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

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1. Introduction

In post-Soviet countries, the state is at issue. Most former states are weak judging by dwindling revenues and their inability to control crime and corruption. At the same time, there is still a strong bureaucracy which often abuses citizens' rights and is widely seen as stifling entrepreneurship. Lastly, leaders – from Putin in Russia to Karimov in Uzbekistan – like to talk about strengthening the state.

Fiscal and budgetary systems of post-Soviet countries reflect all three of these trends: the revenues they provide have greatly declined – relative to GDP and more dramatically even in real terms. The result is a massive lack in the provision of public goods: physical infrastructure – from roads to heating systems to the provision of potable water – deteriorates, a proper legal and regulatory environment is not created, and inequality and poverty increase rapidly while welfare states are dismantled. At the same time, tax administrations still tend to consider force rather than persuasion the best way to increase revenue collection and taxpayers rights are often badly defined or disregarded. And finally, at least in the case of Ukraine, the president appears to have used the tax administration to secure his power – if not necessarily the power of the state.

This paper aims at a more detailed understanding of how state-building has evolved in post-Soviet countries. To do so, it uses a double form of casing.[1] Firstly, public finances are chosen as a focus for state-building. Theorists such as Theda Skocpol as well as students of the post-Soviet region have described public finance as a crucial pillar of state-building. In-depth empirical research into the extraction and expenditure systems of post-Soviet countries has, however, only just started.[2] Secondly, I have chosen one case, Ukraine, as my major case. In a second part, some comparative aspects with other post-Soviet countries will be discussed. This set-up is chosen on the one hand because well-established descriptions and interpretations of post-Soviet countries are still scarce. This is particularly true for factors assumed to matter for public finances. Thus, we need to start with an in-depth empirical study. However, on the other hand we want to a) place our case within the region, and b) provide an indication whether the causal connections which we assume to detect for one case are in any way generalizable. This necessitates a comparative view.

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[1] Charles Ragin, *What is a Case?* Cambridge: Cambridge University Press, 1992, final chapter.

[2] See Peter Evans, Dieter Rueschemeyer, and Theda Skocpol, *Bringing the State Back In*, Cambridge: Cambridge University Press, 1985, 17. Stephen Holmes, What Russia Teaches Us Now. How Weak States Threaten Freedom, in: *The American Prospect*, Vol. 8, no. 33, July 1997. Gerald M. Easter, *The Fiscal Crisis of the Post-Communist State: Structural Origins and Transition Legacy*, manuscript, Boston College, April 2001. Busse, Eva. 2000. "The Embeddedness of Tax Evasion in Russia." A. V. Ledeneva and M. Kurkchiyan (eds.), *Economic Crime in Russia*. Ortxxx: Kluwer, 129-143.

This proposal is organized as follows. The first part gives a brief theoretical introduction, first into the more general issue of state-building and then into the specific focus of public finance and its relevance for state formation and transformation. Thinking about public finance helps us to clarify often used but vaguely defined terms such as state "strength". Furthermore, this part sets out how we want to go about analysing the development of extraction and expenditure systems in post-Soviet states (operationalization). The second part deals in-depth with the case of Ukraine. The third part provides some preliminary comparative evaluation. This part allows us to place Ukraine within the universe of post-Soviet states; furthermore, it points out where post-Soviet countries have developed in similar ways, but also to what degree they have diverged and traces some causes for divergence. (Thus, there are two connected general dimensions to this proposal: The first is the success or failure of state-building in post-Soviet countries and the underlying/causal factors; the second is divergence of post-Soviet states which is increasingly recognized as surprisingly large – Bunce).[3]

2. Theory: debating and classifying states

Discussions of the state include – explicitly or implicitly – a normative dimension about the desirable role of the state.[4] For modern states, this ranges from a minimalist 'night-watchman' state to a maximalist social welfare state. The even more maximalist version, the communist state, has largely disappeared empirically and vanished as a theoretical model as well. However, both sides generally agree that states provide the essential framework for markets to function; while they disagree over the extent to which states should be employed to correct market failures, including socio-economic inequality.[5]

Analytically, we can describe several layers (or: degrees of activism) of the state.[6] As suggested by the WDR 1997, states may be classified as minimalist, intermediate, or activist. Among minimalist activities, the WDR counts the provision of law and order (including a basic regulatory framework enabling markets to function), national defence, public health, and basic protection of the poor. An intermediate role includes the provision of social insurance, a more intense regulation of markets, the management and/or provision of typical market externalities (i.e. goods underprovided by markets) such as general education or

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[3] Divergence is value-neutral. Two countries may have different systems but be perceived as similarly (un)successful.

[4] See also Charles Tilly, "Democracy, Social Change, and Economies in Transition," in Juan Nelson, Charles Tilly, Lee Walker (eds.): *Transforming Post-Communist Political Economies*, National Academy Press, 1997, 403.

[5] Buchanan, James M. and Richard Musgrave. 1999. *Public Finance and Public Choice. Two Contrasting Visions of the State*. Cambridge: The MIT Press.

[6] See World Bank, *World Development Report* (WDR), 1997.

environmental pollution control. Most activist functions of the state include the redistribution of wealth among different strata of the population, and interventions into the market including subsidies, state ownership of enterprises.

Two features are striking: Firstly, already the minimalist vision of the state provided by the WDR is rather demanding. It is the vision of a fully functioning state, rather than a failed state. Secondly, in the real world we are likely to find states with considerable discrepancies, i.e. which pursue some activist goals on one hand while failing to provide some basic public goods (such as law and order; a functioning public health system).

The maximalist-minimalist debate refers primarily to the *size of the state*. The share of the state budget in GDP is often used as a quantitative measure of the state. Maximalist states – such as the Northern European countries – tend to have large budgets relative to GDP.[7] Smaller budgets will be found in countries with a more minimalist approach to public policy.

However, very small budgets (in modern states we might say: less than 15 per cent of GDP) tend to be indicative not of (deliberately) minimalist states, but rather of failed states. Public finance furthermore gives us a good grasp on whether states are deliberately small or not: Thus, where formal tax rates are high while budget revenues are small we suspect a state with revenue extraction problems. If formal tax rates are low but taxes are largely paid we assume to be looking at a deliberately small state.[8]

The size of the state is not equivalent to the *strength of the state*.[9] Large states may be overburdened by too many demands. Rather small states such as South Korea (with a budget of 20 per cent of GDP in 1998) may be regarded as the model of a strong developmental state; while the Russian Federation with a somewhat larger budget size is treated as a dangerously weak state.[10] However, there is a link: a minimum size and, moreover, a match between the intended and the actual size (budgeted expenditures and available revenues) can be regarded as pre-conditions for strength.

The other two crucial dimensions of state strength are autonomy, and capacity. Autonomy means on the one hand that the state is not overburdened with demands and on the other, that

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[7] There are some empirical problems with this measurements, since the size of the shadow economy differs across countries. Using estimates of the shadow economy we can try to determine the size of the budget in "real" GDP.

[8] As states do not have a will of their own, the question arises, small or large on whose deliberation. In long-established democracies we assume a historically grown social compromise. For new democracies, for countries with uncertain regimes, and for countries with recent major changes the answer is more complex. Given space constraints, this question cannot be addressed here.

[9] David Stark and László Bruszt, *Postsocialist Pathways. Transforming Politics and Property in East Central Europe*, Cambridge: Cambridge University Press, 1998, xxx

[10] In this paper, strength only refers to domestic strength and not to the international weight of a state.

the state does not serve one or several narrow interest groups. For the first dimension we may consider budget proposals: When yearly budget demands far exceed available resources, this signals overburdening by demands. The second type of ‘capture’ is likely to be reflected in special privileges – such as the non-taxation of the nobility in feudal times, or specific tax exemptions in modern states.

Capacity means the ability to effectively formulate and implement policies – irrespective of whom these policies serve or who has lobbied for them. Thus, state capacity most of all requires coherence and coordination in the institutional structure as well as an efficient bureaucracy.[11] The inability to formulate coherent tax policies, for example, or the inability to collect stipulated taxes can be read as capacity problems.

Overall, considering fiscal systems can allow us to gain a more substantiated understanding of the relative strength of a state. However, to achieve this, we need to look at more than just the share of state revenues and expenditures in GDP.

Determining the size and the strength of a state may not give us the whole picture, however. What we are also interested in is the *quality of governance*. What use is the available strength put to? Quality may be most obviously measured in terms of results, such as economic growth. If institutions and thus states matter for markets, then growing markets should be founded on good institutions, or in other terms, states with a good quality of governance. However, there may be various intervening variables between governance and results, such as world-wide recessions, legacies from previous periods of governance, etc. Thus, considering the quality of governance, we limit ourselves to considering whether good foundations are laid. This requires first of all, that state revenues are used for public rather than private goods provision. To ensure this, mechanisms of control and accountability need to be in place. With regard to public finance these are likely to include a treasury system that provides transparency, as well as internal and external institutions of financial control (horizontal accountability). Informal mechanisms such as a free press and an active society able to protest misuse of funds are widely regarded as further important components of good governance.[12]

Today, democracy and democratic forms of accountability are widely perceived as preconditions for good governance. However, as Olson and Huntington remind us, stationary

[11] Peter Evans, *Embedded Autonomy. States and Industrial Transformation*, Princeton: Princeton University UP.

[12] See David Feeny, The Demand for and Supply of Institutional Arrangements, in: V. Ostrom et al. (eds.), Rethinking Institutional Analysis and Development, San Francisco: ICS Press, 1993, 159-209.

bandits or well-established dictatorships may also provide relatively good governance (and may be perceived as second-best solutions).[13]

2.1 State-building as institution building

States are institutional structures.[14] State-building thus is a process of creating an institutional structure. However, modern state-building and state-building on the 'rubble of an empire' does not start from a *tabula rasa*.[15] Rather, it starts with the bits and pieces of the previously existing structure and therefore also involves institutional destruction and institutional change.[16]

This process of destruction, change, and creation will affect all three dimensions of the state as developed above: size, strength, and quality. Furthermore, this process is not unidirectional. Rather, the institutional structure may remain in a condition of disrepair; or, as North reminds us, sub-optimal institutions may be created and/or fortified.[17]

On a first level, we are therefore interested in formal institutional structures. What are the institutional structures of public finance that have been created in post-Soviet states? Are they coherent? Do they provide for control and accountability?

On a deeper level, we are interested in causes for the destruction/creation/change of institutional structures, and for factors which make formal institutions work effectively. First of all, we need to gain an understanding of starting points. What was the institutional structure that previously existed? To what degree had it disintegrated when the Soviet Union broke up?[18]

As concerns the post-Soviet period, we might start from the role of the state: was there any agreement about the desirable size of the state, either in the form of a broad 'social contract' or (effectively) imposed from above? Where there one or several competing blue-prints? Did agreement crystallize over time?

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[13] See Olson, Mancur: *Captialism, Socialism, and Dictatorship. Outgrowing Communist and Capitalist Dictatorships*, unpublished manuscript. Samuel Huntington, *Political Order in Changing Societies*, New Haven: Yale University Press, 1968, 9.
[14] Claus Offe, *Modernity and the State*, Cambridge: Polity Press, 62.
[15] See Mark R. Beissinger, "State Building in the Shadow of an Empire-State," in: Karen Dawisha and Bruce Parrott, *The End of Empire? The Transformation of the USSR in Comparative Perspective*, Armonk: M.E. Sharpe, 1997, 157-185.
[16] Klaus von Beyme, "Institutional Engineering and Transition to Democracy," in: Jan Zielonka (ed.), *Democratic Consolidation in Eastern Europe*, Oxford: Oxford University Press, 2001, 8.
[17] Douglass North, *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press, 1990, 8.
[18] Steven Solnick, "The Breakdown of Hierarchies in the Soviet Union and China." *World Politics* 48, 1996: 209-38; and Solnick, *Stealing the State. Control and Collapse in Soviet Institutions*, Cambridge: Harvard University Press, 1998.

Furthermore, was there agreement on the institutional model to follow – resurrection of the Soviet model or change to a free market (minimalist) or a social welfare state (maximalist) model? Disagreement would make the re-building of any institutional structure difficult. Disagreement may have multiple causes and possible solutions: it can result from competition among various narrow interest groups, from the weakness of organized society, or from mutually exclusive demands of broad interest groups. Various forms of regime consolidation may help to overcome disagreement.

As suggested in the literature, agreement may be brought about by strong focal points.[19] In the cases of post-Soviet states, these may for example be provided by history (such previous periods of independent statehood, but also the Soviet period) or through external/international models (such as the Nordic social welfare model). Thus, to make any agreement on the role of the state effective will probably require a degree of regime consolidation – as may be signaled by the adoption (and de facto acceptance) of a constitution. Thus, we would expect considerable interdependence between state and regime consolidation.

A fundamental problem of institution building is the presence and strength of particularistic interests.[20] These become particularly strong in a situation of partial institutional breakdown on the one hand, and disorganization of society at large on the other. Thus, there is the potential of a downward spiral in which the break-down of previous institutions triggers a rise of such interests, which in turn promotes the adoption of sub-optimal institutions. Thus, we are also interested to which degree post-Soviet states entered this downward spiral, avoided or escaped it.

3. Empirical part

3.1. The Soviet fiscal and budgetary system – the past 'equilibrium'

Up to the mid 1980s, the Soviet extraction and expenditure system was in a fairly stable equilibrium. Revenues and expenditures were balanced.[21] However, the system differed markedly from that found in market or mixed economies. Communist states are 'owner' rather than 'tax' states. This has important implications.

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[19] Mitchell Orenstein, *State Projects. Their Presence and Absence in Postcommunist Transitions*. Paper presented at the conference on "State-Building in Post-Communist States: Toward Comparative Analysis," Yale University, April 27-28, 2001. John Carey, Parchment, equilibria, and institutions. *Comparative Political Studies*, Vol. 33: 735-761.

[20] Jack Knight, *Institutions and Social Conflict*, Cambridge: Cambridge University Press, 1992.

[21] Sinelnikov and Reznikov (1995), 3.

Firstly, the fiscal boundaries of the state (i.e. the size of the state) are not well defined.[22] The means of production are state-owned; accordingly, profits and losses are shared between the budget and the enterprise. As a consequence, secondly, tax rates are not uniform. For the two main types of taxes, turnover and profit tax, numerous specific rates were applied. The contribution of an enterprise to the budget was negotiated rather than fixed.[23] Thirdly, there was no direct taxation of the population at large – the state could determine wages and did not need to depend on income declarations and tax returns.[24] Fourthly, extraction is much easier in a communist ownership state as only a few large enterprises, rather than numerous small economic units exist. Extraction was further eased, fifthly, by the limits on banking: all enterprises had to use the easily supervised unified banking system (monobank system).[25]

On the expenditure side, enterprises could rely on subsidies in times of loss-making. The population meanwhile was provided with a broad (if in some sectors low quality) welfare system, including numerous social privileges (*l'goty*) for example for pensioners or students. Furthermore, since planning and budgeting was highly centralized, hard choices were made in Moscow rather than on a republican level.

Internal financial control was institutionalized in the KRU (*Kontrolnaya i revisionnaya Upravlenie*). Important elements of general control were provided by the party and security organs, primarily the KGB. However, during the late Soviet period, fraud by republican and lower level officials was escalating. Semi-formal channels of control such as a free press and public criticism of corrupt officials was largely forbidden.[26]

Do we need to analyze a past equilibrium (and its breakdown) if we want to analyze institutional change? Based on the theoretical literature on institutional change, the answer is yes. Knowing the past equilibrium gives us an idea about the required degree of change (if a market/mixed system is to be institutionalized) – and its likely costs.[27] Legacies furthermore give us an idea where to expect institutional 'stickiness' – such as the negotiated character of company taxation or the absence of direct personal taxation. Furthermore, considering institutional legacies provides us with a crucial puzzle for our comparative part: Why did states with a common formal institutional history develop along very different trajectories in the post-Soviet period? How large is the divergence and what causes can account for it?

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[22] Hutchings, 16, 95-96; Nove, 1986, 235-8; Cheasty and Davis (1996), 10.

[23] UNECE (2000, no. 1), 60. [letzten Satz evt. weglassen → zu wertend → will meine eigene Wertung geben, rather than taking that of s.b. else]

[24] Tanzi (March 1993), 16.

[25] Nove (1986), 251; Sinelnikov and Reznikov (1995), 15.

[26] Konstantin Simis, *USSR: The Corrupt Society*, New York, Siman and Schuster, 1982.

[27] P. Pierson, "Increasing returns, path dependence, and the study of politics," *American Political Science Review*, vol. 94 (2), 251-268.

3.2. Institutional deterioration: **perestroika** *and the break-up of the Soviet Union*

During the *perestroika* years, major changes were initiated in the revenue and expenditure system. Increased investments on the one hand, and increased self-management for enterprises (*khozraschet* system) on the other hand – intended to stimulate flagging economic growth – shifted resources away from the state budget and towards enterprises. Wages rose rapidly.[28] In the last years of the USSR, the center also increasingly lost control over the republics which gained control over enterprises and thus over revenues. Together with unchecked monetary emissions at the republican level during the period of 1990-1991, this amounted to a "genuine civil war in finance" according to Stroev et al.[29] The federal government found itself deprived of fiscal resources an unable to implement revenue raising policies. As a consequence, the USSR as a whole finished the last year of its existence with a fiscal deficit of approximately 15 per cent of GDP.[30]

Both hierarchical control and system-wide policy-integration were eroding rather rapidly.[31] As the CPSU began to lose its monopoly on power and its continued ability to control agents seemed uncertain, lower level bureaucrats began to grab whatever assets of the system they could, a process which Solnick has described as a 'bank-run' triggered by loss of trust in institutional structures.[32]

In short, by the time the Soviet republics became independent at the end of 1991, the previously existing institutional structure had been seriously weakened and crucial parts had been entirely dismantled. Furthermore, important institutional layers (e.g. policy making functions) did not exist at the republican level (reduction in capacity). Assets were divided rather uncontrolled between the center and the NIS, and unregulated privatization had already begun. Thus, the newly divided state structures lost ownership of enterprises, without immediately gaining new capacity to extract taxes. Thus, post-Soviet states were initially shrinking on the revenue side, while demands on the expenditure side remained constant or even increased as still state owned companies experienced serious difficulties due to the break-up of the previously integrated economic space and demanded more subsidies.

[28] Sinelnikov and Reznikov (1995), 4-7.
[29] Stroev, Bliakhnon (?), and Krotov (1999), 293.
[30] Sergei Sinelnikov and Konstantin Reznikov, Budget Crisis in Russia. *CASE, Studies and Analyses*, 1995, 11. Piroska Nagy, *The Meltdown of the Russian State*, Cheltenham, Edward Elgar, 2000, 65.
[31] Barbara Nunberg, with contributions by Luca Barbone and Hans-Ulrich Derlien, *The State After Communism. Administrative Transitions in Central and Eastern Europe*, Washington D.C., World Bank, 1999, 238-242.
[32] Solnick (1998), 7.

3.4 Ukraine: the limbo state

In the initial years of independence, Ukrainian extraction and expenditure policies were entirely disorganized. From 1992 to 1994, deficits were large. The share of the state expenditures rose by almost 15 per cent, from 45 in 1992 to 59.7 per cent in 1994.[33] The major cause was that previous expenditure levels were preserved, while official GDP was falling rapidly (see table 1).

The degree of disorganization becomes even clearer when we look deeper: budgets were often adopted several months late, and envisaged unattainable revenue levels and moderate deficits which were much exceeded during budget execution. The budget deficits were monetized which produced huge inflation. At the same time, capacity to extract from the official economy was preserved. However, a share of the dramatic fall in official GDP is attributable to the loss of control (either to own or to tax) of the state over parts of the economy, and the dramatic growth of a shadow economy.[34]

Table 1

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
GDP (1989=100)	79.3	68.0	52.5	46.1	41.5	40.2	39.4	39.3	41.6
revenues in % of official GDP	32.8	40.0	49.1	40.1	38.6	42.4	39.8	37.0	40.4
expenditure in % of official GDP	45.0	46.5	59.7	48.0	43.2	49.6	41.9	38.4	39.1
budget deficit in % of official GDP	12.2	6.5	10.5	7.9	4.6	7.1	2.1	1.4	-1.3
inflation (CPI, annual average)	1485.8	4734.9	891.2	376.7	80.2	15.9	10.6	22.7	28.2

sources: UNECE, *Economic Survey of Europe*, No. 1, 2001, tables B.1 (GDP), B.8 (inflation); UEPLAC, *Ukrainian Economic Trends*, Quarterly Issue, March 2001 (revenues, expenditure, and deficit), tables 6.1-6.3.

We can trace these phenomena to their institutional underpinnings. First of all, Ukraine was undergoing major macro-economic shocks in tandem with major institutional shocks (both primarily caused by the break-up of the USSR) and resulting institutional weakness. Secondly, two problematic trends marked institution-building during the early independence

[33] In real terms, expenditures remained stable in 1992 and 1993, but fell sharply in 1994; however, GDP was shrinking rapidly at the same time.

[34] Estimates about when and by how much the shadow economy grew vary considerably. According to estimates given by Schneider and Enste, Ukraine had a shadow economy of around 16 per cent of official GDP in 1990, of between 28 and 38 per cent of GDP on average from 1990 to 1993, and of between 47 and 54 per cent of GDP on average in 1994/95. Friedrich Schneider and Dominik Enste, *Shadow Economies Around the World: Sizes, Causes, and Consequences*, Working Paper of the IMF Fiscal Affairs Department, January 2000, table 3.

period: instability and elite struggles over institutional models on the one hand, and continuity of old elites and thus old ideas as well as lower level institutions on the other. As Nunberg and others have pointed out, the institutional situation of post-communist states was marked by a void at the centre after the break-down of party structures.[35] In post-Soviet states, this void a the centre was of course even larger than in Poland or Hungary. In Ukraine, a prolonged struggle emerged over how to fill this void. There was no agreement on whether the basic blue-print should be a presidential or a parliamentary system – which delayed the constitutional process until 1996. Struggles at the top layer lead to contestation of institution-building at lower levels, thus spreading instability. At the same time, old institutional models were the most readily available focal points. Thus, many parts of the institutional structure were left unchanged. This continuity was further reinforced by the fact that no decisive change of elites had been brought about through elections – since reform forces commanded at most a third of the vote.

'Cognitive' continuity preserved by old elites also brought some initial advantages: In Ukraine, free market ideology remained far less influential than it was initially in Russia. As a consequence, official privatisation was much slower in Ukraine – a feature which allowed the preservation of some traditional extractive capacity which was lost in the larger neighbour.

From the mid-1990s onwards, the picture changes: Expenditures were pushed down, and deficits were reduced to around 5 per cent (see table 1). However, the story behind these figures is rather complex. While in the first period inflation had imposed an extra 'tax' on all those holding monetary assets, during the latter period the state stopped paying. Not only were social spending and economic subsidies reduced dramatically; the state also stopped paying wages and pensions, and accumulated arrears on goods and services delivered.

Institutionally, the state began to coagulate in 1996 with the adoption of a constitution and the introduction of a permanent currency. However, the constitutional structure reflected unresolved conflicts and thus has been widely criticised as unworkable;[36] while attempts to change the constitution continued. During this period, tax pressures became increasingly unequal: tax pressures on small but legally operating enterprises apparently mounted, while well connected enterprises and individuals enjoyed official tax privileges or could semi-officially avoid taxation. The situation worsened in 1998/1999 when tax arrears spiralled after the Russian crisis.

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[35] See fn. 31.

[36] See Paul D'Anieri, „The Impact of Domestic Divisions on Ukrainian Foreign Policy: Ukraine as a ‚Weak State' in: T. Kuzio et al. (eds.) State and Institution Building in Ukraine, Basingstoke and London: xx, 1999, 92-98.

In most recent years, recognition of the ruinous effects of instable, unequal extraction on the economy has grown. However, due to the fragmented political system, fundamental reform of the formal tax structure failed. Some institutional improvements – such as the establishment of a treasury system or enhancing the fiscal analytical capacities of parliament – were achieved due to demands of and support by foreign donors. Internal reforms more directly touching upon established interests – such as improving the payments discipline in the energy sector – remained hotly contested. Institutional learning, i.e. adjustment to the new economic environment, has also brought some improvements. Budget planning has become more regularized.[37] Still, special privileges and corruption continue to undermine the state.[38] A lack of regime consolidation on the one hand, and of accountability structures on the other appear to be the most important causes. As a consequence, public trust in elites and state institution is extremely low – worsening the prospects of overcoming the 'negative equilibrium'.

3.5. The comparative view: post-Soviet fiscal developments

All post-Soviet states experienced fiscal difficulties – problems with extraction, with financial control, with regularizing budgeting can be found anywhere in the region. The common past has produced common problems with transition. However, how, how well, and how fast these problems have been overcome differs widely.

Firstly, we can observe that the level of development appears to matter. General government revenues in the Caucasus and Central Asian region have been lower than those in the Western/Slavic and Baltic countries by more than 10 per cent since 1993.[39] In terms of expenditure averages, however, the difference was initially much smaller. During Soviet times, the state had a similar size throughout the USSR maintained by inter-republican transfers. With the break-up of the Soviet Union this system dissolved; leaving most Central Asian and Caucasus states with huge revenue/expenditure mismatches. Such huge size mismatches are very likely to have repercussions also for the strength of the state (see section 2).[40] In Belarus, Russia, Moldova, and Ukraine the state was likewise reduced; but not as sharply. State reduction as well as imbalances were smallest in the Baltic states.[41]

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[37] This has also been eased since the economy started to grow in 2000 after a decade of massive decline.

[38] In 2000, Ukraine was ranked 87th (out of 90) country on the Corruption Perceptions Index by Transparency International. See www.transparency.org.

[39] Compare also the findings in UNECE, Economic Survey of Europe, 2000, 61-62.

[40] Based on the 'first-cut' comparative data presented here, we cannot make judgements about the quality of governance.

[41] The data presented here is expressed in % of GDP; in absolute terms there were sharp falls of revenues and expenditures across the region.

Table 2

	General Gov. Revenue in % of GDP			General Gov. Exp. In % of GDP			Deficit in % of GDP		
	1993	1996	1999	1993	1996	1999	1993	1996	1999
Armenia	28,9	17,7	22,4	82,9	26,2	28,3	-54	-8,5	-5,9
Azerbaijan	40,5	17,6	19,5	55,9	20,3	24,9	-15,4	-2,7	-5,4
Georgia	3,4	9,4	15,6	35,9	14,1	22,3	-32,5	-4,7	-6,7
Kazakhstan	21,1	13,2	19,1	25,2	18,6	24,4	-4,1	-5,4	-5,3
Kyrgyzstan	24,7	15,9	24,4	39,0	32,7	36,8	-14,3	-16,8	-12,4
Tajikistan	27,1	12,1	13,1	54,2	19,0	16,3	-27,1	-6,9	-3,2
Turkmenistan	22,6	16,9	20,5	19,4	16,3	19,6	3,2	0,6	0,9
Uzbekistan	36	34,3	32,1	na	41,6	34,0	n.a.	-7,3	-1,9
average C/CA	*25,5*	*17,1*	*20,8*	*44,6*	*23,6*	*25,8*	*-20,6*	*-6,5*	*-5*
Belarus	54,3	40,9	42,3	57,8	42,7	47,9	-3,5	-1,8	-5,6
Moldova	22,8	32,1	25,4	28,0	36,3	28,6	-5,2	-4,2	-3,2
Russian Federation	35,5	31	34,1	43,6	41,9	36,0	-8,1	-10,9	-1,9
Ukraine	42,8	36,7	34,7	54,4	42,8	37,1	-11,6	-6,1	-2,4
ave. Western/Slavic	*38,9*	*35,2*	*34,1*	*45,7*	*40,9*	*37,4*	*-7,1*	*-5,8*	*-3,3*
Estonia	38,5	39	36,9	40,5	40,7	41,6	-2	-1,7	-4,7
Latvia	36,4	36,6	42,6	na	39,2	46,8	n.a.	-2,6	-4,2
Lithuania	30,2	29,6	31,9	35,4	34,2	40,6	-5,2	-4,6	-8,7
ave. Baltic	*35*	*35,1*	*37,1*	*38,0*	*38,0*	*43,0*	*-3,6*	*-3*	*-5,9*

source: EBRD *Transition Report* (2000); revenue and deficit figures for Ukraine differ from those provided by UEPLAC (table 1).

Secondly, basic institutional choices have differed markedly across countries. Belarus, and to a lesser degree Uzbekistan and Turkmenistan have opted for the preservation of old institutional structures where possible and have filled the central void with authoritarian political structures. Low levels of privatisation and continued state control over financial flows have helped to preserve the traditional system of extraction. Belarus has one of the highest levels of extraction of all post-Soviet countries, while Uzbekistan has the highest level in the Caucasus/Central Asian region.[42]

The Baltic countries have by far had the fastest and most successful reform trajectories, including reform of public finances: deficits were moderate even in the early 1990s, extractive capacity has been preserved (with some problems), and financial control is advancing. There were several advantages: firstly, agreement on the governmental model was achieved fast. Focal points from the pre-Soviet past were available and played a positive role in institution-building. Thus, for example, the Lithuanian Audit Chamber traces its origins to 1919 (rather than 1992). While degrees of elite change differed across the three small states, ex-communist and anti-communist elites in all three countries adopted market reform and EU integration as central policy goals. Certain bad practices, such as non-cash tax payments were discussed but never officially introduced.[43]

In the second reform phase, from the mid-1990s onwards, EU integration has become increasingly relevant for institutional reforms. Massive carrots (EU pre-accession subsidies) have been promised on the condition of establishing thorough financial control and fighting corruption. Large-scale technical assistance has further aided this process. No other post-Soviet countries have enjoyed similar incentives for reform.

At the other extreme lies Georgia. Budget revenues fell to below 5 per cent of GDP in 1993; by 1998 they had been raised to above 10 per cent. Civil war and the inability to establish coherent governance undermined the state's ability to extract. As for other post-Soviet countries at the lower end of development, particularly strong patronage networks are sometimes assumed to be an even stronger informal constraint on revenue collection than in more developed post-Soviet countries.[44]

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[42] Turkmenistan does not quite fit this pattern – so far I have not looked at this case enough in order to be able to place it properly.

[43] Interview with Dzintra Sakevičienė, Deputy Director of the Fiscal Policy Department, Ministry of Finance of Lithuania, Vilnius, July 31, 2001.

[44] Jorge Martinez-Vazquez, Jorge and Robert M. McNab, *The Tax Reform Experiment in Transitional Countries*. Draft, Andrew Young School of Policy Studies, Georgia State University, 2000.

Russia is – somewhat similar to Ukraine – an intermediary case. There are serious problems with revenue collection and financial control, while by international standards extraction is not unusually low. Some collection problems are worse than in Ukraine due to greater decentralization and faster privatisation. Furthermore, Russia is the post-Soviet country with the highest military expenditures. Similar to Ukraine, tax reform was debated but long delayed; while formal and informal tax privileges proliferated. The financial crisis of 1998 brought the mismatch between revenue collection and expenditure demands – and the consequences of large deficits – into sharp focus. However, since then, and helped by economic recovery after devaluation, revenue collection has improved. In contrast to Ukraine, a consolidation of power has taken place in recent years after Vladimir Putin became president. Consolidation was accompanied by increased public trust in the centre of power.[45] This has allowed to push through a major formal reform: the tax code which was adopted in two stages between 1999 and 2000. Preliminary observation suggests that formal reform has indeed triggered de facto improvement.

4. Conclusion

4.1 Placing Ukraine

By intra-regional comparison, Ukraine occupies an upper middle position: Revenues are at the higher end, while by 1999 the deficit was at the lower end of the post-Soviet average. This corresponds to Ukraine's position as one of the more developed post-Soviet republics. However, as our theoretical discussion reminds us, the size of the state is not equivalent to its strength. Based on the revenue and deficit figures provided in table 2, we may for example suppose that the Turkmen state which has run a surplus for most years of independence is more autonomous from various group demands than the Ukrainian state. Overall, the comparative perspective indicates that Ukraine is far from being the worst performing post-Soviet state; while at the same time our case knowledge reminds us that relatively high revenue collection has come at a high cost due to the distorted tax system.

4.2 The puzzle of post-Soviet divergence

Some post-Soviet divergence in the development and performance of fiscal systems appears attributable to the level of development – which has become more apparent after the

[45] Richard Rose, Neil Munro, and Stephen White, *How strong is Vladimir Putin's Support?* Glasgow: University of Strathclyde, 2000. Jakob Fruchtmann, *Stil oder Inhalt*? manuscript, University of Bremen, Forschungsstelle Osteuropa, 2000.

redistribution provided within the USSR broke down.[46] Another share of divergence, however, appears to be attributable to choices of change. While formal institutional choices (and their timing) appear to matter, very different choices can lead to superficially similar outcomes. Thus, both Estonia where wholesale reform was chosen, and Belarus, where least change was pursued, have maintained rather strong revenue collection capacities and control over expenditure and deficits.

Regime coherence or consolidation appears as an important pre-condition for formal institutional reforms, as the fate of a comprehensive tax code in Russia versus Ukraine shows.

For the post-Soviet decade, divergence has been the most remarkable feature. However, as the figures for 1999 indicate, some intra-regional re-convergence may emerge. The majority of post-Soviet states today has significantly lower revenues than those of other post-communist sub-regions (CEE, SEE). Intra-regional copying of formal institutions, and in particular copying from Russia has taken place; currently, future convergence depends on whether other countries follow the lines of Russia's tax reform. However, any future post-Soviet convergence exempts the Baltic states: Their fiscal systems – from revenue types to financial control – and indeed their overall state-building efforts are shaped by EU accession.

[46] There is no space here to discuss further economic specificities such as the relative importance of resource extraction.