7. *Ibid.*, 7.
8. Some leading American economists considered integration of the Ukrainian economy into the world economy as the final end on the road of its recovery. Oleh Havrylyshyn, the alternative executive director for the IMF and formerly Ukraine’s deputy finance minister, noted that Ukraine’s negative colonial inheritance led its leadership to focus on building the key institutions of a nation-state: political, military, and cultural. In the process of economic reform Ukraine should do a series of structural reforms—including privatization, price liberalization, and other measures to encourage market-based activity. After the preceding steps have been taken, Ukraine should be able to attract a significant amount of foreign direct investment, which it could use to improve the international competitiveness of domestic production and make significant progress toward integrating itself into the world economy. Ukrainian firms are not yet competitive internationally, which justifies the maintenance of protective barriers for now. But this approach should in no way create an illusion that Ukraine should try to compete with the CIS products first, and then try to enter the global competition. Oleh Havrylyshyn calls this a “gradualist fallacy” that will merely postpone Ukraine’s day of reckoning with the realities of the world economy. IMF Survey. *Ukraine’s Economy Drifts as Political Concerns Interfere with Adjustment*, 8 November 1993, 351-52.
9. *Kontseptsiya derzhavotvorenniya*, 11.
10. Recording of Leonid Kuchma’s speech at the Center for Strategic and International Studies, Washington, D.C., 23 November 1994.
11. *Literaturna Ukrayina* 19 January 1995, 1.
12. Leonid Kuchma, “Shlyakhom radykalnykh ekonomichnykh reforms,” *Holos Ukrainy*, 13 October 1994, 7.
13. *Holos Ukrainy*, 7 February 1995, 1, 3.
14. Leonid Kuchma, “Shlyakhom radykalnykh ekonomichnykh reforms,” 8.
15. *Programa ekonomichnykh reform i polityky Ukrainy zatverdzhena Kabinetom Ministriv Ukrainy dlya podannya mizhnarodnomu valutnomu fondu*, (The Program of Economic Reforms and Politics of Ukraine. Approved by the Cabinet of Ministers of Ukraine for the Presentation to the IMF), *Holos Ukrainy*, 1 May 1992, 6-7.
16. “Krizisnaya situatsiya prodolzhaetsya” (The Crisis Situation Continues), *Rabochaya Gazeta*, 15 May 1992.
17. *Ibid.*
20. The seduction of neo-integration has not escaped Leonid Kuchma. On 18 May 1993 he claimed: “What is needed is the restoration of the ruptured ties with the republics of the USSR and also with former CEMA countries . . . That kind of work can only be undertaken once we have clearly made up our minds as to what kind of economy and what kind of state we are creating.” Warning about the possibility of taking “emergency economy measures,” Kuchma maintained: “If people believe that it is their government, that it serves the interests of the people, not just the rich,

the people will support that government and will agree to suffer. That is, people should be specifically aware . . . of what everybody will gain from state independence." "Ya nikogda ne obmanyval luidel" (*Pravda*, 18 May 1993).

21. Leonid Kuchma, "Shlyakhom radykalnykh ekonomichnykh reform," *Holos Ukrainy*, 13 October 1994, 6-7.

22. *Ibid.*, 8.

23. *Ibid.*, 9.

24. USIA Opinion Analysis M-11-95 "In Ukraine, National Economy is Public's Main Concern," 13 January 1995, 1-2.

25. *Ibid.*, 1.

26. *Ibid.*, 2.

27. Recording of the presentation of the governor of the National Bank of Ukraine, Viktor Yushchenko, at the Center for Strategic and International Studies in Washington, D.C. on 16 February 1995.

28. For a discussion of the understanding of the meaning of private property in post-Soviet public mentality, see: Volodymyr Zvighyanich, *The Morphology of Russian Mentality. A Philosophical Inquiry Into Conservatism and Pragmatism* (Lewiston, PA: Edwin Mellen Press, 1993), 288-97.

29. USIA Opinion Analysis, *op cit.*, 3.

30. *IFES National Survey of the Ukrainian Electorate*, prepared for the Agency for International Development, 6 February 1994, 8. See also "Post-Soviet Schizophrenia," *The Economist*, 4 February 1994, 47.

31. Recording of the presentation of the governor of the National Bank of Ukraine Viktor Yushchenko on 16 February 1994 at the Center for Strategic and International Studies in Washington, D.C.

32. Olexander Tkachenko, "My-rizni: A Ukrainu pidiimaty maemo razom," *Holos Ukrainy*, 24 January 1995, 4.

33. *Ibid.*, 5.

34. Anatoliy Kosolapov, "Rozdumy z pryvodu zemelnoi reformy," *Holos Ukrainy*, 8 December 1994, 2.

35. Olexandra Kuzhel, "Try dzherela, try skladovi chastyny . . . ," *Holos Ukrainy*, 14 October 1994, 2.

36. Volodymyr Chernyak, "Postchyretro?," *Holos Ukrainy*, 12 January 1995), 3.

37. It is not accidental that the workers in Ukraine started writing "open" letters to the president protesting against the "capitalist" model of development of Ukraine, the privatization program, and land reform. *Holos Ukrainy*, 15 December 1994, 2. The First All-Ukrainian Congress of the Workers openly proclaimed a course on taking political power in Ukraine and establishing a dictatorship of workers. *Holos Ukrainy*, 4 January 1995, 4. See also an open letter to the president of Ukraine of the group of economists-constructors with the demands for increasing state regulation of all forms of economic activity, both state and private, *Holos Ukrainy*, 11 January 1995, 3.

38. Volodymyr Chernyak, "Plusy i minusy monetaryzma v Ukraini," *Holos Ukrainy*, 13 December 1994, 4.

39. Ukaz prezidenta Ukrainy of January 27, 1995 "Pro finansovo-promyslovi hrupy v Ukraini," *Holos Ukrainy*, 7 February 1995, 12.

40. James R. Millar, "The Failure of Shock Therapy" *Problems of Post Communism* (Fall 1994), 25.

41. *Ibid.*, 25.

42. Friedrich Hayek, *The Road to Serfdom* (Chicago, Ill: University of Chicago Press, 1994), 3.

43. *Ibid.*, 67.