

# CORRUPTION AND “RULES OF THE GAME” IN UKRAINIAN ECONOMY

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*You don't grease – you don't ride*

- A Ukrainian proverb

### *Corruption in the Ukrainian context*

In the last 20 years, the issue of corruption has entered the agendas of all major political actors in Ukraine and other Eastern European countries. It became a prominent factor international development and democracy assistance to the region, too. Ukraine is the third major aid-receiving country in Europe after Turkey and Serbia. The EU, IMF, USAID and the World Bank, who are the main donors to the country, are increasingly preoccupied with anti-corruption, and adjust their aid and loan policies accordingly.

To an extent, this concern with corruption reflects the consolidation of the liberal policy consensus about the way the state should intervene into economy and govern society. Critical scholars from a range of disciplines from political science to geography to development studies point at the fact that the international anti-corruption movement is antagonistic to the state and promotes policies usually associated with neoliberal economic regimes. However, this is only a part of explanation.

Just as the post-socialist liberalization in Ukraine promoted markets and enhanced democratic institutions, it swept away real wages in the public sector, tore apart social safety nets, reduced the ability of the state to enforce its laws and undermined habitual modes of sociality and representation through socialist political institutions. People fell back on entrenched informal institutions such as *blat* and “shadow economy” to subsist. Corruption soared. It became the symbol of the rampant socio-political disorder in the country. After the actual growth in corrupt practices, this is perhaps the second main explanatory factor behind [Ukraine's steadily low score](#) – the bottom quartile – in the Transparency International's Corruption Perception Index.

Today bribery, extortion and use of personal connections is a mundane reality for 60,1% of adult Ukrainians, reports the USAID-funded 2011 [representative survey](#) conducted by Kyiv International Institute for Sociology (KIIS).<sup>[1]</sup> When looking into specific forms of corruption mapped onto public sphere sectors, in 2011 on average 25,8% of respondents reported having been extorted bribes in the preceding year. When dealing with government permits, 47,1% said officials demanded payments explicitly, and 40,2% testified bribe extortion in business regulation and inspection. The figure was also high among those who dealt with customs (36,1%) and the judiciary (30,2%). At the same time, in the mentioned domains 21,2 to 30,3% of respondents used personal connections to approach public officials. About half that number, or 10,7% to 16,1% reported having paid bribes voluntarily.

#### *Corruption and informal rules of the game*

As the data demonstrate, the most heavily corrupted domains of public administration are the most heavily regulated ones, where street-level bureaucrats exert considerable discretion over allowing, restricting or imposing sanctions or economic activities<sup>[2]</sup>. Corruption exists not because the state is “weak”, but because it is unaccountably strong, while there are little mechanism for citizen control of the administration. Indeed, although graft is often linked to the weakness or failure of official state structures, the problem lays not in the fact that the law and formal rules do not work, but that they work in unintended ways, often in combination with informal norms and institutions. The Russian sociologist Ella Paneyakh studied how petty entrepreneurs engage with what she calls “formal rules of the game” – official regulations governing economic activity. She found that these regulations are numerous and change frequently (which is also true for Ukraine), so that sometimes even agencies called to enforce them are unaware of the new changes and acknowledge that it is impossible to carry them out. Paneyakh argues that in response to the burden of formal rules that require a great amount of time and paperwork, entrepreneurs seek to play by the informal rules of the game. Thus, she stresses that people see the recourse to law not as a mundane way of resolving conflicts, but

as an extreme measure. This also extends to the ways in which entrepreneurs engage with controlling bodies like tax, sanitary and fire inspections. They prefer to negotiate with state officials and establish informal relations often implying illicit payments so as to harness the state's control over the legality of their business and achieve what is understood as a win-win outcome. The results of the KIIS survey and focus group interviews testify to Paneyakh's conclusions. In presence of informal institutions that modify how formal rules work, and eventually reduce the burden of state's administrative control, corruption carries out an important economic function. Intertwined with mundane formal procedures, it works to reduce transaction costs and smooth sharp edges of business regulations. As development studies scholars have recognized back in the 1970s, corruption can positively affect growth rates in the informal economy.

But informal economy is hardly a solution to the acute problems of social development Ukraine faces now. In the long run, it is costly, generates considerable uncertainty and insecurity, and stifles state revenues. Opening up opportunities for some, corruption cuts them for others. Pervasive bribery and a dysfunctional bureaucracy marginalizes the poor who are not able to pay the bribes, while the rich seem to find other ways to deal with the problem of malfunctioning formal rules and avoid paying bribes altogether, using powerful personal connections. As a result, corruption exacerbates social inequality, which in the long run has negative effects on economic growth.

In addition, with the growing internationalization of Ukrainian economy, the problem of corruption seems to undermine the inflow of foreign investments to the country. At the micro-level, foreign investors who do not possess economic capital and information to buy off bureaucrats deciding on permits and regulations, are likely to lose competition to local firms much more flexible in going about the formal regulatory framework. At the macro-level, the internationalization of Ukrainian economy works the other way round, offering numerous opportunities for informal, although technically legal, "tax optimization" through off-shore funds and companies. The Ukrainian watch-dog association [\*Nashi Groshi\*](#) has been following

Ukrainian public procurement since 2010. They have found numerous instances in which companies that received public contracts could be traced back through off-shores in Cyprus and the UK to family members of public servants and politicians controlling the public procurement tenders.

*Is anti-corruption a prompt response?*

Corruption is thus a serious problem that manifests itself in a variety of different ways. But is the anti-corruption law enforcement a prompt response to the perils of graft? In 2011 Ukrainian Parliament passed a new law "On the foundations of the state policy in the field of anti-corruption," developed in accordance with the recommendations of and under the supervision of the Council of Europe's Group of States Against Corruption (GRECO). The new legislative framework, which set the basis for the National Anti-Corruption Program (NACP), received positive evaluations from GRECO experts. It was said, Ukrainian Government demonstrated commitment to international standards in the field of anti-corruption.

However, now, two years after the anti-corruption bill was passed and the NACP devised, it remains unclear whether there are any tangible changes in the Ukrainian fight against corruption. The NACP is poorly financed, and the prosecution of corruption remains largely confined to the street level of bureaucracy. Charging higher level bureaucrats, let alone politicians is more a matter of local politics than policies of law enforcement. Thus, despite the promoted partnership between civil society and the state in anti-corruption matters, there is little sign of authorities' attention to the investigatory work of *Nashi Groshi* and other watchdog groups. More often than not, officials respond to requests of investigative journalists with a binding collective wall of silence – the Soviet-time *krugova poruka* persists.

But probably the most important problem lies with the way the anti-corruption law enforcement approaches the practices it is called to reduce. In line with the existing scholarship on the subject, Ukrainian anti-corruption legislation defines corruption strictly as

the abuse of public office for private gain. In this way it excludes various corrupt practices, such as trading in informal influence and favoritism from the legal category of corruption. It leaves the law enforcement agencies with no incentive to investigate into vertical and horizontal linkages of informal power that permeate bureaucratic institutions and tie political and administrative institutions at all levels of governance into what people refer to as *systema* – “the system”.

The systemic character of corruption, and its origins in the way social and economic institutions have responded to the transformations of the state after socialism, begs critical scholarly focus and appropriate attention of institutions charged with implementing the new anti-corruption legislation. Without this, Ukrainian anti-corruption will target individual acts of corruption without really solving the problem.

<sup>[1]</sup> As of today, The KIIS survey is the most complete representative study on the topic in Ukraine. Unlike the research done by Transparency International for the Corruption Perception Index, it includes data both on perception and actual practices of corruption.

<sup>[2]</sup> The 2013 [Index of Economic Freedom](#) ranks Ukraine at the 161 place of 177.

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