Economic Liberalism and Security Preferences: A Comparative Case Study of Russia and Ukraine in the 1990s

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The privatization of major industrial assets represents a fundamental economic policy choice. The decision to allow foreign capital to participate in this process represents a fundamental foreign policy choice, one that I believe is framed largely by decision makers' preferences regarding economic security.

In this article I seek to explain what seems a puzzling fact: Since the fall of the USSR, Russia has had a greater preference than Ukraine for foreign ownership of large enterprises, including "strategic" enterprises designated as important for national security. This is contrary to reasonable expectations based on military threat or perception of threat (i.e., Ukraine's desire to build relationships with other powers to balance the perceived threat from Russia; traditional hostility between Russia and the West) and economic interests (i.e., Russia's greater capacity for self-sufficiency). I advance an explanation for this based on psychological factors including the effect of formative events and schematic learning. I am especially interested in the role of imitation or observational learning in foreign policy.[1]

Ukraine and Russia are appropriate for comparison on this issue because of their similarity across a number of important variables. They have similar levels of industrial development and structure,[2] a similar history within the Soviet planned economic system, political and economic elites with similar education and professional experience,[3] similar post-Soviet economic crises, and similar levels of corruption.[4] Russia and Ukraine also contain the bulk of the former Soviet military-industrial complex. The Ural Mountains area, St. Petersburg and Leningrad region, Moscow and Moscow region, and other parts of European Russia were home to most Soviet defense enterprises (69 percent by one estimate).[5] But Ukraine contained about 25 percent of the USSR's military industry;[6] Kyiv, Kharkiv, Dnipropetrovsk, L'viv, and Mikolaiv regions were major centers of military production of aircraft, tanks, ships, missiles, radar, and military computers.[7]

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These similarities allow for a degree of quasi-experimental control that in practice is rare in comparative case studies.[8] Variation in policies between Ukraine and Russia must be due to factors other than these constants, such as, perhaps, differences in military-strategic capabilities and threats, size, economic resources (such as Russia's greater self-sufficiency, especially in energy), domestic political dynamics and institutions, and historical experience. I will therefore investigate the extent to which economic security preferences are influenced by military threat, perceptions of threat, economic interests and resources, domestic politics, and lessons of historical experience.

Following George and McKeown's guidelines for "structured, focused comparison,"[9] I ask questions about the privatization process in each case, paying particular attention to how the list of strategic large enterprises exempt from privatization was defined and revised. I also examine related issues of government-led marketing efforts to attract foreign investment and the creation of a legal and institutional infrastructure to facilitate foreign investment. These factors comprise the dependent variable. Data on the process of large-enterprise privatization, related economic and security interests, leaders' views, and policy arguments serve as independent variables. I also question whether my preferred causal argument is spurious. Can the dependent and independent variables be explained by differences in constitutional power-sharing provisions, as some authors have suggested?

During the period in question, the decade of 1990–99, neither state received much foreign investment. Poland attracted higher absolute levels of foreign direct investment than Ukraine and Russia combined for the years 1993–96 and 1998. Nevertheless, there were considerable differences between Ukrainian and Russian policies and investment levels. Ukraine received slightly less than half the per capita foreign direct investment that Russia did in 1993–98 (table 1).

The Politics of Privatization and Foreign Investment

The "privatization" of state-owned enterprises has become a common aspect of public policy around the world. Foreign direct investment has also been growing

TABLE 1. Total Annual and Cumulative Foreign Direct Investment Inflows, 1993–98 (in millions of U.S. dollars)

	1993	1994	1995	1996	1997	1998	Cumulative
Russia	1,211	640	2,016	2,479	6,243	2,183	
Per capita	8.2	4.3	13.6	16.8	42.4	14.9	100.2
Ukraine	200	159	267	521	624	743	
Per capita	3.8	3.1	5.2	10.2	12.3	14.8	49.3

Source: Adapted from United Nations Conference on Trade and Development, *World Investment Report 1999* (Geneva: United Nations, 1999), 480 (FDI figures); European Bank for Reconstruction and Development, *Transition Report Update: April 1999* (London: EBRD, 1999), 67, 72 (population figures).

rapidly in the wake of a global trend of liberalization.[10] The Thatcher government in the United Kingdom is usually considered the originator of the privatization trend, although Chile was also an early practitioner. In the United States, privatization often has meant running state-owned bureaucracies as if they were private enterprises (such as the U.S. Postal Service) or devolving government functions to private contractors. In more statist economies, privatization involves the sale of state-owned enterprises to private buyers.[11] The latter process is the type of privatization examined here.

Such privatization necessarily presents the state with a dilemma, or tradeoff, involving important national security questions. Many states have faced the "guns or butter" choice between military security and economic efficiency. That choice is usually framed as one between control of important assets, often necessary for military production or the functioning of society, and the vital need for productive, efficient use of resources in a competitive world.

The tradeoff between security and efficiency is amplified when foreign ownership is involved. Foreign investment in privatization has been a feature of recent economic reforms from Hungary to Ghana. It can easily attract public resistance. The impression that the state is "giving away the store" to economic, political, or military competitors can require that policymakers possess strong political will to follow through. For example, in the 1980s, protest in England over the sale of two divisions of the British Leyland Motor Company to foreign buyers forced the deal's cancellation. The privatization of British Gas led to claims that "a unique strategic asset" was being let go. A Labor Party official argued in 1985 that "[o]nly public enterprise can give Britain strategic control."[12] In 1999, foreign sales of large blocs of shares in a Romanian steel plant, a Lithuanian oil refinery, and a Finnish shipping company all met with strong public resistance.[13] The tradeoff between major foreign investment and traditional concepts of national security is apparent for leaders facing such choices. During the economic reorientation of the 1990s, both Ukrainian and Russian leaders faced such fundamental foreign policy choices.

The analysis that follows begins with a general overview of economic reforms in each case, moves on to a detailed examination of privatization and foreign investment, and ends with discussion of the evidence and conclusions.

Economic Reforms in Russia and Ukraine, 1991–99

In October 1991, Russian president Boris Yeltsin outlined a comprehensive program of reform, whose main author was Yegor Gaidar.[14] In January 1992, the government liberalized most prices and trade. In June, the Supreme Soviet (parliament) passed framework privatization legislation. But backsliding on reform due to political resistance was evident by April.[15]

Although the program of mass privatization, or the transfer of state assets to the general population, continued under the direction of Anatoly Chubais, a key member of Gaidar's team, other policies were defeated or diluted. The loose monetary policy of Central Bank head Viktor Gerashchenko, appointed by the parliament, undermined macroeconomic stabilization. In December, after the parliament failed to support his candidacy, Gaidar was removed as acting prime minister. Yeltsin then proposed Viktor Chernomyrdin, and he was easily confirmed. Chernomyrdin had strong ties to the Russian energy sector and was often associated with the industrial lobby. He had expressed only harsh criticism for privatization, in one speech comparing Chubais's program to collectivization under Stalin, but he abandoned public opposition to privatization after reportedly being reprimanded by Yeltsin.[16]

In 1993, with parliament's approval, the state renewed support for industry in the form of credits and subsidies.[17] The conflict between executive and legislative power in Russia came to a head in a violent confrontation in early October. Yeltsin's economic policies were among the most important specific reasons for the confrontation.[18]

From January 1994 through April 1998, Chernomyrdin and the various cabinets he headed continued the basic policies put in place by Gaidar and his team, although their execution was inconsistent, and the original time frame and scope of the program were retrenched. By 1995, a degree of stabilization had been achieved.[19] Inflation fell to 10.9 percent in 1997, which was also the first year of economic growth, albeit only at a rate of 0.8 percent.[20] Chernomyrdin's government undertook a concerted effort at further market reforms, including creating an antimonopoly policy and reducing subsidies to utilities.[21] In spite of the collapse of the ruble and general crisis in 1998, by 1999 growth had been restored to Russia's troubled economy.

In 1991, the focus in newly independent Ukraine was market reform and "economic independence" from Moscow.[22] Ukraine took a major step toward separating itself from the Soviet integrated economy with the transformation of the administrative Council of Ministers into the Ukrainian Cabinet of Ministers in April. The Supreme Rada (parliament) chose Vitold Fokin as prime minister. Previously the head of the republican economic planning agency Ukrderzhplan, Fokin set out to implement the economic aspects of the recent Ukrainian declaration of state sovereignty, suspending a Soviet presidential decree in Ukraine and prohibiting export of various products from Ukraine.[23]

Although the Fokin government did liberalize some prices in July 1992, most were not freed from state control; monetary emissions and especially extensions of credits to enterprises were not reduced, even to the limited extent achieved in Russia. Vice Premier and Minister of Economics Volodymyr Lanovyy, then the country's senior official with a reputation as a market reformer, threatened to resign in protest of the lack of genuine economic change.[24]

In September 1992, Kravchuk announced Prime Minister Fokin's resignation, called for accelerating "radical economic reforms based on privatization and destatization," and implored legislators to unite "efforts to overcome the economic crisis, strengthen executive power and national security."[25] The new government of Prime Minister Leonid Kuchma included three prominent market economists. However, Kravchuk accepted Kuchma's resignation within a year, not long after Kuchma had submitted his reform program to the Rada.[26]

Kravchuk accomplished small-scale privatization during his presidency, but other reforms were not undertaken until Kuchma became president in July 1994. The government then liberalized most prices and trade. As was the case in Russia, these changes encountered strong political resistance and were modified and diluted over time. "[E]ager not to create a fissure [in] society, President Kuchma . . . sought to steer a centrist reform track. The pace of economic reform [was] moderate."[27]

Ukraine did achieve a degree of macroeconomic stabilization in 1995, and in 1996 it introduced its own currency, the *hryvna.* However, privatization of medium and large enterprises was not accomplished as planned. Although by 1999, 70 percent of Russia's GDP was privately produced, only 55 percent of Ukraine's was private. Russia rated significantly higher on large-scale privatization than Ukraine, and it had more success in most areas related to market transformation (table 2). From 1994 through 1997, privatization revenues as a percentage of GDP were on average over twice as high in Russia as in Ukraine (table 3).

Foreign Investment in Major Enterprises

Case 1: Ukraine

Even before the fall of the USSR, there was some support for privatization among top officials of the Ukrainian Communist Party. At least in part, privatization was seen as a tool to diminish Moscow's role in Ukraine's economy. However, Ukrainian leaders also expressed reservations about military conversion and "boundless" privatization plans.[28] In response to Moscow's attempt to create a USSR State Property Fund,[29] Ukraine took control of all union-level enterprises and organizations on

TABLE 2. European Bank for Reconstruction and Development Ratings of Reform Relevant to Privatization

	Percentage GDP private	Large-scale privatization	Trade and foreign exchange	Competition policy	Financial Institutions[a]
Russia	70	3+	2+	2+	2/2-
Ukraine	55	2+	3-	2	2/2
Estonia	70	4	4	3-	3+/3
Moldova	45	3	4	2	2+/2
Poland	65	3+	4+	3	3+/3+
Hungary	80	4	4+	3	4/3+
Czech Republic	75	4	4+	3	3/3

Source: European Bank for Reconstruction and Development, *Transition Report 1998* (London, EBRD, 1998). EBRD ratings score countries on a continuum ranging from *1* (no change from planned economy structure) to *4+* (standards and performance typical of advanced industrial economies). Russia's scores are lower than in previous periods because of policy reversals in banking, securities, price liberalization, and trade and foreign exchange resulting from the 1998 financial crisis.

[a]Financial institution indicators are represented with dual scores. The first score is for "banking reform and interest rate liberalization," and the second is for "securities and nonbank finan-

TABLE 3. Privatization Revenues as Percentage of GDP, 1994–97

	1994	1995	1996	1997	Average
Russia	0.11	0.38	0.12	0.90	0.38
Private sector share of GDP	50	55	60	70	
Ukraine	0.21	0.13	0.25	0.13	0.18
Private sector share of GDP	30	34	40	50	

Source: Adapted from European Bank for Reconstruction and Development, *Transition Report 1998* (London: EBRD, 1998), 187, 197.

its territory. The government declared Moscow's directives on ownership of Ukrainian entities to have "no legal force" and instructed that they were "not to be carried out." Prime Minister Fokin's cabinet issued a special statute, and he "informed the [Rada] Deputies that Union ministries . . . have begun . . . knocking together joint-stock companies out of their enterprises, thereby preventing their transfer first to the republics' . . . ownership." In the Rada, 330 deputies voted in favor of revoking Moscow's authority and only one voted against.[30]

As mentioned, Ukraine had considerable success with small-scale privatization of retail and trade outlets.[31] It established a national State Property Fund in 1992 to administer privatization. However, mass privatization, management-employee buyouts, and larger cash-based privatization projects were not implemented. Volodymyr Lanovyy characterized Fokin's privatization program as "the restoration of neo-socialist ways of looking at questions of property through collective forms."[32] With few exceptions, Ukraine's medium and large enterprises remained wholly state property under President Kravchuk (1991–94). That was not, however, due to a complete lack of interest in mass privatization or foreign investment.

In his 1993 budget address to the Rada, the president proposed that "privatization will be carried out on the basis of . . . an analysis . . . of individual sectors of the economy. This will . . . combine the privatization process with a structural reorganization and . . . the purposeful attraction of foreign investments. . . . [A]ll privileges will be gradually canceled and a course will be taken towards a gradual curtailment of state subsidies."[33] Kravchuk's emphasis was on a gradual change in the structure of Ukraine's economy. He wanted to attract foreign capital, but primarily as "purposeful" investment in certain sectors or enterprises. In July 1994, the program was completely suspended and revamped. In November, under President Kuchma, a new "voucher" program was introduced that proved more successful.

From the earliest days of Kuchma's reform program, there was pressure for the creation of financial-industrial groups.[34] In Ukraine, as in Russia, these proposed economic groupings were seen as attempts by state bureaucracies (mainly sectoral ministries) to maintain their economic functions and consequent rights to budget resources.[35] Some ideas for the creation of financial-industrial groups incorporated plans for joint Russian-Ukrainian ownership of "multinational corporations" comprising enterprises previously linked within the Soviet economy. Alexander Razumkov, a top advisor to Kuchma, believed that it was in Ukraine's interest to create financial-industrial groups combining Ukrainian and Russian enterprises. But the plans were not realized on the desired scale. In 1997, Razumkov reflected that "between Russia and Ukraine . . . non-state structures did not appear. . . . Some corporations did . . . in Kyiv . . . but they only undertook [limited] operations, not financial-industrial operations. . . . We were not able to create a trans-national corporation . . . in areas like aeronautics, space, energy."[36] Ukrainian financial-industrial groups remained overwhelmingly domestic, state-owned structures.

Kuchma's mass privatization program began in January 1995 with eight thousand companies of all sizes. Only Ukrainian citizens or legal entities were allowed to own privatization certificates redeemable for property.[37] The program was implemented slowly and unevenly. By the end of 1995, 25.7 million Ukrainians, only about half of the population, had claimed their certificates.[38]

Nevertheless, initial indications were that Ukraine might adopt a minimalist approach to restricting privatization in the name of security. In January, Oleh Taranov, chair of the Rada's Committee on Economic Policy and also an economic advisor to Kuchma, announced that only eighty Ukrainian enterprises were on a privatization "blacklist" of firms designated to remain in state hands. All others were subject to privatization. The blacklisted enterprises were mainly arms manufacturers, but energy-related firms and key bread bakeries were also included. In addition, Taranov indicated that some of the eighty firms might not be permanently banned from privatization. The number is especially low if one considers Taranov's claim that Ukraine had two thousand defense industry enterprises.[39] Other estimates of the size of the Ukrainian military-industrial complex suggest that although there were anywhere from 350 to 1,840 enterprises in the defense sector, no more than seven hundred produced exclusively for the military at the time of Ukrainian independence. By 1995, reportedly only about one hundred of these were still producing weapons and other military goods.[40]

But by August 1995, the Rada had expanded the list to include 6,100 strategic enterprises exempt from privatization.[41] In addition, President Kuchma had by this time thrown his support behind the idea of financial-industrial groups modeled on, and even merging with, those in Russia.[42] In June, Kuchma had come out in favor of state credits to strategic enterprises designed to reverse GDP decline, which was 23 percent in 1994. Another blow to the privatization program came in October when the Rada reduced the list of enterprises subject to mass privatization by half, from eight thousand to four thousand, and halted the privatization of oil and gas industry firms. All of this effectively strengthened the position of the state sector.[43]

There is some indication that Ukrainian officials were interested in attracting foreign companies, as so-called strategic investors, to specific investments in major enterprises not on the blacklist. However, security concerns moved to the fore. In November 1995, Oleksandr Riabchenko, chair of the Rada Auditing

Commission for Privatization, began to investigate privatizations involving strategic investors to ascertain "whether any strategic investor gained access to a restricted sector." Although the privatization blacklist had shrunk to 5,500 enterprises by November 1995, the Rada then added two new groups of enterprises. One group included 1,475 enterprises, and the other 360; simultaneously, another 224 enterprises were removed. Thus a total of 7,111 Ukrainian enterprises were excluded from privatization because of their "national importance."[44]

According to a report prepared by the U.S. embassy in Kyiv, although 7,308 medium and large enterprises had been partially privatized under the mass privatization program by 1996, foreigners could participate only through intermediaries; they were legally prohibited from directly acquiring privatization certificates. The Rada's blacklist had effectively prevented foreigners from acquiring any shares in thousands of "strategic" companies in energy, communications, metallurgy, defense, and chemicals, including "most of Ukraine's largest firms with the greatest export potential." Foreigners could legally acquire a controlling interest in any enterprise not on the Rada's list, but the process had proven difficult because of vague legislation and bureaucratic interference.[45]

In April 1996, the Rada passed a foreign investment law similar to those in other former Soviet states. It was considered an improvement over three previous laws because it guaranteed registered foreign investors treatment equal to that given to domestic firms. Several priority sectors were designated for foreign investment, including energy development, military conversion, agriculture, food processing, health care, telecommunications, transportation, information services, and banking.[46] However, foreign investment in key enterprises remained difficult. In June 1996, the State Property Fund announced that fourteen metallurgical enterprises were scheduled for privatization, with 25 to 51 percent of shares offered. But, after an attempt by the Rada to block sales of such strategic enterprises to foreign investors, the State Property Fund announced that the state would retain controlling blocks of 51 percent or more in strategic firms.[47]

In July 1996, President Kuchma called for an acceleration of the privatization program.[48] In early 1997, the proponents of privatization of major enterprises made a concerted effort to overcome the Rada's opposition. Riabchenko announced that the ban on privatization of strategically important enterprises was expected to be lifted in April. His commission was preparing a new law, "On . . . privatization of strategically important enterprises," to replace the blacklist.[49] At the same time, Prime Minister Pavlo Lazarenko revived the idea of attracting "strategic" investors to selected sectors and enterprises not on the blacklist. He announced to a delegation from the European Bank for Reconstruction and Development that the government intended to complete planned sales of strategic enterprises in the first half of 1997. A list of 228 such enterprises existed, and the state would retain no more than 26 percent of the shares.[50]

In fall 1997, further legal infrastructure was established to support foreign investment. The Cabinet of Ministers enacted a decree protecting foreign investors against expropriation, giving them the right to repatriate profits, and allowing some exemptions from customs duties. A five-year exemption from the profits tax was also included for enterprises with foreign investment registered by 1995.[51] Potential strategic investors from Russia were especially encouraged. Meeting with Yeltsin in February 1998, President Kuchma signed documents on economic cooperation and stated Ukraine's desire for increased investment by Russian businesses in the privatization of strategic enterprises in Ukraine. He stated that the Russian share of 7 percent of the total $2 billion of cumulative foreign investment in Ukraine was too low.[52]

The government planned to sell fourteen of twenty-five energy distribution companies in 1998. Following the victory of communist and other leftist candidates in Rada elections in April, however, Prime Minister Pustovoytenko ordered the State Property Fund to cancel its sale. Although the official explanation for this was lack of investor interest, during the election campaign leftist candidates had vigorously protested the cheap sell-off of the country's strategic enterprises. By July 1998, only 9,600 of the eighteen thousand medium and large enterprises in the mass privatization program had been partially privatized.[53]

The parliament's approach seemed to change in October 1998. The idea of attracting individual foreign investors to key projects again seemed to gain support. The Rada instructed the government to draw up a list of strategic enterprises to improve both government management and the procedure for privatization of those enterprises.[54] In October, the Rada finally agreed to the appointment of a new State Property Fund head, Oleksandr Bondar. It was likely that legislators were responding to the serious economic crisis brought on by the crisis in Russia. The government needed funds to avoid defaulting on its debt payments, to support the hryvna, and to address mounting wage and pension arrears.

In December, Serhiy Tyhypko, deputy prime minister for economic affairs, announced that the government would give priority to strategic investors in large enterprises. He announced that the major telecommunications company Ukrtelekom would be privatized by a strategic investor, who would then be required to invest in expanding the Ukrainian telephone system.[55] However, even with what seemed a new momentum for privatizing large enterprises, driven by an immediate need for revenues, by February 1999 only 51 of 301 planned tenders had resulted in sales. The government blamed a lack of proper legislation and regulation, but Bondar stated that the main reason was a lack of buyers. Tyhypko voiced his dissatisfaction with the State Property Fund, noting its weak marketing efforts on behalf of Ukrainian strategic enterprises. According to Tyhypko, there were no presentations held abroad to attract strategic investors.[56]

Then, in a major blow to large-enterprise privatization, in July 1999 the Rada failed to approve the government's plan to sell Ukrtelekom. As Timothy Ash observed, privatization had not moved to the major Ukrainian utilities by 1999. In assessing the causes of the general lack of progress in large-scale privatization, Ash noted the fine balance of power between president and parliament in the Ukrainian constitution. He also cited the priority that many Ukrainian politicians placed on "state building," which led to the fear that many of the privatized assets (particularly oil and gas pipelines) may be acquired by Russian investors, which would undermine the process of state building. The sale of strategic enterprises has thus often run into the opposition of an "unholy alliance" of Ukrainian nationalists, who fear domination by Russian investors, and left-wingers who oppose privatization in principle.[57]

This case study brings several trends to light. Most obviously, the blacklist restricting privatization of major enterprises expanded in Ukraine to several times even the largest estimate of the size of the military-industrial complex. By late 1995, the list included 7,111 firms, whereas the most generous estimate of the military-industrial complex is two thousand firms (and the most restrictive would be one hundred). Clearly, the definition of "strategic enterprise" in Ukraine has been broadened, aimed at least in part at excluding foreign capital from most of Ukrainian industry. The major beneficiaries of such a strategy are likely to be the industrial sector ministries and managers of major state enterprises, who have retained control over valuable assets, as well as the ability to exploit those assets without outside scrutiny. They have also retained the state-centered system of enterprise administration, which they are experts at manipulating, while avoiding independent audits, shareholder pressures, and other measures restricting autonomy that would accompany a market environment.

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It is nevertheless also clear that there was some movement toward attracting foreign investment to major enterprises, especially after 1994. A legal and institutional framework to support such investment exists, but there has been only sporadic support from the president or government, mostly in carefully chosen sectors of the economy. It appears that Ukrainian leaders sought to channel foreign capital to certain sectors and protect other sectors. So-called purposeful investment was pursued during the administrations of both Kravchuk and Kuchma. As will become apparent, there was more emphasis on that strategy in Ukraine than in Russia.

That foreigners were not allowed to buy privatization certificates tells of the limited enthusiasm for foreign investment in Ukraine. Potential foreign investors were required to seek Ukrainian partners who legally could do so. The absence of any evidence of a marketing effort by the State Property Fund aimed at foreign capital is also striking.

Finally, it is clear that the Ukrainian parliament played an important role in limiting the privatization plan and in restricting participation in it through the blacklist. In Russia, the State Duma attempted to play a similar role, but was largely ineffective. That raises the possibility, noted by Ash, that differences in policy and practice between Russia and Ukraine can be explained by differences in the constitutional division of power between executive and legislative branches. I will return to that argument in the discussion section following examination of the Russian case.

Case 2: Russia

Russian laws and decrees of December 1990 and 1991 made basic provisions for foreign investment.[58] In late 1991, Anatoly Chubais was named to head the Russian State Property Committee, and the Cabinet discussed the basic principles of Russian privatization. In June 1992, a framework mass privatization program was approved by parliament, but passage involved a compromise with the industrial lobby and labor unions. "Insiders"—employees and especially managers—were given clear advantages in the privatization of their enterprises.[59] Subsequently, all legal provisions for privatization were made through presidential decrees until June 1997, when the State Duma (the lower house of the Russian parliament established by the 1993 constitution) passed a law on cash-based privatization involving the sale of the remaining shares of medium and large enterprises.

Russia's overall economic reform plan was modeled on Polish reforms.[60] But Polish privatization through state-sponsored mutual funds had not enjoyed much success.[61] Chubais and Gaidar preferred a mass privatization program based on the experience of Czechoslovakia. Anders Aslund commented,

> Through . . . discussions in eastern Europe, the idea of free distribution of property gained popularity. . . . The Polish failure to privatize because of attempts to make discrete sales was illuminating, while the Czechoslovak attempt at voucher privatization looked promising. . . . The Russian decision makers looked at privatization in Poland primarily to learn what pitfalls to avoid and at that of Czechoslovakia to learn how to do it. . . . Thus, exactly as in Czechoslovakia, enterprises in selected sectors were compelled to privatize. . . . The Russian reformers carefully avoided the situation . . . in Poland, where the privatization law . . . gave several interested parties the right to veto privatization.[62]

Announcing the program to the public in a televised speech, President Yeltsin indicated that some key industrial and economic assets would remain in the hands of the state: "atomic power stations, certain defense installations, pipelines and land-reclamation systems."[63] But there was no public mention of the exact number of enterprises included. The total number of defense enterprises in Russia was put at 1,800 by a former head of the State Committee on Defense Industries.[64] A report by the Bonn International Center for Conversion estimated that there were two thousand Russian defense enterprises, 269 of which were "bankrupt" by June 1994.[65] Similarly, the Russian magazine *Ekspert*, citing data from the Ministry of Economics, put the military-industrial complex at 1,794 enterprises.[66]

Foreign investment was not initially considered a central element of privatization. Foreigners were considered potential sources of major investments needed to subsidize highly unprofitable firms or to complete unfinished construction projects. This is similar to the Ukrainian emphasis on "purposeful" foreign investment. Nondiscriminatory rules were established; and, significantly, foreigners were allowed to purchase privatization vouchers directly from the population, thus, it was hoped, making vouchers more liquid, raising their market value, and enhancing the appeal of privatization for the population.[67]

At least among some officials, there was a sense of threat to Russia's economic security. For example, Minister of Foreign Economic Relations and Trade Petr

Aven, a member of Gaidar's team, wrote in 1992 that U.S. nontariff barriers were designed to destroy Russia's technological potential.[68] For Chubais, real security threats did exist from foreign capital, but he perceived that threat as minimal. "[T]hrough front men foreigners could get access to enterprises banned from being privatized. There is such a danger and work really does need to be done on this, including by the Federal Security Service [FSB, a successor organization of the KGB], with which we are collaborating. But I think these are more like unique cases than some kind of mass process."[69] Chubais was also sensitive to the political implications of foreign investment; he "worried about foreign investors buying big Russian companies for almost nothing, because that would arouse public hostility to privatization."[70]

Yeltsin dismissed Gaidar in December 1992. One influential group that had opposed Gaidar was the Russian Union of Industrialists and Entrepreneurs headed by Arkady Volsky, which, along with its parliamentary arm Civic Union, was the major representative of the industrial lobby. "[T]hey were hostile to early Western investment, fearing that Western companies would oust them."[71] Although there was some degree of mutual recognition of threat, the policy preferences of the government and the parliament on privatization were in conflict. In an atmosphere of extreme confrontation, the privatization program for 1993 was never adopted. Yeltsin enacted the 1994 program, which more than before favored outsiders at the expense of managers of state enterprises, by presidential decree. Rather than appease the industrial lobby, Yeltsin proved unyielding, and eventually the ranks began to break. Managers of large enterprises had been waiting to acquire capital to buy the firms they ran, but in spring 1994 many apparently decided it was in their interests to participate in voucher privatization.[72]

During the final months of voucher privatization, foreign participation also increased, as some of Russia's most attractive enterprises came up for auction. Over $2 billion in foreign investment entered Russia in this period,[73] demonstrating that significant foreign investment in Russian industry was not only technically legal (as in Ukraine) but politically feasible as well. With the completion of voucher privatization in July 1994, 15,052 medium and large enterprises were partially privatized, representing 80 percent of the industrial workforce. After being twice rejected by parliament, a postvoucher, cash-based privatization program was decreed by Yeltsin.[74]

In March 1995, leading Russian banks made a proposal to the government to secure a privileged role in cash privatization. Variously called the "consortium scheme" or "loans-for-shares," the banks' proposal was described positively by privatization officials as a plan "to mortgage . . . [shares of enterprises of national importance for] funds . . . considered as earnings from privatization."[75] In fact it was an opaque, noncompetitive process for privatizing many of Russia's most important industrial assets.[76]

As the loans-for-shares deal was being negotiated, Vladimir Sokolov, chair of the Russian Federal Property Fund, detailed efforts to attract foreign investors: "[W]e will step up our advertising abroad. . . . [W]e are studying lists of both

Russian and foreign partners so that we could . . . bring . . . revenue to the budget." Sokolov raised the issue of strategic enterprises: "strategic enterprises or enterprises of national importance . . . operate in the areas of . . . the country's defense capability, strategic materials."[77] These would remain unitary firms under state ownership and control (although no list had yet been made public). However, Sergei Beliaev, head of the State Property Fund, also made it clear that any enterprise not considered "strategic" would eventually be privatized.

This was not always the case in Ukraine. In 1995, the Rada reduced by half the number of enterprises subject to privatization. Also, as had been the case initially in Ukraine, in Russia it emerged that some defense enterprises were not considered strategic and that many of the enterprises initially on the list might eventually be removed.[78] According to Zisk, a "large number of state defense enterprises . . . were privatized by 1995."[79]

Stephan Haggard makes the distinction between restrictive "positive-list" and permissive "negative-list" systems of limiting foreign investment.[80] Russian officials repeatedly emphasized the negative-list approach. Enterprises not explicitly exempted were to be privatized and were open to foreign investment. In Ukraine, it appears that only enterprises specifically designated as both scheduled for privatization *and* available to foreign investors were thus in practice. Ukraine therefore can be seen as using an informal positive-list approach.

Russian officials actively marketed Russian firms to foreigners, as well. Sokolov stated that

> we have been sending abroad a good deal of sales information . . . delivered by Reuters. . . . there are over 200,000 recipients. . . . We are expanding the network of our offices. . . . We do not say that we are doing everything possible at the expense of Russian investors. . . . We are trying to create equal conditions for both of them. . . . Let us note that foreign investors buy very few shares in this country. Not more than 10 percent of the shares have been bought by foreign investors. This is woefully inadequately [sic] for implementing economic reform and for meeting the [budget] targets.[81]

Final approval of the loans-for-shares scheme had not yet been given. Budget revenues of 9.1 trillion rubles were expected from the privatization program in 1995, and Sokolov referred to the choice faced by the government regarding "strategic enterprises. . . . We have already touched upon the dilemma of whether they would be sold or transferred in trust to banking groups. These are the main sources of revenue."[82] Thus, the questions of which enterprises were "strategic" and what exactly "strategic" meant were entangled in 1995 in the political struggles among the Russian bankers; the privatization bureaucracy represented by Beliaev, Sokolov, and ultimately Chubais (then first deputy prime minister in Chernomyrdin's government); interests that would benefit from increased budget revenues; and certainly the managers of major enterprises themselves.[83]

In May, Chubais appeared to gain the upper hand in the struggle. He was selected to head the newly created Federal Commission for Budget Privatization Revenues, which was to include representatives of the Russian secret services.[84] In June, a list of 2,809 strategic enterprises banned from privatization was first announced, including defense firms, big oil companies, the telephone giant Rostelekom, and many other Russian "blue chip" companies.[85]

In July 1995, Beliaev announced a finalized list of 3,054 strategic enterprises, including Gazprom. These either were not to be privatized, or were to be held back until 1996 or 1997. Transportation Minister Vitaly Efimov voiced strong opposition to the decision to privatize over twenty transport companies because foreign competitors would "buy off stocks in order to remove Russian transport companies from the Russian market." But the list was not expanded to include those or other firms.

In September 1995, the Russian government adopted Executive Order 949, which classified three thousand enterprises as strategic.[86] A second list contained enterprises included in loans-for-shares. Chubais described them: "These are fantastically attractive enterprises . . . [in] the petroleum sector, steel, transport enterprises, river and seaports and much else. This is . . . very exciting for Russia and indeed for foreign investors."[87] The scheme allowed for limited participation by foreigners,[88] although it is generally considered a closed, noncompetitive transfer of valuable assets at bargain prices to Russia's wealthiest private interests.

In early November 1995, the Duma called on the government to halt privatization, citing the threat posed to national security.[89] In December, forces aligned against loans-for-shares scored victories. Sergei Burkov, chair of the Duma's Committee on Property, Privatization, and Economic Activity (dubbed the "deprivatization panel" in the Russian press), was the leading opponent in parliament. His petition to Yeltsin resulted in the cancellation of eight auctions[90] of firms Yeltsin described as "of strategic importance for national security," including Sukhoi Aircraft Design, Progress aviation company (combat helicopters), and the Irkutsk aviation plant (jet fighters).[91]

The negative political reaction to the extensive and uncompetitive sale of major industrial assets, as well as the presidential elections scheduled for June, probably contributed to the absence of progress in privatization in 1996. In March, a presidential decree established a commission under the State Committee on Defense Industries and charged it with developing a new approach to privatizing the defense sector, "taking into account national interests." Vasily Zhigulin, head of the privatization department of the State Committee, declared that "it is evident that the previous policy of total sell-offs is damaging for the country." The commission was to consider the role of foreign investors in privatization and to review and expand the list of "strategic enterprises." The commission's head, First Deputy Prime Minister Oleg Soskovets, a former USSR minister of metallurgy, named Russia's five largest oil companies, pledged to banks under loans-for-shares, as enterprises that should not yet be privatized.[92]

Challenges to privatization continued, usually with an emphasis on strategic enterprises. In April 1996, Burkov's committee began investigating the privatization of strategic enterprises.[93] In May, the Communist Party—the largest Duma faction—called for protection from foreign competition as well as the state's resumption of control of strategic enterprises and its "leading role" in the economy: "Privatization was conducted in violation of the laws. . . . [T]he country has lost food security and is doomed to be dependent on foreign countries."[94]

Nevertheless, by 1996 a significant portion of defense production was already privatized. Thirty percent was undertaken by joint-stock companies with no state ownership; companies with partial state ownership accounted for another 34 percent. Foreign direct investment in defense enterprises was one method used by these firms to secure access to export markets for their products.[95] Export by defense firms of civilian goods was an attractive alternative to producing for the Russian state, which was chronically late in payment.[96]

After Yeltsin's re-election, banks received the right to buy the shares they had been managing under loans-for-shares.[97] In November, economics minister Yasin announced a new policy of limited support and protection for selected strategic enterprises. There were fears that banks were pressuring the Kremlin for "a new corporatist policy restricting competition and limiting foreign investment." However, November also saw the announcement that a 25-percent-plus-one-share stake in Sviazinvest telecommunications holding company would be sold in 1997 with no restrictions to foreigners.[98] The winning bid ultimately came from a consortium involving U.S. financier George Soros.

"Russian preferences supported increasing budget revenues even if shares of major enterprises fell into foreign hands. Ukrainian preferences were the reverse."

By the beginning of 1997, there were 123,000 private enterprises and 88,000 state enterprises, compared with 205,000 state enterprises in 1992. Although foreigners owned less than 2 percent of all of Russia's medium and large enterprises, they owned 12 percent of the shares of the largest 100 companies. Some restrictions applied. In some enterprises, mostly in the energy sector, foreigners were limited to 15 percent ownership.[99] However, after the privatization of major oil companies, a presidential decree removed that provision.[100] In the defense sector, 502 of approximately 1,800 defense enterprises were completely in private hands as of January 1997, and an additional 509 had been corporatized (transformed into joint-stock companies), with the state retaining all or some shares.[101]

In March 1997, the government initiated a new comprehensive reform program that included continued privatization of major enterprises. An 8.5 percent share of Unified Energy Systems was sold.[102] In June, the Duma adopted a law to regulate cash-based sales. Pavel Bunich, of the pro-government "Our Home is Russia" faction, who authored the law, stated that the definition of a strategic enterprise should remain narrow. "[W]e should not arbitrarily expand the interpretation of the notion of strategic enterprises. *If we arbitrarily expand the list, we will not have an effective economy.* You must remember that private enterprises perform better than state-owned ones."[103] The law included an idea borrowed from international practice: the "golden share," a single share giving the state a veto right over some major decisions. The state's retention of this right was designed to further the privatization of strategic enterprises, although it also clearly limits the rights of the private shareholders.[104]

The government's push to privatize major enterprises continued in 1998. Foreigners were not restricted from participating in the offerings.[105] First Deputy Minister of State Property Alexander Braverman described "an absolutely amazing tendency. While previously we saw that defense enterprises were clearly opposed to privatization, now we can give the Duma an additional list of 400 enterprises which have provided information on each of the 21 criteria required by the Duma [for corporatization as a prelude to privatization]."[106]

Braverman also implied that the list of strategic enterprises had already been shortened. "If you are talking about the privatization of strategic enterprises which ensure national security . . . [w]e have a list of enterprises which the government decided to cut on December 23, 1997."[107] In May, he announced a draft plan to cut the list by more than seventy percent, to approximately eight hundred.[108] This suggests a behind-the-scenes battle within the government. In June, Braverman said that a presidential decree reducing the number of strategic enterprises would be ready by mid-July.[109]

With the 1998 financial crisis the privatization program was severely hampered. In June, after the failure to sell Rosneft because of lack of interest at the given minimum price, Braverman announced the suspension of the sales of the TNK and VNK oil companies.[110] In July, Deputy Prime Minister Viktor Khristenko announced that the government had cut the number of strategic enterprises to one thousand and would now push for further privatization.[111] That represents somewhat more than half of the military-industrial complex.

Responding to pressure from international financial institutions to break up the natural gas monopoly, in February 1999 the Duma passed a law authorizing further and extensive privatization of Gazprom. Gazprom, involved in intense competition for the European market, had formed a partnership with Germany's Rurhgas, which owned a small stake.[112] The new law required that 25 percent plus one share remain state property. Foreigners would be allowed to own a maximum of 25 percent minus one share. Russian journalist Sergei Beregovoi commented that Gazprom believed it could survive intact more easily with private owners, Russian or foreign, than with government officials on the board of directors.[113]

Discussion

The data I present here demonstrate that Ukraine retained its state-owned large enterprises, whereas Russia achieved considerable privatization. Foreign investors played a moderately important role in the process in Russia; in Ukraine, foreign capital was largely shut out. By 1999, Russia's economic security preferences on the question of foreign ownership of "strategic" enterprises had evolved. There was no longer significant resistance to partial ownership, but full control by foreign owners of a major company was still unlikely to gain much support. Gustafson reaches a similar conclusion, "at least in the so-called 'strategic industries,' such as metals and oil."[114] Foreigners owned 12 percent of the shares of Russia's one hundred largest companies. The support of the "leftist" Duma for 25-percent-minus-one-share foreign ownership of Gazprom—the jewel in the crown of Russian industry—marks a considerable willingness to allow foreign capital into the commanding heights of industry. It is in stark contrast to the Ukrainian Rada's rejection of the privatization of Ukrtelekom at roughly the same time. The relative progress of Russia in privatizing the telecoms sector is also instructive (table 4).

It seems evident that the need for budget revenues drove the Russian privatization process to a significant degree. The government's marketing efforts aimed at potential foreign investors can be seen in that light. Chubais and his team of privatization officials understood that the participation of foreign investors in auctions was likely to raise the price of the enterprises being sold and therefore the budget revenues, as well. That was also the logic behind the decision to allow foreigners to purchase privatization vouchers. Russian preferences supported increasing budget revenues even if shares of major enterprises fell into foreign hands. Ukrainian preferences were the reverse.

Nevertheless, a purely "economic interest"-based explanation such as Zisk's is inadequate because both the need for budget revenues and the economic interest of directors in holding onto their enterprises surely were apparent in Ukraine as well. There is no evidence to indicate that the Ukrainian industrial lobby was more threatened by privatization in general or foreign investment in particular than its counterpart in Russia. And if anything, Ukraine had a greater need for budget revenues than did Russia.

The dependent variable of the study—economic security preferences—can be represented by the lists of strategic enterprises banned from privatization in each state. Whereas Ukraine's list had grown to 7,111 by 1998, Russia's had been whit-

TABLE 4. Telecommunications Ownership and Regulation in Eastern Europe

	Percentage of state share in dominant fixed-line operator	Independent regulator
Russia	75	No
Ukraine	100	No
Estonia	51	Planned
Moldova	100	No
Poland	100	Planned
Hungary	6	Yes
Czech Republic	51	Planned

Source: Adapted from European Bank for Reconstruction and Development, *Transition Report 1998* (London: EBRD, 1998). At this point, Ukraine had announced its intention to privatize. Russia's primary operator is Sviazinvest.

tled down to one thousand enterprises (figure 1). As percentages of the military-industrial complex of each state, the contrast is even greater (1,000 percent versus 55 percent; see figure 2). The definition of "strategic enterprise" was broadened in Ukraine to include the defense sector and almost all other major enterprises. In Russia, firms in the energy, metallurgy, and transportation sectors, and perhaps eight hundred firms of the military-industrial complex, were removed from the list. The contrast in policy outcomes in Ukraine and Russia is as stark as are the similarities in basic economic and political variables. How can the differences be explained? The possible explanations include the influence of military threat, perceptions of threat, economic interests, domestic politics, and the psychological effects of lessons of historical experience. A comparative perspective will help eliminate several possible explanations, including some proposed by analysts examining only one of the cases.

There is no mention by opponents or proponents of foreign investment in either case of any immediate military threat. There are perceptions of potential threat in both Ukraine and Russia expressed by opponents of foreign investment in strategic enterprises in the legislature, and occasionally by government officials. The officials involved directly with privatization, such as Riabchenko in Ukraine and Chubais in Russia, evince a more limited sense of possible, isolated threats from foreign access to specific defense-related information or resources. But the key point is that there is little difference in the level of threat perceived by Ukraine and by Russia.[115] In Ukraine, Russia is seen as a threat to some extent, but Presidents Kravchuk and Kuchma consistently called for expansion of economic cooperation with Russia. The level of threat perception was not high enough to prevent Ukrainian presidents from publicly advocating close economic cooperation with Russia. In Russia, in most instances threats are assumed to

FIGURE 1. Number of "Strategic" Enterprises Restricted from Privatization, 1995-98

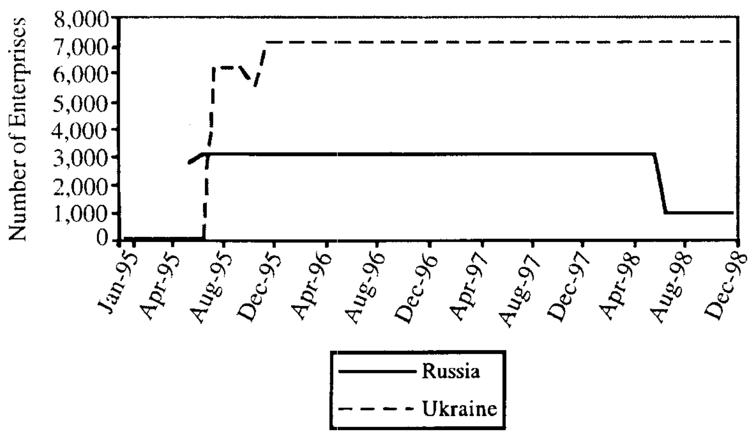
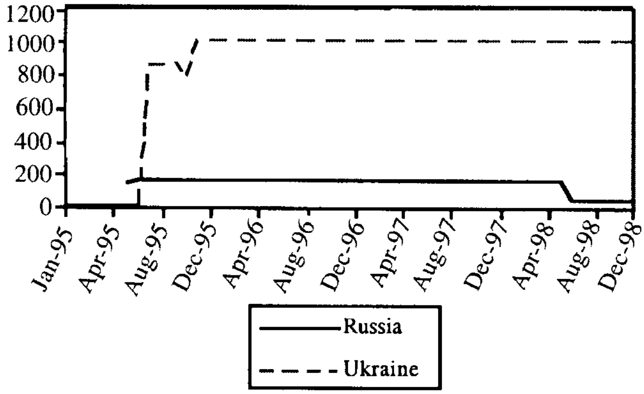


FIGURE 2. Percentage of Total "Strategic" Enterprises Restricted from Privatization, 1995-98



[a]Percentages represent the ratio of enterprises declared "strategic" by each state to actual size of the military-industrial complex. Russia was estimated to have 1,800 strategic enterprises; less than 100 percent of its military industry was restricted from privatization. Ukraine's number of strtegic enterprises was estimated at 700, but it restricted ten times that number from privatization. Ukraine removed almost all of its large enterprises–including the military enterprises–from its privatization program.

originate from the United States and other Western powers; statements by Minister of Foreign Economic Relations and Trade Aven, Transportation Minister Efimov, and of course the Communist Party demonstrate that. As will become apparent below, among both groups of elites, the major threat is seen to be domestic instability.

Neither is it the case that Russia's economic interests were more conducive to an open investment policy than Ukraine's. Ukraine has a population roughly one-third that of Russia, an economy of similar proportion, and fewer natural resources than Russia. Theories of international political economy argue that smaller states have greater incentives for international openness than larger states.[116] Larger states, especially those with sufficient natural resources, have a greater incentive to attempt self-sufficiency or autarky. Katzenstein presents data showing that small European states tend to have a higher proportion of foreign direct investment than do larger ones.[117]

States with insufficient domestic investment capital, or balance of payment difficulties, have also been hypothesized to be more likely to prefer foreign direct investment.[118] In transition economies in general, "[f]iscal pressures appear to have played a large role in encouraging states to move towards cash-based privatisations and international tenders of 'strategic' enterprises to raise much-needed budgetary revenues. This has motivated many governments to increase private sector participation in infrastructure."[119]

Although both Russia and Ukraine were short on investment capital and budgetary funds, and Ukraine certainly had fiscal problems at least as severe as Russia's, achieving 10,000 percent inflation in 1994, Russia at least had significant revenues from energy exports. Thus the relative tendencies in Ukraine and Russia are the opposite of those predicted by economic interests.

Domestic political coalitions against foreign investment are another possible explanation. Ash's explanation for Ukraine's resistance to foreign investment, based on an alliance between nationalists opposed to Russian investment and leftists opposed to any private investment (especially Western), seems convincing to a degree; but it is easy to see how similar forces in Russia could have aligned to resist major foreign investment. Indeed, they did initially. The design of the mass privatization program was compromised to accommodate workers, represented by Soviet-era trade unions, and the industrial lobby. Sergei Pavlenko gives a good description of the powerful antiprivatization forces in Russia. He writes that the political motivations for excluding enterprises from privatization included stopping privatization, excluding foreign investors from the Russian market, and gaining access to budget resources. The political forces behind it were the Communists who wanted to renationalize the economy, managers of large enterprises who feared loss of control, members of Russian financial circles who feared losing income from enterprises, and federal and regional officials who oversee enterprises and benefit from rents.[120]

It seems difficult to argue that in Russia there were not substantial political interests, comparable to those in Ukraine, opposed to privatization in general, and foreign investment in strategic enterprises in particular. A related explanation is institutional. Ash notes the fine balance of powers between the executive and legislative branches of the Ukrainian state. In contrast, the "dominant" Russian presidency is invested with powers allowing it to manipulate or ignore the legislature on many issues.[121] Yeltsin was able to use his power of decree to accomplish most of the privatization program over the Duma's objections, whereas in Ukraine the Rada seemed to be the major roadblock to privatization.

There are two problems with this argument. First, because each society was in the process of creating the institutions of the state, a causal connection between those institutions and policy outcomes is likely to be spurious. The institutions were being created to further the various goals of the political forces involved. Second, before the passage of the 1993 Russian constitution and the 1996 Ukrainian constitution, the executive-legislative relationships in the two countries were similar: based on Brezhnev-era constitutions as amended in each republic. The balance of constitutional power was similarly fluid in each state immediately after the fall of the USSR. The new constitutions are therefore best seen as results of struggles over power and policies, including the central question of economic reform.

Not surprisingly, in both cases the executive did indeed prefer a constitution with a strong presidency, whereas opposition forces preferred a strong legislature. In Russia, Yeltsin resisted the opposition and forced (literally) a referendum on his preferred constitutional draft. In Ukraine, Kuchma also planned a referendum and was in conflict with the parliamentary group proposing its own draft with more legislative powers. However, Kuchma agreed to an eleventh-hour proposal to cancel the referendum and consider the parliamentary draft.[122]

The Rada seemed to gain the power to drive the process of expanding the privatization blacklist. "Economic restructuring and modernisation depends on the divestiture of enterprises, for example Ukrtelekom, that have been deemed strategic. . . . However, such moves have been delayed by legislative conflict."[123] But there is scant evidence of concerted executive resistance to this trend. Indeed, if the Ukrainian president had had the political will to enact privatization by decree, legally he could have done so. For example, President Kuchma did use his constitutional decree power to order the privatization of between 50 and 75 percent of the shares of twenty regional power companies in May 2000.[124]

Finally, the attractiveness of a given country to potential investors may lead to higher levels of foreign investment. Foreign investors can be attracted by a high level of economic development and exportable resource endowments,[125] economic growth,[126] a large domestic market, and general export potential.[127] It is worth considering whether outside interest, and the resulting pressure, was much greater in one case than in the other.

The most significant difference between the Russian and Ukrainian economies is Russia's wealth of energy resources. However, there is little evidence that Russia was willing to open this sector up to significant foreign investment until at least 1997 or 1998, if then. Any advantage Russia may have had in terms of the size of the domestic market is likely to be counterbalanced by Ukraine's higher population density and favorable location closer to the western European export market and Black Sea ports. Indeed, in the final years of the USSR and the earlier years of independence, there was optimism about Ukraine's economic prospects and the opportunities for foreign investors.[128] Although it has to import energy from Russia and Turkmenistan, Ukraine has 60 percent of the former USSR's oil refineries, a wealth of mineral resources, accessible sea ports, extremely fertile soil, and rail links between east and west.[129] If Ukrainian leaders had placed a higher priority on attracting foreign investment, it seems that there was sufficient interest among potential investors.

Haggard proposes that "[v]ariations in the role of foreign capital among countries . . . must be explained by the political and economic threats foreign firms pose, the level of development of local firms when [multinational corporations] enter, and the political links between the private sector and government." However, when these factors do not vary, "national policy," including "basic property rights," "the structure of incentives," "discrete policies toward particular sectors or firms, [and] regulations such as restrictions on equity," can be expected to play a key role in explaining variation in foreign investment levels.[130] The question, therefore, is what remains to explain the variation in Ukrainian and Russian national policies?

The explanation I propose is based on historical experiences and their psychological effects. Experiences, both direct and observed, have shaped the basic assumptions and thought patterns—what psychologists term schemata—of Ukrainian and Russian elites and led them to perceive the world in different ways. Schemata frame perceptions by directing attention toward "relevant" information, and away from "irrelevant" information. In this way they shape behavior at a basic level. If elites learn from formative events, I expect that, regardless of which individual politicians occupy top positions, both individual schemata and the organizational context incorporating lessons learned from history will strongly affect decisions. Because of differing historical experiences, these schemata are quite different in Ukraine and Russia.

Ukraine has had little modern experience of sovereign statehood. The fall of the USSR in 1991 and the subsequent emergence of an independent Ukrainian state were therefore major victories for Ukrainian leaders. This is true for both President Kravchuk and other communists-turned-separatists who retained power after 1991, and for Ukrainian nationalists such as V'iacheslav Chornovil, Soviet-era dissident and leader of the independence movement Rukh. These leaders had worked together to achieve independence, in spite of their differences on many other issues.[131]

Independence, representing the successful achievement of a long-denied goal, heavily influenced how Ukrainian elites framed issues once they set about governing their new state. The need for domestic consensus or at least political compromise was seen as part of the formula for success. This may also be due to the lessons of 1917–21, when Ukrainian elites remained bitterly divided and the sparks of independence were easily extinguished by Bolshevik forces.[132] The sale of the state's most important industrial enterprises to foreigners requires a high degree of political will because of the entrenched interests that it harms and the questions of national security that it raises. In the wake of a major success, Ukrainian leaders sensed little need to change the way they or their state worked or to upset the domestic balance of forces.

Ukrainians' dominant schema, based on the successful drive for independence, shaped their perception of the USSR's failure as well. It was much more comfortable to believe that the policies already jettisoned—control from Moscow, suppression of national self-determination—were the root of the USSR's failure. It was easy to overlook the fact that the political and especially economic systems of independent Ukraine were still largely "Soviet" in form and substance.

Russia's historical legacy held lessons much different than those learned in Ukraine. Russia's elites were acutely aware of the failure of Soviet economic and foreign policies, which led to a loss of Moscow's centuries-old empire and reduced a superpower to a state not likely to be respected or feared (except for its weakness) by the world's major powers. This sense of failure led to a perception that it was necessary to create something fundamentally different in the "new" Russia. Known options from direct experience had been exhausted, so new policy options had to be found. This pointed elites to foreign experiences. The models of Polish "shock therapy" and Czech voucher privatization seemed attractive and relevant. The economic interdependence and openness to investment that contributed to the success of Japan, Western Europe, and North America after

World War II also attracted attention. The cold war, after all, seemed to offer evidence of the superiority of such policies.

Those direct and observed historical lessons gave birth to the political will in Russia to make political and even security-related sacrifices. The goal of privatization, combined with the belief that economic openness was a fundamental element of successful statecraft, led to the pursuit and defense of foreign investment in strategic enterprises. The Russian leadership tenaciously resisted abandoning this policy because it would mean a return to failed Soviet policies of autarky. The Ukrainian frame of reference, in contrast, left little room for the political will necessary to pursue difficult, radical change; such change was also not perceived as vitally necessary. Ukrainian leaders felt that history argued for preservation of a political consensus and that economic planning appropriate to Ukraine's interests (rather than those of Moscow) could pull their state out of its crisis.

Evidence of Elite Schemata in Ukraine and Russia

Before the fall of the USSR, Kravchuk commented on the lessons of the Soviet experience for Ukraine: "[Ukrainians'] desire for independence is . . . the hope that a state of their own will be closer to them, will protect their interests. They say: If we had a state of our own, would it have built the Chernobyl Atomic Power Station so near Kiev? Never!"[133]

Vitold Fokin explained his approach in the following terms:

> Ukraine was a state in the overall system of the Soviet Union. . . . There was a very carefully thought-out system of resource distribution, . . . functions, and responsibilities. . . . When the USSR existed, *this was correct.* It was dictated by the desire to achieve . . . optimization. . . . When Ukraine became independent, then the first thing we needed to do was . . . to decide what was needed for the Ukrainian economy. Do we need metallurgy? How much metal do we need for our interests, and . . . do we need to extract coal? How much? Which machine building branches do we need? What to do with agriculture? That is, we needed to create a base which would be optimal for the needs of Ukraine.[134]

After Fokin's resignation as prime minister, Kravchuk maintained his focus on building political consensus and achieving economic progress through better administration by the state. Kravchuk's new premier, Leonid Kuchma, was considered a "compromise candidate acceptable to both Parliament and Ukraine's large industrial lobby." Although he identified attracting foreign investment and increasing the proportion of manufactured exports as priorities, Kuchma also considered Russian-style shock therapy "unacceptable" and believed "[w]e need gradual evolution. We cannot privatize all major industries today."[135]

Kravchuk also repeatedly stated that Ukraine must maintain or re-establish its economic links with Russia:

> I promised . . . that we would do everything [possible] so that there would not be confrontation amongst our people. . . . [T]his together with our relations and our implementation of agreements with Russia . . . and others will give us the opportunity [for] survival.[136]

> [T]oday not a single state in the former union will be able to solve the crisis unless we create a common economic space and common . . . market within the CIS [Com-

> monwealth of Independent States]. Why? Because links with the West and its economy are links of a qualitatively new level.[137]

> The fact is that Western European states have formed a common market . . . But. . . . movement towards economic integration had always been a gradual process . . . *and without fail had advantages and the strengthening of one's own state, sovereignty and independence.* . . . This is self-evident. . . . [138]

It is clear that Kravchuk's policy preferences included first restoring the functioning of the existing economy, which he believed depended in part on re-establishing ties with other former union republics, and only then moving forward with market reforms. As will be seen, Russian leaders had almost identical concerns about civil peace and survival but took a markedly different approach.

My argument hinges on the generalization of the impact of formative events on the political elite of a country over time and across individuals. Ukraine's second president, Leonid Kuchma, differs from Kravchuk in important ways. He is usually considered more supportive of close relations with Russia, less interested in issues of Ukrainian national identity such as language, and more open to market economics.[139] If, in spite of the differences, formative events have had an impact on Kuchma and his administration's policies similar to the one they had on his predecessor, this would support the schematic learning explanation. In a December 1994 address to parliament, Kuchma outlined his historical perspective and policy priorities:

> As the experience of many countries that have been able to overcome a systemic economic crisis indicates, the decisive factors were connected to the strengthening of the state's administration of stabilizing processes, with the decisive administrative use of macroeconomic factors. That is the way it was for us, too, after the Civil War [1918–21], and during the Great Depression in the United States. . . . For us today the situation is really almost analogical—the state is weak, society is unstructured, and the economy is practically unguided. . . . And we have only one way out—to strengthen the state. . . .
>
> Without a strong government it will not be possible to effectively administer the state sector of the economy, which in Ukraine still comprises more than 85 percent [of the economy]. . . . [W]e have . . . even allowed . . . the deindustrialization of the country. . . .
>
> And for this reason it is especially important that . . . we will succeed in overcoming the confrontational mood, to begin a [domestic] dialogue, which can conclude in a joint victory over the conditions in which we find ourselves.140

Kuchma's emphasis on strengthening the state and encouraging domestic political consensus for economic reform is strikingly similar to Kravchuk's, although he is more aware of a crisis and the need for change.

Although Kuchma remains president past the end of the period of this study (1999), a general policy shift seemed to occur after his re-election in November 1999. The most-often cited indicator of this shift was the appointment of Prime Minister Viktor Iushchenko, a younger figure usually associated with market reform policies during his tenure as Central Bank director. Does this policy shift indicate that the dominant schema of top Ukrainian decision makers has been modified or replaced?

Because Iushchenko has had relatively little to say publicly about the privatization of major enterprises, it is difficult to assess how much his approach differs from previous practice. Regarding domestic politics, Iushchenko still expresses a desire for consensus, but seems willing to risk more conflict than his predecessors. He states that

> [i]n the period of nine years of the modern history of Ukraine it has become an obvious truth that the further we keep away from consolidation [of political forces], the harder it is for us to resolve pragmatic economic tasks. . . . In my opinion, the importance of the need to form a democratic majority grows every day. . . . In fact this consolidation is Ukraine's only choice for the future. If the government manages to make the national-democrats believe that our course may lead to victory, so that they can and must unite their efforts around this course, we could consider our task accomplished.[141]

Iushchenko seems to indicate that he is interested in cooperation with only one of the major factions in the Rada—the national-democrats such as the Rukh party (now divided into two factions). Apparently he has discounted any chance of cooperation with the other major group, the leftists. Iushchenko seems to imply that the national-democrats should be prepared to join his program, rather than expect compromises from the government. In an earlier statement, Iushchenko was more explicit: "Our programme is [appropriate] for both our political forces and the executive. However, I'll be honest: there will be no disaster if the parliament disagrees with our point of view."[142] This may signal a change in approach for Ukraine.

In Russia, the frame of reference regarding economic reform and economic openness was significantly different from that in Ukraine. Gaidar made his first major public defense of reforms in the newspaper *Izvestiya* in 1992. It is clear that neither political consensus nor protection from the global economy is as important to him as immediate destruction of the Soviet economic system, including in foreign economic relations.

> The main thing with which I must categorically disagree is the myth that it is possible to get out of the crisis and save Russia without radical market reforms. . . . In the summer of 1991 the Soviet Union's economy was unmanageable, in a state of free fall. . . . Indeed, we were faced with the questions of whether . . . society would survive. . . .
>
> The breakup of the Union was a heavy price to pay for an unsuccessful attempt to reverse the course of history [the August 1991 putsch]. . . .
>
> Today, having worked out and implemented . . . an . . . open . . . structural policy, we can form competitive production facilities, enter the community of the world's developed countries as equals. . . . But the forces of inertia . . . are . . . pulling the country into the past, into a completely closed defensive position and self-isolation behind high customs fences and toward the same old abundant financial injections that make for the reproduction of inefficiency. The first path led postwar Japan into the ranks of the world's economic superpowers. The second path threw Argentina—one of the richest countries at the beginning of the 20th century—into the embraces of underdevelopment.
>
> Now . . . the traditional power elite are once more reaching . . . for excessive military appropriations. . . . [But] there is no united front of adversaries of reform among the directors of defense enterprises.[143]

For Gaidar, there is no doubt of the need for change. Nor does he harbor any illusion about the possibility of achieving meaningful reform through political consensus. Like Kravchuk, he wants to join the world market "as equals," but continuation or rejuvenation of the Soviet integrated economic system is not an option for doing so. Rather, Soviet domestic and international economic principles are squarely to blame for the dire economic circumstances of the post-Soviet period. In his memoirs, Gaidar describes the origin of his approach to economic and political reform.

> Taking on the work of preparing a program of reform . . . I . . . recalled the Sopron [Hungary] economic conference of 1990. . . . For me the discussion of Russian economic problems . . . with Professor[s] William Northaus of Yale University and Rudiger Dornbush from the Massachusetts Institute of Technology was the most interesting. . . . . For us [Gaidar and his team] in the fall of 1991 the results of the Sopron discussions on such key questions as the synchronization of . . . various aspects of reforms, the opening of the economy, currency exchange policy, were important starting points . . . .
>
> [T]he experience of colleagues undertaking reforms in eastern Europe indicated that the most difficult and conflictual area would be privatization. . . . In the summer of 1992 . . . Poland was already beginning to emerge from the crisis, showing the route along which other countries would travel.[144]

Gaidar was aware of foreign experiences with reform and applied their lessons in Russia. His expectations for the political battles to surround privatization indicate his belief that political confrontation and conflict would inevitably follow market reform.

President Yeltsin's major statement on privatization was given as a national television address in 1992.

> At this point, a very elementary thing has to be comprehended. We are taking just the very first steps toward a normal human life, and we are stumbling and falling. . . . Difficult as it may be, the majority of people understand . . . we cannot go back to the old ways. . . .
>
> At the most critical moments, you and I did not allow ourselves to cross that line that cannot be crossed under any circumstances. Civil peace is the most precious thing that Russia has. . . .
>
> In the next few months, we will begin . . . the distribution of . . . privatization checks among the people. . . . The privatization check is a unique ticket for each of us to a free economy. The more property owners there are in Russia, . . . the sooner prosperity will come to Russia, and the more likely its future will be . . . safe.[145]

Although Yeltsin's emphasis on preservation of civil peace is consistent with statements by Kravchuk and Kuchma, the Soviet past is seen as a mistake, both for its political beliefs and undemocratic nature, and also for its failure as an economic system.

Viktor Chernomyrdin was prime minister until April 1998 (and again briefly after the 1998 financial crisis). His statements provide evidence that elites are indeed socialized into dominant policy preferences and schemata. As noted, Chernomyrdin was compelled by Yeltsin to adopt preferences consistent with those of the general reform line of Gaidar and his associates. In 1998, the former Soviet industrial bureaucrat and one-time vocal opponent of privatization stated that "much has been said about whether privatization has gone right or wrong, but there has been no other way for us. . . . [P]rivatization of big companies will be continued."[146]

In his 1997 presentation to the Duma's plenary budget meeting, Chernomyrdin argued for continuing structural economic reforms and cash-based privatization of major firms, further opening the Russian economy to the rest of the world and attracting more foreign investment to Russian companies. His argument to the legislature hinged on the limited successes already achieved by Russian reforms:

> There is another litmus test for the change in the economic situation. That is the behavior of foreign investors. In only the first half of this year [1997], around $7 billion of foreign investment entered the Russian economy, which is 3.3 times more than in the first half of last year. . . .
>
> It should be frankly admitted that we are making poor use of the potential for attracting foreign investment. . . . The policy of economic growth cannot but be based on our country's active integration into the world economy. . . . I cannot fail to react to the initiative . . . on a vote of no confidence in the government. . . . If we start a fight, we will ruin next year and the following years.[147]

Chernomyrdin goes on to outline a plan for continued major privatizations, military reform to free up investment resources, and continued opening to the world economy. If the deputies choose to oppose him, he promises them not compromise, but a lengthy fight.

The other prime minister to make a major impact on Russian domestic and foreign policies was Vladimir Putin, who became acting president of Russia in January 2000 and was elected to the office in March. Putin has been a controversial figure among Russian and foreign analysts and observers because of what are often seen as his antidemocratic, backward-looking tendencies. The largely successful violent repression of Chechen resistance made him at once popular among the electorate and suspect in the eyes of those concerned with Russian democracy and development. The former KGB agent seemed to cannily use the powers of the state to silence domestic criticism, especially in the mass media, and bring most major political forces under his sway. There was also suspicion that Putin would seek a new confrontation with the West to justify dismantling democracy and the private sector in response to a foreign "threat."

There were certainly signs that he favored a more protectionist approach to foreign economic relations. In November 1999, as prime minister he seemed to signal a new autarkic tendency, telling the Coordinating Council of Domestic Producers that "[i]ntegration into the world economy has led to considerable losses for Russia. . . . Russia is not ready to successfully enter the world economy. . . . The Russian government plans to protect Russian producers that are subject to discrimination from foreign partners. . . . The Russian economy annually loses $2–2.5 billion because of discrimination of domestic goods in the West."[148] At the same time, however, Putin's government was considering the sale of an additional 2.5 percent of Gazprom's shares to a "strategic investor," and an offer of 9 percent of Lukoil's shares "on Western stock exchanges in 2000." Privatization auctions continued to channel significant revenues into federal coffers.[149]

In a November 1999 radio broadcast, Putin addressed economic issues. "I am not sure that [privatization of the fuel and energy sector] was done in full accord with the interests of the state. . . . But this does not mean that we now have to rush back and start revising everything. By doing this, we would inflict even greater damage because it would create total uncertainty in the minds of domestic and foreign investors."[150]

Although Putin is clearly more apprehensive about the effects of the market, especially the global market system, than Gaidar or Chubais, or even Chernomyrdin, there is nevertheless no indication that he advocates a return to highly protectionist foreign economic relations. Indeed, under President Putin the Property Ministry proposed further narrowing the definition of a "strategic enterprise."[151]

In both Russia and Ukraine, it appears that leaders with preferences somewhat at odds with dominant schemata came to power in 1999. However, in the absence of a new formative event to shock the state organization, they have been constrained to work within the parameters of "normal" politics and have been able to amend dominant policy preferences only gradually and incrementally. That raises the interesting question of how, why, and to what extent dominant schemata are modified or amended in the absence of a formative event, but that falls outside the scope of the present study.

Conclusion

In Russia, the list of strategic enterprises exempt from privatization and foreign investment was shortened and the definition made more restrictive, excluding a large proportion of the military-industrial complex. In Ukraine, the list grew longer and the definition apparently expanded to include the entire defense sector and almost all major enterprises. Russia undertook extensive marketing efforts to promote its enterprises among potential foreign investors, but there is no evidence that Ukraine did so. Both Russia and Ukraine developed a legal and bureaucratic infrastructure to support privatization and foreign investment. But while the Russian State Property Committee was eventually upgraded to ministry status, in Ukraine the State Property Fund languished for a considerable period without a director.

Although explanations for either Russian or Ukrainian policies based on economic interests, domestic politics, or security concerns may seem plausible when considered in isolation, a comparison draws attention to their striking similarities across important independent variables and undermines such explanations. The most plausible remaining explanation is psychological: a process of schematic perception based on learning from history's formative events. Ukrainian and Russian elites responded differently to similar circumstances because their perceptions were framed by different schemata based on different historical experiences, both direct and observed.

In Russia, the economic and foreign policies of the USSR were seen as abject failures by 1991. This recognition of failed protectionism and autarky led Russian elites to search for foreign models of success. The data presented here demonstrate that Russian policymakers based their new policies on observed lessons of success, specifically Polish shock therapy and Czech mass privatization. More broadly, the roots of Russian policies extend to an understanding of Japanese postwar economic success and general knowledge of Western-style thinking on domestic and international economic policies. It is noteworthy that

Russians have drawn lessons from foreign failures as well as successes. The decision to allow foreigners to purchase Russian privatization certificates was a policy innovation based on observed shortcomings of reforms in Eastern Europe. Gaidar was also aware of the dangers of Argentine-style corporatist and protectionist policies (i.e., import substitution).

The result of those lessons of direct failure, observed success, and observed failure was the formation of a foreign-policy schema that values the benefits of interdependence over those of military security, butter over guns. Russia's interests are perceived to be better served by allowing considerable foreign investment in major enterprises, which is expected to integrate Russia into the system of mutual interests and interdependence represented by the global market economy. Russian elites state that this serves the vital long-term function of increasing the efficiency of Russia's industry. In the short term, the policy is perceived to provide the important benefits of increasing budget revenues and decreasing the management burden on the state. The benefits are worth the tradeoff in terms of foreign influence, vulnerability to espionage, infringed sovereignty, domestic political conflict, and reduction of the state's short- and medium-term potential for military production.

In Ukraine, statements by the elite, policy, and practice indicate that the government valued military security over interdependence. The USSR was considered a failure in some important respects, but not in those directly relevant to foreign economic policy. Rather, the formative event of successful achievement of independence dominated the elite schema and set the parameters of policy options. Ukrainian elites valued economic independence and sovereignty above openness or efficiency, a policy that cannot be understood by considering actual threats, domestic political factors, or economic interests. However, it is quite understandable given the lessons of Ukrainian history. Emerging from the Soviet empire, Ukrainian elites proceeded on the assumption that maximizing sovereignty and independence took pride of place.

The economic and other failings of the new Ukrainian state were perceived not as symptoms of major flaws in policy, but as temporary side effects of the colonial past. The perception was that with sovereignty and statehood, all other things would come in time. Progress in the economic sphere was expected to eventually emerge as the result of the strengthening of the state. Once decisions were being made in Kyiv rather than in Moscow, better state administration of major enterprises could make them internationally competitive. There was no urgent need to fight risky and destabilizing political battles over foreign (or domestic) economic policy. Domestic political stability was worth the price of policy stagnation because it was perceived to further state building and consolidation of sovereignty. This was the perceived lesson of both the achievement of independence in 1991 and the failure of Ukrainian state building in 1918–21.

Ukrainian leaders recognized some foreign successes but perceived them through the lens of the dominant schema based on Ukraine's successes. Basic policy preferences were already set by the formative event of independence, and references to observed success were consistent with existing policy. President

Kravchuk believed it was "self-evident" that models of economic cooperation such as the European Union or NAFTA had the effect of strengthening sovereignty and independence. But such institutions are usually considered to pose fundamental challenges to sovereignty. President Kuchma cited U.S. New Deal policies as evidence that strengthening the role of the state was appropriate in order to pull Ukraine out of crisis. Perhaps revealing his perception of successful Soviet economic management, he also referred to the period after the Bolshevik victory in the civil war as teaching the same lesson.

This emphasis was a result of the particular historical lessons learned by Ukraine's elites, and not simply of the real and obvious need to build an effective sovereign state strong enough to resist whatever desire Moscow had to reassert imperial power. States such as Latvia, Lithuania, Estonia, Georgia, and Moldova were able to reconcile divisive market reforms, a higher degree of economic openness, and the strengthening of sovereignty to maintain real independence from Moscow in spite of significant ethnic Russian populations, and even serious military threat in the cases of Georgia (Abkhazia) and Moldova (Pridnestrovia), including actual combat with forces closely associated with Moscow. Post-Soviet state building and economic protectionism do not necessarily go together. Rather, Ukrainian elites' perceptions of the lessons of history led them to prefer this policy.

Case studies of complex political phenomena cannot hope to be exhaustive. There are simply too few degrees of freedom to eliminate all potential alternative explanations. But the evidence here strongly supports the assertion that psychological factors play a major role in these cases. Russian and Ukrainian elites perceived the world through different lenses, and this was an important factor—likely *the* decisive factor—causing their differing economic security preferences. There can be little doubt that the nature of security interests varies independent of objective factors. Interests are products of perception, shaped by learning and history.

NOTES

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60. Aslund, *How Russia Became a Market Economy,* 63, 83; Kuboniwa and Gavrilenkov, *Development of Capitalism in Russia,* 4; Remington, *Politics in Russia,* 44.

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85. *Moscow Times*, 21 June 1995.

86. Federal Information Systems Corporation, 5 March 1998. Chubais stated that it contained three thousand enterprises and had the written consent of the president. Although previous references to the list had indicated that 3,054 enterprises were included, it is unclear whether fifty-four enterprises had actually been dropped from the list, or if Chubais was simply using a round figure for convenience. The latter appears to be the case, because the figure of 3,054 was subsequently referred to by government officials.

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142. *BBC Summary of World Broadcasts,* 4 April 2000.
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144. *Current Digest of the Post-Soviet Press* 44, 331–34.
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148. Interfax, 23 November 1999.
149. Ibid.
150. *BBC Summary of World Broadcasts,* 2 November 1999.
151. *RFE/RL Newsline*, 31 July 2000.