

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 being researched

Problems of state-building and resulting state weakness are increasingly assumed to be a crucial obstacles of post-Soviet transformations (McFaul 1995, Holmes 1997). Two strands of literature dealing with post-Soviet as well as post-communist countries in general have arrived at stressing the important role of the state: the literature on democratic transition and consolidation, as well as the literature on the political economy of economic reforms.¹ In this argument, fiscal capacity is seen as a key feature of the state (Skocpol, 1985).² Fiscal capacity is the ability of state actors to extract resources from the economy without destroying its base. Nearly all post-Soviet states have experienced major difficulties in maintaining or rebuilding fiscal capacity since independence; while cases differ on how and how fast they have managed to overcome these problems. The two most fundamental issues of fiscal capacity have been of control, i.e. ensuring taxation of all groups and ensuring that public funds are spent for public purposes, and finding a path of sustainable adjustment concerning the size of the state. Starting from a case study and subsequently moving on towards a comparative perspective, this research aims to provide a first cut of answers as to why these problems arose and persisted; as well as under what conditions attempts at solutions were successful or failed.

2. Economic/political relevance

Success or failure in state building is highly relevant for post-Soviet states themselves as well as for their neighbouring countries. When there are major flaws in fiscal capacity, state failure has momentous consequences: Pensions are not paid, sewage and heating systems are not maintained, and education erodes. Fiscal crises – like the one experienced by Russia in 1998 – undermine the economy and can be politically destabilizing.

3. Theoretical Relevance

In modern history, instances of state-building have occurred rather rarely, with the last wave in the post-colonial period of the 1950s and 60s (resulting in a relatively large number of failed states). In the post-Soviet and post-Yugoslav realms, a large number of state-building processes are currently being undertaken. However, in recent years democracy-building has received far more attention than state-building – while in the literature it is increasingly recognized that a secure and rather well-functioning state is crucial to democratic consolidation (Linz and Stepan, 1996).

Consequently, a host of questions with regard to post-Soviet state-building still remains to be raised, hypothesised and tested through empirical research. In my research, the focus will be on the following nexus: Fiscal capacity is widely seen as a crucial aspect of state capacity (see Skocpol et al.). By focusing on it, we can work towards gaining a clearer understanding of what state capacity is and is not in post-Soviet contexts. Furthermore, we need to be clear that the primary issue of fiscal systems in post-Soviet countries is adjustment, capacity and control rather than distribution (the dimension along which fiscal systems of OECD-countries are most often discussed by political scientists; see Steinmo 1993). Adjustments of the role of the

¹ See Linz and Stepan (1996), 14, 20. Shleifer and Treisman (2000); Nagy (2000); Geddes (1994).

² “A state’s means of raising and deploying financial resources tell us more than could any other single factor about its existing (and immediately potential) capacities to create or strengthen state organizations, to employ personnel, to coopt political support, to subsidize economic enterprises, and to fund social programs.” Skocpol (1985), 17.

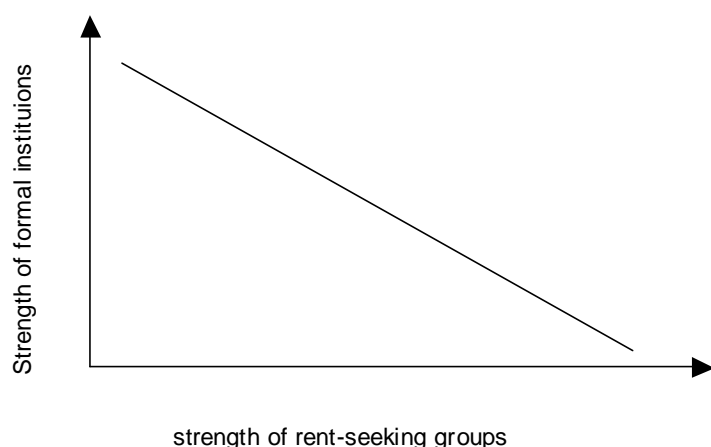
state and capacity to extract in a sustainable way in the midst of massive changes in the economic structure are crucial in a situation of state-building combined with transition; while capacity is most often undermined by problems of control or accountability – i.e. keeping privileges and exemptions limited, ensuring that tax extraction succeeds either through trust and feelings of obligations (epitomized in the Swiss model) or through (more costly) enforcement, and that public monies are used for the purposes intended and not wasted or in the worst case diverted for the conspicuous consumption of elites.

4. *Solutions proposed in the literature and proposed alternative theoretical solution*

In much of the literature looking at post-Soviet cases, rent-seeking groups are assumed to have undermined the fiscal systems by gaining tax privileges, having access to cheap credits which are not returned, to subsidies, etc (Havrylyshyn 1995; Shleifer and Treisman, 2000). However, when we think in comparative terms, this explanation seems insufficient. While rent-seeking clearly is a major problem, this interpretation does not help us to understand why rent-seeking has become so extremely powerful in cases like Ukraine or Russia, while it is a problem of manageable proportions in the Baltics. Why does it threaten to undermine the fiscal capacity of some states but not of others?

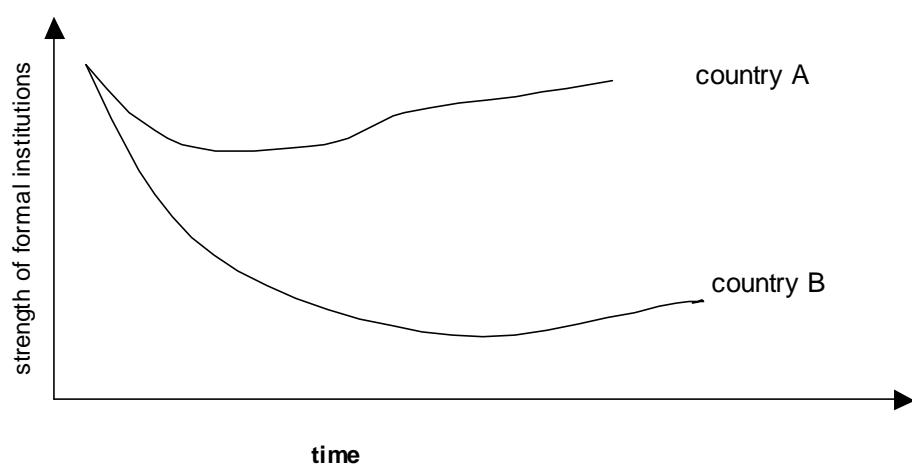
Furthermore, in parts of the literature the importance of Soviet legacies are evoked (Martinez-Velazquez 2000; Vanaganas 1995 on Lithuania). These legacies clearly matter; but the formal institutional legacies are the same for all post-Soviet countries while post-independence development diverges considerably. Rather than institutional legacies, I assume that institutional deterioration and its interaction with interest groups matter most for explaining differential outcomes. Institutional deterioration refers to the erosion or break-down of state capacity during the break-up of the Soviet Union and the post-independence period (for the break-up period see Solnick: *Stealing the State*, 1998). Institutional erosion may be proceed fast and deep: this is most likely the case in countries experiencing civil war (Georgia, Tajikistan, Moldova); and/or it may last for differing lengths of time. For example, Ukraine was the last Soviet successor state to give itself a constitution. Since adopting a constitution is widely seen as the foundation of any post-independence institution-building we can assume that Ukraine experienced a particularly prolonged period of institutional deterioration.

According to Jack Knight (1992), formal institutions constrain powerful actors. Thus, in reverse, institutional deterioration enhances the power of actors with non-institutional resources. Addressing the problem of institutional deterioration, we therefore begin to understand better why rent-seeking emerged as a critical problem in some post-Soviet states, but not in others. As a start, we would expect something like a linear relationship between the strength of formal institutions and the strength of rent-seeking groups:



We can picture the relationship as a vicious circle: During the fluid period of independence, the state fails to tax certain groups. Enjoying de facto tax privileges, these groups flourish economically. Economic power allows these groups to bribe policy-makers who will eventually award them formal tax privileges. This fortifies and perpetuates the importance of these groups.

We assume that all post-Soviet countries were affected by at least some deterioration of formal institutions during the break-up and early state-building period. Why would some countries then have been able to escape the vicious circle while others were not? And under what condition could it be possible to reverse this trend in countries belonging to type B?



5. Methodology

I have begun the research with an exploratory case study of Ukraine. This case study has served to establish a tentative model and to explore the empirical issues of fiscal capacity and control arising in post-Soviet countries, ranging from tax collection by barter to attempts at building treasury systems and internal as well as external audit institutions, to prevalent types of tax privileges. Given the absence of pre-existing meso-level or readily operationalizable assumptions, I consider that starting from a case study was the most suited way to *generate* ideas and hypotheses.

In a subsequent part of the thesis, the tentative model derived from the case study is applied to other post Soviet countries. The first aim is to test whether the assumed relationship between institutional deterioration and rent-seeking holds for other cases. If the model holds, the second aim is to analyse why countries were able to reverse the trend of institutional deterioration. Thus, for example, I will consider the conditions under which institutions of control over public finances were established as well as the conditions under which these became effective or not.

6. Sample

The time frame of the thesis is rather straight forward. The period covered is the decade between 1990 to 2000 – i.e. from the deterioration and eventual collapse of the USSR to the present.

The comparative part of the thesis will focus on selected shadow cases rather than taking all possible post-Soviet cases on board. Given capacity constraints of an individual researcher, depth is privileged over range in this research. Shadow cases will include Lithuania and Russia, which are reasonably close in terms of culture and level of modernization (i.e. having an industrialized economy). Lithuania belongs to the Baltics – i.e. the group of countries with

the most optimal path among all post-Soviet countries. Thus, it will allow us to observe a post-Soviet path of overcoming institutional deterioration relatively early and consistently. Russia has recently undertaken a major step at institution-building by adopting a new tax code. The comparison will focus on the conditions which allowed the adoption of such a new basic framework of rules; and will try to assess the conditions working for or against its effective implementation. Russia would thus be a case of attempted reversal of institutional deterioration at a later stage and from a lower level.

7. Data collection

Data collection in Ukraine has included collecting papers published by local think tanks, research institutions, and foreign donors working on issues of public finance. Furthermore, I have conducted interviews with Ukrainian policy makers (parliamentarians from relevant committees), public officials (MinFin, Accounting Chamber, Tax Administration), researchers, and representatives of interest associations (business associations, trade unions). Lithuania will be covered through research into secondary resources combined with some primary research which I begin this summer (taking interviews from sources similar to those in Ukraine). Russia is well covered in the literature; while I would seek some complementary interviews.

Table

General Government Revenues for Transition Countries (% of GDP)

	1993	1994	1995	1996	1997	1998
Albania	20.5	18.8	24.0	18.3	16.9	20.3
Bulgaria	37.2	39.9	34.9	31.9	32.6	39.3
Czech Republic	42.2	41.0	43.2	43.2	41.8	41.5
Hungary	45.7	45.4	42.1	39.9	37.5	41.8
Poland	45.8	41.9	40.9	39.8	38.8	42.5
Romania	33.9	32.1	30.1	30.1	30.7	35.0
Slovak Republic	44.3	46.4	47.7	45.2	44.6	45.1
Slovenia	47	45.9	45.2	45.2	44.6	45.1
Armenia	28.9	27.7	19.9	17.7	19.8	19.5
Azerbaijan	40.5	33.8	17.6	17.6	19.7	16.0
Belarus	54.3	47.5	40.9	40.9	46.1	47.8
Estonia	38.5	41.3	39.9	39.0	39.1	39.1
Georgia	3.4	7.7	7.1	9.4	10.2	10.5
Kazakhstan	21.1	18.5	16.9	13.2	13.3	13.9
Kyrgyzstan	24.7	20.8	16.7	15.9	16.2	14.8
Latvia	36.4	36.5	35.5	36.6	28.4	42.3
Lithuania	30.2	32.6	32.3	29.6	32.6	34.2
Moldova	22.8	31.3	33.9	32.1	36.3	27.6
Russian Federation	35.5	34.7	29.9	31.0	30.7	35.0
Tajikistan	27.1	44.5	15.2	12.1	12.6	12.8
Turkmenistan	22.6	10.4	12.5	16.9	29.2	17.2
Ukraine	40.0	49.1	40.1	38.6	42.4	39.8
Uzbekistan	36.0	29.2	34.3	34.3	30.5	33.5

Source: Ebrill and Havrylyshyn (1999), Martinez-Velazquez and McNab (2000).

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