

## **Party Funding in Ukraine**

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Several legislative bills have regulated the issues of party finance in Ukraine during the first post-communist decade. The various aspects of party functioning were initially addressed in the law on “Civil Organizations” that was passed by the Ukrainian parliament in June 1992. The law tried to establish the basic principles of party organization and functioning in a former Soviet republic that declared its independence in 1991. A draft law “On Political Parties”, which was introduced for the first time in the parliament in the middle of 1998, has been finally adopted in April 2001. The draft law further elaborated the principles and mechanisms of party finance that were initially introduced in the 1992 law. Besides these two key legislative documents, laws on local, parliamentary and presidential elections have important provisions that deal directly with the issues of party funding during the electoral campaigns (*reference to the chapter on campaign finance*). The draft law “On Political Advertisement”, introduced in the parliament in spring 2001, is another piece of legislation that promises to have a substantial effect on how party raise and spend money on both regular and campaign advertisement.

The 1992 law on “Civil Organizations”, reflecting the immature character of civil and political societies and responding to the political expediencies of state-building in Ukraine, tried to regulate in the same document the activity of both civil associations (non-government organizations) and political parties. Although the law clearly distinguished between civil associations and political parties, covering both type of societal organizations with the same legal provisions had the effect of blurring the distinction between political parties and non-government associations. The law empowered the legislature to determine the maximum sizes of individual and annual contributions to political parties, to award tax benefits to party organizations and foundations, and to create special parliamentary commission for annual review of financial activity of political parties. In practice, all these provisions remained ineffective. During both the 1990-94 and 1994-98 parliamentary terms the deputies choose not to exercise their rights to regulate and directly monitor the financial activity of political parties.

Several other provisions of the 1992 law dealt explicitly with the issues of party finance. The law prohibited political parties to establish commercial enterprises with the exception of mass-media outlets and limited the commercial activity of political parties to the sale of media products, political literature and organization of festivals, exhibitions, and other public events with social or political agenda. The law established the criteria for fund-raising: parties were prohibited to raise funds from any sort of foreign entities (states, international organizations, companies, individuals), government bodies, state enterprises, and anonymous contributors. The law did not provide political parties with any form of public funding, direct or indirect.

The 2001 law on “Political Parties” was a law-makers’ response to the gradual maturation of political parties and growing salience of various aspects of party functioning in the political system. Building on the provisions of the 1992 law on “Civil Organizations”, the new law seeks to provide a comprehensive regulatory framework for party functioning in Ukraine. The contested nature of the law was manifested in the existence of numerous alternative drafts of the law and the fact that the law, which was introduced in the parliament at the beginning of the 1998-02 parliamentary term was finally enacted only in April 2001.<sup>1</sup>

There is a high degree of continuity between the 1992 and 2001 laws regarding the financial aspects of party functioning. The similarities and differences between these laws will be addressed in the course of the discussion of substantive issues that structure this paper’s presentation.

#### *Party structures dealing with party funding.*

Statutes of eight parties, which crossed the 4% threshold barrier in the 1998 elections, declare party conventions as a body that have ultimate control over party property and finance.<sup>2</sup> Party conventions, according to the statutes, delegate various

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<sup>1</sup>For the comparative table of the alternative draft laws see Materialy do Kruglogo Stoly “Zakon pro Politychni Partii v Ukraini: Ukrains’ka Dijsnist’ ta Evropeis’ki Perspectyvy” (Kyiv:Laboratoriia. Zakonodavchih Initsiatyv, 2001)

<sup>2</sup> The 1998 parliamentary elections were the first one in Ukraine conducted on a mixed electoral formula (half SMD and half PR). Previously, single-member district formula was used during the 1990 and 1994 parliamentary elections.

functions of financial management to the coordinating or executive party bodies. There is some variation in the degree of delegation with regard to, first of all, budgetary functions. As a rule, parties delegate the authority to form a budget and control its execution to the political councils or boards that coordinate and direct parties' executive bodies in between the party conventions. Only few parties choose to form and approve budgets at party conventions. Since most of statutes specify that regular party conventions take place less frequently than on the yearly basis central political councils or boards are very important in decision-making regarding party finance.

There is also a variation in the degree of delegation of financial authority from the party central offices to the regional and local party organizations. Both the 1992 Law on Civil Associations and the 2001 Law on Political Parties allow but not require regional organizations of parties to acquire a separate legal status. Party statutes, building on this plurality of legal forms of local party organization, differ in interpreting how much independence and control over local party finance the local organization have. Only in few cases, the relationship between central and local party budget are sufficiently specified in the founding documents. Statute of Social Democratic Party of Ukraine (united), for example, stipulates that 25% of local party income goes to the central budget and is used for funding parties' national programs.

Internal review and control over party finance is exercised by auditing commissions which feature prominently in the statutory documents of all major parties. Unlike articles about the relationship between central and local party finances, statutory provisions dealing with formation, rights, and responsibilities of auditing commissions are well-specified. This particular feature of statutory documents is partly a function of specific institutional memories of Soviet period. Central Revisional Committee of the Communist Party of Soviet Union was an omni-powerful body which shaped the internal politics of CPSU during many decades. Popular Rukh of Ukraine and Ukrainian Popular Rukh, two offsprings of the major anticommunist party Rukh, are the only ones not to have provisions about auditing commissions in their statutes. In practice of other political parties, the auditing commissions, despite their well-elaborated status, are not very influential in party life. There have been no reports in national or central party press of major finance issues that would involve auditing commissions.

### *Membership Dues and Private Donations*

Provisions about membership fees can be found without exception in statutory documents of all major parties. However, only the statute of Communist Party of Ukraine, specifies that membership fees constitute a principal source of party income. Some parties also introduce several types of membership fees. The Statute of Social Democratic Party of Ukraine (united) distinguishes entrance, membership, and special purpose fees. Party conventions, as a rule, determine the amounts of membership fees and payment procedures. Membership fees, according to analysts, do not constitute a principal source of income for any major political party with the possible exception of the Communist Party.

Political parties in Ukraine do not publish their budgets. There are no annual disclosure by political parties of their financial standing and sources of funding.<sup>3</sup> The only financial information available to analysts are parties' annual reports to statistical agencies (*the data is not available yet*).

There is, however, general consensus among academics and policy analysts that official party budgets do not realistically reflect political parties' real income and expenses.<sup>4</sup> Recently, the growing attention is paid by the analytical community to the various forms of involvement of powerful business interests in party politics.<sup>5</sup> The major unreported financial inflows into party politics are attributed to so-called oligarchic groups. While many of these accounts fail to provide an operational definition of the terms 'oligarch' or 'oligarchic group', the combination of extensive economic resources accumulated in the course of economic reforms and political power acquired through formal or informal links to the highest level of executive government serves as a defining characteristic of the term. Three of eight political parties that crossed the 4% barrier in the

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<sup>3</sup> Inna Pidluska "Ukraine: Trends in Development of Political Parties and Party Financing in Emerging Democracy" (unpublished manuscript. 2000).

<sup>4</sup> The author's notes from the general discussion during the seminar "Law on Political Parties: Ukrainian Reality and European Perspectives", Ukrainian parliament Verkhovna Rada, July 9<sup>th</sup>, 2001. Many analysts argue that even if budgets were systematically published they would not reveal the true picture of party finance. The practices of double accounting are pervasive across party spectrum. Contributions and spending are underreported, many transactions are cash-based, and party officials often receive salaries without any financial documentation.

<sup>5</sup> Tomenko, Wilson

1998 parliamentary elections - SDPU(u), Hromada, and Greens – have been recurrently identified by analysts as controlled by a single oligarchic group with specific business interests.<sup>6</sup> Some academic research also show that the fortunes of many centrist factions, which have been formed from the deputies elected to the 1998-2002 parliament from the single-member districts, are also inextricably linked to the specific business interests.<sup>7</sup>

The involvement of organized professional associations in the issues of political sponsorship has not received as much analytical attention as the involvement of business groups. This is partly the function of numerous collective actions problems that professional associations encounter in their functioning and partly the function of tight administrative control that formally party un-affiliated leadership of the executive government (presidential administration, cabinet of ministers) exercise over their activity. At the same time, there are no legal restrictions on the donations of trade unions and professional associations. Political ambitions of the leaders of professional associations, their growing politicization and dissatisfaction with the established channels of influencing politics is reflected in a recent phenomenon of professional associations' direct involvement in founding new political parties. The Ukrainian Union of Industrialists and Entrepreneurs, the most powerful business association in Ukraine, initiated the creation of Party of Industrialist and Entrepreneurs of Ukraine in February 2000.<sup>8</sup>

Trade unions were not actively involved in party politics during the first post-communist decade. The Federation of Trade Unions, the major umbrella organization of trade unions, has remained largely outside of party politics and under the control of non-partycized executive government. Communist party, a political organization with the most extensive ties to workers' movement, can consistently rely only on the support of a fringe "All-Ukrainian Workers' Union". The latter was established with the backing of Socialist and Communist parties in December 1994.<sup>9</sup>

No detailed information is available on the size of contributions or donations that businesses, professional associations, or individuals give to the political parties. While

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<sup>6</sup> Tomenko

<sup>7</sup> Protsyk and Wilson (2001).

<sup>8</sup> Mykola Tomenko ta Volodymyr Olijnyk, *Partiyna Elita Ukrainy* (Kyiv: Logos, 2000), pp.121-122.

<sup>9</sup> Andrew Wilson, "The Ukrainian Left: In Transition to Social Democracy or Still in Thrall to the USSR", *Europa-Asia Studies*, V. 49, No.7, 1997, 1293-1316

both laws regulating party finance oblige political parties to publish their budgets there no specific requirements in either of laws regarding the disclosure of specific budget categories. As it was noted earlier, although the 1992 Law “On Civil Associations” empowered parliament to determine the amount of maximum contributions or donations to political parties, successive parliaments consistently failed to establish such figures. Since no figures had been established, another provision of the law – to publish the names of the donors whose contributions exceed the amount specified by the parliament (Art.26) – did not have any practical implications. In the 2001 law “On Political Parties” deputies choose not deal with this issue at all: the law contains no provisions regarding the limits on the size of contributions.

Restrictions on the nature of contributions are maintained in both laws. The 1992 Law “On Civil Associations” does not allow political parties to accept contributions from state bodies and state enterprises; foreign states, companies, organizations, and citizens; enterprises that are more than 20% foreign or state-owned; anonymous donors (Art. 22). The 2001 Law “On Political Parties” lists the same categories of prohibited donors but in the case of enterprises with state or communal ownership does not provide any quantitative indicators regarding the size of the state or communal share. The law also prohibit contributions or donations from other parties that do not belong to the same electoral block and from charity and religious organizations (Art.15).

While the 1992 law did not specify the exact mechanism of control over the nature of contributions, the 2001 law requires banks to report to Ministry of Justice unlawful contributions and donations (Art.15). According to some experts, the enforcement of this provision will be highly problematic given the lack of specific expertise and interest in banking system regarding tracing the origins of contributions.<sup>10</sup>

#### *Tax status of political parties*

Political parties in Ukraine enjoy certain financial benefits as a result of their non-profit status. They do not pay taxes on their income. Law “On Taxation of Profits of Enterprises”, which is the principal piece of legislation dealing with the issues of taxation

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<sup>10</sup> Parliamentary deputy V. Stretovych’ speech at the seminar “Law on Political Parties: Ukrainian Reality and European Perspectives”, Ukrainian parliament Verkhovna Rada, July 9<sup>th</sup>, 2001.

in Ukraine, exempts political parties from taxes on contributions and donations and on income from publishing and other program-related activity. There are, however, no tax benefits in the form of tax deductibility of political donations or tax credits for the party donors. The lack of incentives for businesses to make donations to political parties, non-government organizations, and charities is considered by some analysts as a major flaw of taxation system in Ukraine.<sup>11</sup>

The functioning of political parties is also affected by oppressive system of payroll taxes. Political party as any other employer in the country has to make a number of contributions to the state budget from its payroll system. Party has to make contributions to social security, unemployment and several other types of state funds for each full or part time employee on its payroll. Given that these contributions impose a heavy financial burden on party organization it is financially challenging for political parties to rely on a significant numbers of professional party functionaries in its work.

Parties' strategy for avoiding this multiple taxation is often to pay non-declared salaries to party activists who are on the official payroll in research institutions, think tanks, or other types of non-government organizations. Similar arrangements characterize the work of deputies' aides, parliamentary factions' secretaries and consultants. Their official parliamentary salaries are often more than matched by the regular payments from unofficial party funds. These money-saving approaches to building central and local party organizations, although especially salient in practice of non-left parties, are exercised by major political parties across political spectrum.<sup>12</sup>

### *Party foundations and party firms*

Ukrainian laws allow political parties to establish “institutions and organizations” to realize goals and objectives declared in their statutory documents (Law “On Civil Associations”, Art. 20). Although there are no explicit provisions in the laws prohibiting

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<sup>11</sup> The author's interview with Dmytro Lutsenko, the expert of US AID – funded Regulatory Reform Program in Ukraine.

<sup>12</sup> Author's private information, obtained from conversations with party functionaries in the Ukrainian parliament, Verkhovna Rada, June-July 2001.



political parties to establish a commercial enterprise it would be against the law to found a commercial firm other than a mass-media enterprise since such an activity would contradict parties' statutory goals and their status as non-profit organizations.

The 1992 Law "On Civil Associations" does not elaborate on the nature of "institutions and organizations" parties are allowed to create. The 2001 Law "On Political Parties" is even less specific about the issue: it contains only a general clause about political parties' right to "support ideologically, organizationally, and materially...civil associations, and provide help in creating them" (Art.12).

Party foundations in classical Western sense do not exist in Ukraine. Weakly institutionalized and volatile party system has been rather slowly developing in the direction of greater stability and predictability. Major political parties, with probable exception of Communist Party and anticommunist Rukh, have developed neither sufficient organizational muscles nor stable electoral base to initiate the establishment of party foundations. If the goals of the latter are to attract financial and intellectual resources and to popularize party causes than, in the Ukrainian context, some of the functions of party foundations are partially fulfilled by think tanks, research institutes, and other types of non-government organizations.

The common characteristic of the vast majority of the Ukrainian think tanks and research institutes is their unaffiliated status. Since 1991 all major policy research institutions have been caught into the intellectual fashion of proclaiming their non-partisanship and independence. Declaration of political neutrality has been almost always perceived as the only way to secure the credibility of a research institution and continuity of Western funding, which has often been the institution's only source of financial support.

At the same time, the informal knowledge about partisan preferences and political origins of research institution has rapidly developed in policy making community. The indicators of partisanship - the names of party-affiliated persons on the think tanks' management lists, systematic biases in research problematique and research outputs, etc. - make it easy for an intelligent observer of the Ukrainian politics to uncover the links between the vast majority of research institutions and specific political parties.<sup>13</sup>

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<sup>13</sup> Author's interview with Inna Pidluska, the president, the NGO "Europa XXI Foundation".

Both grant seekers, research institutions and think tanks, and grant givers, almost exclusively Western foundations, operate upon common but often somewhat hidden knowledge regarding the political interests involved. During the last several years the circle of institutional grant receivers has relatively stabilized. Especially after the major political scandal caused by the tapes implicating the president Kuchma in ordering a political killing and committing a number of other crimes, the Western foundations' financial support to various political forces that oppose increasingly undemocratic regime have solidified. Although the grants are distributed on the basis of individual merits of submitted proposals, the party identity behind the specific research institutions that submit applications seem to affect the decisions about grant distribution especially in the areas of political education, electoral campaigning, mass-media independence. According to the analysts, the grant applications of NGOs or research institutions backed by the national democratic parties of the right or socialist activists of moderate left are more likely to be approved than the applications backed by the centrist parties that are controlled by pro-government business interests.<sup>14</sup>

How do political parties benefit from close, although predominantly informal, cooperation with NGOs and research institutions? Besides the traditional functions of these organizations – to generate new ideas, to provide intellectual expertise, to serve as a temporary shelter for party activists - NGOs and research institutions help to finance some of the activities designed by political parties. A typical regional seminar dealing with the issues of electoral education or local self-government and financed by the grant of Western foundation brings together policy experts, local officials, journalists, and party activists. While during the first sessions or the official part of the seminar the issues of general interest are discussed, during the remaining part of the seminar the party activists are trained and issues of party building are addressed in a selected circle of party functioneers.<sup>15</sup>

Certain political parties also benefit financially from close control of charity foundations and other types of NGOs dealing with specific social problems. These

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<sup>14</sup> Author's interview with Jaroslav Poharsky, a political analyst with Kiev Institute of Politics, one of the leading research institution dealing with the issues of political transition in Ukraine.

<sup>15</sup> Author's private information, obtained from the discussions with party activists during the seminar "Government Decision Making: Costs and Benefits of Consolidated Party System", parliament of Ukraine, February 12-13, 2001.

organizations often are recipients of state funds. In many cases, money not necessarily has to come from state budget. Using various types of administrative leverages (tax, firemen, health inspections; regulatory agencies) the executive government forces business enterprises to make “voluntary” contributions to specific charity funds and social welfare NGOs. The same administrative pressures are used to keep such NGOs compliant with the government-backed initiatives that lead to the use of NGOs funds for political purposes. During the earlier years of post-communist transition it was well-connected individual businessmen or business group who acted as a brokers in such transactions. In recent years, it is increasingly so-called “centrist” political parties, fully financed by these business and backed by the government, who exercise control over finances of some charity foundations.

In this respect, the analysts most often cite the story of All-Ukrainian charity fund “Social Protection”. Allegedly, the fund was used in 1999 to finance the presidential campaign of incumbent president Leonid Kuchma. Oleksandr Volkov, a close adviser to the president and a businessman whose name became notorious due to the numerous allegations in money laundering operations in Western Europe, was one of the campaign organizers. He was also one of the founders of a political party that claimed to be of centrist orientation, “Democratic Union”. Local units of a new party, according to some analysts, were often created on the organizational infrastructure of “Social Protection” fund.<sup>16</sup>

### *Party Assets*

The Communist Party of Ukraine lost its assets after the unsuccessful August 1991 coup in Moscow prompted the presidium of the Ukrainian parliament to impose, first, a temporary suspension and then a ban on the activity of the party structures of the CPU. The campaign to lift a ban over party activities, to revive party organizations, and to reclaim nationalized party property had started almost immediately after the

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<sup>16</sup> Mykola Tomenko ta Volodymyr Olijnyk, *Partiyna Elita Ukrainy* (Kyiv: Logos, 2000), p.92

suspension was imposed but had become especially prominent in the second half of 1992 and the beginning of 1993.<sup>17</sup>

Despite the efforts of communist deputies in parliament and a substantial popular support for re-legalizing the old CPU no restoration of the property of the party took place. A resolution issued by the presidium of parliament in May 1993 allowed citizens who shared communist ideas to establish party organizations but did not restore the old CPU.<sup>18</sup> Therefore, when the CPU was reborn in spring-summer 1993 it was formally a new party with no control over the property of the former Communist Party of Ukraine.

The assets of political parties, similar to their budgets, are not public information in Ukraine. Unlike with parties' annual budgets, the 1992 law "On Civil Associations" did not have specific provisions requiring political parties to publish information about their assets. The 2001 Law "On Political Parties" has already a specific clause requiring political parties to publish information about party assets in national press on annual basis. To date, neither of major political parties published such information.

The magnitude and size of party property is difficult to estimate from indirect sources. Central party offices, potentially the major items on the property lists of political parties, are often rented rather than owned. There are no formal legal rules that would allow political parties to get preferential terms on rent or lease of property. In practice, political parties bargain hard and sometimes secure special deals on property rents. According to the analysts, the quality of deals often depend on the character of party's relationship with local authorities that have a major say in deciding the terms of rent.<sup>19</sup>

### *Public Funding*

Political parties in Ukraine do not receive direct public funding from the country's budget. The Ukrainian laws do not contain any provisions that would commit a certain percentage of state budget or envision other direct forms of providing public money for political parties. The lack of such financing increases the importance of other direct and

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<sup>17</sup> Andrew Wilson, "The Ukrainian Left: In Transition to Social Democracy or Still in Thrall to the USSR", *Europa-Asia Studies*, V. 49, No.7, 1997, p. 1300.

<sup>18</sup> *Holos Ukrainy*, 18 May 1993.

<sup>19</sup> Author's interview with Jaroslav Poharsky, op. cit.

indirect forms of public funding and also magnifies the impact that shadow and hidden financing have on party politics.

The issue of direct public funding became prominent in the Ukrainian politics during the 1998-2002 parliamentary term when the numerous discussions of several alternative drafts of a law on political parties took place. The fact that four alternative drafts submitted to the consideration in the parliament envisioned direct public funding from the state budget is indicative of importance that the various political forces attached to the issue. The differences among finance-related articles of alternative drafts were about the eligibility conditions and precise share of budget allocation rather than about the general principles of direct public funding.<sup>20</sup>

Despite the draft-makers' relatively unanimous views on the issues of party finance the final version of a law on political parties, which was passed by the parliament and signed by the president in April 2001, did not contain provisions for public funding. The deputy commission set up to recon ciliate a number of issues that repeatedly blocked the passage of law decided to exclude the provision about public funding from the final version of the law. The position of communists, the largest faction in parliament, was critical in reaching such a decision. Communists decided to oppose public funding claiming that it is premature to provide funds for political parties when country's economy is in crises and social programs are chronically underfunded.<sup>21</sup> The fear that the fact of voting in favor of public funding can be used in the executive government's electoral propaganda against the communists probably had some influence on the calculations of communists and on their choice of populist rhetoric.

One source of direct public funding that is available for parties represented in the parliament comes from the expense items designated in the budget of parliament for financing the deputies' activity in the parliament. An individual deputy is entitled to have assistants who are paid from the budget of parliament. Party-affiliated members of parliament usually have assistants who are experienced party activists. Party factions in

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<sup>20</sup> Alternative drafts of a law on political parties are compared in Materialy do Kruglogo Stoly "Zakon pro Politychni Partii v Ukraini: Ukr. Dijsnist' ta Evropeis'ki Perspectyvy" (Kyiv: Laboratoriia. Zakonodavchyh Initsiatyv, 2001)

<sup>21</sup> Speech of parliamentary deputy Kriuchkov, the communist party's expert on political parties, at the round-table discussion of the law "On Political Parties" in the parliament of Ukraine, Verhovan Rada, 9<sup>th</sup> July 2001.

parliament, if they meet faction recognition threshold (which was 25 and 14 members for the 1994-98 and 1998-2002 parliamentary terms respectively) are entitled to have faction secretariat which is also financed from the budget of parliament. The positions in secretariat, those of secretariat head and members, are usually distributed by the faction leadership among the younger cohort of party activists.

Indirect public funding, such as free airtime on TV and radio for party statements and presentations, are not envisioned by the Ukrainian legislation for any types of party activity other than electoral campaign. The draft law “On Political Advertisement”, which is currently under the consideration in the parliament of Ukraine, can facilitate the introduction of some forms of indirect public funding but it is difficult to predict the exact shape of this law at this early stage of its introduction in the parliament.

Funding the youth organizations in Ukraine can be considered as one form of indirect public funding for political parties. The youth organizations of such parties as Communist Party of Ukraine, Rukh, Social Democratic Party of Ukraine(united) and others are active members of the Ukrainian National Committee of Youth Organizations (UNCYO), an umbrella organization for youth groups. The UNCYO is financed from the state budget. The organization also has a substantial amount of discretion over the distribution of funds it receives from the budget. Although mentioned youth groups are registered as non-government organizations their activity is closely linked with the activity of political parties whose labels and, sometimes, ideological orientation they share.

### *Reporting, Disclosure and Enforcement*

Both the 1992 law “On Civil Associations” and the 2001 law “On Political Parties” require political parties to publish their annual budget. Yet neither of documents have any requirements regarding the specific items (shares of membership dues and

private contributions, size of contributions, etc.) that should be included into publication or regarding the place of publication. There are no parliamentary resolution or decision of regulatory bodies that would address these issues either. The absence of any specific details regarding the rules for publication of party budgets probably contributes to the general atmosphere of legal defiance that characterizes political parties' attitudes to this legal requirement. As it was already mentioned, no party budgets have been published in major national newspapers during the first post-communist decade.

More basic reasons for ignoring this legal requirement are rooted, however, in the sensitivity of information that publication of party budgets would reveal. As it will be discussed in greater details in the second part of this chapter, party politicians across political spectrum in Ukraine have strong incentives not to reveal the information about their day-to-day finances and their corporate sponsors. Both pro-government and opposition parties have serious stakes in preserving the existing system of non-transparent party finance.

The prevalence of this specific set of incentives also explains why major party players in parliament were not interested in establishing party finance commission. As it was already discussed at the beginning of paper, the 1992 law prescribed that a special commission composed of representatives of all political parties in parliament has to be set up to review the annual financial activity of parties and report the results of a review to the parliament (Art. 26). No such commission has ever been convened. The 1992 law provisions authorizing parliament to establish a maximum size of individual and total annual contributions (Art.8) have also been ignored.

The provisions of the 1992 law that deal with the government bodies responsible for exercising control over the financial activity of political parties lack specific details. The legislation designated state tax inspections to be responsible for the control of all issues related to tax payments of political parties and unspecified "financial agencies" to be responsible for the control over size and sources of contributions to political parties (Art. 25). The legislation stipulated that courts establish whether contributions are made in accordance with the law and make decisions about transfer of unlawful contributions to the state budget (Art.26). As with many other provisions of this law, there were no precedents where these norms would have been used. Other sanctions envisioned by this

law – warning, fine, temporary ban of specific activities, temporary ban of all activities, liquidation - were not explicitly linked to violations of financial rules.

The financial information on political parties, which is collected by tax inspection agencies, is not a domain of public information in Ukraine. State tax inspections in Ukraine are notorious for their secrecy and non-transparency: very little information is disclosed and available for the outside analysis. Analysts' requests for the detailed information are usually ignored and formal guidelines that would oblige tax inspections to disclose such information are non-existent.

The 2001 law “On Political Parties” is even less specific about the details of financial reporting, disclosure and enforcement. The article about financial reporting contains only two clauses: one is the requirement to publish party annual budget and the other obliges parties to “keep their accountancy in accordance with an established order” (Art.17). There is only a mentioning of Ministry of Justice and Central Electoral Committee as agencies responsible for the general enforcement of the norms of the law (Art.18). One specific provision that deals with monitoring and enforcement of party funding rules is a clause requiring banks to inform Ministry of Justice about illegal contributions to party accounts. These contributions have to be transferred by political parties to the state budget or are confiscated in accordance with the court order (Art.15).

Unlike the 1992 law, the new law does not provide for the role of tax inspections in monitoring the party finance. The law-makers' desire to avoid provisions that would directly refer to tax inspections as party finance controlling agencies indicates the law-makers' growing concern with politicization of government agencies. The executive agencies charged with various functional tasks have become increasingly used for promoting political goals of incumbent government during the second term of Kuchma's presidency. The exact wording of party finance clauses in the 2001 law was influenced by the law-makers' desire to limit the involvement of agencies controlled by the executive government into party matters.

### *Scandals*

The disappearance of Vasyl Bojchyshyn, a financial manager of a major opposition party Rukh, in the early 1994 can be considered as a first major political



scandal allegedly related to party finance. During 1993-94 Rukh was in the process of transition from mass anticommunist movement, which played a key role in the processes of democratization of the early 1990s, toward a properly structured political party. As a leading opposition force Rukh controlled a considerable amount of financial resources amassed from contributions of individuals, donations of businesses, and gifts from the Ukrainian diasporas in Northern America and Europe. Although it was never officially established that Bojchyshyn's disappearance was linked to his role in managing Rukh finances the majority of analysts tend to believe in the existence of such a connection.

The case received national prominence after a report about the disappearance was filed with police and media outlets reported the news. Rukh leaders never acknowledged the existence of any financial problems or irregularities related to this matter. There were no reports in press regarding personnel changes or internal organizational reform in Rukh following this matter.

An increasing amount of attention to issues of party finance has been paid in media during and in the aftermath of the 1998 parliamentary elections. Due to the introduction of a proportional element into the electoral law these were the first parliamentary elections where political parties featured prominently.<sup>22</sup> The typical media investigations dealt with the discrepancies between the declared and real campaign expenses.<sup>23</sup> Some of the issues raised during the electoral campaign grew to become very salient in day-to-day party politics.

Such a major issue was the involvement of the former prime-minister Pavlo Lazarenko in financing and personally managing political party Hromada that was successful in crossing 4% barrier and forming party faction in the 1998-2002 parliament. The rise and the fall of Hromada, one of the largest and the least compliant with the government initiatives party factions in the 1998-2002 parliament, was inextricably tied to the changes in the fortunes of Lazarenko. Lazarenko's arrest on multiple corruption charges led to the political exhaustion and organizational

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<sup>22</sup> During the 1990 and 1994 parliamentary elections, which were conducted on a single-member-district basis, specific individuals and not political parties were in the focus of electoral campaigns

<sup>23</sup> For the discussion of some issues related to the analysis of real election expenses in Ukraine see Inna Pidluska "Ukraine: Trends in Development of Political Parties and Party Financing in an Emergent Democracy", (unpublished manuscript, 2000).

disintegration of the party and disbandment of its parliamentary faction.<sup>24</sup> There were no sanctions or formal investigations launched into the financial activity of Hromada, it was rather the magnitude of the scandal surrounding Lazarenko as a party leader that made many Hromada politicians flee the party.

### *NGOs*

A number of think tanks and NGOs monitor party politics in Ukraine.<sup>25</sup> There is a growing understanding in NGOs' analytical community of importance that a state of party finance has for the quality of democracy in Ukraine.<sup>26</sup> There is also a substantial progress made by these organizations in monitoring the issues of party finance related to the electoral campaigns. The analysis of day-to-day party finance is much less prominent in the activity of think tanks and NGOs. Publications of these organizations are much more likely to react to changes in party leadership and in the configuration of business interests supporting the party than to the problems of current party financing. The lack of transparency and reliable information in this field partly explain the low numbers of analytical materials devoted to these issues.

NGOs have not been pro-active in advocating more transparent system of day-to-day party finance either. No major campaign or lobbying activity aimed at bringing the change into the system of party finance have been originated in the community of NGOs. Instability of funding and unpredictability of NGOs' own finances make civil society organizations less willing to launch a campaign to demand more financial transparency inside political society.

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<sup>24</sup> Mykola Tomenko ta Volodymyr Olijnyk, *Partiyna Elita Ukrainy* (Kyiv: Logos, 2000), pp.34-35

<sup>25</sup> Institute of Politics, Ukrainian Center of Independent Political Research, Committee of Voters of Ukraine are among the research institutes and NGOs that exercise the most authority in the field of party politics.

<sup>26</sup> Author's interview with Inna Pidluska, the head of NGO "Europe XXI Foundation", and Ihor Kohut, the head of NGO "Laboratory of Legislative Initiatives"

Anti-corruption programs, which are run by some NGOs under the initiatives of World Bank and other Western developmental institutions, tend to concentrate on the issues of institutional corruption in the governmental agencies rather than on the problems of political corruption. International Center for Policy Studies, one of the largest think tanks in Ukraine, deals with the problems of government regulations of business activity and the issues of bureaucratic corruption that arise from the excessive government regulations of small and medium size businesses.<sup>27</sup> These are the typical issues addressed by anti-corruption programs in Ukraine.

## **Part II.**

Political parties become increasingly important players in the Ukrainian politics. While the early 1990s' politics was excessively personalized, the changes in electoral laws and internally-driven organizational maturation of political parties during the late 1990s have made parties much more ambitious and capable of articulating voters' preferences and influencing decision-making process in Ukraine. The newly acquired ambitions require more funding. In raising financial resources they need political parties (and the future of democratic consolidation in general) face numerous challenges.

### *Transparency and legality of party funding*

Majority of political parties in Ukraine chronically lacks funding. The complete absence of budget financing for day-to-day party expenses and the lack of indirect public funding are among the key factors that make it challenging for political parties to maintain their operations. Scarcity of public money and insufficiency of membership dues make the contributions of corporate sponsors especially critical for sustaining financial vitality of political parties.

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<sup>27</sup> For the description of projects undertaken by International Center for Policy Studies (ICPS) see their website: <http://www.icps.org.ua/>

Extreme dependence on the corporate donations led to the development of at least two negative tendencies in the Ukrainian party system. First, parties have become increasingly dependent on special interests and on how successfully they cater to the private needs of their major institutional contributors. Even political parties with traditionally strong ideological or programmatic linkages to the voters – Communist Party of Ukraine, Rukh, Socialist Party of Ukraine – increasingly have to compromise their programmatic standing to ensure financial support. Including business leaders in their electoral lists and lobbying certain pork-barrel bills in the legislature, according to the analysts, are some of the indications of compromises made.<sup>28</sup>

Second, parties have also become much more vulnerable to complete “capturing” by individual business groups. The latter can either “buy” the existent party label or finance the creation of a new one. What one finds under the attractive party label then is an opportunistic party machine that is devoid of any coherent ideological standing and geared to pursue economic interests of oligarchic leadership and to derive political benefits from the situational positioning with regard to major policy issues.<sup>29</sup> In the Ukrainian context, parties that are run by powerful business groups tend to claim their “centrist” orientations thus contributing to further confusion of voters with regard to the meaning of ideological labels.<sup>30</sup>

Besides the lack of public funding, another major obstacle for ensuring transparency and legality of the Ukrainian party system is the existing practices of handling political competition by the executive government. Using various executive agencies (police, tax, fireman, and health inspections) to raid businesses that are suspected in being sympathetic to the opposition parties became a standard practice during Kuchma’s presidency.

It is a common belief among the leaders of oppositional parties that stricter rules for reporting and disclosing financial information would be used by the executive

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<sup>28</sup>Tomenko

Wilson, A. (2001), ‘Reinventing the Ukrainian Left: Assessing Adaptability and Change’. *Slavonic and East European Review*, January 2002

<sup>29</sup> For the analysis of virtuality of party appeals in the Ukrainian politics, see Birch, Sarah and Andrew Wilson, “Political Parties in Ukraine: Virtual and Re-presentational”, 2000.

<sup>30</sup> Tomenko

government to undermine the financial stability of opposition parties.<sup>31</sup> Businesses, which contribute to political parties, are very vulnerable to all sorts of government inspections. They are forced to operate in semi-legal way due to the ever-changing system of government regulations of business activity and confiscatory system of various social security payments and taxation. Corporate sponsors thus have strong reasons to press politicians they make contributions to from revealing the sources of their funding.

It is not only businesses of opposition that violate legal norms. Oligarchic business groups that “own” some of the centrist parties prosper in the environment of shadow economy. Parties they control are not interested in more transparent mechanisms of reporting and disclosure either. A detailed disclosure would reveal their dependence on very few corporate sponsors. Revealing even not a very realistic budget – underreporting revenues and expenditures - could only strengthen their negative image of “money barrels” by providing the analysts with grounds to compare the declared and real expenses. The analysts usually estimate the latter expenses by summing up the real costs of political advertisement, party-sponsored mass events, estimates of organizational expenses, etc.<sup>32</sup>

Parties of political left and, in the Ukrainian context, it is, first of all, Communist Party of Ukraine, are traditionally less dependent on financial sponsors due to the large pool of volunteers and highly stable core electorate. Being deprived of public funding and facing intense inter-party competition these parties have also become increasingly aware of the necessity to attract corporate sponsors. In this respect, the presence of a number of “odd” business figures on the communist party list for the 1998 parliamentary elections is considered by the analysts as an indication of growing importance of corporate money for the left. Communists’ voting behavior in the parliament during several critical votes dealing with the regulations of business activity and with the specific rules of privatization also suggests the involvement of special interests in the politics of the left.<sup>33</sup> Given these considerations and declared opposition to the executive government communists occupy rather mixed position on the issues of financial transparency.

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<sup>31</sup> Speech of parliamentary deputy Yuri Kliuchkovski, deputy head of People’s Rukh of Ukraine, at the round-table discussion of the law “On Political Parties” in the parliament of Ukraine, Verhovan Rada, 9<sup>th</sup> July 2001

<sup>32</sup> Tomenko

<sup>33</sup> Tomenko; zavod Illicha

Overall, neither of major political forces represented in the Ukrainian legislature has a specific interest in party finance reform. Gross violation of the provisions of the 1992 law “On Civil Associations” became possible because of the political dominance of this anti-transparency coalition. Although the different types of considerations have motivated the members of this coalition, the end result was that many finance-related provisions of the law were bluntly ignored. Those ignored provisions included the following commitments made by the members of parliament: to form a special parliamentary commission for the annual review of parties’ financial activity; to establish a maximum amount for individual and total contributions to political parties; to publish in “Holos Ukrainy”, a national newspaper financed by the parliament, the names of individuals whose contributions exceed the maximum amount.

The same coalition has been responsible for the lack of specifications with regard to the financial aspects of party functioning in the 2001 law “On Political Parties”. Parliamentary deputies opted to keep financial provisions of the law very general. There are no detailed procedures for financial reporting and disclosure introduced in the law. There are no specifications of penalties for financial violations either. The law opts not to establish any special agencies charged with monitoring and enforcement of party finance rules. Ministry of Justice and Central Electoral Committee as agencies responsible for the enforcement of the norms of the law are charged only with supervision of general norms of the law.

The stability of this coalition is fragile. The coalition members agreed on maintaining the status quo regarding party finance regulations due to the very different reasons. The electoral cycle of 2002 and 2004 (parliamentary and presidential elections) can change the balances of power between the legislative and executive branches, brake the existing status quo in the legislature and make legislators revisit the rules of party finance.

In the meantime, the elements of a vicious cycle have been established in the system of party finance in Ukraine. The shadow economy finances party system and political parties respond to the needs of semi-legal businesses by lobbying special interests in the legislature and by securing various concessions and favors from the

executive. These practices endure over time thus proliferating financial non-transparency both in economic and political fields.

Introducing public finding and limiting the omnipotence of the executive government should be the first steps on the way of ensuring transparent and legal system of party finance. Only when these changes are in place it will become feasible to overhaul the existing financial practices with the help of detailed rules on funding, heavy penalties for violation of these rules, and special enforcement agencies supervising party finance.

*Structural biases in favour of some of the political parties*

Two tendencies in the development of party system in Ukraine, which were already touched upon in the previous section of the paper, can be described as shaped by the specific structural biases found in Ukraine. The first one is the dependence of parties' organizational and electoral success on the access to state administrative resources. The second is the growing importance of parties controlled by the specific business or sectoral interests. Both tendencies favor a few political parties that claim to occupy political "center" and that become increasingly active in inter-party competition.

The executive government led by the president dominates the functioning of political system in Ukraine. Semi-presidential constitutional framework envisioned the president to be a neutral arbiter among different branches of government. In practice, the president has turned into a partisan political player with his own political interests and priorities.<sup>34</sup> Both Ukrainian presidents, who were not party-affiliated and lacked an organized party support at the time of their electoral bids, tried to maximize their power and chances of re-election by extensively relying on the administrative resources of the executive government. Political parties that prove to be politically loyal to the president receive access to government resources in order to advance the presidential agenda and to enhance their own chances in inter-party competition.

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<sup>34</sup> For the analysis of the Ukrainian presidency in the context of semi-presidential regimes of Eastern Europe see Oleh Protsyk "*Semi-Presidentialism: The Logic of Institutional Conflict and its Implications for Public Administration Reform in Post-Communist Countries*" (Ph.D. dissertation, Rutgers University, 2000)

Reliance on administrative resources in party building in Ukraine is manifested in many ways. For example, party organizations can be established drawing on the personnel and the infrastructure of executive agencies. Local state administrations help to ensure publicity and membership growth. Municipal bodies can provide better terms of rent for party offices. Local tax administration can “encourage” local businesses to make contributions to the party. And local electoral commissions are used to ensure the party’s electoral success during the elections.

The extensive use of executive agencies for achieving the partisan goals of the executive leadership and loyal political parties became possible in Ukraine mainly due to the lack of institutional safeguards against executive dominance: autonomy of courts, freedom of mass media, and independence of public administration. While substantial efforts were made to introduce meritocratic principles in civil service recruitment and career advancement the implementation of administrative reform is hindered by the recurrent partisan interventions on behalf of the president into the functioning of civil service.<sup>35</sup>

Depoliticization of public bureaucracy can be achieved only if a complex set of reforms are implemented. Changes, which were introduced in civil service laws, have to be supplemented by reforms directed on securing independence and autonomy of judicial systems and mass media. Greater maturity of the party system, which will force presidential contenders to rely on established party machines in their electoral and political bids, can also contribute to the task of achieving bureaucratic neutrality. Neither of two Ukrainian presidents had formal party affiliation or enjoyed unconditional and lasting support of mass political party. This political weakness made them especially dependent on the state bureaucratic hierarchies for implementing their policy and electoral goals. The president backed by strong political party that is capable of

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<sup>35</sup> For the discussion of civil service reform see Krawchenko, B. (1999). The law on the civic service: a case study of administrative reform in Ukraine. In P. D'Anieri, R. Kravchuk, & T. Kuzio (Eds.), *State and institution building in Ukraine*. New York: St. Martin's Press; Oleh Protsyk “*Semi-Presidentialism: The Logic of Institutional Conflict and its Implications for Public Administration Reform in Post-Communist Countries*” (Ph.D. dissertation, Rutgers University, 2000), Ch.4.



mobilizing political support for the presidential initiatives can be more willing to accept the neutrality of public administration.

Consolidation of the party system, which can be facilitated by certain choices of electoral rules and norms of budget financing, can also help to deal with the second structural bias mentioned at the beginning of this section – parties’ dependence on individual business or sectoral interests. Since the Ukrainian economy is not based on a single industrial or natural resources sector neither of business groups enjoys anything close to the full control of economy. At the same time, the analysts consistently name lobbies that are formed on the basis of energy sector, metallurgy, and agriculture as the most influential in national politics. Both sectoral lobbies and business groups that operate across the economic sectors have become increasingly interested in “acquiring” political parties rather than just in lobbying them.

The existing fragmentation of the party system makes it feasible for business groups “to buy” a party. For example, 14-members threshold for forming a parliamentary faction in the 1998-2002 parliament encouraged several business groups and individual oligarchs to form their own factions. These factions have often been personally managed by the business groups’ leaders who entered the parliament by winning elections in single-member districts. The persistent rumors have been circulating in the parliament and in the analysts’ community about regular salaries that members of oligarchic factions receive for their membership. This system of regular pay-offs could be used to attract new members and prevent the defection of current members. Deputies’ ‘traveling’ from faction to faction became a widespread phenomenon in the 1998-2002 parliament. At the high point of factional multiplication, there were 15 factions formed by PR-list and SMD deputies in the parliament.<sup>36</sup>

Changing the procedural rules for the faction recognition in the parliament and finding the means to limit the deputies’ movement among the factions are the first steps in combating the excessive business involvement in party politics. Introduction of electoral rules that encourage party mergers and coalition-building and implementation of the norms of public funding that link the amounts of funding to the shares of votes received in the elections can further strengthen the parties’ organizational and financial

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<sup>36</sup> Protsyk and Wilson (2001).

capabilities. Consolidated parties are likely to be more immune to the attempts of oligarchic business groups to hijack their leadership and agenda.

*The insurance of open and inclusive political process*

The issues of openness and inclusiveness of the political process cannot be adequately addressed in the Ukrainian context without eliminating non-transparency, illegality, and structural biases that characterize the current functioning of the party system. At the same time, conscious efforts to address certain stereotypes of mass perceptions about party politics can lay foundations to more open democracy and encourage broader citizen participation in financing political parties. These efforts have to be directed, first of all, on changing general public attitudes toward political parties. Government, press, NGOs, and political parties themselves have the role to play in the process of political education.

A high level of distrust characterizes the popular attitudes toward political parties in Ukraine. Public opinion polls that are conducted on the annual basis by the well-reputed foundation “Democratic Initiatives” indicate that parties are among the least trusted institutions of post-Communist regime. The same polls show that less than 20 percent consider the existence of multi-party system as “absolutely necessary” for the functioning of democracy in Ukraine.<sup>37</sup> There are also some evidences that the level of distrust to parties have increased after the elements of proportional representation were introduced into the electoral system that had been exclusively based on the elections in single-member districts prior to 1998.<sup>38</sup>

The prevailing attitudes can be explained by the low level of political culture and poor understanding of how democracy functions. The perception of political parties is also adversely affected by the parliamentary politics. The latter is characterized, first of all, by the high degree of fragmentation and internal conflict. The legislature is often portrayed by the media controlled by the executive as a dysfunctional body and as a political club that is preoccupied with internal power struggles and rent-seeking. Even

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<sup>37</sup> Democratic Initiatives “Ukraine 1994-2000”, Materials of public opinion polls (Kyiv: Democratic Initiatives, 2001)

<sup>38</sup> Inna Pidluska “Ukraine: Trends in Development of Political Parties and Party Financing in an Emergent Democracy”, (unpublished manuscript, 2000).

more independent and committed to democratic values press and TV programs tend to portray party politicians as extremely cynical power maximizers and party organizations as machines for political manipulation void of any ideological commitments or principles.<sup>39</sup>

### *Conclusion*

Unlike in many Central and East European democracies, political parties in Ukraine have only recently started to occupy a prominent place in country's politics. Due to many subjective and objective factors the public remains cautious and skeptical about the role political parties aspire to play in a political system dominated by the party-unaffiliated executive and intertwined by informal clientalistic networks. The issues of public funding reform have not received much attention in the political commentaries or public opinion polls yet. Whenever these issues surface - as in the case of debates on the 2001 law "On political parties" – major political players tend to follow the prevailing public attitudes rather than to provide leadership in addressing these issues. It is indicative that when the issue of budget financing was raised in the context of these debates the communist deputies and members of some other parties in the parliament voted against such a provision. Their behavior was primarily motivated by the fear of popular backlash that their vote in favor of budget financing would have caused.

Changing public attitudes toward political parties becomes a very critical task in these circumstances. Such a change can only be achieved if all key political actors – the executive, the judiciary, the mass media and ngo sectors - endorse political parties' bid for a greater role in the political process. The electoral cycle of 2002 and 2004 (parliamentary and presidential elections) is likely to strengthen parties' organizational capacities and legitimacy and thus to provide grounds for revisiting the rules of party finance and for establishing a more favorable regulatory framework for party functioning in Ukraine.

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<sup>39</sup> The TV program "Fifth Corner", which had the format of a blitz interview and was hosted by the popular political journalist Pihovshek, illustrates very vividly how problematic the issues of trust and principled ideological position are in the post-communist society.

