

Aftermath of the Orange Revolution, 2005–08

The hangover was as heavy as the Orange Revolution had been gorgeous. Viktor Yanukovich had learned the trick. After the rerun on December 26, he did not concede but filed hundreds of suits about electoral fraud. Although he had no apparent cause, his complaints prolonged uncertainty for almost a month. Viktor Yushchenko's inauguration was in limbo. He could make no appointments, which greatly irritated the orange victors, who feared that the old regime would steal the government bare, while President Leonid Kuchma continued making appointments.

Within the old regime, recrimination was awful. The day after the rerun, Minister of Railways Heorhiy Kirpa, a strongman vital for election fraud and financing, allegedly committed suicide, but with two bullets. Soon afterward, Yuriy Lyakh, a leading banker close to Viktor Medvedchuk, was stabbed to death. In March 2005, just before he was supposed to give evidence as the key witness in the Heorhiy Gongadze murder, former Minister of Interior Yuriy Kravchenko committed suicide (Wilson 2005, 5–6, 156). The old gas oligarch Ihor Bakai emigrated to Russia, while Oleksandr Volkov joined Yuliya Tymoshenko. Leonid Kuchma quietly retired to his dacha outside of Kyiv without suffering any legal consequences. Most oligarchs enjoyed parliamentary immunity.

The Orange Revolution had changed everything, including the composition of the parliament. In the orange bloc, Our Ukraine had 100 deputies, Tymoshenko's bloc 19, and the socialists 20, adding up to only 139 deputies out of 450. The opposition of 144 consisted of 56 deputies of the Donetsk party the Regions (down from 66), 29 social democratic deputies (the Medvedchuk-Surkis group, down from over 40), and 59 communists. The remaining third of the deputies had drifted away into loose, opportunistic

centrist factions. In 2005 the Our Ukraine faction cracked up as well. The parliament was no longer representative, and Ukraine badly needed new parliamentary elections. Alas, for constitutional reasons, new elections were not deemed possible. Ukraine had to survive with a deficient parliament until March 2006, but the cost would prove considerable.

All politicians focused on the March 2006 parliamentary elections, and Ukraine never enjoyed its moment of “extraordinary politics,” as Leszek Balcerowicz (1994) has called the brief period of political suspension after a democratic breakthrough when greater reforms than usual are possible.

Ukraine recorded two great achievements: democratization and closer relations with the West and the European Union. Freedom was suddenly taken for granted. Everybody freely spoke their mind. The media were unrestricted and voiced diverse opinions. Street demonstrations and minor popular protests became everyday events. The problem was rather how to make and implement democratic decisions.

The political situation proved exceedingly unstable. In the ensuing four years, Ukraine had no less than four governments, led in turn by Tymoshenko, Yuriy Yekhanurov, Yanukovych, and Tymoshenko again. Parliamentary elections were held in March 2006 and again in September 2007. Ukraine joined the World Trade Organization (WTO) on May 16, 2008, and the economy continued growing at a high rate, but no political modus vivendi was found. The three dominant political leaders could not form a lasting or operative compromise because of the dysfunctional constitutional order. The greatest bone of contention was Ukraine’s relation to the North Atlantic Treaty Organization (NATO), and Russia’s president, Vladimir Putin, did what he could to aggravate the situation.

Formation of an Orange Coalition

The orange leaders were all lobbying for high posts in the new administration, and the delayed election results aggravated their infighting. For ten days, Yushchenko took a well-deserved holiday in the Carpathian mountains together with Georgian President Mikheil Saakashvili, but he made the elementary management mistake of appointing a working group of eight leaders to agree on the composition of the new government. As they all wanted to become prime minister, the working group failed miserably.

The two strongest contenders were Yuliya Tymoshenko and Petro Poroshenko. Both were striking personalities, highly intelligent and capable. Tymoshenko was both the most liked and disliked politician, perceived as highly partisan. She claimed that Yushchenko had promised her the job when she supported his candidacy last July. Her short-term goal was to maximize her eponymous bloc’s votes in the March 2006 parliamentary elections, and she thought populist policies would serve her best.

Poroshenko's problem was his substantial business interests. He complained that he had lost two-thirds of his assets because of his opposition to the old regime. People feared that he would use power to claw back his lost fortune. Poroshenko was supported by the other big orange businessmen, David Zhvania, Mykola Martynenko, and Yevhen Chervonenko. Their reputations were worse than Poroshenko's.

On January 23 Yushchenko was finally inaugurated, and the next day he appointed Tymoshenko acting prime minister. On February 4 the Rada approved her candidacy with an overwhelming majority of 373 votes.

Yushchenko formed the government. Tymoshenko received no ministerial portfolios, though her right-hand man, Oleksandr Turchinov, became chairman of the Security Services of Ukraine (SBU).¹ Yushchenko's old liberal ally, Viktor Pynzenyk, returned to the government as minister of finance. Yushchenko's men controlled foreign policy. His loyal chief of staff Oleh Rybachuk was named deputy prime minister for European integration; Borys Tarasiuk returned to his old job as minister for foreign affairs; and Anatoliy Hrytsenko became minister of defense. The Poroshenko group was also richly rewarded, with Poroshenko becoming secretary of the National Security and Defense Council and receiving two ministerial posts.

Somewhat surprisingly, the small Socialist Party received four ministerial posts, including the popular Yuriy Lutsenko as minister of interior and the dogmatic socialist Valentyna Semeniuk as chairman of the State Property Fund. Thus socialists, who opposed privatization, were given this key ideological portfolio. The fourth coalition partner, Anatoliy Kinakh, became first deputy prime minister.

The presidential administration was badly divided from the outset. As his first assistant, Yushchenko took Oleksandr Tretyakov, a gas trader, who had invited the Yushchenko family to stay with him in his fortified residence after the poisoning. Oleksandr Zinchenko, the late arrival from the Medvedchuk camp, became Yushchenko's chief of staff.

Both the government and the presidential administration harbored too many ambitions and opposing interests. They were set for an all-consuming internecine struggle.

Ukraine Turns to Europe

After the government was formed, Yushchenko disappeared from the domestic scene into foreign affairs. He toured the world, celebrating his victory in the Orange Revolution, and recovered from the poisoning.

1. This section draws extensively on interviews recorded in my personal trip reports from January 11–14, March 6–18, and April 24–27, 2005.

On January 24, 2005, the day after his inauguration, Yushchenko met Putin in the Kremlin, anxious to put Ukrainian-Russian relations on a normal footing, and on March 19 he received Putin in Kyiv. But most substance had disappeared from Ukrainian-Russian relations, and ministerial exchanges almost ceased.

On March 1 Ukraine declared that it would withdraw its troops from Iraq. The United States had long accepted Yushchenko's position. His greatest feat was his trip to Washington, where he was given the rare honor of addressing a joint session of the US Congress on April 6.

The Orange Revolution greatly improved Ukraine's political relations with the European Union, which became the priority of the new government. It wanted Ukraine to become an EU member. Deputy Prime Minister for European Integration Oleh Rybachuk, a revolutionary hero, promoted EU integration with great fervor. With his enthusiastic rhetoric, excellent command of English from Georgetown University in Washington, and whirlwind diplomacy, Rybachuk transformed the European face of Ukraine.

As the European Union turned more positive about Ukraine, the nature of its European Neighborhood Policy (ENP) for Ukraine changed. The Yanukovych government had prepared an initial action plan for the ENP but never concluded it with the European Union. It had complained that the European Union imposed many demands on Ukraine while offering little itself. Many EU demands, however, were badly needed Ukrainian reforms. The European Union emphasized that ENP action plans would not be standardized as the preceding partnership and cooperation agreements had been but designed individually for each country, with more cooperation with countries closer to the European Union. On February 21 Ukraine concluded a substantial initial action plan with the European Union.

The action plan laid out the strategic objectives for EU-Ukraine cooperation for the ensuing three years. It envisioned a free trade agreement between Ukraine and the European Union to be concluded as soon as Ukraine became a member of the WTO. It also included substantial Ukrainian cooptation of useful EU institutions, and the European Union offered Ukraine some scientific and education exchanges.

The new government was also determined to pursue Ukraine's accession to the WTO, which remained a top national priority regardless of government, and it became a major focus of legislation.

The Tymoshenko Government: Reprivatization

The Tymoshenko government came to power promising earth-shattering reforms. Corruption would be purged and the state administration would start functioning. Several organizations had formulated concrete

reform proposals and a broad consensus existed.² The new government adopted a program, but it was of no consequence. Alas, no broad, comprehensive reforms were launched, and the orange coalition plunged into internecine strife.

Tymoshenko dominated the cabinet and deprived the deputy prime ministers of their staff and powers, centralizing their power to herself. She kept the cabinet of ministers in long meetings two days a week. The poorly prepared discussions were long and often indecisive. Then the prime minister decided on her own, in what Ukrainians called *ruchmoe up-ravlenie* (manual management). She attacked ministers in public with great vitriol. Yushchenko's secretariat was a similar wonder of disorganization. The Ukrainian government had not seen such chaos since Leonid Kravchuk's days.

The new government focused on cleansing taxation and customs, Ukraine's WTO membership, and closer relations with the European Union, but also on populist policies of reprivatization, price regulation, arresting culprits of the old regime, and increased public expenditures to boost the prime minister's popularity before the parliamentary elections.

Pynzenyk pursued fiscal reform. Since Tymoshenko considered it politically impossible to scale back Yanukovych's pension hikes, tax revenues had to be boosted. Pynzenyk did so by abolishing loopholes and improving tax collection. He eliminated tax exemptions for specific industries and all the free economic zones, which had mainly benefited Donbas and Transcarpathia, leveling the playing field. As part of its accession to the WTO, the government lowered customs tariffs to liberalize legitimate trade, while tightening controls. As a result, customs revenues rose sharply. Total state revenues rose impressively by 4.9 percent of GDP from 2004 to 2005, halving the budget deficit to 2.3 percent of GDP after Yanukovych's excesses.³ The notorious demands for 20 to 30 percent commission for the reimbursement of value-added taxes (VAT) for exporters abated.

The all-consuming issue for the Tymoshenko government, however, was reprivatization. Yushchenko had campaigned for one repeat privatization, Kryvorizhstal, but now he went further. On February 10, 2005, he stated: "We will revoke every privatization case that was conducted in breach of law. Nothing will stop me."⁴ Yet Tymoshenko took the lead. On February 16 she raised the legal reconsideration of 3,000

2. For example, Blue Ribbon Commission for Ukraine (2005), EBA (2004), and OECD (2004).

3. European Bank for Reconstruction and Development online database, www.ebrd.com (accessed on August 16, 2007).

4. Dragon Capital, *The Dragon Daily*, February 11, 2005.

privatizations in the last five years, while Yushchenko tried to limit the number to 20 to 30 specific reprivatizations. The government elaborated several draft laws, with criteria and procedures for privatizations, and the top politicians spent much of their time discussing the flaws of various privatizations.

The reprivatization discussion became highly personal. Tymoshenko took pleasure in pinpointing enterprises belonging to Victor Pinchuk and Rinat Akhmetov. The two competing oligarchic groups, Privat Group and the Industrial Union of Donbas, welcomed reprivatization, although some of their factories were also questioned because they hoped to seize assets from Pinchuk and Akhmetov. The businessmen who had suffered large losses to the Kuchma oligarchs but paid millions to the Yushchenko campaign reckoned it was payback time.

Virtually everybody argued for the swift expropriation and resale of Kryvorizhstal from Pinchuk and Akhmetov. This sale of June 2004 for \$800 million could result in revenues of \$3 billion, and the courts decided the reprivatization of Kryvorizhstal. Pinchuk and Akhmetov complained to the highest courts but lost.

The most aggressive battle took place between Pinchuk and Ihor Kolomoiskiy of Privat Group over the Nikopol Ferroalloy Plant. Pinchuk had gained it in the spring of 2003 in competition with Privat because Privat had only offshore funds, while a condition imposed by the International Monetary Fund (IMF) was that only onshore funds could be used. Kolomoiskiy demanded this valuable factory. He persuaded Tymoshenko to order 2,000 interior troops to seize the factory, while Pinchuk asked thousands of his workers to defend their place of work. Fortunately, no violence erupted. The case was eventually settled amicably out of court between Pinchuk and Kolomoiskiy.

Reprivatization became reminiscent of corporate raiding, which was the scourge of Ukrainian capitalism. Typically, a raider acquired a minority share in a company with several owners already divided. He used his ownership to demand information about the company. Since no firm could act legally in Ukraine's inconsistent legal framework, the raider sued or blackmailed the main owner, and a corrupt court could decide anything. Usually, a raider was paid off, but often he seized the firm, especially if the main owner was short of cash. Tens of thousands of such illicit corporate raidings occurred after 2000.

By March 2 the prosecutor general announced that criminal cases of violations of the law during privatization had been initiated against about 2,000 people.⁵ One opinion poll showed that 71 percent of Ukrainians

5. "Genprokuratura obvinyayet 2 tysyach chelovek v nezakonnoi privatizatsii" ["The General Prosecutor Accuses 2,000 People of Illegal Privatization"], *Ukrainskaya pravda*, March 2, 2005.

supported a revision of privatization of the biggest state enterprises, and only 11 percent preferred to leave everything as it was.⁶

Another hallmark of the new government was huge social transfers. Yanukovych had doubled pensions from September 1, 2004, but the new government hiked the wages of all public employees by 60 percent.

Tymoshenko largely adopted Yanukovych's policies of populist public expenditures and price controls, appealing to his poor and uneducated electorate. Her policy was almost exactly the opposite of the liberal Yushchenko's. She effectively favored state capitalism, aspiring to government control over the commanding heights of the economy to establish vertically integrated state monopolies: "Those big enterprises, at which it is very easy to organize effective management, and which generate excellent profit to the state as owner, must not be privatized."⁷ She launched a campaign to reinforce state monopolies, raise their tariffs, and boost their profits as well as their payments to the state.

She started regulating prices. As domestic oil prices rose in line with global prices, Tymoshenko blamed Russian oil companies for the rising Ukrainian prices: "You know, certain countries were not very satisfied with the elections in Ukraine. During the last months, Russia has increased the prices of oil by 30 percent. . . . Russia's oil traders wanted to obtain excessive profits at the expense of Ukraine and set their prices considerably higher, because they are monopolists and think that they momentarily can turn Ukraine's hands around."⁸ Although Ukraine's oil market was competitive with numerous private companies, Tymoshenko capped gas prices, and refineries and gas stations started closing. When the Russian oil companies protested, Tymoshenko abused them with delight.

Similarly, she tried to regulate meat prices, demanding that producers and shopkeepers sell at low prices. At a televised cabinet meeting in early April, she announced: "Meat prices will be under my personal control." In an eerily Leninist vein, she stated: "We must do what it takes to combat the speculators (middlemen)."⁹ She commanded the governors to draw up plans for meat production in their regions: "This is an imperative directive. You have half a year to draft projects on meat production, engage enter-

6. "Bolshinstvo ukraintsev podderzhivaet ideyu peresmotra itogov privatizatsii" ["A Majority of Ukrainians Supports the Idea of a Revision of the Results of Privatization"], *Ukrainskaya pravda*, May 14, 2005.

7. "'Poseynaya': Do, Posle i Vmesto" ["'Sowing:' Before, After and Instead of"], *Zerkalo nedeli*, April 16–22, 2005.

8. "Timoshenko obvinyayet rossiyan v benzinnovom shantazhe iz-za pobedy Yushchenko" ["Tymoshenko Accuses Russians of Gas Extortion because of Yushchenko's Victory"], *Ukrainskaya pravda*, May 15, 2005.

9. "Prime Minister Tymoshenko Tackles Meat Prices," *New Europe* (Athens), May 9, 2005.

prises and draw investments.”¹⁰ This sounded like the old-style Soviet command economy, and meat started disappearing from the market.

The Orange Revolution had aimed at introducing the rule of law, but the government appeared to penalize some oligarchs and favor others. In April Ukraine’s richest man, Akhmetov, fled to Moscow after his partner Borys Kolesnikov was arrested for alleged racketeering and returned to Ukraine only after Tymoshenko’s ouster.

The protracted public debate over reprivatization undermined property rights and business confidence, and the increased tax pressure aggravated the burden. As a consequence, GDP growth fell by about one percentage point each month until it had become negative in August. Tymoshenko’s economic policy was a disaster.

Ukrainian society woke up only slowly from its euphoria of the Orange Revolution. In late March, the intellectual weekly *Zerkalo nedeli* started complaining about “revolutionary populism.”¹¹ Yushchenko was the only possible counterweight, but since 1999 he had refrained from public criticism of Tymoshenko. Yet in mid-May he started scolding her, first criticizing her relentless campaign for reprivatization: “From the first day, I said that neither I nor my team aim at the nationalization or reprivatization of any object of property.”¹² He also criticized the price controls: “I shall guarantee that the government uses exclusively market methods to respond to questions on the markets of meat, petroleum products and crude oil.”¹³

On May 19 a political bomb detonated. At a large meeting with businessmen on oil price controls, Tymoshenko argued against Yushchenko. Finally, Yushchenko asked her to submit her resignation.¹⁴ She did not do so, but in effect the orange coalition was over. The government and presidential administration were so antagonistic and divided that neither could work.

On September 3 Zinchenko resigned as head of the presidential administration, and two days later he held a scandalous press conference. He accused Secretary of the National Security and Defense Council Porosh-

10. “PM Tymoshenko Orders Governors to Draft Projects to Supply Regions with Meat by December,” Ukrainian News Agency, May 16, 2005.

11. Nataliya Yatsenko, “Revolutsionnaya byudzhelnaya tselesoobraznost” [“Revolutionary Budgetary Expediency”], *Zerkalo nedeli*, March 26, 2005.

12. “Yushchenko ne otdast Krivorozhstal gosudarstvu, no eshche dolzhen podumat’” [“Yushchenko Does Not Give Kryvorizhstal to the State, But He Needs to Think More”], *Ukrainskaya pravda*, May 13, 2005.

13. “Yushchenko govorit, chto ‘Zerkalo nedeli’ pishet bashni” [“Yushchenko Says that ‘Zerkalo nedeli’ Writes Tales”], *Ukrainskaya pravda*, May 25, 2005.

14. Yuliya Mostovaya, “Igra so spichkama vokrug benzyna” [“Play with Matches around Gas”], *Zerkalo nedeli*, May 21, 2005.

enko, First Presidential Assistant Tretyakov, and their partners of using the government for their personal corrupt aims. However, he did not specify actual corruption.¹⁵

Yushchenko did the inevitable on September 8, sacking both sides, Tymoshenko as well as Poroshenko and Tretyakov. He nominated his close loyalists Yuriy Yekhanurov as prime minister and Rybachuk as state secretary, head of the president's secretariat. Yushchenko had made Yekhanurov governor of Dnipropetrovsk oblast, as if he had kept him as a reserve outside of the Kyiv squabbles.

The orange revolutionaries had fallen apart in scandals and disputes. Yushchenko was accused of being ineffective, disorganized, and naïve. Tymoshenko's popularity had fallen in parallel with Yushchenko's, as businessmen were upset by her populist economic policy. Under her watch, economic growth fell month by month from 12 percent in 2004 to -1.6 percent in August 2005. Few laws were enacted because of the government chaos. Her defenders praised the adoption of several WTO laws and the elimination of 3,600 unnecessary regulations. Nobody called her our Yulka any longer.

The orange coalition government was the victim of revolutionary hubris and the absence of new parliamentary elections. The victors felt invincible and infallible, with power being their privilege. Everybody focused on the March 2006 elections, and Tymoshenko was convinced that populism would win. Moreover, the very construction of the government was divisive, leaving the prime minister without any minister of her own.

The Yekhanurov Government: Return to Order

After the fall of the Tymoshenko government, disappointment and disillusion spread to the orange voters at large.¹⁶ Yet a new sense of democratic normalcy and order had taken hold, as democracy and freedom persevered. The many scandals reflected transparency and freedom of the media. As Yushchenko and Tymoshenko floundered, Yanukovych recovered in a quick metamorphosis. After all, he had managed the Ukrainian economy well and possessed a devoted eastern electorate.

In this situation, Yekhanurov appeared the natural choice for prime minister. He was unassuming and usually described as a technocrat, but he had carried out Ukraine's mass privatization from 1994 to 1997 without any stains on his reputation, which was political mastery. He knew the apparatus inside out, being perfectly organized and hardworking. Amazingly,

15. "Skandal'naya press-konferentsiya Zinchenko" ["Zinchenko's Scandalous Press Conference"], *Ukrainskaya pravda*, September 5, 2005.

16. This section draws on my personal trip report from a visit to Kyiv, October 11–16, 2005.

for such a prominent politician, he had few enemies. His weakness was that he was less of a popular politician. Given that parliamentary elections were due in March 2006, his was a caretaker government.

The parliament had to confirm Yekhanurov. The initial attempt on September 20 failed by three votes as 223 deputies from seven party factions voted for him, while the Bloc of Yuliya Tymoshenko (BYuT), the Communist Party of Ukraine, and three oligarchic parties, including the Regions and Medvedchuk's social democrats, opposed him.¹⁷ Yushchenko could have mobilized three additional votes for Yekhanurov in a repeat vote, but he preferred to play it safe, making an agreement with Yanukovich. On September 22 the Rada approved Yekhanurov with 289 votes thanks to the Regions' 50 votes.¹⁸

Yekhanurov quickly appointed a new government that was a coalition among Our Ukraine, the socialists, and Kinakh's industrialists. It was reasonably cohesive, apart from two socialist ministers blocking privatization. Eleven of the 25 ministers were exchanged as BYuT and the big businessmen from Our Ukraine departed. The new ministers were largely young professionals from Yushchenko's Our Ukraine. The rising star Arseniy Yatseniuk became minister of economy. Kinakh replaced Poroshenko as secretary of the National Security and Defense Council. This cabinet kept a lower public profile than Tymoshenko's, but it worked.

Yushchenko outlined the task, "to restore economic, political and social stability,"¹⁹ which suited Yekhanurov. To reassure the businessmen he organized the first meeting ever between the president and the 20 biggest Ukrainian businessmen, following the example of Boris Yeltsin in Russia in the mid-1990s (Hoffman 2002). Yushchenko's message was that the businessmen had nothing to fear and the government demanded nothing from them, and they dared to stay and work in their country again.

Yekhanurov's overwhelming priority was to stop reprivatization and secure existing property rights. He accepted reselling one company, Kryvorizhstal, fulfilling Yushchenko's campaign commitment. On October 24, Kryvorizhstal was resold in a televised auction, with the two biggest steel companies in the world, Arcelor and Mittal Steel, bidding against one another. Mittal won with a cash bid of \$4.8 billion, six times the price paid by Akhmetov and Pinchuk in June 2004 (steel prices had risen sharply in the interim). This sale was a great success and boosted

17. "Parlament ne podderzhal kandidatury Yekhanurova" ["Parliament Did Not Support Yekhanurov's Candidacy"], *Ukrainskaya pravda*, September 20, 2005.

18. "Rada Approves Yekhanurov as Prime Minister," Ukrainian News Agency, September 22, 2005.

19. "President Interviewed by Four Ukrainian National TV Channels," BBC Monitoring Service, October 4, 2005.

both state revenues and foreign direct investment, which took off in 2005. Politically, however, it benefited Tymoshenko, who attended the auction.

Yekhanurov had little time before the parliamentary elections scheduled for March 26, 2006, but by stopping reprivatization he managed to revive business confidence and thus economic growth, because Ukraine's businessmen had been so frightened by Tymoshenko's reprivatization drive that some had held back production. He and Yushchenko had no visible conflicts.

Russia Disrupts Gas Deliveries: Higher Prices

The biggest drama during Yekhanurov's term as prime minister was that on January 1, 2006. In the midst of the winter, Russia's Gazprom turned off gas to Ukraine because the two countries had not agreed on a price for 2006.²⁰ Since 80 percent of Russia's gas exports to Europe went through Ukraine, gas supplies to eight European countries, Austria, France, Germany, Hungary, Italy, Poland, Romania, and Slovakia, were reduced. Moscow had not warned them, so this supply disruption provoked strong international protests.

As a reaction, Russia ended its gas embargo after two days, and a Ukrainian delegation hastened to Moscow to reach an agreement. Ukraine had a five-year agreement from 2004 on gas deliveries from Russia, which Tymoshenko and the Ukrainian steel barons insisted was valid, but Gazprom objected that Ukraine had not fulfilled that agreement so it no longer applied. Three key issues were:

- Would Ukraine buy Turkmen or Russian gas?
- Would RosUkrEnergo (RUE) be allowed to continue as an intermediary?
- What would the price be? Gazprom demanded \$230 per 1,000 cubic meters, while Ukraine had paid \$50 in 2005.

Public discussion focused on the price. World energy prices had risen sharply in 2004. After the Orange Revolution, Ukraine had advocated market prices out of principle. Yushchenko stated: "If Ukraine really wants to become economically independent, sooner or later we have to move to market relations in the energy sector and organize our energy consumption rationally."²¹ Gazprom appreciated such statements,

20. Sources of this section are Global Witness (2006), Stern (2006), Teylan and Gustafson (2006), Dubien (2007), and Milov and Nemtsov (2008).

21. "Yushchenko obeshchaet ne ustraivat' shokovoi terapii" ["Yushchenko Promises Not to Organize Shock Therapy"], *Ukrainskaya pravda*, December 17, 2005.

as it desired swift transition to European prices that were four to five times higher.

In the wee hours of January 4 the Ukrainian state energy company Naftohaz Ukrainy and Russia's state-dominated gas company Gazprom came to an agreement with the enigmatic trading company RUE about deliveries of Russian and Central Asian gas to Ukraine. The agreement was greeted with relief, but it was hastily concocted and left much unclear. The gas price was set at only \$95 per 1,000 cubic meters, less than what any other country apart from Belarus paid, but just for the first half of 2006. Almost all the gas would come from Turkmenistan. A clear improvement was that barter would be abandoned and all payments made in cash.

The new gas agreement was controversial from the beginning for several reasons. RUE was given a major role in trade in and around Ukraine. It became the sole legal importer of gas in Ukraine. Together with Naftohaz Ukrainy it set up a joint venture, Ukgaz-Energo, which became the dominant seller of gas to factories in the country, which was the most profitable part of the domestic gas market. RUE also exported substantial volumes of natural gas further to the West into Europe.²²

Yekhanurov underlined that Gazprom insisted on RUE transiting Ukraine's gas purchased from Turkmenistan and that Ukraine had no choice, since Gazprom controlled the supply route. RUE's official explanation was that an intermediary was needed to trade natural gas from the four producing countries, Russia, Turkmenistan, Kazakhstan, and Uzbekistan, and transit it to Ukraine, but the Ukrainian public never accepted that argument.²³ BYuT and the Regions exploited this outcome for a vote of no confidence in Prime Minister Yekhanurov and his cabinet on January 10, 2006, assembling 250 votes.²⁴ However, this vote was ruled unconstitutional, having no legal effect, and Yekhanurov's government stayed on.

Ultimately, the issue was possible Russian control over the Ukrainian gas sector, Russian-Ukrainian relations, and large-scale corruption. As details became known, criticism amplified. RUE was a joint venture between Gazprombank and Centragas, a private trust with hitherto un-

22. "The Text of the Agreement between Naftohaz Ukrainy, Gazprom and RosUkrEnergo," Ukrainian Independent Information Agency, January 5, 2006; "Gazovoe SP stvoreno. 5 let po \$95" ["Gas Joint Venture Created. Five Years at \$95"], *Korrespondent*, February 2, 2006; Vladimir Soccor, "UkrGazEnergo: New Russian Joint Venture to Dominate in Ukraine," *Eurasian Daily Monitor* (Jamestown Foundation), February 16, 2006; Roman Kupchinsky, "A Profile of RosUkrEnergo," Radio Free Europe/Radio Liberty, January 18, 2006.

23. Interview with RosUkrEnergo official Robert Shetler-Jones in Kyiv, January 2006.

24. "Rezultaty golosovaniya za otstavku Yekhanurova" ["Results of the Voting for Yekhanurov's Demise"], *Ukrainskaya pravda*, January 10, 2006.

known beneficiaries. On April 26, 2006, the Kremlin-controlled Moscow newspaper *Izvestiya* revealed the names of RUE's owners: Dmytro Firtash held 90 percent of Centragas and Ivan Fursin, an Odesa banker, 10 percent.²⁵

Parliamentary Elections, March 2006

On March 26, 2006, Ukraine held its first ordinary parliamentary elections after the Orange Revolution. They were free and fair with a high participation of 67 percent, showcasing Ukraine's maturity as a democracy. These first purely proportional elections led to the desired consolidation of the party system. The number of party factions was reduced from 12 to 5 parties. Only 22 percent of the votes were wasted on parties not crossing the 3 percent hurdle compared with 24 percent in 2002.

The Regions came roaring back, receiving 32 percent of the votes against 22 percent for BYuT and a mere 14 percent for Our Ukraine. These three center-right parties obtained no less than 90 percent of the seats. The socialists entered parliament with 5.7 percent and the communists with a tiny 3.7 percent, as the marginalization of the hard left continued (table 8.1).

This vote reflected an amazing constancy between the orange and blue camps. In December 2004 Yushchenko defeated Yanukovych with a margin of eight percentage points, while the balance between the orange and blue coalitions shrunk to six percentage points this time. The geographic dividing line remained the same as in 2004 (Clem and Craumer 2008).

Within the orange coalition, however, Tymoshenko's bloc won overwhelmingly over Yushchenko's Our Ukraine. Tymoshenko was an outstanding campaigner, and she railed against the old regime in moralistic rhetoric. Her main slogan was justice, reminding the voters of Yushchenko's unfulfilled promise from 2004: "Bandits to prison!" She attacked the Russian-Ukrainian gas deal of January 4 but no longer mentioned reprivatization and played down social promises, as her populism faded. Our Ukraine's campaign was inept and featured its least popular representatives, such as the discredited Poroshenko, while the president and Yekhanurov kept low profiles.

These elections marked Ukraine's transition to a presidential-parliamentary democracy with reduced presidential powers. A prime minister had to assemble a coalition in parliament of at least 226 deputies.

Ukrainian elections remained extremely expensive. Before these elections, Speaker Volodymyr Lytvyn stated that seats on party lists would

25. Tom Warner, "Dmytro Firtash, Ukrainian Billionaire Nobody Knows," *Financial Times*, April 27, 2006.

Table 8.1 Results of election to the Supreme Rada, March 26, 2006^a

Party	Votes (percent)	Seats
Left	13.1	54
Communist	3.7	21
Socialist	5.7	33
Center-Right	82.9	396
Party of Regions	32.1	186
Yuliya Tymoshenko Bloc	22.3	129
Our Ukraine	14.0	81
Against all or not valid	4.0	0
Total	100	450
Voter turnout (percent)	67.1	

a. Pure proportional election.

Source: Central Election Commission of Ukraine, www.cvk.gov.ua (accessed on September 31, 2007).

cost up to \$5 million. Yanukovych retained the support of Akhmetov, who for the first time decided to become a member of parliament, taking no less than 60 of his senior employees to the Rada and forming his own company party within the Regions. The Industrial Union of Donbas supported Yushchenko, and Privat Group was closest to BYuT, while Pinchuk kept a new distance from politics and left parliament. Other large business groups were also engaged, rendering all parties, including the communists, oligarchic.

After the parliamentary elections, seemingly endless coalition negotiations ensued. As two or three of the five parties in parliament were needed for a coalition government, this game was almost unsolvable. An incredible circus of intrigue started. Five coalitions were seriously discussed until a government was formed in August, more than four months after the elections. Meanwhile, Yekhanurov ran his caretaker government.

Initially, a renewed orange coalition looked obvious. BYuT, Our Ukraine, and the socialists discussed the formation of a new government program. But Oleksandr Moroz demanded the speakership of the Rada, no NATO accession, and no land privatization,²⁶ and Yushchenko did not want Tymoshenko as prime minister again. Finally, the big businessmen in Our Ukraine, who hated Tymoshenko, persuaded Yushchenko to drop her for an alliance with the Regions.²⁷

26. Oleg Varfolomeyev, "End of Orange Coalition Looming?" *Eurasian Daily Monitor* (Jamestown Foundation), June 14, 2006; Yuliya Mostovaya, "Koalivshchina" ["Coalition Games"], *Zerkalo nedeli*, May 13, 2006.

27. "'Liubi друзi' ybedili Yushchenko ob'edinit'sya s Yanukovichem?" ["The 'Dear Friends' Convinced Yushchenko to Unite with Yanukovych?"], *Ukrainskaya pravda*, April 18, 2006.

In early June, Akhmetov and Yekhanurov successfully negotiated a coalition government between the Regions and Our Ukraine. The Regions accepted virtually all Our Ukraine's demands. Yekhanurov would stay as prime minister, and each party would receive half the portfolios. A full agreement was ready for Yushchenko's approval on June 18.

But on June 20 Tymoshenko stormed into Yushchenko's office and convinced him to form a new orange coalition, alleging socialist support. Without consultation, Yushchenko dropped an alliance between Our Ukraine and the Regions.²⁸

Moroz, however, who was supposed to yield the speakership to Poroshenko, defected. On July 6 he was unexpectedly elected speaker of the Rada with the support of the Regions, the socialists, and the communists. The following day these three parties signed an agreement on a majority coalition with 241 seats. Both Yushchenko and Tymoshenko had lost out. Tymoshenko claimed that Moroz had received \$300 million to change sides, for which he sued her. The socialists insisted that the Regions gave them both the policy and posts they wanted.²⁹

Yushchenko seemed to have outintrigued himself. He had ended up with the coalition that suited him the least. On July 25, two months had passed since the cabinet's resignation, entitling Yushchenko to call new elections. He used this leverage to convene a roundtable with all parties and propose a draft declaration (*universal*) of national unity. This declaration roughly coincided with the government program agreed between the Regions and Our Ukraine in June. His main demand was support for Ukraine's Euro-Atlantic integration.³⁰

On August 3 the Regions, Our Ukraine, and the socialists signed the *universal*, while the communists did so with a reservation. Tymoshenko refused and went into opposition. Yushchenko's coalition of national unity formed the government, and Yushchenko accepted Yanukovych as prime minister. Yanukovych graciously praised the positive influence on Ukraine of the Orange Revolution: "However hard it was, this period has been of benefit to the state. . . . We have started to free ourselves from dirt that had accumulated for years."³¹

The Rada confirmed Yanukovych by 271 votes, with support from the Regions, the socialists, the communists, and 30 of Our Ukraine's

28. Oleg Varfolomeyev, "Orange Coalition Parties Re-Establish Government Coalition" *Eurasian Daily Monitor* (Jamestown Foundation), June 28, 2006.

29. Yuliya Mostovaya, "Na stsene maidana—Zanaves" ["The Curtain Drops on the Maidan Stage"], *Zerkalo nedeli*, July 18, 2006.

30. Oleg Varfolomeyev, "Yushchenko Lays Out His Conditions for Accepting Yanukovych," *Eurasian Daily Monitor* (Jamestown Foundation), July 28, 2006.

31. "Yanukovich budet prazdnovat' po-muzhski" ["Yanukovych Will Celebrate Like a Man"], *Ukrainskaya pravda*, August 4, 2006.

80 deputies.³² The new government was supposed to incorporate checks and balances. The Regions received the whole economic bloc in the government with Mykola Azarov as first deputy prime minister and minister of finance again, Andriy Kliuev as deputy prime minister, and Yuriy Boiko as minister of fuel and energy. The heavies from Donetsk were back. Moroz stayed as speaker, and Semeniuk, the sworn enemy of privatization, remained chair of the State Property Fund.

The president's men, Borys Tarasiuk and Anatoliy Hrytsenko, returned as foreign minister and defense minister, respectively. Our Ukraine received law enforcement and the humanitarian bloc in the government with the portfolios for interior, justice, culture, family, health care, and education.³³

The declaration of national unity represented a historical compromise and was supposed to be the government program.³⁴ Ukraine was to be a unitary state. Ukrainian would remain the official state language, but "every Ukrainian citizen is guaranteed the right to use Russian or any other native language in all walks of life." Private sales of agricultural land would be introduced no later than January 1, 2008. Ukraine was to "take all necessary legislative steps to join the WTO before the end of 2006." All wanted European integration, leading to membership in the European Union, and to negotiate a free trade zone with the European Union. Ukraine accepted the Russian-sponsored Common Economic Space but only as a free trade area. It favored "mutually beneficial cooperation with NATO," but a referendum on accession had to be held.

Our Ukraine and the Regions differed most on foreign policy, which Yushchenko dominated, while both parties professed similar free-market policies. Both favored liberal tax reform, judicial reform, and anticorruption measures. National tensions were resolved, and the Regions accepted a Western-oriented foreign policy, while Tymoshenko offered pragmatic but challenging opposition. The four months of governmental crisis suddenly seemed productive, generating a potentially constructive administration.

The Second Yanukovych Government: Oligarchy Restored

Unfortunately, the second Yanukovych cabinet did not work out because of devastating disputes over foreign policy and the constitution. Yanu-

32. "Yanukovich—prem'er. Moroz pokazal emu ego mesto" ["Yanukovych Is Prime Minister. Moroz Showed Him His Place"], *Ukrainskaya pravda*, August 4, 2006.

33. "Novoe pravitel'stvo utverzheno" ["The New Government Is Confirmed"], *Ukrainskaya pravda*, August 4, 2006.

34. "Universal natsional'nogo edinstvo" ["Declaration of National Unity"], *Ukrainskaya pravda*, August 3, 2006.

kovich steamrolled through his decisions, while Our Ukraine indulged in infighting. Meanwhile, corruption gained new momentum.

Yanukovich immediately intruded in foreign affairs. His first foreign trip as prime minister took him to Putin's summer residence in Sochi. Before his trip, Yanukovich speculated that Russia would symbolically reduce its gas prices, but Putin made clear that Yanukovich should pay back, so he returned empty-handed.³⁵ Ukrainian-Russian relations remained insubstantial and cool.

On September 14, 2006, Yanukovich visited NATO headquarters in Brussels. Contrary to the Declaration of National Unity, he desired no closer cooperation with NATO, infuriating Yushchenko, Tarasiuk, and Hrytsenko. Although the president appointed the minister for foreign affairs, Yanukovich forced Tarasiuk out on January 30 by cutting financing for his ministry.

In September 2006 Yushchenko changed his liberal and pleasant chief of staff Oleh Rybachuk for a tough manager, Viktor Baloha, a businessman from Transcarpathia. Baloha was a crisis manager and fighter with no apparent ideology.³⁶ He took firm command over Yushchenko's secretariat and cleansed it of all liberals and orange revolutionaries. Soon he established his reputation as Ukraine's Rasputin.

For a couple of months, Our Ukraine continued quarrelling about whether to join the coalition with the Regions, although it already had 10 ministers in the government. Eventually, a majority of Our Ukraine deputies voted against the coalition, and most pro-presidential ministers resigned on October 19. Our Ukraine seemed to be pursuing slow *hara-kiri*.

In an ultimate insult to Yushchenko, Yanukovich and Tymoshenko settled constitutional matters without him. On December 21, 2006, the Regions persuaded BYuT to vote with them, the socialists, and the communists for a Law on the Cabinet of Ministers. This law would reinforce the powers of the parliament and the prime minister at the expense of the president. Although Tymoshenko favored strong presidential powers, she supported it in exchange for an "imperative mandate," which meant that a deputy could not change party faction after being elected to parliament for one party because the mandate belonged to the party. Yushchenko vetoed this law, but the four other parties overruled his veto. In reality, little changed.

The Yekhanurov and Yanukovich governments restored economic growth to the prior growth path with 7.3 percent in 2006 and 2007.

35. Vladimir Soccor, "Yanukovich Cold-Shouldered on First Visit to Russia," *Eurasian Daily Monitor* (Jamestown Foundation), August 17, 2006.

36. Viktor Chyvkunya, "Baloha: Yushchenko's New Favorite," *Ukrainskaya pravda*, September 19, 2006.

However, apart from the laws needed for WTO accession, Ukraine hardly legislated, and no structural reforms occurred.

Old corrupt practices gained new momentum. The Tymoshenko and Yekhanurov governments had successfully reduced the corruption in VAT refunds for exporters, but with the return of Yanukovych and Azarov, demand for commissions of 20 to 30 percent to obtain VAT refunds reemerged.

The three main Ukrainian officials involved in RUE were, once again, Yuriy Boiko, chairman of Naftohaz Ukrainy in 2002–05 and now minister of energy; Ihor Voronin, long-time deputy chairman of Naftohaz Ukrainy but also president of Ukgaz-Energo; and Serhiy Levochkin, formerly Kuchma's first assistant and now Yanukovych's chief of staff (Global Witness 2006, Dubien 2007). In a complete conflict of interests, Boiko and Voronin were Ukraine's top gas officials but also represented RUE.

The gas sector posed persistent problems. Domestic consumer prices were fixed at a low level, which meant that the Ukrainian state subsidized the importation of natural gas. Domestic producers were paid less for their gas by Naftohaz than Ukraine paid for its imported gas, as domestic production was theoretically earmarked for residential customers. In spite of many attempts, no significant foreign energy producers managed to work in Ukraine. Naftohaz comprised a nontransparent and poorly managed maze of state enterprises and partially private companies. About once a year, the Ukrainian government was forced to bail it out with a couple of billions of dollars because of its chronic losses. Meanwhile, Ukraine continued to be one of the most energy inefficient countries in the world.³⁷

The *casus belli* for Yushchenko was that the Regions gradually purchased deputies from Our Ukraine and BYuT. Its leaders spoke aggressively about increasing their majority, together with the socialists and communists, to 300 to reach a constitutional majority to be able to override presidential vetoes and amend the constitution. At the end of March 2007 Kinakh, now one of the leaders of Our Ukraine, joined the government as minister of economy together with 10 other deputies from Our Ukraine and BYuT. Such transactions always cost big money. Yushchenko decided to act before he lost his constitutional powers.

Ironically, the informal owner of the Regions, Akhmetov, was also unhappy with Yanukovych and his government. Akhmetov had declared that he joined parliament to improve legislation, especially to reinforce private property rights, so that he never had to flee his country again as in the summer of 2005. But he had little influence on legislation, and none of Akhmetov's people became ministers. Instead, the Regions was splitting

37. Edward Chow and Jonathan Elkind, *Where East meets West: European Gas and Ukrainian Reality*. *Washington Quarterly*, January 2009.

into two factions of similar size, a powerless Akhmetov party and a ruling Yanukovych party, including the heavyweights Azarov, Kliuev, and Boiko.

Dissolution of Parliament and New Parliamentary Elections, September 2007

The president was pressed against the wall with few options left. Contrary to the 2004 constitutional changes, Yanukovych had not allowed the president to appoint his own chairman of the SBU and minister for foreign affairs. The amended constitution did not allow deputies to change factions in parliament, but the Regions unabashedly bought deputies. Yet Yushchenko's constitutional ground to call for new elections was questionable, but Tymoshenko, who had been campaigning for the dissolution of parliament since August 2006, supported him.

On April 2, 2007, Yushchenko dissolved the parliament with three motivations: Party factions had been formed illegally, the parliament had been ineffective, and it had adopted nonconstitutional decisions (referring to the Law on the Cabinet of Ministers) (Åslund 2007c). A huge demonstration of some 100,000 people laid the groundwork for his action. Yushchenko acted fast, securing his control over law enforcement and most regional governors.

Yanukovych had gone too far. Corporate raiding was thriving as never before, and the government did nothing to stop it. Gas trade corruption was rampant, as was tax corruption. A constitutional court judge was caught red-handed accepting a bribe of \$12 million. Yushchenko sacked her, but Yanukovych's side reinstated her.³⁸

Yanukovych did not accept the dissolution of parliament, and in late May, his and the president's special forces entered into a televised fistfight outside the general prosecutor's office. Hardly ever had Ukraine been so close to civil violence, but once again Yushchenko and Yanukovych reached a compromise: Yanukovych accepted the holding of new parliamentary elections on September 30, 2007.

Free and fair democratic elections had become a routine, but the electorate was tired. Participation fell to 62 from 67 percent in 2006, still far higher than in neighboring Poland. As in 2006, five parties passed the 3 percent hurdle. The main winner was BYuT, which increased its votes from 22 percent in 2006 to 31 percent. The Regions expanded slightly—from 32 to 34 percent. Our Ukraine maintained its share of 14 percent, partly because of Yushchenko's recent resolute behavior and partly because popular Yuriy Lutsenko had joined Our Ukraine (table 8.2).

38. Pavel Korduban, "Can Ukraine's Constitutional Court Be Unbiased?" *Eurasian Daily Monitor* (Jamestown Foundation), April 17, 2007.

Table 8.2 Results of election to the Supreme Rada, September 30, 2007

Party	Votes (percent)	Seats
Left	10.0	27
Communist	5.4	27
Socialist	2.9	0
Center-Right	87.1	423
Party of Regions	34.4	423
Bloc of Yuliya Tymoshenko	30.7	156
Our Ukraine—People's Self-Defense	14.2	72
Lytvyn Bloc	4.0	20
Against all, or not valid	2.9	0
Total	100	450
Voter turnout (percent)	62.0	

Source: Central Election Commission of Ukraine, www.cvk.gov.ua (accessed on October 16, 2007).

In addition, the communists and the newly formed Lytvyn Bloc entered parliament. The latter was a centrist party sponsored by three big businessmen. The left continued to be marginalized, receiving only 10 percent of the votes and 6 percent of the seats. The socialists fell out of parliament because they were seen as traitors and blatantly corrupt. Party consolidation proceeded, as the share of votes wasted halved to 11 percent from 22 percent in 2006.

As in all democratic Central and Eastern European countries, corruption was the dominant election theme, and it was naturally blamed on the incumbent government. The eminent Bulgarian political scientist Ivan Krastev has observed that nearly all incumbent Central and Eastern European governments have lost elections. Accordingly, Tymoshenko won as the most effective critic of corruption. One effect of Ukraine's democracy was that a party could gain votes by going into opposition.

The political appeal of the three big parties had changed considerably. Their economic programs had converged, and by European standards, they all belonged to the democratic center-right. They wanted deregulation, more privatization, stable macroeconomic policy, lower taxes, accession to the WTO, and membership in the European Union. Such a broad consensus about economic policy is rare for any country. Gone were radical demands for higher social transfers and reprivatization. BYuT changed the most. In 2005 it had applied for membership to the Socialist International. Now, it joined the European People's Party, of which Our Ukraine already was a member. The Regions, however, only cooperated with Putin's United Russia party. The biggest policy difference remained in foreign policy, as only Our Ukraine insisted on an early membership action plan for NATO, while the Regions opposed closer cooperation with NATO, and BYuT took no clear stand.

The overall rather stable results hid huge voter streams, as people voted less than previously with region and more with class. Although the parties' regional concentration remained strong, all parties lost votes in their strongholds and gained votes in enemy land. As a result, all parties became more national, as an urban-rural class divide had been superimposed over the east-west division (Clem and Craumer 2008). Our Ukraine emerged as a rural party for its fight for private sales of agricultural land. The Regions, as the most credible advocate of low taxes, attracted the urban upper middle class. BYuT appealed to the populist lower middle class.

The big Ukrainian businessmen stood behind this convergence of economic policy. They poured a fortune to the tune of \$500 million into these extraordinary elections, paying a record \$10 million for a safe party list seat. The big business groups reportedly paid about \$100 million each to their parties.³⁹ Akhmetov continued to support the Regions and extended his personal parliamentary group from 60 to 90 deputies, but Yanukovych enjoyed other business support as well. Amazingly, Privat Group and the Industrial Union of Donbas undertook a short casting between the 2006 and 2007 elections, as Privat switched its support from BYuT to Yushchenko, while the Industrial Union of Donbas went from Yushchenko to BYuT. Tymoshenko also benefited from support from Konstantin Zhevago of Ferrexpo, now the fifth wealthiest business group with a large iron ore mine in Poltava. One prominent businessman reportedly paid \$30 million for 10 deputies, hoping to trade them for \$70 million.⁴⁰

To form a government this time, two of the three big parties had to conclude a coalition. That might have seemed easy given their similar policies, but since any two parties could form a coalition, the game had no natural conclusion. They all talked to one another but with profound distrust in this game of cheating and chicken. The big businessmen further complicated the game because of their proven habit of ditching politicians and their sharp mutual competition. They put the politicians in an impossible dilemma. The politicians had to betray either their business sponsors, who expected corrupt returns, or their voters, who abhorred corruption. The voters could nothing but be disappointed. The persistent war over the constitutional powers added to the complication.

This political system failed to deliver what the country needed: a government that worked and a parliament that legislated. Instead it generated dysfunctional corruption. Ukrainians were increasingly tired of politicians doing nothing for them.

39. Information from conversations with insiders in Kyiv before and after the elections.

40. Tymoshenko alluded to him in her televised speech: "Moreover, those people who paid \$30 million for treason will no longer have those shadow millions" (Ukrainian Independent Information Agency, December 20, 2007).

The Second Tymoshenko Government: Stalemate

BYuT and Our Ukraine had a majority of only two seats, which quickly shrank to one. Even so, because of a firm preelection agreement, Yushchenko and Tymoshenko concluded a substantial coalition agreement after only two weeks. Tymoshenko would become prime minister. BYuT and Our Ukraine would each receive 12 cabinet posts. An orderly balance of power between the president and the prime minister was prescribed. Tymoshenko would control all economic posts and Our Ukraine foreign policy, security, and humanitarian affairs. The agreement also included a package of a dozen draft bills.⁴¹

The formation of the government was delayed, however, because of Our Ukraine's minimal party discipline. Some deputies insisted on a broader coalition including the Lytvyn Bloc or the Regions. Finally, on November 29 a new orange coalition was formed, and on December 18 the parliament confirmed Tymoshenko as prime minister with a bare minimum of 226 votes. She appointed her new government immediately. Big businessmen were absent from the new cabinet as a consequence of prior scandals.⁴²

Tymoshenko and Yushchenko had drawn the opposite conclusions from her first cabinet. Tymoshenko emphasized that she had learned her lesson from 2005: She sought cooperation, stuck to a normal market economy, and did not raise reprivatization. Although food and energy prices rose sharply, she liberalized foreign trade and limited her efforts to control prices. She delegated within the cabinet. It helped that she had a trustworthy inner cabinet, consisting of Turchinov as her first deputy, Hryhoriy Nemyria as deputy prime minister for European integration, and heavy-weight Minister of Finance Viktor Pynzenyk. She was also conciliatory toward the Our Ukraine ministers, among whom the most prominent were First Deputy Prime Minister Ivan Vasyunyk and Minister of Defense Yekhanurov. The young political star Yatseniuk became speaker of the parliament.

Yushchenko had drawn the opposite lesson. He had lost out to Prime Ministers Tymoshenko and Yanukovych because he had been too conciliatory. His apparent insight was to never be reasonable again. Together with his militant chief of staff Baloha, he tried to maximize presidential powers. He never gave Tymoshenko a chance to govern, and he achieved a complete government stalemate. From April, he vetoed nearly all legis-

41. Viktor Chyvokunya, "Tymoshenko and Yushchenko Share Power," *Ukrainskaya pravda*, October 16, 2006; Pavel Korduban, "Differences within Ukrainian Coalition Escalate," *Eurasian Daily Monitor* (Jamestown Foundation), October 31, 2007.

42. "Ukraine Has New Government," Interfax Ukraine, December 24, 2007.

lation and decisions emanating from Tymoshenko. According to the constitution, the regional governors were subordinate to the president. Baloha drew this oddity to its logical extreme, prohibiting them from seeing the prime minister.

Tymoshenko adopted an extensive government program in line with the coalition agreement. To begin with, the budget inherited from Yanukovych was tightened. She carried out the few steps remaining for Ukraine to enter the WTO and initiated negotiations on a free trade agreement with the European Union.

She focused on privatization, quickly composing a substantial program with 19 big state-owned companies slated for privatization in 2008. Sensibly, the new government offered majority stakes, appealing to strategic investors. In February the government extended the list to 406 companies to be sold in open auctions, the most transparent form of privatization. To render privatization popular, Tymoshenko wanted to spend the privatization revenues on compensation for savings that had been inflated away in the old Soviet Savings Bank by the hyperinflation in the early 1990s. As the moratorium on private sales of agricultural land ran out, two laws were drafted to legalize sales.

In April, however, Yushchenko prohibited all these privatizations in a series of decrees. Having always favored privatization, he complained that the privatizations reminded him “of a seasonal sale in a Kyiv department store.” State assets had declined to 21 percent of all national assets, which he called a “critical volume of state assets.” No privatization should be undertaken until the government had approved a national privatization program. The privatization of electricity companies threatened the country’s national security.⁴³ Yushchenko spoke like an old-style socialist, even vetoing Tymoshenko’s decree allowing private sales of land as contrary to the constitution.⁴⁴ When Tymoshenko attempted to sack socialist Semeniuk, as chair of the State Property Fund, Yushchenko blocked her decision.

In gas trade, Tymoshenko minimized the role of Ukrغاز-Energo, the domestic gas trade joint venture between RUE and Naftohaz Ukrainy. Next she persuaded Gazprom and Naftohaz to exclude RUE and trade gas without any intermediary from 2009. On October 2 Tymoshenko visited Prime Minister Putin in Moscow with suspect mutual friendliness, and they tentatively agreed on a three-year transition to European prices for Ukraine.

43. “Yushchenko sovetuet Tymoshenko krasit’ kryl’ya i menyat’ bamper” [“Yushchenko Advises Tymoshenko to Paint the Wings And Change Bumper”], *Ukrainskaya pravda*, April 24, 2008.

44. “Yushchenko zablokiroval Tymoshenko v zemel’nom voprose” [“Yushchenko Blocked Tymoshenko in the Land Question”], *Ukrainskaya pravda*, April 25, 2008.

Customs, which Tymoshenko had cleaned up in 2005, had again become a focal point of corruption, so she appointed a strong head, Valeriy Khoroshkovskiy, who repeated her prior success. Restoring VAT refunds for exporters was another priority, but she recorded no success there.

WTO Accession, May 2008

On February 6, 2008, after completing negotiations, the WTO General Council invited Ukraine to join the organization. Subsequently, the Ukrainian parliament ratified the accession, and on May 16, 2008, Ukraine became the 152nd member of the WTO, marking the greatest achievement of the four governments after the Orange Revolution.

Ukraine had applied for membership in November 1993, but it did little in the 1990s.⁴⁵ From 1998 to 2003, four small countries in the Commonwealth of Independent States (CIS) became members of the WTO: the Kyrgyz Republic, Georgia, Moldova, and Armenia. Ukraine and Russia were negotiating their accessions in parallel, carefully watching one another. Russia repeatedly asked Ukraine for coordination of their WTO accessions, but Ukraine had no interest in such a demand, which would only cause delays.

Ukraine needed the WTO more than Russia did because of its export structure. About two-thirds of Ukraine's exports consisted of so-called sensitive products, goods often exposed to protectionist measures such as antidumping, namely steel, agricultural goods, chemicals, and textiles. International studies suggested that Ukraine could gain one to two percentage points in economic growth from WTO accession in the next half decade (Copenhagen Economics et al. 2005a, 2005b, 2005c). These numbers are uncommonly high because Ukraine is an open economy with many institutional barriers that WTO rules could mitigate.

From the Yushchenko government in 2000, Ukraine started paying more attention to the WTO, adopting several major laws required for accession, such as the customs code of July 2002. Our Ukraine and BYuT made WTO accession their priority, and the first Tymoshenko government adopted a substantial package of WTO laws in the summer of 2005. At that time, the Regions still opposed liberalizing agriculture and steel, but in early 2006 it turned positive on the WTO. In exceptional unity, all three big parties worked for WTO membership. The WTO negotiations were carried out by a steady team of civil servants led by

45. Overall sources of this section are Williamson (1995); Åslund (2003a); and Burakovsky, Handrich, and Hoffmann (2003).

Deputy Economy Minister Valeriy Pyatnyskiy regardless of government changes.

In parallel, the European Union acknowledged Ukraine as a market economy in December 2005, and the United States did so in February 2006. These were unilateral assessments of market conditions in Ukraine, which were important for its defense against antidumping complaints. A nonmarket economy always loses antidumping cases, while a country classified as a market economy can defend itself.

A US peculiarity was the so-called Jackson-Vanik amendment to the US Trade Act of 1974. It required the Soviet Union to allow free emigration of Jews as a condition for most favored nation status in trade, which was subject to annual review. After the collapse of the Soviet Union, the Jackson-Vanik amendment was applied to all the CIS countries, although the Soviet Union was gone and emigration of Jews was free. In March 2006 the US Congress finally “graduated” Ukraine from the Jackson-Vanik amendment and granted it permanent normal trading relations after the United States had concluded its bilateral protocol with Ukraine for its entry into the WTO, one of 50 bilateral protocols Ukraine had to conclude.

Ukraine’s accession was not particularly complicated. Its tariffs were low and caused little concern, though its institutions had to be improved. Agriculture posed the greatest problems as in most countries (Von Cramon-Taubadel and Zorya 2000). The burgeoning Ukrainian chicken industry called for protection through exceedingly strict inspections of imported poultry. The oversized and overprotected sugarbeet industry desired the maintenance of import quotas, but partner countries were satisfied with Ukraine raising bilateral import quotas. Ukrainian governments repeatedly imposed temporary prohibitions of grain exports, which had to go. Its agricultural subsidies were small, but the agrarian lobby wanted to keep the option of higher future subsidies open. Intellectual property rights were largely a new field for Ukraine requiring new legislation, and the government had to defeat piracy in audiovisual production. The last concern was to eliminate export tariffs, notably on scrap iron, an important input for the steel industry, which was settled in early 2008.

As a member of the WTO, Ukraine can demand bilateral negotiations on market access to Russia, which is still trying to become a member. This is Ukraine’s best opportunity to solve its many trade problems with Russia.

NATO Controversies and Russia’s War in Georgia

Until 2004, President Kuchma and his various governments had worked in consensus for closer relations with NATO. During the presidential

campaign in 2004, however, Yanukovych made NATO the most contentious foreign policy issue.⁴⁶

Immediately after independence, Ukraine had started developing its contacts with NATO, and it did so in parallel with Russia in the 1990s. In 1994 Ukraine was the first former Soviet state to join NATO's Partnership for Peace. In 1997, when Poland, the Czech Republic, and Hungary became members of NATO, it formed a NATO-Ukraine Commission.

NATO suffered only one serious backlash in Ukrainian public opinion, when it bombed Yugoslavia in 1999. Ukrainians reacted like Russians in solidarity with the orthodox Serbs. They had seen NATO as a defense alliance, but it attacked Serbia. Yet Ukraine contributed troops to all peacekeeping operations in the former Yugoslavia.

In May 2002 President Kuchma announced that Ukraine's ultimate goal was to join NATO, for the first time proceeding much further than Russia. However, since Ukraine did not fulfill NATO's democratic requirements, Kuchma's statement attracted little attention and no controversy. The Ukrainian public was largely indifferent to NATO. In early 2003 Ukraine contributed 1,700 troops to the US-led invasion of Iraq, as Kuchma attempted to improve his poor relations with the United States.

The presidential election campaign in the fall of 2004 changed the situation. Yanukovych campaigned against NATO, which the communists, the socialists, and the Russian government also opposed. Yushchenko had all along favored NATO, but he sensibly focused his campaign on more vote-winning issues. Thus Ukrainians heard many criticize NATO, while hardly anybody defended it, which turned the public attitude lastingly negative.

After the Orange Revolution, President Yushchenko ran foreign policy together with Foreign Minister Tarasiuk and Defense Minister Hrytsenko, who all aspired to Ukraine's full integration into the Euro-Atlantic community, including NATO. In April 2005 the NATO foreign ministers agreed to intensify their dialogue with Ukraine, which appeared to be a precursor to a membership action plan (MAP).

Yushchenko designed the August 2006 Declaration of National Unity as a step toward a MAP for Ukraine to be given by NATO at its summit in Riga in November 2006. However, as newly appointed prime minister, Yanukovych went to the North Atlantic Council in Brussels in September 2006, stating that he favored close cooperation with NATO but not a MAP.

In January 2008 Yushchenko started anew, sending a letter to NATO Secretary General Jaap de Hoop Scheffer, asking for a MAP to be granted to Ukraine at the NATO summit in Bucharest in April 2008. He persuaded newly appointed Prime Minister Tymoshenko and Speaker Yatseniuk to sign it in line with the coalition agreement. This request unleashed vicious

46. This section draws on Pifer (2004, 2008).

tirades from Russia, as Ukraine's relationship with NATO had become a focus of Russian foreign policy.

US President George W. Bush supported Ukraine's MAP, and so did the new eastern NATO members, but most old European members opposed it because of limited domestic Ukrainian support for NATO and staunch Russian opposition. The summit in Bucharest did not offer a MAP to Ukraine, but its communiqué stated boldly: "NATO welcomes Ukraine's and Georgia's Euro-Atlantic aspirations for membership in NATO. We agreed today that these countries will become members of NATO. . . . MAP is the next step for Ukraine and Georgia on their direct way to membership. Today we make clear that we support these countries' applications for MAP."⁴⁷

President Putin also attended this summit, where he, on April 4, intimidated Ukraine sharply and at length, effectively threatening to end its existence:

- "As for Ukraine, one third of the population are ethnic Russians. According to official census statistics, there are 17 million ethnic Russians there, out of a population of 45 million. . . . Southern Ukraine is entirely populated with ethnic Russians."
- "Ukraine, in its current form, came to be in Soviet-era days. . . . From Russia the country obtained vast territories in what is now eastern and southern Ukraine."
- "Crimea was simply given to Ukraine by a CPSU Politburo's decision, which was not even supported with appropriate government procedures that are normally applicable to territory transfers."
- "If the NATO issue is added there, along with other problems, this may bring Ukraine to the verge of existence as a sovereign state."⁴⁸

Thus Putin disqualified Ukraine's claim to sovereign statehood and territorial integrity, in a sharp reversal of Boris Yeltsin's policy and in contradiction with the 1997 Russian-Ukrainian Treaty on Friendship, Cooperation and Partnership. He suggested that its composition was artificial, its borders arbitrary, and the transfer of Crimea to Ukraine illegal. More nationalist Russian politicians, notably Moscow Mayor Yury Luzhkov, hammered away on their theme that Sevastopol and Crimea belonged to Russia. In June 2008 Luzhkov stated: "Sevastopol was never

47. Bucharest Summit Declaration, issued by the Heads of State and Government participating in the meeting of the North Atlantic Council, Bucharest, April 3, 2008, available at www.nato.int.

48. "What Precisely Vladimir Putin Said at Bucharest," *Zerkalo nedeli*, April 19, 2008.

given to Ukraine. I have studied all basic documents carefully, and I can make such a declaration.”⁴⁹

From April, Russian aggression against Georgia intensified. In early August 2008 military action escalated in the secessionist Georgian territory of South Ossetia. On August 7 Georgian troops went into South Ossetia but were immediately rebuffed by well-prepared and overwhelming Russian troops. Russia secured South Ossetia and Abkhazia, both Russia-friendly secessionist Georgian territories. Russian troops also occupied some other parts of Georgia. Several Russian planes were shot down with missiles bought from Ukraine, while the United States refused to deliver arms to Georgia for defense against Russia. Soon afterward, Russia recognized Abkhazia and South Ossetia as independent states, justifying their action with the Western recognition of Kosovo and the large number of Russian citizens there, but they resulted from Russian distribution of passports there.

These Russian acts scared even its closest allies, Belarus and Kazakhstan. Yushchenko took an immediate and strong stand for Georgia and his friend Saakashvili. Yanukovych, by contrast, praised Russia’s recognition of Abkhazia and South Ossetia, while Tymoshenko said as little as possible. Although she eventually defended Georgia’s territorial integrity in the same terms as the European Union, Yushchenko accused her of high treason and of being a Russian agent, opening a criminal case against her.

Suddenly Ukraine faced a new threat from Russia. Although Russia’s attack on Georgia had been successful, it revealed Russia’s military weakness: Its military power was limited to remnants of the now obsolete Soviet military. Russia could not plausibly attack Ukraine with conventional forces. Instead, Russia’s threat to Ukraine lay in destabilization, against which NATO was no obvious defense. Moreover, the United States had already provided substantial security guarantees to Ukraine in connection with its denuclearization. In the trilateral statement by the presidents of the United States, Russia, and Ukraine in Moscow on January 14, 1994, “Presidents Clinton and Yeltsin informed President Kravchuk that the United States and Russia are prepared to provide security assurances to Ukraine.”⁵⁰

Renewed Financial Crisis and IMF Agreement

In 2008 Ukraine was hit by renewed financial crisis. The Ukrainian economy was overheating after eight years of unprecedented boom, and as

49. “Luzhkov izuchil vopros Sevastopolya i reshil, chto ego ne peredali” [“Luzhkov Studied the Sevastopol Question and Decided That They Had Not Transferred It”], *Ukrainskaya pravda*, June 24, 2008.

50. US Department of State Dispatch, Trilateral Statement by the Presidents of the United States, Russia, and Ukraine in Moscow, January 14, 1994.

elsewhere in the region, inflation became the biggest economic concern in early 2008. In May 2008 inflation peaked at 31 percent over May 2007 (figure 8.1, Dragon Capital 2008). In spite of persistent government crisis, Ukraine maintained a tight budget policy with a budget deficit of around 1 percent of GDP.

Rising inflation, mainly food and energy prices, was a global phenomenon, but Ukraine's inflation was the third highest in the world. In a region dominated by the euro, Ukraine kept its exchange rate pegged to the US dollar. Given that the dollar had fallen by 15 percent in relation to the euro in a year, Ukraine imported substantial inflation through its peg. The high inflation allowed commercial banks to charge over 50 percent a year in hryvnia for consumer loans, which they could finance at about 6 percent a year in Europe. The National Bank of Ukraine (NBU) bought hard currency to maintain the exchange rate, boosting the money supply and inflation. With a refinance rate of only 16 percent a year, Ukraine had a negative real interest rate of 15 percent a year. Large consumer expenditures went to imports, which rose sharply. As a consequence, trade and current account deficits expanded fast, as did private foreign debt.⁵¹

Commercial bankers were reaping brisk speculative profits, and few understood how dangerous this policy was, but this Ponzi scheme could not continue. Ukraine would become uncompetitive and overindebted. An untenable financial disequilibrium was mounting which would naturally erupt in a financial crisis. The key problem was the exchange rate policy, for which the national bank was responsible. The dollar peg needed to give way to a floating exchange rate, and the NBU needed to focus on keeping inflation low through inflation targeting (Truman 2003). Yet, any change of the exchange rate was unpopular, as savings in either dollars or hryvnia would be devalued. Fortunately, the NBU loosened its peg in late April, which moderated the inflow of speculative money, and inflation moderated month by month.

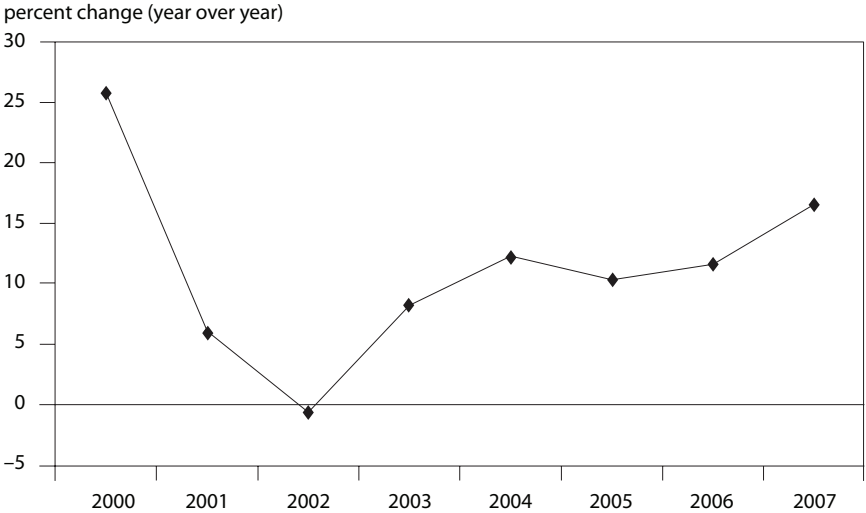
Reminiscent of the Asian and Russian crises in 1997–98, in late September the international financial crisis that had originated in the United States hit Ukraine, which was effectively frozen out from international finance. Nobody wanted to refinance any credit to Ukraine, so when one fell due, the debtor was bankrupted. The domestic banking system froze, and with it large construction projects working on credit. The stock market fell precipitously, and by late October, it had fallen as much as 82 percent from the beginning of the year.⁵²

Ukraine was one of the first countries to be hit, although its financial indicators were reasonable. The state budget was close to balance, and

51. Åslund (2008). The statistics are from Dragon Capital, *The Dragon Daily*, various dates.

52. Dragon Capital, *The Dragon Daily*, various dates.

Figure 8.1 Ukraine’s inflation rate (consumer price index), 2000–2007



Source: European Bank for Reconstruction and Development online database, www.ebrd.com (accessed on July 1, 2008).

public debt was tiny, at 10 percent of GDP. The international currency reserves peaked at a respectable \$38 billion in August 2008. About 40 percent of the banking system was owned by respectable foreign banks, facilitating access to international finance. The most worrisome indicator was the current account deficit, but it had been moderate at 4.2 percent of GDP in 2007, and it was more than financed by foreign direct investment. Yet it rose to 7.2 percent of GDP in 2008 because of the excessive short-term capital inflows and falling export prices for steel.

In 2007 steel accounted for nearly half of Ukraine’s exports, but in the fall of 2008 prices and demand for steel plummeted. Global steel prices peaked in July but had fallen by half in October. Ukraine’s steel producers responded by cutting production of crude steel output by 49 percent in October 2008 over October 2007.⁵³ Ukraine had too many steel producers, and most were not sufficiently efficient. Neglect during the good years became harmful. The whole steel industry fell in sudden, rampant crisis and called for consolidation.

Yet Ukraine’s messy politics singled out the country as one of the first victims of the international financial crisis. International investors did not believe its policymakers were able to undertake the necessary belt-tightening to handle the deteriorating balance of payments.

53. Ibid.

The Ukrainian government sensibly called on the IMF again and asked for a large emergency credit line to open up international finance again, unfreeze the domestic credit market, and salvage the exchange rate from a sharp dip. On October 26 Ukraine concluded a two-year IMF Stand-By Arrangement with financing of no less than \$16.5 billion. The conditions were many and arduous, anticipating a fall in GDP of 3 percent in 2009 and a slump in imports of 20 percent, but the orange parties voted it through in parliament on October 31. Yet Ukraine was set for a severe recession with the devastation of its steel and construction sectors.

Yushchenko Insists on New Elections

In the midst of this severe crisis, Yushchenko insisted once again on new elections. From April 2008 Yushchenko and Baloha devoted all their efforts to three related endeavors: to break up the coalition between Our Ukraine and BYuT, oust the Tymoshenko government, and provoke early parliamentary elections. In the summer of 2008, opinion polls indicated that Yushchenko enjoyed the support of only 5 percent of the population, Yanukovych 20 percent, and Tymoshenko 25 percent in a presidential election, and their parties had a similar standing.

It made no apparent sense for Yushchenko to provoke early parliamentary elections. He, his divided party, and his nation would be devastated. New elections would not solve any problem but leave Ukrainian politics in shambles until the presidential elections scheduled for January 2010. But Yushchenko seemed obsessed with Tymoshenko, speaking and acting as if his only endeavor was to destroy her. Strangely, Yushchenko apparently hoped to be reelected despite blocking all legislation and enjoying minimal popularity.

In early September Tymoshenko turned Yushchenko's sword against him. Tired of political stalemate, she got together with Yanukovych, and they passed two important laws with massive majorities. The first act was a renewed Law on the Cabinet of Ministers, which deprived Yushchenko of most of his powers, transforming Ukraine into a parliamentary state. The temporary Tymoshenko-Yanukovych alliance also adopted the long-desired Law on Joint Stock Companies, which Yushchenko had advocated for years to constrain illicit corporate raiding, but Our Ukraine voted against this keystone law, claiming that it was not perfect, while the communists voted for it. Eventually, Yushchenko signed it into law.

An intensified political circus with Yushchenko and Tymoshenko as the main actors ensued. Yushchenko put maximum pressure on the Our Ukraine faction in parliament, which finally voted to break the orange

coalition with a minimal majority on September 2 and officially left the coalition.⁵⁴ On October 7 and 9 Yushchenko issued decrees dissolving the parliament, calling for extraordinary parliamentary elections.⁵⁵ Tymoshenko complained to a court, which dismissed the president's decision. Yushchenko responded by sacking the judge, but the council of judges reinstated the judge, leaving the dissolution of parliament in legal limbo.⁵⁶ Human Rights Watch protested against both Yushchenko and Tymoshenko interfering in the judiciary.⁵⁷ For days, Yushchenko blocked the vital IMF anticrisis legislation, demanding that the parliament first allocate financing for new elections.

Ukraine is dominated by three political personalities, Tymoshenko, Yanukovych, and Yushchenko. The general expectation is that they will be the dominant candidates again in the presidential elections scheduled for January 2010. Yushchenko seems to have burned the last of his capital of trust in 2008. Tymoshenko is likely to suffer from the financial crash, as she was prime minister when it took place, though she might save her skin by the decisive anti-crisis measures. Yanukovych is lucky to have been out of power at this time of hardship.

Yushchenko's behavior in 2008 was perplexing. Although he formed a coalition with Tymoshenko, he never gave her government a chance to work. His whole presidency has been marked by legislative stalemate. The only legislation worth mentioning during his tenure was the WTO accession and annual budgets. His own popularity was at an all-time low, and his old party, Our Ukraine, risked being wiped out in the next elections. Ukraine faced both an evident security threat from Russia and an acute menace of financial collapse primarily because of domestic political instability, but Yushchenko insisted on new elections.

Approaching the end of the Yushchenko presidency, disappointment prevails. His two achievements have been to maintain democracy and to bring Ukraine closer to the European Union. Yet his term has restored the gridlock of the Kravchuk presidency, and the danger is evident that this inability of government discredits democracy in Ukraine.

54. "Our Ukraine Voted to Leave Coalition," *Ukrayinska Pravda*, September 2, 2008, available at www.pravda.com.ua (accessed on October 21, 2008).

55. "Votes of Verkhovna Rada and Tymoshenko Did Not Prolong Parliament's Life," *Ukrayinska Pravda*, October 21, 2008, available at www.pravda.com.ua (accessed on October 21, 2008).

56. US Agency for International Development (USAID) Parliamentary Development Project, "Council of Judges reinstates head of court dismissed by President," October 20, 2008, available at www.iupdp.org (accessed on October 21, 2008).

57. "BYuT Will Defend Court that Has Revoked Election," *Ukrayinska Pravda*, October 14, 2008, available at www.pravda.com.ua (accessed on October 21, 2008).

Limited Social Achievements

So far I have not mentioned social reforms in this book because almost none have been accomplished.⁵⁸ The main exceptions were trimming Nomenklatura benefits and the adoption of a new labor code and a law on pension reform, but that was never implemented. The Ministries of Health Care and Education have been consistently inert. They have been manned by Soviet-era bureaucrats and have resisted any structural reforms, just calling for more resources to be wasted on the old overcentralized Soviet systems.

Kuchma (2003, 179) recognized this failure:

Our first steps toward market economy were based on a formula: reforms come first, social issues later. This formula resulted in reforms at the expense of social issues. . . . Income inequality was as large as in Western Europe in the last third of 19th century, in conditions preceding a social revolution.

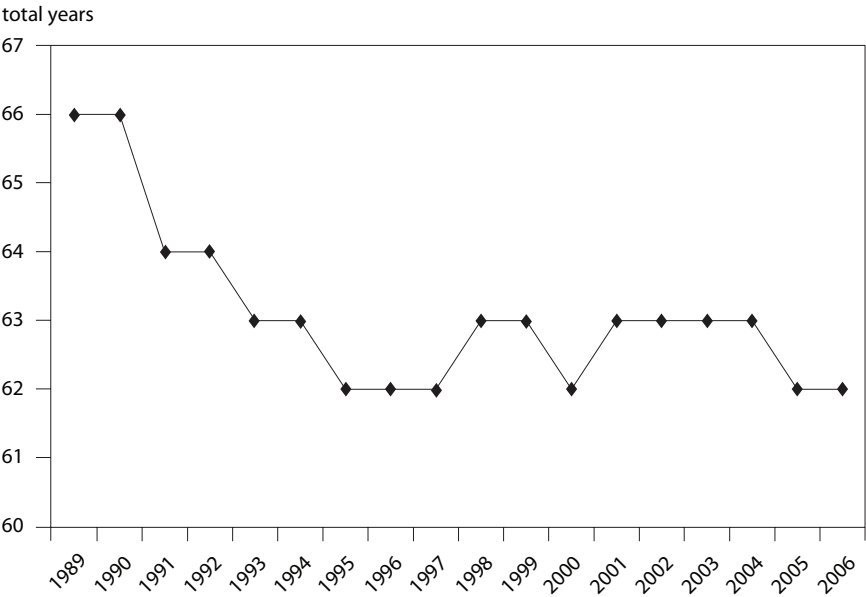
The most devastating social statistic in Ukraine is male life expectancy (figure 8.2). It increased for a couple of years after Gorbachev's ferocious antialcohol campaign that started in 1985, reaching a high of 66 years in 1989, which was not very impressive. With post-Soviet transition, male life expectancy fell to 62 years, the level of a rather poor developing country. Worse, male life expectancy has not recovered significantly but stayed at about 62.5 years.

Ukraine shares this problem with Russia, where the situation is even worse. For years, Russia's life expectancy for men has been about 59 years. The overwhelming explanation is that East Slavic and Baltic men often drink themselves to death. Drinking was always heavy, and in the transition the government could no longer collect the previously exorbitant excise taxes on alcohol (Brainerd 1998). More profoundly, these men were company men who were lost in transition and did not know how to adjust to changed circumstances. While women adapted and lived long, men suffered so badly from the stress that they drank too much and died from violence or heart attack, as Judith Shapiro (1995) so perceptively noticed in the early transition in Russia and as has been well documented in later research (Shkolnikov, Andreev, and Maleva 2000). No Ukrainian government has undertaken a badly needed antidrinking campaign.

A better measurement of the efficacy of the health care system than life expectancy is infant mortality. It increased from 13 infants per 1,000 births in 1989 to 15 in 1993 during the collapse of communism. Since 1993, infant mortality has fallen by one-third to 9.5 in 2007 (figure 8.3). Although this is a significant improvement, it is not impressive. In Poland and the Czech Republic, infant mortality has fallen by two-thirds since the

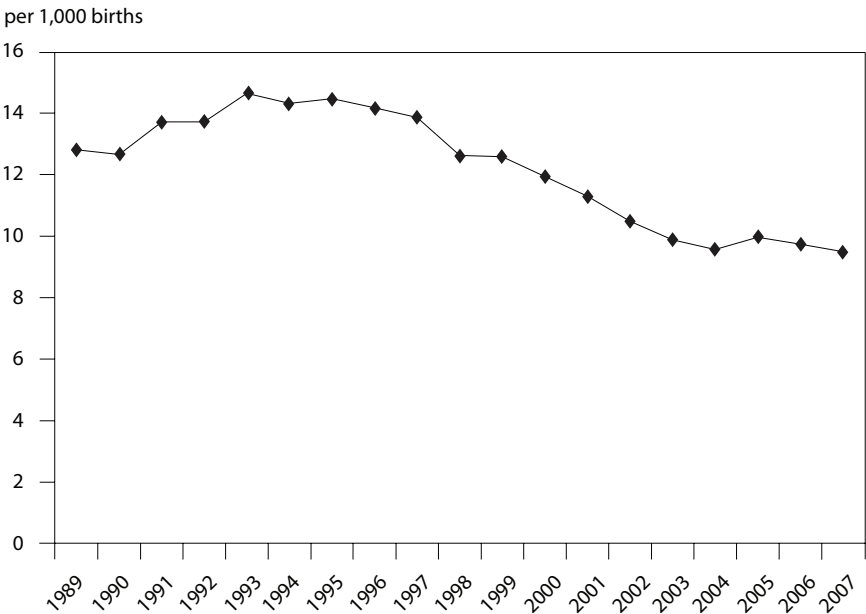
58. Major sources of this section are Góral ska (2000) and Mal ysh (2000).

Figure 8.2 Male life expectancy at birth, 1989–2006



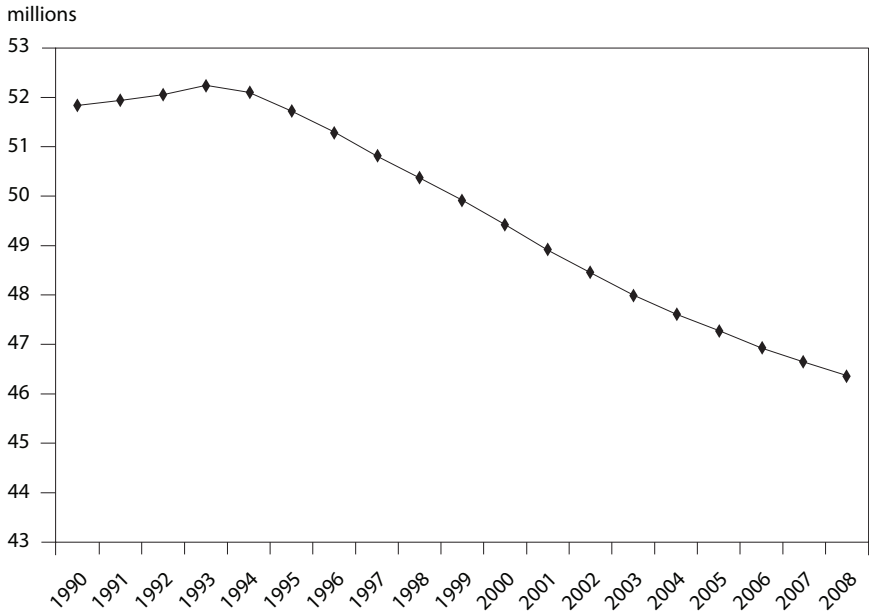
Source: World Bank, *World Development Indicators* database, <http://devdata.worldbank.org/dataonline> (accessed on July 1, 2008).

Figure 8.3 Infant mortality, 1989–2007



Source: US Census Bureau international database, www.census.gov/ipc (accessed on July 30, 2008).

Figure 8.4 Ukraine's population, 1990–2008



Sources: Statistics Committee of Ukraine, www.ukrstat.gov.ua (accessed on November 4, 2008).

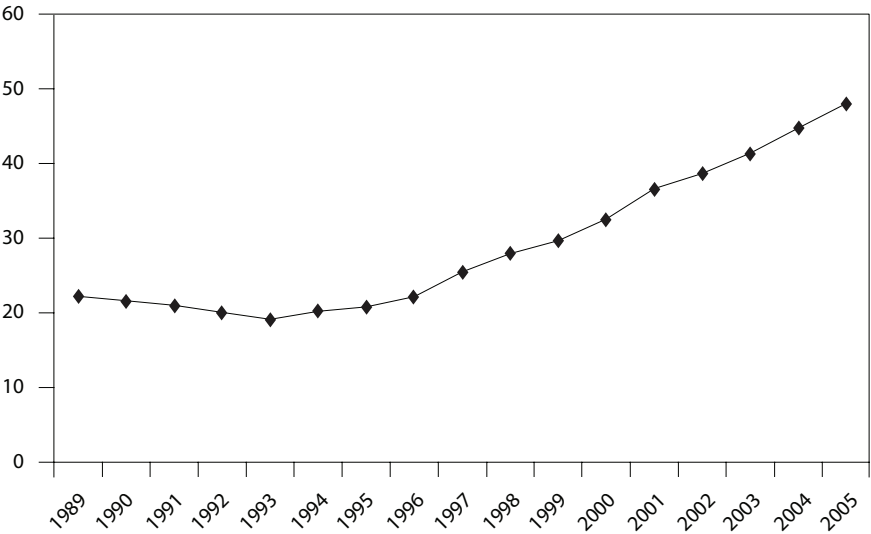
end of communism. The main reason for this decline is probably greater access to drugs rather than any improvement within the public health care system.

Another shocking statistic is the decline in Ukraine's population. Officially, it has shrunk from 52 million in 1992 to 46 million in 2008 (figure 8.4). But even this figure is embellished because an additional 5 million to 7 million Ukrainians are abroad, largely working illegally in Europe, typically in construction, agriculture, and households. The population actually living in Ukraine has thus shrunk from 52 million to about 40 million to 42 million, or by some 20 percent in 15 years, which is a great blow to the nation, even though the population has plummeted even more in Georgia, Armenia, and Moldova.

The most positive social statistic is the investment Ukrainian youth make in their own and the country's human capital. By the narrow UNICEF definition, the share of Ukrainian youth pursuing higher education has increased two and a half times from 19 percent in 1993 to 48 percent in 2005 (figure 8.5). According to UNESCO (2008), which uses a broader definition, no less than 73 percent of young Ukrainians went on to tertiary studies in 2006. These numbers show the ambitions of young Ukrainians, and most of them pay substantial official or unofficial tuition fees, but much of the education on offer is unfortunately of poor quality.

Figure 8.5 Share of college-age youth pursuing higher education, 1989–2005

percent of population aged 19–24



Source: UNICEF, TransMONEE Database, 2007, www.unicef-irc.org/databases/transmonee (accessed on August 16, 2007).

One of the most important reform efforts in education was the introduction in 2008 of national tests for all high school graduates so as to reduce the notorious corruption in the admission process in higher education institutions.

Ukraine needs social reforms in health care and education to make them more efficient and raise their quality. The pension system also needs to be reformed. Public social expenditures, however, have persistently been quite high and larger than characteristic for a country at Ukraine's level of economic development (Tanzi and Tsibouris 2000). Lack of efficiency, not resources, is Ukraine's constraint.