

# The Ukrainian Week

International edition

#7 (101) July 2016

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and their chances in elections

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from 1991 till today

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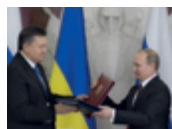
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## The Ukrainian Week

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ТИЖДЕНЬ









## BRIEFING

# Liberal Parties: Multiplication by division

Bohdan Butkevych

**W**ithin days of each other, people whom everyone had expected to see in the good ship *Mikheil Saakashvili* announced the launch of two new liberal parties. On June 28, Saakashvili's associate David Sakvarelidze finally officially announced that he was beginning to form a party. Then, on July 9, Mustafa Nayem, Serhiy Leshchenko and Co. held an official convention for their revived party, based on the Democratic Alliance.

PHOTO: UNIAN



Despite declarations on both sides that these two entities will be on friendly terms, it is obvious that, in fact, things will be the exact opposite. Even the virtually simultaneous start testifies to their rivalry and desire to stake out a place as the pioneer among the “alternatives.” The fact that these two teams will be pounding the same electoral turf, which almost 100% the same as their Facebook followers, suggests a pessimistic outlook.

Here is the sad reality: Ukrainians, as usual, but especially in the progressive democratic camp, don’t know how to get along. And so they end up time and again losing to the more consolidated anti-Ukrainian or simply pro-government forces.

Without being a total skeptic, the synchronized start of two parties that are so similar in rhetoric and personalities, as well as in their theoretical voter bases, can only cause alarm. Of course, we can make use of slogans like “More parties that are nice and varied” or “The more of us, the less of them,” but when it comes right down to it, Ukrainians now have the launch, not of one long-anticipated progressive civic party that was supposed to unite around itself a broad circle of those who want change and have pro-European attitudes, but two. And any ritualistic laments from both sides about the fact that they will not fight between themselves seem quite silly.



**ANY LAMENTS FROM BOTH SIDES ABOUT THE FACT THAT THEY WILL NOT FIGHT BETWEEN THEMSELVES SEEM QUITE SILLY. POLITICS IS, AFTER ALL, A BATTLEGROUND, ALWAYS AMONG ALL, AND EVERYWHERE**

Politics is, after all, a battleground, always among all, and everywhere. All the more so, that neither team bothered to explain why they decided to go their separate ways since, theoretically, they had no disagreements. Just a few months ago, all the members of these two teams were hugging each other at a series of anti-corruption forums organized by Saakashvili.

So here we stumble on the eternal problem of Ukrainian politicians: an inability to unite and suppress their personal ambitions. All this time, the press and pundits have tirelessly been smacking their lips over squabbles within the hypothetical Saakashvili team over who would lead—Mikho himself, MPs Leshchenko and Nayem, DemAlliance leader Vasyl Hatsko, Viktor Chumak, and others. Rumor has it that they all wanted to be the face of the new project. Meanwhile, not one step has been taken towards party-building even as time keeps moving on, along with voter confidence.

Getting away from hypotheses, the realistic electoral cap that a united liberal-democratic party might hope to gain, based on opinion polls, is around 10%... ideally. And that’s only if such a party avoids raising such controversial flags like

gay rights, legalizing recreational drugs, guns, and so on. For political party that wants to call itself liberal, this is not entirely correct. But ok, let’s toss doctrinaire positions aside and stick to numbers.

It turns out that these 10% have just been split in two, and even the personal ratings of Saakashvili, which have fallen in recent months from a high of 20% to 5-7%, will not help his party. In short, even if there were just one party, the most that it could hope to bring to the Verkhovna Rada would be around 20 deputies. With this force split in two from the very start, both parties are already wavering on the hairpin threshold of 4%.

Some might say, that’s stupid, because Saakashvili himself has more than 850,000 followers in Facebook, and that was more than enough for Batkivshchyna to make it into the Rada during the last election. Meanwhile, Leshchenko and Nayem have something over 200,000 followers between the two of them, and their readership is no less than what the ex-President of Georgia can claim. And that’s without even taking any people away from other parties. Moreover, Vitaliy Kasko and Chumak are popular in social networks, and equally popular among hipsters is the former Deputy Minister of Economic Trade and Development and one of the authors of the revolutionary electronic state procurement system ProZorro, Maksym Nefyodov. In short, there’s plenty of social capital there.

Still, there is practical reality to consider: people in Facebook get to their polling stations less often than grannies paid off through the kinds of “electoral pyramid schemes” that were once thought up by Chernovetskiy and continue to be successfully exploited by those who want to stay in power—especially in the regions and the backwoods. And less than the witnesses of the Tymoshenko or Liashko sects. The main point is that nobody has ever said that all those who follow someone are prepared to vote for the people they simply read in social networks.

The biggest question will be that neither team has real party organizers who are not concerned with getting themselves on television but with real, grassroots party-building among an electorate that is poor, apathetic and spoiled by constant vote-buying over the last 20 years. It’s not an easy task. Dreaming about your popularity and star quality isn’t going to work here. Sweat equity will—something that all the members of both teams will have serious problems with.

And that’s without even touching on the eternal issue of financing. Rumors persist that both Saakashvili and Leshchenko are being funded by oligarch Kostiantyn Hryhoryshyn (aka Konstantin Grigorishin). A serious competition between the two projects could end up burying all the participants of these liberal start-ups.

In short, it looks like the one and only chance these freshly baked liberals have to succeed is by uniting into a single entity. Otherwise, their rivalry will simply lead to the premature death of an idea whose time has really come. ■



# Brewing and ripening

Roman Malko and Bohdan Butkevych

*The Ukrainian Week* looks at the new parties looking to emerge in the country

**A**lthough it's unlikely that a snap election will be called in the Verkhovna Rada this year, politicians of all stripes are busy preparing for them—and not just within existing parties, which have been rapidly losing voter confidence over the last two years. Quite a few activists from both extremes of the political spectrum are busy promoting new political projects that are supposed to replace the ones that are in decline and give their founders a much-desired seat in the legislature.

## SAAKASHVILI STRIKES

Let's start with the most highly-anticipated political force, the party of former Georgian president and Governor of Odesa Oblast, Mikheil Saakashvili, which was supposed to bring together all the major movers and shakers of civil society. But since the winter, when Saakashvili did a multi-city tour with his Anti-Corruption Forums, plenty of water has flown without noticeable results. The courtship is over without having turned into a real political movement. »

PHOTO: UKRAINIAN PHOTO



**Political mobilisation.** Many new parties place their bets on ATO veterans



Back then Saakashvili managed to gather all the party activists who are euro-optimists, such as MPs Mustafa Nayem, Serhiy Leshchenko, Svitlana Zalishechuk, Yehor Frisov, and Viktor Chumak, anti-corruption activist Vitaliy Shabunin, ex-PGO staffer Vitaliy Kasko, DemAlliance leader Vasyl Hatsko, and other individuals whom journalists were confidently adding to the ranks of the ex-Georgian president's party not long ago. Yet this did not lead to a building of one party. Most of the abovementioned people have decided not to wait for "Mikho" to get moving and instead to build their own political careers elsewhere. One example is Firsov, an ex-Poroshenko Bloc MP from Donetsk Oblast, who is running as an independent in Riding #206 in Chernihiv. Others are announcing their own parties.

## IN THE LAST WHILE, SAKASHVILI SEEMS TO HAVE FINALLY COME TO LIFE. THE SEARCH IS ON FOR POLITICAL STRATEGISTS WHO CAN COME UP WITH A SUITABLE PLAN AND SET UP THE PARTY ORGANIZATION

In the last while, Saakashvili seems to have finally come to life. Not long ago, a huge office was leased for this party in the center of Kyiv on chichi Muzeynyi Provulok, and among possible sponsors, the name of Russian billionaire Konstantin Grigorishin<sup>1</sup> keeps coming up. The search is on for political strategists who can come up with a suitable plan and set up the party organization. Rumors have it that Saakashvili has already agreed to cooperate with Pavlo Riabikin, who was previously a functionary in Vitaliy Klitschko's UDAR, and a few other UDAR members who found themselves out-of-place when their party merged with the Poroshenko Bloc. The first party convention is supposed to take place quite soon.

### AZOV'S TIME HAS COME

On to the right-wing sector. Until recently, the name Azov was associated exclusively with the voluntary battalion and the war. One of the most successful volunteer battalions, it has been credited with participation in the liberation of Mariupol and Shyrokyne. It is also known for being Ukraine's most disciplined and well-trained army divisions.

Not long ago, Azov has begun to be spoken of in a political context as well. Its noticeable pyrotechnical campaign in Kyiv against elections in Donbas left no doubt that Azov's people have serious ambitions to get into high-level politics. This was confirmed by its leader, Andriy Biletskiy, who immediately also announced that the similarly-named regiment in the National Guard of Ukraine had no relationship to politics and that all political actions were to be associated exclusively with the Azov Civil Corps as an independent entity. So, Biletskiy's own political ambitions are also serious, especially when Interior Minister Arsen Avakov's patronage of Azov is taken into account.

Azov does not shrink from direct action, which has enabled it to win the hearts of those looking for quick and simple solutions. It rejects any association with oligarchs out of hand, to avoid been seen as a pet project of those in power or of even Avakov. How serious Azov's chances will be as a party is hard to say so far.

### THE UKRAINIAN MEJLIS

Vilni Liudy, or Free People, is another highly anticipated new political platform. Its initiator is Andriy Levus, MP with Arseniy Yatseniuk's Popular Front and an active member of Maidan's Self-Defense, as well as his team. The project is being seriously looked at by Popular Front as an alternate vehicle if PF bottoms out in the ratings. So far, this group has not directly announced that it is establishing a party, although its membership already includes quite a few seated deputies from different levels of government and government officials. Given its aims and the scale of activities that have been launched, the transformation of Free People into a party will probably happen very shortly.

This group made itself known even before the Euromaidan Revolution, when the network's activists launched the Euro Offensive campaign with the aim of defending Ukraine's Eurointegration aspirations. Afterwards came the EuroMaidan, during which three Samooborona (Self-Defense) companies were formed—the 14<sup>th</sup>, 15<sup>th</sup> and 35<sup>th</sup>. After the Euromaidan ended, it was time to work actively against separatist declarations in Kharkiv, Zaporizhzhia, Dnipro, Odesa and the Donbas. Hundreds of members of FP also joined the volunteer battalions at the front, while in the rear guard, an eponymous volunteer network was rolled out to supply them.

Free People's social base is activists from patriotic and nationalist organizations. There is no single leader among the FP. Instead, it is run by a group of coordinators that they jokingly refer to among themselves as the "mejlis," after the Crimean Tatar governing council, which establishes the main areas of action, and plans and carries out projects. At this point, the network's activists are focused on fighting Russia's business in Ukraine, punishing representatives of the previous criminal regime, and de-occupying the country. They are also working to counter Viktor Medvedchuk's separatist projects.

So far, FP members categorically refuse to discuss an independent political project, but the first steps towards forming a party have already been taken: a National Action Committee has been formed, along with a coordination center that includes, in addition to Free People, representatives of Dmytro Yarosh's movement Diya (Action), the Officers' Union of Ukraine, and parliamentary group called Nastup (The Offensive), and a large number of well-known community and political activists. The next step, according to the initiators of this project, will be to set up a national civil and political movement. Judging by FP's current pace of development, this is most likely to happen closer to the fall.

<sup>1</sup> Born in Zaporizhzhia, Grigorishin (Kostiantyn Hryhorishyn in Ukrainian) is a Russian citizen and has extensive interests in the power industry. See issue #6 (100) of June 2016 for more information on Grigorishin's assets in Ukraine



## A NEW RIGHT SECTOR OFFSPRING

The civil and political movement Diya, meaning the Statehood Initiative of Dmytro Yarosh (ex-leader of the Right Sector – Ed.), has announced that it will hold its first congress in the fall in Kyiv. Diya began to emerge immediately after a split in yet another patriotic political force that was born during the EuroMaidan and had seemed powerful until recently, Praviy Sektor. For the moment, it's hard to know, other than from the information of its organizers, what kind of entity this will eventually be.

Yarosh has stated that Diya's goal is to bring together all the forces for statehood in order to defend Ukraine's independence and embody the ideals of the Maidan.

"We want to bring together all those people who have not been engaged in politics so far and who are patriots but not necessarily nationalists, as was the case with Praviy Sektor," says Yarosh.

Yarosh also does not rule out forming a party based on this unified movement, which will resemble nothing so much as "Narodnyi Rukh prior to Ukraine's independence and bring together people from absolutely different political and ideological convictions," without regard to language, faith and so on. Diya considers itself a center-right organization and is actively recruiting people who have gone through the war. From the very start, it had a portion of former PS members, representing a number of military units, who are fighting on the front under the label "Ukrainian Volunteer Army," and their medical arm, "Hospitaliers."

It's too early to say much about the prospects for Yarosh's Statehood Initiative in the political arena. At least the first congress needs to take place when it should become clear who the top players in Diya are. Still, it's already clear that this movement is only likely to be successful if it can come to agreement with other patriotic organizations and to draw them into its circle, and to offer voters the kind of agenda that those who are tired of the war and feeling hopeless about their government will be unable to refuse.

## THE LEFT FLANK

The left is also coming to life in Ukrainian politics after two years of deep crisis, due both to the loss of traditional funding from the Party of the Regions and the Kremlin, and to its ideological impasse. The absolute majority of leftist movements and parties had openly supported Russia's aggressions, placing themselves outside the laws of justice and morality. The majority of active leftists have been working hand-in-glove with the militants and fled long ago, either to the territories occupied by the Russian Federation or to Russia itself.

A recent issue of *The Ukrainian Week* wrote about the process of setting up a new, consolidated leftist political force based in part on Oleksandr Moroz's Socialist Party. The new entity, formed in 2015, is called "Socialists," whose leader is a one-time foreign minister under Azarov and loyal Yanukovich man, Leonid Kozhara (see **The new left front and Sabotage in the name of "peace"** at [ukrainianweek.com](http://ukrainianweek.com)) Funded by the Yanukovich "Family," Kozhara has been touring the country in an effort to get all leftist and anti-Ukrainian organizations

to consolidate into a single entity. According to *The Ukrainian Week's* sources, his Kremlin handler, Vladislav Surkov, has decided once again to bet on leftist parties whose work will be to promote the idea of a ceasefire, fighting the oligarchs, and social justice, while actually working in Moscow's interests. And of course Kozhara, with the support of a network of suitable organizations, is expected to be one of the leaders of this party.

Kozhara's main rival right now is a former "political prisoner of the Yanukovich regime," Vasyl Volga, who is just as eager to stake out the vacant post of leader of the left for himself with his Union of Leftist Forces. Rumor has it that his Moscow handlers are individuals opposed to Surkov in the forces: Putin's Chief-of-Staff Viacheslav Volodin, Sergei Ivanov and others. The Kremlin powers-that-be are counting on the image of a "victim of the former regime" to help Volga persuade anti-Ukrainian voters by presenting himself as an alternative to both the "nazis" in power and the evil oligarchs.

Another rival not prepared to let Kozhara simply walk in is former Communist Party leader Petro Symonenko, whom the Poroshenko Administration has so far been unable to charge with stirring up the war in eastern Ukraine. His new project, called the Left Movement cannot be removed from the balance because he still has considerable political and media resources at his disposal, including the Gamma TV channel, the Holos site, and considerable cash left from the halcyon days, when the CPU was completely supported by Party of the Regions.

**KREMLIN HANDLERS DECIDED ONCE AGAIN TO BET ON LEFTIST PARTIES WHOSE WORK WILL BE TO PROMOTE THE IDEA OF A CEASEFIRE, FIGHTING THE OLIGARCHS, AND SOCIAL JUSTICE, WHILE ACTUALLY WORKING IN MOSCOW'S INTERESTS**

The final political project that also falls into the nominally left flank is the "Successful Country" project. Its leader and main source of funding is none other than Oleksandr Klymenko, who headed the Ministry of Revenues and Taxes, "Ministry of Death" in popular slang, during Yanukovich's time and is a member of the Family. For more than six months now, generously paid news and videos have been appearing in the media with the latest announcements by this corrupt official along the lines of "Everything's OK" or information about the latest convention of his supposed party. He clearly has a dream to return to politics in Ukraine, hence the serious money being put into his project. The main intellectual and media center serving Successful Country is the Vesti holding, which also belongs to Klymenko. Some say that his entire platform and operations plan is being put together by staff at the notorious freebie paper of the same name.

And so, the political garden is full of new sprouts, some of which are quite poisonous, but not very developed yet and just waiting for the signal that a new election season is about to start. The question now is, when this season will be announced. ■

# Putin on the squeeze: The Yanukovych debt

Vitaliy Melnychuk and Lyubomyr Shavalyuk

The anatomy of Yanukovych's "loan" from Putin. Should Ukraine repay it?

**B**reaking up the European Union, playing like equals with the US, and destroying Ukraine as a sovereign state—these are the prime geopolitical objectives of the Kremlin that Putin's Russia is spending enormous resources on. And not just on acquiring modern weaponry, maintaining an army that is 800,000 strong, waging a massive information war, annexing Crimea and occupying Ukrainian soil in Donbas. The other major expenditure in the Kremlin budget is for "friends of Putin," for bribes and pay-offs that Moscow figures will bring it geopolitical and strategic dividends. Ukraine is no exception there.

## THE KREMLIN'S FINANCIAL DEALS

Russia has been giving illegal financial support to extreme right and left parties in Europe in order to get them to set in motion the process of breaking up the European Union. It keeps the two pseudo republics in occupied Donbas, DNR and LNR, afloat and finances its fifth column in Ukraine to destabilize the situation and help anti-Ukrainian forces get to power. It was caught bribing top officials in FIFA in order to be given the World Cup championship games. Russia both legally and illegally buys off high-profile politicians and community activists in other countries in order to have leverage over both domestic and foreign policy there.

Not long ago, the US announced the start of a massive investigation into the Kremlin's financing of parties and politicians outside of Russia, which the Congress delegated to the CIA, according to an article in *The Telegraph*. The leading position in this investigation could well involve financial and political deals that the Kremlin cut in Ukraine, one of which is the subject of this article.

## YANUKOVYCH'S DEBT

At the end of November 2013, Russian President Vladimir Putin and Ukraine's Viktor Yanukovych cut a deal where Russia would lend Ukraine US \$15 billion at 5% pa. The way the deal was set up, Yanukovych was to order the Azarov Government to agree to issue external government bonds worth US \$15bn and place them on the Irish exchange in Dublin in several tranches. That is when the term "Ukrainian Eurobonds" first was used, meaning that Ukrainian government bonds were placed and sold on one of the European stock exchanges and were denominated in dollars, euros or another foreign currency.

Russia, in return, promised to completely buy up the Ukrainian Eurobonds on the Irish exchange, tranche by tranche.

On Dec. 24, 2013, Ukraine's Eurobonds—or, more accurately the "Yanukovych-Azarov bonds" were placed on the Irish stock exchange and immediately purchased by the Russian side. The very next day, the first tranche of US \$3bn was placed on the account of the State Treasury of Ukraine. Insofar as Yanukovych left Kyiv on February 20 and shortly made his way to Russia, that tranche was the first and last.

Ordinary Ukrainians call this US \$3bn loan "Yanukovych's debt." In essence, that's what it is, but formally and legally, the money was received by the government of Ukraine and its ultimate beneficiary was supposedly the state budget, completely controlled by Yanukovych's ally, Mykola Azarov, his son Oleksandr Yanukovych, the then-Governor of the National Bank of Ukraine Serhiy Arbuzov, Yuriy Kolobov, Oleksandr Klymenko and a number of others, all of whom belonged to the "Family."

This means that the debt officially has to be repaid by the Hroysman Government today, out of the public purse, meaning out of the pockets of Ukrainian taxpayers. Whether it's the right thing for Ukraine's Government to do, to return this money from public funds to Putin, who is waging war against Ukraine, moreover money that was borrowed for Yanukovych's private interests, a man whom the people pushed off his throne and chased off to Russia? There are a number of nuances.

## PUTIN INSISTED ON THE LOAN

Our administrative audit and analysis shows that Russia gave Yanukovych this loan against all economic logic, common sense and a sober evaluation of the situation. The impression is that Putin for some reason really wanted to give this money to Yanukovych, based on a number of facts:

**First.** Russia had no spare cash at the time and its economic situation was not especially positive. Moreover, the budget year was just ending and there were severe limits on granting foreign credits that had already been reached.

The necessary funds were "found" in the Russian Federation's sovereign National Welfare Fund (FNB), which accumulates surplus petrodollars that were earned when oil prices were high to cover pensions for Russian citizens. Then, with the go-ahead "from the highest level," the funds for the future loan to Yanukovych were reserved in the FNB and the first





**A trap.** The lose-lose deal

PHOTO: UKRAINIAN PHOTO

trance of US \$3bn was “invested” in “Ukrainian Eurobonds.”

**Second.** According to Russian law at the time, the Fund was allowed to invest abroad only in government bonds with the highest rating, AAA, which meant only 14 countries at the time, including the US, Germany and the UK. Ukraine, meanwhile, was five positions down at B- in investment ratings. And in order to give this deal the veneer of legitimacy, the Russian Government effectively superseded the law and, in the best traditions of hand-managed governments, approved a special resolution on Dec. 23, 2013, one day before the Ukrainian emission was scheduled, that allowed itself to invest in the bonds of countries that were considered risky “based on individual Government resolutions.” Immediately after this, a second resolution was issued that allowed the RF to invest in those same “Ukrainian Eurobonds.”

**Third.** From the start, the Yanukovich loan had absolutely no investment appeal. From the outside, it looked like a waste of Russians’ money that had been accumulated for their pensions. At 5, the interest rate on the loan was not market-based, given that Ukraine was paying 8-10% on global financial markets for credit at that time.

**Fourth.** In 2013, Ukraine’s economy was stagnating and slowly slipping into recession. The current account deficit at the end of the year was US \$16.5bn. The NBU’s gold and currency reserves had shrunk by US \$7.1bn, not including, of course the money that came in as Yanukovich’s loan, and these holes needed to be patched.

All other factors being equal, the US \$15bn that Ukraine was supposed to pay off within two years after receiving the first tranche would have simply been buried in the sand to support “stability” under Yanukovich. As it turned out, the money was spent much sooner than that: we now know that in 2014 global prices for raw materials began to fall sharply and that, after Ukraine received the US \$3bn, the financial markets where the Yanukovich regime had been drawing liquidity over 2011-2013 closed their doors on Ukraine completely.

In short, the Yanukovich regime could not have repaid that loan.

## ULTERIOR MOTIVES

Why, then, given all these facts, would the pragmatic and extremely cool-headed Putin—as authoritative experts assess him and have so far proved to be quite right—offer a reduced, non-market and economically and investment-wise foolish “credit” to Ukraine’s president? It would seem that the Russian president knew perfectly well that Viktor Yanukovich would never return the money—and he was not even counting on that: he was betting on something much more valuable than US \$15bn of pension money that belonged to Russians.

What exactly might this something have been?

**First.** On November 27, 2013, two days after meeting with Putin in Sochi, Yanukovich refused to sign the Association Agreement with the EU at the Eastern Partnership Summit in Vilnius. Clearly, this refusal was one of the conditions for getting the loan from Russia. The first tranche of US \$3bn was nothing more than Putin’s little “gift” for turning down Euro-integration and crushing the Euromaidan (which had begun on November 21 after then-Premier Azarov announced suspension of preparation for the signing of the Association Agreement with the EU). In short, a bribe, as President Poroshenko has referred to it.

If Ukraine’s rejection of Eurointegration had not been on the agenda in this one-on-one meeting between Putin and Yanukovich, there would have been no purpose for Yanukovich to fly to Sochi for urgently organized negotiations over “strategic cooperation” a day before the Vilnius Summit. Official meetings at that level are normally organized months in advance and never take place the way this one did.

**Second.** There is little doubt about the second geopolitical condition for the provision of this credit. As of January 1, 2014, Ukraine was committed to joining the Customs Union and the Eurasian Economic Community (EAEC), a pseudo-economic international organization with little economic purpose—certainly for Ukraine—, but one that gave Russia considerable political and strategic leverage over the members.

This condition was evident in the hyperactivity of the Kremlin’s lackeys in 2013, such as Putin’s personal assistant Glaziev, and their counterparts in Ukraine. One of their tasks was preparing the falsified “academic” calculations that supposedly provided concrete numbers and illustrated the scale of the advantages for Ukraine that membership in the EAEC would bring and the losses that its economy would suffer from Eurointegration.

**Third.** Experts confirm that one of the other conditions was handing over companies in Ukraine’s military-industrial complex (MIC) to Russia and effective full-scale integration. Confirmation of this came in an urgent visit by the Russian Deputy Premier in charge of the RF MIC during that time to Dnipro, Zaporizhzhia and Kharkiv. Sevodnia, a Ukrainian paper, reported on Dec. 3, 2013:

“Today, the Russian Federation’s Deputy Premier Dmitri Rogozin arrived for a working visit in Dnipropetrovsk. He visited enterprises in the missile and space sector: the Pivdenniy Construction Bureau and Pivdenmash, the machine-building plant. ‘We are prepared to go as far as you are prepared to go,’ said Rogozin.”

»

Building the Kerch bridge, which is now on hold for lack of funding, was one of the points in the agreement, indicating that the active integrate Crimea into the Russian Federation was on the cards.

**Fourth.** At the end of February 2014, the Yanukovich regime was supposed to receive a second tranche of US \$2bn from Russia. The prospectus for the issue of “Ukrainian Eurobonds” had already even appeared at the Irish stock exchange, waiting for their buyer. As events turned out, Russia never bought these bonds from the Government of Ukraine.

What went wrong? Plenty. Yanukovich’s ignominious zigzag from Kyiv to Kharkiv, then to Crimea and finally to Rostov-on-Don meant that all the secret deals between him and Putin with their ulterior motives lost meaning—and so the need for a “sweetener” for carrying them out disappeared as well. Had this debt been a genuinely financial one, nothing should have stood in the way of delivering the second and further tranches of the loan.

### “TOSS THE SUCKERS”

But Putin would not have been Putin if he had not clearly planned out how he intended to toss the “khakhol suckers,” including in his understanding both “president” Yanukovich and Ukraine. He was confident of returning the principle with considerable interest, and Ukraine thrown in to the bargain—as events have shown.

**First.** The “loan agreement” included Russia’s unique right to present the bonds for redemption should Ukraine’s public debt rise above 60% of nominal GDP. This would have made the holders of Yanukovich’s debt preferential among all other holders of Ukrainian Eurobonds and all of the country’s other creditors. Given that Ukraine’s total external debt guaranteed by the state at the end of 2014 was US \$70bn, that made Russia, which held only 4.3% of Ukraine’s debt, more influential than those creditors who held the remaining 95.7%.

This placed an instrument that afforded enormous financial pressure in Putin’s hands and an effective noose around Yanukovich’s neck. Facing international isolation after rejecting the Association Agreement and a coward by nature, he would simply have betrayed Ukraine’s interests, one by one.

**Second.** One of the conditions of the “loan” was that Ukraine would not issue creditor counterclaims as a way of refusing to service the debt. In other words, if Russia had owed Ukraine anything, the Ukrainian Government would nevertheless have to pay interest and cover the principle of this “loan.” This is very similar to the situation now, where Ukraine is refusing to pay Yanukovich’s debt, arguing that the Kremlin illegally annexed Crimea and expropriated many Ukrainian assets. Russia claims that, according to the agreement, Ukraine has no right to do this.

And so, was Russia was already preparing to annex Crimea and anticipated the consequences by including the necessary conditions in the prospectus for the Eurobond issues? And so the very handy Yanukovich really did hand everything over to Putin.

**Third.** By its nature, the “loan” was an inter-state loan, but in its form was strictly commercial be-

cause it involved Eurobonds that were listed on the Irish stock exchange and could have been bought by anyone, whether an individual or a corporation. The fact that the RF Fund bought these “Ukrainian Eurobonds” that returned only 5% per annum, with dividends paid out twice a year, it could have sold them on to anyone, both in Russia and beyond it. That is, the Yanukovich debt is not inter-state. It’s the debt of Ukraine specifically, even though held by a state entity in Russia.

**Fourth.** Another aspect of this “loan” was provisions that allowed its status to be abused by playing both sides against the middle. International financial experts say that Russia refused to restructure this



**IT WOULD SEEM THAT THE RUSSIAN PRESIDENT KNEW PERFECTLY WELL THAT YANUKOVYCH WOULD NEVER RETURN THE MONEY — AND HE WAS NOT EVEN COUNTING ON THAT: HE WAS BETTING ON SOMETHING MUCH MORE VALUABLE THAN US \$15BN OF PENSION MONEY THAT BELONGED TO RUSSIANS**

debt through the Paris Club, which handles issues with inter-state debts, arguing that the “loan” was private. At the same time, Moscow refused to restructure Ukraine’s external state debt held by private creditors, arguing that it was an official, therefore inter-state “loan.”

### “SEE YOU IN COURT”

Russia has filed suit against Ukraine in a London court to recover the Yanukovich debt. The case is currently being considered.

Why did Russia not exercise its right to call in the US \$3bn debt after Ukraine’s public debt passed 60% of GDP? The answer is very obvious: Firstly, with the changed circumstances, it would not have received what it had planned on from the very start, that is, the fulfillment of the hidden provisions of the agreement and the acquisition of parts of Ukraine in one form or another. Secondly, at that point negotiations over restructuring had already begun with private creditors, so Russia would not have been able to arrange an artificial storm on the Ukrainian Eurobond market. Moreover, no matter what anyone says, but the financial, organizational and verbal support of the West would have been enough to localize any such storm.

Given that Ukraine enjoyed the support of the EU and US, Russia was unable to make use of the Yanukovich debt as a lever to pressure Ukraine and gain dividends, so it went for principles instead, treating Ukraine as a sucker who’s not going to make you lose, no matter what. Moscow still expects to get back its US \$3bn in full and so it’s gone to court to do so.

### SUCKER’S DEFENSE OR SUCKER PUNCH?

Ukraine’s arguments for not honoring Russia’s “loan” are based on four key points:

**First,** the “loan” agreement was illegal because it did not come within the caps established by the Law on the State Budget. That 2013 Budget Law was only amended by the Azarov Government after the money



had arrived from Russia, not prior to the agreement, as the Russians had done. The ceiling increase was backdated specially to match the amount coming in from Russia. This haste suggests that there were secret conditions for the issuing of this “loan” to Yanukovich.

**Second**, the Yanukovich regime, however odious it may have been, was operating under duress from repeated threats on the part of Russia and its lackeys, and trade restrictions that Russia tended to institute from time to time starting in 2012.

**Third**, there were secret, covert provisions that were not written into any of the agreements, as we discussed above, as well as a commitment to pay off debts to Gazprom. Possibly Ukraine’s lawyers will be able to expand the list and evidence of such hidden conditions prior to the case being heard in court.

**Fourth**, the annexation of Crimea and Russia’s expropriation of considerable Ukrainian assets, both state-owned and private, are self-evident. These actions by the Russian Federation not only resulted in enormous material losses for Ukraine and forced the country to increase spending to defend itself at a time when the destruction in Donbas and the annexation of a chunk of territory have resulted in a significant loss of revenues.

Premier Groisman has singled out this particular line of defense. According to Bloomberg, international lawyers say that this is the most persuasive angle. There’s no question that this approach to the defense is seen as promising by the Ukrainian side as well.

### ODIOUS DEBT: ILLEGAL AND UNENFORCEABLE

International law has a concept called “odious debt” that refers to national debt incurred by a regime for purposes that did not serve the best interests of the nation but was used for personal enrichment or to finance personal interests. And when such a regime is overthrown, the new government can abandon old obligations, which are considered the debts of that regime.

There’s no doubt that the Yanukovich debt qualifies as an odious one, because this money bought the rejection of Eurointegration and the acceptance of the Eurasian Economic Community against the will of the Ukrainian people. Furthermore, the Yanukovich regime was kleptocratic and criminal to the core. For them, the difference between the EU and the EAEC was not substantive or civilizational as many Ukrainians consider it. It was simply a matter that whoever was prepared to pay more, that’s with whom they would play ball. What’s more, at least half of the amount coming in was earmarked for the pockets of the Family and people connected to it. According to *The Ukrainian Week’s* sources, audits of state procurements during the Yanukovich Administration have shown that up to 50% of the amounts allocated from the state budget, especially for Euro 2012, went to companies owned or controlled by the Family.

In short, they traded Ukraine’s prospects like whitebait at the Odesa market. By 2013, this approach had taken on especially vivid forms. In mid-year, the regime had organized a huge investment conference involving business representatives from over 80

countries at which, like boxers in a ring, supporters of integration with the EU and EAEC were sicced on each other, raising the bets in the fight for Ukraine.

Not long ago, the black books of the Party of the Regions were published, testifying to the scale of personal enrichment of the Yanukovich regime, which far outstripped the first tranche of the Russian “loan.” If US \$2bn was handed out as bribes and every amount backed in this book by authentic signatures of specific individuals, then at least as much again remained in the hands of those in power, who were none too generous and never ever forgot about their cut.

And so it was that the US \$3bn donated by Putin passed through a state budget completely controlled by the Yanukovich clique and at least half of it was “detached” for the benefit of the Family. This was a kind of personal bribe that Yanukovich took for himself and shared with his henchmen (and henchwomen) as payment for services rendered to Putin.

### A RIGGED REGIME, AFTER ALL

The other aspect that is being raised more and more often, not only by civil society but also by some politicians, is the legitimacy of the Yanukovich regime. It is now apparent that Yanukovich came to power illegally and exercised his powers of government through intimidation, stupefaction, persecution, bribery, and threats to accomplish everything it wanted, from selling a plot of land to the right person to changing the Constitution. Evidence is also mounting that the presidential election of 2010 was rigged, just like the second round of the 2004 election, which led to the first Maidan.

Ukrainians can only hope that, sooner or later, the lion’s share of crimes of this regime will be brought to light and lead to court sentences and the incarceration of those who are guilty. If we think in terms of odious debt, then it’s possible to conclude that all of the debt incurred by Ukraine during the Yanukovich years qualifies as odious. The net growth of state debt and debt guaranteed by the state grew from February 2010 to February 2014, the period Yanukovich was in power, was US \$30.5 bn. Most of this has nothing to do with Russia at all. It all went into the pockets of Ukrainian kleptocrats running entirely democratic and market institutions.

If Ukraine can prove the scale of theft of the Yanukovich regime over the four years it was in power to be on a similar scale as this figure—and it’s not at all unrealistic—then it can easily defend its right not to pay off any debts or to demand that all credits, not just those from Russia, but also market lenders, be restructured on far better terms. After all, they knew with whom they were dealing and they anyway kept giving Yanukovich money.

For Ukraine to successfully apply the concept of “odious debt” in court, it will have to have impeccable legal representation to prepare and execute this assignment. Ideally, Ukraine’s judiciary should show up in court in London with hundreds of volumes of cases describing the corruption of various members of the Yanukovich regime, complete with consolidated figures reflecting their theft, and a long list of those serving time. Prominent among them should be the case of the Yanukovich debt. ■

# Constitutional confrontation

Oleksandr Kramar

Many of the problems connected to Ukraine's Basic Law are the result of trying to rebuild it on the foundations of a soviet constitutional heritage that does not reflect current realities

**T**he current version of the Constitution of Ukraine resembles a house of cards that, at any moment, will collapse from the slightest puff of air coming from those who are prepared to demonstrate the necessary political will. Ukraine's Basic Law is not the outcome of a social contract or of a nationwide consensus, but simply of a series of forced compromises among political actors jockeying for power. Today, this tug-o-war is currently at a fever pitch.

## A STICKY POST-SOVIET MESS

Setting aside the “managing and directing” role of the Communist Party, which was dropped even before Ukraine became independent, the Ukrainian SSR was nevertheless a soviet republic. Art. 2 of its last Constitution, approved in 1978, clearly stated “the people exercise government of the state through Councils of National Deputies... All other government bodies are subordinate and accountable to Councils of National Deputies.” At the pinnacle of this system was the Verkhovna Rada.

The new model of government in Ukraine after seceding the USSR was built upon the parliamentary model the country had inherited, while taking into account a new institution, the presidency. Its emergence in 1991 led to a slew of unsystematic corrections and additions to the 1978 Ukrainian SSR Constitution, which continued to be in force in 1995 and 1996. Altogether, 18 amendments were made after Ukraine became independent, and the original fairly streamlined model, where the Verkhovna Rada stood above all other government agencies, including the “highest body,” the Cabinet, started falling apart.

Amendments that came with the institution of the presidency declared this individual the “Head of State and of the Executive Branch,” “responsible for bringing the Constitution and Laws of Ukraine to life through the system of state executive bodies.” The president effectively was the end point for the entire executive branch and mediated its interactions with the legislature: “manages and directs the executive activities of the Cabinet of Ministers; “heads the system of central executive bodies (CEBs), and provides for their interaction with the Verkhovna Rada;” “presents the draft state budget and the report on its fulfillment to the Verkhovna Rada for review;” “nominates candidates for the posts in his remit, that is, the Ministers of Foreign Affairs, Defense, Finance, Justice, and Internal Affairs, and the chairs of State Border Security Committee and the

State Customs Committee to the Verkhovna Rada approval; dismisses these individuals from their posts;” “establishes, reorganizes and dismisses ministries, agencies and other state executive bodies; appoints and dismisses the directors of these agencies; revokes legal acts of the Cabinet of Ministers, ministries and other central executive bodies.”

On the other hand, the Government, even though it is subordinate to the president, remains “accountable and responsible before the Verkhovna Rada,” which had the right to express non-confidence in the premier, individual ministers or the Cabinet as a whole, which could result in their dismissal.

## PEOPLE POWER OR POWER TO THE PRESIDENT?

As it soon became apparent, by leaning on the legislature, premiers like Leonid Kuchma in 1992-1993 could challenge the authority of the president in the executive branch of government and attempt to confront that individual.

Moreover, the question of subordination in the executive at the local level, which was dependent on local, county and oblast councils, remained unclear. A systemic conflict among different branches of government led to a political and constitutional crisis and, in the end, to early elections to the Verkhovna Rada and the presidency in mid 1994. Nevertheless, this did not resolve the problem of the tug-o-war over influence, and by May-June 1995, these two government institutions once again were on the verge of open war.

On May 18, 1995, the majority in the Verkhovna Rada adopted a bill “On state government and local government in Ukraine,” but was unable to get the necessary two-thirds vote to make the necessary amendments to the Constitution as well. On May 31, 1995, President Kuchma issued a decree to survey public opinion over trust in the president and the Verkhovna Rada but the Rada vetoed this act. The only solution to the loggerheads was a temporary compromise, known as the Constitutional Agreement between the Verkhovna Rada and the President, signed on June 8, 1995. Consisting of 61 articles, it was, in effect, a replacement for the country's Basic Law in terms of the separation of powers.

The preamble to this pseudo-constitution was illustrative as it emphasized the equality of the two sides, which “received their powers directly from the people” and “on the basis of good will, mutual concessions and compromise were able to agree on the following: “...the Verkhovna Rada is the sole





lawmaking organ in Ukraine...the President is the Head of State and head of the executive branch of government of Ukraine... The two sides are aware that failure to uphold the provisions of this Contract will result in chaos in society, the collapse of the economy, the threat of social upheaval, and could jeopardize the very existence of a sovereign, democratic Ukraine.”

This excerpt is important as it illustrates what motivated Ukraine’s lawmakers to come up with a new Constitution given how imbalanced the existing one was. It wasn’t about drafting a document from scratch to provide an ideal model of government for the country, but only about compromising between two parties that were at war over governing powers and were trying to prevent it from spilling over into a real domestic war. In that situation, the position of the Head of State was clearly stronger than a poorly-structured legislature that had been elected after several tries using the FPTP system and whose members were effectively carved up. Thanks to this, the president gained the upper hand.

Art. 19 of the constitutional agreement established that, as head of the executive branch, the president exercised its powers “through the Government/Cabinet of Ministers led by him and the system of central and local state executive bodies.” Although only individuals elected to chair their respective councils were to be appointed heads of local state administrations (MDAs), the president was granted the right to dismiss them from both posts for not carrying out his orders. In short, the formal conditions did not eliminate the real dependence of all MDA heads on the Head of State.

At this point, the president could effectively run the country independently of the Verkhovna Rada, while the legislature could barely pass a bill without his approval. For instance, Art. 25 of the Constitutional Agreement provided that “The president issues decrees on economic reforms that are not regulated by existing legislation.” What’s more, if the Rada tried to “regulate” similar issues against

the will of the Head of State, he could simply issue a veto, at which point 300 lawmakers needed to agree to overcome the veto. The Rada also had the right to veto presidential decrees, but only if they were actually unconstitutional and prior to the issuing of a ruling on them by the Constitutional Court.

### THE POST-INDEPENDENCE CONSTITUTION: A LOPSIDED COMPROMISE

The Ukrainian Constitution that was passed on June 28, 1996, was based largely on the balance of power between the president and the legislature established in this agreement. Moreover, its passage was also done under pressure from the president, who maintained the initiative. In order to stop the games in the Rada with inserting thousands of corrections intended to weaken the power of the president in the draft Basic Law that had passed first reading, on June 26, Kuchma issued a decree stating that there would be a national referendum to adopt the new Constitution on September 25. Facing such a threat, the deputies spent 24 uninterrupted hours working up the final version of the Constitution on June 27-28 and finally passed it—after which the presidential decree was withdrawn.

Formally, the new Constitution no longer referred to the president as the head of the executive branch, but his status was essentially preserved, while control over local government bodies became more clearly articulated. The Verkhovna Rada also lost its power of veto over presidential decrees, which now became binding on all branches of the executive, including MDAs or local administrations, while the Head of State hung onto the power to veto bills passed in the Verkhovna Rada. As before, overturning a presidential veto required a “constitutional” majority of two thirds of the seats in the Rada, or 300 votes.

“The highest body in the executive branch” became the Cabinet of Ministers, but it was still responsible before the president, who had the power to appoint and dismiss its members, including the premier, as the Head of State. And, of course, the president could still cancel an acts issued by the Cabinet, while the Cabinet, among its activities, not only had the Constitution to honor but was obligated to carry out all acts of the president and all legislation, which could only come into effect with the imprimatur—of that same president. The president also maintained the right to establish or reorganize ministries and other CEBs.

Art. 118 of the new Constitution clearly stated that executive functions at the oblast and county level was handled by local state administrations (MDAs), whose heads were appointed and dismissed by the president at the recommendation of that same Cabinet of Ministers that was subordinate to the president, and were accountable before them. Their relationship to former local councils, whose chairs they had to be in the past, was now limited to being accountable “in those areas of competence relegated to them by the relevant county or oblast councils.”

Thus, the 1996 Constitution in its original edition established an idiosyncratic duality of power in the country. On one hand, the entire executive

branch could function basically completely autonomously from the situation in the legislature—under the direction of the president, the Cabinet, and the local MDAs. On the other, fundamental decisions such as the Law on the State Budget, which were regulated exclusively by laws according to the Constitution, the appointments of the premier, prosecutor general and a slew of other heads of CEBs were supposed to be approved by the Verkhovna Rada.

Dominated by leftist populists until 2000, the Verkhovna Rada and the executive branch headed by the president could effectively live in parallel universes under the 1996 Constitution for quite some time. The Rada all too often passed laws and resolutions without the say-so of the president and Government that were completely detached from any reality and did not bind anyone to anything. And the rare joint decisions were adopted on the basis of fairly complicated opportunistic compromises.

To carry out systemic transformations, the president and Government needed stable legislative support from a Rada majority that shared responsibility for the country's development with them. But no such creature was provided for in the 1996 Constitution.

After Kuchma was elected to a second term, he tried to launch a new offensive against the legislature and get a new balance of power to be considered. In January 2000, he announced a referendum to ensure him the necessary support for decisions allowing him to dismiss the VR if it fails to form an effective majority within 30 days or if it failed to pass the State Budget within 90 days. He also wanted to remove from the Constitution provisions that allowed deputies to be sued in criminal court, detained or arrested only with the approval of their colleagues in the Rada, to reduce the number of seats in the legislature from 450 to 300, and to institute a two-chambered parliament, one of which would represent regional interests across Ukraine.

### THE PRESIDENT VS THE RADA

Still, the president's offensive against the Verkhovna Rada, which based itself on the 2000 constitutional referendum, was choked off by a conflict within the center-right majority and ended up in its collapse and the dismissal of the Yushchenko Government in early 2001. The struggle over who would take over after Kuchma in anticipation of the 2004 election began in earnest. Ukraine's political elite were not prepared for a radical change in the balance of power simply because it wasn't certain whose hands it would be in next. Thus, the next set of changes to the country's Basic Law became possible only when the next threat of all-out war arose—during the Orange Revolution.

The Law amending the Constitution that was adopted on December 8, 2004 was intended to unbalance the government in order to weaken the influence of the new president. It managed to pass with 402 votes out of 450 only because of the fear that one of the candidates was prepared to take over using force. When it came into force on January 1, 2006, the altered Constitution led almost immediately to a political crisis because of a vote of non-confidence in the Government appointed by the president.

The transition to a parliamentary-presidential model took place, in which the Head of State lost some of the main leverage over the executive, which now became the domain of the Cabinet of Ministers, and influence over the formation of the Cabinet, with the exception of the ministers of defense and foreign affairs. The Cabinet was formed from a coalition of factions in the Rada and was answerable to it.

At the same time, the president continued to have powerful options for blocking any actions of the legislature and Cabinet with which he disagreed: veto power over Rada decisions if fewer than 301 deputies voted for it; the right to stop acts of the Cabinet of Ministers; and an unclear separation of powers in terms of forming and running local state administrations. Moreover, this entire arsenal was effectively used in a series of power struggles in the triangle formed by the legislature, Government and President over 2006-2009: first between Yushchenko and Yanukovich in 2006-7, and then between Yushchenko and Tymoshenko in 2008-9.

The result was that this period went down in Ukraine's history as wasted on constant tugs-o-war rather than developing the country. President Yushchenko used whatever leverage he had, forcing early elections in 2007 and attempting to do so again in the fall of 2008, rather than learning from Kuchma's tactics how to force the necessary changes to the Constitution to remove the cause of these conflicts.



### **PETRO POROSHENKO ASSURED UKRAINIANS FROM THE START OF HIS TERM THAT HE WOULD HONOR AND UPHOLD THE PARLIAMENTARY-PRESIDENTIAL MODEL AND PLANNED TO USE OTHER SOURCES OF LEVERAGE ON VARIOUS GOVERNMENT BODIES**

The Yanukovich regime came up with its own way to escape the situation in 2010 that, in his typically authoritarian approach, corrupted, co-opted and reorganized all the branches of power under himself. This included the unconstitutional formation of a majority in the Verkhovna Rada and the subsequent appointment of the Azarov Government in March, getting the Constitutional Court to declare null and void its constitutional reform of December 2004 in September 2010, using administrative leverage to force all local councils to be subordinated to the president, paying off or threatening deputies in the fall of 2010, and taking over the judiciary.

However, the result of this usurpation of power and willful use of authority by Yanukovich led to the Euromaidan Revolution and the restoration of the constitutional reforms of 2004, with the inclusion of technical changes to it in 2011 and 2013 regarding the terms of office for government agencies and local government agencies, and of the Accounting Chamber.

### **WORKING TO FIX THE SYSTEM?**

The new president, Petro Poroshenko, assured Ukrainians from the start of his term that he would honor and uphold the parliamentary-presidential



model and planned to use other sources of leverage on various government bodies (**see The Fine Art of Compromise at [ukrainianweek.com](http://ukrainianweek.com)**). The amendments to the Constitution that he has initiated do not offer the president any more powers, but strengthen the independence and effectiveness of the judiciary and local governments.

First of all, this is the Bill “Amending the Constitution of Ukraine (regarding the judiciary),” which was passed in the Rada on June 2, 2016. This law reduces the influence of the legislature and the president on the judicial system and the Higher Council of the Judiciary, which is based on the current Higher Council of Justice, and expands the Council’s powers. Other amendments to the Constitution affect the prosecutorial system, among others, removing the Verkhovna Rada’s right to vote non-confidence against the Prosecutor General.

These changes supposedly will reduce corruption and strengthen the sense of responsibility of judges for wrongdoings. However, in a system where corruption is high total and very deeply entrenched among judges, these changes actually risk turning Ukraine’s judiciary into a closed, untouchable corporation whose members are engaged in mutual hand washing, which means that they will be primarily independent from responsibility for any illegal actions. The problem is that now, to dismiss judges or take them to court for even the most obvious crimes will be impossible without the agreement of members of the judiciary corporation, who will have an absolute majority on the Higher Council of Justice.

The constitutional amendments affecting local government passed first reading in August 2015 but have become hostage to provisions demanded from outside to provide “special status” for the counties of Luhansk and Donetsk Oblasts that are currently occupied by Russia, known as ORDiLO. This has put a brake on the passing of the main body of changes, which affect the formation of self-sufficient communities and eliminate their dependence on the appointment of heads of local state administrations (MDAs) by the Cabinet on recommendation from the president, and the passing of the main authority to ensure that residents can live normally and responsibility for this on local governments.

Another lingering problem is the consolidation of administrative territorial units. Between the 1978 soviet Constitution and the current Basic law, an absurd fixation with a complete list with the exact names of all 24 oblasts. If counties are consolidated, a number of oblasts will no longer need to exist: they will end up with 3-4 counties, so maintaining a coordinating superstructure over these counties in the form of the current oblast administrations will make no sense. This means that the Constitution will have to also be amended to reduce their number, change their boundaries, and rename them in those cases where the oblast center has been renamed in order to complete the reform of the system of local government.

The opposition is critical of the new institution of prefects who will be appointed by the president and be responsible for overseeing that local government bodies adhere to current legislation, although

this does not in any way extend the powers of the president. The president currently has far more influence at the local level through MDAs than what prefects are likely to provide. In fact, dragging out local government reforms actually looks convenient for the president, politically speaking. Whereas he controls power at the central level and in some local councils, he could lose some of this power over local councils if his ratings fall and they face re-election with the conclusion of local government reform.

## THE CONUNDRUM OF SOCIAL GUARANTEES

A more serious problem are the provisions regarding free healthcare and free education at state institutions that Ukraine inherited from the soviet Constitution, Arts. 49 and 53, and the guarantee that all pensioners will receive a benefit that is no less than the subsistence minimum, Art. 46. These provisions are no longer appropriate to market realities but according to Art. 173 of the current Constitution, they cannot be changed. The only way to resolve this problem is to approve a new Constitution or a political, legal decision to change this article—which could then be challenged in the Constitutional Court of Ukraine at any time.

Meanwhile, the nominally “guaranteed” free healthcare and education—this from K-11 through tec-voc school and university—at public institutions will lead to their further steep decline through progressive underfunding in Ukrainian realm. A similar situation arises with Art. 46, which provides for “pensions and other social benefits and assistance that are the main source of living for the individual to be no less than the subsistence minimum established by law.” The consequences of maintaining this norm are only two possible ones and they are identically destructive for the social security system. The first is progressive social injustice when the level of state assistance to those who never contributed is hardly different from the benefits provided to those who conscientiously contributed over decades, which is a disincentive to contribute to such social funds. The second is progressive but arbitrary reduction in the subsistence minimum by the government until it ceases to serve its intended function as a social standard. ■



# Chaos and the law

Interviewed by Anna Korbut

Who is changing the Constitution of Ukraine today and how? How are these innovations linked to reforms in the country? *The Ukrainian Week* speaks to constitutional and administrative law expert Ihor Koliushko, chairman of the Center of Policy and Legal Reform



PHOTO: UKRAINIAN PHOTO

**M**anipulation of the Constitution. Most of the Ukrainian political scene started to talk about the need for changes to the country's Basic Law in 2007. Previously, the document was amended in 2004 to make provisions for switching to a premier-presidential form of government and limiting the powers of the president. In fact, this was nothing more than speculation to seize an appropriate moment. At that time, one side needed to change the law on presidential elections and the other one wanted to deprive the future leader of sweeping powers, because they were going to lose the next poll. Therefore, changes were made to the Constitution quickly and shoddily, in terms of both content and procedure.

In 2010, the Constitutional Court declared the 2004 version unconstitutional, so the Basic Law was changed according to its decision. This was done contrary to the Constitution, although the judges hedged their bets: the verdict was formulated in such a way to not mention a return to the 1996 Constitution. Instead, there was a phrase saying that the 2004 changes were unconstitutional, therefore all state authorities should take appropriate steps to bring acts of legislation into conformity with the 2010 decision. The then Minister of Justice Oleksandr Lavrynovych and everyone else who was responsible for the legal sphere immediately took the opportunity to change the Basic Law. Since procedures were violated during this process, it gave grounds to declare the decision unconstitutional in the future. It allowed to potentially return to the 2004 version: there was a lot wrong with it, but one good thing too – the president does not have the right to single-handedly dismiss the prime minister.

**The history of amendments.** During Yanukovich's presidency, the Constitutional Assembly (CA) was responsible for preparing amendments to the Basic Law. It formulated concepts on a number of issues: different working groups worked on decentralisation and reform of the public prosecutor and legal system, as well as streamlining the highest bodies of state power. Politicians showed almost no interest in these new developments: MPs did not attend meetings of either the assembly or its working groups. These groups managed to reflect virtually all of the above reforms in a concept for constitutional amendments, with the exception of the public prosecutor: neither the removal of the section of the Basic Law regarding this authority, nor radical changes to it were supported in the end. However,

this concept was never approved. It was completed in November 2013, and the CA was supposed to meet on December 6. On December 2, some of the experts, including myself, left the Assembly in protest against the assault of students on the Maidan. In the end, the meeting was cancelled altogether.

During the Euromaidan, everyone was aware that the Constitution then in force was a tool for Yanukovich to usurp power. That is why he changed it in such an unnatural way – through the Constitutional Court decision and its further interpretation by the justice minister and other officials, effectively without consulting parliament. For that reason, a lot of people were saying that one of the goals of the revolution should be to change the Basic Law.

During the Maidan, two approaches to this matter formed: one advocated writing a new draft law on the amendments and submitting it to parliament according to procedure. By the way, at that time there was a broad consensus on this among experts (academics and politicians). Others, above all certain public figures, wanted to solve another problem: the revolution would have to end somehow with a compromise. With the change of government as one of its components. The 1996 Constitution made it impossible to reach such a deal with Yanukovich: it gave him the authority to dissolve the government and remove the prime minister at any time. Therefore, the simplest possible solution was proposed: deem that the court exceeded its authority in making the 2010 decision. This option was adopted as part of the agreement brokered by international representatives and signed on February 20, 2014 between the authorities and Maidan protesters, represented by their political leaders. And then it was implemented, despite the fact that Yanukovich fled.

Nevertheless, everyone – both politicians and the public – called for a draft law on amending the Constitution to be prepared immediately. The changes were to concern the decentralisation of power, reform of the judiciary and public prosecutor, and the improvement of power distribution between the president, parliament and government within a mixed premier-presidential republic. The aim of the latter point is not so much to restrict the powers of the president in some way, as to clearly define them in the Basic Law, in order to avoid the ambiguities that were manipulated during the 2008-2009 conflict between Yushchenko and Tymoshenko.

**Work on the Constitution after the Maidan.** A public working group was immediately established by the people who worked most actively in the Constitutional Assembly, and propositions on a potential draft law were agreed upon. Experts talked about three themes. Firstly, for constitutional reform to be successful, it must be offered to the public when a window of opportunity opens and be acted on very quickly. Secondly, the bill of amendments should be drawn up professionally from a legal point of view with the assistance of experts. Thirdly, the changes should be presented as a concession to the public from the authorities, rather than the initiative of, say, the president. Meanwhile, parliament created its working group headed by

[Poroshenko Bloc MP] Ruslan Kniazevych. It did not try to engage society.

President Poroshenko wasted almost a year before he created the Constitutional Commission in April 2015. It was very large, but did not include any of the people who had fought for decentralisation in previous years, for example. The commission had the task of preparing three draft laws: on decentralisation, judicial reform and the improvement of human rights. The reform of the highest bodies of state power was no longer mentioned. Consequently, three working groups were set up at the Constitutional Commission too. The one that was responsible for decentralisation, for instance, took the previous experience of experts on this matter into account, elaborated it and submitted a more or less concrete bill to Petro Poroshenko. The one on the judiciary had meetings in the Presidential Administration and discussions dragged on for a long time – there was a lot of talk, but few results, because judges dominated the process and everything was moderated by a representative of Poroshenko.

**Decentralisation.** In April 2014, the Cabinet approved the principles of decentralisation reform – the Concept of Local Authority Reform and the Territorial Organisation of Government.

**FOR CONSTITUTIONAL REFORM TO BE SUCCESSFUL, IT MUST BE OFFERED TO THE PUBLIC WHEN A WINDOW OF OPPORTUNITY OPENS AND BE ACTED ON VERY QUICKLY**

Its first stage was to conduct an administrative and territorial reform of communities. This was supposed to lead to the emergence of competent communities that could take over responsibility for all the necessary powers and finances. Without constitutional changes, it would only be possible to implement this reform based on the Law on the Voluntary Association of Communities. On the one hand, this would provide a certain transition period to ensure that citizens get involved in the process. And over the past year and a half there really have been some extremely positive transformations: people have seen real money in their village council bank accounts, plus a new road or school in the area and realised that all this is realistic. Today, the newly established communities are still learning, sometimes from their mistakes, and showing others how to follow this path. Legislation on associations and local autonomy is being improved in parallel. However, there is no country in the world where all communities have united voluntarily. So the government should give citizens a few years to bring their own initiatives to life and then complete the administrative and territorial structural reform by a corresponding law. But this is all impossible without changes to the Constitution.

Secondly, the Basic Law documents the existence and powers of local state administrations. So we cannot reform them at the moment. Con- »



sequently, decentralisation is only occurring at the lowest level. The District State Administrations that remain will preclude the development of rural councils by not really allowing them to be independent. So, in general, it is impossible to carry out this reform in full without changing the Constitution.

In addition, during the preparation of the draft law on decentralisation, experts and the Constitutional Commission wanted to avoid any ambiguity and debate. However, some unclear features emerged in it after the president submitted it to parliament. For example, some points were added about the prefects: they ensure the implementation of government programs and exercise other powers as stipulated by law. And this is not the only example.

**Elections in the occupied Donbas.** The most important change is the one that the president added to Item 18 of the Transitional Provisions: the specifics of local government in certain districts of Donetsk and Luhansk Oblasts are defined by a separate law. This phrase coincides with the name of the law "On the special procedure for local government in certain districts of Donetsk and Luhansk Oblasts", dated September 16, 2014, so many politicians immediately suspected an attempt to legalise this particular document through constitutional changes, even though it was unconstitutional and not in force. So the entire discussion on the decentralisation draft law was reduced to a very emotional debate on the Donbas, rather than consideration of the actual reforms. This was dishonest on both sides: those involved in the debate went completely off-topic and said whatever they wanted without reference to the content of the bill. Naturally, there were not enough votes in parliament to pass it eventually. This is still the case today. Next, instead of acting constitutionally – updating the bill and sending it to the Constitutional Court for re-consideration – MPs decided to do the exact opposite: they appealed to the Constitutional Court for an interpretation of the wording "next regular session" [from the article that describes the procedure for changing the Constitution].

Let's not forget the external dimension: none of the experts know what happened at the Minsk negotiations and what the Ukrainian party promised. The list of requirements that was published after talks in February 2015 did indeed include Item 11, which says that Ukraine should amend its Constitution. It is complemented by an annotation that discusses the exact method for this. The details repeat verbatim the law "On the special procedure for local government in certain districts of Donetsk and Luhansk Oblasts" dated September 16, 2014, which was passed at a closed session of parliament with the electronic voting screen switched off (a precedent in our history). From a legal point of view, this item is worthless: no one has the right to commit to amending the Constitution on behalf of the Ukrainian people. But then the president proposed the decentralisation bill with his own amendments and started to tell everyone that this is needed to comply with the Minsk agreements. Then came the questions from foreign officials: what is going on with that law on fulfilling the Minsk agreements? It

became necessary to explain the difference between decentralisation, those agreements and amendments to the Constitution. In the end, this all did a lot of damage. The decentralisation reform that we should have had is basically lost. Plus, we are giving in to Putin, who is waging war against our reforms and opportunities to develop and integrate into the European community. By not implementing decentralisation today in our peaceful regions (it is not possible in the Donbas), we are virtually preventing or at least hampering our development.

**Judicial reform.** The changes were coordinated and prepared over for a long time, but these were not connected with the Minsk agreement, so the bill on the changes enjoyed a slightly happier fate. Its content was quite a compromise: a lot was developed and supported by experts. Many changes truly improve the Constitution, although some aspects could have been refined even more. However, at the same time certain things appeared that were always seen as unacceptable. First of all, the monopoly of lawyers not only in criminal, but also civil and administrative proceedings. In the context of Ukraine, this creates a lot of problems: it impedes citizens' access to justice, as now a person facing trial (if they do not have legal training and cannot defend themselves) will always have to hire a lawyer. The same applies to public authorities. Instead of being represented by the in-house lawyers who are responsible for preparing the documents appealed against in court, government agencies will also have to hire attorneys and pay for their services from the state budget. Why was this done? It looks like unconcealed lobbying for lawyers' profits.



**THE CONSTITUTION SEEMS TO BE MORE OF AN AD HOC PROCESS THAN ONE WITH A STRATEGIC VISION AND CLEAR GOAL, ALTHOUGH IT IS AT LEAST TAKING PLACE**

Another shameful thing is that ratification of the Rome Statute of the International Criminal Court is not permitted for the next three years. Some people say that if Ukraine ratifies it, it would open the door to certain abuses by various parties. But we call on the ICC ourselves to investigate Russia's crimes in the Donbas. And then they ask, "So you only want us to look at their crimes?" There are no adequate explanations for this.

The bill on amendments to the Constitution regarding human rights is still being drawn up. However, it is not even visible on the horizon yet.

Everything I have said illustrates the chaotic character of current amendments to the Constitution. It seems to be more of an ad hoc process than one with a strategic vision and clear goal, although it is at least taking place. In addition, our politicians from all camps tend to try to use constitutional reform exclusively in their corporate interests. When that fails, they attempt to avert any alteration of the status quo. As they are not used to thinking about the interests of society and its citizens. ■

# The fuel of transformations

Lyubomyr Shavalyuk

## What the gas sector reform will bring

**W**ar is incredibly multi-faceted. Today we have a unique chance to observe war with all its diverse consequences. For almost all Ukrainians the war in Donbas, with its broken lives and economic toll, is evident. For many, the information war also being waged is clear. But one other effect, an underrated one, is that too much attention is being paid in Ukraine to negative developments and too little to positive changes, such as the real reforms that are now being implemented. Politicians talk mostly about the faults of their opponents, journalists report predominantly on the government's shortcomings, while citizens discuss the negative actions taken by the authorities. The goal of the information war is achieved: good news falls off the radar, even if it is related to landmark changes taking place in the country. The gas industry is a good example. The media for the most part discuss only the next increase in gas tariffs, accompanied by hysteria and populist criticism of the new government. The results of the new system of subsidies as a positive outcome of the reforms are discussed much less. Almost no one mentions that another war, a war for independence, is being waged in this industrial sector. So far it has been quite successful, and at the current pace it is bound to result in a complete victory for the Ukrainian people. In the long run, all or almost all Ukrainians will win.

### DYNAMIC EXTRACTION

In mid-spring, the First Ukrainian Gas Investment Forum took place in Kyiv, bringing together various energy professionals: from technical experts to gas company chief financial officers, investors (and potential investors), and energy sector officials. Even though the country is undergoing an economic crisis, the attendees did not express much pessimism. They talked about qualitative changes that gave them enough confidence to look ahead and make plans for the future, and pointed to the current obstacles to the implementation of these plans. In short, the forum was surprisingly constructive.

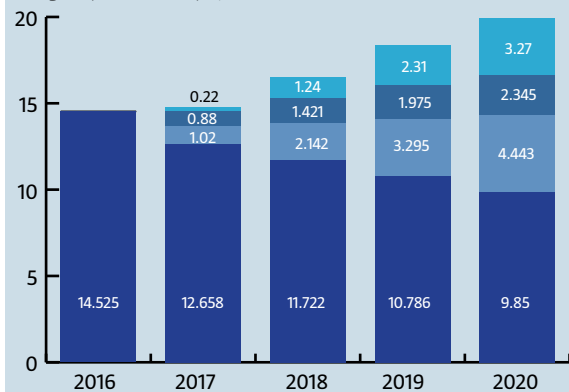
Let's begin with the plans. The main milestone for the industry is the goal of producing 27 billion cubic meters of domestic gas in 2020, including 20bn cu m to be produced by state-owned Ukgazvydobuvannya (UGV, a subsidiary of Naftogaz of Ukraine<sup>1</sup>), which currently accounts for about 80% (14.5bn cu m annually) of the domestic production and holds the lion's share of special permits for hydrocarbon extraction (see **Bright prospects**). This figure, 27bn cu m, was repeated at the forum many times. It does not mean much to those outside the industry, but it's extremely important to industry professionals for several reasons. One is that although Ukraine has a great history of gas production, and the sector once produced more than three times what it produces today, in the mid-1990s natural gas production froze near the level of 20 billion cubic meters.

<sup>1</sup> Naftogaz of Ukraine is a state-owned oil and gas exploration, extraction, and transportation operator.

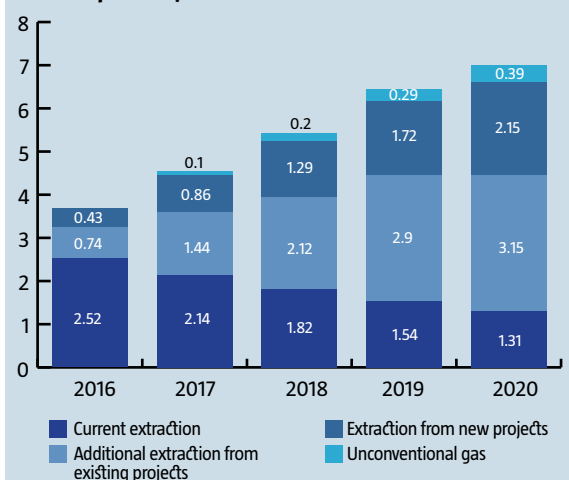
### Bright prospects

Ukraine can increase gas extraction to 27bn cu m by 2020, which would be 48% more than in 2016. However, that would require a revolution in the gas extraction industry

#### Ukgazvydobuvannya, bn cu m



#### Private operators, bn cu m



Source: Ukrainian Association of Gas Producers

Having survived 20 years of stagnation, the industry suffered the loss of much of its human and intellectual potential, falling behind in its technology, and experiencing the physical deterioration and depreciation of its assets. Under such conditions and with such a starting point, discussing production growth of almost 50% within five years may seem wildly optimistic. Not surprisingly, former Energy Minister Ivan Plachkov, who was the moderator of one of the forum's panels, repeatedly expressed his surprise at this figure and his skepticism about such plans. However, he later admitted that he also did not believe in the possibility of setting up the reverse supply of natural

gas from Europe in any significant quantities. Today, this reverse supply is a fait accompli, and Plachkov's skepticism about the prospects of increasing gas production may be unjustified just as well.

Finally, the last two years have been extremely hard for Ukrainian gas producers. The state's financial problems became a heavy burden for companies working in the sector, as the state more than doubled the royalty rate for natural gas extraction in 2013. As a result, gas producers cut investment programs and have barely survived, let alone grown. Moreover, as the direct result of the Russian aggression, Ukraine can no longer develop its Black Sea shelf, and has lost control of Chornomornaftogaz and its assets. In addition, the global players Chevron and Shell have refused to develop shale gas resources in Ukraine. After all this, it is rather hard to believe that the country would be able to get the annual production up to 27 billion cubic meters in five years.

A wise man once said that when you look to the past, you turn your back to the future, and are therefore not ready to face it. It's the same here. The worst of what the gas extraction industry must face is behind it. We need to look ahead, think in terms of growth, and remove the obstacles to it. There are three major obstacles.

## PRICE

The first one is the price of gas. The biggest potential change in the gas sector would be the transition to a single market of gas prices for all consumer categories and the establishment of a natural gas market proper. Of course, in the current economic climate, market prices for gas would be a burden on Ukrainian households, but these considerations must be removed from the equation. This problem can be solved by the system of subsidies, which, however, still needs to be refined and polished. The negative social aspect of introducing market rates for natural gas is the only strong argument actively used by the populists and lobbyists of some archaic influence groups to oppose increased gas prices.

The advantages of market prices for natural gas would be much greater for everybody. First, companies working in the sector will receive resources for intensive capital investment. In general, according to the Ukrainian Association of Gas Producers' estimates, to achieve the annual production level of 27bn cu m of natural gas by 2020, \$3 billion will need to be invested in the industry annually, while the peak level of investment, achieved in 2014, was only \$620 million. Half of the required amount could be provided by Ukrzavvydobuvannya, but only if the purchase price of gas produced by the company is allowed to rise to the market level and the royalty fee is reduced to the average fee paid by all Ukrainian producers (however, private companies seem to fear that UGV would then grow at their current rate, leaving them less room for growth). Second, the state will be able to make the royalty uniform for all producers. At worst, it will remain high, and while ensuring the budget revenues necessary to finance subsidies, it will also help avoid the distortion of market incentives that made the industry deteriorate up to the present. At best, the royalty will be adequate, and the revenues generated by the companies will be reinvested. Third, market prices for gas will eliminate the possibility of speculation by buying fuel at a low price and reselling it at a higher price. The prerequisites for the rapid growth of the numbers of oligarchs, who are still abundant in Ukrainian politics and, unfortunately,

still influence so many of the processes in the country, will be gone. The "gray" gas, amounting, according to experts, to 2–5 billion cubic meters per year, will come out of the shadows and fill in the deficits (which will have a direct positive impact on budget revenues and the energy balance of the country). Fourth, introducing market prices for natural gas is the first step to attract global investors to the domestic market, who will bring with them their technologies and capabilities. What they are interested in is a fair game over the long run. They don't want uncertainty in terms of volumes of gas retained, or taxes levied by the state depending on who is in power.

Another advantage is the progress made on the path to energy efficiency, which, however, will have a positive impact not so much on gas production, but on the economy in general. According to the World Bank, Ukraine's GDP per unit of energy use is 25–50% that of the developed countries, including Ukraine's closest western neighbors (and almost 67% of that used in Russia with its gas squandering). These figures are for 2013, when Ukraine's GDP in dollar terms was 2.5 times higher than it is today. Low gas prices make unprofitable any investment projects aimed at energy efficiency, thus slowing down their implementation. Increased gas prices will have the opposite effect, which is already noticeable: gas consumption in Ukraine decreased by 20.7% in 2015, while business activity (real GDP) dropped by 9.9%. With the restoration of global energy prices, such dynamics will be even more evident.

Populists oppose the increase of natural gas prices to market levels. They might be right in only one respect: under previous governments, most of the additional cash flow generated from higher energy prices by the state-owned companies currently producing over 80% of Ukrainian natural gas would have slipped through the cracks due to the embezzlement and corruption of their managers (it is not ruled out that considerable amounts were previously paid to these self same populists who are now so vocal, having lost their bread and butter). In this case, the increase in tariffs would become just another fleecing operation of the simple Ukrainian people by the political elite, of which there have been hundreds if not thousands since independence. However, the old practices are gone now. The new management of Ukrzavvydobuvannya, hired for astronomical sums, has already paid for itself by saving for the state (and thus for the taxpayers) about UAH 1bn in less than a year through its work on procurement, which previously often involved offshore companies as intermediaries. Naftogaz last year had an operating profit of \$4.5 bn. Mismanagement is gradually becoming a thing of the past (some steps taken by the new management point clearly to the fact that it is committed to defending national interests, both domestically and internationally). This is direct evidence that the additional cash flow earned by the companies under the current management will be put to good use, namely, invested in growth.

There is also no doubt about all the benefits for the country at large theoretically arising from adjusting natural gas prices to market levels (be it the global or at least regional markets). The process is already underway, and the obstacles are gradually disappearing.

## OTHER GROWTH PROBLEMS

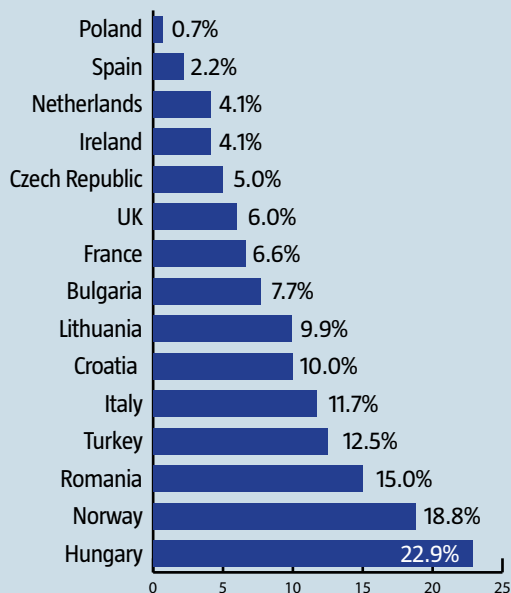
The second obstacle is a tactical rather than a strategic one. It is the high gas extraction royalty fee. This year it was already lowered compared to 2014–2015. But if we look at the average levels for different economies, there is



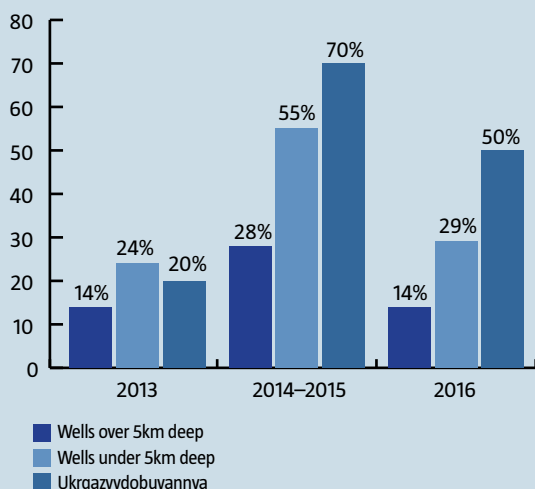
### An obstacle to development

The main obstacle to the development of gas extraction in Ukraine is the lack of qualified staff, and less so – obsolete technology. High rent is the tactical barrier

#### Effective rent and similar fees, % of revenues



#### Ukraine



Source: Ukrainian Association of Gas Producers

still room to maneuver. Industry lobbyists point out that the average royalty fee for gas extraction in Europe is 9.3% of gas companies' revenue. This rate is actually several times higher in Ukraine, and this is supposed to be the reason for its radical reduction. However, lobbyists lose sight of the fact that Ukrainian salaries are a fraction of the average salary in Europe; therefore, if the royalty is reduced to the European average, gas producers will generate proportionally higher profits. This could arguably be allowed in order to ensure the fast growth of the industry by forming a tax regime that would make the reinvestment of earnings profitable, but this would be the other extreme, which does not quite fit today's Ukraine, given the social challenges faced by the govern-

ment. Ideally, the most practical royalty fee would allow for fully funding the subsidies for housing and public services (the largest share of which, the gas and heating costs, are tied to energy prices) to the vulnerable segments of the population. Given the figures in the 2016 budget, this is exactly the level of royalty that the government has achieved. The planned revenues to the treasury from gas extraction royalties account for nearly UAH39.2 bn, while the planned subsidies amount to UAH 35bn (these subsidies may eventually increase due to the hardships imposed by the new uniform gas price of UAH 6,879 per cu m).

Besides the royalty, there is a whole range of other issues pertaining to taxation. At the forum, for example, industry experts and politicians agreed that a share of royalty revenues should be used locally to fund the development of local communities, which could benefit from the impact of local gas business on infrastructure. Another issue is what the state should do to ensure that the profits earned by gas producers stay within the sector and are used for its development, instead of being channeled offshore or invested in real estate in Miami or elsewhere. In other words, the state should talk to the industry. Given that the dialogue has already begun and the royalty has been lowered, the process is underway.

The third obstacle is the most strategic and complex one. It is about resources, mostly human capital, but that's not all. While the necessary \$3 billion of annual investment in the industry can still be found somehow (especially due to the increase in gas prices to market levels), increasing production requires a completely different pace of work in the industry. According to forum participants, while today the new wells drilled in Ukraine each year are few and far between, to achieve the goal set for 2020 the country needs to drill hundreds of wells, starting tomorrow. This requires a considerably larger numbers of engineers, the rapid and systematic allocation of land with a minimum of interference from officials and others wanting to have a lick of the spoon, large-scale regular exploration works, public and competitive allocation of special permits for hydrocarbon extraction, open access to geological information, and much more. Finally, corporate governance at Ukrgezvydobuvannya and Naftogaz need to be organized in such a way that no change of power could allow these two companies, jointly dominating the sector today and therefore bound to become its leaders in the near future, to go back to the corrupt management practices of the past. Most of these changes depend on the state, and cannot come about without its involvement. So, again we are talking about reforms, this time sectoral reforms, which until now Ukraine has implemented very slowly and selectively. Can the country make a breakthrough in this particular case? Let's wait and see.

According to the Ukrainian Association of Gas Producers, their industry accounts for about 5% of budget revenues and 7% of GDP. If gas production is increased by 50%, these figures will grow proportionally. According to the Ministry of Energy, a UAH 1bn investment in the industry results in a GDP increase of UAH 2.1bn and an increase in gas production of 1.35 bn cu m over 10 years, accompanied by improved balance of payments, increased tax revenues, new jobs, etc. All of this makes it worth implementing reforms in the sector and fighting for the increase in domestic natural gas production. Let the dogs bark, and let's hope that the caravan will move anyway. ■

# Of vouchers and men

Bogdan Butkevych, Vitaliy Melnychuk

Privatization in Ukraine after the collapse of the Soviet Union and its role in the rise of oligarchy

**W**hen the Soviet Union collapsed, about 96% of all enterprises in Ukraine were owned by the state. Not to mention flats and land – this figure was close to 100%. One of the most important questions was how to divide up everything that only yesterday belonged to "everyone" and "the people". Decisions on who should own the several dozen square meters in a Khrushchovka apartment building, where most urban Ukrainians lived, or the hectares on collective farms where they worked, were capable of disrupting society no less than issues of language, religion and nationality. The results were very varied. The concept of privatization envisioned that citizens would become the owners not only of their apartments, but also an appropriate share of the national wealth. Therefore, the so-called voucher certificate system was chosen – every person was to receive their share of the state's property and could dispose of it as they desired. The land situation was the same. However, instead of creating a nation of nearly 52 million shareholders, privatization gave birth to today's oligarchic economic and political system. And, in the grand scheme of things, has never been brought to its logical conclusion.

Indeed, the idea that laid the foundation for privatization was noble in its own way. All the citizens worked to create the national wealth, right? So everyone should have the right to an equal share in the form of property privatization certificates, housing privatization cheques and land privatization vouchers. The plan was to privatise up to 70% of the assets of state enterprises that were subject to the programme, thus creating a "powerful class of owners as a fundamental base and main subject in society, as well as a driving force behind market reforms".

However, some small reservations remained. For example, only those who lived in state-owned apartments (the vast majority) could take part in their privatization, and only those who actually worked in agriculture could take ownership of the land. Everyone without exception could privatise the assets of enterprises. Just two or three years were assigned for all this, after which all the citizens who would have already become owners could trade their shares for cash through a normal stock market. To all intents and purposes, that is what happened. Just with a huge deviation from the original plan.

The Concept of Denationalisation and Privatization of Enterprises, Land and Housing, adopted by the Verkhovna Rada of Ukraine on October 31, 1991,

formed the legal basis for so-called mass voucher privatization. These principles were finalised by the March 1992 Law on Privatization Documents. All citizens of Ukraine who lived there full-time or moved their permanent residence to Ukraine before January 1, 1992, were eligible to receive privatization documents. The National Bank of Ukraine issued the vouchers, while the State Property Fund (SPF) was supposed to work on new proposals and generally supervise the privatization process.

The National State Corporate Rights Management Agency was also created and was intended to make a register of state corporate rights, assess their value and manage state-owned shares in enterprises. On the other hand, a specific executive authority to deal with privatization was never established. The SPF inherently could not be such a body, because it was similar to an accounting department, whose competences could clearly not include operational management issues. Instead, the Fund turned into an agency that literally decided everything. This opened up huge risks for abuse, which were very soon taken full advantage of.



Interestingly, this voucher privatization was in no way a Ukrainian innovation – at that time, the Poles and Czechs already had some experience, and parallel processes were underway in Russia. To give credit to Ukrainian legislators where it is due, our vouchers, unlike the Russian "cheques", were only issued to citizens of the country on the registered basis. Moreover, in theory, and in the first two or three years of practice, their circulation was very limited. That is, they could not be sold, they were not money as such, could not be used as a means of payment or as collateral for payments and loans, and no dividends were paid on them. But very soon the situation would change: vouchers started to be traded, even after their inflationary depreciation, and the very idea behind them was ruined.

The vouchers could be exchanged at nominal value for shares of companies by their employees and on a competitive basis by others wishing to become shareholders or pass the securities on to an investment fund or trust for management. In other words, in return for a voucher a person could get shares in a company and make a profit. And, of course, they could be exchanged for housing cheques or land vouchers (which were never actually issued).

However, a crucial problem immediately arose that would later lead to the failure of the entire process – the issue of converting and valuing the vouchers. From the start, the nominal value was calculated by a purely mathematical method – the average worth of one voucher. The assets of state enterprises were measured in roubles, housing in square metres of total floor space, and land in hectares of farmland. At the same time, a law on the privatization of land was never passed, so the vouchers for this were not actually involved in exchanges. As for the others, the property cheque was given a nominal value of 30,000 roubles, the housing one – 12,000 roubles. The values were subsequently changed: 105,000 roubles and 420,000 on 1/11/1993, 50 million roubles and 20 million roubles on 1/1/1995, and 500 hryvnias and 200 hryvnias from the introduction of new Ukrainian currency in 1996 until 1999. They could be exchanged at a ratio of 1 to 2.5, i.e. 1 property certificate was equal in value to 2.5 housing cheques. Or, alternatively, 1 housing cheque for 0.4 property certificates.

However, the soaring inflation of 1992-1994, when the transitional Ukrainian currency depreciated hundreds of times over, very quickly nullified all these calculations. There was no talk of reasonably recalculating the value of vouchers. At that point they were worth \$10 on the black market, despite the fact that their value had actually been an equivalent of more than \$1,500 when issued. In parallel, the fixed assets of enterprises depreciated, but were not revalued at the same time as property certificates. So the real ability of citizens to take ownership of these shares quickly became fiction.

In addition, certificate exchange was often not allowed at privatization auctions. Therefore, many citizens simply kept hold of their vouchers, espe-

cially housing ones. Not to mention the elementary ignorance of the majority of Ukrainians, their failure to understand what they should do with these pieces of paper, where to go with them and what they are entitled to. No awareness-raising activities were conducted. As a result, at least 3 million people did not use their vouchers at all.

Later, voucher privatization became a complete sham: when Leonid Kuchma came to power, the state started to ignore the fact that vouchers were being traded, even though they were registered papers. This immediately benefited people from the criminal world, who started to buy up certificates from the gullible citizens with "black money". And they did it with the assistance of corrupt police and government officials. Now we reach the point where those who it is now customary to call oligarchs made their first huge fortunes.

**FROM THE FIRST DAYS OF PRIVATIZATION, TOP MANAGEMENT ARTIFICIALLY INHIBITED IT AT THE MOST INTERESTING ENTERPRISES AND ONLY PUT THINGS OF RELATIVELY LOW VALUE UP FOR SALE**

But the biggest problem was the reluctance of the then political elite to organise privatization honestly and under some semblance of public control. Do not forget that the same communist nomenclature remained in power in Ukraine and Leonid Kravchuk created the ideal conditions for them. Young reformers from the democratic opposition missed their chance to take matters into their own hands through ineptitude. If the alliance of old Communist regional committee heads and "red directors" of state-owned companies agreed to privatization, then only on terms that were beneficial to them. Ones that left the most profitable enterprises under their control and let the people have the dregs that would flop anyway in a market economy. From the first days of privatization, top management artificially inhibited it at the most interesting enterprises and only put things of relatively low value up for sale, sensibly waiting for a time when they could take over the more attractive companies themselves.

That moment came with the advent of Leonid Kuchma – the true creator of the current oligarch/lumpen social system. At that time, vouchers had already lost any real value and shady businessmen close to the government started to snap them up on the cheap. The management of the State Property Fund, which almost single-handedly controlled all of the assets, started to systematically give the tastiest morsels to those who agreed with senior political leadership. So ownership could be obtained through political and personal loyalty, which completely cancelled out the market aspect of mass voucher privatization. A few years later, privatization moved into the realm of cold hard cash, so the road to the "national wealth" was completely blocked to ordinary citizens. And that is the story of how we ended up with a nation of oligarchs instead of a nation of shareholders. ■



# The burden of ownership

Lyubomyr Shavalyuk

## Current state of publicly-owned assets in Ukraine and plans to privatize them

The generally accepted economic theory is that the state cannot be an effective owner. Hundreds of books on economics say the same thing. In the face of this theory, global practice shows quite a few substantial countries, such as China, Brazil and Russia in which not only does state capitalism continue to exist but has actually burgeoned in recent decades. Still, while the largest state-owned enterprises grew like weeds prior to the 2008-2009 financial crisis, since then all the dark sides of state capitalism began to show themselves. In the last two-three years, the disadvantages of state ownership have become particularly obvious. A massive money-laundering scandal in Brazil that involved state companies, Russia's use of state corporations for geopolitical purposes, and the conservation of overcapacity, inefficiency and party graft in the largest Chinese state-owned conglomerates are just a few examples that illustrate why the state cannot effectively manage assets—especially if its institutions are weak.

### A MOUNTAIN OF ASSETS

Ukraine is no exception here. Although the country set itself on track to privatize from the very beginning of independence, central executive bodies (CEBs) and local communities continue to own an amazing array of assets. In terms of weak public institutions, Ukraine is definitely in the top three in Europe, especially in terms of decline from previously-achieved levels, but the ineffectiveness of its management of these assets is also impressive by its variety. Not only is the inertness of the state striking, but also the human ingenuity and enterprise applied to making private profit off its assets.

The diversity of the assets owned by Ukraine, their origins and the history of their management are enough

to overwhelm a researcher and are most likely the deeper reason why such chaos continues to reign in this area.

The best public assets in Ukraine, its blue chip companies, are the large corporations and banks: the oil and gas giant Naftogaz, the national railway network Ukrzaliznytsia, the state savings bank Oschadny Bank, and a dozen other corporations are very high profile, constantly in the news, and very much in the public eye. According to data from the Ministry of Economic Development and Trade (MEDT), the assets of the largest 100 state-owned companies, excluding seven banks, were worth UAH 926 billion, around US \$37 billion, at the end of QIII 2015. This is almost one sixth of the assets of all Ukrainian enterprises, which was UAH 6 trillion at the beginning of the year, and about 90% of the worth of all public enterprises.

In addition to these giants, the state owns a large number of other companies, most of whose names are not familiar to ordinary Ukrainians. According to MEDT, Ukraine owns 1,829 functioning enterprises known as DPs outright and controlling stakes in another 272 that were formerly DPs but have undergone incorporation and partial privatization. If we take away the top 100, there are still around 2,000 commercial entities with a combined value of UAH 100bn or about UAH 50mn or US \$2mn per company—a very average amount, which gives a good idea of the scale of activity of these 2,000 firms.

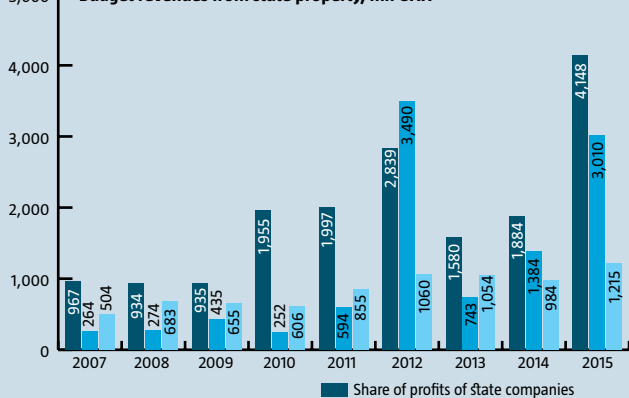
### USELESS BALLAST?

Finally, there is a much more numerous group of commercial corpses. According to MEDT data, more than 1,500 state enterprises no longer operate, being in the process of liquidation, reorganization, restructuring, or bankruptcy. Their assets are largely the remains of what were once huge manufacturing plants that have been frit-

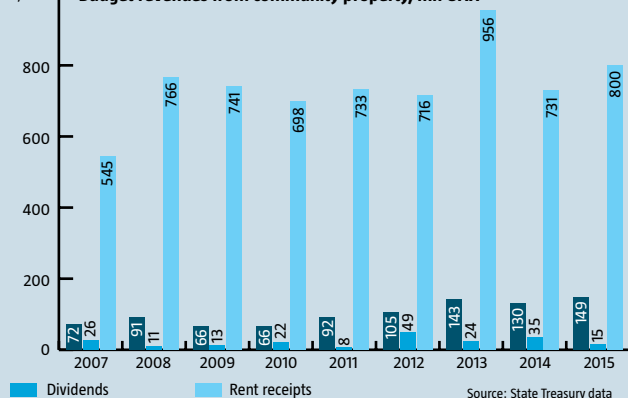
#### Could be more

State and community assets bring budgets of all levels billions of hryvnias in revenues. Given the size of the assets that are in state hands, this amount should be tens of times greater. Either most of it is landing in the pockets of thousands of bureaucrats, or else their management of state assets is so bad that it doesn't bring anything in.

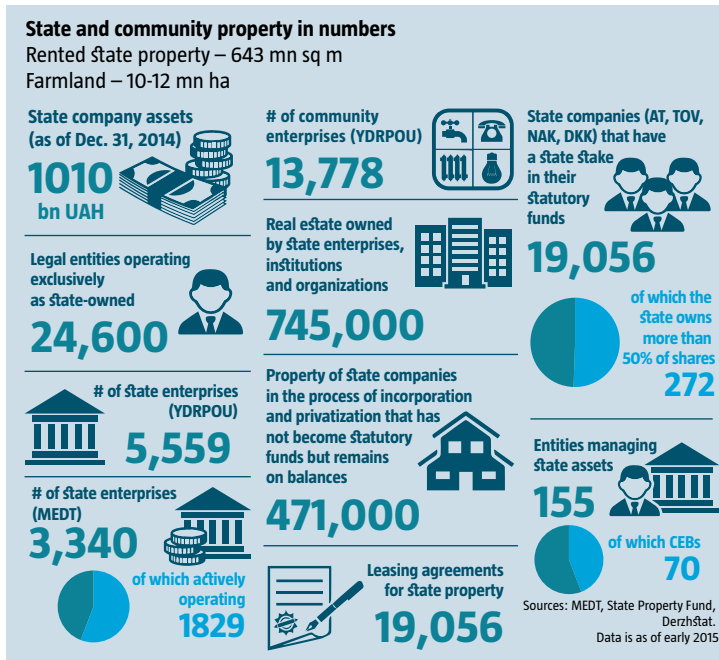
**Budget revenues from state property, mn UAH**



**Budget revenues from community property, mn UAH**



Source: State Treasury data



tered away over the years since independence for lack of proper management. They still have some value, but are no longer capable of producing anything.

A large number of ghost companies can be added to this group. According to the Single State Register of Enterprises and Organizations in Ukraine, YDRPOU in Ukrainian, 5,559 state and 32 public enterprises were registered at the beginning of 2015, a number that was more than 2,200 higher than the number of companies reported by MEDT and the Register of Commercial Entities in the Public Sector established by the State Property Fund (SPF). Most likely, these firms are little more than a name and a line in the register and exist only on paper.

Not only is the Government the biggest capitalist in Ukraine, but it is also the single largest owner of real estate. Not much is said about this, but government agencies own an enormous number of properties, from the Cabinet of Ministers with its useful space of 235,000 sq m to the unfinished shop that was being built in some Smalltown. According to SPF data, at the beginning of June 2016, there were more than 19,000 active rental agreements involving state-owned properties covering 643mn sq m of premises—about 75% of all space available in Kyiv or 3.5 cities the size of Lviv! An additional 5,700 properties or so are available to renters. This does not include social infrastructure such as dormitories and performance halls that belongs to the state and local communities. Many of these were once on the balance sheets of enterprises that were shifted to government agencies once the companies were incorporated and privatized.

Last, but not least, is land. According to experts, the Ukrainian government owns some 10-12 million hectares of farmland, which amounts to about 25% of all farmland in the country. Since land is one of Ukraine's greatest riches, this is probably the crown jewel of public property, one that should enrich the state budget but in fact enriches those officials whose positions allow them to control these lands and decide who may or may not have access to a given asset.

Next comes community property: enterprises, real estate and land. Community enterprises include countless commercial entities that belong to local communities. According to YDRPOU, 13,778 were registered at the beginning of 2015. How many of these are active is hard to say but the number is substantial. The problems that arise in managing these companies merit a separate discussion.

All this mosaic of assets belongs to the state and its communities and is supposedly contributing revenues to the state budget and making ordinary Ukrainians wealthier in the process. But that's possible only if there is proper management of these assets. In fact, the public sector has almost entirely suffered from mismanagement for all the years of independence. Everyone who could tried to carve something out of them, and people like that are in the tens and hundreds of thousands.

## GRANT THEFT ACES

Many of the problems with state ownership have been around since long before independence. As one hero in a soviet film classic put it, "Their heads are a mess." The Soviet Union has long gone into oblivion, but it still plays a noticeable role in socio-economic processes in Ukraine today. During soviet times, stealing from the state became a social norm among citizens, high and low. A clear majority of workers was always able to get something, either products or goods and materials at the enterprises where they worked. This was especially true of collective farms or kolhosps, and plants manufacturing the most basic goods.

It might seem that there's nothing particularly awful about this, but this kind of theft on a national scale amounts to stealing from yourself. The other aspect that Ukrainians learned under the soviets was to work the way you are paid and never to show any initiative. These two attitudes are like a thin red thread running through the processes that have gone on for years now with state assets and have led to the situation in which Ukraine finds itself today.

Let's start with the dead enterprises and ghost companies, which are in the thousands. Where have they come from? They are the result of systematic pilfering of state assets, when typesetting machines worth millions of dollars were shipped to another country or, even worse, cut up for scrap. This was done and continues to be done by very many people, including today's "highly-respected" oligarchs. Had Ukrainians not been taught to steal from the state or if the state were stronger, this phenomenon would never have reached such a scale. So there's no point in talking about effective state ownership when there are so many examples of extremely barbaric alienation of public assets. Ukrainians argue hotly over whether to privatize one state enterprise or another, but fail to notice that thousands of others have been robbed to the foundations and are essentially dead enterprises.

With ghost companies, the question is why the state needs them. They don't contribute to the budget yet they constitute a little statistical tail that migrates from year to year through various reports and wastes resources on accounting and maintenance. The answer is apparently very simple: no one at the relevant government offices is prepared to exert themselves to resolve this issue by establishing a proper bankruptcy procedure or taking on a strategy of working with dead companies. What's more, the process of pilfering continues, obviously, making it a bit soon to cut off that tail once and for all: it's only going

to grow back again, like a lizard's. This is an example of the deplorable inaction that is at the root of the extremely poor management of public assets in Ukraine.

The other problem is how to organize the management of state assets, which is now in a nearly primeval state of chaos. Most legislation that regulates the tracking, systematization and inventorying of state assets has been on the books only 5-10 years, while the YDRPOU has only been actively used for the last three. Among the more than 24,000 legal entities registered with the YDRPOU as actively operating and wholly owned by the state, 4,800 have not yet been taken in hand, that is, their affiliation to the relevant state agency has not yet been confirmed. This means that nearly 5,000 legal entities have gotten lost on the way from the YDRPOU to the appropriate government entity that is supposed to run them and the Government officially has no idea what kind of enterprise this is, what kinds of assets it has and what's going on with it. What kind of effective management can there be when the government hasn't even bothered to figure out what exactly it owns?

One final aspect of the chaos is that, according to the SPF, 155 government entities manage public assets today, 70 of them CEBs. Many of them, such as the National Academy of Sciences, the State Affairs Administration, and so on, have neither the human resources, nor the qualifications to properly manage the assets they are responsible for. Why are there so many of these agencies? The only purpose seems to be for officials to enrich themselves at the expense of the state and for as many as possible of them to be given key posts in ministries and agencies only to make some money in this way. Add to this the oblast offices of the SPF—and not just the Fund—which manage state properties, local government administrations who are empowered to give away community property and we have an entire army, perhaps even an entire class in the traditional marxist sense, of civil servants who live well thanks to state assets, useless in any professional sense but extremely interested in maintaining status quo, who are holding onto their posts tooth and claw for the opportunity to convert these posts into cash.

### CENTRALIZING PUBLIC ASSETS

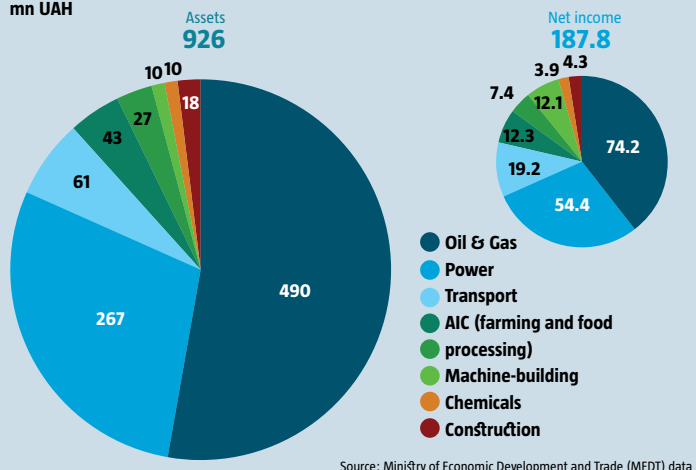
There has been a gradual move around the globe to centralized systems for managing public property, when one agency, such as a ministry, a sovereign fund, a holding company and so on, manages all the property owned by the state. At the same time, in many countries there is a model of dual subordination, when the branch aspects are managed by the line ministry, while issues of corporate management and the coordination of all state assets is delegated to a separate ministry or agency. Ukraine would do well to choose one of these models and quickly switch to it, as they are considered the most effective ones today. Still, understanding the need for this kind of switch only came to the upper levels of government after the Euromaidan Revolution.

Perhaps the most widespread and infamous problem with managing public assets is the way people siphon money off the cash flow generated by them. Ukraine's oligarchs have co-opted managers that run state enterprises, posts that are bought from those close to the helm. And these individuals divert part of the cash flow to their patrons. Political parties that come to power cut deals over portfolios because these give them the right

### The State's Hundred

Assets of the 100 largest companies that are state-owned are worth close to a trillion hryvnias. Nevertheless, the size of operations in no way guarantees profitability: net profits for three quarters of 2015 were only UAH 2.2bn.

Financial indicators for largest 100 state-owned companies for Jan-Sep 2015 by sector, mn UAH



to manage certain state assets, which can be converted to cash. Those at the top in the ministries and agencies horse-trade positions at state and community enterprises and those who buy them convert their purchases into a share of the cash flows generated by their enterprise. Those same officials sell the right to lease state land and property as well, setting prices that are well above what the public purse will see and pocketing the difference. All this results in budget revenues being one tenth of what it could. Meanwhile, tax-paying Ukrainians shoulder this burden and feel far poorer than they ought to.

### HANDS IN THE TILL, NOT ON THE TILLER

To try to describe and analyze in detail all the partial problems that affect the management of groups of assets or specific government properties in Ukraine, it would probably be enough material for a dissertation or two. So this article focuses on the most typical and widespread issues that are widely known.

The presence of leeches that suck cash flows from state property is one of the biggest problems. Worse, they are not so easy to get rid of. The most notorious example was UkrNafta, where the state, through NaftoGaz Ukrainy, owns more than 50% of the shares, although, in fact, the company was controlled by Ihor Kolomoyskiy, the owner of PrivatBank and former governor of Dnipropetrovsk Oblast. Not only can Ukraine not receive its share of dividends for several years now, but multibillion hryvnia tax arrears have been added to the mix. The company simply does not have any cash because money that was regularly diverted to the benefit of Kolomoyskiy companies using a number of different schemes. What's more Kolomoyskiy keeps threatening to take the country to court for billions of dollars and is very likely to win the suit because when these schemes were set up, he used all the familiar methods to get the then-officials to sign contracts on very favorable terms.

The case of UkrNafta is hardly the only such instance. When it comes to losing their succulent host, leeches use every possible means to prevent it: buying off judges, threats, blocking government decisions through bribing the necessary officials, paying people to stage protests, and more. Even if highly aware, patriotic politicians



come to power in Ukraine, it will take them more than a year or two to get rid of all these leeches. Unfortunately, this is the way of things in Ukraine's corridors of power. Companies like UkrNafta are frequently in the public eye, but what about all the small enterprises owned by the state or communities whose cash flows are also being diverted constantly, and whom the long arm of the law does not get to simply because there aren't enough terms in a conscientious politician's lifetime to clean out these Augean stables of their trash.

The behavior of the management of public companies is also the second source of serious losses for the state. While their salaries were marginal for managing companies with million and even billion hryvnia assets, they had no incentive whatsoever to preserve, let alone multiply, the value of those assets. And so they engaged in spending company money on their own luxury lifestyles: expensive restaurants, fancy cars, business trips to famous resorts, and so on. Meanwhile they cut deals in the name of the company through intermediaries whom they overpaid for goods and services to the extent that they lined their own pockets.

A few months ago, the civil servants pay scale was considerably expanded and now the top salary for the largest enterprises can be as much as 200 minimal salaries of an employee in that basic profession at such a company. Now managers have incentive to work effectively which, together with a competitive selection process for the top positions in public companies immediately led to an influx of top-quality managers to the public sector, including foreigners, such as in the case of UkrZaliznytsia and UkrPoshta, the rail and postal monopolies. Such individuals value their reputations and so Ukrainians can now expect that they will firmly reject the old ways that were common at these enterprises.

The third problem is how officials act. Here, there are dozens of examples that can be brought to bear. For instance, take a look at a list of community enterprises in Kyiv: the construction giant KyivMiskBud, the urban planning company GenPlan, the road building company KyivAvtoDor, the advertising arm KyivReklama, markets such as Zhytniy Rynok... There are dozens of them and most of them have been involved in at least one major scandal over corruption. It's hardly surprising that Kyiv's Mayor felt like a feudal lord when he took over the office and control over all these lucrative properties. Needless to say, the temptation to use this control for personal enrichment is very high. The same is true of many cities. Notably, some experts point out that some community enterprises don't even have separate cost accounting because their finances are integrated into the local budget. This offers a very broad space within which to engage in embezzlement.

### GOOD MANAGERS ARE TRAINED, NOT BORN

Then there is public real estate. As mentioned, over 19,000 leases have been signed, with the average rate being UAH 72/sq m per month, not including integrated complexes and leases to other government agencies. In small towns and villages, this rate might be normal, but even there, that seems unlikely. For a larger city, this is peanuts. Some properties in Kyiv are going for UAH 50/sq m when the market rate for commercial space is several hundred hryvnias, and sometimes as high as UAH 1,000/sq m. Clearly, those officials who agree to such cheap leases are getting significant kickbacks for their

"amenability." We're looking at hundreds, possibly thousands of officials who are paying for their fancy cars, apartments and flights to the Maldives at the expense of the state, that is, of tax-paying Ukrainians.

The effectiveness of how state institutions make use of real estate is also worthy of attention. According to the press, the Presidential Administration building on Bankova contains more than 22,000 sq m of space for only 428 individuals, including service personnel. The population density of this building effectively provides each staff member with the equivalent of a mid-sized one-room apartment in area. On the property market, this building could bring millions of hryvnias in revenues to the Budget. Various sectoral and individual problems arise with state ownership as well. Some companies, for instance, own backbone infrastructure: UkrZaliznytsia owns all the track in Ukraine, Naftogaz owns the gas transport system (GTS), and the list goes on. Ideally, these infrastructural assets should be getting paid for being used and part of this money would go towards maintaining them in proper condition. Instead, revenues that they generate often end up in the general funds, out of which very little is allocated for infrastructure repair work. The country's infrastructure capacities are simply being eaten away.

The other side of the coin is the social functions that some state companies are obligated to carry out. UkrZaliznytsia, KyivPasTrans and other transportation entities are expected to carry certain classes of passengers for free, Naftogaz was still selling residential gas at below-market rates until recently, and many public entities have to support social infrastructure, such as kindergartens and dormitories. All this prevents the managers of public companies from focusing on becoming more efficient, which might otherwise allow them to generate sufficient cash flows to actually finance all these social commitments of the state's.

Then again, many of the problems related to state-owned assets are highly individual. For instance, profitable companies like TurboAtom bring in high profits but are not being developed because they are underinvested. Coal mines are generally loss-making and squander considerable budget resources. These problems have their social and environmental aspects as well. Antonov has largely stopped production of aircraft and will need an extremely professional, tactful management team to bring it back on a growth trajectory at least in the longer run. The assets of many companies, especially natural monopolies, are highly depreciated but have to continue to operate under those conditions because the government simply does not know how to invest: it has never really done this and when it did try, the investment generally ended up completely embezzled. What's more, natural monopolies need to be regulated properly, which is a problem in nearly all industries in Ukraine. Ukraine's ports are highly profitable but their capacities are limited and they are not prepared to carry out the tasks the state needs of them, such as handling very large container ships or supertankers.

In short, the problems with managing state assets are myriad. They all show that the state cannot be an effective owner, especially with weak public institutions like Ukraine's. If the current situation continues, it will simply perpetuate the backwardness of the economy and of the country itself. The result can be seen in the pay rates, mentality and worldviews of those Ukrainians who work in the public sector. ■

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# Selling it all?

Ukraine is looking to privatize chemical and energy companies first and foremost. In order to speed up the process, the Government has filed a bill to exclude a number of companies supervised by the Ministries of Agriculture and Infrastructure from the list of entities banned from privatization. For example, the bill proposes lifting restrictions on the sale of over a hundred companies involved in the production of spirits and alcoholic beverages. So, investors can now privatize numerous wine and liquor facilities across the country, such as Uzhhorod or Odesa Cognac Plants, or champagne productions. The Government expects hefty revenues from the privatization of ArtemSil, Europe's biggest producer of salt located close to the contact line in Eastern Ukraine.

Volodymyr Hroysman and his Cabinet announce this huge sale of state enterprises as a key area in reforming Ukraine. They insist that quick privatization will allow Ukraine to eradicate corruption scams that benefit only the officials running them. Against this, as expected, are representatives of various opposition forces, from the Opposition Bloc to Batkivshchyna, Radical Party of Oleh Liashko and Svoboda. They fear missing the best pieces of the cake for themselves and their sponsors as privatization gains momentum.

**"Big privatization" companies are listed in G\* group. The State Property Fund is preparing their controlling stakes or the entire companies for sale or privatization**

Company	Statutory capital, UAH mn	Stake
SumyKhimProm PJSC	434.69	100
Svema OJSC, Shostka	488.07	91.6
MykolayivOblEnergo Public JSC	39.66	70
KhmelnyskyOblEnergo Public JSC	33.64	70
KharkivOblEnergo JSC	64.13	65
ZaporizhzhiaOblEnergo OJSC	44.84	60.2
TernopilOblEnergo OJSC	15.27	51
VNIIAEN, Research and Design Institute for Atomic and Power Pump Building, Public JSC, Sumy	11.23	50
Ivano-Frankivsk Locomotive Repair Plant Private JSC**	19.56	100
TsentrEnergo Public JSC***	480.23	68.3

\* Group G (f) includes companies recognized as entities "of strategic important for the economy and security", are part of the military and defense industry, "have unique productions", use "rare resources" etc.

\*\* Planned for sale

\*\*\* Offered for privatization

Source: State Property Fund



Read the full article on all entities, big and small, up for privatization in the near future at [ukrainianweek.com](http://ukrainianweek.com)

**Stakes to be sold in other companies listed for "big privatization"**

	Statutory capital, UAH mn	Stake
<b>Announced for sale</b>		
Industrial Glass Company Public JSC, Kherson	68.34	23
Odesa Radial Drill Plant Public JSC	35.56	15
Siversky Meat and Dairy Complex Public JSC, Novhorod-Siversky County, Chernihiv Oblast	15.26	25
Ukrainian Bank for Reconstruction and Development OJSC, Kyiv	11.8	99.99
Zaliznychnyk Bread Factory, Trostianets, Sumy Oblast	3.21	48
RatNeagroBud JV, Volyn Oblast	0.81	19.3
UkrSotsBank OJSC, Kyiv	0.62	4.0E-5
Kaniv Incubator LLC	0.47	15
<b>In preparation for sale</b>		
Stebnyk Mining and Chemical Company Polimineral, Lviv Oblast	59.65	6.4
SumyOblEnergo OJSC	44.28	25
Odesa Power Plant OJSC	43.52	99.99
UkrNaftoProduct OJSC, Kyiv	36.65	50
Dniprovsky Machine Building Plant OJSC, Dnipro	35.65	25
Systema R&D Company OJSC, Kharkiv	30.55	99.99
Kherson Power Plant OJSC	29.74	99.8
Dniprodzerzhynsk Heat and Power Central OJSC, Kamianske	25.41	99.9
DniproMetroBud OJSC, Dnipro	8.38	95
R&D Institute for Electric Mechanical Equipment OJSC, Kyiv	6.38	94.4
EletroAvtomatyka Zakarpattia Plant OJSC, Bushtyno, Zakarpattia Oblast	5.63	94.5
Orion Machine Building Production OJSC, Odesa	1.44	50
Volodymyrske State Enterprise, Kazankivsky County, Mykolayiv Oblast	0.51	100
Nikopol Pipeline Fittings Plant OJSC, Nikopol	0.2	30
Stepove Nucleus Breeding Unit, State Enterprise, Mykolayiv Oblast	-	100
AgroPromTechnika State Enterprise, Uzhhorod	-	100

Source: State Property Fund

# A Cieszyn syndrome?

By Ihor Losev

**D**anger lurks in Polish policy makers' initiative to recognize the Volhynian events of 1943 as genocide

The alarm bells for Ukrainian leaders had rung earlier, warning of this highly probable outcome. Suffice it to remember the statement made by Volodymyr Viatrovych of the Ukrainian Institute of National Remembrance about a rising anti-Ukrainian hysteria in neighbouring Poland and the unfavourable trends in the country on which we (albeit not always reasonably) relied as on our strategic stronghold in the West. And now it has arrived. The Senate, the upper house of the Polish parliament, mustered the majority of votes to plead the Sejm to recognise the Volhynian events of 1943 as a "genocide of Poles" by Ukrainian nationalists and declare July 11 the day of remembrance of the victims. In the future this can provide the descendants of the *kresowiaki* (inhabitants of the Eastern Borderlands) with grounds for territorial claims and eventual multi-million-dollar lawsuits against Ukraine.

The Senate's resolution will very much reinforce the Kremlin's position, inspiring the latter to further action and making it even more insolent; on the other hand, it will substantially weaken Ukraine.

Polish society turned out far from mature and European, as it demonstrated its sheer inability to see the geopolitical connection between the security of Ukraine and that of Poland. Some in Poland's political circles have decided to take advantage of the difficult moment to satisfy their interests at Ukraine's cost. A similar situation inspired Taras Shevchenko's line *Poland crumbled down and crushed us*, meaning hard geopolitical consequences of Rzeczpospolita's collapse for Ukraine. The current situation is almost a replica.

Strangely enough, the "Volhynian card" is being played over and over again in Poland, even if the problem seems to have been settled in a civilised and fair manner by presidents Kuchma and Kwasniewski, with Yushchenko following suit later. "We forgive and ask forgiveness" is the only possible formula if true reconciliation is the goal, rather than winning a historical victory at the neighbour's expense. Such a formula establishes the equality of parties and the equality of victims. But certain Polish politicians do not seem to want equality with Ukrainians neither in the past nor now.

It must be the effect of the so-called Cieszyn syndrome. In 1938-39, instead of making an alliance with Czechoslovakia against Hitler, Poland took advantage of the Czechs' plight and occupied the then Těšín District, an area in the north-east of the country, thus taking part in the division of Czechoslovakia alongside with Germany and Hungary. Meanwhile Czechoslovakia, which was called "Europe's armoury," could have become Poland's only real and strong ally in the region.



Today the situation is pretty similar. Poles, who have passed such a doubtful and irresponsible decision, rely enormously on NATO, imagining that they can afford to play suicidal games behind its back. However, in 1939 Poland had very serious guarantors like Britain and France. They even declared war on Germany three days after the Nazis' assault on Poland. But did it help Poles a lot back then? It did, only after six years of cruel Nazi occupation and excruciating suffering of the Polish people.

Two years ago Poland's former minister, Mr Sikorski, let it slip that Putin, via secret channels, had offered the leaders of his country to take part in the division of Ukraine's territory. According to Mr Sikorski, he had refused. But clearly not everyone had done the same. And not everyone learned the lessons of 1939 and the bitter fate which Poles had chosen when they tried to make a deal with Hitler. In 1934 the latter made a secret treaty with Józef Piłsudski to fight the USSR. According to this

**POLISH SOCIETY TURNED OUT FAR FROM MATURE AND EUROPEAN, AS IT DEMONSTRATED ITS SHEER INABILITY TO SEE THE GEOPOLITICAL CONNECTION BETWEEN THE SECURITY OF UKRAINE AND THAT OF POLAND**

Polish-German deal, after a joint victory the territory of the Ukrainian People's Republic, occupied by Bolsheviks in 1919-20, was to have become part of Poland. However, the driving force of these processes, Piłsudski died in 1935. Hitler ordered to commemorate him in Berlin on the top level. One photograph in particular shows him during a wake next to Piłsudski's symbolic coffin covered with the Polish white-eagled flag. In 1939, after the capitulation of Poland and the capture of Krakow, he ordered the military administration to organize a daily watch of honour at Piłsudski's tomb. Against this backdrop Polish accusations of the OUN of collaborating with the Nazis look rather extravagant. Similarly, the Volhynian events of 1943 are difficult to comprehend adequately disregarding the fact that the Polish government in emigration had been waging a colonial war against Ukrainians in Volhynia, which typologically was not very different from France's colonial war in Algeria and Portugal's in Angola.

Ukraine has no other choice left but pass a symmetrical law on the Polish genocide against Ukrainians in the west by the hands of the Home Army, Polish Peasants' Battalions, and other Polish formations. Otherwise we will be constantly blackmailed and forced to give in, while the others will try to take advantage of our plight.

Has Poland a backlash of the Cieszyn syndrome, which had a similar result? ■



# The forced friendship

Nina Leinonen

How today's Finland understands security and relations with Russia, and what the international community misses about finlandization

**P**rofessor, former foreign policy advisor and ambassador of the President of Finland, Mr. Alpo Rusi knows what he is talking about when the topic is Finlandization. He has been accused and leaked on purpose to the media under the secret investigation, being a spy for the security service of East Germany, the Stasi, with basically no evidence in 2002 to 2003. The prosecutor fully relieved him of allegations in June 2003.

Rusi's 15 years elder brother, the head of government information office in early 1970 had been a Stasi contact 1965-77. However, Alpo Rusi himself had nothing to do with the Stasi. The Stasi just had registered his name as a young student in the autumn of 1969, but that was all, and former Stasi officers cleared his name in 2003. Alpo Rusi tells that he was targeted because his boss, then-president Martti Ahtisaari was pushed out of office. This was all part of the domestic politics of Finland. And this is not the 70's. This all happened in the 21st cent.-Finland. Sounds like a spy story from the Cold War era, only it is not.

Russia, and the Soviet Union before that, has had and still has a strong thumb on Finland. Before the turning point in 2014, the relationship between Russia and Finland, as well as other Western European states, started to look more open and trustful. Business relations were improving even after 2008 economic breakdown and the war in Georgia.

Then came Crimea. It is still hard to find an open answer whether Crimea is the reason the military started shaping up in Finland as well. It can be read between the lines but one will not get a direct answer from the official level. The sanctions against Russia however are recognized by all. Or they were recognized by all, until Finlandization raised its head again. For several months now, a few members of parliament, mainly from the Finns Party (previously known as the True Finns) and the Center Party, have been broaching the possibility of lifting the Russia sanctions.

## FINLANDIZATION DEFINED

Rusi sums up the definition of finlandization in four points which describe the concept itself, as well as the influence of Finlandization.

First, Rusi quotes an experienced and highly respected Finnish diplomat Max Jakobson. He estimated some years back that the Finnish political elite had been finlandized but the people turned towards the West already during the Cold War era. Rusi agrees with Jakobson's definition. The head of the state, as well as many leading politicians, were leaning on Russia while the people looked towards the West.

A former US national security adviser Zbigniew Brzezinski (brought up) proposed Finlandization as a solution for Ukraine in 2014. He said that Finland is a member of the EU and not a member of NATO. Throughout the Cold War, Finland's foreign policy was based on official neutrality. He continued that this resolution, "a positive Finlandization", may be possible with Ukraine dealing with the West, moving closer to Europe, but also having relationships with Russia, like Finland does.

Rusi criticizes Brzezinski's point of view. He says that a suggestion of Finlandization for Ukraine shows that there is not enough correct information about the concept internationally. In Ukraine's case, this would mean that it is a recognized part of Russia's sphere of influence but obliged to pursue neutrality by its foreign policy.



**THE FINNISH ELITE, LIKE MANY OTHER ELITES IN EUROPE, FAILED TO UNDERSTAND THE CHANGES IN THE BIG PICTURE OF SECURITY IN THE BALTIC SEA REGION AND IN RUSSIA. THIS HAS BEEN AS BIG AS THE FAILURE TO PREDICT THE COLLAPSE OF THE SOVIET UNION**

Secondly, the definition of Finlandization can be significant when one evaluates why otherwise pragmatic Finland stayed out of the NATO enlargement wave in 2004. This is the time when the Baltic States joined NATO.

Rusi reminds about the statement that the president of Finland Tarja Halonen (2000-2012) made in 2005. She justified why Finland did not join NATO with the Baltic States by saying that Finland could not join the defence union with the former communist states, because by doing that Finland would have admitted that the country was finlandized during the Cold War. "This was a false statement about Eastern Europe. They were occupied territories against their own will. Finlandization should not be mixed in this way into the security policy discussion. This is not the way to prove whether there was Finlandization, or not," Rusi claims.

Thirdly, few have managed to read correctly the big picture of the changing security environment in Europe. For this reason, for example, Sweden abandoned its regional defense and conscription system but is building it back now.

Finally, NATO debate in Finland has been going on without necessary historic depth. The reason for this is that the image of NATO is colored by the Cold War era.

Rusi says that, on the one hand, Finlandization is a policy of realism, but, on the other hand, it enables



**Secrets uncovered.** Alpo Rusi: "After being a diplomat for 15 years during the Cold War era, I can assure you that our main task was to show that there is no finlandization. But we all knew that it was there"

a phenomenon such as "the Moscow card" and "the Home Russians" to be used in Finland. The phenomena include two dimensions of logic, i.e. the gradual submission to the Soviet and, in today's situation, to the Russian domination.

Ukraine has been a subject of enforced Finlandization by Russia since 2004. This is what Brzezinski did not fully understand although his intention was good without any doubt.

### HIDDEN TRUTH

The official Finland avoids the definition of Finlandization when talking about the time after World War II. "After being a diplomat for 15 years during the Cold War era, I can assure you that our main task was to show that there is no Finlandization. But we all knew that it was there. One had to be dishonest not to admit it. Even the Russians had officially noted themselves that they were pressuring Finland all the time," Rusi says. "In addition, the Winter War (1939-40) was the Soviet Union's crime against Finland. After that quite many things went wrong because Finland was brought to the WWII and almost lost its independence in 1944," he adds.

Rusi is demanding a White Book of the Cold War era relations with the Soviet Union in Finland. This is because quite many "problematic" records and documents were and remain closed in Finland. "This is the best evidence of Finlandization. The records remain closed because no one has the courage to open them," Rusi says. As an example he gives "the Tiitinen list" of about 20 Finns who may have been agents of Stasi. The list was received from German Intelligence in 1990 but not investigated. It was prepared in the last Stasi Resident in Helsinki by colonel Ingolf Freyer who coordinated his work in Helsinki with the KGB every second month. "Its meaning has been understated but it will be closed until 2050. 60 years. In my opinion it is against

the Constitution. The closing time was decided to be so long because the state wants to cover up several suspected crimes," Rusi says.

### FINLANDIZATION IN REAL LIFE

During the Cold War era, a clear sign of Finlandization was the prohibition to talk against the Soviet Union. In 1972, the Finnish parliament even tried to pass the law which would criminalize anti-soviet actions and opinions. If the parliament had approved the law, Finland would have had persecution against anti-soviet people. A step towards Eastern European political atmosphere, as Rusi says. Luckily enough, the law was not approved. Some of the MPs proposing the law became key politicians of Finland in the 1990s and 2000.

Today, Finlandization can also be seen in the discussions of NATO membership. "This is about marginalization of opinion. Is it better for the country to quiet down experts who warn about the consequences of staying out of the NATO?" Rusi questions.

He says that there are no such security reasons which should kill the discussion about NATO membership. Yet, it is usual that the higher officials and the political elite quiet down the discussion. Rusi urges to consider the means by which Russia could do more harm to damage Finland if the country joins NATO. "Russia does not want to sharpen the conflict between the Alliance and itself. Russia does not have the strength or resources to fight a large-scale war. They can have their small wars and hybrid warfare but there is no point even for them to launch an all-out military exchange," Rusi argues. "And, strategically, why would they want to ruin their good relations with their neighbor? If it is because of NATO, then there are no such good relations," Rusi adds.

He is convinced that all Finns would like to have good relations with Russia, but not at any price, not by being too humble. Finland must be a solid part of the Western camp. "It is our humiliation that we are not allowed (in Russia's opinion) to bring NATO infrastructure to our borders but they (the Russians) are allowed to bring Iskander missiles to their western borders. We are under their nuclear threat all the time but still not allowed to take even a minimum cover," Rusi says.

### KEEP QUIET

Rusi is glad that some younger politicians and experts in Finland are breaking away from the pressure of Finlandization, and we are talking about the positioning of Finland as a member-state of the EU, as well as NATO. He sees some light at least with some younger MPs with the Coalition Party, the Swedish People's Party and the Green League. (For example, the head of the Green League, Ville Niinistö, has stated several times that Finland should get rid of the burden of Finlandization.)

"The Finnish elite, like many other elites in Europe, failed to understand the changes in the big picture of security in the Baltic Sea region and in Russia. This has been as big as the failure to predict the collapse of the Soviet Union. What has happened in the 21st century is related to the Finlandization that is not discussed through enough after the Cold War," Rusi crystalizes. "We need to have a new beginning for European integration and transatlantic relations after Brexit." ■

# Looking to Mutti

With Britain stumbling towards the exit, it falls to Angela Merkel to give the European Union new shape



**A**s in crises past, Europe this week turned its gaze towards Angela Merkel, looking for clues to how the German chancellor plans to keep the continent from cracking up. Amid all the uncertainty that has followed the Brexit referendum, one thing seems clear: with Britain leaving the European Union, or dithering over how to do so, Germany's already awkward weight in the remaining club of 27 will grow even heavier. Henry Kissinger's (probably apocryphal) question about whom to call when you want to call Europe no longer needs asking: obviously, you dial Berlin. That seems reassuring to some, unbearable to many. France, Italy and Spain henceforth "take their lead directly from Chancellor Angela Merkel", sneers Marine Le Pen, France's Eurosceptic-in-chief, "without running through Brussels."

For all the sudden interest in her views, Mrs. Merkel is in no hurry to supply them. Her slow, measured style is one reason she was able to accumulate such power in the first place. The Germans have even coined a verb in her honour: "to merkel" means to delay decisions while time diminishes problems to a manageable size, and opponents make valuable mistakes. Since the referendum on June 23 she has thus been simultaneously tough on Britain ("no cherry-picking" during negotiations, she promised the Bundestag) and lenient (seeing "no reason to be especially nasty"). If it were up to her, she would say no more for now.

Domestic politics, however, will force her to break her silence sooner than she would like. Germany's next federal election is not until September 2017. But the junior partners in Mrs. Merkel's grand coalition, the centre-left Social Democrats (SPD), have taken the Brexit vote as a cue to begin their anti-Merkel

campaign early, using the European question to differentiate themselves.

Now that the pesky Brits can no longer play their habitual obstructionist role, the SPD wants the EU-27 to push hard for deeper European integration and centralisation. In a joint paper Sigmar Gabriel, the SPD's boss (and Mrs. Merkel's vice-chancellor, as well as her presumptive challenger), and Martin Schulz, president of the European Parliament (and another potential SPD candidate against Mrs. Merkel), call for "refounding Europe". The European Commission in Brussels, so loathed by Eurosceptics everywhere, must become "a real European government", elaborates Mr. Schulz. This new and improved EU, they contend, must pour huge investments into roads, power grids and data cables in southern member states to reduce youth unemployment there and boost growth. This is a form of German hegemony that would delight France, Italy and Greece.

But they won't get it. The Social Democrats are only the junior partners in Germany's coalition, and Mrs. Merkel's Christian Democrats are pulling in the opposite direction. For now it is Wolfgang Schäuble, the finance minister, who is voicing the party's views. Mr. Schäuble, originally a European federalist in favour of ever closer union, has concluded that the referendum signals that Europeans will not stomach yet more centralisation, as he told a German newspaper, *Welt am Sonntag*. What, he asks pointedly, does "refounding Europe" even mean? Rip up the treaties and start anew? That would take time the EU does not have. And anyway, "Now is not the time for visions."

The EU, he thinks, must instead pick a few big problems and prove to its disenchanted citizens that it can solve them: controlling refugee flows and securing the bloc's external borders, say, or tying national energy grids together. And "if the commission fails to act, then we will just take control and solve problems among our governments," he adds. In the jargon of Eurocrats, this threatened "intergovernmental" approach is the direct opposite of the "supranational" path favoured by federalists. It moves power from the commission, the EU's central executive body and civil service, to the European Council, made up of the leaders of the separate member states.

As in the euro crisis, such a shift raises the profile of those leaders, and especially of Mrs. Merkel. Germany's policy elite is aware, indeed worried, that perceptions of her dominance could elicit a backlash. If other leaders team up to balance her power, it will stir old German fears of isolation. Frank-Walter Steinmeier, the foreign minister and another leading Social Democrat, calls this a recurrent "simultaneity: an expectation of Germany, but also a fear that Germany becomes too strong within Europe."

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## SOUTHERNERS SPEND, GERMANY PAYS

Yet insiders say that since the referendum, Mrs. Merkel has been preoccupied by a greater fear: that the EU is arriving at a form of German hegemony in which Germany is expected to take on the union's burdens and responsibilities, while everyone else picks and chooses among its benefits. In the euro crisis German money and guarantees have stood behind the common currency. In the refugee crisis Germany maintained its "welcome culture" while others closed their borders. In the coming Brexit negotiations Britain may demand access to the single market without granting freedom of movement to EU residents, while Germany and its welfare system remain open to all.

In a Europe overshadowed by Brexit, Germany is thus feeling the dilemma of hegemony that America has known for seven decades: the temptation to use its power in its own interests conflicts with the duty to use that power to preserve global order. In Europe that means containing the EU's "centrifugal forces", as Mrs.

Merkel said repeatedly in the week after the referendum.

But the order she has in mind seems like the looser Europe once favoured by the British, not that of the federalists. "What is 'the Union'?" she asked rhetorically at a press conference on June 28 during the European summit. It is the council, the commission and the par-

**MRS. MERKEL HAS BEEN PREOCCUPIED BY A FEAR: THAT THE EU IS ARRIVING AT A FORM OF GERMAN HEGEMONY IN WHICH GERMANY IS EXPECTED TO TAKE ON THE UNION'S BURDENS AND RESPONSIBILITIES, WHILE EVERYONE ELSE PICKS AND CHOOSES AMONG ITS BENEFITS**

liament, she answered, and of those, in German, the first is masculine, the second feminine, the third neuter. Perhaps Germany's "Mutti" intends to be Europe's father figure. ■

## In a rut

**Brexit is merely one more worry for Germany's leading lender**

**T**he biggest bank in Europe's most robust economy may seem an unlikely victim of Brexit. Yet in the fortnight after Britons voted to quit the European Union Deutsche Bank's share price tumbled by 27%—putting Germany's biggest lender in the unexalted company of British and Italian banks. On July 7 it slid to €11.36 (\$12.58), a record low.

The price has since clambered back towards €13. But Deutsche still trades at only a quarter of the supposed net value of its assets—far behind its peers (see chart). Its shares fetch half of what they did a year ago and an eighth of what they did in 2007. It lost a staggering €6.8 billion in 2015. The newish chief executive, John Cryan, is carrying out an overdue spring-clean: he has told investors to expect no profit or dividend this year (and scrapped last year's too). Brexit makes the job a little harder.

Mr. Cryan is overhauling Deutsche's rickety computer systems, closing offices and shedding 9,000 jobs. But his most pressing task is to thicken Deutsche's capital cushion. The bank is not in mortal danger, but in these post-buccaneering days regulators insist that lenders have ample means to withstand big losses. European "stress tests" this month may not flatter Deutsche, partly because they take no account of its capital-boosting plans.

Deutsche's ratio of equity to risk-weighted assets, an important gauge of resilience, is 10.7%. Had the latest regulations been in place in 2009, estimates Autonomous, a research firm, Deutsche's ratio would have been a threadbare 2.4%, and just 5.5% even in mid-2012. Despite this improvement, Deutsche still lags its peers. Mr. Cryan wants to lift its score to 12.5% by 2018.

The sale of a stake in Hua Xia, a Chinese bank, due to be completed soon, should close around 0.5 points of that 1.8-point gap. The disposal of Postbank, a German mass-market retail bank of which Deutsche took control in 2010, is slated to bring in most of the rest. (Deutsche also has another, posher retail operation under its own name.) But Mr. Cryan has soft-pedalled on the sale. Postbank relies chiefly on deposit-taking and mortgage lending, and the euro zone's ultra-low interest rates have made it less attrac-

tive to would-be buyers. Hurrying to sell makes little sense. The Brexit vote portends weaker growth in Europe and thus even lower rates, making Postbank even less alluring. Still-lower rates also make it harder for Deutsche to fatten capital by making and retaining profits. Its net interest income (the difference between what it pays depositors and charges borrowers) dropped by 7%, year on year, in the first quarter.

Slower growth in Europe is also little use to Deutsche's investment bank, which suffered with the rest of the industry in the market turmoil at the start of the year. The second quarter may have been better—and Brexcitement boosted trading volumes. But the second half may be weaker again. And in recent years Deutsche has been hampered by its focus on fixed income—selling, trading and underwriting bonds—in which it is among the world's leaders. According to Huw van Steenis of Morgan Stanley, industry revenues from bonds, currencies and commodities fell by 9% a year in 2012-15, while equities businesses grew by 6% annually. Among big banks, none relies on fixed income more than Deutsche does.

The bank has legal worries too. The biggest of these is an allegation by America's Department of Justice that Deutsche misrepresented the value of residential mortgage-backed securities before the crisis of 2008. Other leading banks have already settled similar claims. American and British authorities are also examining whether slack controls at Deutsche let money-launderers spirit cash out of Russia. Deutsche has set aside €5.4 billion to cover legal bills. Another looming headache is a proposal by international regulators that would sharply increase capital requirements for mortgages and other loans.

Mr. Cryan said this month that he didn't see his bank as a takeover target. He's right about that: regulators think banks are big enough. He also said that Deutsche would reach its capital target without needing to tap up investors. He may be right about that, too—but it's much less certain.

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# Best of frenemies

Julia Oliynyk

Germany and Russia are the two states whose relations of the past 250 years have been defining the fate of Europe in general, and Ukraine in particular



**Building the wall.** When Khrushchev was enjoying rounds of applause in East Berlin, the Germans were already thinking about the price of Germany's reunification

**T**he Hohenzollerns were hardly the most outstanding dynasty in Europe: a small South German family that bought the Elector of Brandenburg title, subject to the Holy Roman Emperor. Later, the family bought Prussian lands and recognized Polish kings as its suzerains. The kingdom kept growing through successful matrimonial deals and military operations and took its right place on the European map in the 18<sup>th</sup> century, squeezing out the old monarchies of France, Great Britain and Austria. A great help in that was Russia, then ruled by the monarchs of German origin who actively claimed European hegemony. The union of these two *parvenu* was shaping the fate of the continent at that time.

## A LATE START

The first military contact between the Russian Empire and the Prussian Reich took place during the Seven Years' War and turned into a tragedy for the Germans. Yet it also defined the entire future history of the German-Russian relations. At the start of the war, the Russian leaders were unable to start battle action because the Germans used an effective tool of defense against Russia (one they would later use many more times): both the commander in chief of the Russian Army, Stepan Apraksin, and Chancellor Bestuzhev, regularly received hefty sums for sabotaging the start of the war. Not before Piotr Saltykov replaced Apraksin did the Russians step out on their first march on Europe, taking Königsberg in the

spring of 1757, and Berlin in the fall of 1760. The first Russian who ruined the Prussian capital was a Saxon, Gottlob von Tottleben. The sum of the contribution he demanded from the opponent was humungous, but a larger part of it was paid by Johann Gotzkowsky, a banker, factory owner and a rich man. In the future, German capital would save their country many more times again. Back then the Russians limited their impact to “only” ruining palaces in Schönhausen and Charlottenburg.

The battle-hungry and arrogant Friedrich II, – the Soldatenkönig – faced then a series of defeats. Who knows how his young Reich would have fared had it not been for Peter III, a German and an old supporter of the Prussian king, who took the Russian throne then. The young tsar played things back quickly and signed a defense treaty with Friedrich in the spring of 1762. That framed the beginning of the alliance that would later become a strategic axis of all European politics. In 2014, the citizens of Kiel built a monument to their compatriot, the Russian tsar Peter III, as a symbol of “common history”. The Russians are ignoring it though: for too long Peter III had been presented to them as an idiot. That campaign began when his successor, Catherine II, was in power. This was probably the only way for Sophie Auguste Friederike von Anhalt-Zerbst to construct an image of herself as a great mother and enlightener from what she was in fact, a poorly educated and fairly dumb German princess. Under Catherine II, Russian nobility ultimately turned into the class backbone of the empire, constituting the group of slave owning landlords who constantly needed new lands and serfs. In the 19<sup>th</sup> century, when Russian nobility started talking about “Orthodoxy, monarchy, nationality”, as well as the special mission of the Russians, who else, but the Hohenzollerns, could make theirs ally as they themselves were fighting for their future desperately?

The creator of the First Reich, Friedrich II, died in 1786. The Soldaten-könig found his last shelter at the modest garrison church in the Sanssouci palace. It would later be visited by virtually all European monarchs. In 1809, Napoleon Bonaparte as the new ruler of the Old Continent came to kneel before the remains of the Prussian king. “Bare your heads!”, the French emperor was rumored to have told his people crowding behind him. “If he were alive now, you wouldn’t be standing here!”

In 1943, when the ruinous impact of the carpet bombing of German cities, including historical and cultural sites, by the allies became obvious, the sarcophagi of Friedrich II and Wilhelm I were removed to a concrete bunker. This proved to be the right decision: the little church at Sanssouci was eventually bombed down and burnt. As the Soviet Army approached Germany, the monarchs’ remains were transported south, to the American-controlled area. Apparently, this proved to be the right decision as well. That’s where they waited out the epoch of the divided Germany. That was also when a legend was born: Alte Fritz won’t abandon the Germans. As soon as he returned to his proper place, the soviet Colossus would fall, the legend said. Alte Fritz must have known a thing or two about the future: the government of the united Germany reburied the remains of the Prussian kind at Sanssouci on August 17, 1991.

## THE “UNION OF EAGLES” AGAINST THE REPUBLIC

Friedrich II’s successor was Friedrich Wilhelm III, a man of no military appetite. Under his command, the once glorious Prussian army lost a series of battles to Napoleon and essentially ceased to exist. The Germans then placed high hopes on the power of the Russian weapons (or, the number of the Russian soldiers, to be more precise). Prussian queen, the beautiful Louise, tried to put her charms on Russia’s Alexander, invited him for intimate meetings and conversations, and pinned the Prussian Order of the Black Eagle on his uniform with her own hands. In 1805, the Russian tsar pledged allegiance to the Russian-Prussian union at the Sanssouci garrison church. But in 1807, at the famous meeting of three emperors in Tilsit, Alexander I appeared as an ally of Napoleon, while Friedrich Wilhelm III was often only let as far as the corridor during negotiations. However, the city preserved long memory of Louisa’s stay there. In 1907, the local entry gate over the Neman river, was adorned with the queen’s portrait to celebrate the anniversary of the Tilsit Treaty. From 1945, Eastern Prussia no longer existed on the map of the world. It turned into Kaliningrad Oblast, Tilsit turned into Sovetsk, while the gate was adorned with the Soviet Union symbol. But even in the 21<sup>st</sup> century Russia still desperately needs German money, just like before. That’s why Louisa’s image reappeared on the bridge in 2007, now looking at Lithuania and the EU. Take a look if you happen to cross Neman.



## BISMARCK’S BENEVOLENCE TOWARDS RUSSIA WAS BASED ON PRACTICAL CALCULATIONS OF PROTECTION FROM FRANCE, LIBERAL AND SOCIALIST IDEAS, AND NOT ON COMMON VALUES

When Napoleon entered Berlin through the Brandenburg Gate (built by Friedrich II to celebrate the subjugation of Saxony), he ordered the quadriga removed from the gate, and Prussian eagles from the city. The French particularly longed to humiliate the arrogant Prussia. That’s why they took part of its territory and turned it into a member of Rheinbund that was dependent on the French emperor. No united and strong Germany – whether the French Empire or Republic, it feared the emergence of such a Germany for a long time to come, until these fears were finally cured with the establishment of the European Union.

When Napoleon triumphed, the Hohenzollerns, devoid of their capital, moved to Königsberg where they lived in poverty and modesty, expecting salvation from the Russian emperor. Not only because a German was the Russian tsarina, or because the tsar pledged allegiance to the tomb of Alte Fritz, but rather because no country in Europe was more interested in expansion than Russia. It was for a reason after all that grandma Catherine II named one grandson Alexander (like in Alexander the Great), and the second one – Konstantin (with a hint to the Byzantine Empire). Eventually though, it was the third grand-



son, Nicolas I, whose fate was to try and implement the ambitious plans and take over Black Sea Straits. The price was his life.

After all this, could there be a more dedicated and grateful ally for the Russian monarchy than Prussia once the Russian tsar took to supervise the international order following the Congress of Vienna in 1815, turning into the “gendarme of Europe”? After the casting of the “Russian-German friendship” in the years of Napoleon’s wars, the Germans understood very well what Alte Friz meant when he said: “Out of all Prussia’s neighbors, the Russian Empire is the most dangerous one given its power and position. Prussian kings who rule after me have plenty of reasons to keep friendly relations with these barbarians.”

### THE LABORS OF BISMARCK AND GERMAN CAPITAL

So, Napoleon put an end to the German Reich built by Alte Friz. But the Germans wouldn’t have been the Germans if they didn’t try to build the Second one. France was no longer able to prevent this: its army was devastated while emperor Napoleon III became Bismarck’s hostage. The Germans took their revenge: the Chancellor had the treaty to form the German Empire signed at the Versailles Hall of Mirrors on January 18, 1871. The very same hall where talks to liquidate the Second Reich would take place in 1919.

The Germans and the French considered Russia as an ally in their mutual arguments. An ally that was an obsolete semi-Asian empire whose Tatar-Ukrainian-German aristocracy splurged on entertainment, luxury items and benevolence of governments in Europe. Nothing changed much in terms of the essence of interaction between the Russians and Europeans ever since.

The “Iron Chancellor” who united the Germans had a pretty good concept of what Russia was and no illusions in that regard. In 1859, he was sent as Ambassador of Friedrich Wilhelm IV to the court of Alexander II. Bismarck resided at the palace of Count Stenbock on Neva. Earlier, tourists used to walk by the building and only notice the Aurora cruiser moored nearby. Today, the residence has a memorial plate in Russian and German for the years when Otto von Bismarck lived there: obviously, Russia still needs German support.

In St. Petersburg, the person who became Bismarck’s teacher in the art of diplomacy and whose impact defined the development of Russian-German relations, was Alexander Gorchakov, the Russian Empire’s Minister of Foreign Affairs. The luxury-loving Bismarck fit well into the social life of the tsars’ capital. He learned to speak Russian, admired local culture, attended salons and even set up one of his own. It was then that Bismarck developed his concept of “the union of three eagles” (Austrian, Russian and German) against France. Only that was exactly when tensions were rising between Russia and Austria around Turkish control over the Balkans and the Straits.

The idea to divide Russia emerged in European diplomatic circles back in the mid-19th century: a 100-million empire posed a growing threat with its backwardness and ambitions of annexations.



**Chilly dialogues.** Vladimir Putin’s personal attitude towards Angela Merkel conceals something deeply flawed, similar to the hatred of the impotent past against the future

Russia’s northern parts were supposed to go to Sweden. The rest of its territory could be divided between Poland, Malorossia and Velykorossia. Who knows what these projects would have led to if it hadn’t been for Bismarck who put an end to all that. He saw France as the key enemy against the unification of the Germans, so he needed a friendly and strong Russia in the rear. That explains why Germany was virtually the only European country that supported the suppression of the January Uprising in Poland.

After Bismarck’s term in St. Petersburg expired, he became ambassador to France. The Russian trail followed him there as well: he fell in love with Yekaterina Orlova, the daughter of Count Nikolai Trubetskoy and the wife of Nikolay Orlov, Russia’s ambassador to Belgium, during vacation at the fashionable Biarritz resort. She was 22, Bismarck was close to 50. This late love remained in the Iron Chancellor’s memories till the last days of his life: he had a medalion with the portrait of the charming Yekaterina in his suit pocket.

As he accepted the proposal of King Wilhelm I to become Chancellor, Bismarck immediately outlined his agenda for the Reich’s development: unification of the German lands, removal of competition from Austria, development of the army and the fleet. Without Russian support, however, he would never have been able to bring his plans into life: it was the threat from Russia that prevented a union between Austria and France and a war against Prussia. Bismarck paid Russia back: it once again gained the right to have its military bases and fleet on the Black Sea (lost with the defeat in the Crimean War) at the conference in London lobbied by Bismarck. The Chancellor had an idea what the new armament of the ally could lead to, but did not see threats to Germany in it. He believed that German politicians would stick to the will of Friedrich II.

Yet, the conflict between Germany and Russia was inevitable: panslavism was slowly creeping from literature discussions into political practices in the Romanovs’ empire. The defeat in the Crimean War hushed up talks about Russia’s special mis-

sion and being “the God-chosen”, but all that came back to the forefront through wars against Turkey in the 1870s. Alexander Gorchakov, the patriarch of Russian expansionism, tried to cement the empire’s influences in the Treaty of San Stefano, but the Berlin Congress of 1878 organized and hosted by Bismarck fixed a somewhat different balance on the European arena. This postponed the likely conflict and moved the field of the clash to the Balkans, West Asia and the Middle East. Yet, it did not solve the eternal Russian problem: the country needed money, the landlord aristocracy did not feel comfortable living in poverty. At that point the German government imposed protective duties on Russian grain and metal products in 1879 in an attempt to protect national economy. That forced the exporters of Ukrainian grain that used to follow the new railway route from the Black Sea steppes through Yelysavetgrad and Balta, to Odesa, to seek new clients.

At the same time, Otto von Bismarck remembered very well the will of Alte Friz and did not have in mind an argument with Russia. He tried to revive the “union of three eagles”. When that failed, he suggested a bilateral treaty to Russia. His utmost desire was to avoid a war on two fronts. As soon as he retired, Germany took on the concept of two fronts and the start of war became only a matter of time.

**THE CRISIS THE EU IS GOING THROUGH IS RATHER THE “PROBLEM OF GROWTH” THAN A FALL, DESPITE ALL HOPES FOR THE LATTER FROM THE LEADERS OF THE “NEW RUSSIAN ARISTOCRACY” COMPRISED OF THE SILOVIKI AND CRIMINAL ACTORS**

In 2015, Germany celebrated a 200-year anniversary of Bismarck’s birthday. His name is used today to achieve political goals. SPD’s Gerhard Schröder, once Germany’s chancellor and now a friend of Vladimir Putin, is now busy with taking care of Russian business affairs in Germany. As board chairman of the Nord Stream consortium, he is a great fan and promoter of Bismarck’s cause (as he understands it). Unfortunately, lack of education and superficial knowledge leads to primitive and mechanic analogies. Bismarck’s benevolence towards Russia was based on practical calculations of protection from France, liberal and socialist ideas, and not on common values. Has Russia managed to help Germany throughout this time? This is a rhetoric question given the fact that these countries ended up on two different sides in both World wars. Is a confrontation with France still relevant for Germany today?

**GERMAN RUIN AND GERMANY POWER**

The 20<sup>th</sup> century saw the bloodiest period in the German-Russian relations. Russia’s transfer to the camp of Germany’s opponent, France, in the late 20th century, and the growing ambition regarding Turkish domain changed the situation and caused the explosion of World War I. The confrontation on two fronts dealt the final blow to the Hohenzollern

empire, and the German Republic came to replace the Second Reich.

In Russia, by contrast, the fall of the Romanovs led to a new, totalitarian regime which now disguised its ambition to rule the world in the *zem-shar respublika sovetov* – the “planetary republic of soviets” (which didn’t prevent the Russians from switching back to the concept of the special “Russki Mir” mission in the 1990s). Once kicked out from the club of European states, the two pariahs of European politics made a deal in Rapallo and thus essentially laid down *modus operandi* of further bilateral relations, whereby the Germans needed a trade partner after their defeat in the military conflict, while the Russians need money (as they always did). The two sides continued to live by this modus up until the reunification of Germany in 1990 – in the interwar period when Stalin build his Red Army at the expense of the German economy; after the war when the Soviet Union was milking more and more loans, technologies and goods from Germany while tangling the carrot of possible reunification in front of the German noses. It’s worth remembering that Russia was one of the four winner states in World War II whose decision was key in the prospect of allowing German unification. That’s why the talks between Nikita Khrushchev and Konrad Adenauer, or Leonid Brezhnev and Willy Brandt, or Mikhail Gorbachev and Helmut Kohl, pretty much boiled down to the German attempts to reunite and offer the Russians money in return.

The essence of the German-Russian relations remains the same even after the reunification of Germany and the collapse of the Soviet Union. Only with one important nuance: in the 21<sup>st</sup> century the tricks of the 20<sup>th</sup> or 19<sup>th</sup> centuries do not fly. Russia may be blackmailing Europeans with military aggression against Ukraine, flows of refugees from the Middle East or placement of missiles in Kaliningrad Oblast, but it won’t get the result it seeks from this, i.e. money. The rise of the European Union turned one-time enemies into allies who share common values, currency and military doctrine. The crisis the EU is going through today is rather the “problem of growth” than a fall, despite all hopes for the latter from the leaders of the “new Russian aristocracy” comprised of the siloviki, criminal actors and bandit militant formations from the Caucasus. Putin’s hopes that Russia will once again be able to solve things through secret diplomacy, special operations and weapons, are vain. A century after Spengler’s *The Dawn of Europe*, Europe is still standing and pretty resilient to all the shakes. The strong Germany has become the cement of the strong Europe.

That’s why the goal of the Russian regime is to destroy the European Union, and Germany as its richest country. Vladimir Putin’s personal attitude towards Angela Merkel conceals something deeply flawed, similar to the hatred of the impotent past against the future. In terms of their age, the leaders of Germany and Russia belong to one generation. In terms of historical epoch, the countries have parted ways for ever. Will Russia be able to catch up with the time it has lost? As long as it remain an empire, never. ■

# A subtle balancing act

Interviewed by Anna Korbut

What kind of a leader is Germany between the US, China and Russia? How do German politicians view their country's role in the world? *The Ukrainian Week* spoke about this to Stephen Szabo, Executive Director of the Washington-based Transatlantic Academy



**The nature of German power.** Germany's diplomatic strength is based on its economic power, not military strength. Its diplomatic strength comes out of its ability to use its economic power to leverage other countries, as well as to provide aid. Two examples would be Greece and the eurozone issue. And, of course, the Russian sanctions issue where Germany took the major lead.

Whether this will be changing in view of the current challenges - that's the key question which the Germans haven't really answered. There are small signs that they will increase defense spending a little bit, and the German public supports this a bit more. But that's still pretty small.

The result is a geo-economic power facing a confrontation with the military power in Russia. At this point, they have to rely on NATO and the US for the military backup. I don't see it changing too much: there is a deep aversion in the German public to the

use of military force and tools. Plus, it takes away their resources from economic policies. I tend to think that Germany will continue to ride on American military power when it's necessary.

**Is there a consensus in Germany on what kind of a leader it should be?** Angela Merkel represents a large part of public opinion in Germany today. She has been crucial to the German position on, say, sanctions against Russia. Also, Merkel is not happy about Nord Stream 2 project. But she probably felt that she had to let this play out to keep the coalition with the SPD going. She might be still hoping that the European Commission will somehow block this. Why is this happening? Simple: Gerhard Schröder, his role in Gazprom, influence in the SPD, and the interests of German business to continue building long-term business relationship with Russia. SPD also has a long-standing built-in culture of willingness to work with Russia after *ostpolitik*.



So, as long as she stays chancellor, Germany's policy on that will stay firm. And the German public will provide support in that because, even if the sanctions are costing them a lot, they still feel that it's important to make the point on what the Russians have done in Ukraine. If, however, she had to leave too early, a change in the position would be possible. What we're seeing right now is the SPD beginning their campaign for next year (German federal election will take place in late summer to mid-fall of 2017 – **Ed.**). The SPD are trying to find an independent profile from the grand coalition with the CDU. They only have around 20% in the polls and are desperate at this point.

**Germany and Russia.** The Russians were very surprised by Western unity on sanctions and the Minsk issue. But Vladimir Putin probably still thinks the West will not hold together in the long run, he's playing the longer game and thinks he can outlast the rest of the West. Germany has been the solid pillar that's held the West in terms of sanctions together. Putin is probably hoping that Merkel will somehow be destabilized in the next couple of years. If she's replaced, the sanctions will probably get weaker and maybe even end.

In the past six months, however, the US has been Germany's biggest trade partner; Germany invests a lot there. France had been the top trade partner for years before. Also, economic relationship with China is probably more important for Germany than that with Russia. Still, there is substantial energy dependence on Russia. In addition to that, big companies in Germany still see a long-term future with Russia. They've been there since Catherine the Great, so it's nothing new.

**Germany and the US.** It's been clear for a while that Germany has become the key partner for the US in Europe, especially as Britain and France have had their problems and have not taken leadership roles in the past couple of years. President Obama has made it very clear that Brexit would create a major problem for the US-British relationship and would clearly lead to a stronger reliance on Berlin. What we'll probably see developing now is a much closer Germany-American relationship in Europe.

At the same time, Washington has been pulling back from the European focus and Germany took the lead. That will probably continue to be the case, unless Russia escalates in Ukraine or somewhere else in Europe. As long as the situation remains relatively

stable in Europe, I don't see a major US re-entry into the European scene, even though I think it's necessary for the US to re-engage. Donald Trump would definitely not do that. Hillary Clinton might be willing to re-engage in Europe. But the US has a lot of other things to worry about. Generally, the future of Germany depends on the future of Europe. For the US, the future of Europe is not as existential as it is to Germany.

**Germany in Europe.** The question is whether the Germans will take a stronger lead, and whether Europe will accept that – Europeans don't like to be led by one country. A lot of problems could develop out of that. That's why the Germans were worried about Brexit – that would leave them out there in the open, given that France is very weak right now, so Germany becomes the only leader. When it leads, however, everybody gets nervous. You can see that not only on Ukraine, but also on the refugee issue, the eurozone, the deal with Turkey. A lot of things the Germans have tried to do have led to very strong reactions. So a good question to be asked is whether Europe can be led? It's a very diverse area and with various national cultures, interests. The federalist option seems to be dying. The next ten years in Europe will be a very uncertain period. By the way, it is extremely important that Ukraine survives and succeeds. If Ukraine falters or the Russians can win out in Ukraine, then we're talking about a very different and dangerous Europe.

**A LOT OF THINGS THE GERMANS HAVE TRIED TO DO HAVE LED TO VERY STRONG REACTIONS. SO A GOOD QUESTION TO BE ASKED IS WHETHER EUROPE CAN BE LED?**

I really worry about German-Polish relations right now – these have been crucial to unity on Russia policy over the last couple of years. If the Poles decide that they want to take a more anti-German line, that would be very dangerous for undermine solidarity over Russia.

Overall, Germany is a central European power. It has to develop some sort of constructive relations with its partners. It doesn't like what's going on in Poland or Hungary, but at the end of the day there will probably be some way of working together. The Germans can't afford to have a hostile Eastern Europe on their borders. It's also important to them economically. But finding that way would be difficult.

That goes back to the question of Germany leadership – if it gets too strong as a leader, not only the Greeks, but the Poles, Hungarians and others will get nervous. So, it's a delicate balancing act: they need to have leadership within the European context. If it only becomes leadership only within a bilateral or national context, you'll have problems with suspicions and concerns about German power in Europe.

There is still a lot of concern that Germany will return to the equidistance position between the US and Russia, especially if it becomes more independent and Europe begins to unravel, while Germany has to live with Russia. ■

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# Double imprisonment

Stanislav Kozliuk, Hanna Chabaraï

Ukrainian prisoners in Crimea are being transferred to Russia, given Russian passports and punished for rejecting them

**T**hey are the Ukrainians convicted in Crimea, who were held in Simferopol remand prison and other pre-trial detention centres on the peninsula. According to the Human Rights Information Centre, which among other things monitors prisoners, more than 3 thousand were being held in Crimean penitentiary institutions at the time of the annexation. Not only Crimeans, but also residents of other Ukrainian regions, who were taken to the peninsula to serve their sentences. Later, they began to experience problems. Firstly with citizenship. As you know, the occupying Russian authorities decided to forcibly issue Russian passports to Ukrainian citizens. They had a month to turn down this "service". But prisoners had some trouble with this. According to lawyers, they were given forms for refusing a Russian passport, but it seems most of these documents went missing without a trace.

"In some cases, prisoners were handed forms and told that they should fill them in if they do not want to be citizens of the Russian Federation. They completed them and the forms were collected without any comments. After that, the prisoners were given Russian

passports. The Ukrainians said that they filled in the refusal documents. However, prison authorities have responded that they have no information about this. There were times when they didn't even hand the forms out," lawyer Roman Martynovskyi, Ukrainian Helsinki Human Rights Union expert, said in a comment to ***The Ukrainian Week***.

According to him, those who renounced Russian citizenship were thrown into solitary confinement.

"It is clear that their refusal was not the direct cause. Guards found the slightest reasons to put the prisoners in solitary. And when they came back, they were offered citizenship again. They refused again. So they were thrown back into solitary confinement. It also happened that prisoners with a pro-Ukrainian position were put in cells with those who supported the 'DPR and LPR'. It got to the point that these people were sent to Russia to 'serve their sentences' before others were," said Martynovskyi.

## DOUBLE TRIAL

And the problems did not end with the assignment of citizenship. The occupants began to create their



own "courts" in Crimea, which started to review Ukrainian prisoners' sentences and "bring them in line with Russian law". Next – a transfer to Russian territory. The Ukrainian Foreign Ministry in a reply to The Ukrainian Week's request stated that they are currently aware of about 170 cases when Ukrainians were reconvicted and 179 cases of transfers from the annexed Crimea to Russia.

According to Deputy Justice Minister Serhiy Petukhov, the sentencing of Ukrainian citizens in Crimea by Russian courts and their transfer to Russian territory is a violation of international humanitarian law, which defines the legal regime of occupation. In particular, this is in reference to the Hague Convention of 1907 and the Fourth Geneva Convention (1949). In addition, in 2014 Ukraine adopted a law on ensuring the rights and freedoms of citizens and the legal regime in the temporarily occupied territory. According to international norms, the judicial system should remain unchanged in such a territory. There is also a ban on transporting people to the aggressor state.

Meanwhile, the Foreign Ministry has stressed that the number of transferred Ukrainians may be much higher. According to Parliamentary Commissioner for Human Rights Valeriya Lutkovska, Ukrainian prison authorities still do not have a list of citizens sentenced before the annexation.

"We do not know how many people are left in Crimea that were sentenced by our courts in accordance with Ukrainian law. There is an approximate figure – 2 thousand people, but no one knows exactly how many and which institutions these individuals were in," she said in an interview with Radio Liberty.

Lutkovska added that about 20 relatives of Ukrainian prisoners who are now in Russia have contacted her.

"We have two forms of data: names and the total number. Our list differs from the ministry's and contains about 90 people. But the numbers change daily. For example, today there are 28-29 prison camps in Russia where Crimean prisoners are serving their sentences. We only have information from 16. There alone there are roughly 2,200 inmates. And there are another 11-12 colonies for which we don't have any data. We know that people are there, but we don't know how many," said Martynovskiy.

"In addition, we don't have all the names yet either. We don't know where 25 people are now. It is known for sure that they were in the Simferopol pre-trial detention centre, from where they were sent to serve their sentences in Russia. After that, the trail is lost," he added.

Inmates transferred to Russia repeatedly tried to contact Ukrainian diplomats, but this was not made easy for them. For example, Dmytro Sotnikov, the lawyer of Ukrainian political prisoner Oleksandr Kostenko, published a statement from prisoners sent to the Kirov Region in late March. When Ukraine announced an amnesty, prisoners demanded that the Russians apply it to them too. However, this was denied because of their "new sentences", i.e. the ones "brought in line with Russian law". In addition, as Sotnikov explained to *The Ukrainian Week*, representatives of Ukrainian

consulates were prevented from coming into contact with the prisoners. In particular, the Ukrainians were thrown into solitary confinement, which made it impossible to meet diplomats.

Later, on May 11, Ukrainian citizen Elvis Asanov tried to slit his throat in court, protesting against the attempts of a Crimean court to convict him as a Russian citizen and transfer him into the penitentiary system of the Russian Federation. His life was saved.

Asanov and other prisoners wrote a letter to the Ukrainian government that has been published in the media. They asked for forgiveness from Ukrainian society for their crimes and declared that they want to return home, as they are being forced to serve their sentences in a state whose laws they did not violate.

"What we once did not does not deprive us of our country's citizenship. We want and hope to return home to our loved ones. We want to live for the good of our country, but we cannot see the desire of the country to help us," referred to in the letter.

## AN EPHEMERAL RETURN

Ukraine may demand the return of its imprisoned citizens based on at least three documents: the Convention on Legal Aid and Legal Relations in Civil, Family and Criminal Cases, the Convention on Serving Criminal Sentences Abroad and the European Convention on the Transfer of Sentenced Persons. However, when Lutkovska made a request to Russia in 2015 for these people to be transferred to Ukraine in order to serve their sentences, Russian ombudsman Ella Pamfilova replied that this would only be possible in accordance with the Convention on the Transfer of Sentenced Persons, which provides for the transfer of prisoners from one state to another. And here a big problem arises: since Ukraine does not recognize Crimea as Russian territory, it is impossible to use this mechanism.

"Ukraine cannot request the transfer of prisoners to serve their sentences, because they are already in Ukraine. Otherwise, there would be recognition of the fact that Crimea is not our territory. Problem number two: Russian authorities have revised the Ukrainian sentences. And passed new verdicts according to which the Ukrainians are now serving time. If the two Ministries of Justice were to prepare documents for the return of these people, our ministry would have to recognise the judgments of courts created in Crimea. But they were 'created' after the annexation, so are not recognised by Ukraine," explained Martynovskiy.

The same position was supported by Justice Ministry advisor Petukhov.

"Even if they are serving their sentences in Russia, the reason for this is a decision made by a Crimean 'court'. And when these people make a request to be returned to Ukraine, we get documents from this 'court', which is not recognised by Ukraine. According to the law 'On ensuring the rights and freedoms of citizens and the legal regime in the temporarily occupied territory of Ukraine', which is currently in force, we do not accept any documents created by the occupying authorities. That is why these people cannot be brought back through the Convention »



on the Transfer of Sentenced Persons," explained Petukhov.

So Lutkovska proposed Pamfilova a draft memorandum for returning Ukrainians on an ad-hoc basis. The memorandum envisages that the transfer of people convicted in the Crimea before the annexation to Ukraine in order to serve their sentences would be coordinated by the ombudsmen of the two countries without appealing to these conventions.

The Russian Ombudsman rejected the proposal, so the plan was stopped in its tracks.

In April 2016, a new human rights commissioner was appointed in Russia – retired police major-general Tatyana Moskalkova. Riding the wave of "humanity" following Putin's pardon of Nadia Savchenko, the newly-minted ombudsman said that Ukraine "is not doing anything" to take back its prisoners from Crimea and Russia "has no reason to hold them", because they committed crimes before the annexation, "on the territory of another state".

In an open letter on the same day, Lutkovska reminded Moskalkova that Ukraine has been trying to initiate the return of these prisoners for the past two years and re-sent the same draft memorandum that was offered to Pamfilova. The fate of the document is as yet unknown, but the ombudsmen have talked over the phone (on Lutkovska's initiative) and agreed on a personal meeting "within a short timeframe" to solve the problem of getting the prisoners home.

At the same time, Martynovskiy points out, there is no universal solution to this problem.

"There are options for various categories of prisoners. The first is Lutkovska's plan, the signing of a memorandum between the two countries' ombudsmen. The second is fulfilling the requirements of the convention that provides for the transfer of persons to serve their sentences in their home country. There is also the option of pardoning them and returning them to Ukraine. People whose sentences have not yet come into force can be brought back through cooperation between the public prosecutors. As you can see, there are a lot of ways to solve this problem," said the lawyer.

According to the Ministry of Justice advisor, not all is lost for the Ukrainians convicted by Russian courts. Appeals for their return are being received and the process is continuing. Therefore, legally Ukraine should bring the Russian court's verdict in line with its own legislation, determining the time and place where the sentence should be served.

However, there is yet another problem. Because of differences between Ukrainian and Russian laws, there is a category of people who had their sentences reduced by Russian courts. It is logical that these prisoners would not want to return to Ukraine, so as not to do "extra" time. It is not yet clear how to deal with them and how they can be brought home without violating their rights.

Martynovskiy stresses that a return home is based solely on a prisoner's desire. If they do not want to come back, they will serve their sentence in Russia. In this case, a consul must visit the prisoner and make sure that they made the decision voluntarily and not under the pressure of certain circumstances.

"There were situations when terms were reduced, but also vice versa. Ukraine's position should remain unchanged: it is not possible to worsen a prisoner's situation following a return to Ukraine. This would be inhumane and unfair. And a further obstacle to coming back. Imagine a person who got life in Ukraine, but 15 to 20 years in Russia. They've served this term and should return to Ukraine. But then there's a risk of going back behind bars. A former prisoner, who has remained a Ukrainian citizen, cannot continue to live in Russia: sooner or later, they will be deported. In my opinion, we must apply the principle of humanism. That is to say, the situation of prisoners should not get any worse," says Martynovskiy.

A separate problem is determining the status of persons who were sentenced by Ukrainian courts and taken to Russia, where they have already finished serving their sentences and want to come home. Especially since the new, so-called "Savchenko law" in Ukraine stipulates that each day of pre-trial detention should count as two days in prison. The mechanism of applying this law to such people has not yet been thought out.



## **THE OCCUPANTS BEGAN TO CREATE THEIR OWN "COURTS" IN CRIMEA, WHICH STARTED TO REVIEW UKRAINIAN PRISONERS' SENTENCES AND "BRING THEM IN LINE WITH RUSSIAN LAW"**

"Otherwise, tomorrow we will have a problem when people will return to Ukraine after serving their sentences and go to court demanding that their imprisonment over the term that should have been reduced by the 'Savchenko law' be recognised as illegal," said Martynovskiy.

In this context, the Ministry of Justice has drafted a law on regulating the legal status of persons who have served sentences in the occupied territory of Ukraine and the ATO zone. There are promises to publish it for public comment in the near future. According to Petukhov, the document provides a legal mechanism for reviewing the legality of their release and, accordingly, regulating the status of these people. The law should specify that such prisoners have served their sentences in full and are free to move around Ukraine.

The Ukrainian ombudsman, commenting on the release of our citizens from the occupied part of the Donbas, has already stated that prisoners who completed their terms there would not have to go back behind bars in Ukraine. We can therefore assume that the Ukrainian government is ready to take this step for other detainees too.

But the problem is not yet solved. And the public has still not seen the announced draft law. What's more, Ukrainians in Crimea whose sentences have not entered into force still remain deprived of their rights. Equally, more and more Crimeans, especially Tatars, are being held in Simferopol remand prison, waiting to be tried according to Russian law. This only means more work for Ukrainian diplomats and lawyers. ■

# The roads of underground capitalism in the USSR

Valeriy Prymost

The story of a Stalin-era shady businessman



It is strange that the Ukrainian public is shocked by the treasure troves found during searches of property belonging to ministers, public prosecutors, local administration heads and their deputies. It is even more surprising that some people think millionaires only emerged after the rejection of socialism and that they did not exist in the Soviet Union, except for in comic books. It is everyone's favourite Soviet myth—there was no corruption when Stalin was in power!

In fact, there were capitalists (of course, underground ones) during the Bolshevik era, and corruption flourished too – on a massive scale! We are not talking about the hedonists at the top of the power pyramid here, nor their hangers-on and the Cheka-NKVD-KGB mafia, but active and enterprising citizens. Since no Communist Party programme could eliminate the natural thirst for enterprise.

What could a businessman look like under Stalin? A certain Mykola Pavlenko, for example...

## BEGINNING OF THE ROAD

Here is what Russian Wikipedia has to say about him: "A fraudster, founder and commander of the mythical self-supporting organisation MCD-5 in 1942-1951, which operated in the Moldovan and Ukrainian Soviet Republics. The criminal took advantage of wartime confusion and faked documents to create a group that was disguised as a secret military construction unit." Of course, everything was much more interesting in real life: even Aleksandr Koreiko and Ostap Bender could not dream of fooling an entire empire. Mykola Pavlenko far surpassed his literary counterparts. In this sense, he was a true "Benderite".

Pavlenko was born in 1912 in the village of Novi Sokoly, Kyiv Oblast. He was the seventh child in a wealthy miller's family, which was doomed from the very beginning of the collectivisation process. Mykola left home at 16, shortly before the family were "dekulakised" and sent to Siberia (no one returned).

He forged new identity documents, giving himself an extra four years of age and a more appropriate social background. He enrolled at the Kiev Civil Engineering Institute (or, according to other sources, Minsk Polytechnic). The young lad always dreamed of becoming a builder: he wanted to build roads – a symbol of faraway uncharted territory for peasants, who were firmly rooted to their land.

Pavlenko was an outstanding student and started to believe that he had got away with it, would be able to quietly graduate, integrate into Soviet society and do the thing he loved the most. These illusions lasted for two years.

The regime needed new sacrificial offerings and the search for "enemies of the people" was gaining momentum. Personal files of teachers and students began to be checked at the institute where Pavlenko was studying. Realising it was only a matter of time before he would be exposed as a kulak's son, Mykola disappeared.

And became an ordinary worker: he went to build roads. Even this did not save him, and in 1935 Mykola was arrested in the city of Yefremov, Tula Region, Russia under the decree "On protecting the property of state enterprises, kolkhozes and cooperatives, and strengthening public (socialist) property" from the USSR Central Executive Committee and Council of People's Commissars dated 7 August 1932 (the so-called "seven eighths" law). After spending 35 days in remand, realising that things were bad and he had to find a way to survive, Pavlenko did not put up any »

resistance and allowed NKVD agents Sakhno and Kerzon to recruit him as a secret informer.

It is obvious that Pavlenko's natural insight, sharpness and intuition came in very handy for this sort of work, because Sakhno and Kerzon soon recommended him as a "conscientious" and "loyal" member of staff for the position of construction manager at the Chief Army Construction Department (CACD). There, Pavlenko rapidly carved out a career for himself and was promoted to head of his construction district (in Minsk). Moreover, he was already being looked at for a job at the central office.

This is when Pavlenko formed his *modus operandi*, and also when he read Ilf and Petrov's book *The Golden Calf*, which made a lasting impression on him. The Minsk Construction District worked quickly and efficiently, and – most importantly – very economically. This was incredible in a socialist economy, where everything was stolen: by producing substandard materials, simplifying production techniques and not worrying about worker safety. At first, Pavlenko also looked to cash in on the imperfections of the system, but his approach was fundamentally different. His savings scheme significantly reduced costs, and spare building materials were sold on the side: who can you blame for the fact it was dangerous to have entrepreneurial talent during Soviet times?

Mykola again thought he could finally get on with quietly doing what he loved – building roads. But then war broke out.

## THE ROADS OF WAR

On 27 June 1941, assistant engineer of the 2nd Infantry Corps, first-rank military technician and Senior Lieutenant Mykola Pavlenko left to join his unit at the front. The corps suffered huge losses and retreated to the town of Vyazma. Pavlenko had no desire to fight and die for the system that had deprived him of his home, family and future, and which could offer him nothing but the chance to be repressed and die like cattle or cannon fodder for the empire.

So in September, forging an assignment notice and assigning himself the rank of Captain, Pavlenko raced away from the front in a truck full of stolen canned meat with a personal driver behind the wheel. Arriving in the rear, he found acquaintances from his pre-war life, who had also deserted, in Kalinin (now Tver). This was not difficult, because an entire network of deserters with its own contacts and sources of funding operated in the front-line city. The NKVD periodically raided their secret rendezvous, but there were many ex-soldiers in town who had gone AWOL and their number increased daily as more Soviet units were routed.

The men had everything they needed to lie low for a reasonably long time: Pavlenko had his meat and a fellow Ukrainian, Ludwig Rudnichenko, had a virtuoso talent for counterfeiting documents. Ludwig greatly impressed his colleagues when before their very eyes he cut the words "Kalinin Military Commissariat" out of the sole of a soldier's boot to make a stamp. That is how they provided themselves with documents that solved their housing, food and security problems.



**Mykola Pavlenko.**  
A master of turning construction units into profitable firms

Some people, perhaps, would be satisfied with this, but not Pavlenko. He decided that having such opportunities and using them in such a limited way was simply ridiculous. He suggested to his flabbergasted comrades that they stop hiding and go into real business. To be more specific, by creating a military construction organisation.

Why construction? Because a scheme will not last for long if it only exists on paper. And what did Pavlenko know how to do well? Correct, build roads! It was a favourable time for fraud: there was complete disorder at the front and in the rear after the summer defeats

– no one had any idea which units were still around. The main instrument of law and power was a piece of paper with the right stamp and a prudently offered bribe. Therefore, provided the documents were done properly, it would be extremely difficult for the NKVD to expose the swindle.

They called their organisation Military Construction District №5 (MCD-5). Pavlenko was "unit commander" and "third-rank military engineer" (equivalent to an army major). Rudnichenko would take care of the paperwork, and another accomplice, Yuri Konstantinov (aka Konstantiner) was entrusted with security.

Having used forged ration cards to get their hands on more canned meat and condensed milk, the freshly minted builders visited the local printing house. The necessary stationery was quickly prepared in exchange for these groceries and Military Construction District №5 became a legitimate organisation. Not just that – the counterfeit documents allowed them to open an account at the Kalinin branch of the State Bank and get some uniforms from clothing depots that corresponded to their military branch and invented ranks.

After some "cordial" conversations with the local military commissar and commander, Pavlenko gained the right to recruit category G servicemen (the wounded who were being treated) into his unit. Shortly after, the number of personnel reached 40, promptly reinforced by deserters and soldiers left behind by their subdivisions. The equipment issue was easily resolved too: they simply collected the trucks, excavators and bulldozers that were abandoned at the roadside during the retreat.

The newly formed military unit got down to work. Pavlenko concluded contracts for road building and construction work with various organisations in Kalinin. They operated quickly and efficiently, earning good money, paying wages punctually and dividing profits between the "shareholders". Subsequently, Pavlenko introduced cash bonuses and the soldiers, accustomed to menial labourer status and miserable pay in rations, responded with an explosion in workplace enthusiasm.

The "business" grew quickly: the quality offered by MCD-5 stood out too much compared to the work done by other units. Everything was set up seriously: there was an "officer corps" personally loyal to Pavlenko, a Counterintelligence Service under the command of Konstantiner and – most importantly – the soldiers did not even suspect that they were serving in a non-existent unit!



All this continued for a year, until the Kalinin Front army formation was disbanded in autumn 1942. It made no sense for Pavlenko to stay in the rear, where there was more supervision and less work. They had to follow the front line, which was moving towards the west.

Pavlenko had a good reputation and considerable resources, so easily found a new home – the 12th Aviation Base District. Thanks to a bribe, it was possible to ensure not only full pay for his construction unit, but also the necessary cover for following the Red Army.

All this time Mykola did what he loved the most – built roads. Satisfied customers recommended him to their friends and colleagues, so the "business" grew in leaps and bounds. By the time they reached the Soviet border, Pavlenko's construction unit had two hundred employees and a brilliant track record, while the earnings of the "shareholders" amounted to one million roubles. How did Pavlenko manage to pull this off under Stalin's system of total control and accountability? Even amidst the confusion of war-time? Either he was fantastically lucky. Or...

Or his contacts with the NKVD did not end when the war started. Military road-building organisations were subordinate to not only the Ministry of Defence, but also the NKVD. This had been established practice since the 1930s, when construction bureaus were manned with prisoners and worked on the "Great Construction Projects of Communism". So we can assume that a financially successful organisation could not possibly exist without catching the all-seeing eye of the people in blue-topped caps. It is quite likely that Pavlenko had protection within the NKVD, in return for which he passed kickbacks up the chain of command – a principle that modern Ukrainians are all too familiar with. All he had to do was work well and not get into trouble. Which is exactly what he did. Enriching himself and his invisible patrons.

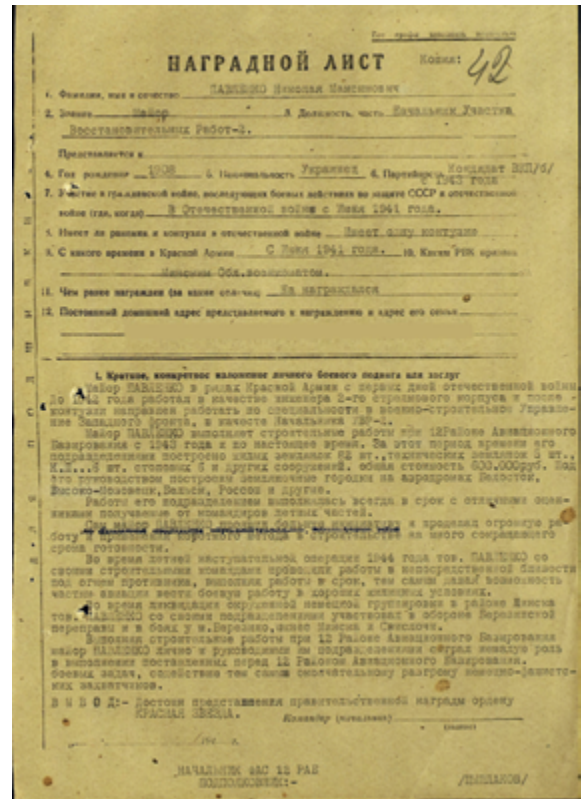
## THE ROAD TO BERLIN

But the real feast for the "clandestine capitalists" of the Stalinist regime started in Europe. Officially, they built bridges, roads and airfields, getting nothing but words of thanks from commanders in return.

However, Pavlenko did not only build things in the wake of Soviet forward units, but also earned money in another way. His men entered the empty Polish and German cities and... scooped up war trophies – both abandoned equipment and the property of the "liberated" population: cars, tractors, bicycles, carpets, sewing machines, gramophones, accordions, livestock, fodder, building materials, gold, jewels, works of art... By the time they made it to Berlin, their income exceeded that paltry first million many times over.

Interestingly, Pavlenko had his principles in the "trophy business" too: it was forbidden to touch anything that had owners (or the owners themselves). Once, he even shot three of his men dead for violating this ban. Although it was of course difficult for him to have full control over his subordinates in such a situation.

Pavlenko made his way to Berlin in comfort, alongside his wife, whom he met in Kalinin. Arriving in the German capital, he realised that he had hit the jackpot: thanks to bribes, Chief Logistics Command



**Glory beyond money.** Pavlenko had everything that meant a successful career in USSR — decorations, titles and so on

instructed him to collect captured enemy equipment. He sold some of the "harvest" and made an agreement with representatives of the Ammunition and Transport Supply Department and people from the military commandant's office to be allocated an entire train of 30 carriages to take the rest back home. The "shareholders" earned another 3 million roubles.

Back in Kalinin, Pavlenko decided to disband his unit in April 1946: the war was over and inspections were toughened, so the underground millionaire did not see the point in taking any more risks.

Personnel who had no idea about the true status of the organisation were demobilised first. At a ceremony, Pavlenko presented his men with orders and medals (a total of 230) that he acquired thanks to a fake report and a large bribe, as well as cash bonuses for their strong work ethic: 7-12 thousand roubles for soldiers, 15-25 thousand for officers. Pavlenko did not forget himself either: he picked up a 1st and 2nd Class Order of the Patriotic War, Order of the Red Banner, Order of the Red Star and 90,000 roubles.

## ROADS OF PEACE

After the war, he took charge of a civil road construction company in Kalinin – Plandorstroy. It seemed the future would be rather serene: he had finally found his safe haven. Mykola Pavlenko had a wife and young daughter, and planned to live in the lap of luxury: they had their own houses in Kalinin and, of course, Ukraine. As well as cars (the fine Pobeda model, obviously) and other trappings of the high life for those who were not threatened by the Ukrainian famine of 1946-1947 or deportation to Siberia.

This happy ending only lasted two years. The situation in the country was changing. A new witch-hunt began and people started to be examined more intently, while Mykola Pavlenko's nest egg unexpectedly plummeted in value following the 1947 currency reform. He felt the urgent need to relocate and return to his favourite occupation. He stole all the cash from the Plandorstroy coffers (339,326 roubles) and moved south with his wife and daughter.

## IN UKRAINE

In the Soviet Union of 1948, there was only one restless region with weak state control – Western Ukraine, where Banderite rebels did not stop their fight despite the “victory of the Soviet people”. Pavlenko arrived in Lviv, had a look around, got in touch with Konstantiner, Rudnichenko and the rest of the “shareholders”, and the wheels of their machine were set in motion again. In Lviv, the “builders” created a new “Military Construction Administration” (MCA-1). Following their tried-and-tested scheme, they produced the necessary documents, recruited men, obtained equipment and set to work. The initial conditions were excellent: the “shareholders” had considerable underground business experience and Pavlenko looked rather dignified in the role of decorated war veteran. Most effective were hints that MCA-1 was carrying out secret missions for the NKVD (this gambit worked well before, and it was flawless in post-war Western Ukraine, which was teeming with special agents and informers).

Pavlenko really did collaborate with the Ministry of State Security: local security agencies selected personnel for MCA-1 and provided them with weapons for “protection against Banderites”. In “liberated” Ukraine, MCA-1 did not stand out from the crowd of Soviet military units with its daily routine, combat and political training, patrols and flag.

The new “business” expanded rapidly. Within four years, it was a huge structure with headquarters in Chisinau and branches in Ukraine, Belarus, Lithuania, Latvia and Estonia. More than three hundred people (military and civilian) worked for the “firm”, which built mining, machine-building, food production and winemaking facilities in six Soviet republics.

From a modern perspective, Pavlenko was just a successful businessman who honourably fulfilled the contracts he entered into: bridges, roads and buildings were constructed on time and to high standards. His methods were market-driven: workers and engineers were paid well, depending on results, while dedicated workhorses were sometimes rewarded with a barrel of beer at the end of their shift. As for the bribes... well, a backhander to an official is a valuable entrepreneurial tool in adverse conditions for doing business.

Pavlenko was not a revolutionary and, indeed, not an ideological enemy of the system. Despite his hatred for the Soviets, he did not make a conscious stand against them. He was a simple entrepreneur who lived as far away from the system as possible and just did his job. As he later said himself, “We did not conduct not anti-Soviet activities, we simply built things as well as we could, and we were good at it.” During those four years in Ukraine, MCA-1 concluded

ed 64 contracts worth a total of 38,717,600 roubles. The “shareholders” were making such large amounts that their spoils of war from Germany seemed like small beer.

Mykola Pavlenko, an imposing and confident colonel (he conferred this rank upon himself in 1951), had influence in local government and was invariably sat next to the presidium at all official events. As before, he personally supervised major projects: it was the only way to ensure the quality that had become the hallmark of MCA-1.

It seemed that Mykola Pavlenko had become a person of national, rather than regional, significance in Ukraine, and he again began to think that he could strike a balance in life and quietly reach old age.

However, the larger an organisation becomes, the more difficult it is to control. Endless success created a sense of impunity in his closest partners, who were, to put it mildly, not the most decent of people. Over time, more and more slip-ups occurred: one of the “shareholders” would get drunk and start a fight in a restaurant or run someone over in their car, so Pavlenko would have to persuade the police to release him; once, a drunk Konstantiner dropped 2 million roubles, which he was taking to their high-ranking patrons, on an airport runway – much of this sum was lost as hush-money. Another time, Ludwig Rudnichenko, persuaded by his wife, decided to demand money from Pavlenko, threatening to turn in the entire “firm”. Rudnichenko ended up with 17 days under arrest, but Pavlenko later gave him 25,000 roubles anyway.

These careless members of Pavlenko's inner circle were never severely punished, the level of discipline in the unit started to fall, and it was only a matter of time before the entire house of mercantile cards came crashing down. It is unlikely that Pavlenko, with his exceptional intuition, did not realise this. But he was probably unable to leave his work behind once again and try to restart from scratch somewhere else. MCA-1 was a substitute family for the one that the Soviets had taken away from him in 1928 – he would not be able to go through that sort of loss again.

Pavlenko's “protection” continued to hold up, covering him against such slip-ups. But sooner or later something inevitably had to go so wrong that there would be no way out, and it would affect the entire “firm” – so much that it attracted the attention of the very top of the Soviet system.

## IN THE GUTTER

That is what happened. A stupid, but typical detail ruined Mykola Pavlenko and his “underground business”. Since MCA-1 positioned itself as a normal Soviet military unit, it, like the others, was supposed to distribute government bonds on a voluntary/compulsory basis. And because MCA-1 could not get them legally, they had to be bought on the Lviv black market. Once, an officer got greedy and decided to keep some of the money meant for such a deal. As a result, one of the civilian workers – a certain Party member called Yefimenko – was issued with bonds worth a smaller amount than he was owed. Yefimenko dashed off a complaint to Marshal Voroshilov, informing him that Colonel Pavlenko was not only disrupting a matter of national impor-

tance (the bond campaign), but also hired escaped prisoners and former Nazi collaborators.

An order was given to prosecutors in the Carpathian Military District to investigate and a criminal case was opened in Lviv on 23 October 1952. By 5 November it had been transferred to the Chief Military Prosecutor's Office. What a surprise it was for the authorities when it became clear that the military unit MCA-1 does not really exist! This colossal structure with branches in six republics, hundreds of people, tons of equipment, two dozen bank accounts, a turnover of millions and a huge number of completed projects was a hoax, no traces of which could be found in any database at the Ministry of Defence or other government agencies.

It emerged that Pavlenko had been on the nationwide wanted list since the Plandorstroy incident in 1948. Now these two cases were consolidated into one.

There was shock in Moscow: in the strict police state that was Stalin's Soviet Union, there had been a huge illicit military structure that made millions for years on end thanks to the illegal labour of Red Army servicemen! And worst of all – it was a capitalist structure! Which functioned perfectly in the very heart of the socialist system!

The operation to eliminate MCA-1 was conducted simultaneously in six republics. On 14 November 1952, 50 officers and 300 privates were arrested and more than 100 firearms, almost 70 vehicles and construction equipment were seized, as well as a huge number of seals, stamps and letterheads.

On 23 November, Mykola Pavlenko himself was arrested too. Order №97 for his arrest was signed by the Deputy Minister of State Security for the Moldavian SSR, Lieutenant Colonel Semyon Tsvigun. An interesting nuance: epaulettes for a General were found at Pavlenko's home during his arrest.

Prominent representatives of the republic's establishment were found to be involved in the MCA-1 case, such as Moldovan Food Industry Minister Tsurkan and his deputies, First Secretary of the Tiraspol Party Committee Lykhvar, Secretary of the Bălți Party Committee Rachynskyi, several Prombank managers, directors of state enterprises, commanders of military units and so on. Nevertheless, it is obvious that Pavlenko's most senior "contacts" avoided responsibility.

A special team of experienced investigators, headed by V. Markalyanets and L. Lavrentyev, was created by the Chief Military Prosecutor. They had quite a bit of work to do: over two and a half years, they collected 164 bundles of evidence.

Above all, the investigators were amazed that Pavlenko was paid for work that was actually carried out – and better than others could do it, at that. Alexander Lyadov, a senior investigator at the Central Railway District who worked on Pavlenko's case, remembered it as follows: "He built well. He brought in outside experts under contract. Paid wages in cash that were three to four times higher than at state-owned enterprises. He checked the quality of work himself. If he found any shortcomings, he wouldn't leave until they were fixed. After the first test of a completed line, he would put out a few barrels of beer and snacks for his workers free of charge, then

personally give the engine driver and his assistant a bonus, right there in front of everyone. At that time, many workers were getting 300-500 roubles a month. [...] But I didn't tell anyone about it. They wouldn't have believed me anyway."

## END OF THE ROAD

The trial began on 10 November 1954. The judges took turns to read out the indictment over several days. Pavlenko and 16 of his closest associates were charged on three counts: undermining state industry through the corresponding use of state enterprises, anti-Soviet agitation and participation in a counterrevolutionary organisation. Pavlenko admitted his economic crimes, but declared he "never had the goal of creating an anti-Soviet organisation".

## THE PAVLENKO-LED MINSK CONSTRUCTION DISTRICT WORKED QUICKLY AND EFFICIENTLY, AND – MOST IMPORTANTLY – VERY ECONOMICALLY. THIS WAS INCREDIBLE IN A SOCIALIST ECONOMY

Incredibly, he was acquitted of this charge – the rest was already enough. On 4 April 1955, the verdict was announced: Pavlenko was found guilty on multiple counts under Article 58-7 of the RSFSR Criminal Code and was sentenced to the maximum penalty (execution by firing squad), while 16 of his colleagues – Rudnichenko, Konstantiner and others – were sent to prison for terms ranging from 5 to 20 years, in addition to the restriction of their rights, confiscation of their property and revocation of their government awards. The verdict was final and not subject to appeal.

Party and government functionaries found to have ties with Pavlenko were punished in various ways: court hearings, dismissal, exclusion from the party and reprimands.

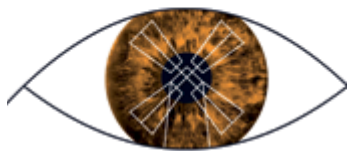
Brezhnev himself was in great danger, but he was very lucky that his close friend Tsvigun was working on the case. Tsvigun did everything he could to take the heat off Brezhnev, which was extremely risky, as a campaign against the misuse of authority by senior government officials was taking place at the same time in Moscow on Stalin's instruction. The Leader was planning yet another purge (this time based on economic criteria) and Brezhnev, accused of having links with Pavlenko, would have looked great in the dock. After all, over two years as first secretary of the Communist Party of Moldova he failed to prevent the "anti-Soviet armed organisation MCA", as it was called in military prosecutor documents, from operating in the republic. Tsvigun saved Brezhnev, although he was demoted to deputy head of the army's Chief Political Directorate.

Pavlenko was less lucky. He was executed by firing squad shortly after the verdict. He was 43. History repeated itself in a strange way: his parents' family had been stripped of everything and sent to Siberia, and now his wife and daughter had their property confiscated and were exiled to the same place as family members of an "enemy of the people". ■



**August 4****The Month of Readings with Writers 2016****Dzyga art center**  
**35, vul. Virmenska, Lviv**

Throughout July, Lviv is hosting a transnational literature festival that is taking place in parallel in five cities in Europe. 31 writers from Spain, as well as 31 authors from Poland, Czechia, Slovakia and Ukraine are involved in the literature action. Spain is the honorary guest of this year's readings. Interestingly enough, these writers' months were launched back in 1999 by the Czech publishing house Větrné mlýny and has been a good annual tradition ever since. Ukrainian writers/readers this year include Iryna Tsi-lyk, Pavlo Arie, Andriy Lyubka, Yuriy Izdryk and many more.

**August 19-21****ZAXIDFEST****Charivna Dolyna complex**  
**Rodatychi village, Lviv Oblast**

The festival summer is in full force, continuing with three days of total non-stop music satisfaction at one of the top festivals in Western Ukraine. The most gourmet music lovers will find something for their taste among the dozens of bands and solo performers from Ukraine and abroad. The line-up this year includes DevilDriver, Enter Shikari, Emmure, Crystal Castles, Hollywood Undead, Oomph!, IAMX, Zebrahead, Vopli Vidopliasova and more. The guests will have three stages to choose from: the main stage, the rock/night one, and the indie stage. Also, the festival offers food and entertainment areas.

**August 24****Social contract****Izolyatsia. Platform for culture initiatives**  
**8, vul. Naberezhno-Luhova, Kyiv**

Establishing a discussion platform between artists, society and government – this is the role the organizers ascribe to the *Social contract* project. This discussion will focus on the re-thinking of memory objects from various periods in history, such as in *Inhabiting Shadows*, an art intervention by Cynthia Gutierrez at the location of the Lenin monument in Kyiv that was knocked down. The project's starting point can be the exhibition of art works from ten countries aimed at encouraging the viewer to think about the issue. The public program involving workshops, discussions and lectures will help transform the thoughts born in the process into words.

**August 27-28****Skhid-Rock****Kruhlyi Dvir fortress**  
**Troštianets, Sumy Oblast**

The festival capital of Eastern Ukraine is prepared to host guests at its old fortress dating back to the 18th century with an ocean of positive vibes, drive and an incredible line-up. This year's festival will feature American band Our Last Night, Überyu from Switzerland, and Fire Next Time from Canada, as well as Ukrainian bands The Hardkiss, Skriabin, O. Torvald, Rolliks and many more. The organizers encourage the audience to bring tents, food and good spirits with them. Beautiful nature and a great music show – what else would one need to be happy?.

**August 28****London-Kyiv****Art 14 gallery**  
**14, Mykhailivsky Provulok, Kyiv**

A symbolic name for the exhibition of works by the Ukrainian-British painter Oleksandr Shuldyzhenko seems to reflect his life. Born in Kyiv, he shaped his artistic persona in the capital of the UK. His tendency to lean to Western trends in art made his works difficult to comprehend amongst peers in the Soviet Union. Even today, Shuldyzhenko's art is known in a narrow circle of experts. It will be very interesting for anyone in Kyiv to take a behind-the-stage look of the painter's work and get to know his paintings.

**August 30. 7 p.m.****The Bad Plus****Atlas**  
**37-41, vul. Artema, Kyiv**

Critics describe their music as acoustic jazz of the future. Peers call it a staple of contemporary American jazz. Fans simply can't wait to see the band play live in Kyiv. Its repertoire includes covers of hits by David Bowie, Radiohead, Nirvana, Pink Floyd and other legends of the world's rock scene. Performed by the legendary trio, the familiar tunes gain a new, jazz twist. Their latest album, *The Bad Plus Joshua*, was recorded in 2015 in collaboration with the famous American composer and saxophone player.



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