

The State of the State: a Fiscal Perspective on State Formation and Transformation in Ukraine and Other Countries of the Former Soviet Union

1. Question to be researched, relevance

- Problems of state-building and resulting state weakness are increasingly assumed to be one of the crucial obstacles of post-Soviet transformations (McFaul 1995, Holmes 1997). The critical 'state of the state' has important implications for other areas of transformation and in particular for achieving economic restructuring and growth.

Fiscal policies – i.e. the extractive and expenditure policies – are a core aspect of the state-building and state restructuring process. New states need both to establish extractive capacity and – if they choose to embark on transformation – to restructure their extractive/expenditure system as these systems differ substantially in planned economies plus authoritarian regimes from those in market economies plus democratic regimes. To research fiscal policies will therefore help us to understand more precisely how state formation and transformation works in post-Soviet countries, and where main obstacles as well as possible solutions lie.

In the research, states are defined as complex public institutional structures the primary potential beneficial role of which is to produce public goods (Offe 1996, 66). However, as North (1990) has pointed out, while institutions may produce considerable benefits they can also evolve in sub-optimal ways or even be welfare reducing.

Other important insights from North are that when we consider periods of institutional change we need to be attentive to legacies (i.e. the degree of change vs. the degree of continuity) and to the relationship between formal and informal structures as the latter may influence in important ways how formal institutions are (re)shaped.

- Fiscal and budgetary policies are generally a rather understudied area in political science. An important contribution to the nexus of "taxation and democracy" has been made by Steinmo (1993). However, with regard to post-Soviet countries and, in particular, Russia interest in fiscal issues is rapidly increasing as the problems of financing the state and resulting consequences (lack of public goods provision) are realized as major obstacles to transformation (Treisman, 2000; Martinez-Vazquez and Wallace, 1999; Busse, 2000; Yakovlev, 2001). As the field is relatively novel, meso-level theoretical assumptions and hypotheses are still in the process of formation.

- One of the most widespread assumption is that state capture and rent seeking by powerful business lobbies with strong political influence have caused short-falls in revenues as well as distortionary tax systems which stifle economic recovery and equitable growth (Aslund, 1999; Havrylyshyn et al. 1994). Others have used an institutionalist approach in order to analyse fiscal systems and explain their policy outcomes (Alesina, 1999; Campbell, 1996). Based on the insights of North and Offe, this research seeks to combine both approaches to analyse the evolution of fiscal and budgetary policy in Ukraine since independence. On the one hand, we need to look at institutions and problems of institutional dissolution and reconfiguring if we want to understand while rent-seeking may be debilitating in some circumstances while in other it is much less so. On the other hand, we need to look at the interaction of formal institutions with wider social (or informal) structures if we want to understand the de facto functioning of formal institutions as well as their reconfiguration during periods of change.

- Post-Soviet countries have embarked on a major project of change, fundamentally revising their path of development for the second time in the 20th century. Transformations result in major economic shocks. These shocks have hit post-Soviet countries at a time when their

institutional structures were particularly weak. During the period of *perestroika* and into early independence integration and control within the state structure seriously eroded. Corruption – which was already widespread in Soviet times – became endemic. Alternative forms of control, compatible with a democratic system of governance (Schedler et al., 1999), did not become functional in many post-Soviet countries as they hovered between authoritarian and democratic regime forms.¹ In such a situation, fiscal and budgetary institutions providing for a) a broadly non-distortionary system of extraction, b) transparency and accountability – were not established or established only very slowly. Furthermore, most of these countries lack intermediary organizations which would be able to channel and compromise over broad societal demands concerning the accepted scope and role of the state (integration). Where an agreement on the role of the state is lacking, necessary adjustments due to falling revenues have been delayed – resulting in various forms of deficits and their consequences (debt, high inflation, large-scale pension and wage arrears) to or ad hoc adjustments carrying considerable costs. Furthermore, the inability to redefine the state creates disorder which opens up opportunities for rent-seeking groups. Where the loss of control and integration was particularly pronounced, widespread rent-seeking resulted. As rent-seeking groups become entrenched they in turn present major obstacles to the formation of 'public goods' producing institutions.

- The research is primarily analytical rather than policy advice oriented. Some broad implications are clear: Institutions establishing forms of control compatible with democratic regimes should be established in post-Soviet states. However, the research will most likely show that such institutions are not easily created and that existing state actors (i.e. governments, parliaments, presidents, etc.) may not be interested in 'public goods' enhancing institutions due to their own rent-seeking interests. Policy advice may therefore be addressed to a) 'reform-oriented' members within post-Soviet governments, b) to external actors (WB, EU, Council of Europe, etc.), c) to emerging civil society groups within post-Soviet states. The advice to group a) is to support the institutionalization enhancing democratic forms of control (horizontal; accountability to the population) and weaken autocratic forms of control (control from above, via Secret services or via political uses of the tax administration). Create conditions in which organizations aggregating societal demands can flourish. Explain policy choices concerning the role of the state to the population (i.e. level of taxation – level of public goods/welfare provision – costs of taxation).

To group b) the advice is to give technical advice concerning institution-building options (for example: on strengthening external accounting of public finances; a treasury system providing transparency, etc.), generally to concentrate more on supporting institution-building and policy *capacity* rather than to develop action programs which are unlikely to be adopted and implemented. To group c): use the resources and leverage of group b) to grow and to establish channels for voice with the government. Seek government transparency on issues of public finance and try to make the wider public aware of policy options and policy actions taken by state actors.

2. Methodology/Research design

- This is an exploratory case study in which the case of Ukraine is used to generate ideas and hypotheses concerning the under-researched area of fiscal policies in post-Soviet countries. On the basis of this case study, some preliminary testing on other post-Soviet cases will be done. Other post-Soviet countries will have the same institutional starting conditions: i.e. they used to have the same fiscal and budgetary system, the same overall state structure and political regime which collapsed at the same time etc. Initial differences may include size and

¹ Authoritarian forms of control are organized predominantly from above. Democratic forms of control are both horizontal (checks and balances) and from below (free press, free elections, public opinion).

regional structure, presence of natural resources, level of development, and broadly, social structure.

If my assumptions concerning Ukraine are relevant, than first of all, similar patterns should show up in other post-Soviet countries. Secondly, post-Soviet countries which have done better in terms of transformation results (primarily the Baltic states) should show a faster development of institutions providing for control and integration. [If they do not, than institutional factors would be less relevant than I assume; and 'underlying' factors such as size or level of development translate directly into better policy outcomes]. Lastly, I will be interested in cases where countries on a 'sub-optimal' trajectory have undertaken particular reform steps in the realm of public finance. The most obvious case here would be the recent tax reform in Russia which was essentially aimed at reducing the cost and the role of the state by radically lowering taxes.

- The time period: The study covers the first decade after independence. In order to analyse legacies and their potential relevance a summary of the Soviet fiscal and budgetary system, as well as its erosion and eventual break-down during *perestroika* and the dissolution of the USSR is provided. Since the study focuses on what may be called a time of 'critical juncture' some results will necessarily be preliminary. However, given a time period of ten years, we can already observe some evolution of new and stabilizing trajectories.

- An initial round of empirical data was collected during three months of field research in Ukraine. The data collected includes: Budgetary laws and data (planned and executed budgets); data on and analysis of the budgetary system, data on the tax system (rates, tax base) and actual tax collection (tax administration; tax arrears); interviews with members of relevant parliamentary committees, with foreign advisors and professionals of control organs (Accounting Chamber, State Treasury), with representatives of business associations (both for small and large businesses) and trade unions; with representatives of the third sector; interviews with and material produced by local policy analysts; with representatives of NGOs; analysis on problems of the tax and expenditure system produced by foreign advisors (WB, KPMG-Barents Group), newspaper coverage of relevant topics.

I will need to do some further empirical work in Ukraine. Other cases will be covered primarily on the basis of secondary literature; where this proves insufficient to support my arguments I will do some primary research basically covering similar ground as in Ukraine as needed.

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