INTERACTIONS BETWEEN THE BUREAUCRACY AND SMALL INDEPENDENT ENTERPRISE IN POST SOCIALIST UKRAINE

ROMAN PETER ZYLA

UNIVERSITY COLLEGE LONDON
SCHOOL OF SLAVONIC AND EAST EUROPEAN STUDIES

APPLICATION FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

SEPTEMBER 2001
ABSTRACT

The emergence of new states from the collapse of the Soviet system resulted in a new enterprise sector as well as new tasks for state administration. As implied by existing theory, the interplay between those two is critical to the development of a strong and vibrant economy. Where there are difficulties in the relationship, obstacles cause impediments to development of enterprise, which in turn affects economic growth.

This thesis examines the concepts of bureaucracy, enterprise, interactions and corruption. This is the starting point for the analysis of normative and positive versions of interactions between small independent enterprise and official agencies, termed bureaucracy. These interactions are broken down analytically and their component elements explored. By highlighting differences between the two versions, it is possible to identify problems, potential problems or non-problem areas of particular interactions and draw some more general conclusions. The task is also important for the purpose of legal, regulatory and policy reform.

The thesis assesses the role of bureaucracy in the development of small enterprise in Ukraine. Case studies focus on five bureaucratic interactions and reveal the weaknesses of the relationship, as well as some areas where interactions pose no impediment to enterprise development.

An assessment of difficulties and correlation between normative and positive versions of the interactions shows that there is little consistency among the five types of interactions analysed. Thus, while the role of bureaucracy has a significant effect on the development of enterprise, more specific problem areas may be identified. The thesis concludes that while there is a need for a more detailed examination of the relationship between bureaucracy and enterprises, nevertheless, the current evidence suggests that enterprise development is difficult and the relationship with bureaucracy is fraught with pitfalls, which has serious implications for economic development.
ACKNOWLEDGEMENT

In 1991, shortly after arriving in Kyiv for the first time, I was asked to give a bribe to a bureaucrat, a demand for which my Canadian life experience had not prepared me. Before I could reply, a Ukrainian friend rescued me. The friend insisted that the official show us the documentation proving the need for such a payment and that a stamped receipt be provided for any money handed over. The official backed down. I had experienced my first overtly corrupt interaction in Ukraine.

This lesson was only the first of many that opened my eyes to the problem of inappropriate behaviour at operational level interactions between officials and those they serve. This study is my effort to bring attention to such problems.

This work may contain lapses and errors, for these I alone take full responsibility. But anyone remotely involved in my life deserves no less than my complete gratitude for their role in keeping my spirits high, my procrastination at bay, and my eyes open.

I dedicate this work to my father, who would have taken an enormous interest in the subject. He would have offered much support and helped illuminate many new ideas. I missed him through this process. I also dedicate the effort to Meletiy, my son. I hope that he will grow up in a world that has managed to make the conditions for those with dreams and a will to work easier and without obstacles. If not, I hope that he becomes wise and learns how to overcome these difficulties without abandoning his values.

I thank Dr. Tomasz Mieckiewicz, despite arriving late in the process he showed me that I had some interesting contributions to make. Oksana Bashuk Hepburn, whose weekly phone calls and occasional visits, not to mention the re-reads, kept me going chapter by chapter. Several friends who offered help and support in various forms. Evhen Deneka, Michael Dickmann, Ken Hepburn, Craig Johnson, Taras Kuzio, Vitaly Lysenko, Orest Rebman, Dafne Ter Sakarian; thank you.

Finally, I thank my wife Larissa Talpash, who contributed in more ways than even she is aware. Most of all I thank her for uprooting her life and moving to London, providing me with her love and support throughout the process. I thank her for understanding that I needed to do this. Дякую!
CONTENTS

Abstract 2
Acknowledgements/dedication 3
Contents 4

Part A 6
Chapter I. - Introduction 6
Chapter II. - Concepts 16
  1. Corruption 17
      Understanding corruption; Towards a definition; What institutional framework makes corruption more likely?
  2. Enterprise 30
      Towards a definition
  3. Bureaucracy 34
      Bureaucrat
  4. Interactions 38
  5. Conclusion 39

Chapter III. - Theory - Master or Servant? 42
  Introduction 43
  1. Bureaucracy - enterprise relations 46
      Bureaucratic interactions with small enterprises
  2. Concepts and functions 51
      The products; Other characteristics; The state's provider function;
      The principals; Bureaucracy; Enterprise; Behaviour of entrepreneurs;
      Incentives; Knowledge; Government
  3. The environment of interactions 68
      Bureaucracy-enterprise relation; Public service contract; Bureaucracy's role in interactions;
      Why the divergence between the positive and the norm;
      Rationality: making do with a bad situation; Survival: going nowhere fast with less;
      Enterprise's role in the interaction; Enterprise's maximand: cost of being official and the decision to opt out;
      Rationality and survival revisited
  4. Interactions 86
      Opportunities for corruption or foundation of regulation
  5. General conclusions on interactions, bureaucracy, and the development of small enterprise in Ukraine 91

Chapter IV. - Mise-en-scène 94
  1. Institutional behaviour: A mindset from over a century ago 97
  2. Current economic conditions: the heritage of old problems 100
      Impact on the enterprise sector
  3. Present circumstances: Same old institutions, same old workforce 105
      Economic weakness begets institutional weakness
  4. Conclusion 114

Chapter V. - Outcomes and dynamics of the bureaucratic interactions 116
  1. Information and documentation on interactions 118
2. Money and interactions 122
3. Access: its whom you know 124
4. Time spent with officials 126
5. Bribery 128
6. Behaviour of officials 130

Chapter VI. - Methodology 133
1. Overview 133
2. Strategic approach 136
3. Validity and reliability 139
4. Research design: Identifying interaction and informants 141
   Units of analysis; Contacts; Brief description of information sources
5. Fieldwork: walking among the grassroots 149
   Key topics; Fieldwork
6. Standardising information 153
   Ensuring comparable data
7. Turning case studies into data analysis 156
8. Summary 160
9. Limitations of the study and future research 161
   Research perspective; Study sample; Methodology; Treatment of findings; Appendices

Part B. Empirical Results 168
Chapter VII – Registration Case Study 1 172
Chapter VIII – Standards Certification Case Study 2 192
Chapter IX – Sales permits (Patenty) Case Study 3 215
Chapter X – Tax Inspection Case Study 4 230
Chapter XI – Premises Inspections (Fire Safety) Case Study 5 259
Chapter XII. - Summary, Results and Implications 279
1. Case summary 280
   Cases; Elements; Documents and information; Official costs; Access; Time; Bribes; Behaviour of officials
2. Results 292
   Legal/institutional environments; The environment of interaction "survival-mode functionality"; Opportunities for corruption or strong foundations
3. Implications 302
   Conclusion

Chapter XIII. - Conclusion 305
   Focus of the thesis and its contributions

References 312
PART A

CHAPTER I - INTRODUCTION

Efficient laws, regulations, and procedures are among the very few key fundamental public goods for which the government is responsible. Public goods exist for everybody. Even and transparent provision of public goods is a critical measure of the fairness of a state's bureaucratic system. This, in turn, establishes whether the environment is conducive to the development of institutions within that country. By contrast, a country, in which the legislative and regulatory framework is open to manipulation by those charged with its implementation, creates a difficult environment for the development of enterprise and, consequently, restrain the economy overall. It is the bureaucracy, as the operational body of the government that is responsible for ensuring the enforcement and implementation of the "rules" in a fair and equitable manner. Through its system of policies, programs, regulations, and procedures, bureaucracy becomes the keeper of the public good.

Bureaucracy is a powerful institution no matter where it exists. Despite the fact that often its structures and activities are targets of frustration and derision, it remains a stalwart constant in the modern age. In many well run countries it is the pillar of governance while providing among others continuity, not only from the passing of one government to the next but in regimes with fundamental transitions from one form of government to another. This
continuity provided is a necessary element of transition. A stable bureaucracy helps to bridge such transitions and underpins the new political and economic order.

In the flux of change that ensued with the demise of the command economy of the Soviet Union, the bureaucracy was able to prop up the country thus providing a modicum of support and stability to Ukraine during transition. The bureaucracy has acted as a binding agent for weakened or crumbling institutions and, it may be argued, for the state itself. Despite the difficulties and the derision from the population and the newly emerging structures, bureaucracy has maintained the institutions of government and applied the existing legal and regulatory framework. By doing so it has consolidated its role in the development of the new economy and the transformation of its political system.

The transformation in Ukraine and the move toward the market economy, requires among other things the development of an effective economic infrastructure, an entirely new budgetary regime, a revenue system, as well as macro and micro economic stabilisation, and general structural and institutional reform. Only the state bureaucracy has been a constant player in this transformation easing, however uncomfortably, the old institutions into a new era as well as introducing new institutions into a system where previously they had been absent. Furthermore, it needs to be underlined that the bureaucracy itself has not been untouched by the transformation. Bureaucrats have been subject to changes and reforms that have effected every department and every level of the government. Policies, programs, procedures, processes, staff, organisation budgets, wages, benefits, morale, advancement, training and much more have, all been affected. The quality of work and the work place have been changed dramatically by the transformation.
Bureaucracy faces enormous challenges in times of transformation. Nonetheless, those who feel the full impact are not primarily the bureaucrats themselves, but those whom they are meant to serve and those from whom they are meant to usher into the new economy.

Among those to be ushered into the emerging market of Ukraine, autonomous enterprise is the newest participant taking on the role of counterpoise to bureaucracy. While bureaucracy puts into operation the legislation and regulations, enterprise seeks to exert pressure on the rules and to use them creatively in order to fill the market and to expand the economy. In developed economies, enterprises ritually complain about government bureaucracy as "getting in the way", as being an obstruction to their development. The ongoing adjustment or micro-adjustment of the bureaucracy is as important to the development of the enterprise, and indeed is, as the development of the enterprise itself. Thus, the struggle that exists between the two entities is generally understood and expected to be a constructive one. In newly emerging markets, the same complaints are voiced, though the tenor of that complaint is significantly more poignant.

It may seem therefore, that a bias exists and that bureaucracy may be blamed for problems that exist in bureaucracy-enterprise relations. The only bias that is assumed in this study with respect to apportioning responsibility however, is in the roles bureaucracy and enterprise each have in their mutual relationship, to be developed in chapter 2. The role of the enterprise is to create jobs and to become the principal agent for trade and economic activity while at the same time creating revenues for the state. The bureaucracy's role is to develop the infrastructure, policies, programs and procedures in order to implement and to
enforce the law/regulations established by the political legislative process and to ensure a level playing field for all. In other words, the enterprises push the law to its outer limits, and the bureaucracy provides a restraint on that pressure.

In this regard, Ukraine faces two serious problems. The first is a relatively underdeveloped enterprise sector. The second, and perhaps more worrisome, is a bureaucracy seen to be largely failing in its mandated tasks as a result of corruption opportunity that exists in such circumstances. Corruption in this instance is driven largely by low wages and lack of professionalism within the bureaucracy leading officials to seek their own benefits and compensation from the workplace. This prevents a constructive dialogue between the bureaucracy and enterprise from taking place and leads to obstruction to the development of enterprise in Ukraine, as will be demonstrated in the case studies and the analysis chapter.

Corruption is perceived to be among the most important obstacles in all less developed countries.¹ The consequence is an unstable relationship between enterprise and official structures. This is borne out in other studies by international organisations, which specifically target the regulatory framework of the economy.

The conclusions of the study will show that the imbalance between enterprise and bureaucracy in Ukraine is symptomatic of larger existing or potential problems including economic stagnation or even backwardness, social difficulties and political instability. The most serious negative consequences of the imbalance between business and bureaucracy are

the costs imposed on entrepreneurial activity and ultimately the greatest cost for any enterprise: business failure. Therefore it would seem obvious that in the interest of any nation, it is critical to have a vibrant entrepreneurial class that is a critical element in the transformation of the economy.

The types of enterprises of principal concern herein, are small domestically initiated enterprises. These small independent enterprises (SIEs) are regarded as essential grass roots participants in the economy, whose role in developed economies is recognised as very important and often contributing significantly to overall employment and to the GDP. In countries of Central Europe, it has been seen in the past decade or so, that the small enterprise is a major economic ingredient absorbing the unemployed, participating in the development and positively affecting economic policies by developing confidence in the transition process itself and creating pro-reform constituencies. This has not been the case in Ukraine and difficulties in the environment for SIEs should be regarded as a culprit. Chapters 2 and 4 elaborate on the starting conditions of the economy as well as the general place of enterprises in the process of transition.

Why is such a study important? Merely stating that the relationship between the bureaucracy and enterprise in Ukraine has experienced difficulties is not enough. Nor is simply saying that such an interaction between a particular agency and a business is obstructive. A deeper look into each interaction is needed in order to determine where the problems lie. It is only by determining the more precise details of the problems that they can be addressed properly.
The overall aim of the study is to determine the role of bureaucracy in the development of small enterprise and in that context to examine the areas of existing bureaucratic practice that exact the greatest cost on small business in Ukraine. This will be done by examining the direct interaction between state organs and the SIEs in order to show where problems lie and what effect these problems may have on the growth of the Ukrainian entrepreneurial sector.

To do this the study will set out to accomplish several things. The first is to provide a mis-en-scène whose purpose will be to establish that Ukraine's starting point of independence left the country in a disadvantageous position. A position characterised by a legacy of lack of rule of law, a weak legal infrastructure, a lack of political will and a psychology among the people which has stifled their ability to stand up and defend a host of rights. Such a starting point has serious consequences on the development of a middle/small business class.

For the entrepreneurs, inexperience may prove to be a decisive factor in their lack of development. While there is no set pattern to running a small enterprise, there are plenty of ideas and attempts at doing so. For most beginner entrepreneurs, the reliance on the bureaucracy is heavy. The bureaucracy in many ways has been ever present and has been the definitive source of information on how to get anything done officially. The entrepreneur continues to rely on the bureaucrat for getting the small business set up.

The starting point therefore also has to take into account the state of the bureaucracy. Using Niskanen's economic theory of bureaucracy, motivation for behaviour will be examined. It is believed that such motivation plays a significant role in bureaucrats' approach to their
work and their attitudes towards the rules that govern their jobs. A look at the environment in which lower ranking officials work and their situations will help establish the motivation behind bureaucratic behaviour.

The second aim of the dissertation will be to show that the relationship between the government, through its institutions/agencies and small independent enterprises (SIEs) is best observed through their direct relations. These relations may exist as legal regimes or as abstract economic relations. This dissertation however, will examine the direct face-to-face interaction that occurs between SIE and government representatives. Often the interactions themselves are identified as the problem. Taxation and licensing are examples of such difficult interactions that observers point to as culprits in obstructing business development. In this study, these interactions are broken down into a series of component elements involving direct contact with bureaucrats, each to be examined to determine if it might be considered an obstacle to the growth of SIEs.

Aim number three is to build a number of case studies based on the theoretical/legal explanations of the procedures as determined by the officials and the law, the practical experiences of the SIE owners and workers, as determined through interviews, and first hand observation. These cases will serve as units of analysis for the interactions themselves and will be analysed against the background of the propositions, to be elaborated further in chapter five. The intention is to establish a number of patterns and conclusions with which to examine the broader question of what impact bureaucratic procedures have on SIE development.
Finally, the goal of this thesis is to develop an understanding of which elements of the interactions and the relations with official organs are indeed obstructive to small enterprise development in Ukraine and which ones less so.

By accomplishing this, the study will be able to conclude with a better understanding of the role played by bureaucracy as maximising its utility, or in the case of individual bureaucrats maximising personal compensation and its effects on SIEs. While the costs to business may not be quantifiable in real terms, the findings of this study may be seen in terms of whether a particular element of the interaction obstructs or impedes business development, its insignificance; or, in fact, its helpfulness to SIE growth in Ukraine.

The results of research on bureaucracy-SIE interface reflect more general characteristics of the post-communist system. Unpredictability of government is indeed a new aspect of Ukrainian life. DiFrancesco and Gitelman are not alone in pointing out that under Communism people were often put in positions where they had to encourage bureaucracy to perform its tasks. Otherwise people could expect only complacency and 'inconsideration'. But this need to coax a bureaucrat into performing his task has become ingrained in social behaviour as a result of decades if not centuries of practice. This, despite how grossly unfair the practice is seen to be to those who cannot and who could not pay. Thus the unfair treatment caused by bureaucratic corruption has often been decried as a principal cause of poor economic development.

It is not enough to repeat, as many reports by domestic and international organisations do, that government meddling is hindering the work of the entrepreneur in Ukraine. As expected of any business community, the fledgling business community of Ukraine is also vocalising its displeasure at government over-regulation. It is further expected that the reaction of business be different from that of individual citizens who in their daily lives come across incidences of corrupt behaviour. A record of individual citizens' reactions and complaints against the government are found in studies such as one done by Miller, Grodeland and Koshechkina (2001), have illuminated the private citizen's response to official corruption. The analytical difficulties of such a study lies in its need to judge individuals' responses in terms of the answers being a mixture of gossip, hearsay or real experience. Hence, conclusions are difficult to make because the agenda of the individuals are as varied as the number of individuals replying. Closer to business and of greater concern to the study at hand, are reports by organisations such as the World Bank, IMF and Transparency International which take a broad-based look at the entire economy or enterprise sector by taking into account the views of predominantly foreign investors and multinational corporations. The perceptions and experience of multinationals and foreign companies in Ukraine, while interesting to the understanding of the business environment, confuse the study of domestic business development. Studies such as these are taken within the context of global performance and the Ukrainian economy within the international business framework. These therefore contribute a view of how the big business sector is

---

3 This reaction by business is typical of any business anywhere in the world. <http://www.fraserinstitute.ca/publications/books/econ_prosp/part3.html>
5 The studies by these groups are done to meet the specific needs of their clients, which are for the most part either government institutions, other international organisations or corporate structures. Their interest is
performing in Ukraine or how Ukraine is doing in terms of large corporate investment. This gives no indication of small entrepreneurial success and/or development within the context of the Ukrainian domestic economy.

This study of small enterprises and their relationship with the government of Ukraine looks at the responses and reactions to policies and implementation of services. It is believed that, while such a study may only provide a glimpse of the small business sector and its relationship with government, the focus is more specific than the examination of Ukrainian citizens at large. This narrow perspective allows for more accurate explanation of the problems in the relationship between enterprises and officials. Furthermore, it will provide a more intimate picture of Ukraine’s domestic business situation than one provided in studies conducted by international organisations as described above.

A maintained assumption in this thesis is that business’ motive is predictable. The rationale is that the task of business is to maximise the benefits in any way they can while working within the rules. The role of government is to provide a favourable environment for business and subsequently improve the country’s economic performance. Questions asked of the entrepreneur dealt specifically with the business entity, its activities, and its relation with officials at various levels. Yet, from the outset it was assumed that the relationship between government and enterprise may be tainted by official corruption.

characterised by interest in macroeconomic indicators with little interest in detail of domestic business other than its actual contribution to the GNP or the aggregate number of enterprises in Ukraine.
CHAPTER II - CONCEPTS

This chapter seeks to define the major terms and concepts of the thesis and to elaborate on their usage. The purpose of defining these various terms serves to specify what particularly is being studied in the case of 'corruption', 'bureaucracy', 'enterprise', and 'interactions'.

The Weberian model of the ideal bureaucracy/bureaucrat serves as a natural starting point, though itself offering little by way of applicability to this study. The concept of a bureaucrat selflessly working towards the general good by operating under well-defined terms of reference and being rewarded appropriately is simply too distant a point of reference for a bureaucracy in a transition economy. A more applicable view comes from public choice theory that examines the institution of bureaucracy and its members as rational players, often seeking the satisfaction personal needs ahead of professional duty. In the relations with enterprise in a setting such as Ukraine, the model appears to be more useful.

Enterprise in this chapter is defined in classic economic terms disregarding the agency problem. The enterprise is an operation that competes in the open market with pressures from both its competitors and its obligations to the state. The enterprise is further determined by its size in terms of number of employees. In this thesis it is limited to small...
operations that are domestic and independent. They are termed small independent enterprise (SIE).

The chapter begins, however, with defining the term 'corruption'. Though not an overtly evident concept throughout the thesis, it lies at the heart of the subject being examined. As the relationship between enterprise and bureaucracy is explored, the issue of corruption, a term loaded with a myriad of definitions and perceptions, inevitably emerges as a reason for difficulties in the bureaucracy-business interaction, or as its ultimate resolution. Regardless of where in the interaction it appears, it is first useful to discuss the concept in order to define it for our purposes, which will help to understand the problem and the possible impact of the relationship between the players.

1. Corruption

Corruption in any country is a complex matter difficult to define and difficult to study. As the anecdote at the head of this chapter illustrates, the image of the “beast of corruption” has many faces and one is left to draw one’s own conclusions as to how it looks. Yet, in a study of corruption’s effects on economic transition, a clear picture of the beast’s face must be drawn. First, the following examination of the existing literature on the topic will assist to determine a useful depiction of the ‘beast’. Corruption is endemic to every society. It has many shapes and forms making a full study of it and its multitude effects nearly impossible. A discussion of typology will help to understand the broad scope of possible areas affected.
by corruption. Examining it in an economic sphere only makes this task somewhat more possible. Limiting it to the bureaucracy makes it manageable indeed. This will make the study more manageable from the point of view of data collection and analysis.

Understanding Corruption

In some way the term ‘corruption’ has a strong connotation for everyone; we can instinctively identify what is, to us, corrupt. Most authors have applied their perception of the term to specific studies in an effort to better understand the complexity of their subject, rather than the complexity of corruption itself. Holmes correctly asserts that it is impossible for anyone to provide a universally acceptable definition of corruption. Alatas also correctly asserts that the transmission of notions of right and wrong is not dependent on the conclusions of scholars. There is a natural inherent sense of behaviour and of what is good and what is bad. Alatas believes that there is no need to wait for social science to arrive at a definition to know what is right and what is wrong. He argues that the failure of social science to arrive at a finite definition of corruption has lead “to the relativism and carefully guarded talk” on the subject of corruption. He writes that it is unnecessary to have a precise definition in order to study a phenomenon.

Thus, it is generally agreed that social science has had some difficulty in determining a precise definition of corruption. Yet, what is needed is a definition that will create

---

parameters for the discussion so as to provide a framework for the study. The word corruption has been used predominantly to identify behaviour and a state of being. This thesis will follow the established pattern of applying a definition, albeit imprecise and not universal, to a specific study rather than attempt the impossible task of determining an all encompassing term.

The existing examples of varying definitions reinforce the fact that 'corruption' as a term, is nebulous and difficult to define. Several forms of distinction can be used, and the divisions can be drawn along lines of economics. Onoge, and to some extent Theobald, use distinctions between economic groups to distinguish between types of corrupt behaviour. Onoge uses the terminology of class as the yardstick between the intolerable “class based misappropriation of the surplus value created by the working masses” and the seemingly tolerable “secondary” abuse of office which he writes is an “everyday” occurrence. This provides an example of how the distinction between the various definitions is not economically bound, as they are more accurately rooted in politics. Thus, one method of classifying corruption definitions would be a division along political lines, for example the ideologies of the cold war East versus West. Many authors, namely Holmes, Kramer and Clarke, examine the Soviet or post-Soviet political structure, however their definitions of corruption do not apply exclusively to the Soviet model.

The following section will classify definitions of corruption in terms of the relationship the corrupt element has with the powers or the authority of the state. The first type of

---

definition of corruption involves activity that is seen as against the state, against established rule of law, and almost always assuming the legitimacy of the state. In other words corrupt actions are performed by those individuals/groups who find themselves outside the parameters of officialdom. The second type of definition focuses on corrupt activities occurring within the structures of the state, generally describing the use of office for the purpose of private gain. As evident in the following examples, both categories are closely linked, however the distinctions are a useful means of identifying the definitions that are of concern to this thesis.

The first category is made up of definitions which, for the most part, come from studies where the state has an established reputation and is generally regarded as legitimate authority within the context of the study. For the most part, this study has attempted to stay with the context of a state, however the examples drawn from social and corporate studies have proven to add useful insight. Authority has come from political power, in the case of states. The term ‘political power’ is more applicable than elected or democratic power since in many examples, the source of authority is merely seen to be the fact of power rather than the form of or method of attaining empowerment. In other words the definitions have come from studies which examine polities and structures, while not judging the means by which the form of that structure developed. In the case of class or corporate structures, the source of legitimacy of power is economic.

When we relate ‘corruption’ to the concept of political power a distinction between officially acceptable and unacceptable becomes critical. In her work, Los emphasises the “second economy” or ‘shadow economy’. Her definition of corruption, synthesised from a number
of definitions used by contributors to her volume, focuses on the economic activities of individuals or groups that she determines are inconsistent with accepted or official roles. These are determined, by the degree of inconsistency of the activity, to be either illegal or quasi-illegal acts against the status quo. To this explanation of corruption, Los adds any activities that are perceived to be ideologically suspicious by existing powers. Such would-be suspicious activities, although not illegal, face considerable opposition from within official structures and are based on some ideological reason.

Many definitions try to define corruption in behavioural terms, i.e. as actions against authority, specifically economic authority. What the definitions lack is a clear explanation of what or whom specifically is under attack by corruption. In the definitions above, corruption is seen as activity that has an impact on the environment within a structure, in these cases, the state.

Leff, adds that corruption is “an ‘extra-legal’ institution used by individuals or groups to gain influence over the actions of the bureaucracy”. The use of the term ‘extralegal’ is problematic because it avoids determining whether the actions of those trying to corrupt the bureaucracy are in fact legal or illegal. What is useful about Leff’s definition, which is also used by Nye, Scott, and McMullen, is that it determines a target for corruption and clearly establishes the two sides of the relationship: the bureaucracy on one side, which is targeted by individuals or groups on the other.

10 Cited in Theobald, 111
11 Nye and Scott, and McMullen are all cited in Jan Tomasz Gross, Polish Society under German Occupation, Guildford: Princeton University Press, (1979) 146
The old Soviet criminal code defines corruption simply as “the abuse of authority or bribery.” Such a definition allows for much interpretation and provides little understanding of what corruption actually entailed under the Soviet regime. What it does provide however, is an introduction to the second definition category. Unlike the first, this type of definition no longer involves an outside force influencing or affecting the state or other structure: the notion of corrupt activity within the state is implied. Soviet law was aimed broadly at officials or anyone who abused their authority. Johnston defines corruption simply: “At its most basic level, corruption is the abuse of public roles and resources for private benefit.”

Onoge attempts to distinguish the forms of corruption. The two forms he mentions include “the class misappropriation of the surplus value created by the working majority” and “the everyday abuse of office.” The second is more appropriate to this thesis. It is similar to Johnston’s argument in that it determines that corruption is committed by people in positions of authority, but neither definition expands on what kind of abuse is perpetrated.

Kisunko’s definition of corruption, based on the Russian experience, removes the element of state from the definition and offers an opportunity to apply the definition to other institutions. His terminology suggests the notion of corruption from within although not specifically the state. He writes that corruption is “[the abuse of] power related to a particular job or position to gain unlawful wealth or influence.” In his examination of behaviour within bureaucracies, Downs provides a definition that avoids any elucidation of

---

12 Criminal Code of the USSR, Article 170 and 173-174
14 Theobald, 10
the infringements of officials and furthermore limits the scope of the definition to a question of legality rather than a more broad indictment of morality and dubious behaviour. Theobald writes that bureaucratic functions have within them an inherent flexibility that allows for efficient performance. This supports Downs’ definition in that it allows the study to avoid having to determine a point at which all bureaucratic functions fall under the suspicion of corruption. Theobald argues that the use of the term ‘illegal’ suggests that laws exist to govern the activities of officials but that enforcement of the law is another matter.\textsuperscript{16} The problem with such a definition is that other forms of activity that could be deemed corrupt are overlooked. As well, these definitions are problematic due to their simplification of the abuses of public officials and the target, or targets of that abuse.

Most definitions of corruption avoid broadening their view of the activities and opt for expanding the details of the perpetrators. An example of a law identifying criminals rather than the crime is Ukraine’s law, “On the Struggle Against Corruption”, which was adopted in July 1995. It states that corruption involves “activities of persons authorised to perform state functions which are aimed at the illegal use of the powers granted to them to obtain material goods, services, privileges or other benefits.”\textsuperscript{17} This law appears to target only illegal activities which result in the perpetrators acquiring goods and services, it does not elaborate on the methods of illegal activity, nor does it take into account the acts which violate popular


\textsuperscript{16} Theobald, 11-12

\textsuperscript{17} Taras Kuzio, “Organised Crime and Corruption in Ukraine.” \textit{Jane's Intelligence Review}, Vol. 9, No. 1 (January 1997) 13
levels of acceptable behaviour. A useful definition of the term therefore should ultimately determine, in some form, what is to be considered corrupt.

Banfield comes close to providing an adequate definition. He writes that, "an agent is personally corrupt if he knowingly sacrifices his principal's interest to his own, that is, if he betrays his trust. He is officially corrupt if in serving his principal's interest, he knowingly violates a rule, that is, acts illegally or unethically albeit in his principal's interest." Without identifying the principal, Banfield makes the definition broad enough to incorporate a wide range of possibilities. The definition can thus be used in a study of not only state structures but of any organisation in which agents act on behalf of the "principal". The initial assertion is not a violation of the law but it is to be seen as inadequate behaviour of the agent. This in itself is not illegal, though it may be perceived as corrupt. A problem with Banfield's definition is that the determinant of corruption remains an official matter and the role of public perception is not incorporated.

Friedrich brings together many elements that are sought in a definition of corruption. He writes that corruption exists "whenever a power-holder, which is charged with doing certain things... is by monetary or other rewards not legally provided for, induced to take actions which favour whoever provides the award and thereby does damage to the public and its

---

18 Such a standard is based on the public perception. As an example, the demonstrations in the Fall of 2001, expressing outrage at the President over the disappearance of journalist Georgy Gongadze.

interests.” This definition begins to highlight the elements ‘public’ and ‘public interest’ that ought to be the prime determinant of what and who is corrupt.

Definitions used by Banfield and Friedrich contain all the necessary elements for creating our own definition, but it is Leslie Holmes who provides an explanation that seems to encompass all them all. For Holmes corruption is “action or non-action - by individuals or small groups of individuals occupying an official position (party and/or state and/or legal and/or military and/or socially responsible) elected or appointed position(s) - that are perceived, by at least some criteria to be improper and illegitimate in the particular sense of being seen as simultaneously against the collective (societal) interest and the official’s (officials’) individual (self-regarding) interests.” Holmes’ definition is in fact an omnibus solution that encompasses all the previous definitions in some form, while not providing a useful definition that will serve in a study such as this. Contrary to the shortcomings of the other definitions, Holmes’ includes too much.

Most of what is in the Holmes definition will be of use in defining the parameters of corruption for this thesis. Among them the notion of “[perception], by at least some criteria to be improper.” allows for non-legal determination of impropriety. Phillip Jos also includes the idea that the public should determine what is a violation and what is not. He writes that, “corruption, like the concept of power, power is a relational term... that implies a serious violation of standards or expectations associated with a broader set of public relationships and processes.” This definition includes the concept of public expectations and standards that are not expressly official. As Holmes argues the need for some implicit criteria in

20 Carl J. Friedrich, “Political Pathology.” Political Quarterly, Vol. 37, No. 1 (1966) 74
addition to legal rigidity, Jos suggests that the notion of a public domain versus a private
domain and the views of the general public within a polity determine corruption. In other
words public opinion has the function to determine what is, and what is not acceptable
behaviour for those in public office. Furthermore, Clarke writes that there are universal
elements of the concept of corruption, among them decay, depravity, secretiveness and self-
interest, which are inconsistent with official positions in public office. The victim of such
elements is public trust, or broadly stated, public interest, and only the public can determine
what is in its interest and what part of the trust has been betrayed. This is particularly true in
societies like Ukraine’s in which studies have shown that there are generally low levels of
popular satisfaction with, and trust of the government and henceforth a different tolerance.21

Yet, the value of public interest and public view in debates about corruption is often
questioned, raising concern that public interest is too vague a term and attempting to
incorporate the multitude of opinions leads to problems when studying corruption.
Huntington considers the public interest in his definition of corruption: “behaviour of public
officials which deviates from accepted norms in order to serve private ends.”22 If “accepted
norms” are taken to mean “public interest”, an acceptable definition of corruption emerges
based on the premise that corruption is what the public deems it to be.23

21Richard Rose. “Russia as an Hour-Glass Society: A constitution Without Citizens.” East European Constitutional
Review, vol. 4, No. 3 (Summer, 1995) 34-42. Also see William L. Miller, Stephen White and Paul Heywood,
22 Sam Huntington, Political Order in Changing Societies, Newhaven CT.: Yale University Press (1968) 59
23 Theobald, 7
For the purposes of this study, the definition of corruption must include many of the elements included in the aforementioned definitions. The definition of corruption is any conduct of persons in positions of responsibility and/or authority resulting in personal (direct or indirect) benefit and deemed to be contrary to the interest of the public they serve.

This working definition may be analysed in several sections. First, conduct is not solely determined by rule of law but by a perception which is determined by the opinions of people, and their views on matters which demand a collective position. Second, the public is a variable that may be as large as the entire nation, a particular sector of the economy, or a collective farm department responsible for veterinary services. In many countries and institutions, the responsibilities of individuals are commonly determined by the terms of reference for their position. If terms of reference are not provided, which in a country such as Ukraine often is the case, the expectations of the public determine the role that individual should play. As it is the public who pays for the service and thus, has preconceived notions regarding the functions of the office, and thus have certain expectations of that office. Finally, the public interest is the most difficult section to define since the notion of public interest is nebulous and ever changing. Clark writes that corruption is "most appropriately seen as a legal construct". He adds that while moral and ethical questions are not excluded from the analysis, the study of corruption demands a legalistic rather than a normative approach is to be used. In this thesis however, it is held that the legalist perspective can only be applied to cases in which a solid legal tradition exists and where laws reflect the polity.

---

24 Clark, 6
An approach that more appropriately reflects the reality of political economic and social conditions has to be applied to a study of corruption. Clark himself acknowledges the possibility that within certain contexts, cultural distinctions make it difficult to apply the universal moral or ethical construct. He cites a group of researchers and concedes that "actions are 'situated' within socio-cultural contexts. Corruption [can] be regarded as a negotiated classification of behaviour rather than an inherent quality of behaviour." This lends support for the use of public perception and public interest as the gauges for determining what is corruption in Ukraine. There is some debate as to whether any merit may be placed in taking public views on matters of justice as having any bearing on academic discourse. Swift, Marshall, Burgoyne, and Routh ask the question, "does it matter what people think?" They conclude however, that people's opinions are of importance and that their behaviour is affected by how they view and judge that behaviour. It can be said therefore, that any official views on corruption are rooted in what people think of corruption.

**What institutional framework makes corruption more likely?**

In addition to the concept of corruption, it is worthwhile to determine a framework to gauge where the likelihood of corrupt behaviour is highest. From the discussion above, it is possible to extrapolate the conditions that promote or allow for corruption behaviour. In this thesis, three institutional environments are used in the examination of bureaucracy, their

---

specific role in the theoretical framework are covered in more detail in the theory chapter. To mention them briefly, the first is an environment where the conditions for enterprise development are optimal and where the official interprets and implements the interaction as a 'servant' to the SIE. In such an environment the interactions faced by SIEs are transparent, accessible and open and one that results in low transaction costs. The role of officials is understood by the SIEs and by the officials themselves. The interaction is general simple and easily completed. The second environment exhibits conditions where the role of the official is that of a 'master'. In this environment the execution of public function is done in the interest of the bureaucrat and where the SIE progresses through the interaction at the discretion of the official, but where the regulatory framework supports the operational methods of the officials. In this context the transaction costs are deemed high. Regulations exist but their interpretation is made at the operational level. It may be argued that this is legitimised abuse of authority. The third environment is one where the officials treat their area of jurisdiction as fiefdoms, where they pursue their own interests at the expense of the SIEs. What is critical about this environment is that the transaction costs are indeterminable and ongoing, that is, once a payment has been made, continued related payments are demanded. Such an environment shows incomplete or poor legal/regulatory framework, lapses in support from the government for the activities of the bureau, and deficiencies in support for individual officials, whether in payment or in leadership. Regulations are poorly defined, functions and duties often undetermined and left to be interpreted by individual bureaux or officials. Thus operationalisation of the interaction is left to the discretion of the officials themselves. In such conditions there is often little recourse for SIEs but to comply with the demands set by bureaucrats. This environment is characterised to some extent by
the "roving bandit" bureaucrat. Both the 'master' and the 'roving bandit' environments provide, to varying degrees, the necessary conditions for possible corruption.

2. Enterprise

While "corruption" is an underlying theme in this thesis, two other terms need to be clarified in order to provide a clear understanding of the concepts being discussed. This section will examine "enterprise," a concept not as complex a term as corruption, and one that is not being redefined per se. What this section does is identify what type of enterprise is being considered. A broad conceptualisation of enterprise exists. This section aims to review several basic definitions of enterprise, critically considering the most appropriate elements of these definitions and then propose an applicable definition for this study.

A wide definition of the term suggests that enterprise can be any economic activity ranging from a major corporation to part-time, self-employment. This statement is, of course, much too broad to be of any purpose to this thesis. Reynolds suggests constraints to the definition in order to limit the discussion and to begin structuring a more manageable


27 In this understanding of ‘roving bandit’, the bandit does not expect to see his victims again. In the borrowing of the concept herein, the repeat violation of victims is not uncommon, and the mobile nature of the interactions examined in this thesis, particularly the inspections, make the concept applicable.

understanding of what might be considered ‘enterprise’. Among the suggestions is that enterprise might be limited to represent activity resulting in full-time self-employment. For a study of the situation in Ukraine, such a limitation is difficult to apply because very often enterprises do not offer full time employment although they may offer full time activity. Many individuals who work for companies or as owners also have other jobs that bring in revenue when the enterprise in question is not. Another limitation may be only to consider businesses that create jobs or employment for others. Again in the context of an emerging market many enterprises operate as single person operations primarily due to the lack of capital to pay wages. These operations should not however be taken away from the pool of enterprises simply because they do not employ others.

An organisation that creates a major change of economic activity or production might be another useful criteria. Such a restriction is virtually impossible to apply to a single small enterprise. Because Reynolds refers to a perceivable change within the economy, it is highly unlikely, but not impossible, for a small enterprise to have that kind of economic clout. Such an approach is entirely applicable to enterprises in Ukraine since few, if any publish their financial results and overall economic contributions making verification difficult. These restrictions offer little in the way of defining enterprises. What they do is begin to focus the issue of criteria.

In this look at bureaucratic operationalisation of regulations and its effect on small enterprise, terms used in theoretical literature, such as enterprise, are adjusted to be applicable here. In the context of this study the term ‘enterprise’ will also take on the character of “public”, “citizen” and “democratic interest”, and occasionally the terms may be
used interchangeably. In works where theory deals with public choice, enterprise both as individual entrepreneurs and as legal entities will be taken to be corresponding to “public”. Yet, it does not always follow that public interest is limited to the interest of the enterprise and the entrepreneur. Moreover, a citizen is a bearer of rights and duties in a society. They are not isolated individuals as contrasted with the notion of customers. A customer does not share the wider interests of the community and can abandon the relationship with the provider in order to seek maximum advantage. The “citizen” is expected to work together with the other players in the broader relationship through democratic means to improve the state of affairs.

Towards a Definition

Chapurnenko and Vilensky provide a definition from the Russian context that also suits the needs of this thesis. They suggest that a small enterprise should be seen as “economic activity by persons engaged in management and control of their [own] business”. It is understood that the ownership of the enterprise is directly involved at all levels of the day-to-day running of the company. That daily operating of the company makes the interaction with official agencies so much more pivotal. The successful running of a small enterprise depends on the ownership being able to actively participate in completing the process successfully. This is the pivotal distinction.

29 Alexander J. Chapurnenko and Alexander V. Vilensky, “Small Business in Russia” in Brezinski and Fritsch, 60
Some criteria that will help determine the type of enterprise selected for this study has already been noted. The issues of size and forms of ownership are the principles are found within the laws of Ukraine. Yet, Ukrainian law is vague on what is meant by an enterprise and provides no definition of enterprise per se. It makes do with categories for enterprise employed by official organs for the purposes of taxonomy and statistics. The Ukrainian law On Enterprise for example offers no definition of what is an enterprise. Instead it lists five forms of enterprise including private, collective, agricultural, communal, and state. The Presidential Decree on Simplifying Accounting Practices for Small Enterprise June 1998, defined the small business as one with no more than 10 employees and having annual sales turnover of under 250,000 UAH. The State Committee for Statistics annual figures suggest that a small enterprise is a company with fewer than 50 employees. Firms with fewer than 10 workers are categorised as micro enterprises. This study has considered firms that range in size from 1 to 10 employees. No consideration of turnover, or financial standing was taken into account, though for most interviewees the 250,000 UAH threshold admittedly was not surpassed.

Legal status in the understanding of enterprise for this study was not an issue. The fact that a company had no legal status in terms of registration did not eliminate it from being considered in the study. After interviewing a number of "illegal" companies, it became clear that many wanted to be legal firms, but circumstances prevented that from being so. Non-registration was not seen as enough of a barrier for preventing the company to be examined.

---

If the enterprise attempted to go through official channels to establish it and to receive services from official structures, it is considered a small enterprise in this study.

Most of the necessary criteria needed to define the type of enterprise used in this study have been briefly covered. It is now assumed that a small enterprise is a business entity that employs fewer than ten people, private in ownership and whose owners play an active and direct role in the day-to-day management of company affairs.

This study has already determined that it will deal specifically with small enterprises. Further, in the interest of pursuing an examination of the relationship between enterprise and bureaucracy, the study will examine privately owned firms. This in part because it is anticipated that the results will show the widest possible divergence of interests.

In this thesis, the use of the designation "enterprise" will be used interchangeably with the term "client", as in the client who pays for services or goods provided by the bureaucracy. The term might have been made more immediately specific as "enterprise-client", however such a term appears cumbersome.

3. Bureaucracy

When Weber wrote about the rational bureaucracy his intent was to describe an ideal type of bureaucracy rather than an actual reality. There was no mention of a definition of a bureaucracy in his writings partly because of the constraints such a definition may have imposed. The absence of definition in Weber may imply that there is no correct way to
understand the function of bureaucracy and that every context, every state, even every institution is different. The volumes of explanation of Weber’s bureaucracy and the ensuing debates prove that. Obviously the types and the nature of bureaucratic activities vary greatly, the fundamentals however, is not. Owing to the focussed examination of a particular stratum of bureaucrats within a particular context, it is clear that such an examination could not possibly be restricted to a general discussion of rational bureaucracy.

The term bureaucracy has always had a pejorative nature. Initially the charge of bureaucracy was taken to identify excessive government. French philosopher, Baron de Grimm wrote that “the real spirit of the laws in France is that bureaucracy... here the offices, clerks, secretaries, inspectors and intendants are not appointed to benefit the public interest, indeed the public interest appears to have been established so that offices might exist.”31 Today however the term has a less nasty connotation and is used synonymously with public administration. In this thesis the use of the term bears no pejorative nature. Furthermore the use of the term in Ukraine (though used scornfully at times), is also widely accepted as a general description of the group of people who perform functions of public administration.

Because this thesis seeks to analyse the role of bureaucratic corruption in the development of small enterprise, it is necessary to explain what we mean by ‘bureaucracy’ and ‘bureaucrat’. This section aims to define ‘bureaucracy’ and to distinguish a particular segment within it. It will further be necessary to differentiate the part of bureaucracy being examined. The institution of bureaucracy is a vast structure of bureaux and their personnel; directors, office workers, managers, and clerks all active in performing the mechanics of government.
Because there is no hegemony in the bureaucratic interest it is essential to identify the subgroup within the structure of officiandom that is to be considered. Yet, even once such group is identified it is still not entirely certain that the group behaves cohesively. Nor does this thesis seek to suggest that there is such group identity or behaviour. Nevertheless, the distinction of a subgroup of bureaucrats will make the exploration of the relationship between enterprises and official structures more manageable. The identification of a segment of bureaucracy will allow us to discuss the issues with a clearer sense of a particular bureaucratic archetype.

The definition of bureaucracy for the purposes of this study is a sub-group of the official body of employees of the government administration. That sub-group of bureaucrats and their corresponding stations are those who interface with enterprise on a regular basis. They are referred to as operational level bureaucrats, inspectors, or occasionally low-level bureaucrats, though not as a reflection of their qualification but rather their position on the policy ladder structure of the bureau, or quite simply as bureaucrats.

This thesis does consider a definition of bureaucrat if only because of the focussed examination of a particular subgroup of bureaucrats within a particular economy. It is clear that such an examination could not possibly correspond to a general discussion of rational bureaucracy despite the usefulness of Weber's contribution to understanding the function and role of the modern bureaucratic structure and offering a starting point in the theory.

---

Thus, this study is concerned with the role of the operational level of bureaucracy. This vague term, describing a level within bureaucracy can be limited to a set of officials and based upon the function they serve. The operations level bureaucrat is one who works on the so-called front line of bureaucratic service. In other words, such a bureaucrat is one who is in direct contact with and immediately involved in the interaction involving the agency and the enterprise. These officials are responsible for a variety of functions. They are the agents who take payment from enterprise for services on behalf of the agency, they carry out the procedure of the service, they accept documents, return documents, process documents, and who are directly linked with the interaction as representatives of the bureau itself.

Like “bureaucracy”, “bureaucrat” too has historically carried with it a negative connotation. Balzac used the term with the same scorn writing that bureaucracy was a “gigantic power set in motion by dwarfs.” Regardless of the historical scorn put to bureaucrats, the reality or their existence remains in every society. What is critical to understand is their responsibility to the state. This responsibility helps identify the bureaucrat and his role. Balzac and others may place bureaucrats in a negative light, individuals who lean politically towards favourites, or who wield their authority any way they see fit. Others such as Kingsley argue that the bureaucratic responsibility in modern society is not found in their “largely fictitious impartiality” but in their commitment to the purposes of the state and its policies. In other words, a bureaucrat who fulfils his/her tasks in the spirit of the purpose of the government can be said to be responsible

The term bureaucrat is also widely used simply as the description of the people who perform functions of public administration. Similar to 'bureaucracy', in this thesis the use of the term 'bureaucrat' bears no pejorative sense. The thesis argues as will be discussed in the theory chapter, that to a great extent the bureaucrat is not responsible to the spirit of the government's policies as regarded by Kingsley and others. Instead the bureaucrat seeks out own advantage, or at best the advantage of the immediate needs of the department (taken as narrowly or as broadly as the case may warrant).

A more precise conception of bureaucracy or bureaucrat is not necessary in as much as most understand that the bureaucrat is the functionary of the state. But, for our purposes bureaucracy is narrowly identified as a subgroup of the official body of employees of the government administration. This subgroup is made up of individuals identified earlier as bureaucrats.

4. Interactions

The interaction is the chosen unit of study for this thesis. In straightforward terms it is the point at which the bureaucracy and enterprise meet face to face for the purpose of conducting the exchange of payment for service. It also includes the fulfilment of duties of

---

one or both sides to conform to legally established requirements. These are unlike Williamson's transaction, which includes a broader set of interface in which goods or services are “transferred across a technologically separable interface. One stage of activity terminates and another begins.”

The interaction may be seen as a subset of transaction, incorporating the direct interface and the precise moment of exchange.

Each interaction is made up of a series of steps, each of which is taken to be an individual element of the process. Each element in turn is composed of a series of attributes whose function is to help assess categorisation of each element as supportive or not supportive of a given proposition.

5. Conclusion

This chapter has sought to identify and explain some of the key terms used in the study in an effort to focus the scope of the study. The concentration has been on the definition of corruption, a term loaded with meanings and often left undefined. The terms enterprise and bureaucracy or bureaucrat are also included, though their respective meanings are far less vague, they are described in this chapter in an effort to determine exactly what aspect of each is being referred to in the study.

This review of corruption, enterprise and bureaucracy are by no means exhaustive. In the case of corruption, it is unlikely that a comprehensive definition or universal conception of the phenomenon will ever exist. This is not an apology however, for a limited study of the issue. William A. Clark writes that “the imprecision of the study and the weakness of the data in no way make the study of the phenomenon any less important to better understanding the changes and patterns of behaviour in politics and economics in the region.” The fact that relatively little is known about corruption makes it that much more important to study in all its forms and from a variety of perspectives. Only when this work has been conducted and completed can we hope to arrive at a better comprehension of the matter.

This thesis has sought to provide a look at some of the main contributing and defining elements of corruption. The theoretical work that has been done on the subject is extensive although limited by numerous factors, most related to the impossible task of determining a universal understanding of the issue. Therefore, it is crucial to examine a number of factors in order to grasp corruption’s full meaning in a particular society, country or region. Without putting it into context, corruption is a “catch-all” phrase without real meaning and application to an empirical study. This thesis has sought to identify a number of the factors that help determine the parameters of the concept of corruption for the study of Ukraine and its transition to a capitalist system. Culture, regionalism, history, and public opinion all play a role in understanding corruption.

35 Clark, 17
Enterprise as used in this study reflects the set of firms examined in the study. They are identified as small independent enterprise, whose role in the economy is recognised as critical but whose relationship with the bureaucracy is uncertain. These are enterprises run by Ukrainians, with no investment from foreign companies, few with credit support and most making their way through a bureaucratic system on their own.

The bureaucracy has been examined from the Weberian ideal to a more appropriate public choice structure with all of its inherent flaws. This study has isolated a particular group of bureaucrats, at a particular level of the official structure, and has established operations level bureaucrats and the regulatory implementation at their level as one perspective of the study.

The definition and clarification of major terms, as well as the explanation of several specialised terms used in the analysis, concludes the introductory part of the thesis. The following chapters will follow with theory, the data collecting and information management strategy and show the cases, their analysis and conclusions.
CHAPTER III - THEORY

Master or servant: The role of bureaucracy in the development of small enterprise in Ukraine in the context of post communist transition

This chapter sets out to discuss the theoretical underpinning of the study and to arrive at a theoretical construct that will help understand the interaction between the bureaucracy and small independent enterprise in Ukraine. The construct will be less a full model and more of a foundation upon which to place the study.

The chapter is divided into three sections. The first starts with the short empirical description of the general economic construct in Ukraine. This serves as a starting point for developing a more general framework. The point at which there is a direct exchange between the operational level of bureaucracy and enterprises is examined. This relationship is described as an ‘interaction’, a process whereby the enterprise seeks to obtain official services and public goods from officials. Later in the first section the concept and functions of interactions, as points of direct link between enterprise and bureaux, will be discussed including the state’s role as provider of services and public goods. Finally, this section will identify the principal actors: bureaucracy, enterprise, and government, and discuss their behaviour, including incentives, motivation, and knowledge.

The second section concentrates on the environment in which interactions take place. It discusses the relations between the bureau and the enterprise. First by looking at the public
service contract notably the bureaucracy's specific role in the particular interactions, and the
question of the bureaucrat maximising personal interest; second by examining the
enterprise's place in interactions and the maximands of the entrepreneur.

The final section takes a closer look at the interactions themselves and sets the groundwork
for understanding interactions as opportunities either for corruption or as foundations of a
regulated system based on the rule of law and the correct application of normative
procedures.

Introduction: Problems in the interaction between bureaucracy and enterprise

Bureaucracy's role in the development of small enterprise is an important one as it
characterises the quality of the relationship between the two entities. In turn, the quality of
that relationship affects the ability of business to function and to grow and to contribute to
the economy as a whole. Because the nature of this relationship is being questioned here, it
is assumed that a conflict exists in the relationship as it is currently structured.

In Ukraine, the popular view of bureaucracy-enterprise relations is that problems exist. By
examining points of interaction between them, concrete problems become visible and open
to scrutiny. As such they are no longer seen as merely abstract difficulties of bureaucratic
meddling or entrepreneurial ignorance of the rules but as predictable reactions to given
environmental factors. In some cases, certain parts of individual interactions may be
identified as particularly problematic without blanketing the entire procedure as such. The
obvious point of direct dialogue between the two occurs in interactions for government goods or services. This chapter will develop a theoretical construct of interactions between bureaucracy and enterprise in the context of post-Communist transition in order to determine points of difficulty between the two at the operational levels.

The application of a theoretical construct of interactions between operational level bureaucracy and small enterprise in Ukraine is based on an amalgam of an economic theory of bureaucracy and a theory of corruption. The construct revolves around two principal players, bureaucracy and enterprise, with a significant third player - the central government and the relationship that links them in a direct manner on a daily basis. This link is critical; it touches common interactions established by laws and the regulatory structure of the country.

Bureaucracy was the principal institution in the lives of Soviet citizens. In many ways little has changed and it remains the main institution of post-Soviet society. Bureaucratic processes have strong effects on everyone in the region. Strangely somehow, bureaucracy is arguably the most powerful, and yet in many respects, the least effective institutions in the newly independent states. In the Soviet period its power stemmed from its direct links to the political powers and the intertwining of authority. Political powers supported the bureaucratic, while the bureaucratic did the same for the political. The state had a firm grip on people's lives. Almost every activity was at one time documented, filed and kept by the bureaucracy; virtually every aspect of people's daily activities was monitored or regulated. It has since become relatively ineffective. Bureaucracy's control of people's daily lives has visibly diminished.
Current economic realities of the former Soviet States are largely responsible for this change. The inability of the state to provide the services once offered has contributed to the loss of authority. Furthermore, the once strong links between political and bureaucratic authorities have weakened. Where there once was strong leadership there now exists a vacuum and a breakdown of authority. This is partly due to the break-up of the USSR leaving bureaucracies without direct links to their upper level authority in Moscow, and partly due to the inexperience of republican leadership to exercise full control over the regional bureaucracy without the directive and example from the Kremlin. The legacy of the Soviet bureaucracy however, remains. This legacy is responsible for whatever authority the bureaucracy still has; be it through coercion, fear tactics or even real authority, the character of today's bureaucracy in Ukraine is stamped with the image of the past.

Enterprise as a sector is a new concept to most ex-Soviet citizens and, in many ways the practice of business is in a “beginner” phase. This implies that the rules of the game may be far less clear for government, bureaucracy and enterprise, than all players may wish to admit. Most possess knowledge of the former social/political/economic 'system', and some understanding of the emerging one. But in the uncertain and changing environment many have figured out ways of either circumventing it or using it to their advantage. While new found creativity in the interactions might serve a variety of purposes for a while, now and in the future, a more professional and uncorrupted approach is a must.
In order for an economy’s entrepreneurial sector to prosper, small business operators must be able to work within a set of rules that allegedly meet international legislative standards.\textsuperscript{36} For individual enterprises, the incentive to work within a legal framework brings advantages. Among them, the promise of democratic protection for all under the legal system makes the small entrepreneur strive for a clean record so that they may indeed be treated in a fair manner should they have trouble. Yet, there are factors, such as opportunities for corrupt behaviour among bureaucrats that may prevent the clean running of a business or which simply make the daily chores of business complicated matters.

The chapter concludes by examining the interaction within a corrupt environment and the consequences for the players involved. Opportunities for corrupt behaviour at operational strata of officialdom may find origin in the historical development of bureaucracy. Innumerable accounts of bureaucratic malfeasance exist in most if not all countries at virtually any point in time. Contemporary manifestation of opportunities for corruption are determined by certain factors that have a direct impact on the role and responsibilities of the operating agency as well as the nature of its relationship with the constituency it serves.

1. Bureaucracy – enterprise relations

There is a generally weak understanding of bureaucratic functioning in Ukraine. “The very familiarity of its presence obscures its complexity”.\textsuperscript{37} A sub-structure of the Soviet

\textsuperscript{36} This international standard is not formalised but one that is claimed by the legislators who draft laws and adopts them. Their claim is bolstered by the Ukrainian Legal Foundation, which aids member of the Verkhovna Rada in preparing legislation.

bureaucracy, its independent examination was uncommon. Also hampering a full study of Ukraine’s bureaucracy has been the secrecy, in which the bureaucracy worked and continues to work. Added to this is the so-called transition period that envelops the countries of the FSU and which makes for difficult analysis as a result of constant and often extreme political and economic change, not to mention the social uncertainty at the moment. A further reason for the difficulty in answering the questions above may stem from an unclear picture of the enterprise sector. There is much about doing business that is learned by experience and by time. The enterprise sector in Ukraine has had little of either. The lack of wisdom and experience are compelling as reasons for difficulties in doing business. There are however, many examples of people running enterprises without difficulty despite only recently starting up. This suggests that the difficulties may in fact be related to external factors, among them the working relationship between bureaucracy and enterprise, and the behaviour of bureaucrats.

Academic study of the Soviet bureaucracy and Soviet society was the function of ‘Sovietologists’ whose assessment today can be viewed as only partly useful. While they provided plenty of analysis about the structure of Soviet bureaucracy on one hand and its relations with society on the other, they could offer little by way of defining the relationship with organisations such as private enterprises as these did not exist. But even in matters of state-citizen relations, the literature is scant. Moreover, there has been an unsatisfying record of conclusions regarding official processes and behaviour, beyond indications that

---

38 It can be argued that attention to citizen-state relations has for the most part been poor but gained slightly with the publication of such texts as Theodore Friedgut Citizens and Soviets: Can Ivan Ivanovich Fight City Hall? in Comparative Politics (10 July 1978) or Jeffery W. Hahn, Soviet Grassroots: Citizen Participation in Local Soviet Government, London: I.B. Tauris. (1988). The Hahn book has been called by some a
they were omnipresent, complex and difficult to penetrate. Finally, there has been little access to detailed information associated with intricate bureaucratic procedures themselves.

The study of Soviet bureaucracy has been dominated by an examination of the Moscow based bureaucracy, or as it is often referred to, Russian bureaucracy. Pikhovshchek asserts that former 'sovietologists' and other observers of the FSU exhibit a "weird psychological dependence on the Russian experience" suggesting that the experience of Russia is reiterated in Ukraine on most fronts.³⁹ This does not suggest that there was a vast difference in the character of bureaucracy in the republics, it may even be argued that the republican version was/is a virtual mirror image of the USSR central bureaucracy. Yet there did exist two distinct Soviet bureaucratic types each with its own peculiarities. One dealt with the entire Soviet Union and the other with the specifics of regions. Many well-qualified bureaucratic candidates were attracted by challenging and prestigious work in the Moscow-based bureaucracy leaving the regions to be administered by bureaucrats who may have had more limited skills. With nationhood suddenly foisted upon the regions, the national administrations populated by officials largely untrained for that kind of leadership was expected to take charge. Today the former regions of the USSR have a different model of bureaucracy from that of the past as well as from that of their former administrative centre, Moscow, as they face greatly different circumstances, particularly economic ones. The groundbreaking study of its type. Nevertheless, it is maintained that the direct links between state agencies and the citizen have by and large been left to one side for a variety of reasons.

³⁹ Vyacheslav Pikhovshchek, "Oligarchology" in Dominique Arel, The Ukraine List(Internet newsletter), UKL #52 (6 August 1999)
traditions of organisational behaviour passed from one generation of officials to the next have become inapplicable methods of approaching tasks faced in current circumstances.\textsuperscript{40}

\textit{A theoretical construct of bureaucratic interaction with small enterprise}

The remainder of this section outlines a model of bureaucratic interaction with small enterprise, the environment in which each operates, and the motivating triggers of behaviour within the relationship. Their relationship including the expected roles of each and how corruption fits into their interactions need to be discussed. Questions such as what establishes a strong and effective bureaucratic process and what exemplifies an inefficient and corrupt system need to be asked. Adapting the theory that Niskanen (1973) initiated with his economic theory of bureaucracy, followed up by Brunetti, Kisunko and Weder, (1997) the discussion in this section will examine the place of bureaucracy at the helm as the master or as the servant of the emerging economy.\textsuperscript{41} With that goal achieved the matter of corruption opportunities will be added to complete the theoretical model of bureaucratic corruption. Also to be discussed is the place of enterprise in the relationship with bureaucracy, the concomitant costs imposed on the enterprise, and its eventual choices regarding the direction of business practices and the involvement in the official economy.

\textsuperscript{40} Certain behavioural assumptions that worked for organisations in the past are taught to new members as the correct way to approach problems. One theory of organisational behaviour argues that the shared framework of information processing leads to the development of an information system which is collectively identifiable and accessible. See C.W. Choo, \textit{The Knowing Organization: How Organisations Use Information to Construct Meaning, Create Knowledge, and Make Decisions}. New York: Oxford University Press (1998)

This model examines behaviour of bureaux using a direct analogy to established economic theory of the firm on which the theory of market supply is based. In his theory of bureaucracy, Niskanen examines the relations between the bureaux and the "sponsor". For the most part, Niskanen avoids addressing the third party in the economy of bureaucracy, i.e.: the citizen/client. Instead the relationship between the sponsor (government or the agency paying for the services of the bureaucracy) and bureaucracy is emphasised. In the modified approach adopted in this thesis, analysis of provision of services to clients by bureaucracy or bureaucratic supply is included. Since this thesis examines the interactions with bureaucracy, the supply side model provided by Niskanen remains useful. Concentration on the relationship between citizen/client (small enterprise) and the bureaucracy signifies a departure from Niskanen's focus on bureaucracy and sponsor but not from his template.

Brunetti et al. provide support for the modified theory arguing that a positive relationship exists between business perceptions of the credibility of official structures and their growth, and increase in GDP. Schram also contributes with the dynamic of individual motivations. He argues that individuals seek selfish gains, however his argument also suggests that there may be other motivations behind action. Three elements of a theory of bureaucracy identified by Schram are also applicable and serve as a good starting point for this discussion. They include, 1) the distinguishing characteristics of interactions, 2) the nature of bureau relations with their environment, and 3) "Maximands" of bureaucrats and business.

---

42 Niskanen, S. Niskanen's "sponsor" is a term used to identify the entity footing the bill for services, usually the government but not exclusively.
2. Concept and functions

The main characteristic of interactions

Interactions between operational level bureaucrats and enterprises are characterised as fulfilling either one or both of the following:

1) To generate revenues for the budget (in some instances, as prescribed by law directly for the bureaux) in exchange for the provision of a good or service. (implicit taxation).

2) To provide public goods and services effectively to business that will enhance the productivity of the economic system.

Briefly: Bureaux provide revenue generating services and goods to business, oriented towards maintaining an economic and/or regulatory environment that encourages the participation of enterprises in the development of the national economy. The services or goods provided are typically those that cannot be effectively organised by voluntary market exchange, for instance because of their immeasurable nature as a “public good”.

The first characteristic includes those functions within most bureaux where there is a direct public interface providing documents or collecting dues to the state such as taxes. The

44 “Maximand” refers to the element being maximised (profits, sales, capital, budget, perquisites...)

51
functions also include assuring compliance to regulations that serve to meet the second of the above-mentioned tasks. Where the regulations are not met the functions may involve assessing fines or exacting penalties for non-compliance to regulations. In other words, "service" indicates a task that directly involves interaction with the public whether it is to their immediate benefit/need/liking or not\(^5\), as well as collecting revenues.\(^6\) Revenue in this instance includes any direct payment for a service provided. The second part of the characteristic relates to the functionality of the bureaucracy whose implied role is to provide service that is efficient and non-obstructive to the principal activity of the enterprise.\(^7\)

The result of this is twofold: the enterprise sector grows while the individual enterprises participate in the official economy and contribute to the revenue needs of the national budget.

*The products*

What goods and services does the bureaucracy deliver? It should first be made clear that products referred to are not offered to meet a natural demand or a desire of clients. They are part of what the government deems necessary to stimulate revenues or regulating the sector, or what the bureaucracy needs to develop a system facilitating the collection of

---

\(^5\) Many functions of bureaux are not directly related to the function of serving the public. Obviously these are not to be considered. Further, functions which are indirectly linked to the public, where the public may benefit in some manner as a result of the bureaux function, are also not included.

\(^6\) The downstream distribution of revenues has been consciously left out since the destination of that revenue in many instances may be a determining feature of the role of operational level bureaucracy.

\(^7\) This may be obstructive, if there is an external gain, which outweighs the cost. For example in limiting pollution.
revenues. It is a product imposed on the client by law. The rest of the answer lies in the part of the bureaucratic characteristic that addresses the earlier point about the appropriation of funds. The bureau specialises in providing a service or a good that is required by the client, but which cannot be obtained anywhere else but which is an obligatory part of running a legal business. These services or goods are of the type that conjoins the state and the client, which link the functions of the private interest with the existing regulatory system. Such links form interactions between bureaux and clients. Interactions, taken broadly, involve activities such as inspections, registering a company, obtaining permissions, undergoing assessments and acquiring certifications as well as getting the accompanying documents.

Legislation and normative acts create the framework for interactions involving the provision of the services or goods. In Ukraine these laws are by and large based on the legal structure of the USSR adapted to fit the Ukrainian reality. Laws that are modified statutes or drafted as new legislation are determined at several levels starting with the Supreme Council, the executive branch, the Cabinet of Ministers and the upper hierarchy of the bureaucracy itself. The lower levels of bureaucracy use these laws and acts to establish procedures, which in turn become part of the empirical bureaucratic process. The interactions are the part of the procedure that directly involves an enterprise and a bureau. They are a critical part of the practical dealings of enterprises; the public goods and services delivered by government have a wide reaching impact on the citizen/client.\footnote{The discretion exercised by officials is the result of a legal foundation that Shen writes is “prolific on generalities and short of specifics. This he adds requires frequent amendments, clarifications and revisions. Moreover, it discredits the interpretative role that officials play in the implementation of such legislation and regulation while encourages discretionary decisions by individual officials. Shen infers that officials, even at}
**Other characteristics**

Within the framework of the interactions the bureaux have a monopolist position on the supply of the particular service or good provided.\(^9\) There is simply no other agency to which the enterprise can turn to in order to complete the interaction. There may exist organisations acting as middlemen in the interaction and who create a buffer in the direct relationship between bureaux and client. There are nevertheless, elements such as cost and time spent, energy lost, and difficulty of access, all of which clients are aware and that affect them directly. The most tangible monopolist characteristic is the superior position actualised vis-à-vis the enterprise in any dispute over the service performed or good provided, assuming there is no independent court procedure available. A consequence of this is that officials feel a sense of empowerment with the knowledge that the authority of the state rests behind them. Behaviour of the individual bureaucrat is not above reproach, although in such an environment this is not always the case. The enterprise in many instances has no recourse in high levels, are active in the minutiae of operational administration and “practically behaving like a fire corps.”


\(^9\) It may be argued that in certain cases that discretion by local authorities at the administrative level may lead to a form of competition by offering a choice to businesses that they exercise by moving from one jurisdiction to another. In a country such as Ukraine several points show why this is complicated. First, the economic difficulty of SIE owners to move their business (this is true not only of Ukraine). Further, the cost, while small per interaction, adds up over the process of a number of such interactions. The atomised payment structure (unofficial) makes it difficult to justify a move over the cost of a single interaction. While the sum of many of these smaller payments may take a long time to add up, the cost of relocation is deemed too high, particularly in an environment where short-term strategies are adopted by SIEs. Moreover, it is difficult to imagine (though not excluded) that the situation in the neighbouring district, or raion would be significantly different. Second, in former communist states where a tradition and to some degree regulation on internal migration both make the option of relocating to another jurisdiction difficult. Finally it may be argued that though there is some discretionary authority at the local level, it is a function of these offices assuming certain authority rather than it being legally given to them. It is assumed in this paper that power in Ukraine is still greatly centralised.
terms of appeal in the decision. In most cases the appeal would not even be made because of the existing psychological barrier evolved out of the legacy of the *homo sovieticus*.

Another characteristic of interactions that links to the study is the collection of fees/charges. It is a task often done by a local bureau and, at times, by an individual bureaucrat. This has several results. Regardless of any amount of justification on the part of the official structure that the government requires the collection of revenues, the client’s perception is that it is the bureaucrat and the bureau that are collecting the money and as yet, too frequently. The final purpose of that collection is uncertain. The bureaucrats may also be psychologically affected in that as the collector of the fees, they may assume a sense of superiority over the client. These characteristics do not define the role of bureaucracy according to the normative definition, however, they are important in the assessment of bureaucratic function.

*The state’s provider function*

In Ukraine there is at this time simply no other institution that can provide these public goods and carry out the services of the type mentioned above. Because the services in question are economically sensitive and relate to public safety or to matters of state revenue, it is the government’s interest to make certain that they are under its control. This raises issues of loyalty and state organisation.

Historically, bureaucracies were staffed with individuals whose loyalty was assured, who would carry out the will of the ruler. Today the modern civil service has replaced the
ideologically committed party official, loyal cleric or obedient slave. It ensures its responsibility through an ethical standard that says that it is wrong to benefit personally from the provision of government assured services or goods. The payment of wages and the conditions of work ensure such loyalty. In the conditions of a post-communist context, where the continuity of political leadership is broken, the legacy of the past is partly responsible for the entrusting of such regulatory work to a contemporary bureaucracy. Moreover, the organisation of a post-communist state offers no alternative. In such circumstances where the 'state as provider' function is weak, the role of the market should be more significant in providing service, than in countries with good public administration like Germany for example. So far, in Ukraine this does not seem to be the case. The private sector there has simply not developed to the extent that it can undertake some of the devolved functions of the state. It also raises the issue of the relationship the government has with enterprise as a player in the development of an emerging economy. This relationship is caught in a time preference dilemma: For the state, enterprise is at the same time a building block for long term economic growth and stability and in the short term it is one of the scarce sources of tax revenue. Generally speaking government has a short-term view of economic development, partly as a reflection of relatively short political terms versus the longer economic forecast. In transition economies this is particularly the case when governments try to stabilise their economies for the next IMF tranche or other international handout. This has the potential effect of destabilising the government and works against reform in the long run.

51 Andrew Stone, Ukraine National Integrity Survey: Experiences of Public Service Quality, Integrity and Corruption (World Bank: Washington DC. 1998) 54. According to the report, the main reason for citizens...
More generally, a key difficulty, as Niskanen rightly points out, is that government, citizen and bureaucratic objectives must be consistent. "When the objectives are not consistent, the difficulty of defining output and the consequent difficulty of instructing the bureaucrat can lead to output that is systematically different from that desired." Assuming that the government’s intended policy is accurately spelled out in legislation and that the bureaucracy understands it correctly and implements it effectively, and if it can also be assumed that the stated objectives of the service are clearly defined and expressed publicly, then it follows that the client can presumably take advantage of the service with a high degree of confidence and trust. Easton maintains that “if institutions perform as citizens want, then institutions will be trusted”. If, for example, a bureau is responsible for reviewing accounts for taxation purposes, generally such a service should be respected and trusted. If, however, the activities of that bureau are such that their activities are hidden or if the officials behave in a manner contrary to the expectations of the clients, a level of distrust builds. Ideally, the role of the bureaucracy should be determined through a communication process involving the three principals (enterprise, bureaucracy, and government), if their objectives are consistent.

The principals

The following section highlights each of the main groups involved in interactions. Bureaucracy and enterprise are examined closely focussing on their respective roles as well as

---

using public services is the lack of alternatives. Only the Post Office, banking, health care and home repair are noted in the report as having alternative private sources. Telephone service can also be added to this list.

52 Niskanen, 11
possible motivation behind action or inaction. Central government is also briefly examined if only to place it within the interaction but without dwelling on its role and the possible dynamic change it can exercise on the interaction. This is for another thesis.

Bureaucracy

According to Niskanen, the first distinguishing characteristic of bureaucracy as a whole is that it is a not-for-profit organisation that receives grants or periodically appropriates funds for its functions.\textsuperscript{54} The premise initially suggests that bureaucracy should not want for funding in any extreme way. At the same time the premise suggests something far more important. Because of its functional role, a bureaucracy should operate on the basis of not having to worry about competition for profit. It is however, understood that one of its functions is to maximise the tax revenues by enforcing existing tax regulations (provided the tax structure is sound), but predominantly bureaucracy has purpose other than simply generating income. That purpose is to provide service and goods in an equally accessible and fair manner according to clear and effective regulations.

Yet, it should not be misunderstood that agencies of the bureaucracy are without concern for financial support. On the contrary, among the subdivisions of bureaux there is competition for funding and there is preoccupation with sources of revenue. Furthermore, the needs of the individual bureaucrats, to be addressed later, are of great concern in a

\textsuperscript{53} Easton as cited in Mishler, William and Richard Rose, Trust in Untrustworthy Institutions, Glasgow: Centre for the Study of Policy, (1998) 4

\textsuperscript{54} Niskanen, 11
country like Ukraine. In this case a modified version of Niskanen's premise might be that bureaucracy, as a whole, does not want for support, it is the parts that make up the whole that do. As a result, these parts and the individuals within them seek alternative ways of receiving their due.

Another characteristic is that funding for bureaucracy's operations and activity comes from grants and/or periodic appropriations. This suggests that bureaux have direct access to funding either by way of grant or by some method in the procedures that allows for taxing or charging clients for services. If the grants are not forthcoming from the government, the appropriation of funds may then become the main financial source. The fiscal needs supersede "efficiency." Clients are charged for services and goods. A certain amount of that charge is allocated for the running of the department while the rest is absorbed into the state revenue accounts to be disbursed later by the government. These funds are eventually divided among departments according to a competitive disbursement mechanism. The suggested competition among bureaux assumes to some extent that each will attempt to maximise their portion of the budget. This assumption may or may not work at the higher level of inter-departmental politics. The high level managers have a prime interest to maintain strong funding for their departments from the "sponsor". In an economy where revenues are low and where the size of the budget is small however, the politics of interdepartmental competition means less to bureaucrats who are more likely to think of their own personal needs first. That is to say that the fiscal politics played out in the higher ranks of the department are of little or no concern to the low ranks if they are not getting

---

55 This is not to suggest that the bureaucracy as a whole is indifferent to funding, but where funding concerns bureaucracy "as a whole" is related to government / central administration.
significant wages in the first place (if any wages at all!) The realities of the lower ranks of bureaucracy manifest their own characteristics.

The first of these is that operational level bureaucrats interpret regulations based on a variety of factors from personal needs, needs of their immediate section, through their immediate department's requirements to those of the state in general. This means that the overall strategy of the government or the spirit of the law as intended by the legislation is not necessarily of immediate concern to the bureaucrat. It was the classical model of the firm that assumed that everyone on the shop floor was pulling for the company. In the same way that a classical view of bureaucracy suggests that its very presence mitigates corruption. Certain bureaucratic tasks may be easy to monitor particularly those within interactions where the tasks are repetitive. Further, monitoring work in branch offices or the activities of an official in the field may not be as straightforward. To assume that all officials are "pulling for the company" is unrealistic. Not everyone in the bureaucracy has the same aim as held officially by the bureaux or the government. The further away from the policy setting function of the bureaucracy the more this is likely to be true. Nevertheless, as the policy-implementing agents, their role is critical to the overall economy.

As a concluding note to this section, it is important to state that the bureaucracy has a function other than simply collecting money for services and goods. It has to provide public goods and services in a manner that is fair and accessible to all clients, and consequently to help build a favourable environment for the interests of the public, in this instance enterprise.
The characteristic that best describes enterprises within the interactions is that they are unwilling participants. Generally, enterprises will seek ways to avoid paying fees and any penalties especially if they are perceived to be unfair. This is not however to say that they avoid all payments to the government. According to public choice theory, clients will often ‘satisfice’ costs, time or energy, and make decisions on spending based on whatever they feel are reasonable amounts to them. As explained in McLean, “satisficing” means fixing a “good enough” value and quality of a good or service and seeking until ‘it’ is found or until it is felt that there is not point in searching further. That said, it must be underscored that all enterprises that are a part of the legal economy make a trade-off between hiding profits and making payments to officials because they have a vested interest in being legal. They seek the rights accorded to them by law and the profit that comes with being official.

Formal status within the economy has proven advantages: financial, legal and moral.\textsuperscript{57} Financially, companies outside the formal economy have costs associated with avoiding authority and subsequent penalties. Such avoidance is both by choice and by circumstance. Such enterprises cannot advertise; they are targets for petty bribery by officials and their activities are restricted to certain locales where they feel they can operate “safely”. They face costs resulting from net transfers be it through indirect taxation, inflation or very high

interest rates for informal credits. Legally, these informal companies face the realities of not being protected by legislation where/when these laws do work. They have no recourse to the legal system in the event of a contract dispute and they have no extended property rights meaning that they cannot efficiently take advantage of the property they own or use. Morally, there is a stigma attached to being an illegal company. Costs in this area are paid in the lack of reputation or in the preference of clients dealing with a reputable enterprise. Illegal firms face adverse consequences of getting involved in the underground economy, though it is worth noting that there may be different kinds of trade-offs or consequences for different types of enterprise.  

As with Niskanen’s sponsor, the client (enterprise) exhibits similar characteristics that involve behaviour of entrepreneurs, incentives, and knowledge. Though these may be far more complex than explained here, these general patterns are assumed adequate for the purpose.

Behaviour of entrepreneurs:

---

58 The potential hazards of participating in the underground economy are clearly understood in a comment by one small entrepreneur from Kyiv: “Once the line of legal right had been overstepped, “they” own you and you can never go back to being on the right side of the law.” (B3) It is also worth noting that for large enterprise or those involved in heavy industry, it is much more difficult to hide activity in the underground economy, for small enterprise this may be easier. The gains made by each form of enterprise are likely to be different. Further elaboration of the consequences of getting involved in the shadow economy is found in Robin Theobald, *Corruption, Development and Underdevelopment*, London: The Macmillan Press (1993) 125-132
The behaviour of entrepreneurs can be summed up as being motivated by self-interest. The prospects of the general good are only of relevance insofar as they may benefit from a general improvement in the economy. In the daily affairs of running a business and particularly in interactions with bureaucracy, entrepreneurs are out to help only themselves. An entrepreneur has a full-time commitment to the task of running a firm and achieving its goals.

**Incentives**

The enterprise is a profit seeking entity. This means that all efforts are focussed on increasing profits and cutting unnecessary spending. Only a rare enterprise looks forward to the prospect of spending money or losing time and energy on official processes. Any task or bureaucratic obstacle, which prevents or reduces the profit share, is challenged despite the fact that many understand the need for the service. Each step in the process is monitored. Its cost, time consumption, effort to complete, and effect on business is carefully considered. The reality of the situation however, is that the enterprise rarely has the time to properly launch a challenge against the bureaucracy.

**Knowledge**

As a rule, the amount of documented information available to a client to determine its obligations to the state are far greater than what is generally accessed by clients. The
entrepreneur simply does not have the time or resources to spend reviewing all legislation
and regulatory documentation in order to determine if too much money is being charged for
a service. As a rule, the bureaucrat has the upper hand regarding the information about
costs and processes. This information gives the bureaucrat infinitely more power \( \text{vis-à-vis} \) the
client. Niskanen rightly points out that the bureaucrat needs relatively little information to
exploit a position of monopoly provider.\(^59\)

The readily available official information provides little beyond the immediate needs of daily
dealings with the bureaucracy. This does not mean that clients have no information or that
the information that they have is poor. On the contrary many business publications keep
small enterprises up to date with changes in regulations. Furthermore, the information that
is generally of greater relevance to the client is not what is printed in legal documents.
Rather, it is the information that is available in the marketplace; or what can only be learned
through experience. The SIEs in transition economies, however, are all relatively new and
the difficulty there is that the marketplace cannot yet offer much experience or lessons for
the benefit of others. Thus, they rely either on their own experiences or are required to trust
the lessons of others, be it hear-say or published, as is happening with greater frequency in
business magazines and newspapers. What it all means is that information is available.
Clients are generally aware of regulations and official processes, though the knowledge is not
expert and often unreliable.

\(^59\) What is critical is that the information needed by the bureaucrat is little because much can be estimated by
the revealed behaviour of the client. On the other hand the client needs a great deal of information, very little
of which is revealed through behaviour of officials, in order to take advantage of his/her position as a user of
official services. Niskanen, 16
At operational levels of bureaucratic interactions, the government’s role is a passive one. The principal characteristic in this examination is that government controls the legal framework only to the extent that it creates it. (Figure III.a) The procedural information that forms the detail of interactions is a product of the bureaucratic management of information and operationalisation of the process. Interactions may be a part of the government’s will but do not necessarily reflect the government’s intent. In other words, the result of the law and the spirit of the law are not always congruent. This defines the passive nature of the government role since in most instances, it is the bureaucracy that has the final say in how the interaction is carried out.

Figure III.a

\[\text{Figure III.a} \]

\[
\text{G} \quad \text{B} \quad \text{E}
\]

\[\text{Legal norms, laws, regulations} \]

\[G = \text{government} \quad B = \text{bureaucracy} \quad E = \text{enterprise} \]
In Niskanen's model the sponsor-bureau relationship is characterised by the fact that the sponsor finances the bureau, generally from tax revenues. While the sponsor depends on the bureaucracy to provide or to implement the services, the bureaux have, in principal, only one source of financial support. Assuming for a moment that that support is consistent, the revenue intake by the bureaux is highly likely to find its way into the budget and redistribution of those funds will occur. The bureau that initially collected the funds may have an arrangement in its constitution which allows it to retain part of the revenues for its own purpose, nevertheless the revenue does at some point come back to the collecting agency. When the risk of the revenues not returning to the bureaux are high, the dynamic of collecting revenues changes dramatically. This relationship is therefore often awkward since the sponsor in the Ukrainian context may or may not be able to redistribute the revenues consistently.

The absence of revenues precipitates budget deficits and often, as in the case of Ukraine, results in cutbacks to necessary expenditures such as welfare payments and wages. In the past decade, civil servants have often been underpaid or unpaid as a result of poor revenue intake by the government. It appears that for the time being the government cannot contribute sufficiently to the running of the bureaucracy. An indication of this may be found in the statistics measuring wage arrears. In Ukraine the general wage arrears in 1997 were at 3.66b UAH ($2b) slightly higher than in previous years according to some sources.\(^\text{61}\) In 1999, the budget share of wage arrears rose 38% over the previous year, and only in 2000

\(^{62}\) To clarify, the concept of government here the term refers to the legislative, i.e.: law making and, importantly, the budget allocation institution. The bureaucracy is distinct from this as the executive arm of the government.

\(^{61}\) *Economist Intelligence Unit Country Report: Ukraine* (1st Quarter 1997) 21
and 2001 do the figures begin to show a decline in wage arrears. Nevertheless government continues to have difficulties in reducing public salary arrears (-8% in 2000) that have plagued it from independence. In 2001 the figures receded only to 1997 levels showing that wage arrears in the public sector remain a problem for the bureaucracy and the economy. These numbers may be more closely linked to political machination than it is to the stable administration of the bureaucracy.

By being passive, the government sanctions inappropriate bureaucratic behaviour. Generally, prosecutors and politicians are not concerned with low-level corruption except if a complaint is filed directly to them or raises media interest. In most cases the penalty is the loss of a government job. From the perspective of the government there is benefit to tolerating this type of behaviour, as the pressure from the employees of the state is somewhat eased.

In Ukraine government passivity is reinforced by the lack of lobbying done by the small enterprise sector. Although a number of small business associations and unions exist throughout Ukraine their role as players on the political stage is limited. Such ineffective participation has been detrimental to small enterprises. As noted earlier, this was shown in 1998, with the Verkhovna Rada veto of the presidential decree aimed at simplifying the regulatory environment for enterprises including lowering of taxation levels.

---

63 Ukraine-European Policy and Legal Advice Centre. Ukrainian Economic Trends (December 2001) 27
64 Economist Intelligence Unit Country Report: Ukraine (1st Quarter 1999) 20
The interdependent work and support among the bureaucracy, enterprise, and the
government determine the environment in which interactions take place. There are some
specific links in such relationships have greater significance than do others. Niskanen’s
model argues that the bureaucracy’s relation with the government is the key determinant of
the environment in which it functions. This interpretation takes the view that the
relationship between the bureaucracy and the government serves to set the stage for the
environment in which interactions are carried out between bureaucracy and enterprise. If, in
what may be perceived as normal circumstances, the government/sponsor provides the
necessary support to the bureaucracy, then its dealings with enterprise are likely to be
positive and thus more conducive to business development and, by extension, the economy.
In the event that such support from the government is not forthcoming, the bureaucracy
exhibits what may be termed ‘survival-mode functionality’. Such behaviour is not guided by
standards. Instead it functions by determining the amount of pressure to exert on clients
(enterprise) to maximise its intake. In such an environment the purpose of the bureaucracy’s
intake becomes more personalised: the bureaucrats own survival is dependent on the
revenues generated and the energy exerted to provide service. Here, the relationship
between the bureaucracy and the client becomes tilted in favour of bureaucracy’s interests
and the bureaucrats act according to their own individual needs. The operational
environment is distorted.
Bureau-enterprise relations

The main characteristic of the relationship between client and the bureaucracy is that within emerging economies, in general, the client often has no choice but to obtain services from the bureaucracy. The service is simply not performed by any other institution. As noted earlier in the chapter, there are instances where competitive service may be obtained by relocating to another jurisdiction. In a country such as Ukraine, and indeed in many transition economies, however, there is no option for an SIE to move to another location. Here, bureaucracy's monopolistic position in the market has enormous implications to the client. Assuming the bureaucracy as the sole provider of particular services, and that those services are only provided by one office, the client usually has no choice but to receive that service on the terms provided. The bureaucracy in this instance is a coercive entity that sets the terms and conditions for a service that can only be obtained through its offices. Enterprises have little option but to deal with the interaction according to the dictates of the bureaucracy.

The second characteristic emerges when a bureaucracy offers a 'product' to clients. Its behaviour towards the client becomes more similar to a profit-seeking firm than to a public service organisation. Niskanen observes the differences between profit-seeking methods of business and the bureaucratic method. "In bureaus [sic] the attention to customer interests depends on the addition to the total financing (revenue) that originates in the sale of a
service; in profit-seeking firms, this attention depends on the addition to total profits. In a distorted environment, the interactions between bureaucracy and enterprise are based on the ‘attention’ the bureaucrat can get in addition to the official fees. That environment creates the opportunity for corrupt behaviour.

Public service contract

The contract between the bureaucracy and the public is different in an emerging market than it is in the western capitalist one. Under the communist system, the bureaucracy was an all-controlling body. It enjoyed an information monopoly to which access was based on privilege rather than on service to the public. A bureaucratic process was in place and few, if any questioned it without facing reprisal. Moreover, interactions were limited to doling out privileges rather than issuing permits for the pursuit of entrepreneurial interests.

Today the situation is different. An emerging democratic population uses newly found liberties to change the norms of institutional behaviour. This suggests that bureaucracy, long a dominant but irreproachable force in that society now becomes a target for democratisation, more of its functions open to public scrutiny and debated. The role of the bureaucracy is open for discussion. The contract has moved from being one where the population obeyed the authority of the bureaux, to one where the population is very much in a dialogue with the bureaucracy. The contract has become fluid and the expectations of fair treatment and procedural efficiency from the bureaucracy for the client is much greater. Yet,

---

66 Niskanen, 19
as discussed, the relationship that the bureaucracy has with the client is also dependent on
the quality of the relationship the bureaucracy has with the government/sponsor.\textsuperscript{67}

Bureaucracy is seen here to be a monopolist provider of public goods and services. As a
result, regulations concerning bureaucratic procedures are set by the state. This function
fulfils part of the contract that the government has with the citizens.\textsuperscript{68} The ability of the
bureaucracy to behave like a profit seeking company needs to be limited by the regulations
set out by law, which prohibit such behaviour. Two difficulties appear with such an
arrangement.

The first is that the government has to remain a strong body with as much authority over its
bureaucracy as possible.\textsuperscript{69} The government must be stable, able to fund, initiate, assess, and
evaluate programmes and functions of bureaux, as well as to be able to respond to those
evaluations. Without this ability the central government has little authority. The second
difficulty is that the function of interpreting the regulations remains with the bureaucracy.
This is a powerful tool.

Etzioni-Halevy writes that a powerful bureaucracy with strong authority does not mean that
the decisions of political leaders cannot be carried out. The government can still assert its

\textsuperscript{67} A good example of the incomplete contract as suggested in Williamson (1990).
\textsuperscript{68} This too has changed with the collapse of communism in the FSU. Where once the government was able to
dictate all aspects of life, now the democratic nature of the state prevents that behaviour. Of course in both
the government and the bureaucracy’s relationship with the population at large, vestiges of the old system may
still remain.
56. As bureaucracy has developed in the modern context, bureaucracy’s role in the power structure of the state
has grown. Etzioni-Halevy describes the modern bureaucracy as an almost equal partner in policy making.
will over bureaucracy. But every time governments clash with bureaucracy, their energy is sapped and power is eroded. "Hence" writes Etzioni-Halevy, "they will usually exert their authority over the administration on a limited number of, to them, critical issues." As long as the government is able to maintain its part of the relationship, the bureaucracy will abide by government legislation. The same holds true for the individual bureaucrat, if the bureaucratic structure continues to receive revenues and is able to pay the wages of its staff, the individual bureaucrat (or any unit within the bureaucracy) will follow the procedures and work to the goals of the bureau. Once again, the contract between the bureaucracy and the client is heavily dependent on the quality of the relationship between the government and the bureaucracy. If the relationship remains strong the bureaucracy is likely to retain significant authority over lower level procedures, which the government does not consider priority functions but may jeopardise its interest in matters perceived to be higher in priority. In the event that the relationship between these two breaks down, the bureaucrats will seek another means by which to supplement their incomes, benefits, or other perks and it is the client who ends up paying or providing the benefit.

_Bureaucracy’s role in interactions_

One of the key characteristics of a government bureau is the non-market nature of its output. Mueller argues that "a bureau does not typically supply a number of units of output as such, but levels of activities from which output must be inferred. This makes monitoring

"The realistic picture today in not one of control but of mutual influence between the top administration and the political level."
efficiency impossible it also sets the stage for bureaucracy's position of strength in the interaction." In an environment of uncertainty the client (enterprise) may possibly be at the mercy of the individual official or the bureau as a whole, especially where salaries and budgets are unrelated to the efficiency of the operation.

Bureaucracy is a not-for-profit organisation that periodically receives grants for its functions. In the context of the economy as a whole however, it would seem more appropriate to treat the bureaucracy and the government as profit-seeking entities in the sense that they collect revenues through the provision of goods and services. The revenues are often, though not exclusively, collected through interactions of the type described in this thesis. Indeed the bureaucracy in this respect should be taken to be not one single entity but rather many departments each acting separately in the revenue collection function. In Ukraine, for example, the collection of revenues has been a monumental struggle for the government. Here it is somewhat similar to companies struggling for profits. At the bureaucratic level, the scarce resources available from the central government are such that some departments must meet a self-determined level of revenue collecting, in order to make up their internal budgets. For other departments that level is set by law. Difficulties with the internal budget often means that the principal needs of bureaucrats, i.e.: wages and perquisites are threatened. As a result bureaucrats seek compensation for the losses using what Johnson, Kaufmann and Ustenko call "survival strategies". A person whose wage has been reduced or whose work conditions deteriorate will continue to work, but it is

70 Etzioni-Halevy, 56
72 Niskanen, 8.
understood that this implies a lower commitment to the agency. Second, an individual put into such circumstances will engage in various alternative ways of earning income as compensation. The result is the functioning of bureaucracy and bureaucrats at 'survival' levels.

It must first be recognised that bureaucrats are people. Often when bureaucrats are described they are made out to be faceless and heartless beings working at their task without any sense of their 'human-ness'. For this reason it is important to observe the bureaucrat as one who pursues personal interests and needs. Unlike Chang's view that argues that bureaucrats can and do act in ways that are not solely self-interested. This construct maintains that in situations where the immediate needs and interests of the bureaucrat are not met, the “public-spiritedness” and altruism Chang assumes, are either absent or indeed veils hiding the real motivation for carrying out tasks. In the absence of adequate conditions of work bureaucrats are, more than likely, going to act on their own interest, particularly at the lower ranks. What, then do they seek to maximise?

Niskanen suggests that most economists would respond to this question by arguing that everyone including bureaucrats seek to maximise personal utility. But, for precisely the same

---

73 EIU Country Profile 2000, *Ukraine*, (2000) 26-7. The EIU concludes that Ukraine has yet to recover from its sharp drop in revenues of the first 5 years after independence. Only since 1999 have reforms to boost revenues been implemented, their results have yet to be seen.
75 von Mises describes an exaggerated but useful image of the bureaucrat representative of perceptions found in writings on bureaucracy. "The civil servant emerges as a saintly being, a sort of monk, who forsook all earthly pleasures and all personal happiness in order to serve the king ...” See Ludwig von Mises *Bureaucracy*, New Haven: Yale University Press (1944) 78.
reason that Niskanen feels the answer is not very useful, this thesis argues that it is. Bureaucrats in Ukraine maximise their personal utility and the benefits that flow from that effort. Williamson would add that human agents are “assumed to be intendedly [sic] rational, but only limitedly [sic] so.” This condition is brought shown by their engagement in behaviour that reflects some purpose other than “the general welfare and the interests of the state.” Their behaviour is focussed on the immediate matter of bringing in revenues either to the department or to their own pocket in order to assure themselves some form of remuneration.

According to Niskanen there are two concepts which support the utility framework. The first is rationality and the second, related to the first, is survival. Briefly, rationality describes the ability to compile a preference and to chose actions accordingly. ‘Survival’ characterises rationality in that the choice of actions is directly linked to the self-interest of the individual in question.

The utility framework argument supports assumptions regarding bureaucratic behaviour. Personal utility maximisation of the bureaucrat is demonstrated to be a characteristic of rationality if the labour contributed to the bureaucracy is positively dependent on the remuneration for services and conditions of work. The choices made by the bureaucrat are based on the options faced. The bureaucrat maximises his/her personal utility when in direct contact with the enterprise. Each contact with the enterprise is unique because the

---

78 Niskanen, 21
79 Niskanen, 21
bureaucrat has to assess the enterprises' ability to pay. Furthermore, the bureaucrat may extract different amounts of informal fees from different clients given that, generally, they do not communicate with each other. Psychologically, the bureaucrat may feel the need to seize each opportunity to gain from enterprises they encounter, maximising utility at every opportunity. The thinking may be driven by the idea that there are a finite number of enterprises and capitalising on each is important. Alternatively, the motivation may be that regulations governing interaction procedures may change and opportunities to maximise utility may disappear.

Why the divergence between the positive and the norm?

Rationality and survival are considered here as complementary ideas, despite certain suspicions that moments of desperation are often faced with irrationality. The concepts help to understand bureaucratic behaviour by showing the reasons behind the actions or inactions of officials thereby establishing a basis for the theory to be tested. The effect they have on small enterprise development will be examined through the cases.

Rationality: making do with a bad situation.
Schram argues that individuals seek selfish gains, even though their motivations may be varied and occasionally linked with altruistic intentions. Schram’s position is valid only in a situation where the relationship between the government and the bureaucracy are good/stable. In a situation where motivation triggers are low or absent, individual utility maximisation is not consistent with the general (intended) objectives of the government. This is not based on a cynical view of bureaucracy but rather in the context and on the legacy of the bureaucratic tradition in the FSU. Two problems are raised. First, the incentives do not relate to the effort of officials; and second, remuneration of officials is generally low.

Incentives may include salary, perquisites, prestige, opportunities to advance, authority, job security, and respect. An individual in an organisation will act according to the levels of motivational triggers set by the organisation, which can be taken as indication of performance potential at any level of bureaucracy. At the operational level, a bureaucrat adequately rewarded and with a secure job is more likely to show loyal service to the employer. If, however, the incentive system does not work; if officials are powerless to control these incentives; if they are not personally able to improve the motivation as in a better pay packet or better job security, or if the incentives do not correspond with effort, their behaviour will reflect their frustration or even desperation. If any, or all, of these is threatened, the rational approach demands behavioural changes. By nature the bureaucrat calculates the consequences and takes action to recover the benefits of the reward sought. This action may take the form of inefficient behaviour within the office such as stealing.

---

8 Schram, 231-232. Schram suggests that action by individuals may fall into three categories: rent-seeking based on selfish choices, “seeking benefit through other regarding behaviour”, or “gains from co-operation”.
supplies, frequent absences, and long lunches. The behaviour can however, take on more extreme action and can be such that it damages the reputation of the departments as it affects the clients of the bureaucracy. In such cases rationality leads the bureaucrats to seek supplementation, albeit inappropriate, for low motivators.

In some instances the supplement for one low motivating trigger may be an increase in another. For example, an official may tolerate a wage freeze if, say, the opportunity to advance is increased, or if some perquisites offset the wage cap.² The problem however, becomes acute when all the motivators are reduced regardless of the behaviour of officials, when the incentive system fails because of factors beyond the control of the bureaucrat, such as budgetary crisis or institutional collapse. This sets up a situation of rationality where the bureaucrat, motivated only by external factors such as feeding the family or paying off debts, is left filling the position, but whose effort in fulfilling the remit reflects incentives that are not related to effort.

Subsistence: going nowhere fast, with less.

The subsistence notion complements the rationality of bureaucrats and goes one step beyond. Subsistence in this instance is understood as achieving a minimum income or

---

² This includes relative wages related to outside opportunities including the state of the labour market, unemployment rate and benefits for the unemployed.
benefit without losing a job. In this context incentive systems simply do not work, rewards
do not correspond to efforts. Further, remuneration is so low that incentives cannot work.

Bureaucrats face a tough existence on the front line. In the public interface officials are
expected to perform their task efficiently with the full support of the bureau behind them.
Such support has not, in some cases, been forthcoming. Hence, the motivating triggers for
officials are often absent or remuneration is so low that incentives cannot work. As a result,
other motivators, beyond the control of the sponsor, take over. A subsistence instinct
engages and the behaviour resembles not that of a public-serving bureaucrat but that of a
self-serving rogue official or in Olson’s vocabulary, ‘roving bandit’.

This behaviour directly affects the reputation of the bureaux. More importantly it affects
relationship between bureaucracy and the constituency it serves. Consequently, the
relationship of enterprises with the general economy is also affected. Bureaucrats’ behaviour
may destroy faith in the system; the enterprise begins to seek ways of pursuing its interests,
which are dysfunctional.

Enterprises’ role/place in the interaction

Reynolds details the stages of a firm’s development and regards the nascent firm as the one
that has completed its first interaction. Through a developmental chart he illustrates a small

---

82 Mancur Olsen, “A Theory of Power” Conference paper delivered at the conference on Russian Reforms:
Established Interests and Practical Alternatives (Moscow, April 1995) 4
firm's life from incubation to maturity at which point he sees it as the generator positive cash flow and a responsive participant within current economic conditions. Many nascent firms can be said to exist in an emerging economy, where so many are involved in transacting on a daily basis for subsistence. These are not however, necessarily formal companies. There are few small firms that attain Reynolds' defined threshold of positive official cash flow, although most are quite responsive, in their own way, to changing conditions of the market. It may be more accurate to suggest that the small firm achieve a certain level of maturity when it completes an interaction with the bureaucracy. This qualifies the company as a formal entity rather than some structure within the shadow economy or simply a once off participant in a casual interaction.

The interaction with the bureaucracy therefore becomes a critical point of development for the small enterprise. As a participant in a coercive-type interaction with bureaucracy, enterprise is by and large an unwilling partner caught in a dilemma of rationality: to operate within the legal structures and within the rules ascribed by authorities or to forgo any legal rights and become part of the shadow economy.

The entrepreneurs’ activity is based on the functionality of running a successful and efficient enterprise. Success is related directly to the profit seeking function, which is in turn linked to choices and actions often precipitated by external forces. Efficiency is also related to, but not necessarily dependent upon the profit function. It depends also on internal effort by

---

83 In the conditions met within the transition economy, certain efficiencies are used to pursue business but not necessarily related to making profits. An example of this may be paying a periodic fine for a fire violation without making repairs or adjustments as required by the inspector, so as to maintain good relations with local fire authorities and to avoid possibly greater difficulties with authorities.
enterprise and choices it makes regarding external factors, which may have a positive or a negative effect on business practice and development. These external factors are unpredictable at the best of times. In emerging economies the predictability of these factors is even lower due to macroeconomic factors, changing regulations, taxes and the role of the bureaucracy itself. Their effect on business development is felt regardless of the actions taken by enterprise to encourage them or mitigate them. In any economy the rationality of choices may not necessarily be clear, but the aim is one and the same. Moreover the rationality of entrepreneurial choice is assumed to be the same regardless of the environment, the regulatory environment, or with whom they are dealing with at that moment. Small enterprises behaviour in an emerging market, however, does differ by becoming short-term oriented. What is specific to the transition is the existence of opportunities caused by inefficiencies in price structures, inadequate markets, and gains from inflation and the like. Trade, in these circumstances, tends to be favoured because of the relative ease to capitalise on opportunity offered by arbitrage. This is in contrast to the more long-term focus of production that demands long term investment combined with a long period of return and requires a more stable economy.

What of the role enterprises play in interactions? To the entrepreneur, bureaucratic interactions are generally seen as intrusions into their business activity. In emerging economies the reasons for pursuing enterprise go beyond the obvious. Among the principal ones is the notion of moving away from any association with the state in pursuit of one’s own matters on one’s own terms. The appeal of independence is enormous in societies where the possibility of independent ventures had in the past been limited or forbidden.
Nevertheless, the engagement of enterprises in interactions with bureaucracy is to a great extent a matter of legal obligation.

*Enterprise’s maximand: costs of being official and the decision to opt out.*

The enterprise will participate in the interactions on bureaucracy’s terms up to the point where it becomes impossible to do so as a result of external conditions; the deciding factor is the profit margin becoming negligible or nil. At that point the enterprise ceases to be a participant in the interactions. In brief, the maximand here is corporate benefit within the law and with some respect of law. An enterprise seeks to optimise its profit intake, however there are several fundamental factors that are universal and which play a particularly strong role in enterprise development. These factors also seen as costs, become the basis for most of the guiding propositions of this thesis as described in chapter V.

High residual cash flow is a fundamental element to running a business. Therefore, the amount of cash flow an enterprise can keep from being taxed is perhaps more accurately the strongest goal for enterprise. Costs incurred through its relations with an official structure affect the enterprise. Once the costs of compliance with official procedures begin to cut into a company’s residual cash flow without bringing perceivable recompense, resistance sets in. Or if they prevent companies from pursuing their aims, the interaction itself becomes an obstruction to business development.
Second is reliable and accurate information. Enterprises seek clear explanations of procedures and regulations. This is essential to the smooth completion of any interaction. Both participants must be aware of the procedural rules. It follows that any changes to the procedures must be well publicised. While the enterprises have little quarrel with the information being obtainable, if the rules of the interaction are difficult to follow, however expensive or unclear, the likelihood of business opting out is high. As a minimum, an enterprise can hope for readily available and well-explained information regarding regulations.

The third factor is time. An enterprise in this context will seek to limit to the greatest extent possible, the amount of time spent on government matters. Although the time factor is often a difficult cost to measure, it is often cited as a prime reason for discontent with procedures.

The fourth is access. It stands as a cost because of the particular value personal connections have in certain economies, where access to public services is sometimes only available through a developed network of contacts. It is particularly important at the initial stages of the relationship between bureaucracy and enterprise. If unavailable it can have detrimental effects on business start-ups and development.

Fifth, just as costs play a significant part in determining the direction of enterprise relations with the bureaucracy on an official level, the cost of bribery does the same on an unofficial level. Though this is an element of choice on the part of the enterprise, it falls under the rubric of costs. The enterprise seeks to diminish the need for paying bribes, however, in the
event that a bribe is paid, its cost has to be lower than the value of the benefit. Bribery, like any of the elements in a production function lowers some costs, but in turn, has costs of its own.

Rationality and survival revisited

The rationality and survival arguments used here to characterise bureaucratic action also serves to explain entrepreneurial behaviour. Rationality in this instance is based on the maximands of business. Corporate profit maximisation is the natural pursuit of business followed by the responses to the economic environment and market pressures. But it is underpinned by a rational decision based on staying within the market as a legally operating entity, or entering the shadow economy. The "invisible hand" helps to resolve this dilemma by bringing a predictable order to an economy that has been dominated by a central planning and command economics. Rationality explains reactions and decisions of business to regulatory obstacles and changes in legislation. Any decision taken by enterprise will be taken towards maximising corporate benefit. Adam Smith wrote that the individual is constantly striving to achieve the most beneficial position for themselves under the best possible circumstances. In this context, enterprise may be shown to be seeking only their own gains. They are led by the invisible hand, which may lead them to an end that was not necessarily part of their intention. Rationality shows itself in the decision processes resulting in satisfying the maximand. The motivation stems from the factors described

above. Profit, time, access and other costs, are minimised. The end result is that the characteristics of costs, as implied by alternative behaviour, together determine the rational decision making process.

Subsistence for an enterprise is often measured in terms of dichotomy of positive net present value (of profits) and bankruptcy. Yet, the notions of rationality and survival play their part much earlier in the decision making process as enterprises decide on their interaction strategy. Rationality and survival type behaviour, are evidenced in the strategy selected for an interaction. The entrepreneur's approach on all levels, including personal behaviour, accounting practice, openness in terms of giving access to the officials, becomes more than a matter of course but rather a calculated method which often determines the way in which the interaction will ensue. Subsistence in such cases demands a strategy that will allow the business to continue operating as the entrepreneur wishes, or make major adjustments to satisfy the officials. Once a particular pattern of behaviour has been set, it is often difficult to make major adjustments. An enterprise may display belligerence towards an official who in turn may decide to apply the regulations more stringently in that particular case. Alternatively, a firm may offer an official more than mere access to their premises or accounts but also a special office and the necessary attention along with what may be seen to outsiders as excessive comforts. For the enterprise these strategies set the tone for subsequent dealings with the officials. In the same way that the behaviour of officials may leave a lasting impression on the clients, the behaviour of the enterprise can determine the ease with which the interactions are completed. Thus many decisions and actions of the enterprises are based on the rational decisions that ensure subsistence. This gives rise to the issue of growth versus subsistence. An enterprise may decide not to grow because it may draw the attention of the bureaucrats, there is evidence for this from the SIEs in the case
studies. Several entrepreneurs discuss the reasons behind staying small; among them camouflage from attention by officials. From the bureaucrats perspective it may be in the interest of officials to prevent business from growing in order to continue to derive benefits from them. A larger business is more difficult for a single bureaucrat to control.

4. Interactions

Interactions are not intentionally designed to be corrupt. In practice however, the processes do fall into difficulty. What is it that creates opportunities for corruption within an interaction? In this section the theory looks at likely reasons behind corruption opportunity, the benefits to bureaucracy and the costs to enterprise.

In the examination of causes of corruption, generally, several economic and legal conditions tend to reoccur. A corruption environment or one ripe for corruption might include several of the conditions described. First, the principal reason for corruption offered by most writers is the lack of competition in the market. Economists often argue that corruption is unlikely to be found in highly competitive environments. The argument being that the market forces, and the balance of strong civic legislation would make corrupt behaviour ineffective and intolerable. Secondly, the matter of deterrence is often cited. It is believed that a lack of strong law enforcement and legal structure is a prime reason for corruption in many jurisdictions. A third possible reason for corruption is the wage arrears and low wages
paid to relevant officials. The argument put forth most often by enterprise is that higher wages would eliminate the need for ‘survival’ behaviour, as raised earlier, as prime motive for seeking rents and getting involved in other corrupt activity. Another reason may be the lack of information at any stage of interactions. Where any of the participants in the interaction is unaware of the ‘rules of the game’, or where fundamental information is lacking, the opportunity for taking advantage of the situation is high. The lack of information may be on a formal normative level, unfamiliarity with the conventions of the market system. And still another reason may be the overbearing behaviour leading to intimidation allowing bureaucrats to exercise an upper hand, leaving SIEs little alternative but to abide to their interpretations, discretion, and decisions.

Kaufmann argues that traditional writers have generally avoided looking at specific causes of corruption. Also, he argues that the problem of corrupt activity cannot be solved merely through several macroeconomic changes, although these may have some benefit and may be part of the ultimate solution.

Two ideas have dominated the discussion of corrupt opportunity in transitions. The first is the lack of regulations to direct official structures both in matter of procedures and behaviour. The second is concerned with the change from one economic order, in this case from a command system with no free enterprise to a market driven system where people

---

86 Daniel Kaufmann, speech at the EBRD January 1997, London. Though Kaufmann does not elaborate as to which macroeconomic changes need to be made specifically, he suggests changes such as improving revenue collection or removal of soft budget constraints. The presumed intent of Kaufmann’s argument is that removing the discretionary elements within the system will lead to a reduction in corrupt behaviour.
choose to pursue their own interests despite the state. Both are plausible explanations of corrupt opportunity in general and are far more satisfying than categorical statements that all bureaucracy is corrupt. Sutherland uses these arguments to explain the shortcomings of an economy as a whole. But applied to interactions they underscore ‘how’ corruption is exercised and how pervasive it is or can become.

To add to Sutherland’s observations, three supplementary ideas concerned with further opportunities for corruption. The first touches on the lack of communication between participants in the interaction manifest in the absence of or weak efforts at public engagement by bureaux. The opportunity for corrupt behaviour within an interaction is increased with a breakdown in necessary dialogue between the participants in the exchange. That dialogue is one which takes place either before the interaction begins, or during the interaction itself. In the first instance the communication between bureaucrat and enterprise needs to be open leading up the interaction. Enterprise and bureaucracy must be in communication about the interactions on a level that helps establish the procedures themselves be it through the discussion of policy or the prioritising of common needs. Even common understanding of language is important to avoid occasion for impropriety. The opportunity for corruption occurs in the breakdown of such communication that offers the bureaucrat an opportunity to use his authority to make demands on the enterprise. In such cases corrupt behaviour might take place or might create the perception of inappropriate bureaucratic manipulation among enterprises, especially if the requirements or the negotiations take place in an atmosphere of suspicion or where common communication tools are not being used.

---

The other thought claims that poor management has an impact on the opportunities for corruption within an interaction. This occurs on two levels: unchecked negative bureaucratic behaviour and interpretation of behavioural guidelines.

The first is the level of control over individual bureaucrats. Where individual bureaucrats are not well controlled by immediate superiors, or where their conduct is not subject to a code of behaviour, corruption opportunity is likely to be high. Increase in the opportunity for corruption resulting from the management of individual bureaucrats may be the result of lax or rigid control. Control is more likely to foster discipline, yet there might be a situation where a superior acting out of self interest controls a number of juniors requiring them to behave in corrupt manner. Lax control, on the other hand, is likely to increase the opportunity for corrupt behaviour within interactions when an official knows that there are few or no repercussions from superiors for illegal behaviour. A code of conduct may act as a conscience-regulating tool. Though it is generally non-binding, its very presence in the law serves to reassure the public and offers and behavioural guideline to bureaucrats.

Somewhat different type of control is related to the nature of the relationship between the government and the bureaucracy and the ability of the former to manage the latter as a whole. The ability to discipline a bureaucracy as a whole can also serve as a gauge of rogue behaviour. If government is unable to make the bureaucracy follow the regulations through motivating mechanisms, the bureaucracy ends up following its own regulations for its own purposes. Controls may come in a variety of forms including disciplinary, promotional, financial, judicial, legislative or political. Similarly to the motivating triggers raised in an
earlier section, Bunn maintains that the controls insure accountability of the official to the superior. If such controls do not exist nor work properly the officials' actions go unchecked leaving bureaucratic processes open to corrupt behaviour. While it is virtually impossible to over-control, the lack of established control procedures, or the presence of weak ones, provides a forum for unchecked behaviour and increases the likelihood of corrupt practice.

This leads into the second level of potential human resource mismanagement: the discretion over interpretation of guidelines. Once again detailed control over bureaucrats is an impossible and unnecessary task. Every bureaucrat will exercise a certain degree of discretion regarding the regulations. That degree of discretion must however, reflect the needs of the enterprises as determined by the enterprises or the market itself. In an environment of weak controls there exists a strong possibility of officials making decisions that benefit them personally or their departments at the expense of the enterprise.

A high level of corruption opportunity exists where the controls over bureaucracy are weak or non-existent, and where interpretation of regulations is done according to the needs of the bureaucrats and their interpretation of the rules, rather than meeting the interests of the enterprises. Before leaving this point it must be said that overly stringent controls can also enhance opportunities for corruption. In short opportunities for corruption are enhanced by inappropriate management practices.

---

Finally, in addition to poor communication and human resource practices, the opportunity for increased corruption can occur yet again where there is uncertainty over the responsibility of bureaucrats. Bunn suggests three useful considerations of responsibility: accountability (answerability), responsiveness, and 'explicability'. First, bureaucrats are responsible for actions if they can be held to account for them by others - superiors. A second form of responsibility can be determined by the bureaucrats' responsiveness to the needs and wishes of the government. The underlying matter is to determine if the bureaucrat can anticipate and support the interests of the government by exercising judgement in daily routines reflecting the will of the government. Thirdly, responsibility can be judged in terms of “explicability” - the care made to obtain all relevant facts, balanced deliberation and due regard for consequences of action. The official who acts without regard to such considerations and consequences is irresponsible.

While interactions themselves are not intentionally created to be corrupt, factors that have an impact on those who implement the procedures can render the exchange to become corrupt. Lack of regulations or an inappropriate regulatory environment, systemic change, breakdown or lack of communication, poor human resources and undefined accountability of officials, all play a role in making the interaction more or less opportune for corruption.

5. General conclusions on interactions, bureaucracy, and the development of enterprise in Ukraine.
The most important general conclusion of the theoretical construct used in this thesis; the interactions are necessary but imperfect mechanisms for delivering service and goods from the state to enterprises, and collecting fiscal revenues from enterprises for the state. Despite the imperfections, it would be imprudent to suggest that all interactions are corrupt or that even some parts of all interactions are corrupt. The principal reason for this is that individuals perform interactions: individuals interpret the regulations and implement the directives of the government. These people are subject to a variety of environmental factors which may lead them to engage in behaviour contrary to the spirit, and often the letter of the legislation. Such performance has impact on the way regulations are interpreted and on whose interests are being served. As a result, in such an unhealthy environment enterprise are unable to neither develop effectively nor be the economic engine of their national economy.

At the same time, the benefit of such a system to bureaucracy as an institution is that a number of its concerns are addressed by the opportunity to benefit from corruption within interactions. In a situation where a bureaucracy does not enjoy the full moral, policy, and financial support of the government, the potential for corrupt behaviour among bureaucrats is high, as is the rationale. If the state cannot, or will not deliver on its obligations vis-à-vis its state employees, they subvert the system for their own, rather than the public's, benefit. The corrupted system meets some of those obligations. Sometimes both the government and the bureaucracies benefit. Such benefits include relief from budgetary pressure within the agencies or the departments, strong motivating force for actual work getting done; the sense of empowerment to disenfranchised/dissatisfied bureaucrats.
Regulations that serve as framework for interactions must be clear. Any lack of clarity, or
constant change, serves to disadvantage the enterprise and allow the bureaucrat to apply
regulations unfairly or improperly. In an environment where the regulations are not clear or
where there exists a lack of effective appeal procedure, it is conceivable that the application
of fictitious rules may also occur. Systemic change as a reason behind corruption
opportunity may be relevant at the interaction level. This may be particularly true in cases
where specific interactions have either not previously occurred or where they are unfamiliar
to both sides of the exchange. Such uncertainty gives rise to opportunities for corrupt
practice to develop.

It needs to be concluded that based on the realities faced by both sides, certain conditions
are conducive to corruption and elements in the process of interactions are potentially at risk
of becoming corrupt. Indeed, identifying such elements provides a useful instrument to spot
potential or real corrupt activity. The elements serve as a guide to isolating corrupt
interactions, separating processes which are properly carried out from those which are facing
difficulties of an economy in transition but are unrelated to any corrupt activity. Overall
they assist us in understanding why and how corruption might set in and serve to help
prevent it.
This chapter seeks to place the thesis in the context of conditions of the Ukrainian economy prior to the break up of the USSR and the conditions that have remained in place. By doing so the chapter will set out the factors that contribute to poor bureaucratic practice, encourage opportunities for corruption and impair good relations between the operational level of bureaucracy and enterprise. With respect to enterprise not having the necessary sophistication to run enterprise within a market economy, this chapter will argue that the skills of an entrepreneur are learned in the marketplace: the conditions of the market mould entrepreneurial skills. Thus difficulties in a marketplace are a result of the rules of the market rather than the inability of enterprise coming to terms with the regulations.

The root of Ukraine’s current economic situation is linked to the legacy of the Soviet Union and even the tsarist era. This legacy reveals itself in the examination of today’s government and bureaucracy and their interface with enterprise.
In their examination of the institutional restructuring of post-Communist societies, Elster, Offe and Preuss explain the effects of the past on current structures as a “fixity of inherited constraints.” They argue that these fixed constraints affect three conditions in the new state. The first is the “inner environment or the state of institutional behaviour.” This includes work ethic, habits, mental residues, aspirations, and so on. The second is the state of the economy and its resources including the states’ ability to support the workforce responsible for operationalising legislation, policy and regulation. Third, the established élites and their informal power resources, agents of the old regime who have not been physically liquidated, discredited or defeated. The result is continuity from the past coming into clash with present realities. Each of these three conditions is important in post Soviet Ukraine and their consideration as a means of building a context for such a study is essential and cannot be ignored.

The legacy of the Soviet period on a country such as Ukraine not only established an economic system averse to private enterprise but also helped ingrain attitudes about enterprise as well as patterns of procedure and behaviour within official structures. This Soviet institutional behaviour along with subsequent obstructive implementation of regulations has been, in part, responsible for the poor development of enterprise in Ukraine. Also, the old system prevented the development of real entrepreneurial skills rewarding mainly those useful in avoiding authority and surviving in shadow environments. Nevertheless, some were able to hide their activities and to make money or even run an enterprise: this was part of subsistence in Soviet times, for the entrepreneur as well as for the

---

consumer. The result of this has been a certain entrepreneurial sophistication and set of skills necessary for the effective running of enterprise. Be it as it may, current economic realities are a product of the old ways. It is by discussing them that we can hope to arrive at a mise-en-scène for the thesis. The chapter follows the three conditions affected by the fixity of inherited constraints.

The first part examines institutional behaviour of the bureaucracy by highlighting certain factors inherited from the past, in particular from the Soviet period. The argument will be that the bureaucracy continues to operate with a mindset from the past. As a result, the chapter will argue, the potential for reforming the bureaucracy in the near term is small; certain personal and environmental characteristics will need time to reform.

Part two again examines the legacy of the Soviet Union on Ukraine and on forming current economic conditions. A product of Soviet economic planning, and to some extent a victim of centre-periphery relations, Ukraine has been left with an economic situation that retards the development of an evenly applied regulatory environment and productive bureaucracy - enterprise relations. In addition, as a result of poor enterprise development pattern in the past as well as a Soviet ban on entrepreneurial activity, the place of enterprise in the new market order is characterised by inexperience and lack of "market skills". As well, a deficit of business education has created an enterprise sector lacking in the sophistication of markets in the west.

Part three examines the present economic and social circumstances that continue to perpetuate some of the conditions destructive to appropriate institutional behaviour and
good bureaucracy and enterprise relations. In particular the leadership of Ukraine, is governed with its inability to grasp changes and adapt accordingly, as well as its approach to dealing with corruption, are examined, while its ability to support the needs of those for whom they are responsible are questioned.

1. Institutional Behaviour: A mindset from over a century ago

The current psychology of the public service along with the general mindset towards duty and function in the Ukrainian bureaucrat appears to be characterised as “passivity for rewards” as opposed to “risk for rewards.” This, as a means of safeguarding one’s position, is not a self-preservation mechanism born out of relatively recent events starting in the late 1980s. This legacy of imperial Russian official was left to Soviet bureaucrats and their legacy to the current crop of officials is part of a continuum of behaviour stretching over centuries. Jancar (1991) provides convincing historical interpretations of bureaucracy under tsarism and Banaian (1999) continues that view into the Soviet period.

On a broad bureaucracy wide level, the effects of the tsarist officials' behaviour and the relations between Moscow and the regions continued in to the Soviet period. According to Shen, “All important decisions concerning Ukraine were made or approved by Moscow.” Shmelev and Popov write that “The most disagreeable aspect of the command economy may be that it has created the kind of public consciousness that was required: economic

92 Shen, 20
inefficiency and 'levelled distribution' have brought about profound shifts in the public psychology. Officials developed an almost religious belief in the "organisation", and were disinclined or unable to see that pressure, haste and, appeals for conscientious work could achieve nothing worthwhile in the economy."

Shen continues the theme by saying that Ukraine's decision-makers were "prevented" from deciding issues whether national or even local in scope. "Ukrainian officials only served as administrators of directives from Moscow, and there was no autonomous Ukrainian administration at any level." The thrust of his position is that an autonomous Ukrainian civil service ceased to exist under the Soviet period. Moscow nominated ranking officials and Kyiv was filled with non-native administrators. The integration of Ukraine's economy with Moscow was total. The result was a bureaucracy that "implemented Moscow's directives with minimal need for independent decision making. Fear, in combination with pragmatism, resulted in habitual shunning of decision making responsibilities." This has led to the development of a Ukrainian mindset, a product of something Kuzio calls the 'Ukrainian character.' The absence of will and political consciousness is the result of Soviet influence. "Physical, cultural and spiritual destruction: all created Ukrainian mentality composed of introvertedness, sentimentality and anarchic individualism that lacked discipline and organisation." Kuzio argues that the past has had a profound impact on the current Ukrainian psychology, which is played out particularly in state organisations. Seventy years

94 Shen, 21
of such tradition eventually become entrenched as passive adherence to central regulation and no recourse to creative economic thinking.

As a result, in significant areas, Ukraine has remained closely linked to the FSU for markets. Many state run enterprises and national structures continue to be linked to the networks of Soviet era contacts and suppliers. The bureaucracy’s regulatory system in many cases is based on the Soviet model and, most importantly, the people implementing those regulations have not been replaced, retrained, or indeed, have not had the opportunity to exercise their administrative creativity and decision making abilities.

Perhaps as a result of their lack of experience and shaky faith in their own governance capacity, Ukraine’s leadership has been unable to instil great confidence among Ukrainians: insecurity seeps down to all levels of the state. Indecision about reform, its direction, speed, poor definition of roles, politicking and disputes have left the country frustrated, and not provided the bureaucracy with leadership. “Legislation, executive action, and bureaucratic initiative have been uncoordinated and as a result, often inconsistent even contradictory. This lack of clearly defined purviews frustrates not only the political community but also lower-level administrators and industry decision makers.”

The procedures for establishing policies, procedures and practices in a country such as Ukraine are problematic. According to Bilous, there is no formalised method by which to prepare, review, and resolve acts of the Cabinet of Ministers of Ukraine. Bilous argues that

---

96 Shen, 31
97 Bilous, Artur, Політико-Правові Системи: Світ і Україна, Київ: АМУПП (1998) 95
if processes are not being formalised at the highest levels, then it is very unlikely to have taken place at the operational levels.  

It is because of the legacy of the command economy, as well as the traits taken from the imperial and Soviet past, that a bureaucratic mindset has been produced; learned in the past and closed to the needs of the present. The lack of strong leadership, blind acceptance of the command from above, the lack of decision making skills at all levels are such that Shmelev believes that it will take a “years, perhaps generations to rid [themselves] of this psychology.”

2. Current economic conditions: The heritage of old problems

Two areas of interest are taken up in this part of the chapter. The first is a look at the current economic situation, a heritage of a communist planned economy and to a great extent a victim of centre-periphery relations. The second deals with the condition of the enterprise sector. Over all, this part, like the previous, will underscore the inadequate legacy of the Communist past for today’s needs. As proper enterprise development was forbidden in the USSR, following its collapse, few people were equipped with business skills, while the state was itself unprepared to handle enterprise development.

98 Bilous, 97
99 Shen, 36
With regard to the current economic conditions in Ukraine, Prizel's comments may be partially right. He suggests that the relative level of success of emerging economies was determined by support offered by the West, particularly the G-7 economies.\textsuperscript{100} Success, he maintains, has been greatest in areas of highest levels of support from the west. Others, such as the World Bank argue that it was the macroeconomic conditions at the 1991 declaration of independence, and the immediate reform policies introduced by the government that determined the conditions of the current economic situation. These views are perhaps too retro-visually myopic to claim that the troubles for Ukraine started only at the break up of the USSR. Foundations for current conditions were laid some time before 1991. They are the result of developmental processes that began with Lenin and the Bolsheviks, with some traits left over from tsarism as well, and now exacerbated by the political and social upheaval of post-Communism. Both systems engendered an unworkable economic system for today, yet one that cannot be, it appears, turned around with a mere decade of western intervention.

The process that conjoined Moscow and Ukraine was total in its scope and complete in its effect. The strategic location of Ukraine protected Moscow from Germany after the war, acted as a buffer from NATO in the Cold War, and provided access to warm water ports in the Black Sea ensuring strategic economic links to the world. Being the second largest population in the Union, it was useful for drafting labour and conscripting soldiers. Most importantly Moscow needed full access to Ukraine's land and natural wealth. Accomplishing this would require full integration and control of Ukraine's economy. In characterising the

\textsuperscript{100} Ilya Prizel, “The First Decade After the Collapse of Communism” in S/1/5 Review, Washington DC: Paul H Nitze School of Advanced International Studies, Johns Hopkins University (Summer-Fall 1999)
relationship between Moscow and Ukraine, Spechler uses the term ‘imperial’ arguing that the integration of a state in an imperial structure has both benefits and costs. Nevertheless, the integration is total and normally benefits the centre at the expense of the periphery.

Historically the relationship between Russia and Ukraine was dominated by Moscow’s needs, leaving Ukraine as a source of wealth for Russia rather than an independent economy. A more detailed discussion of this relationship is found in Spechler (1991) as well as in Krawchenko (1991). Under the Soviet Union the relationship was little changed. The decimation of the intellectual class; the victimisation and liquidation of the property owning stratum of Ukrainian society; the rapid industrialisation based on wartime planning, all served to create a neutered state. More importantly, the legacy of the past created a unique Soviet psychology preventing innovative and independent behaviour. Banaian (1999) and Shen (1996) provide an expanded examination of the economic developments during the Soviet period that solidified the institutional and psychological foundations that continue to have an impact on Ukraine.

In the Soviet period wages in the state administration sector of the Ukrainian economy were generally below the average. (See figure IV.a)

Figure IV.a: State administration wages

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>State Admin Ukraine</td>
<td>78.8</td>
<td>98.7</td>
<td>111.8</td>
<td>114.7</td>
</tr>
</tbody>
</table>

102 See Kuzio (1998) and Bilous, (1998)
Real wages rose moderately, though less rapidly than other wages as compared to the averages of the USSR and Ukraine as a whole. The increases for the state administration sector were the lowest of all state employees in the 1960-1974 period rising 46% as compared to agriculture, which for the same period rose 125%. In the post Soviet Ukraine, despite regular wage increases, real state administration sector wages in September 1996 were only 33% of December 1991 levels. Further increases in average monthly wages have been relatively small rising from 204 UAH per month in 1997, to 206 UAH per month in 1998.

The state of wages in the post Soviet period alone may be strong indication of the collapse in the relations between the bureaucracy and the state as a key motivator, wage disappeared and so did the incentive to work. There are, however, other areas of difficulty. The Anti-Corruption Committee fight against corruption, started in 1992, has targeted mid and lower levels, making bureaucrats feel vulnerable. As well, the constant threat of reducing the numbers of bureaucrats has made many seek ways of either “taking what they can while still in their jobs” or making their tasks indispensable to the departments they serve. This they accomplished by either bringing in a reasonable amount of ‘shadow revenue’ that was split

<table>
<thead>
<tr>
<th>Average USSR</th>
<th>80.6</th>
<th>96.5</th>
<th>122.0</th>
<th>141.1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ukraine wages (av.)</td>
<td>78.3</td>
<td>93.9</td>
<td>115.2</td>
<td>128.5</td>
</tr>
</tbody>
</table>

Figures shown in Roubles. Source Gertrude E. Schroeder 103

103 Gertrude E. Schroeder, “Consumption and Personal incomes” in Koropeckyj, (1977) 87
104 D’Anieri et al, 93
with the department and the contributing bureaucrat. The decisions to reduce ranks appeared inevitable. Consequently, the ingratiation to supervisors was at a peak.

**Impact on the enterprise sector**

The legacy of the communist past also has present day implications for the enterprise sector. The most obvious residue is the lack of experience of operating in a legal framework. Furthermore, the suppression of the independent spirit of human psychology through the past century has almost eliminated the characteristic that allows one to stand up to officials or appeal their decisions. This also has a serious impact on enterprises whose owners face bureaucratic decisions on a daily basis and need to be able to challenge them if required. Finally, past lessons have taught current enterprises to be wary of government and its agents. The relationship between the governed and the government was difficult for many people on an individual level. Today this is mirrored in the small enterprise relationship with government agencies.

For the enterprise sector the fixity of the past also plays a strong role in determining its place in the new economic order in Ukraine. The past has seen Ukrainian enterprise constrained and focussed on specific sectors, namely agriculture and heavy industry. Its ability to serve the market needs of the national region was seriously curtailed or banned outright. Balan’s (1991) description of commercial Ukraine is useful and illustrates the underdeveloped character of 19th century Ukrainian enterprise. Feldbrugge (1989) places the sector in its place within the Soviet economic system. Emerging from these conditions of the past, the
current state of enterprise is not surprising; the historic constraints must be recognised as a part of the context in which this thesis is to be understood.

Much about doing business is learned by experience and over time. The enterprise sector in Ukraine has had little of either. The lack of wisdom and experience create difficulties in business. There are however, many examples of people who run successful enterprises, despite recently entry into the market. This suggests that the difficulties of enterprise development may in fact stem from elsewhere. The legacy argument put forth in this chapter points out that the difficulties for starting and operating a successful enterprise are a product of a leftover mindset and institutional behaviour that remain locked in the past. Furthermore, that they are unable or chose not to advance into the realities of the new economic system.

Current circumstances in Ukraine’s emerging economy involve two entities unfamiliar with each other attempting to develop an environment that allows both to co-exist under the new economic order. One of them, a bureaucracy poorly structured with serious institutional and historic problems; the other a new economic sector coming to terms with unfamiliar and ever-changing rules and conventions of legitimate enterprise.

3. Present circumstances: Same old institutions, same old workforce
The third constraint on the current conditions is the continued service of ‘old regime’ personnel, an analogous group to what Olster and Preuss (1998) describe as the élite. The term used in a broad sense, refers to those who continue to occupy positions of authority at every level in Ukraine and who perpetuate the mentality and the behaviour and most importantly, the continuity of old institutional structures. This part of the chapter will look at the conditions that have led to an ongoing problem of weak institutions in Ukraine.

Current economic and social conditions in Ukraine tend to perpetuate the historical institutional weaknesses. A triumvirate of these existing conditions has exacerbated existing contextual difficulties making reform of the bureaucracy difficult and rendering the economic environment poor.\(^\text{106}\) The first is the leadership’s inability or unwillingness to come to terms with the ongoing economic crisis characterised by problems such as wage arrears.\(^\text{107}\) The second has been the absence of a clear vision for the bureaucracy and its management.\(^\text{108}\) Finally, an ongoing anticorruption effort has focussed on junior officials (малі рівні) creating an environment of suspicion and paranoia at lower echelons of the bureaucracy without eliminating corruption. Such difficulties prevent positive contextual change for institutions. The knock-on effect makes operational work of the bureaucracy difficult. It finds little, or misdirected support for discharging its duties from the very government that holds it accountable for these activities. Due to this lack of clear government direction and support, the bureaucracy in Ukraine has had to redefine itself

---


\(^{107}\) The Ukrainian leadership’s inability to deal with economic problems reached a peak by 1996-1997 when it became clear that the reform package lay virtually unadopted, in part due to political coolness. See Anders Aslund and Georges de Ménil “Introduction: Reform Dilemmas” in Anders Aslund and Georges de Ménil, 10-12
unilaterally as an institution, becoming self-reliant and giving the bureaucrat little choice but to act on individual interest while wielding official powers.

In North’s explanation, institutions are understood to be a set of rules, procedures, and behavioural standards that are meant to act as guidelines. “The humanly devised constraints, that determine incentives and shape human interactions in all societies.” The transformation of a bureaucracy in a transition economy from one burdened with the legacy of the past to one that effectively serves the needs of the economy requires appropriate institutional change. The same can be applied to the entrepreneurial sector. This sector too requires similar institutional reform. The critical point, however, is that for enterprise the reform has to occur in the official sphere first. Without the reform of bureaucratic institutions the change in the entrepreneurial sector can only happen in the shadow.

In a World Bank thesis, it is argued that the key ingredient in the transformation of new economies is the reform of the public sector, a crucial change enabling the environment for private sector development. That change, however, does not necessarily involve elements often seen in transition economies; shrinking the ranks of the cadres, reducing wages to save money, shirking responsibility for creating a regulatory structure for implementation, or altering the structure by witch hunting for corrupt elements, or employing other stop-gap measures. Rather, among others it requires an appropriate legislative regime and regulatory framework, an independent bureaucracy that has the government’s confidence and is

---

108 Åslund and de Ménil, 24
appropriately trained and remunerated. It means reforming institutions to allow those who administer and enforce the rules to work appropriately and effectively. In relation to this it also means providing the existing structures with an environment that will be conducive to the development of the economy.

Raiser writes that in most transition economies the process of institutional reform tends to move from “the easy to the more complex and administratively demanding as the transition proceeds.” Exchanging an entire generation of officials trained in the past and maintaining a link to the institutions of the past is a supremely difficult task. Yet, establishing ultimately strong institutions is one dimension of reform of a more complex nature and a necessary prerequisite to a strong or well functioning economy. Assuming that the ‘easy to complex’ dynamic is accurate, it can be agreed that that Ukraine is a country plagued with weak institutions; a weak state. Here, the result of such arrangement is unpredictable and undermines the value of regulatory structures. This has a broad impact on reform and leads to procrastination in the reform process.

_Economic weakness begets institutional weakness_

The consequences of this economic legacy led to severe output decline and general economic instability became the trademark of Ukraine’s independence. The decline is

---

blamed largely on the inability of the Ukrainian government to react effectively. D'Anieri et al., argue that Kyiv saw the decline in output as "the problem, rather than the inevitable correction [of the economy] after seventy years of socialism."[Emphasis added] Such misinterpretation concentrated efforts on preventing further collapse of production output. Attempts to prevent falling production by maintaining high employment and causing inflationary budget deficits led to hyperinflation from 1992 to 1995. In 1993, prices increased more than 100 times 1992 levels, and in the 1991-1996 period, the cumulative effect of inflation meant that prices increased more than 16,000 times. The government's attempt to correct its previous focus on industrial credits and subsidies created wage arrears, pensions, and inter-enterprise debt crises. Details of this crisis and the impact of the Russian crisis on Ukraine are detailed in Kravchuk (1998). The result of this crisis, however, has been to create a working environment that is unstable, uncertain and one that compels employees to seek out complementary forms of income.

There may, however, be a more sinister, albeit speculative reason behind all of this: It appears to be economically convenient to have bureaucrats fend for themselves; this means less pressure on the central budget to pay timely wages. It is viewed that some in Kyiv's halls of power believe that by not paying wages they can encourage self-reliance, save money for the budget, and at least in the short run, cause no serious damage to the economy. In Soviet times this was certainly the case. Gaddy writes that in Soviet Union planners actually lowered official wages to sectors where the opportunity for generating income from

---

112 D'Anieri et al, 93. It should be noted that a correction in the economy was expected and normal, however not on such a scale. The result was a panicked reaction from Kyiv.
inappropriate behaviour was high. This approach may have been brought forward into the new economy as a means of state's continued existence.

Another effect of the wage arrears crisis was an effort by the government to reduce the ranks of the public sector. Norberg and Krawchenko both argue that the size of the bureaucracy inherited by Ukraine is small. According to Norberg, too small to run an independent state and lacking many of the needed skills to do so. From 1990, 57 ministries were reduced to 27 and current government plans are to reduce these further. In 1992, the central ministries employ about 13 000 officials (in contrast to the UK with approx. 500 000) that number was been reduced and by 1996 the number of bureaucrats was 20% less than in 1992.

Initial success of macroeconomic stabilisation was eclipsed by the growing crisis in wages administration and as a consequence, faith in the government's ability to handle the economy was virtually destroyed. More to the point, the time needed to build a public administration was lost. The rapid rebuilding of a bureaucracy that abides by regulations is efficient, and fair in its duty is critical to the transformation of the economy. The effect of the wage crisis and the ensuing lost time has had a negative effect on Ukraine's bureaucracy and on the individual people within it, and the quality of work they perform.

---


Clear vision for bureaucracy

Ukraine's bureaucratic structure is disjointed and weak, a leftover from the past and a fault of initial mistakes after independence. Moreover, the country has not established a clear role for its bureaucracy. The lack of direction creates serious difficulties for implementing legislation and normative processes. Norberg argues that this is due to structural difficulties. There is considerable duplication at the highest levels with deputy Prime ministers and ministry heads vying for control. The psychological dependence and other leftovers from the past contribute. At the operational level there is a void in the detail of implementation of government policy. There exists no management strategy for the bureaucracy and, as noted above, the civil service remains underpaid. It is agreed by many that badly needed changes may only take place over a generation and thus can only be regarded as a long-term objective.

Krawchenko writes that the very concept of a unified civil service as a body of professional administrators did not exist at independence. Ukraine's bureaucracy developed out of a communist-based experience, and was firmly controlled by the Communist Party. Little has changed since then, though positive strides have been made. The bureaucracy is still heavily politicised and not all the measures taken to bolster the bureaucracy have been effective.

---

116 Marc Norberg, 41-46
117 Taras Kuzio, (1998) 41
Among those measures has been the legal structure of implementation. In many cases it appears that the laws, as they are initiated remain virtually intact through the normative review. According to Bilous, the proposed legislation once initiated passes through an informal process "whose details are clear only to a narrow government élite."\(^{119}\) Bilous writes that process of changes and working groups from lower strata in the hierarchy occasionally makes amendments to the law, though amendments from such working groups are rare. Despite the ongoing discussion regarding changes, the amendments are only made upon direct request from the Prime Minister or the ministerial level.\(^{120}\) The result of this is that proposed legislation is weighted with intention but incomplete in detail on implementation. Each ministry and state committee has its own management system. "The leadership...at all levels...[acts] according to their own understanding of things, by happenstance."\(^{121}\) This problem is due, in part, to an immature legislative regime, over-politicisation of bureaucracy, and, in part due to an underdeveloped party system. The result is loosely defined terms and little focus in the implementation of regulations. This vagueness serves the needs and aims of special interests. To illustrate: In 1994, the Ministry of the Economy submitted eight proposed programmes for economic stabilisation each of which was rejected for lack of details on implementation.\(^{122}\) The evidence provided in the case studies of this research offers more evidence of such gaps in the legislative/normative details that undermine good government.

\(^{119}\) Bilous, 95  
\(^{120}\) Bilous, 95  
\(^{121}\) F. Nazarenko cited in Krawchenko, 137  
A lack of detail within the legislation makes demands on those implementing the law. These demands of interpretation result in uneven application of policy, misunderstanding of operations and function, and makes the general environment for interactions between the state and the citizen difficult. Overall, there appears to be a lack of transparency. The biggest concern, from an implementation of reforms perspective is that while in the past command economy, the divisions between politics and administration were blurred but meaningless; the clear division needed in a market economy is absent.

The Soviet constitution, which made little sense of the division of power between the government (politicians) and the bureaucracy, determined the division of authority in the independent Ukraine. Norberg writes that until the new constitution was adopted in June 1996, there was a continuous institutional power struggle. Even under the new constitution, problems of divisions of authority continue to trouble Ukraine. Among the difficulties is that implementation of government policy has been devolved to regional and local administrations. The result has been that, although policy is still set by the central authority, conflict among all levels continues over the details of the regulations and their implementation. Such fundamental conflict over the mechanics of policy administration has prevented a unified application of law. Further, the smooth functioning of bureaucratic structures, a requirement of economic development, difficult and clarity and transparency at the bureaucratic operational levels near impossible.
4. Conclusion

Creating a mise-en-scène, the particular psychological character in Ukraine, created by seventy years of Soviet rule and previously the tsarist era constructed the mindset of today's bureaucracy which must be acknowledged if current circumstances in Ukraine are to be understood. This chapter set out to show that the present state of Ukraine's economy and specifically its bureaucracy are mired in the psychology, mindset and institutional problems of the past. Restructuring, reforming, and change has not been complete nor too successful. As a consequence, it is this reality that must be taken as the context for the study of economic interaction between enterprise and bureaucracy and the difficulties with reform that ensues.

But that is not enough. Some characteristics of the Ukrainian economy are shown in the mise-en-scène to play a significant role in creating an environment for enterprise development. The particular mind-set and work ethic within the bureaucracy has been created by a system that does not offer adequate support, that has misunderstood fundamental economic needs, and has investigated operational level bureaucrats for corruption while ignoring possible malfeasance at senior levels. The entrepreneurial class too has been beset by past traditions of underground activity and popular notions about entrepreneurial activity. Further, the limitation of entrepreneurial activity to specific sectors since tsarist times has left the entrepreneurs searching for creativity in a new environment that has little to offer by way of experience and assistance. These conditions for both bureaucracy and enterprise help to create the context for the transformation of the economy.
Keeping as their context the points raised here, the next sections will focus more closely on the interactions between the bureaucracy and enterprise.
CHAPTER V - OUTCOMES AND DYNAMICS OF THE
BUREAUCRATIC INTERACTION:
GUIDING PROPOSITIONS

The opening chapters have presented the historical, social, economic and political context in which the interactions between enterprise and bureaucracy occur. The interactions selected appear among lists published in surveys by various authors (Kaufmann (1997), Miller et al. (2000), Rose (1994), (1998)) and are believed to reflect an accurate image of the interaction between business and bureaucracy.

This thesis explores two versions of procedures between officials and enterprise using the interactions as the focus point: theoretical or intended, practical or applied. With these, the project challenges some key ideas reflected in the literature on corruption and enterprise development as already discussed in the theory chapter. In its 'normative' section each case study reflects an official position while the 'positive' second half of the case looks at the practical version as supplied by the enterprise. Interactions were selected to show direct links between the official and the entrepreneurs both in the legal documentation and in the practical manifestation of those interrelations. The principal argument is that the interaction as a whole is not necessarily to blame for slow enterprise development, but that elements or parts of the interactions can be specifically identified as problem areas.
This chapter presents a framework that will provide consistent content, direction, and a clear structure for the case studies and their analysis, "direct[ing] attention to something that should be examined within the scope of the study."\textsuperscript{123} The use of these ideas as a structure for the narratives and for subsequent analysis allows the case studies themselves to take on the shape of units of study for the dissertation overall. Following prescribed case study norms, preliminary questions are asked to set direction for the case studies.\textsuperscript{124} Propositions have been determined to help examine the specific elements of interactions.

The propositions also provide continuity for the case narratives giving them a balanced structure and a clear framework in order that they may be analysed and compared. Each of the five case studies will help assess the propositions.

The following section examines the propositions and the underlying issues they address. A brief explanation is followed by a view of the effect that the proposition's premise may have on business development. It will further set out the criteria by which a case is determined to agree or disagree with a particular proposition. Although it may not be possible to quantify the results of the case in real numbers, it is possible to show divergence between the official and the practical version, which may be expressed as positive costs, insignificant costs, or benefits.

The propositions are used to achieve two goals; the first being to show a general pattern of inconsistency between what is described within the law and regulations and what is


\textsuperscript{124} The norms set out by Yin (1984) 17, 30-31
encountered in practice over several cases. This pattern demonstrates the presence of divergence between versions of the interaction. Individually, the cases suggest that differences exist between what is purported by the regulations and the implemented procedures within any interaction involving government and enterprise. Together the presence or indeed the absence of such patterns has a broader implication of systemic obstruction within the bureaucratic environment in which the enterprises operate. For the sake of theoretical discussion, such a conclusion will strongly support divergence between the bureaucratic utility maximising and functional objectives of the system. It will show that as a result of mandated tasks not performed according to regulations, and the obstruction caused to entrepreneurial participation in the official economy, the bureaucratic participants in interactions are achieving their own goals at the expense of enterprise. In more practical terms, the conclusions will provide an indication of where policy attention needs be focussed and what elements of interactions need to be remedied to provide a better environment for business development.

1. Information and Documentation on Interactions

The first proposition {P1} is about the documents rather than their content. Though an overall sense of the content is considered, the details are examined later. Information in this case means the legal and regulatory documentation and explanations that describe the procedures. Included in this is interview material from officials involved with the particular interaction. This information may include the forms and applications necessary for the procedure, or the documents required from the enterprise. Simply put, 'information' herein
encompasses available published matter regarding the procedure and examines issues of access, requirements, availability, sources, and accuracy.

Two possible problems may exist with respect to official information. The first is that even though the information is precise and clear and in existence, it is costly to obtain or hidden away from public scrutiny for institutional reasons be it legacy of state secrecy, lack of tradition of broadcasting public information, and so on. The second problem may be that the information is vague and that the interactions are not well described leaving much to the discretion of the officials. The end-result however is the same. Enterprise is at a disadvantage going into the interaction because of poor availability of information or information that does not accurately describe the interaction procedure.

In assessing the problems a number of issues must be examined. The first problem requires an examination of whether a small enterprise can access the information it may need to successfully complete its part of the interaction based on the information provided. If not which of the following factors are to blame: cost, clarity, consistency, sheer amounts of text to sift through. Second, when the official version of the information is accurate, consistent and clear, do the bureaux communicate laws and official regulations on procedures to enterprises?

To agree with the proposition, whether official information about the interaction is accurate and available, or if the information on the procedure parallel the daily interaction between officials and enterprise, the case study must show the presence of one or more of several issues. One is that the bureau has documentation that appears to be accurate in that it
explains the procedure well enough, but that access to information is difficult. This
difficulty of access may include the lack of publication of accessible materials, the
unavailability of applications, or lack of documentation of general information, or an
inundation of legal information through which a small entrepreneur could not possibly be
able to sift in order to determine the procedures. Alternatively, a qualitative difference needs
to be shown between what is written in official documentation or claimed by a government
official in a position of authority within the relevant structure and what is understood and
actually experienced by enterprises. This difference, while not necessarily contradictory,
must be such that an enterprise is unclear on the procedure and is hindered from
participating in the interaction.

The demonstrated cost to enterprise involves uncertainty in their dealings with the official
structures. This in turn has the effect of delaying the interaction from both sides as the
enterprise accesses and processes the information. This generates costs that manifest
themselves in loss of time and energy, as well as increases the likely perception that the
structures of the government are difficult to access and that business is obstructed from
doing its work.

\[\text{PI}\] - Official information is unavailable to enterprise, or the existing information
does not parallel the daily interaction between enterprise and officials.
The contribution of this proposition to the analysis will be to indicate a tendency away from the intended system of information and indeed of the regulations, which may be assumed to follow the ideal of transparency.

If this hypothesis is not confirmed, the case studies may show that the information provided in the laws and regulations is accurate and that the official version of the procedure is indeed reflected in the practical experience of enterprises. Perhaps it is the case that officials do not attempt to maximise their utility by withholding or obfuscating information by making it vague, inaccessible or unreliable. In such an instance the proposition is not confirmed.

Thus, there is a possibility that despite some of the difficulties raised in the earlier section and regardless of the current economic conditions which exists in Ukraine, procedures established by the official structures are in fact communicated to the enterprises and do not pose an obstacle to their operations. The information regarding the process is properly disseminated through official channels and the media. Moreover, the application of those procedures is in keeping with the intent and the spirit of the documents, is transparent, and that the review process is an open one involving all interested parties.

The benefits are obvious. A correct system where information provided correctly describes the details of the relationship surrounding the interaction, that is clear and easily accessed, offers enterprise an environment for growth, not only individually, but also as a sector.
2. Money and interactions

The second proposition \( P_2 \) examines the financial costs to enterprises of interactions with official agencies. This proposition is specifically concerned with money paid by domestic SIEs to Ukrainian officials for services rendered or goods received.

In its assumptions proposition \( P_2 \) holds that micro business is obstructed in its development in part because of high official costs, broad-based charging above official costs, unclear instruction about who to pay, discriminatory rulings of fines and penalties, informal payments or “alternative arrangements”. As most interactions between a government and an enterprise require financial outlay, the case studies examine the fee structures and payment process as elaborated officially in legal documentation and the costs incurred by enterprise to complete a interaction as experienced on the street level.

Agreement with the proposition requires the case to show that officially documented costs are not the same as those being paid in the context of the interaction. In cases where the official fee is either unpublished or one that is based on a discretionary calculation, a perception of inordinately high fees may be sufficient evidence to show agreement with the proposition. Evidence of informal fees being exacted, above and beyond the officially set fees also show support for the proposition.

\[ \text{It should be noted that a case might exist where procedures are transparent but despite this they remain time consuming and costly. As we are concerned with an ideal alternative to the status quo, we will not trouble} \]

122
Because the issue of money is so integral to the running of an enterprise, any hint of unfair practice be it hidden cost, rent seeking, or abuse of authority with respect to fees, fines and payments, may lead to a perception of unfair treatment and, thus, bad bureaucratic practice. This, it is argued, is a hindrance to business performance and an obstacle to enterprise development.

Patterns of bad or unfair practice will be demonstrated in inconsistent payment policies across the case studies. These inconsistencies may include shortfalls in the information available to enterprise through official/legal documents, misleading information, and information that changes often or which is unevenly applied across jurisdictions. Patterns may also show that demands for informal payments added on top of official charges, or instead of official costs in so called ‘alternative arrangements’, are commonly evident in the interaction process. Moreover, the fact that these fees are not seen as wrong but ‘normal’ without which business would be unable to obtain necessary documentation is also a measure of the irrelevance of official fees and the acceptance of the fact that informal payments are essential to daily business interaction with officials. These patterns clearly demonstrate an unhealthy business environment and a challenge to the individual enterprises’ ability to function normally, thereby showing support for the proposition \{P2\}.

\{P2\} - The official business fees are irrelevant. Paying informal fees to officials is a necessary part of business practice.
Conversely, it is possible that a case may show that in practice it is relatively simple to get service from government for the official costs prescribed in the documentation setting forth the procedures. What is shown in such a case is that this particular aspect of interactions is one that does not impede the development of business as a result of high or inappropriate costs. Thus it is possible that the proposition will be refuted and the official cost of an interaction is acceptable to enterprises and does not contribute to obstructing business development.

3. Access - It's whom you know.

An official entry point designates the individual or the place within the bureaucratic structure where an interaction is conducted, or where information is obtained. The next proposition {P3} examines the ease with which an entrepreneur can access official services. Agency access to enterprise in the event of an inspection is also examined. Issues such as the selection process of enterprises for inspections and ongoing communication with an agency also fall under these propositions.

Proposition {P3} maintains that unofficial entry points are the only effective way to gain access to bureaucratic service regardless of the officially determined steps to be taken for that same government service. Access through personal contacts, “swä liudh” or through favours owed, all point towards an uneven playing field and one that favours those who hold authority. Furthermore, if information is not forthcoming and has to be obtained through connections and favours, the proposition also holds true.
To agree with this proposition the case must show that there is a trend of informal access to public goods. The tendency of having to rely on such method for receiving a service leads to unequal treatment of clients. Moreover, it creates a system of favouritism within the process. In such cases bureaucrats can selectively provide service to those enterprises willing to make the payments or do the favours rather than provide equal service to the public.

The proposition will demonstrate that there is unequal access to existing services and that small enterprises are disadvantaged if they do not seek or if they do not have alternative access to individuals or offices that provide public services. To accomplish this end, the proposition needs to establish a pattern of evidence showing that enterprises have had to resort to informal access in order to receive information or services. Alternatively that business activity has been curtailed as a result of lack of access. This it will do by taking evidence from the case and comparing the available information provided in the official documentation with the experience of the entrepreneur. The inability of a businessperson to come up with a contact is perceived as a significant obstacle to development. Another way of showing agreement with the proposition would be to show in cross case analysis that the access point is not clearly identified in the policies and programmes, and procedures. Such evidence looks strictly at the written documents to determine if there are provisions for access. While experience may lead the enterprise to learn how to access bureaux, the absence of an official description of access makes the exploitation of informal contacts a necessary alternative. This, as in previous propositions, creates an unsuitable environment for enterprise development.
This proposition underscores discrepancy between the bureaucrats' utility maximisation tendency and normative objectives of the system asserted in our interpretation of Niskanen. A trend of having to access services through unofficial routes indicates problematic delivery of public goods by the bureaucracy.

\[ P3 \] - Access to public services is straightforward through informal contact. Without this type of contact, it is very difficult to get business done.

4. Time spent with officials

The fourth proposition \( P4 \) to be tested by the case studies deals with the matter of time spent with officials, as opposed to time spent on pursuing business activities. Loss of time and energy is reflected in the seemingly constant running between government offices and proverbial red tape.

The propositions examine what time allowances are made in the regulatory environment to complete a particular step of the interaction, and how that contrasts with the real time requirements. The principal issues here include the amount of time required to complete the interaction from start to finish, or in some cases, where there is a limit to the amount of time spent on each phase of the interaction. In other cases (inspections) the amount of time officials are allowed to spend on site versus the amount of time enterprise spends with officials on site and the repetition of those interactions is also considered. Time spent
waiting for officials to complete the background duties of the interaction are considered as well as the frequency of visits required by the enterprise to the offices of the organ all contribute to time burden placed on business.

Case agreement with proposition \( \{P4\} \) is based on the actual amount of time spent on a business request for government service being greater than the officially determined amount of time to be spent on that same interaction. In the absence of legal representation on this matter, any evidence of abuse of time by officials performing their duties is also taken to be evidence in support of the proposition.

This evidence comes from the testimonials of entrepreneurs who approximate the amount of time spent with officials. This provides a measure of frustration faced by entrepreneurs about time lost on official matters.

The degree of difference between the normative and the positive in this instance is not the key issue as it is with some other propositions. What is important here is the frustration among enterprises and the damage done to business by the perceived and actual waste of time on official matters. The pattern across the cases needs to show that the amount of time spent with officials is inordinately great and goes beyond the time allowance set out in the regulations. Another pattern may suggest that the legal parameters for time spent on any particular point of the interaction is undefined in the documents. This, in turn, may suggest one of two possible situations. The first being that the regulatory document is purposefully
vague on the matter giving the officials interpretative powers to determine the amount of
time needed to conduct the interaction. Second, that there is simply no way of gauging how
long an interaction may last.

In either case the support for the proposition is there. Moreover, the opportunity for
bureaucrats to take advantage of the situation and to benefit directly or indirectly is great.

{P4} - The amount of time spent with government officials either exceeds that
designated by procedural regulations or is perceived to be excessive

As with other propositions, the converse may also be an option to be examined by the cases.

5. Bribery

Closely related to the second proposition on costs, proposition {P5} states that without
paying bribes to officials, legal businesses in Ukraine are doomed to fail or to move into the
shadow economy. Furthermore, the current state of opinion in Ukraine suggests that the
tolerance towards bribery is high and that paying bribes is a “normal” part of daily life.127
This proposition seeks to determine if bribery is necessary for business in Ukraine. The
proposition differs in that official costs of interactions and the unofficial costs that often

126 A case may arise where the officially determined time required for an interaction to take place is prohibitive.
We assume herein that the officially determined time is a reasonable ideal amount that allows for the
interaction to be completed without hindering a particular business process.
accompany interaction between business and the bureaucracy have been separately distinguished.

To agree with the proposition there needs to be a pattern of evidence across the entirety of the cases or within the elements of a single interaction of evidence, of bribes being paid to further the procedures involved in the interactions. The bribe may be a financial payment or a favour in kind. In some instances there maybe no requirement of money to be paid. In the law there may even be a clear indication that no money is to be paid for the interaction. If money is asked for in this instance, this constitutes evidence of bribery/extortion.

**BOX {P5} - It is difficult to get business done without paying bribes to officials.**

Alternatively the opposite can be submitted as a proposition that in fact there is little that suggests that bribery is endemic in a case study and the motivation for this type of behaviour has taken its secondary place. This may be as a result of better remuneration or improved conditions. It may also be a result of improved anticorruption activities of the authorities in the militia and secret service. To show disagreement with proposition {P5} a case study would have to show that there has been a change in the dynamic of the interaction, be it in the officials' work situation that removes the incentive to seek bribes. The case could also show that within a particular department, a successful anticorruption scheme has been implemented.

6. Behaviour of officials

The final proposition \{P6\} considers the attitude of officials in their dealings with enterprise. It is understood that this proposition may not be directly applicable to the cases in the same manner as the other propositions due to the subjective nature of the assessment and the lack of legal requirements for attitude and behaviour. Attitude is nevertheless considered to be a significant part of the interaction and may have an effect on its outcome.

The elements of the interactions taken into consideration include attitudes of officials, and the key value added of the public/citizen engagement. The behaviour of officials may be understood in several ways. First, it is taken to be the attitudes of officials towards the enterprises they serve in the course of the interaction. It can also be understood as the code of behaviour established within the legal documentation. Many economies have implemented a code of behaviour for their public servants, and it is through such codes that the amelioration of service provision begins, develops and is sustained. Though a country like Ukraine may be some distance from formally establishing a code of this type, the ideals of effectiveness, efficiency, transparency and probity to name a few of a considerable list of appropriate bureaucrat behaviour conducive to best bureaucratic practice, cannot be overlooked. Such a code needs to be considered as the vehicle that will internally drive
bureaucracy to improving its performance thereby creating the desired environment for SIE
development.

The UK Civil Service Code is used here as a guide in particular the articles with reference to
professional conduct in relations with the public. Of particular relevance are the following
points from the Code:

- Civil Servants should serve the duly constituted Government in accordance with the principles set out in this
  Code and recognising:
  - the accountability of civil servants to the Minister or, as the case may be the office holder in charge of their
    department;
  - the duty of all public officers to discharge public functions reasonably and according to the law;
  - the duty to comply with the law, including international law and treaty obligations, and to uphold the
    administration of justice; and
  - ethical standards governing particular professions.

- Civil Servants should conduct themselves with integrity, impartiality and honesty. They should give honest
  and impartial advice to Ministers, without fear or favour, and make all information relevant to decisions
  available to Ministers. They should not deceive or knowingly mislead Ministers, Parliament or the public.

- Civil Servants should endeavour to deal with the affairs of the public systematically, efficiently, promptly
  and without bias or maladministration.

- Civil servants should not misuse their official position or information acquired in the course of their official
duties to further their private interests or those of others. They should not receive benefits of any kind from
a third party which might reasonably be seen to compromise their personal judgement or integrity.

The value added of public engagement refers to the efforts of the agency in involving the
public in dialogue towards the improvement of the service or the policies themselves. the
evidence for this is found in the provision for public engagement in the law, which may
include such efforts as public education through various forum, public broadcast, or
participation in business development association activities, conferences, or seminars.
Proposition \{P6\} focuses on the behaviour as it has been observed and or determined by the legal documentation, interviews with officials and how that behaviour has been experienced and perceived by the SIEs.

To agree with proposition \{P6\} the case must show one of two things. The first is that officials behave in a manner inappropriate according to a code of conduct resulting in creating a threatening, offensive, or antagonistic environment for enterprise. This may be evident in individual behaviour or in the method of fulfilling the tasks of the interaction. Second, the behaviour of officials must show a trend towards poor development of public engagement. Such public engagement may include education campaigns, advertising, and participation in conferences and seminars; some attempt to engage the public in the development of policy, programmes, and procedures of the bureaux themselves.

The cases need to show that the officials are performing their tasks in a manner that is unacceptable to the enterprises, is damaging to the relationship between the two sides, and/or creates hostility during the interaction.

\{P6\} - Behaviour of officials is detrimental to the completion of interactions with enterprises.

In contrast cases may show disagreement with the proposition, i.e.: when officials’ behaviour does not impede business development; rather the value of client engagement is increased. In such an instance the cases will show that the utility function of the bureaucrat as described by Niskanen, is not being maximised at the cost of the official objectives of the
interaction while the usefulness of the bureaucrat is increased and their participation in the interaction is deemed either positive, or at the very least neutral.\footnote{128}

\footnote{128 Because proposition \{P6\} examines behaviour of officials from two different perspectives, the findings will show a distinction within proposition \{P6\}. One part of the findings relates to public engagement and the other to the compliance of bureaucratic behaviour to a code of conduct.}
CHAPTER VI - METHODOLOGY

1. Overview

This chapter discusses the research strategy and methods chosen to conduct the research as well as the approach taken for the analysis of the data. The main question is how and where are bureaucratic regulations and procedures affecting the development of small enterprise in Ukraine. The main concern is which elements of bureaucracy-enterprise interactions pose obstruction to businesses. Moreover, which elements of the interactions in particular have this impact? A second question is where are some of the weak points in the regulatory environment concerning small enterprise and can they be isolated for further consideration? Based on the nature of the direct interaction of enterprises and officials, Chapter V on propositions presents a number of propositions that structure the research and help focus on these questions. Section two justifies the validity of the case study method as the general research strategy. The nature of the interactions, including the need to examine people's perceptions, as well as the inherent difficulties of calculating the impact of an experience in numbers, have all ruled out the use of a quantitative methodology. Moreover, current research being done by the World Bank, among others, makes use of quantitative methods to obtain data and examine similar issues.\textsuperscript{129} Section three discusses the assessment of validity used in the data collection and subsequent analysis.

\textsuperscript{129} Andrew Stone, Petter Langseth, Обстеження державної доброчесності на україні, Washington: World Bank (1997) Also IFC, Проблеми малого бізнесу в україні, Київ: IFC/Norway Ministry of
The fourth section describes the units of analysis. The focus on interactions has already been justified. It remains therefore to explain the reasons behind the selection of interactions, provide an overview of the case interactions and describe the lead-up to data collection.

Section five describes the fieldwork process. Accessing participants, hunting down documents and the general tone of the interviews will be outlined. Also in this section the difficulties of work in the environment of relations between officialdom and enterprise will also be examined.

The availability of materials in such a study is difficult to assess ahead of the collection. Section six addresses the issues of access to information by the researcher and the standardisation of the material across the case studies providing a key framework within which the data has been collected and presented.

Section seven establishes the framework of categorisation of data from the cases and their elements. In cases study method, much material is generated and such a framework is necessary to focus the dimensions of the analysis. Here three levels of analysis are described. First, the attributes of the elements are examined within each case. Second, the elements of each case are compared with the others to see if there is support across cases for propositions. Finally, the use of pattern matching of research results and some comparative

Foreign Affairs/USAID/Ukrainian Marketing Group (1997), and IFO-Institut für Wirtschaftsforschung, Продержка предприимательства местным органами управления в украине, Munich, IFO/Kyiv
work by other international organisations will help in establishing the criteria for, and interpretation of, the findings.

The last two sections provide a summary of the methodology and a brief look at the limitations of the strategy and methods.

2. Strategic approach

In this thesis, the case study method, more common to management and business studies than to social science, will be used in order to help overcome some of the difficulties of research work in Ukraine on a topic that may be sensitive to some individuals. Furthermore, by using the case study methodology, the intent is to design a research project that may be applied to virtually any country or sector.

In his seminal work on case study research, Yin provides a breakdown of several strategies of research each with its own strengths and weaknesses. The five strategies he identifies are, experimental; archival analysis; history; and case studies. Yin distinguishes each type using criteria of time, control over events, and the form of the research question. The purpose of his distinction is to show that case studies, while often regarded as ‘the weak sibling among research methods’, are in fact preferred strategies in certain circumstances. Yin argues that the selection of strategy must be done on the basis of three questions: the type of research question; the degree of control the researcher has over the actual behaviour or events, and

ICIKyiv (1996)
the time frame involved, be it a contemporary or historical perspective. If we look at the questions above and ask each in regard to this study, the choice of the case study strategy becomes clear.

The basic "types" of research questions are "what", "who", "where", "how", and "why". Questions examining "what" fall into two categories, the first being "exploratory". The goal of this type of strategy, according to Yin, is to establish propositions for further inquiry. Any of the strategies can be used for this type of question. The second type of "what" question describes a 'how many' or 'how much' line of inquiry. Such questions are appropriately addressed by surveys or archival strategy, which can both be designed to help determine the "what".

Yin writes that similarly to the "what" enquiry, the "who" and "where" lines of questioning can also be answered effectively by using survey and archival strategies. These strategies are useful when the goal of the study is to "describe the incidence or the prevalence of a phenomenon or when it is to be predictive about certain outcomes."

In contrast to "exploratory" questions are "explanatory questions", which lead to case study experiments and histories. "Explanatory" questions are interested in the process of change over time rather than the mere incidence of events or occurrences. Neither of these is appropriate to this thesis.

Having eliminated two of the five research strategy options, we turn our attention to the question that deals with the degree of control over behavioural events. This question makes
it possible to determine finally, the appropriate strategy. Assuming that the research questions are “how” and “why”, we can examine each of the strategies individually. Experiments dealing with questions of “how” demand rigid control of the environment and behaviour in which the study takes place. Similar to the case study, it examines contemporary issues. However, in a research subject such as the one put forward in this dissertation, the experiment strategy is eliminated because the subject of corruption’s effects do not allow for any control over business and corrupt behaviour nor their environment by the researcher.

A historic examination is an appropriate strategy when there is no control over the behavioural methods. This applies particularly when the subject deals with the distant past, when there are no living witnesses and when a researcher must rely on primary and secondary documents, and artefacts. However, historical method can be applied to studies of contemporary subjects as well and can overlap the final strategy to be considered: the case study.

The matter of overlap in this dissertation, however, is not critical. History requires a great amount of primary documentation that establishes linkage to past activity through which the development of the issue can be traced. A case study does rely to a certain degree on historical accounts of recent events. The historical strategy, however, would be ineffective for two reasons: first, the subject of this thesis deals primarily with an issue that spans a small period of recent memory, rather than distant history and secondly, there is relatively little documented information available upon which to build a proper historical thesis. As a

\(^{130}\) Yin, 18
method of inquiry that responds to the questions 'how' and 'why', which demands no control over behaviour of the subject, and which is interested primarily in contemporary subjects, the case study offers the best strategy for this dissertation. In Yin's view, case studies are empirical inquiries that "investigate a contemporary phenomenon within a real-life context"; which are particularly useful when the demarcation between the phenomenon of corruption in business and the context of corruption in business are not clear, and where many sources of information are exploited. What needs to be determined at this point is what type of case study format will be used and why.

3. Validity and reliability

An important concern in case study research is the assessment of validity. There are several phases at which case studies can and will be verified. "Construct verification" occurs in the design of the case study itself. Using what Kidder refers to as "correct operational measures", the first phase, which takes place during collection of case materials, involves using several sources of information and establishing a structured collection of evidence. This was accomplished through identification of three distinct groups of interviewees: enterprises, officials and international organisations/observers and analysts. Each one provided a unique perspective of the situation and ensured the necessary elements for a balanced exploration. Active participation was attempted as a means of gaining first-hand experience in the procedures. Also casual observation of events provided much

131 Yin, 22-23
information. Printed documentation from a variety of sources including the three interview groups provides yet another source for information.

Another step often used in validation during the first phase is to have the informants review the case once it is complete. However, since in most cases, the information may be sensitive, and will likely have to be gathered through indirect means, the task of having each respondent review the case study would be unfeasible. This, however, can be overcome. Third parties, with similar experience can be called upon to compare their experience in doing business in Ukraine. The validity of the cases can be upheld by the testimony of these third parties. This testimony was gathered concurrently with the data collection from enterprises and officials. This concurrent collection of information from third sources was done in part to resolve the difficulties of mailing information to and from Ukraine, a process fraught with hazards.

The second phase of verification takes place in the analysis of the research. This is termed “internal validity”\(^1\). The important points to be noted here are that the research of this topic may demand a certain degree of inferred material, since certain questions cannot be asked of the subjects. The inferences about any point must be carefully considered and any alternatives must be explored before a concluding statement can be made. The other point is to be certain that the logic of the initial research question is correct. The “external validity” test is the third phase of verification identified by Kidder.\(^2\) Using generalisations, the study assesses whether the conclusions drawn from one case are applicable to another.

\(^{1}\) Kidder, 7-8
\(^{2}\) Kidder, 8
By repeating the study and applying the conclusions to other cases, the validity of the arguments increases. This will become more evident in the analysis chapter that will seek out patterns in the cases.

The final analysis phase is borne out in the general approach of the thesis. The steps taken in the field and in the analysis are structured so that a repeat study, following the same methodology, should arrive at similar results. While the study does not allow for a subsequent study to survey the same enterprises, the methods used and the strategy of the research are easily repeated in Ukraine and in other countries as well.

The method suggested is the creation of a reliable database for case materials and other information, as well as a clearly defined case study protocol. This ensures to a great extent that any data collection process is uniform across the study and that cases are as similar as possible for easier comparative study, pattern matching and corroboration.

4. Research design: identifying interactions and informants

Units of analysis

Having identified research questions formulated propositions and having selected a research strategy, points of direct interaction between government agencies and enterprises were selected as the units of analysis.
A point of direct interaction as the unit of analysis provides a clear procedure involving both officials and enterprise. It has clear structure in terms of being a tangible relationship between two players. It also has, or should have, rules that are supposed to regulate that interaction. The scope of the subject matter is manageable and is less risky than focusing specifically on one or the other participant of the interaction. Using this unit of study offers the chance to examine the official version of the interaction versus the practical version of the same in the same study. This offers a balanced means of examining the relationship between officials and enterprise. The purpose of the study, once again, is to understand the specific difficulties faced by business in their direct relations with official structures. Thus the interaction point is the preferable choice. This thesis will examine five interaction points, where business and official structures interface directly: Official registration, certification, obtaining a sales permit, tax inspection, and fire inspection.

Elements within these interactions are subsequently explored in greater detail. These elements become the sub-units of study and they are determined by the enterprises themselves through the interview process. In other words, a certain procedural point is identified by an enterprise as problematic this point is taken up and becomes the elemental part of the sub-unit of study to be compared with the official version of the procedure. The elements used in the study are those that were found to be part of the collective experience among the interviewees.

Among those interviewed and within each case study, several sub-units of study will be examined in an effort to determine in the first place if certain parts of the interactions are
obstructive or non-obstructive to the enterprise, and secondly, whether these can be identified as possible opportunities for corrupt behaviour.

The principle criteria for selection of the points of interaction were their constant exposure in research by international organisations and mass media, as problematic. Secondly, interactions were selected where direct interface between the authorities and enterprise was necessary. Where individuals representing each side had to meet and exchange information or documents in some form, rather than through policy creation or other such means that do not involve face-to-face meetings. Finally, where access to information and interviews was believed to be available.

It is necessary to explain that the units of study are not of the same type. One set of interactions involves officials making on-site visits and the contact is direct, the other set contains interaction where the entrepreneur goes to the official bureau in order to obtain a document in the form of registration, permit, or certificate. Thus the units of study and their respective sub-units of study are divided into two slightly different lists, though both lists have comparable themes. The first set of interactions is made up of those elements of study related to certification of business activity, licensing and obtaining sales permits. Differing only to reflect the type of interaction they make up, they include “the paper chase”, “payment”, “waiting for the man”, “getting it all back and moving on”, and “the behaviour

---

137 Patent in this context is a sales permit to engage in business activity without premises, i.e. street vending
of officials. As with the first set of elements, several specific points to be examined include: requirements of the applicant; availability of information/application forms; requirements (documents), arrival at official bureau; costs; time requirement; frequency of visits to complete one interaction; communication with office; behaviour of officials; frequency of renewal of documentation, and the like.

The second set includes tax inspection and fire/safety inspection. The elements of the interaction are “the paper chase”, “on-site inspections”, “the relationship continues”, “payment”, and “the behaviour of officials”. Within each of these elements a number of specific points are examined, among them: the selection of enterprises for inspection; frequency of inspection; notification of inspection; unannounced inspections; protocol of inspection; provisions for inspectors; premises inspection; duration of inspection; repeat / subsequent inspections; fines and penalties; behaviour of officials.

Contacts

Pragmatism and convenience guided the search for individuals to comment and interview on these points of interactions. Selected enterprises had to be domestic firms with no overseas investment, and had to qualify as small firms, that is under 25 employees and with a small turnover of under 250,000 UAH annually. Selection of small independent enterprises (SIEs) was chosen primarily to attempt to ensure an indiscriminate SIE viewpoint. Interviews were conducted with selected firms whose experience with government institutions varied though all had some experience at some stage of their development. It was however hoped that a
significant number of the interviewees had experience with all interactions chosen for the case studies.

Traditional methods of approaching both business and official contacts such as corresponding with prospective interviewees in advance were not applicable. Letters sent in advance were believed to have little use. First because it was suggested, and experience has shown, that people in Ukraine prefer to meet face to face through introductions, and second, appointments made well in advance are often not kept or delayed. The method of 'showing-up-and-waiting' seemed to be most effective.

Officials were approached using connections through the Canadian Embassy, the American Chamber of Commerce in Ukraine, the law firms of Baker & McKenzie and Squire, Saunders & Dempsey, as well as Peter Hackett and Partners, a UK property management firm. Further contacts were made through private connections in Ukraine.

Interviews with bureaucratic officials had to be conducted with a degree of stealth and luck. Access to higher authorities was relatively straightforward, though less desirable than discussions with operational level officials. In every instance, higher management proceeded to explain the points of interaction from a policy perspective without reference to the actual details of the procedure. Moreover, they were reluctant to have their subordinates participate in interviews. Several meetings were set up out of working hours or during on site visits. Few operational level officials were prepared to make any comment about the procedures and insisted on the researcher talking to their superiors.
Official documents were found in a variety of places. The laws of Ukraine and many of the supporting documents were found on-line through the Verkhova Rada website. Other documents were obtained either through the official contacts made in Ukraine, through publishers' offices and from news kiosks in Kyiv.

*Brief description of information sources*

The enterprises selected cover a broad range of activities. Although a random pattern of selection was of primary interest, the broad nature of their experience was also a factor.

Table VI.1 - Number of SIEs in the survey by number of employees

<table>
<thead>
<tr>
<th>1-3</th>
<th>11</th>
</tr>
</thead>
<tbody>
<tr>
<td>4-6</td>
<td>9</td>
</tr>
<tr>
<td>7-10</td>
<td>3</td>
</tr>
<tr>
<td>10+</td>
<td>4</td>
</tr>
</tbody>
</table>

Table VI.2 - Number of SIEs in the survey by sector See also Ch VI, Appendix 2

<table>
<thead>
<tr>
<th>Manufacturing</th>
<th>4 (B4, B10, B20, B25)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>5 (B5, B7, B16, B17, B19)</td>
</tr>
<tr>
<td>Manufacturing and Trade combined</td>
<td>2 (B8, B13)</td>
</tr>
<tr>
<td>Services</td>
<td>9 (B1, B3, B4, B6, B11, B15, B18, B21, B26)</td>
</tr>
<tr>
<td>Distribution</td>
<td>1 (B23)</td>
</tr>
<tr>
<td>Research and technology</td>
<td>6 (B2, B9, B12, B14, B22, B24)</td>
</tr>
</tbody>
</table>

Three business associations (one in each L'viv, Kyiv and Kharkiv) were approached and representatives interviewed in order to grasp a broad understanding of enterprise reactions.
to the various interactions. Due to the limitations of time and resources, the opinions of the
business associations were sought. These are presumed to represent similar views to those
of the enterprises themselves, but on a broader scale and with some degree of analysis
already built into the responses of the representatives. The reactions from these associations
did not seem out of place or in any way deviant from the general viewpoint of the
respondents.

Table VI.3 - Number of SIEs in the survey by region

<table>
<thead>
<tr>
<th>Region</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kharkiv</td>
<td>2</td>
</tr>
<tr>
<td>Kharkiv oblast</td>
<td>2</td>
</tr>
<tr>
<td>Kyiv</td>
<td>13</td>
</tr>
<tr>
<td>Kyiv oblast</td>
<td>4</td>
</tr>
<tr>
<td>Lviv</td>
<td>4</td>
</tr>
<tr>
<td>Lviv oblast</td>
<td>2</td>
</tr>
</tbody>
</table>

Officials were selected initially on the basis of the departments or agencies with which they
work. Only relevant agencies were approached. Operational level officials were approached
directly in an effort to avoid any obstructing by senior managers. Initially this was difficult
but with the assistance of several contacts, such officials were found and interviews set up.
Generally, contact with the office director was difficult to avoid. On the occasions that
permission for an interview was needed from higher authority, typically, however, a certain
degree of cordiality was offered up for a research student writing about the development of
the Ukrainian business sector.

In most cases the official was able to answer questions and talk openly without the director
present. On one occasion an official told me to read out the list of questions I was going to
ask. After each question he stated that he would not answer a single question and that either I had to ask the director or to put the question in writing and they would consider answering it. In this situation the director was more open than expected. It was assumed that an operations level official would be less inclined to hide behind rhetoric. These individuals were felt to provide a better glimpse of the relationship between enterprises and their agency by virtue of being on the proverbial “front-line”. Official documentation is nevertheless be the main source of information from the official side. This is so in part because the cases examine the official version of the interaction, but also because the author holds suspicions that often officials in Ukraine are not well informed of the “big picture”. In other words, there are occasions when changes in the legislation are made and officials are not always aware of these changes. Moreover, there are also instances when managers provide their subordinates with one interpretation of a directive while another department may provide another interpretation altogether. It is possible that directives given to subordinates are not part of a policy at all but merely serve the purposes of the director or middle managers of the departments. Despite these possible variations, this thesis relies to some extent on interview material from officials.

The third method used in information gathering was direct observation. Although this method may only yield limited information about the cases themselves, the context in which the businesses operate can be effectively observed while in the field. The relations between enterprises and the government agencies provide useful information about the relationships between the players. First-hand experience with bureaucratic procedures offers an insight into how companies actually experience these situations. A limited amount of participant
observation was attempted, though this proved to be difficult because the entrepreneur became uncomfortable about having an ‘outsider’ involved.

5. **Fieldwork: wandering among the grassroots**

The analysis of any case study and research is only as good as the data collected. Good data is determined by the methods used to collect data for the study (some being more appropriate than others are) and adhering to well-established principles of inquiry. This study based much of its research on three methods of data collection. The first was through personal interviews. Open-ended interviews with the key people involved in the case studies provided information about the issues directly as well as opinion on matters surrounding the issue.

Regarding enterprises, the individuals interviewed were entrepreneurs, managers and owners of firms in Ukraine who have been in business in the period since Ukraine’s independence. The degree of business success was not criteria for determining their participation in the case study, although it was assumed that an unsuccessful company may be more likely to place blame for their lack of success on outside forces rather than on their own internal management. Therefore, interviewees were selected among enterprises with varied success records. Where company’s documentation and records were available, although rarely, they serve as evidence of the business’ activities, structure and in some cases, performance. Small Ukrainian enterprises do not generally have elaborate documentary evidence of their operations. Furthermore, Ukrainian entrepreneurs tend not to show their books to anyone.
unless the law requires it and even then it is done with some reluctance. The media can also provide useful material about given companies and their operations, as well as providing insight into their relations with various government agencies.

In doing case research fieldwork, it must be remembered that not everything about a case study can be discovered thus requiring a focus. Interviews need to cover a number of areas in order to assure the best consistency of information. Documentary evidence also has to be consistent. Overall the interviews stressed the development of enterprise with respect to the regulatory environment (in the case of officials) and its practical implementation (in the case of enterprises). The documentary evidence though taken from a variety of sources, attempts to cover the same subjects through a consistent (legal) examination of the documentation.

Key topics

Interviewees were selected in order to get a broad but experienced view of the subject at both the official theoretical and entrepreneurial practical levels. Semi-structured interviews were chosen as the preferred method as it was advised that structured interviews were more threatening in their tone. As none of the interviewees were willing to be recorded, it was decided that an unstructured approach would be met with the most openness. A frequent comment from the interviewees was that they would agree to have an “informal discussion” (“поговоримо неформально…”). Furthermore, the unstructured interview allows for exploration of particular areas of expertise and experience and it acknowledges that a fixed sequence of topics and questions may not suit every interview. Additional information was
sought from individuals with perspectives on both sides. Having divided the sources of information the key subjects broached with all of them were essentially the same though the discussion had to be sensitive to the specific concerns of each group.

The procedures of the interaction, the step by step requirements for the procedure, time requirements, frequency of visits, renewals, access, financial implications and costs were discussed. (See Ch. VI, Appendix 1) These areas of interest were taken up with all interviews and served two purposes. First, and particularly for the enterprise interviews, they allowed for an initial assessment of the general state of regulatory difficulties, while for interviews with others a general assessment of issues surrounding the interactions. Second, they revealed the initial points of divergence and congruence between the official/theoretical version of the procedures and the practical experiences of those directly involved.

Other topics were brought up at each interview as appropriate to the individual in an effort to draw out information specifically relevant. Behaviour of officials, expected changes in the procedures, methods of enforcement, personnel issues in official structures, access to information and its reliability, and bribery were all discussed. These topics revealed the specific concerns of the groups, as well as further highlighting the differences of perspective. More importantly the perceptions of the enterprises were revealed in this part of the interviews.

In the multi-case design the researcher needs to decide how much to concentrate on specific single cases and on particular interviews. The multiple case approach allows for pattern matching and finding divergences between the perspectives. But it cannot be assumed that
the patterns will show themselves immediately in the structure. Each case must therefore be understood on its own terms. Recurring topics and particular questions help establish the patterns of information, but the cases themselves emphasise the specific considerations of the information as given by the interviews. This is particularly so in the positive section of the case studies.

Fieldwork

In total, 40 formal interviews were carried out in three cities in Ukraine: Kyiv, Kharkiv, and L'viv in March/April 1998 and March 1999. Several individuals interviewed in 1998 were revisited in 1999 and a follow-up interview was conducted. Of the seven re-interviews in Kyiv and L'viv, none had noted any significant change to their responses from the previous year, and only two had found themselves in significantly different situations. One director was working in a different enterprise and another had gone to work for the local business association. All the interviews were done face-to-face as none of the interviewees were prepared to interview by telephone or email. 28 interviews were done within enterprises. In some SIEs a number of people were interviewed either together (two or three managers or directors) or separately (director and employees). Six interviews were conducted with officials, eight were conducted with outside specialists, people from international organisations, law firms, embassies, and multinational consultancies, each providing information about bureaucracy-business relations and the regulatory environment. Most interviews were carried out in Kyiv as access to officials and to specialists was greater. Meanwhile, the interviews in Kharkiv and L'viv were with enterprise. Informal interviews
were also conducted but were used as additional material rather than core information because of their limited theme or scope, and consequently are not included in the counts in tables VI.1, VI.2 and VI.3.

As may be expected, qualitative method may result in researcher bias stemming from data overload, unreliable information, dominance of first impressions and to some extent over confidence in data by the researcher. Two means of avoiding these pitfalls were implemented. Corroboration of information from one interview to the next was applied as part of the interview process. A second method is triangulation, for example using several sources to confirm the same phenomenon. Triangulation as a means of helping to avoid researcher bias has proved difficult in some areas. Many sources selected to substantiate claims and statements were also seen to fall into several traps of first impression bias and simple lack of contextual experience combined with heavy reliance on “official” views of their respective corporate assessment rather than an experienced and knowledgeable view. Where this was evident, attempts were made to have information substantiated by experienced, though perhaps not expert, opinion.

6. Standardising information ensuring comparable data

Having established the method of collecting information, the principles that support the data collection itself must be understood. These are well-established principles and can help ensure the reliability of a study such as this. The first principle is the use of multiple sources
of information. For each case, this study proposed to speak to as many entrepreneurs and business people as possible. They were interviewed individually rather than in a group setting that in order to ensure greater reliability as well as provide privacy for each interviewer. In past experience, group interviews involving Ukrainian respondents offered limited success, largely because of natural hierarchies that establish themselves in these groups. With officials particularly, this hierarchic dynamic is evident. In a few rare instances several business people were together in a group setting, though where this was allowed, it was understood that the participants were of equal status within the company, for example as co-proprietors.

For official documents, the need for a reliable source is essential. Initially, relevant official bureaux were targeted as sources for the legal and procedural documentation. After comparison with documents available on the internet and from western legal firms multiple sources were drawn upon. Law firms and NGO libraries were the prime source of legal documentation, while business centres and news kiosks were a source for supporting documents such as applications and regulatory documents. In some instances it was easier to obtain the supporting regulatory documentation from the publisher rather than from the bureau.

\[138\] Yin, 77
\[139\] In a pilot study, the researcher surveyed directors of agricultural structures in an effort to determine problems that exist in their ability to access Western markets. The survey was initially done in a group setting where, amongst a collection of directors, deputy directors and several officers from different agribusiness, the directors responded, often in a rhetorical fashion, while the others sat and listened. When pressed the others simply agreed with the responses their directors had given. It was clear to the author that in several responses the non-director participants did not agree with the answers given by the directors, and a new format was employed for further investigation. By talking to respondents individually there was far greater variety of opinion and the answers were polarised rather than reiteration of the directors' responses.
Maintaining a chain of evidence is essential to case study work. This principle also includes the creation of a clear and methodical database for retrieving information. The information must be retrievable quickly and accurately. The intention of this study was to select a number of companies and specific government agencies with which the companies had interactions. Three sets of files were maintained. The first set of files was based on enterprises and their activities. The responses of each interview will be used to establish one version of the interaction. The second set of files contained the official version of interactions be it through documentation or through interviews. The third set of files was kept as part of the validation process. International observers, representatives of national missions, and other organisations' representatives, who were deemed able to verify the versions of the various interactions were also interviewed.

No effort was made to standardise the responses for consistency. The nature of the question, while seeking some trends and patterns, did not seek absolute answers. From the perspective of the enterprises, the aim has been to examine perceived differences between the official and the practical. Despite the fact that though there may not be an absolute figure attached to the difference in quantifiable terms, the differences can be assumed to be indicative of a problem without actually being indicative of the size of that problem.
7. Turning case materials into data analysis

Turning from the difficulties of fieldwork to the complexities of analysis, the part of the case study often overlooked in methodology, according to Yin.\(^{140}\) The research established an analysis plan before setting out to do the case studies themselves. By doing this, the analysis technique ensures that data collection is done as effectively as possible. As well, an ongoing review of data collected has helped to determine gaps in the case study material. This has been an indispensable part of the research exercise.

This dissertation will analyse data first by using the interactions that helped establish the foundation of the research. The sub-units of analysis, the elements of the interaction, help focus the scope of the thesis upon the issues raised by enterprises and therefore on relevant data gathered in the case studies. Secondly, the propositions help organise the case study and give an opportunity to explore alternative explanations for results.

To this point, the methodology of data collection and the structure of the thesis have been examined. The following sections will set about establishing the way in which the data will be examined and how it will be analysed.

Case study method often demands custom built analysis. Existing literature however, provides a basis for isolating the areas on which to concentrate. Miller, Koshechkina, and Grodeland focus on the interaction between the bureaucrat, the bureaux and government agencies and the citizen as an individual. Their study concentrates solely on the client side of
the equation. The present study integrates the micro perspective of the client view used in Miller et al., and adds to it the officially stated version of the service provided. It then takes a broader examination of the interactions between SIEs and bureaucracy while being able to assess that interface in broader terms of enterprise development. This involves determining how obstructive, neutral or beneficial they are to the process of completing a given interaction. Below, the process of linking the data to the propositions is described:

A main focus of this research is on the case study elements. At the official level, written information on the interactions is found in laws, decrees and documents of the Cabinet of Ministers. The detail of the elements is described at the operational level in procedural texts and pamphlets or public instructions provided in business press. It is the non-legal documentation such as media analysis and interviews that temper the legal version to complete as accurate an illustration of the official version of the interaction. The experience of the enterprise provides the counterbalanced version of the same cases and their respective elemental parts. This version was compiled from interviews, in field observations, and media coverage. With the data gathered, attention must now be turned to analysing it with the aim of drawing out the conclusions.

Each case element is then analysed against the background of its relevant proposition. For instance the element titled “paper chase” is assessed against all seven propositions where the subject and the sub element are suitably matched by theme. Each proposition takes into account the different attributes of the paper chase theme.

---

140 Yin, 105
If the elements show a match across the cases, it can be concluded that they support the corresponding proposition. If only a minority or none of the elements or attributes shows support, the proposition can be said to be invalid. In the instance of a mixed result, evidence may lead to a variety of conclusions about reasons for the unclear result. By replicating the findings among the elements of two or more cases, 'literal replication' can be said to have occurred, thereby establishing an even stronger result of the analysis.141

Assessment of the evidence is done based on criteria assigned for each proposition. This assessment happens at several levels.

i. The attributes are assessed to see if there are any patterns to be seen that may show a trend of obstruction at that level. The repetition of certain attributes as supportive of a particular proposition may also be an indicator of an obstructive trend in that area.

ii. The elements from each are examined with the aim of determining the appropriate version of the proposition for the particular case. The propositions will be ranked based on the level of support for it found among the cases. The ranking will help determine, to the extent possible, greater or lesser comparative obstruction, neutrality, or non-obstruction. Subsequently patterns in the findings are sought in an effort to determine trends and to arrive at conclusions regarding the need for closer examination of these areas.

141 “Literal replication”: The repetition of a pattern of findings over a series of two or more case studies.
Finally, each case study as a whole is assessed overall against the propositions. Cases can also be ranked from 1 to 5 based on the weight of the positive support of propositions. It is here that general conclusions about the case studies and propositions can be made.

*Pattern matching*

The pattern-matching component of the case study design is used as a method of interpreting the findings. In this study, the experiences of enterprises with government agencies will provide evidence of the obstacles and difficulties. The legal and normative base for the procedures as well as the views of officials themselves (obtained through interviews and documents) will provide the materials for the official side of the case studies. By comparing the "theory" with the "practice" it will be possible to determine where there are significant gaps in the procedures. Through a parallel examination of the case studies, units of study, and the sub-units of study, a pattern is expected to emerge. Matching patterns amongst the case studies will yield a useful interpretation of the data, and will help in drawing conclusions.
8. Summary

In this chapter, the methodology, research strategy, and analysis approach have been explained. The principal questions asked in the thesis are how are bureaucratic regulations and procedures affecting the development of small enterprise in Ukraine, and which elements of the interactions in particular have this impact? To determine this, the case study method has been selected and arguments made as to its validity as an effective strategy, taking into account the subject matter, the peculiarities of the context, and the resources available to the researcher.

The use of cases, their elemental steps and the attributes of those steps are justified as essential building blocks to the argument. By understanding the differences between the official versions of the cases and the elements, it is possible to draw conclusions about the effect the gap in the operationalisation of the regulatory system may have on small enterprise.

The chapter follows an established approach to case study fieldwork as described in leading literature, and takes into consideration the recommended approach to interviews, data collection, data management, and standardisation.

The analysis of data using categorisation of data from the interactions and their element parts is described and followed by the introduction of pattern matching as a means to draw out conclusions from the data. Finally, the chapter outlines the need for comparison of the results with those of similar studies by international organisations.
To make sense of the material collected and to be able to perform adequate analysis, the methodology must be well thought out. The use of established method was intentionally chosen to provide a useful and reliable guide, making the information as consistent and reliable as possible. The following chapters present the details of the data and findings and their subsequent analysis.

9. Limitations of the study and further research

While there is significant literature on bureaucracy and corruption and their place in western advanced and developed economies, the literature on these related to the context of a transition economy such as Ukraine is scarce, owed in part to its relatively recent emergence. The thesis has a number of limitations that are outlined below under the headings of research perspective, sample, methodology, and applicability of the findings.

Research perspective

The theoretical foundation establishes that the role of the bureaucrat is one of maximising personal utility. The addition of the ideas of corruption to the modified theory developed in chapter III shifts the perspective to an examination of bureaucratic behaviour. Because the study examines the question of the role that bureaucrats play in the development of SIEs in Ukraine by judging the interactions between the two players, it is less suitable for
determining the reasons behind bureaucratic behaviour, or reasons for corruption. One of its strengths however, is that it can take these theoretical foundations as reality or context and examine the interactions between two sectors of the economy in order to understand the shortcomings in those relations. The reasons behind the actions of the officials are yet to be determined, but the consequences for SIEs begin to emerge herein.

Among the alternatives for focus might have been a more detailed examination of the bureaucratic sector, giving an understanding of the mechanisms of decisions related to interactions. Another alternative might have been to focus on the financial flows stemming from the interactions back to the state revenue structure as a means of showing where the interactions fail in their role as revenue generating procedures. The drawback to such alternatives is that the official side of the interactions is difficult to penetrate beyond what is officially given. Access to information and to the halls of bureaucracy are protected by the very traditions and behaviour noted in the theory chapter. In a context where the use of informal contact and unwritten rules is prevalent, it is better to rely on information that is readily available: for this study, official documents and the experiences of SIEs.

Study sample

There were key reasons for selecting SIEs in Ukraine. One reason is that little work has been done on the domestic small independent entrepreneur in Ukraine, while much has been concentrated on foreign firms or medium and large companies. Another reason is that while such work is used as a benchmark of the health of developed economies, indications of
Ukraine’s SIEs were few in number leading to important unanswered questions about the reasons behind the poor health of that sector.\textsuperscript{142} The downside of using SIEs in Ukraine is that such entrepreneurs lack the experience their counterparts in developed economies have. They lack tools that allow them to assess their own place in their relations with bureaucracy, and the language to put the difficulties into common terms. Another downside is the difficulty in tracking down and interviewing enough individuals who fit the profile of SIE able or willing to be interviewed. Expanding the sample would have greatly increased the scope of the study. The efforts made to take into account regional diversity would also have benefited from a larger sample.

\textit{Methodology}

The adage “if I only knew then what I know now” is undoubtedly repeated in every researchers mind during the closing stages of any study. Having established the methodology \textit{a priori}, based on literature, the rigidity of the initial structure was loath to consider methods and models emerging from the investigation.

The interaction between enterprise and bureaucracy is an enormous subject that can potentially take on vast dimensions. The amount of data necessary for a case is never certain though the accuracy versus the amount is a balance that needs to be carefully maintained. Moreover, responses received and interpreted need to be verified for accuracy. The

\textsuperscript{142} The poor health of the Ukrainian SIE sector is characterised by the State Committee on Enterprise Development and its comparisons with other transition economies namely neighbouring Poland over a similar
logistical difficulties in maintaining a correspondence with small operators cannot be dismissed. Third parties, experts in enterprise development as well as observers of Ukraine's economy, were asked to corroborate interview material, as a result the material in the cases present a relatively accurate interpretation of the positions of both the SIEs and the normative materials.

There is more to the development of enterprise than quantitative data and survey results. The researcher was interested in presenting a sense of the relations between SIEs and bureaucracy and offering a glimpse of where the difficulties lie but more importantly what effect they have. A quantitative study may be useful to complement and to help validate the findings of this study. Moreover, it is believed that using the methods employed here, other researchers would obtain similar findings and reach similar conclusions.

**Treatment of findings**

The use of qualitative research raises questions about the generalisations derived from data. A continuously changing legal and regulatory environment does cause some difficulty in making the findings relevant to policy makers. If however, the findings are taken as examples of the potential strength or weakness of elements of an interaction, then the method to examine the cases can be applied to structuring new regulations. Further, the conclusions also indicate broad areas where attention needs to be focussed over many ministries and bureaux, thereby increasing the value of such a study.
The structure of this study was not dependent on a single country profile. The application of the research model on other countries is feasible. A broader study with a multinational dimension would serve to enhance the findings of the individual country cases, and offer a wider spectrum of insights and interpretations. The broadening of such a study to other economies has the potential of generating a matrix of patterns across political borders thereby opening possibilities for finding solutions to problems, rather than merely findings.

To sum up, the thesis used a broad approach to explore the relations between enterprise and bureaucracy in Ukraine. Given the limitations noted above, the key conclusions appear strong.
Ch VI, Appendix 1.

Guide questions for interviews.

Note: For reasons given in this chapter, the interviews were unstructured but generally followed this line of inquiry.

Questions for interviews:

1. Among the following interactions with government agencies, which did you undergo? (registration, certification, obtaining a sales permits, tax inspection, fire inspection) - [for each agency dealt with, do a separate sheet as an individual interview]

2. Describe from your own perspective, the procedure you went through to get (appropriate document) from (appropriate agency)
   - What was the cost?
   - Was there an officially stated cost?
   - How much time did the procedure take?
   - How many visits were needed to complete the interaction (per/an., per/mo.)?
   - Did you have to pay anyone informally?

3. What effect did this interaction have on the daily operations of your firm, on its financial status?

4. How do you see this affecting your business' development?

5. What have been the biggest difficulties in dealing with government officials?

6. What strategy do you use when approaching the government for service or assistance?

7. Did you find the behaviour of officials to be consistent – could you form a strategy for dealing with the officials?
Respondents business activity

- B1 - grocery/hastronam
- B2 - accounting
- B3 - funeral home
- B4 - medical equipment/services
- B5 - dating and travel (matchmaking services)
- B6 - legal
- B7 - vendors
- B8 - food and beverage (preparation and sales)
- B9 - IT
- B10 - food and beverage
- B11 - travel agency
- B12 - business consulting
- B13 - IT
- B14 - business consulting
- B15 - real estate
- B16 - vendors
- B17 - vendors
- B18 - insurance
- B19 - business consulting
- B20 - clothing/fashion
- B21 - fine art
- B22 - surgical/dental equipment manufacturing
- B23 - IT
- B24 - IT
- B25 - prefab building construction
- B26 - language school
PART B - EMPIRICAL RESULTS

This part introduces the empirical work starting with data presentation. Specifically, this chapter exhibits the case studies. The first section of the chapter explains their structure and their intended place in the overall thesis. The second section is made up of the cases themselves.

Five chosen case studies are structured as suggested in business administration methodology literature of case writing. Leenders and Erskine suggest an approach that allows for easier pattern matching and cross case comparisons. The parallel construction of the cases will make the subsequent analysis more manageable. The cases are also set up in a manner that will allow any cross case referencing orderly and clear. As explained in the methods chapter, the cases are the principal unit of study each dealing with a single interaction point between SIEs and the bureaucracy.

---

Cases are divided into two sets of interaction types. The first are interactions based on obtaining documentation from official structures. In these interactions the enterprise comes to the offices of the bureau to obtain the required documentation/services. The three interactions examined are official registration of a firm, standards certification, and sales permit registration. The second set is based on interactions where the bureaucrat comes to the enterprise to perform an interaction. The interactions used here are inspections for fire safety, and tax inspection. Each of the five cases follows a similar structure in order to assure continuity of structure and information.

The case studies are made up of five segments. The first is a brief overview of each interaction case acting as introduction to the case. The second introduces the interaction within its operational context. This is followed by a third segment providing the legal background and a review of the prime legislative sources for the case. Following that is the normative description of the case. This segment takes most of the information from the legal documents and regulations as provided by the official organs as well as information obtained from officials through interviews conducted while in Ukraine. The fifth and final segment is the positive version of the interaction as determined through experiences of the entrepreneurs interviewed during fieldwork. Both the ‘normative’ and ‘positive’ segments are subdivided into the element parts of the interaction as described earlier in chapter VI on methods.

The elements addressed in each case also follow a consistent structure but specifically determined for each set of interactions. The “documentation” set, in which the onus is on the enterprise to initiate interactions such as official enterprise registration, standards
certification, and sales permit registration, examines five specific elements. The first is the “paper chase” this includes matters of information such as the documents required by the enterprise to initiate the interaction, the availability of applications, information leaflets, and official documentation. The accuracy of these documents as compared to information provided by alternative sources of information, along with ease of access to the documents is also examined. Finally within this element, the process of submitting the documents and applications to officials is touched upon. The second element looks at the financial matters including official charges, informal payment and the question of who to pay. The third element is access, be the access to the bureaux, to the individual officials, or to the interactions itself. The fourth element examines the time involved in the interaction. More specifically the amount of time required to complete the interaction, the amount of time spent waiting at the various bureaux, the frequency of visits, and the level of communication with the bureau during the interaction. The fifth element in the cases looks at bribery. Element six is the behaviour of officials during the interaction. This examines the attitudes of the official towards the entrepreneur and the firm, as well as their behaviour in carrying out their mandated tasks. Finally, this element looks at the key value of public/citizen engagement.

The second set of interactions (inspections) demands slightly different elements to be examined though the fundamental questions are for the most part the same. The first element is the same as in the first set. The “paper chase”. With these cases however the issues examined include the process of selection of firms for the inspections, the general availability of information, the accuracy of that information, and the actual notification of inspection. The second element focuses on the inspection itself. Among the issues are
surprise inspections, the moment of arrival of inspectors (identification and announcement),
the premise inspection, and its duration. The frequency of inspections is also examined and
leads into the third element of the ongoing relationship with the bureau. The repeat
inspections are examined as is the appeal process and the communication arrangements with
the officials. The fourth element is the financial payments related to the inspection. This
examines the officially determined fines and penalties associated with inspections. This
element also takes on the issue of alternative arrangements between the enterprise and
bureau. The most common such arrangement is bribery. The issue of whom to pay is also
considered under this element.

The final element under inspections is that of behaviour of officials. Of particular interest in
this element is attitudes of officials and perceptions of those attitudes by enterprises.
Though there may be little by way of legal documentation concerned with this, the
behaviour of officials is often the rationale behind the spirit of the legal texts. Provisions
for inspectors are also examined within this element as well as behaviour being a key value in
public engagement. In many instances the way in which an individual is treated during an
interaction with an official, will determine the perception of that individual about the nature
of the interaction itself.
CHAPTER VII - REGISTRATION:

A SIMPLE PROCEDURE OF DELAYS AND COSTS?

CASE STUDY 1

Introduction

Almost all legally operating companies in Ukraine, regardless of their area of entrepreneurial activity, require official state registration. The exceptions, of which there are a few, will be examined in the case study on sales permits. Procedures described in the regulations apply to all small independent enterprises (SIEs) in Ukraine. Therefore, their experience in this interaction has been broad. This makes the registration process a useful opening case study in the examination of interactions between government bureaucracy and enterprise.

The immediate and obvious difference between a company that is legal and one that is not, is its registration status. An officially registered company is one that is listed with various relevant ministries and organs of the government. The firm is a participant in the official economy of the state. It contributes to the nation’s revenue through taxation, its sales figures are reflected in the official statistical data, and the risk to potential consumer is low because certifications are required and there are inspections of its activity. Registration offers benefits such as the right to register a corporate bank account, legal protection of entrepreneurial activity rights, and the added marketability that legality adds to business practice. Labour laws protect employees of such firms. Labour councils work towards the
promotion of the interests of employees of registered firms, which include pension schemes and remuneration negotiations. A commonly asked question is therefore: Why would a company not register? For many, rights and privileges of the registration are very attractive. For others, the fear of increased government scrutiny or excessive taxation of income has led them to the unofficial market. In addition, difficulties in the registration process itself may exist. In many ways the official registration process is the starting point of a relationship with the government that many do not want or one they fear.

For most entrepreneurs however, it is a conviction that registration with official structures leads to difficulties. Indeed, this appears to be the case with such difficulties varying greatly from one business to another and may include a lack of information to the registrant, high, arbitrarily determined costs, and a drain on time and energy resources to complete the process. For some, therefore, these difficulties have been the reason behind not registering, for others the process has been difficult but not to the point of preventing them from pursuing their activities. Yet, for others still, the process has been simple and without difficulty at all.

Background

Before 1989, there were no legally sanctioned private small enterprises of the type examined in this thesis. It was only under Gorbachev in the last years of perestroika that provision was made for some private concerns to begin operations. With that change, the process of official business registration was initiated. The registration of joint ventures was more
common than any other form of registration during the first years of the post-Soviet era. Soon to follow were registrations of foreign firms and representative offices. The registration of domestic small enterprises began relatively late and has only grown in the last five years. The law On Enterprise passed by the Verkhovna Rada in February 1991 set the preliminary groundwork for registration. In conjunction with the Law of Ukraine, On Enterprises in Ukraine (September 1991), along with documents of the Cabinet of Ministers, procedures for official registration began to be developed. Despite the rapid need for preparation of the laws after the collapse of the USSR, there was a significant time lag before small businesses were being registered en masse. According to Natalia Prokopovich, the first years of Ukraine's independence were lean times for legal business development and it was not until 1994 that the number of registrations of small enterprises in Ukraine began to grow in earnest.\footnote{Natalia Prokopovich, Head of the Department for the Support of Foreign Investment and Economic Activity of Entrepreneurship, State Committee of Ukraine for Entrepreneurship Development. Interview: Kyiv (March 1999). Prokopovich stated that business registration figures grew relatively more than before 1994, but also added that such growth was not exceptional when compared to Poland or Hungary, or even to Russia.} According to the State Committee for Ukraine on Enterprise Development, in 1998 the total number of registered enterprises in Ukraine was 396,000 (in 1994 - 145,000). Of those, only about 100,000 were recognised as productive firms.\footnote{Prokopovich interview} Prokopovich suggested that the figure for small and medium sized enterprises was “close to 140,000.” In close confirmation the World Bank’s own figures put the number of small and medium sized firms in Ukraine at 148,000 in 1998.\footnote{Prokopovich interview} In addition to this, figures for the same 1998 show that there were just under 900,000 single proprietor businesses in Ukraine, these not needing official registration.
Part A: Normative

The fundamental elements of the procedure of enterprise registration are set out by the laws ‘On Enterprise’ and ‘On Enterprises in Ukraine’, passed by the Verkhovna Rada in February 1991 and March 1991 respectively. 147

The Law On Enterprises in Ukraine makes two general points about registration. The first, in Article 5 titled ‘General terms of creating an enterprise’, introduces the idea that an “enterprise assumes legal status (rights) on the day of official state registration.” The second point, the entire 6th Article titled ‘State registration of enterprises’, explains that “state registration of enterprises is effected in compliance with the Law of Ukraine On Enterprise.” 148

The Law of Ukraine On Enterprise elaborates on the points above regarding registration. This paraphrased translation of the relevant sections provides details about the procedures.

Ukraine Law On Enterprise
Section II article 8
State registration of enterprises is done in the executive committees of the city council, the raion council office (within the city administration) or in the raion office. Also in the raion administration offices of Kyiv and Sevastopol (further read as Organs for State Registration), according to the location of enterprise if not otherwise stipulated by the law.

147 Law of Ukraine On Enterprise (Закон України Про Підприємництво) (7 January 1991) n. 698 XII, BBP, 1991, Article 5, line 4
148 Law of Ukraine, On Enterprise, Article 6
For state registration of the enterprise, the following documents must be provided to a state notary:

- Agreement by the owners or legal representative agents thereof, regarding the creation of a legal entity (except in the case of a private enterprise). If owners or agents number two or more, the document required is the contract and protocol of the inaugural meeting.
- The statute, if necessary to the establishment of the particular form of enterprise.
- Registry card, which at the same time is also application for state registration.
- Document proving payment to the enterprise's capital fund in the amount specified by the law.
- Document(s) proving payment for state registration.

Section II article 8
Citizens wishing to establish a firm without creating a legal entity must submit a registration card which serves as application for registration, a copy of the certificate confirming adoption of the identification number for taxation and other obligatory payments, and document which proves payment for state registration.

Place (location) of enterprise activity on the date of registration can be the address of one of the founders, or another location, which is proven by a lease (rent) agreement or other appropriate documentation.

The OSR is prohibited from demanding of the registrant any documentation not specified in this law.

State registration of enterprises is based upon the review of documents for a period of no more than five working days. During this time it is the responsibility of the OSR to submit data from the registration cards to the registry of enterprises and to issue a certificate of state registration with the identification code (for legal entities), which is given to the OSR by the Organ of State Statistics, or the identification number of a tax-paying entity.

Officials carry administrative responsibility for meeting the terms of registration and duties of issuance of registration.

During the five day term from the date of registration OSRs are required to send a copy of the registration card with the application for registration to the corresponding state taxation organ and organ of state statistics and submit notice of state registration to organs of the social welfare fund and pension fund of Ukraine.

Certificate of state registration of enterprise and a copy of the document which confirms input of data to taxation registry, permits the opening of accounts in any NBU accredited bank in Ukraine and banks in other states, upon agreement between the bank and the enterprise.

In the event of a name change, organisational change, or legal form change, as well as a change in form of ownership, notification must be given within one month of the change. Documents must be submitted for re-registration.
Re-registration of an enterprise follows the same procedure as registration.

Responsibility for due diligence for correct documentation to be submitted for registration, falls upon the owners or agents of the enterprise submitting the documentation.

Cancellation of registration takes effect with notification of owner(s) or their agent(s) or notification of proprietor owner, and after the decision of the courts.

Cancellation of registration can be made on the basis of:
- Submission of false or illegal documents;
- Failure to notify authorities of changes in name organisational form, form of ownership and location;
- Engaging in activity contravening the laws of Ukraine and or the ‘terms of activity’ (mandat) of the firm.
- Declaration of bankruptcy (in cases foreseen by the law)
- Non-submission of tax returns, declarations, accounting documents to the taxation authorities as required, over a period of more than one year.

Fees for state registration are determined by the Cabinet of Ministers of Ukraine.

Collected revenue from fees for state registrations are distributed in a formal process as determined by the Cabinet of Ministers.

According to Ukrainian law, special registration for specific forms of enterprise may be issued.¹⁴⁹

Procedures set out in this document are further elaborated in the Cabinet of Ministers of Ukraine Resolution #276 titled “Position of State registration of enterprises” (Положення про державну реєстрацію суб’єктів підприємницької діяльності).

¹⁴⁹ Law of Ukraine, On Enterprise, Article Section 2 Article 8. Translation by author.
An individual, or group of individuals, applying for official state registration of a business, begin the process of registration by preparing documentation for submission to the OSR. The Cabinet of Ministers resolution identifies these documents as follows:

- The inception thesis of the company which include the company statute (статут);
- A letter from the owner(s) of their intent to start a company;
- And in addition, a registration card that serves as the application for registration.

According to a Cabinet of Ministers position thesis, the enterprise may be asked to provide a certificate from the anti-monopoly committee. If the applicant or one of the co-applicants is a corporation (юридична особа), that applicant must provide documentation showing this status. In the event that an entrepreneur intends to register without becoming a legal entity, three items must be submitted: a registration card (реєстраційна картка), a document proving payment of registration fees as well as a document of personal identification.

Two original sets of documents along with one copy must be prepared and notarised. In some raions the notary service is performed by the registration office prior to the submission of the application. The exception is the application card itself; it must be submitted in triplicate. When and if needed the OSR is permitted to provide assistance in filling out the applications.

It is stated in the Resolution that the OSR cannot demand any additional documentation from the applicant, nor can it make demands above and beyond what is stipulated in the Resolution.
Payment

Payment for registration has to be made at a bank, the deposit registered and a receipt issued. The cost of state registration of enterprises is elaborated upon in an addendum to the Cabinet of Ministers Resolution #276. The normative document sets out the amount to be paid for registration depending on the form of ownership and the type of business. The cost of registration is based on pre-tax minimum values (неоподатковуваних мінімумах). No other mention of the fees is made in the Cabinet of Ministers document except in determining how revenue derived from registration is to be divided among the authority structures. Fifty percent of revenue from registration is to be turned over to the municipal budget that oversees the jurisdiction in which the legal address of the company is found. The other 50% are retained by the OSR that registered the enterprise.

Once payment has been made and appropriate amounts have been entered into a statutory fund, the registration can be completed. All documentation prepared and obtained to this point is then taken by the applicant (or by a representative agent) to the OSR and deposited at a designated reception area (приймальня).

Waiting for the Man

---

150 As identified by law as a form of enterprise.
151 The pre-tax minimum values are used in a context of volatile exchange values and uncertain monetary policy in Ukraine. The pre-tax minimum value was set at 17 UAH from the introduction of the Hryvnia until the end of 1997, the pre-tax minimum value was 34 UAH in March 1999.
Upon receipt of the documentation the OSR verifies that the information and documents are in order and a file is opened with the exact time and date of receipt noted. The representative(s) of the firm are issued a file number and a receipt indicating the date and time of deposit of documentation. Applicants are then either told when to return to collect the registration certificate or that they will be informed by letter when the application is to be collected or when to expect it by post. The Resolution states that the OSR is responsible for the completion of the registration process from this point on.

According to the Resolution, the OSR is obligated to complete the procedure of official registration and to provide the applicant with a certificate of registration within a period of no more than five (5) working days. In that time the OSR must accomplish three tasks:

- entering data from the registration card onto a national database of enterprises;
- preparing and issuing a certificate of registration along with an identification code for the enterprise, and ;
- Registering the enterprise with the State Statistics Bureau. The information provided by the applicant is also shared with the State Tax Service, the state pension fund and the social security fund and the Ministry of the Interior.

The information provided to all of these bodies is the basis upon which company stamps, letterhead and opening a bank account can be completed.

Getting it all Back and Moving on

180
After five working days the applicant is to receive from the OSR the original certificate of registration plus three official copies as well as the original initial application package of information along with one copy, both bearing the OSR's stamp. Re-registration, adding supplementary information or obtaining duplicates follows the same basic procedure as the initial registration.

According to officials interviewed, the registration process is simple and well documented. (G1) The process is fair and without intent to make registration a chore: The only interest is to maintain order by documenting statistical data of the companies and, more fundamentally, to inform the taxation office of new businesses.

The OSR version of the same document appears to be a paraphrased brief of the original found in the Business newspaper *Halytski Kontrakty* (Галицькі Контракти). Although little appears to be omitted, there are some minor points that are not as clearly stated in the OSR version.\(^{152}\)

As noted above there are differences in the versions of the Resolution available. The version of the Cabinet of Ministers Resolution provided by the OSR lists only three specific documents needed from enterprise. The original resolution as found in the business press, lists the same three documents with the addition of two more, including a document proving

---

\(^{152}\) The importance of noting this minor discrepancy is that part of the difficulty between business and government lies in access to information. While it would be simple to verify the original document as put out by the Cabinet of Ministers, it is more useful to this paper to examine the documents in the form they appear in the sources used by either business or the OSR. The experience of interviewees from both sides suggests that it is impossible to get the official documents from the Cabinet if Ministers. For this reason business relies on the publication of many of these documents in several business magazines, and the OSR either receives a
payment of funds into statutory accounts as well as another document from the antimonopoly committee approving the creation of the new enterprise.

The next point (paragraph 7) deals specifically with entrepreneurs who intend to register without creating a legal entity. It lists the three requirements for such registration:

- submitting a registration card (рєєстраційна картка);
- proof of registration fee payment, as well as;
- A document of personal identification.

The published version of the Resolution makes it clear that the registration card also serves as application for registration, a detail not specified in the OSR version.

Officials at three centres said that they base their internal procedures on the law and resolutions there is no cross reference between OSRs according to one director of OSR (Pechersk raion) they cannot afford to link up with other OSRs although there is a plan to do so. There has been some indication from the interviews that attempts at dialogue between SIEs and officials have been made and met with limited success. Certain OSR have tried to organise public seminars about starting businesses. According to interviews it was though that such dealings with business were best left to business incubators and business associations.

Part B: Positive

single copy from the Cabinet of Ministers or they create a facsimile from the Verkhovna Rada law or from the same business journals read by entrepreneurs.
Of the SIEs interviewed, most felt that in general, the registration process was simple and straightforward with no particular difficulties, although there was some divergence in that opinion. Registration is perceived to be a simple procedure, relative to others (to be discussed in the next case studies), where there is not much scope for complication. About two thirds of SIEs interviewed commented that registration was not a problem. "Registration is a relatively easy procedure." (B3), "There was little trouble registering the firm" (B10), "Registration being difficult in Ukraine is a bit of a myth. The [international organisation] had some difficulty in registering its business centres; the process took up to half a year. Several articles were published describing the cases and this has led to some misperception. The truth is that the process is not all that complicated. The [international organisation's] case was particularly difficult owing to changes in the status of the centres and the poor management of the project." (B13) "When we registered the procedure was simple" (B21) "excellently" ("підмісто") (B 23), "There was no problem registering our company, no, no problems" (B22), "Registration? Without problems"("Без проблеми"). (B24)

No single interviewee who had gone through the process indicated that the whole procedure of official registration was an outright problem. Several did however, indicate difficulties within some steps of the registration.

_Paper chase – Documents and Applications_ 

In the quest for official registration, obtaining and preparing the correct documentation is a first step in the relationship between business and bureaucrat. For most businesses interviewed, the process begins with a search for information, predominantly based on word
of mouth and the experience of others or through the business press (*Halytsky Kortrakty, Bizness* – two leading Ukrainian business publications). The main concern for most is getting accurate information and information that is up to date. “I know that each law has two parts, there is the formal written part and there is the way in which it is practised. The [laws] should spell out the procedure as ABC. The truth is that it rarely does.” (B19) “There are so many changes it is hard to know which version of the process is the current one, we are vulnerable that way” (B26)

In their search for a source of reliable information most business people avoid going to the OSR to learn about the registration process. “The information is published in Bizness. We can get all the information there. It’s much more reliable than going to the [OSR]” (B1) “Applications and information are all published by commercial publications, that is the only reliable place to get them. You go, you buy it, what you need is there and you go on. ("Пішов, взяв, е те що треба і пішов далі.")” The [OSR] however, would often use different procedures. That’s how it used to be, now it is much better.” (B3)

Remarkably, there is a current of surprise that people would even consider a government agency to be a reliable source of information about registration: “Some people look for problems in simple matters. Registration for example, you can go and get everything you need from the kiosk [in print]. Why go to the OSR if it is well known that they won’t have what you need there. Go where you know you’ll get it.” (B8)

Collecting the correct documentation and preparing it is obviously a serious topic of discussion and concern for start-up enterprise, some have seen the opportunity to set up a small enterprise that would help others through the registration process. “We hope to be able to provide our clients with a new service which would provide a business one stop business set-up centre with information and all the documents. For us this would be easy to do. For a businessman, keeping up with the procedural changes is the hard part.” (B8)
This is parallel to the opinion of officials quoted above, who feel that it is not their task to inform the general public about the procedure. Clearly, the bureaucracy does not consider facilitating information flow as their primary task. Moreover, it is here that expectations of entrepreneurs towards officials are so low that they consider the outcome satisfactory, even if there is a large gap in both time and financial cost between actual and official versions.

Some businesses decide that there is simply no sense in trying to figure out the registration procedures themselves and rely on a business centre or a middleman of some sort. “I went to a firm that specialises in registration. They provide me with a legal address and a legal name, if I don’t have one. I pay them a small fee and they stand in the queues for me. Very soon my company is registered without trouble to me.” (B17)

Once the entrepreneur is satisfied that the information is correct the preparation and collection of documents begins. “It took a while for the documents to be collected, but there was no real trouble getting them” (B22)

Most businesses interviewed felt that the process was reasonably simple, though a time consuming one of collecting the correct documentation. There were, however, admissions that any complications in the initial stages might have been the fault of the applicants: “Documentation takes some time to collect but that is our duty, we have to fill in the application. Delays are often our fault because we are slow in filling out our applications.” (B23) The perception from both sides is that it is not the task of the bureaucracy to make procedures easy and facilitate the
process. In general, not much is expected from officials, they are not perceived as public servants.

Payment

The formal costs being those stated by document or by officials as the cost of registration appear to be either misunderstood or misrepresented in the information received by the SIEs. “Registration will cost 23.80UAH, not too expensive.”(B5) “For $100 registration can be done in two days.”(B6) “The cost of registration was 60UAH, which the official probably pocketed.”(B10) “Registration, the law says it should be $125(1996), I managed to pay only $60.”(B19) “The cost to register is low, about $50.”(B21) “I paid about $30, but my friend had to pay more. Maybe because he is registered in a different raion.”(B23) None of the SIEs mention the payment scale found in the Cabinet of Ministers document nor had they been shown some version of such a scale. This provides ample scope for corruption.

With delays come “informal costs” are an option used as a means to avoid long delays. Some SIEs have commented on the use of informal payments to speed the processes of registration: “Normally it takes up to 60 days for $100 it will take two days.”(B6), “If a bribe is paid, it can be done immediately, if not it can take several weeks.”(B19)

Waiting for the Man
The head of the SME department in one raion OSR asked “what could possible delay a registration?” (G1), the assertion being that the process was clear, simple and free of graft. Some enterprises however, had contradicting experiences. Before the application is submitted each company is notified that a notary must approve all documents. This process is not required by the normative documentation but without it the application is invalid. Many applicants are directed to a notary operating in the same building as the registration office. According to one OSR clerk, “It is convenient and we know that notary can be very helpful to our applicants. Another notary may not be as familiar with the requirements or the documentation.” (G1)

In some instances the OSR is said to have turned away applications because the OSRs had not seen the documents designated notary. Normally a stamp from any accredited notary is sufficient. There is evidence that in the case of one raion the OSR and the notary were colluding to collect fees from each application submitted, but this may also be the case in other raions as well. Most respondents did not mention the notary as part of the registration process. It can be assumed, for the most part, that the notarisation of their documents was simple and without difficulties, though it should also be assumed that the financial cost of notarising documents must play a role as well. “All the documents were in the right order, and the notary merely had to verify them.” (B10) One respondent appeared to have delays with the notary, “The lawyer is still reading the thesiss and will tell if they are in order in a few weeks.” (B5)

Selecting the OSR and the raion most convenient for a business is important as some raion registrations are more efficient and trouble free. It must however be noted that only in large

153 Reported internally within the State Committee for Entrepreneurship Development. Prokopovich interview.
centres can such choosing of raions be possible. The propiska system prevents individuals from moving at will. This makes even travelling to and from a different raion office complicated and likely to discourage distant registration. One Kyiv raion is particularly well known for its implementation infringements. Most applicants recognise that they have to be careful in selecting the raion for submission of documents. “Registration is a straightforward interaction in Ukraine. There are some problems with individual companies or even in certain districts, but if you choose strategically there should be no trouble.”(B15)

Most problems for SIEs involve delays and waiting for the registration to be issued. “A business can be ready to work but it has to wait one month during the registration process. If there are any changes to the application, another month of waiting is tacked on.”(B2) “The registration documents have not been approved yet...”(B5) “Normally it takes 60 days to register a firm.”(B6) “It took about two weeks.”(B13) “We know what the law says, but it has been known to take up to two months.” (B23)

The waiting may also include returning to the OSR several times before the documents are issued. “The registration procedure has taken about 15 separate trips. Each trip requires several stops to different offices and from one official to another.”(B5) “Registration took two visits.”(B17). For some the number of visits, though more than one or two, was a welcome delay; welcome in the sense that it wasn’t longer. “Registration was easy, it only took a few visits, that’s because the documents were not all in order.” (B10)

*Getting it all Back and Moving On*
None of the SIEs commented on additional requirements from the OSR upon receipt of the registration certificate. There were also no comments on the need to return to the OSR for repeat visits. None of the SIEs interviewed had made changes to their registration. Several had suspended their registration but without having officially “de-registered” It is more than likely that the registration of these companies has been cancelled from the State Registry of Enterprises, though the SIEs did not indicate if they had been informed of such cancellation.

*Behaviour of Officials*

There was little comment made about the behaviour of officials in the OSR with the notable exception of the behaviour of staff at the OSR in a Kyiv raion. The example is notable because it was volunteered by the director of another OSR rather than by one of the firms registered in that raion. “[Name of raion] is particularly bad for business. The registration office will immediately send all the information to the tax inspectors in the raion, and they also send information about new companies to other officials who are linked in rackets. The director of that registration office approves applications himself however he is rarely present and the backlog is huge. Registration there involves one question to the applicant: What kind of business are you opening? This question is asked out of pure interest only. The information somehow finds its way to the racketeers in the raion.”(G1)

One entrepreneur commented about questionable behaviour saying that “the process of registration should have cost 300 Roubles [1992] but the official suggested that I pay 40 roubles to him directly. I offered him 5 extra Roubles to do the registration without delay.”(B3) The process was completed three days later and confirmed by a notice from the Ministry of Statistics. Only one other
voiced suspicion that officials were being less than honest in their task, "The cost of registrations was 60UAH, which the official probably pocketed." (B10)

Non-registered Entrepreneurs

Among those who, in normal circumstances, need official registration, some refused to register. The principal reason was that there was a perceived loss of independence that came with official status. "I simply did not want to be registered, this allows me to be my own man" (B3) "I am afraid of what will happen to my small income if I register" (B20) "I won't register, I don't need it" (B25)

It was the opinion among non-registered SIEs that the registration process was corrupt and that the complications for their own enterprise would begin with official registration. A number of interviewees were concerned with what registration meant to their company: Some felt that registration and its subsequent link to other state bodies was a catalyst for further negative intrusion of other government agencies. "I once owned a company that was registered, that caused too many problems (...) too many officials came to see us." (B4) "Registration brings the tax inspector the fire inspector and the others. Why would I want to invite them to see what I do?" (B24)

Among the interviewed businesses, several registered through 'middlemen' companies that offered full registration packages for a substantial amount of money, but resulted in a hassle free process. All who chose this option commented unanimously that their main concern was to have as little to do with the bureaucracy as possible. They suggested as well that it was better to have someone expert in the process find their way through the regulations and
procedures and to do it right the first time than it was to waste their own time stumbling (блукати) through the process.
CHAPTER VIII - STANDARDS CERTIFICATION

CASE STUDY 2

This case study stands out from the others included in the thesis because the interaction described may not be experienced by every firm doing business in Ukraine. In the sample of enterprises only 8 firms were subject to the certification interaction.

Introduction

Licences are required by enterprises trading in products specifically identified by regulations, any imports unless exempted by law, or by firms producing any type of consumer good. Two types of standards certificates are issued in Ukraine for those firms that require a certification: compulsory and voluntary. Their designation is related to the specific good produced and many enterprises fall into either of the two categories depending on their business activity. According to Ukrainian business associations, few small independent enterprises chose voluntary certification, making that category relatively insignificant to the case and hence not included here. This case therefore, considers all relevant business activity as having to conform to the certification procedure. Although the certification may not apply broadly, the process by which certification is obtained is similar enough in most cases. For that reason they can be lumped together in one group.
This case study will examine the process of certification by the State Committee of Ukraine for Standardisation and its agencies otherwise referred to as Derzhstandard. Other standards may be set and certification administered by other departments, the responsibility for national standards, nevertheless, falls under the jurisdiction of Derzhstandard.

The procedures described in the case are general and where possible, applicable across the spectrum of compulsory certification. Specific certifications may, however, be cited as examples.

Background

Certification of products and the standardisation of production were part of the Soviet Union’s trade and industry legislation tradition that included membership in the International Standards Organisation. The Soviet era legislation was adopted by Ukraine following independence and was maintained until the reform of the Soviet system of standardisation in 1993. The reform was a response to the social economic crisis facing the country making necessary new mechanisms of market and state regulation for goods, services and industrial production. Over 500 laws, decrees and normative acts currently regulate the standardisation procedure. The principal documents governing the certification procedure however, is the Decree of the Cabinet of Minister of Ukraine, On Standardisation and Certification, 10 May 1993. Details of the procedures vary slightly from one type of certification to another, each having its specific regulatory/normative document. It is primarily these documents that will be used for the case study.
The current system of standardisation has since 1991, come under attack particularly from international organisation representatives as well as multinational branch offices in Ukraine. Their prime concern has been that Ukraine’s standardisation system has been slow to reform procedures that permit foreign produced goods entering Ukraine. Derzhstandard has been unequivocal in its response. Their task, according to the former head of Derzhstandard, has been to protect the consumer and to prevent the dumping of poor quality goods on Ukraine’s market. “We [Ukraine] are a target for poor products. Our population craves western goods. But often we are unable to tell if a product is good or badly made or if it will harm our children in any way.”^154 The function of Derzhstandard - protection of consumers - applies to small independent enterprises indigenous to Ukraine too. The procedures to which they are subject are intended to protect the consumer. How they affect the producer however, needs to be examined.

Part A: Normative

As noted, the principal document that regulates the standardisation procedure is the Decree of the Cabinet of Ministers, On Standardisation, was brought into law by the Verkhovna Rada in June 1997. Of specific interest to SIEs is their direct interaction with state officials, a matter addressed in several key articles. Among them, Article 12, affirms that Derzhstandard is to provide information on issues related to the national standards of Ukraine, international

---

^154 Tatiana Kisilyova, Director Derzhstandard, speech at the meeting of the American Chamber of Commerce in Ukraine (March 17, 1998)
standards, classifications, and certification, including the order of issue and responsible agency. The Decree defers additional information about each of these to the normative documents of each certification.

The two forms of certification noted above are addressed in this Decree as is the criteria that determines compulsory and voluntary certification. The details of 'compulsory' is also not detailed in the Decree and it is up to the normative acts of specific certifications to determine.

The Decree also addresses the matter of fees. Article 19, Fees Related to Compulsory Certification of Production (Оплата робіт пов'язаних з обов'язковою сертифікацією продукції), states that fees include payment for all tasks related to compulsory standardisation. This includes preparation, expert analysis, accreditation, testing, control and registration. Furthermore, all payments for certification are included in the net value for certification. Finally, fees related to certification are determined by agreement between the applicant and the executor of the certification. Section V, Article 23 of the same document identifies the sources of funding for Derzhstandard as the state budget, assigned foreign currency and loans from financial institutions, special projects, and fees for certification. Revenues from fees paid by enterprises are divided for two purposes. The first to cover immediate costs of service provision (wages and office costs), the rest for research, technical development, and international co-operation on standardisation.

155 Український науково-дослідний інститут стандартизації, сертифікації та інформатики. Сертифікація в Україні: Нормативні акти та інші документи, vol. 1. Cabinet of Ministers of
Set procedures are described and can be found among the many specific certifications. Although there are details particular to certain certifications, the general procedural steps are essentially the same. In the 1996-1997 period more than 105 substantive changes, in the form of amendments to the laws were made requiring enterprises undergo new verifications and obtain additional licences from various ministries, committees and other authorities.  

Paper chase – applications and documentation  

Each certification is described by a normative document that determines the specific requirements of the certifications. These are based on a second key document titled Procedure for Certification of Products (1 April 1997). The broadly stated procedures established by this document serve as guidelines for the certification agencies to establish their own modus operandi and setting requirements for certification applicants.  

With respect to documentation, this general procedural act states that the applicant must submit the relevant documents for an inspection where the completeness, correctness, and compliance with new changes are verified before they are registered as an official application for certification. Once the inspection is passed the application is registered and the certification process begins.  

---  

Ukraine, Decree On Standardisation and Certification, #46-93, Article 19, Lines 1,2,3 (May 10, 1993) 10  
156 Orest Danelevych, director, Lvivinaudit auditing company, personal interview (March 1998)  
157 The requirements for documentation for application are assembled from several regulatory acts covering different certifications. Держстандарт України, vol. 1 (1998) 109, 152-3, 267, 286-7, 317  

196
The documentation for application includes the application form and a testimonial document confirming intention for domestic production. For the application to be formulated the certification application procedure the registration of the enterprise must be complete and the registration number of the firm must be included in the application for certification.

Applicants are obliged to provide information about the name of the company, its officers and a legal address. If the firm’s registration code is unavailable the applicant simply indicates the date of application for official registration. A letter guaranteeing the “existence” of contracts ensuring continued production capability must be included as well as a comprehensive list of the technical process of production, a description of conditions required for production, and a copy of protocols of periodical factory testing of product. If these already exist from manufacturers of parts or components, they also need to be included in the application. Other documents may also be required depending on the product or its component parts. In some cases such as electronic goods, counting machines, and computers, the operational handbook/instructions are also to be submitted. If a product is made in a series specific documentation attesting to this must also be submitted. In the case of computers, the manufacturer must provide a detailed description of any component parts that may be added to the computer and used by the consumer (monitor, keyboard, printer, software, etc...).

Once the documents are collected they are submitted to the certifying body (If the process requires certification from more than one body, the applicant may submit documents

158 Держстандарт України, vol. 2, 216
without following a specific order). Verification of correct and essential documents completed, their registered opening of an application file completes the submission process.

*Payment:* 

In an April 1997 *Derzhstandard* procedural document it is stated that tasks related to the certification of products are to be paid by the applicant. This is reiterated in the Decree of the Cabinet of Ministers of Ukraine, On Standardisation\(^\text{199}\), Section IV, Article 19, stating that “Payments are required for all tasks related to the standards certification process including preparation, expert analysis, accreditation, attestation, testing, control and registration.” Both documents further state that the payment made by the applicant for certification is part of the cost. Finally, both documents state that cost of certification is determined by agreement between the applicant and the executor (*Derzhstandard* or its agent bodies) based on the tasks required for certification of a product. This is the only mention in available procedural documents of *Derzhstandard* that details the set value of tasks that may be used in certification.

The April 1997 *Derzhstandard* document includes an appendix labelled “recommended” or *(рекомендований)*, which includes several formulae as a basis for fee negotiation; the type of certification is also a factor in setting fees. The formulae are based on the time and monetary value of a variety of tasks required for the completion of the certification. Each task is pre-assigned a set norm of time and cost. While this is the basis for the *Derzhstandard*
negotiation, there is no means of determining if the formulae are applied as described. Equally important, it is unclear from the document what recourse the applicant has in the case of disagreement over the fees.

Waiting for the Man

Once Derzhstandard is satisfied that the application is in order, it is registered. According to documents it should take no more than 15 days, from the date of registration at the bureau, to reply to the applicant as well as to the testing laboratory with a decision on the case.\(^\text{159}\)

The decision amounts to the development of a certification program for the product in question, which may include additional analysis, attestations, and controls. The agency also determines the most appropriate testing facility within its system, number of samples to be tested, a mechanism of sample selection, and criteria and aims of the testing process. Finally, the normative acts explain that Derzhstandard and the applicant come to an "agreement" about the timeline and the value of the tasks needed for the certification.

The normative acts offer no other indication of time required for completing the verification of products in laboratories.\(^\text{161}\) Any single Derzhstandard established process for certifying of

\(^{159}\) Decree on Standardisation, 12

\(^{160}\) Порядок Прохождения документів у центральному апараті МЗЕЗторгу України для видання ліцензії на право імпорту, експорту спірного етілового, коньячного і плодового, експорту, імпорту алкогольних напоїв та тютюнових виробів (17-06-96, #343) Держстандарт України, vol. 2, 487. 15 days in alcohol and tobacco related items but in some instances such as building materials, electronics/computers, and transport equipment, the decision can take up to one month.

\(^{161}\) Similarly to the payment structure, the timeline is determined in part using the "recommended" appendix, which includes a schematic of time required to perform particular tasks.
a specific product might only be used three times on a particular product in a single calendar year.

Getting it all Back and Moving On

Results of the certification process are returned to the applicant in the form of a manufacturing certificate. Corresponding copies are forwarded to the other verifying bodies of certification, as well as to Derzhstandard, the co-ordinating body for the process.

The certificates have time limiting validity requiring producers to reapply every one to three years depending on the product type and its certification. Derzhstandard, even monitors some products continuously after sale even (as is the case for electronics and computers). The regulations regarding such monitoring are detailed in the Procedure for Certification of Products. Each of the specific normative acts refers back to this document without significant elaborating on the provisions or how they affect the certification of the product.

The Act says that the agency that issued the certification has the responsibility to monitor production for compliance with certification. That agency has the authority to call upon any other agencies relevant, to assist in carrying out the monitoring function.
The head of the Derzhstandard agency responsible for the product establishes the monitoring processes, its frequency, scope, and method in question. This process involves assessment of the production according to standards set by the certification process, confirmation of the ability of the producer to manufacture goods according to the normative standards, and to make recommendations regarding the frequency and type of technical supervision required for such production. The assessment process is determined for each case.

It is important to note that Derzhstandard has the power to terminate or suspend production or it can order additional verifications or conditions as a result of the periodic monitoring of production.

No other information regarding requirements or demands from the producer is included in the acts.

Certification of Imported Goods

An additional note should be made to highlight the procedure for any Ukrainian company that importing products for resale or for added value. The normative document, On Procedures of Certification of Quality Control of Foreign Production According to Established Norms of Investigation, Attestation and Certification, establishes the order in

---

162 Держстандарт України, vol. 2, 222-23
which the procedure of registration occurs. Briefly, the process begins with the application and submission of documentation for certification. Normative documentation must be correctly registered in accordance with certification requirements. These include documents confirming origin of the product, the manufacturer's certification, and a quality certification document stating the manufacturer's responsibility for the integrity of the product. A weigh bill stating the size of the shipment and/or amount of goods in the imported lot, and other documents, may be required of the specific product being imported. Finally, one sample of packaging (without contents), or if unavailable, a product label is needed too.

Following application acceptance, an ad hoc oversight commission is created. The commission undertakes the task of structuring the analysis process, comprising of attestation, the analysis itself, and finally, certification. The sample is selected and processed in the testing site. The results are submitted to the commission. The product is registered and the certificate is issued and a legal licence for production is issued. Finally, the result of the process is returned to the applicant. Sometimes the results lead to the establishment of a policy for testing other similar products.

Behaviour of Officials

The normative documents make no requirement for officials to initiate public engagement. The State Committee for Standardisation Certification has, however, on its own initiative, attempted efforts to communicate its operations to the public. In this role, public
administration has to be replaced by private initiative. Conferences held by business associations as well as ongoing seminars are part of a wide campaign to make the duties and operations of the certification process more clear to business.

Part B: Positive

Those interviewed on matters of certification generally felt that the standardisation process was a necessary difficulty in their business activity. Many domestic SIEs see the standardisation process as protection not only to themselves but also to their clients. It is unclear if this is meant as local or nationalist protectionism, there were however some concerns raised about the dumping of poor products on an unsuspecting market. This is in direct contrast to foreign companies trying to bring their goods into the country. During spring 1998; in particular, the foreign business community was loudly voicing its displeasure with Derzhstandard for creating an environment unsuitable for their activities.

There are however, indigenous entrepreneurs who feel that the constant testing and re-testing of goods slows down their ability to work. There is also a frustration with Derzhstandard’s reluctance to accept the standards certificates of other countries especially on well-known brands. This being said, none of the entrepreneurs wanted to sell bad products and risk damaging their reputations. Certification, many stated, was helpful in separating acceptable from unacceptable goods. Some also suggested that standards protect the country from becoming a dumping ground for unwanted goods. “I don’t want to sell rubbish (свиньество) that the Poles won’t buy. Why should my customers buy it? The customer in Ukraine is very aware of bad production.” (G17) Thus the overall idea of standardisation is not one to which the
enterprises object. It is the process of applying for certification that has less enthusiasm behind it.\textsuperscript{163}

\textit{Paper chase}

The initial steps required for getting a product certified are less problematic than some other interactions, largely due to the small number of documents needing preparation. The initial step for most companies is to prepare their official application. "There aren't really many documents to put together, the application and then a sample of the good. The application covers most of the information you need." (B8). In some instances the application documents were delivered to a firm shortly after its official state registration. "They left the thesiswork for us to fill out." (B1) In other cases however, particularly where a firm has many products that need to have certified, a lawyer is hired to prepare the documents. "We have our lawyer prepare the documents. It is better that way. There are lots of forms and they need to be done properly. Better to pay the notary to do that." (B22) This is more often the case in firms that import consumer goods or those who produce several products domestically.

Many interviewees commented that filling out the application was not a complicated step, only a time consuming one that only became expensive with the engagement of legal

\textsuperscript{163} Then whole idea that the administration has to protect consumers is inherited from the central planning system. In a market economy, depending on the legal institutions in place and the cost of their implementation, competition will enforce the lions share of quality control. It is however, understood that the
assistance. The general view on the availability and access to information was by and large the same, easy to obtain when not done through official sources. The overarching sense being that official information sources are not reliable and that any officially produced information was either difficult to obtain or that one simply had to trust the word of the Derzhstandard official. "My information comes from the Derzhstandard laboratory staff." (B17) "We provide our clients with access to information about standards. We get our information at the Derzhstandard office in Kharkiv. We have a person who is always at Derzhstandard noting details of changes to any aspect of standards." (B14) "The information given to us [by Derzhstandard] is clear, and we can respect that. The law is on our side in the sense that the standard set by the government is the lowest allowable one, we exceed that with each product. We have to, it’s the reputation we have." (B22) "We bring our samples to the [laboratories] and then they tell us what changes there have been. This is easily verified in the normative acts. Our lawyer has access to that material." (B22) Other enterprises are less comfortable with the idea of taking any information from official sources. "The information about standardisation is very clear and what isn’t clear can be quickly understood once the bureaucrats come to conduct the standards inspection or when the customs agent tells you what has to be provided. The worry we have is shared with many others in “Business L'viv”. There is no way to verify if what the officers tell us is true until well after the fact. Who is going to ask for a second opinion when goods for which you bear responsibility are at risk of disappearing forever." (B8) "I don’t have the energy to look the regulations up myself, I have so many other tasks to fulfil that looking up another detail for my business is nearly impossible. I take their word – I really have no choice. Either way, If I don’t comply to what they ask, I don’t get my product checked, so I might as well do what they tell me." (B17)

A number of respondents felt that official sources of information were inadequate or untrustworthy and believed that all the necessary information on standardisation could be obtained in the business press analysis and from casual contact with other entrepreneurs.

certification process is advantageous for producers that have completed it as they are protected from new
"There is a network of entrepreneurs that communicates the regulations among themselves. They get the information from the press and from the Derzhstandard. There is lots of speculation about what is correct information and there is no way of telling what is correct and what is not. You have to be very aware of the conditions that apply to your business and work with that. I would not even take the inspector's word on the regulations." (B9) Though the press may be the most trusted source for some even show concerns about the accuracy of the information provided here, and in the end rely on their own experience as the most trusted source of information. "Most information that you need about standardisation is found in the business press. The best information comes from experience. The press usually writes about changes in the laws, but they don't always print the detailed changes of each standard." (B9)

Several respondents noted about the constant changes being made to the laws and the difficulties they posed for enterprise. "There are constant changes to the standards regulations. Keeping on top of that would be a nightmare for any enterprise although it is in their business interest to comply." (B14) "The principle guideline to follow in Ukrainian law is that officials can add to the law even after it has been passed through the Cabinet of Ministers or regional councils." (B19) For some the changes are not so much a serious problem as they are nuisances. "I think that the information is irrelevant. This is true of 90% of standardisation processes already in place. There are so many nuances and the Derzhstandard people can take absolute advantage and use the information to their own benefit. We don't dream this up, we are understanding this from what we learn from our membership." (B19) "Some changes can be ignored. What I mean is that you learn which changes are temporary and will be changed back soon. This information is critical for our members." (B14) Some see little problem with changes to the laws and actively play a role in helping establish the standards. "There are not likely to be serious changes to the law. We are in fact setting the standard for the quality of the instruments." (B22)
Almost all interviewees stated that submitting the applications is an uncomplicated part of the procedure. Most who submitted their application and documents on their own were impressed by the lack of complexity. "I arrived at the Kyiv main Derzhstandard building, they told me in which office to leave my application, there was a big office with lots of people taking forms and sorting them by type of certification needed. I dropped my application there and left." (B17) "In L'viv the application for certification goes to a main Derzhstandard office where the forms are taken and a receipt is given. Very straightforward." (B19) "As far as I am aware the system is easy in terms of where to go and whom to see about applying. There are no tricks at that stage." (B9) Similarly, "Our members have few complaints about the application process itself. It is the standards themselves which are a problem for most." (B14)

For those who employ an agent to perform the detailed steps of the certification process, there appears to be little concern at the stage of application submission. "Our person responsible for standards certification walks the application to the regional office and drops them at one of the offices." (B8) "Our person takes care of all that, they are connected with the Derzhstandard offices and the process from what I am told is simple. Drop off the application, get a receipt and leave. Nothing simpler." (B22)

One entrepreneur believed that the reason behind the simplicity of the process at this stage was the sheer number of people submitting documents. "We leave the applications at the head offices for Derzhstandard where they get processed. The system for dropping the applications off and return is pretty simple, they have lots of applicants so the machinewas established." (B8)

There was some mention at this point about knowing the right people, switi likely. Several entrepreneurs noted that knowing the right people or having people on the inside either would be or was a timesaving benefit in this process. "We have a person who is well connected in
the offices of Derzhstandard. It doesn’t get us a certificate all the time but it does get us through the queue faster.” (B9) “If I only knew someone I am sure my life would be easier. But who am I and why would they want to know me. Besides what am I going to give them?” (B17)

Paymmt

The way in which the standardisation authority calculates the cost of certification appears to be complex, and it is poorly understood mechanism by the entrepreneur. Generally, it is felt that the fees for each individual certificate is not excessively high, however, there are many other minor costs associated with the process which, when added together, amount to a significant sum. “The standardisation people told us to pay a small application fee maybe 30 UAH, and then they also wanted a fee for the laboratory work on each sample. They said that they could do the whole certification process for about 400 UAH” (B1) “The fees for each standards certificate is not high but the accumulated costs of each little certification needed to run a business is enough to drive anyone out of the market. This is happening to many Kharkiv based firms.” (B14) “We pay per brand item as well as the cost of the samples and the laboratory costs, and the registration of the brand charge. It is our responsibility to pay for it all.” (B8)

Certification costs is not an issue for small enterprises not requiring it. Those however, whose nature of business depends on certification, view the fees as high. Such costs play a significant part in their business strategy and production decisions. “The overall cost is high. It has prevented us from registering some pieces that we know may not sell well, but that we know are important to some of our clients. This hurts our business. Sometimes we can get around it by producing a small number
on consignment.”(B22) “The cost depends on whether the production of the goods is ours or if we import them. As importers, each one of our brands has to be certified. This often means that we have to limit what we sell or what we produce. It’s a balance that is forced on us.”(B8) “Speaking about our own production, our own brands are even more expensive to standardise, not only because we need to provide the same samples and laboratory work as for the imported brands, but we need to have the production premises inspected and certified, also our lines of production. It is a long and expensive process.”(B8) “It is a common problem that we cannot always afford to pay. Why do you think there is so little production going on in Ukraine.”(B14)

Occasionally, the fees are negotiated and are so high that the entrepreneur is unable to pursue the entrepreneurial activity despite the potential and the need for the product in the marketplace. “I know of many who are desperate for [this product], but I need to get a laboratory analysis along with the application and registration of the formula before anyone will touch it. [Dorshka] wants $2000. If I had it I would pay. But I have no money and no hope for producing [the product]. I have no option, but to wait, sooner or later someone will sponsor the formula.”(B17) Such issues as fees are, according to some, the reason for low levels of production in Ukraine. This notion supports the assertion of enterprise development agencies that most Ukrainian SIEs are involved in trade rather than production. “Do you think we cannot produce our own chocolate or our own preserves or soft drinks? We can but the costs of standardising often keeps those who want to produce these things out of the market.”(B14)

Most respondents understood that the fee for the certification process is negotiated on a case by case basis. In some instances there are those who succeed in getting a very good deal for themselves. These enterprises often have little complaint about the mechanism. “Because we have many items that need certification they charge us the same rate for each one. We negotiated the price with them a while ago and we agreed on an increase based on the annual inflation rate.”(B22) Other firms who face the negotiation process are bewildered by the complexity of the
calculations and the discretion left to the officials in the way the fees are determined. "The certification process requires the applicant to negotiate with the Derhstandard to determine the price of the certification process. That is absurd. There needs to be a single process; and it needs to be clear to everyone."(B19) "Costs? What can I say, everyone complains about the costs. I can't tell you what each of our members pays because the system does not work that way. There is no one fee. Everyone has to negotiate. Each [enterprise] it is different."(B14)

Waiting for the Man

Waiting for certification is almost invariably noted as a problem for companies. Of those questioned none was satisfied with the expediency with which Derhstandard was able to return documents on time. "The certification process took time. The analysis of our few samples took about three weeks meaning that the issue of the certificate was delayed."(B1) "It is difficult to say. The time for each application varies enough to make it difficult to depend on the time you are told at Derhstandard or at the laboratory."(B8) "This is another frustrating thing about the certification of products. It takes a long time and people are frustrated that they cannot get their production plans ready. Some wait months while others can get it quite quickly."(B14) "This is a good example where the procedures are not followed. There is a set amount of time for certificates to be issued, but they rarely are. People need these documents to run their affairs."(B14) "Hard to say about the time it takes. If you complain that it takes too long, it seems to take longer, if you say nothing there is a risk that they will forget about the file completely."(B14) "I lose sleep at night, does that count too?"(B17) "We spend a lot of time awaiting our certifications. Even after the testing and registration, it is only supposed to take a few days but they manage to drag it out for weeks sometimes."(B22) Though for some there are good reasons for the procedure to be a time consuming one. "For me it is taking a long time because I haven't the money to get the formula to the next
stage. I have applied for the certification, but until they get a payment the application spends time as a saucer
for someone’s tea (підставка)."(B17)

Some speculation was raised that the delays met in the process are part of a deliberate strategy
on the part of the government agency. “The time it takes to be issued a certificate is inversely related to
the amount of money Derzhstandard will get for the certification."[The more the client has agreed to pay the
quicker it gets through the process](B19)

Waiting not only means being physically present at the offices of Derzhstandard; it can also
include travel to and from the office of Derzhstandard. “I go there, it takes a few hours before I see
someone. I return home. It may only be a few hours there and back but then what have I to show for it.
Practically speaking I am still waiting because nothing has happened. It is not a straightforward matter to
wait.”(B17)

For many enterprises the procedure is not a straightforward one of document deposit and
subsequent collection. It often means several trips for a variety of reasons. “The standards
people came twice and we were required to make several trips to the main Derzhstandard offices, I don’t recall
how many, maybe two – three.”(B1) “I’ve been back to that office maybe ten times.”(B17) For some
however the back and forth to Derzhstandard is not viewed as a nuisance but is accepted as
normal practice. “People go back to the offices and ask about their applications in person. Sometimes they
may go back three, four times. That is normal here.”(B14)

Once it has been submitted, any form of communication with the Derzhstandard office
regarding the status of the application has to be initiated by the applicant in most cases.
According to their experience, the onus is on enterprises to find out when the application is
complete or where it may be in the process. “Once the process is going on the responsibility for finding out where in the procedure your application may be is entirely up to you. You can go often and monitor the process or you can forget about it after you apply and eventually you might hear about it.” (B1) “Our members tell us that the communication part of the relationship is largely one way, that they have to initiate the request for information and that they have to keep coming back to learn more about their applications.” (B14) “The normal way of finding out where your application is in the process is to keep coming back to the office and asking, they won’t volunteer the information.” (B19)

*Getting it all Back and Moving On*

In the experience of most enterprises, renewing basic certifications is not necessary. “We have not had to renew a certification on a product.” (B22) “If you have a product that is licensed, then the license as far as we are concerned is good for as long as the product is made in that manner. We tell this to our members.” (B19) Despite this however, there are two situations that do require a new certification application. The first, when the enterprise introduces new goods to its inventory of trade or production. “We were expected to have a certificate for any production of foodstuffs. If we made a type of sausage this week and another next week, we would be required to have a certificate for both.” (B1) “We require a certificate for every new product we bring in.” (B8) Second, if there is a change in the production of the good itself or in the standards set by the state. The latter, according to some may happen more frequently than expected. “This is understandable, but too expensive and inconvenient for a small producer” (B1) “[Re-certification] applies also to products that we already bring in but that have undergone some change.” (B8) “The frequency of renewal is as frequent as new innovations to the product. The problem is that the process stalls the development and
improvement of new products by the little producers.” (B14) “Unless for some reason there is change to the actual standards in which case the certification would have to start again. This is all possible in Ukraine today.” (B19) The businesses I see get their [cash registers] certified constantly. Perhaps the frequency of change to the registers is what demands this kind of constant re-calibration?” (B9)

**Behaviour of Officials**

The entrepreneur is widely suspicious of the official at Derzhstandard. Although their suspicions appear to indeed be based only on a sense of mistreatment or inappropriate attitude, there is evidence that a lingering discomfort exists in the relationship between the entrepreneurs and officialdom. “When they came to the *histrionon* they were professional but they also made us feel like we might be guilty of something. I didn’t like that.” (B1) “That depends which people you are asking about. Those who negotiate the price of the certification process are arrogant and they make the process seem like a favour, even though it is compulsory.” (B8) “There is nothing we can say to the officials – they are in charge and we follow instructions.” (B22) Some however offer theories about their discomfort in dealing with these officials. “My suspicion is that bureaucrats at Derzhstandard delay the process through greed. They prioritise the files according to who will pay more and the rest are of no interest to them.” (B14)

At the Derzhstandard offices and laboratories the behaviour was perceived to be better than it was when Derzhstandard agents were out in the field. “Calm. I can only say it was calm and professional. People behave differently among their own kind [in the office]. Out here they can do as they please.” (B1) “Laboratory people just seem to do their work. We never have problems with them. I think it may be because they can keep the samples (imported and domestic alcohol)” (B8)
Some entrepreneurs felt that there was no point in taking out frustrations on the bureaucrats. They were merely implementing a bad regulation but could do nothing about it. In the entrepreneurs' view, two outcomes are possible: a change that would improve the system; or a shift in the dynamic between the entrepreneur and the bureaucratic structures. "It is hard to get angry at the person that you see at the desk. They are doing their job. The process is good or bad, but the people are just doing a job. Treat them badly they will find ways of getting back at you. I smile and remember that there is nothing that person can do." (B17) "Der Thstcmdard and the business community will have to come closer together, their mutual understanding will grow and I think relations will have to improve as well. This does not mean that there aren't always going to be problems, but for in this transition period there is room for rapprochement." (B8)

Changes Hoped for in the Procedures

The changes suggested by the enterprises are mainly focussed on the fees and the timing of the payment of fees. "We would like to see a moratorium on standards fees for domestic producers until they reach a threshold of productivity. They should be allowed to pay for the certification with their productivity and not prevented from being productive altogether." (B14) "I'd like to see a system where the producer is not forced to pay up front if he cannot. There needs to be a certification process which does the analysis but then allows the producer to pay afterwards." (B17)

Some enterprises' desired changes in the interactions reflect a certain attitude seen among business people all over the world in demanding more productivity from officials regardless of what their tasks. "The only change I would like to see is that the people who do the standardisation did even half of what they are supposed to according to the book. That would already be something." (B19)
CHAPTER IX - SALES PERMIT (PATENT)
QUICK AND EASY?

CASE STUDY 3

This case examines the process of obtaining a basic document, often the only legal permit held by many SIEs.

Introduction

Sales permits, patent in Ukrainian, occupy a unique place among documents relating to business activity. They permit an enterprise to pursue many business activities including simple trade in markets or in street kiosks, or complicated business like currency exchange and gaming without creating a legal entity while retaining full ownership rights. This distinguishes them from other enterprises that have more complicated ownership structures, that are generally larger and from those with varied activities.

The procedural guidelines for obtaining a business sales permit are created by the Verkhovna Rada as well as the Cabinet of Ministers. Responsibility for issuing sales permits lies with the office of the State Taxation Authority. The principal document regulating the sales permit is the Law of Ukraine, On Patenting Certain Types of Entrepreneurial Activity"(#98/96, 23 March 1996).
Sales permits are certificates issued to traders by the government through the office of the State Taxation Inspectorate, giving permission to engage in a stated entrepreneurial activity. The permit, in effect, registers small retailers as businesses and, at the same time, provides a limited amount of protection to the consumer: traders are officially identified. Moreover, registration provides the tax Inspectorate with a direct link to the taxpayer. Sales permits are required by enterprises involved in retail of goods not viewed as essentials. Those who trade in essentials are provided with a sales permit but at no cost to the retailer.

The principal benefit of a sales permit is that it identifies the holder as a legitimate retailer. Such designation is important for assuring the public of a legitimate business. Furthermore, the sales permit provides proof to enforcement authorities that the retailer is a legally registered taxpayer and is allowed to trade in goods or to engage in activity noted on the sales permit.

Existing types of patenty in Ukraine can be divided into three groups: trade/retail patenty, intellectual property rights, and other miscellaneous sales permits. The one of most interest to SIEs is the first. The trade or retail sales permits are subdivided into two categories. The first are specifically trade and retail sales permits including paid, non-paid, and short term. The second category includes sales permits for “special purposes”, consumer services (бутових послух), currency exchange, and for running a gaming business. This case study is primarily concerned with the first category; sales permits relating to trade and retail.

Sales permits in many ways are the most straightforward forms of business permit available in Ukraine. Any individual or company may obtain one, and needs to, for the purpose of
selling goods to the public. Some businesses are able to obtain “relief” sales permits. This is a low fee sales permit designed for those selling goods used for, among others, personal development, enterprise development, education, and public information such as newspapers and magazines. The list also includes essential household goods and gardening supplies. There are however many people/enterprises selling goods without a sales permit. The regulations appear to target enterprises selling non-essential goods, and exempting those that are home made - the wares of cottage industry or poor households. For example, individuals selling live/fresh or processed produce from plots and gardens at local markets are exempt (they do pay a fee for working at the market). Street vendors (depending on the wares they sell) or their umbrella organisations however, are required to hold sales permits. The sales permit therefore, is the most basic form of business permit available to SIEs in Ukraine.

According to officials from the State Committee on Enterprise Development, the sales permit is designed to be the simplest business permit, easiest to obtain. It is also one of the most commonly required documents for small business. The process by which it is obtained is an important one as it sets a standard for other permits. If there is difficulty in obtaining this sales permit, the difficulties obtaining any other permit is likely to be, or perceived to be significantly greater.

---

164 A list of exempt goods is appended to the law and includes such items as food staples including bread, fish, meat, poultry and eggs, salt, sugar, children’s food, milk and other dairy products, and so on.
In the Soviet Union, small trade was the keystone to the underground economy. Buying and selling outside the official economy was technically illegal. The reality of the Soviet economy was that the petty underground retail trade made up a large proportion of the consumer goods market. Without it the Soviet population would have found obtaining a variety of such goods almost impossible. Under perestroika, with the softening of the anti business rhetoric, small retailers began to flourish.

Ukraine’s government approval of this process was formalised with the introduction of the sales permit in 1996, in the Law of Ukraine, On Patenting Certain Types of Entrepreneurial Activity, in March 1996, established the process by which retailers were to obtain sales permits. It gave small-time retailers a legal right to pursue business. At the same time the consumer was offered a degree of protection from rogue traders and “fly-by-night” salesmen who, without a sales permit, were not legally permitted to operate.

Part A: Normative

The principal act regulating the process of obtaining a retail trade sales permit is the Ukrainian Law, On Patenting Certain Types of Entrepreneurial Activity (23 March 1996).  

The Law states in Article 2 that “the trading sales permit is a state permit that testifies the enterprise or the individual trader to engage in the business activity as stated on the certificate itself.”\textsuperscript{166} The law details the types of businesses that come under its provisions and are obliged to obtain a sales permit. These include all shops, kiosks, stalls, car dealers, petrol stations, trade counters. The exception are those that operate under the roof of a larger market structure and who pay a fee to the market.

The bulk of the law text identifies those areas of business activity that do not need a sales permit, or that need one but as a result of their essential type of business, are not required to pay for the permit. Among them are businesses that deal exclusively with essential foodstuff, basic medicines, basic household items and domestic fuels. Further exemptions from paying for a sales permit go to retailers selling books, magazines and newspapers, art supplies, and stationary including office supplies. Finally, in the category of those businesses that do not require sales permits are factory retail outlets and their subsidiaries, shops found on military bases and those selling own production, that is home made goods. Any enterprise can establish itself to sell these products providing it meets all other standards and norms required by law. Therefore all trade in essential goods can be done without a sales permit or a non-paid sales permit. All other trade requires a sales permit for conducting business in Ukraine.

The sales permit is obtained from the State Taxation Inspectorate, which operates under the Law on the State Tax Service of Ukraine, making it a relevant piece of legislation for this case study.

\textsuperscript{166} Закон України, Про патентування деяких видів підприємницької діяльності, p138.
Article 8 of the Law, titled Functions of the State Tax Administration of Ukraine sets out the duties and responsibilities of the STA. It states that "The State Tax Administration of Ukraine shall carry out or arrange for state tax administrations and Inspectorates to control observance of the laws on taxes and other compulsory payments, (...) verifications of official registration certificates of business entities. Licenses, sales permits and other special permits allowing certain lines of business."\(^{167}\) This is the only one of two mentions of sales permits in this law; in Article 10. Among the functions of the State Tax Inspectorates operating in subdivisions of municipal and local authorities, is the same ones noted in Article 8, with the addition of sales permit verification.

*Paper chase*

Obtaining the sales permit requires the applicant to submit, in person, an application to the state taxation administration (Inspectorate). The application requires basic information including the name of the applicant, an excerpt from the founding document of the enterprise regarding the legal address of the company or a legal document confirming status of subsidiary. In the case of an enterprise where the sales permit is the principle legal document for the company, a written statement from the local authority confirming a legal address is also required. Additionally the application must provide a statement on the type of business activity being undertaken and most importantly which part of that business is to be considered by the sales permit. This part must include a description of the product being

---

sold, its retail price, and the number of units being sold. These are the requirements for information from the enterprise specified in the regulations on sales permits.

Documents explaining the law to enterprises are explicit in noting that the state tax authority cannot dictate or instruct the value of the products being sold and that such figures are to be determined by the entrepreneur only.\textsuperscript{168}

\textit{Payment}

The applicant for a sales permit has the choice of how to pay for it. The options are based on making monthly instalments or a one-time payment for a one to three year period. This option must be determined before the sales permit is issued. The law states that payment is made to the regional State Tax Inspectorate offices. The process for payment is explained including the method of making a deposit at the bank and returning the deposit slip as proof of payment. In the case of a mobile business, payment is made at the local State Tax Inspectorate office in the region where the business is officially registered.

The cost of the sales permit is determined by the regional representative office of the State Taxation Inspectorate, the value of the sales permit however, cannot exceed the rates set by the law On Patenting Certain Forms of Entrepreneurial Activity. These set maximum values are 160 ECU per month in Kyiv, 80 ECU in Sevastopol, and 40 ECU in the rest of the

country. For those on an instalment payment option, payment has to be made on the 15th of the preceding month. Upon applying for the sales permit the applicant must include a deposit payment equivalent to one month’s fees, this is held in trust and applied to the applicant’s account as payment for the last month of the sales permit’s validity.

The applicant may choose to pay the entire three year sales permit fee up front. The sum total of the fee is based on the value on the day of application. By doing so the applicant is exempt from paying any top-up payments to make up for any fee increase(s) over the subsequent three years.

Waiting for the Man

The process of getting a sales permit should be quick: The application is submitted and the permit is issued that same day. Though the legislation does not intend delay, it makes no mention of the time frame involved. The taxation officials interviewed observed that the process of obtaining a sales permit was a brief one.

Getting it all Back and Moving On

As the sales permit is provided immediately, there is no delay to the applicant in terms of returning for the company documents or picking up the sales permit itself on a following
day. Once the sales permit has been issued the applicant can go about their business. The only caveat being that the sales permit has to be displayed and used according to the regulations. The document must be prominently displayed, it cannot be used in a region beyond the jurisdiction of the issuing authority, nor can it be transferred to another person or business.

The follow up

The renewal of the sales permit happens once a year at a minimum or a maximum of once every three years. This is determined by the payment option made on the sales permit. Those paying in instalments must renew annually, while those paying a one; tow or three-year one-time payment may renew at the end of the term. The process of renewal is essentially the same as the initial application and the same documentation has to be presented to the issuing authority. Monthly visits are required for the monthly payment option.

Part B: Positive
The dominant comment from the entrepreneurs interviewed that had a sales permit or that were in the process of obtaining one was that the process itself was simple and without complications. There was some concern about the authority entrusted with the issuing of the *patenty*, but overall most were satisfied that they were not treated unfairly. “The sales permit was the easiest part of setting up the legal business – we got the *patenty* and we forget we even have it in the shops.” (B1), “The sales permit is easy to get” (B7), “We have a sales permit, but we had no difficulties whatsoever in obtaining it, the tax people are happy for us to have it, it means more businesses for them to inspect.” (B8), “The problem for our business community isn’t to get the sales permit but to put up with the verification that the business is following to the letter of the sales permit mandate.” (B14) “I have a sales permit and the process of getting it was easy, but the difficulty is coming up with the monthly payments if I have made very little that month.” (B17) “Sales permits are easy to get and they cause only small headaches to entrepreneurs.” (“Big headaches come with other matters, when you have a small headache you can still get lots done”) (B19)

Even those companies that are able to take advantage of free sales permits because of the essential nature of their business found similar ease in getting a sales permit. “The sales permit was not the most difficult of our business tasks” (B22) “We had no difficulty in getting a sales permit, it was one small relief we had.” (B10)

*Rynok* merchants or those selling at metro stations are supposed to have sales permits and many of them do particularly those who seem more established with a tent or a stand. These people show their sales permit with an affirmation that the process of getting it was simple and without hassle. Some however do not need a permit as they sell their goods within a designated market meaning that they pay a small fee to the market authority, or those who sell their goods straight from the factory where they are produced are also exempt. “We have a
sales permit which we use to sell our products, but since we sell our goods from the factory we have no need to
pay for the sales permit, it is very convenient.” (B22)

Paper chase

Among those interviewed none suggested that there were difficulties in getting the
application for a sales permit. Information on where to get it was available in the business
press or obtained at the State Taxation Inspectorate. “The newspaper Bianes explained what we
needed to apply, we took the application form with us and handed it o the reception desk.” (B1) “I would say
that the information for getting a sales permit is clearly understood. The applications are available everywhere
and there is nothing to prepare - fill in your name and what you are selling. The end.” (B14) “I agree with
what others have said, that this is not a complicated permit to get. The path is well worn by others and the
information is easy to get.” (B19) “I can’t remember, [getting information about the sales permit] must have
been simple because it doesn’t bring back bad memories. It must have been quite simple.” (B22)

Those respondents with sales permits had to appear at the State Taxation Inspectorate to
submit their applications. This fact alone did not make the process difficult according to
them, however, the idea of getting the document processed at the Taxation Inspectorate was
noted as being psychologically daunting. “Getting the sales permit wasn’t the problem, getting it from
the Tax Inspectorate was. There is a certain discomfort in going to the enemy to get what you need.” (B1)
Then same respondent appeared to expect difficulties, illustrating the inbred distrust that
exists towards officialdom. “The fact that there were no complications made us all the more
suspicious” (B1) “It is true that the application was easy to get and to fill in but then we had to take it to the
state Inspectorate. That was the hard part but it had to be done, but that was quick. No one wants to go there
if they can help it.” (B10) “The [tax] Inspectorate are a crafty bunch, they make it easy to get the sales permit but then they come and inspect you and make life difficult later. A bit like giving an anaesthetic before ripping out a tooth.” (B17)

Payment

Of the entrepreneurs interviewed, not one had opted for the full payment of the fees for one or more years. Similarly, business associations indicated that among their membership few were likely to pay such a large sum up front. Most would opt for smaller monthly payments. “Of those we represent, few if any have the money to pay up front for a sales permit. Bigger business may be able to, but small enterprises no.” (B8) “Most of these people are living poorly and their business is a slow way out of that. I know of many that can’t even make it beyond their monthly fees. How can they possibly get a lump sum payment, it is unrealistic.” (B14) “It costs 10-15 UAH per month, it is like paying a subscription per month” (B7)

The monthly payments have drawbacks, as poor monthly revenues are common. Although the fees are generally low, it does remain a potential worry for some. Most indicated that the main problem was being able to make the payment at all. Many enterprises pay the fee at the tax Inspectorate kasa (pay office) rather than at a bank. Also, in some raions, many people make their monthly sales permit payments on the 15th of each month. Overcrowding at the local Tax Administration offices means that some are unable to make the payment on that day. This can lead to fines. “I try to make my payments every month on the 15th like I am supposed to. But with the number of people at the tax office making their payment it can take a day if not more to gain
access to the office and that can take up a great deal of my time. If I am late and miss the payment date I get fined.” (B17)

For street vendors, the “paid sales permit” is not part of their operating costs. They do not worry about the monthly visits to the Inspectorate because their trade is mostly in essential consumer goods, allowing them to do business with a “non-paying sales permit”. Their principal concerns are fines and penalties. There is temptation for these entrepreneurs to sell beyond what their sales permit allows. The costs for this are severe and may include a fine as well as the confiscation of goods, which for most means that they owe their supplier the value of the goods above their penalty, a cost few can afford to pay.

Waiting for the Man

As noted earlier and based on the limited information from the Law On Patenting Certain Forms of Entrepreneurial Activity, it is assumed that the process of obtaining a sales permit is immediate: the application is submitted and the permit is awarded. Most of those interviewed make no mention of delay at all. “The sales permit is quick to get, you apply and they return to you a sales permit immediately.” (B10) “The sales permit is the easiest process there is, it is one of the few instant documents available from our bureaucrats.” (B22) The merchants, who need a sales permit but who do not need to pay for it are also apparently of the unanimous view that the sales permit is easily obtained in a day and without much waiting. “Once I arrived at the office, the sales permit took about two hours in the morning to get. Of course I had a friend who worked there who was able to get to my application immediately, but I think it could have been done quickly even without his
help." (B17) For many enterprises getting the sales permit, or paying for it, was not the difficult part of the process.

Getting it all Back and Moving on

Complications and abuses at this relatively straightforward process were experienced during the follow-up monitoring of business activity, such as checking on presence of sales permits or that the business was not operating beyond the parameters of the sales permit. The majority of those interviewed indicated that at some point inspectors regularly checked them. "The sales permit is clearly visible and still they stop us from what we are doing and demand to have the manager present while they read the sales permit. This happens every month sometimes more." (B1) "Checking the sales permit happens constantly, I can't even count how many times they ask to view the document." (B7) "The tax militia comes around quite often to verify who is where. This gives them control of the area and if there is someone new or if someone seems to have new goods to sell, they verify the sales permit and while they do, there is no one to watch the goods and so we cannot sell at that point. This happens enough to be irritating." (B16) "We are harassed by the militia who come around trying to scare off those without sales permit." (B16) "The tax militia comes by occasionally to take a look at the sales permit, they are unwanted of course but we have to let them in." (B10) "We are out of sight because really we do not sell directly to the mass public, but from time to time they do come to inspect the sales permit." (B22) "Yes they come every few weeks to see if we are trying to sell things we have noted on the sales permit. We know when they come because everyone passes the news quickly. If we have [goods not listed on the sales permit] they will take them away and we can lose several months profits." (B17) "Of course people always have goods to sell

228
that may not be on their sales permit, but for many despite the risk of getting caught it is worth it. Inspections are frequent and the risks are high.” (B19)

Behaviour of Officials

Some interviewees suggested that the behaviour of officials was reflective of the behaviour of the entrepreneurs towards the officials. Overall, the reaction of entrepreneurs indicated that officials were difficult and that their behaviour was intimidating. “If we are nasty towards them, we can expect the same if not worse back, the difference is that their behaviour has the law behind it and we can do nothing.” (B22) “If the inspectors are in need of filling a quota of fines or revoked sales permits, they will find them, they will finish someone’s business whether rules were broken or not, it comes down to the official and the needs of the organ behind him.” (B10) “The best thing is to smile and let them go past as fast as possible, don’t let them hook onto anything. When they do there is trouble with them.” (B16) “In the tax administration offices the behaviour of the officials is fine. Nothing out of the ordinary.” (B8) “The sales permit is a simple document to get and still so many officials and payments, they are smothering us in their bureaucracy, without changes, enterprise in this country will not survive.” (B24)

170 Tax militia is the enforcement arm of the State Taxation Inspectorate. They act as a police force responsible for investigating tax related matters and enforcing relevant laws and regulations.
CHAPTER X - TAX INSPECTION:
NOT UPON OUR WORST ENEMIES?

CASE STUDY 4

This case focuses on what is perhaps the most sensitive interaction between enterprise and bureaucracy. It is popularly viewed as the key part of the ongoing battle between both sides in trying to get more out of the other, and where the opportunity for corrupt behaviour is high.

Introduction

"Taxation is the most important instrument influencing the economic interests of the State, regions, individuals, and of enterprise." Of all interactions between legal entities and the state this is one that affects every enterprise in some way, whether they choose to pay taxes and/or if they choose not to. For those who do pay, taxation establishes permanent relations between the enterprise and the State and an even more intimate relationship with the State Revenue Service. The character of that relationship has much to do with the image the revenue organ has among business people. Furthermore, the relationship has an enormous impact on the development of business. Taxes are designed to stimulate progressive and effective development; and to regulate contradictions that may arise in the realisation of economic interests. A system of taxation is most effective when it is

171 Гера, П.Т., Правовий режим оподаткування в Україні, Київ: Юріком (1997) 7
“comfortable” for the taxpayer and straightforward for the regulator. For some enterprises the system may encourage legal pursuit of activity while for others it may motivate the creation of a shadow economy, or, in the worst option for all concerned, to suspend operations altogether.

The State Revenue Service is without doubt the most detested government body in Ukraine. In particular, the tax Inspectorate is popularly seen as that organ of the government that is determined to take as much as it can from the taxpayer, regardless of circumstances or the law. An impending tax inspection is often understood to mean an automatic outlay of money and favours. This popular notion may be the result of years of experience of taxpayers, years of non-tax payment coming to and end for taxpayers or indeed perhaps mismanagement of the body itself.

Popular views aside, the State Tax Administration is the principal organ of collecting revenues for the government budget. It is responsible for maintaining observance of taxation law, accounting accuracy, complete and timely payment of revenues. It develops appropriate legislation, maintains a national registry of taxing entities, and it carries the task of “explaining questions regarding tax law and regulations to taxpayers.” In addition to these functions, the State Tax Administration (STA) contains within it the State Tax Inspectorate (Inspectorate), which acts out the principle public role of the STA. Its power comes from the government’s need for revenue.

---

172 Гера, П.Т., 8
Most enterprises in Ukraine are aware of their responsibility to pay tax and, in most cases, are happy to do so. This is so only if the tax regulations and laws are applied in a fair and equitable manner; and if they can expect fair treatment at the hands of the tax officials, particularly the tax inspectors (нiдатковцi). It is the Inspectorate that is most visible to the enterprise and its performance is judged by virtually all taxpayers. And it is this judgement that determines for many firms their ability to develop as going concerns and consequently for the enterprise sector to develop and survive in the legal economy.

Background

Taxation has been a prominent part of economic life in the region since the tsars. More recently, Soviet law required that the bulk of revenue be derived from the socialised sector of the economy rather than the populace.\textsuperscript{174} In the Soviet era, state firms were seen as independent “profit-making” entities, as were collective farms, co-operatives, and public organisations and, therefore, all subject to tax. State enterprises were, without question, the major contributors to the budget. They did not operate separate accounts from the state and so their tax was in reality an accounting function.

The Inspectorate itself is a new entity in Ukrainian taxation. Organisational evolution may trace it to the verifying organs established within the Communist Party. Its functions are

\textsuperscript{173} Закон України, Про державну податкову службу в Україні, ВР № 510-12 from 04.12.90 (with changes up to and including (05.02.98) Article 2

\textsuperscript{174} Newcity, Michael, Taxation in the Soviet Union, London: Praeger (1986) 48
The Ukrainian State Tax Inspectorate was established in the 1990 Law of Ukraine, On the State Revenue Service. The recognition of the need for a body to oversee the collection of taxes from entrepreneurial structures that emerged during the period of perestroika enabled the state to begin the process of taxing profit-making enterprises in a manner similar to Western economies. In 1997, 98% of revenue targets were collected by the STA. In 1998-9, that figure was increased to 102%.

Part A: Normative

Relevant Legislation, Official Documents

- Law of Ukraine, On the State Revenue Service in Ukraine (#510-12, 4 December 1993)
- State Tax Administration, Instruction On the Order of Conducting the State Tax Inspection of the Operational-Accountancy Registry of Taxes and Non Tax Obligations (#37, 12 May, 1994)

175 The “verifying organs” were parallel bureaucracies created to check on implementation of directives. In the Ministry of Finance, they represented Gosplan and were responsible to the Council of Ministers. These too were created to ensure implementation of directives, root out falsification, and ensure efficiency in economic matters. Dunmore, Timothy, *The Stalinist Command Economy*, London: Macmillan (1980) 19

176 Klymenko, Ihna, “СВІТЛО В ОКРЕМІ ВЗЯТОМУ ВІДОМСТВІ”, Des #49 (17 March 1998) 4

The law of Ukraine, On the State Revenue Service of Ukraine, determines the status of the principal revenue body in Ukraine. It describes its legal operative grounding and functions. Within the law On the State Tax Administration, Article 10 is most pertinent (Functions of the State Tax Inspectorate in raions, cities without raions, raions within cities, inter-raion and intra raion State Tax Inspectorates). It describes some of the functions in greater detail. Section III, Article 11 (Rights of the organ of the State Revenue Service) also forms a fundamental part of the legal regulation of the Inspectorate.

Despite the vast amount of documentation that exists surrounding taxation, little available information pertains to the procedures involved for inspecting enterprises. The Law of Ukraine on the Revenue Service includes one relevant article covering information regarding the functions, duties and rights of the STA and the Inspectorate. For the STA, this includes the administration of the Inspectorate, both on the chief Inspectorate as well as the local organs. Regarding the Inspectorate, the law describes the duties and functions of the organ:
Section II, Article 10
Functions of the State Taxation Inspectorates in Districts, City Districts and Towns

The State Tax Inspectorates in districts, city districts and towns shall fulfil the following instructions:

1) conduct control over execution of the legislation, other payments to budget, contributions to state funds;

2) provide the full registration of tax payers, other payments to the budget, their duly and timely transfers, and also to provide registration of natural persons- tax payers and other statutory payments;

3) control timely submitting by payers of accountancy reports and balances, tax declarations, settlement reports and other documents connected with raising taxes, other payments to the budgets, dues to special state funds, and also checks whether these documents duly specify the objects under taxes, other payments to the budgets, and dues to the special purpose funds;

4) control legality of currency interactions, keeping to the established procedure for settlements with consumers, using control cash machines, trade cash record books, amounts of the cash and its use for payments for goods, jobs, services;

5) keep records of promissory notes for paying import and export tax, and exercise control over their clearing off;

6) provide timely imposing of financial sanctions as provided by this Law, other legislative acts on taxation, and also raising administrative fines for violations made by officials at enterprises, establishments, organisations and citizens;

7) analyse reasons and estimate data on facts of violations of tax legislation;

8) carry out comprehensive check ups of the facts of hiding and reducing tax amounts, other payments and deposits to the state funds;

---

178 Law of Ukraine, On State Revenue Service in Ukraine, Kyiv: Verkhovna Rada (December 24, 1993), N3813-12 Section II, Article 10. (Translation by the law firm of Baker & McKenzie)
9) on behalf of special divisions for fighting organised crime check the documents on accounting and paying taxes to the budget and special state funds;

10) within their competence, reveal illegal activities of enterprises, establishments, organisations and citizens, which may testify to criminal activity, or create conditions for such activity, and submit the information to special organs fighting organised crime;

11) submit to law enforcement agencies the materials on facts of violations involving criminal responsibility, and also appeal to courts of justice and arbitration courts against enterprises, establishments, organisations, and citizens on violations concerned;

12) carry out work connected with finding out registration, estimation and realisation of confiscated property, property inherited by the state treasury;

13) exercise control executive committees of rural councils of people's deputies to observe the procedure for collection and accounting of taxes, other payments from the population, timely and duly transfer of these amounts to the budget;

14) consider applications, proposals and complaints from citizens, enterprises, establishments and or organisations on issues of taxation, and complaints against officials of the State Taxation Inspectorates;

15) submit to the respective financial bodies' reports on incomes from taxes to the budgets, and deposits to the special purpose state funds.

Other versions of this same law are available from different sources, and though most are virtually identical, some include additional information while others omit certain material. One such version of the law includes additional information about the use of mass media to explain the application of the law and normative acts concerning taxation and other duties.
Selection of Enterprises for Inspection

Neither the Law nor the available normative acts make mention of how an enterprise is selected for inspection. The language of the law On the State Revenue Service implies that all enterprises undergo inspection. The Instruction On the Order of Performing the State Tax Inspection Article 10, paragraph 25 states clearly that no accounts are exempt from inspection.

Section II Article 8 of the law states that the Chief State Tax Inspectorate is mandated to “directly realise and organise the work of the state taxation Inspectorate connected with the realisation of control over compliance with the legislation on taxes and other payments to the budget, deposits to the state funds, legal character of currency interactions, and among other various tasks, establishes procedures for payments.” In turn, local Inspectorates are charged with providing “complete accountancy of tax payees and depositors, their duty and timely transfers, and the provision of registration of natural persons-payers of taxes and other statutory duties. The process of determining which companies are to be inspected is stated in the Order of the State Tax Inspectorate of Ukraine. Section 2.1.1, of the Order describes that it is the local, raion, and town Inspectorates that are responsible for drawing up a plan for inspection as well as a list of entities to be verified. How the list is determined is

unclear from the legal documents although, according to one official, it is based on the order of state registration of enterprises at the local offices.

The law indicates that some selection process does take place at the preparation of lists of enterprises subject to planned inspections. Such a plan must be submitted to the State Treasury no later than the 25th of October of the preceding year. The details of the selection process are not provided and it is stated that “access to information on the preparation of plans for tax inspection is strictly limited.”

*Frequency of Inspection*

The law, On State Revenue Service of Ukraine states that the frequency of inspections is determined by the STI. According to the Instruction On the Order of Performing the State Tax Inspection (1994) Article X, paragraph 25, an inspection is to be carried out at least once a month on the accuracy of individual accounts. In September 1997 an Order from the State Tax Administration of Ukraine was issued ordering annual inspections. The July 23, 1998 Presidential Decree On Certain Measures of deregulation of Entrepreneurial Activity, confirmed the STA order. As a result the number of times that a business in Ukraine is to be inspected by a state organ, has been reduced substantially. Moreover, all state organs

---

180 Cabinet of Ministers Order, Порядок координації проведення планових виїзніх перевірок фінансово-господарської діяльності суб’єктів підприємницької діяльності контролюючими органами (втілення), Kyiv: Cabinet of Ministers of Ukraine (29 August 1999, # 112) paragraph 5

181 "Підприємців перевіряти треба не частіше разу на рік" in Habski Korrespondent (42/97) 13
must co-ordinate their inspections to match with national, regional and local inspection plans. 182

Notification to Enterprises

As there are two types of inspection methods, one on site, the other at the STA, both have different mechanisms for notification. In the case of an inspection held at the STA, the enterprise must be notified in writing delivered by registered mail. The notification has to include the basis for the inspection, the time and date as well as the place where the entrepreneur is to appear. There is no mention in the law On the State Revenue Service of Ukraine of how far in advance this notification has to be provided. In the case of on-site inspections there are no details provided in the law regarding the process of notifying the enterprise of the visit. The Presidential Decree of 1998 however, specifically indicates that notification for on site inspection must be given no later than ten calendar days before the inspection is to take place.

 Surprise Inspections

In the early 1990s, surprise inspections were the norm for most regulating agencies. Since then the number of state organs permitted to conduct such investigations has been reduced.

182 Presidential Decree, Про деякi заходи з держулювання пiдприємницької діяльнiстi', Київ: Верховна Рада #817/98 (23 July, 1998) Paragraph 2
At present there are four organs with authority to conduct unannounced inspections. The STA is among them. The principal laws of Ukraine make no mention of surprise or "unplanned" inspections by the Inspectorate. The Presidential Decree On Certain Measures Deregulating Entrepreneurial Activity notes that "unplanned" inspections are deemed unplanned if they are not included in the official program of the regulatory organ. Furthermore, the surprise inspection can only be conducted in a situation where there is, as a result of a previous inspection, suspicion of fraud. A surprise inspection can also be carried out if wrong or incomplete information had been provided by the enterprise, in the event of a complaint registered against the officials by the enterprise; or if an enterprise is being liquidated.

*Arrival of Inspector(s)*

The principal law documents make no reference to the presence of inspectors at an enterprise. Officials form the STA are required by the order to sign a registration booklet upon entering the premises of an enterprise for the purpose of performing and inspection. The Order on Confirmation of Format and Order of Maintaining a Register of Regulatory Agency Visits to Enterprises (Inspection Registration Booklet) recommends that enterprises obtain such a booklet.

*Provisions for Inspector(s)/Rights of the Inspector*
The enterprise is required by law to provide access and certain documents during the inspection. These provisions are noted in the Law of Ukraine, On the State Revenue Service in Ukraine, Part III, Article 11, and Rights of State Taxation Inspectorates.

The inspector reviews all payment documents, record books, reports, lists of expenses, declarations and other documentation connected with the calculation and payment of taxes, and other obligatory payments. All related documents including identity and registration are verified. The inspector is to receive “free of charge” information on activities, received income, all forms of expenses, cash circulation in accounts, and any other material concerning accountancy tax payments. The inspectors have the right to inspect any property connected with the enterprise including production and storage facilities. They can demand that enterprises correct any violations in tax payments. Moreover, they have the authority to control compliance of such corrections. Actions perceived to be preventing the Inspectorate from exercising its authority could be stopped by the inspector who can remove from the enterprise any documents, including registration certificates or permits. These, in turn, are sent to the issuing agency for cancellation. The inspector is to be given access to “a means of communication” belonging to the enterprise. An inspector can demand from leaders of the inspected enterprise, to provide an inventory of basic production assets, trade-material values, money and accounts, and where necessary can seal cash boxes, offices, store houses and archives. Finally, the inspector can levy penalties on enterprises. These include “a single tax or other payment recalculated in the course of an inspection, or twice that amount if another transgression was made during the year in which the previous one was detected and retaliated; ten percent of tax amounts payable, in retaliation for non-presentation or untimely
presentation to tax authorities of tax returns, computations, audit reports, and other documents required for the calculation of taxes.” No other provisions are required.

Duration of Inspection

The law On the State Revenue Service in Ukraine, makes no comment about the length of duration of an inspection. There was no mention of the time allowed to carry out a taxation inspection in the principal laws, or in the available normative acts until the introduction of a reform order by the Cabinet of Ministers in August 1999. At the time the Cabinet of Ministers Order On Regarding Planned On-Site Inspections of Enterprises by Regulating Authorities stated that tax inspections “should not last for more than 30 working days.” The Order indicated that any extension of an inspection’s duration is to be decided by the head of the STA.

Repeat Inspection

The Presidential Decree On Certain Measures Deregulating Entrepreneurial Activity states in paragraph 4, that only in certain circumstances can repeat inspections be carried out. Such situations occur when a decision of the Central STA is made to verify the work of a

183 Law of Ukraine, On State Revenue Service in Ukraine, Kyiv: Verkhovna Rada (December 24, 1993) N3813-12 Section III, Article 11. (Translation by the law firm of Baker McKenzie)
lower taxation authority, or in the case of action being brought against an official of the STA.

_Fines and Penalties (finances – division of revenues)_

The Law of Ukraine, On the State Revenue Service in Ukraine, Article 11, paragraph 7-10 describes the fines and penalties that can arise out of the inspection. Although the inspectors themselves do not impose the fines, they are responsible for providing the STA with the information that it reviews and determines the amount of fine to be levied against the enterprise. Inspectors are also not responsible for collecting fines and legally cannot handle financial interactions regarding the payment of fines and penalties. No indication is given in the available documents about where payments are to be made.

**Part B: Positive**

The body of interviews divides into four categories. First, those who primarily have complaints about the Inspectorate, second, the fewest, those who are mostly positive on the issue, third, those who see the need for more experience, education and understanding on both sides, and finally, the group of entrepreneurs unaffected by the tax inspectors.
Among the SIEs interviewed, most are anxious to talk about their experiences with the tax Inspectorate. The overall image of the Inspectorate is negative and the process of inspection is perceived as conflictive. One entrepreneur put the feelings of the business community succinctly, “The tax inspection is the most dreaded and seemingly most regular part of doing business in Ukraine.”(B1) Others also share the view. “The biggest problem [faced by our members] is pressure from taxation.”(B8) “Tax inspection is a problem for our business because we don’t make very much money.”(B10) “There is so much to say about the troubles we have had with tax inspection”(B11) “Reporting to the taxation Inspectorate is a nuisance.”(B13) “Our relation with tax inspectors is the same everyone’s: They harass us.”(B21) “To pay all their taxes would lead to business failure.”(B26)

Occasionally, positive comments are made about certain elements of the procedure, but this is rare. One overall positive consequence of the taxation process came out during the interviews, “The system is more fair now. Before we used to expect the state to do all for us, now we survive on our own without them. That is fair until the inspectors begin to take all from us.”(B5) This opinion however, is reflective of entrepreneurial independence rather than on the taxation regime itself.

The third category of SIEs opinions shows a more balanced view of the problems suggesting that there are deficiencies on both sides. “Tax management is a skill few people have. (...) The problem with the tax department is that inspectors are poorly trained. Up to 60% of tax employees has no formal training in this area. Some are without university education at all. The lack of qualification and knowledge is a real problem for both business and STA.”(B15) The Ukrainian Chamber of Commerce, Enterprise Development Department, upholds this view. “The level of professionalism of tax officials is a real problem to small and large enterprises. The biggest deficiency is in their training. These people came out of a tradition of doing what they were told to do and the on the job training reflects an old-style way of working. (...) There is a new college for taxation inspectors and militia.
The first graduates are about ready to start work." (W9) There are signs of understanding among the SIEs that both enterprise and officials need to learn much more about each other and about their own functions in order for things to improve. "There is growth and learning on both sides. The taxation people are slowly coming to terms with the changes in Ukraine and the business people who are anxious to get things moving are learning that there is a growing process in the regulations and that they are not yet fully completed." (B2)

The fourth group is seemingly unaffected by the tax inspectors. This group includes most open market and farmers market merchants who generally feel no pressure from tax inspectors. Because they act as individuals they are not inspected at their workplace and they make their tax contributions as part of personal income tax. Moreover, these merchants pay a fee to the market to be allowed to sell their wares, the market, in turn, pays taxes. The fee is effectively an indirect tax on the merchants.

*Paper chase - Information and Procedures*

Problems identified by the enterprises regarding the laws, regulations, and the procedures are many. These include the lack of access to documents, and where there is access, there is no realistic way for a SIE to take the time to review the laws. Entrepreneurs point out the constant changes to legislation and the lack of training of the STA personnel, due to ignorance of the law or of changes. Unfair tactics by the STA are part of enterprise concerns. Among these are retroactive taxation and vague wording to regulations making the system inoperable for those working towards compliance.
Similarly procedures used in the tax regime are viewed sceptically because of the lack of access to information. "It seems to me that the rules that tax and other inspectors enforce, are not printed. But I am told that there are plenty of places that one can go to get normative thesiss and documents proving [the inspectors] right or wrong" (B11) "Where am I going to find the time to see these regulations? It is absurd to think that I would be able to find the time to read through all." (B17) "There are people who specialise in taxation I don't have the background. (...) It would be good to read the materials but there is too much and for me it is too complicated" (B21)

A significant majority criticises the frequent changes to laws. "From my perspective the Verkhovna Rada makes too many changes to the basic laws and basic income tax. It is generally accepted that there are significant changes every two weeks to those laws." (B13) "For most businesses, changes in taxation regulations are a headache and sometimes lead to panic" (B14) "The rules seem to change every time we are inspected or go to the Inspectorate." (B21)

Some of the difficulties in this regard are seen to be the result of officials being unsure of the regulations, particularly after changes have been introduced. "It has happened so often that SIEs find out during consultations, that the inspectors themselves are unaware of changes in the rules. There have even been instances where inspectors arrive knowing surprisingly little about tax inspection." (B13).

A number of entrepreneurs commented on the low level of efficiency of the procedure. They claimed that the system is too easily fooled and that the accounting system is unreliable making the inspection process pointless. "According to current accounting regulations there is very little to prove that money exists in a firm. On thesis it is too easily hidden. The opposite can also exist. A company can in reality be bankrupt, but on thesis it can be made out to have money. The tax inspectors come
in a see this and require the company to pay taxes.” (B24) 

“I see [inspection] as a waste of time. It involves a huge amount of documentation, 80% of which has little to do with accounting and which gives [the state] no useful understanding of my business, or and concrete evidence of commercial activity.” (B22)

Most of the entrepreneurs concerns are over unfair practices such as retroactive accounting pursued by the STA and the Inspectorate. “Often changes to the laws are applicable to income realised months ago. So retroactive accounting and auditing has to take place” (B13) “Many legal provisions are vague and this allows the tax inspectors to interpret the law on the basis. I have been told that in the past I took advantage of a provision in the law, and now I am to be fined for something that I was told was legal only several months ago. It is as though the law is set up to trap us. This is the result of inspectors being allowed to interpret vague regulations.” (B15) “I have heard of retroactive reinterpretation of tax laws, it does happen” (B23) “Inspectors have told us to follow a traditional practice of accounting since certain changes are implemented for a short period of time and then reverted back to the old way. Any serious changes then are simply done later towards the time of quarterly or annual reporting. This is really stressful, we can get caught and then what, it isn’t [the inspector] paying the fine” (B24)

Vague legal wording is a problem as well. The suspicion is that the less clear the law, the easier it is for the inspectors to find discrepancies. “Tax regulations have been diluted to make them more vague. It is to give more power to the Inspectorate for revenue collecting. If they can adapt the vague law any way they can, they can collect more money.” (B26)

Selection of Enterprises for Inspection

184 This is understandable. For instance a company may siphon profits by non-payments from another company (or barter, etc...). In such a case it is reasonable to demand taxes based on accounting profit figures,
According to most small business owners, none knows how their business is selected for inspection. Most of those interviewed suggested that the inspection was a regular occurrence and that there was no way of avoiding it. “Our name must get drawn often because [the inspectors] come about eight times in a year, sometimes more.”(B21) “There should be a method of choosing a company for inspection, but I don’t know what that might be.”(B3) “I wonder how it is that they decide which business to visit. There seems to be no order.”(B10) “We are on some registry for tax inspection, we are a registered firm and so I assume that is why [inspectors] come to visit us often. I have no idea how the system of choosing us works.”(B21)

**Frequency of Inspections**

For almost all interviewed firms inspections are frequent. Many comment on this as being unacceptable. For many the inspections seem to be every few weeks despite the presidential decree limiting inspections to once a year. “The inspection service inspect too often.”(B1) “I am angry with the number of times [inspectors] show up here and the number of times I have to go to the taxation office.”(B5) “Visits concerning taxation - about every two weeks.”(B17) “We are a fast growing firm and we have advertising which makes us visible. As a result we are visited every few weeks.”(B18) “The tax inspectors will sometimes come to the enterprises once every two weeks.”(B19) “There are weeks that so many inspections occur that there is no time to go out and look at new products.”(B23) “Inspections occur too often.”(B26) “Constant inspections. Just as a project gets on the rails, the inspection arrives. Really it is all the time.”(B21) One interview suggests that the frequency of tax official visits has changed not cash (in general cash balance is easy to manipulate and cash easy to transfer outside so that it cannot be a
recently. "The inspectors used to come as often as once every two weeks. They would spend the whole day and sometimes two reviewing our books and watching what we do. They still take as much time now but they don't bother us as often." (B11)

**Notification**

When notification of inspection occurs, there is less complaint. Concerns arise with the subsequent unannounced inspections. "We got a letter to announce the first inspection, then the same individuals come by and they never let us know when they come." (B10) "I sometimes get telephone calls or notices by post. The phone messages I can ignore but when a notice arrives in the post, I know it is serious." (B17) "They send us official notice, but mostly we know when the inspection is coming, through our contacts in the taxation office." (B18) Some experiences show that the process of notifying the enterprise is inconsistent. "(...) they are rarely announced and we have no choice but to brace ourselves and hope for the best." (B1)

The experience of many firms is that the required ten day minimum notification period is rarely adhered to. "A few days notice is normal." (B6) "One, two, maybe three, maybe even four days before the inspection I get a notice, not more than that." (B23) "Notices come about a week before the visit, maybe less. I have had a notice that arrived as the inspector was sitting at the desk." (B26) In the interviewed group one commented that the notification period was consistently maintained "I would say that notification is done normally. About two weeks before and inspection we are told what to have ready and when the Inspectorate will arrive. That way we are ready and there are few surprises." (B22)

---

249
For some the notification does not happen at all. "[Tax inspectors] come often, and unannounced (...). "(B21)

 Surprise Inspection

Surprise inspections are very common and until recently were somewhat of a norm. This is the source of great stress and anger among many entrepreneurs. "In my business life I have yet to receive a notice that they are coming. They come whenever they want. That is my experience." (B4) "Why do they hide and then arrive unannounced at people's doors? This scares people." (B5) "The surprise visits are not that common. They happen, but that may be the fault of not getting the post or missing the message" (B15) "It is difficult to call this an unexpected inspection. They are all expected whether they tell us or not. The inspectors will come sooner or later, it makes little difference if one knows that they are coming." (B17) "Sometimes they inform us that the inspection is due, sometimes not. I prefer it when they do, I can then prepare psychologically." (B18) One published account recently told of an enterprise owner being visited by the tax inspectors on a Sunday morning at home. Though the home address was not the business address of the company, but only the home address of the owner, the inspectors said that they had to complete their work on time.  

 Arrival of Inspector(s)

---

185 Chern'ova, Nadia, "У неділю до вас у гості тепер можуть збігати не лише свідки Єгови, але й податкова адміністрація", Habyski Kontrakt #5 (1998) 126
According to the enterprises there is little about the inspectors’ arrival to the site that is of note. Preparation may involve gathering materials requested by the authority in their notification, otherwise there is little preparation involved. The process seems to start uneventfully with little formality or structure. “It is not possible to prepare for their arrival (...)” (B1) “[inspectors] show up on the doorstep to the shop and we have to stop what we are doing to show them our books” (B1) “Exactly like you. You arrived, you said ‘good day I would like to talk to you about inspections’, simple, they do it the same, only with them the consequences are quite different” (B2) “I don’t know how it is supposed to start, they come in and review whatever they want. (...) I don’t know how else it is supposed to start.” (B5) “They arrive at my office and simply say good morning we are with the Inspectorate this is an inspection. But I know who they are before they even say anything.” (B8) “Inspectors have already told us in the notice what to have ready. The books are ready for them when they arrive. But they inevitably ask to see more. That sometimes takes time to put together or to collect from the safe or even from home.” (B10) “An inspector will often show up and spend a day or two ‘inspecting’ our books and often more than just the books.” (B11) “[Tax inspectors] just turn up, no notice, no letters, nothing, they are there on the step demanding to come in.” (B12) “The tax inspectors come into our office. (...) We don’t know when they will be there, they just turn up.” (B18) “As a legal business, the tax inspector can now come to me and get my books for verification. However, they don’t have my home address and so they cannot find me physically. They do have my legal address, which ensures that they only send notices to that one place. I can choose to pick up the notices there.” (B17) “They arrive, without notice every few weeks(...)” (B19)

Provisions for Inspector(s)

A number of respondents described certain provisions provided for and on occasion demanded by the tax inspectors. Documents and full access to files is provided. In most
cases the enterprise provides a desk or an office at which the inspector can work. In some instances that place is permanently reserved for the inspectors. "We have an accountant who is responsible to meet with the taxation officials, there is even a special office put aside for their use while they inspect us." (B18) The provisions are sometimes used as a part of a strategy to make the inspector happy and comfortable. "The tax inspector uses an office here and becomes one of the employees. We make them feel at home, they have our coffee and they talk to our employees." (B8) On occasion the Inspectorate is very precise in terms of what the enterprise must provide. "Tax inspectors regularly give businesses instructions on how to handle (yak obsluhovuwaty) the on-site inspections. They are told that breakfast should be served at about 11 am and there should be sandwiches and champagne, lunch at noon and if they are still at the offices at dinner time there should be a meal taken in the evening in a restaurant." (B11)

On-site Inspection

The inspection itself is seen by the enterprises as many different things at once. The inspection involves the review of the accounts/books, and the payment of fines. Entrepreneurs view the inspector as an interloper and to some extent one who is determined to find errors in the books, even if such errors do not exist. "Taxation officials search the books for some discrepancy until one is found" (B1) "[Inspectors] review the same thessis over and over, as though looking for errors or some little detail to blame the business and then to set a fine." (B13) "they are always asking why we do certain things and what things cost. Even if I am doing a favour for someone, they will ask why I am not getting money for the service" (B11)
Some believe that the Inspectorates methods are unfair, and, in some instances, mounting a long-term investigation into the operations of the enterprise. Furthermore, the enterprises feel a sense of helplessness in the face of such procedures despite the presence of an appeals mechanism. “The fines and contravention of the rules are all documented and are used during and following inspections as a track record of what has been paid. But as a business there is no way we can verify if the claims made by inspectors are valid. There is an appeals process but first of all it is expensive and second there are few businesses brave enough to complain against the inspectors.”(B1) “Books cannot be properly inspected based on current accounting practices, evaluation of taxes is done by intuition.”(B13) “When [inspectors] are here, I try to look at my own company as though I were an official. It’s the only way of understanding the process. You must see the rules from their perspective. They interpret the rules, we pay.”(B15) “No matter what they do, it is correct, who would be stupid enough to argue with them?”(B17)

**Duration of Inspection:**

The question of time and cost are two principal indications of difficulties with the procedures. They are measurable to some extent but their inconvenience leaves a lasting bad impression on entrepreneurs, one they are likely to recount to others. The problem most SIEs have with the duration of the inspection is its length coupled with frustration of not knowing how long it is supposed to take. “They spend as much time as they need to find discrepancies in the accounting and to levy fines and penalties.”(B1) “The visits takes up a lot of our time, much more than it should.”(B1) “Our shops are fully computerised and our books are computer generated. They are submitted regularly according to the law and still the inspectors come and sits on us for days - far too much time is lost on matters of tax.”(B1) “They spend anywhere from a day or two reviewing our books. They then take books with them and spend weeks looking at them in their offices.”(B4) “For me, the
inspections last far too long. There are times when the inspection can go on for days. Is it supposed to take up that much of my time?” (B18) “What is really a problem is the amount of time they spend here. (...) The tax officials come by and they watch our work, they stay, I think, because there are always lots of people about whom have cigarettes and we have lots of coffee. That may be partly the attraction to stay for such a long time.” (B21) “The procedure is long and the waiting for results of the inspection can take up to two weeks. Asking me to wait for two weeks is unbelievable. What do we do without our books for two weeks. I have an accountant that I pay and she can’t work off Xeroxes.” (B22) Some entrepreneurs simply mention that the inspection lasts for some time but they are seemingly not bothered by that fact.

“The visits normally last about two to three hours, and on occasion they will come for two or three days in a row. This only happens once in a while.” (B19)

Repeat Inspections:

Multiple visits are a well-known problem, widely reported in the media. Many of the entrepreneurs indicate that they are visited several times. “Of course they come back several times. They bring with them details of their last visit and recheck everything. (...) They come back five or six times” (B1) “[Inspectors] come as often as they need to. That sometimes means four or five visits a year, sometimes more. I have heard of some firms being visited more often.” (B2) “We pay taxes constantly and so we are inspected constantly. It almost seems normal. But so many repeat inspections with the same figures reviewed. Why do we need this?” (B4) “Members have told us that the repeat inspections are a problem, there are many of them and they take up lots of time and energy. We need to know what the future will be so that we can plan for the constant intrusion into our businesses.” (B8) “[inspectors] are always coming and inspecting. Our books are looked at every quarter, though now it should be less, but it isn’t. They continue to
arrive and review our documents.” (B10) “The Inspectorate seems to send their people to the same businesses repeatedly.” (B13) “Repeat inspections are common.” (B15) “There are repeat inspections.” (B21) “Yes, we are repeatedly inspected. This is a waste of our time.” (B22)

Fines and Penalties: As certain as death and taxes

Losses of time and actual costs are the lead financial losses to a company stemming from inspection. Though it is difficult to gather accurate evidence of the figures themselves, the general notion and perception of payments is a useful measure. The companies interviewed declined to open their books, and no one wanted to disclose the actual sums they were paying out legally or as informal payments. They were in some cases, prepared to state that they were being told to make payments, sometimes these were significant amounts. “The [payments made during the inspection] vary from insignificant amounts to large sums. We have paid so many different amounts that there is no way of telling how much it has been.” (B1) “The inspector comes and I am already thinking of the cash I will be paying him.” (B3)

Some companies understand that the payment they make is a means to conclude the inspection. As though the process of inspection is used as a form of harassment, encouraging business to pay officials to stop the provocation. This is seen by most as a wrongful type of payment but one that they cannot avoid. “When tax inspectors arrive they are paid off quickly after small errors when they discover some small errors in the books.” (B4) “I know they are ashamed of taking the money and we all know that it is going to them and not to the budget” (B5) “A small payment often concludes the inspection. The tax inspector is happy to have some money and the retailer is
happy that a minor charge was made but that the books were not completely reviewed and the inspector is off
their back.”(B9) “I cannot afford to tell the inspector I will not pay him.”(B11)

Only a small number of companies interviewed suggested that the payments were
acceptable. These entrepreneurs also proposed that the tax inspections were becoming
professional and responsible for their work. Among these, some also suggest that there were
fewer demands for bribes. “Personally I believe that it is a good time for taxpaying. The process is
improving and the money paid is clearly being passed on to the state budget. Receipts are issued and the
mechanism for checking up on the inspectors is known.”(B15) “The legal tax burden is unlikely to change,
but there will be amore professional tax Inspectorate and competent inspectors. This will change the informal
payments.”(B15) “We are assessed and the payments are quite fair. Sometimes we are caught and
fined.”(B18) “Recently I have felt that [inspectors] have been more diligent in taking official fines and less
interested in taking money for themselves.”(B24)

Behaviour of Officials

In the relations with officials, the entrepreneurs often comment on the general behaviour of
the inspectors. These comments also give an indication of the character of the relationship
between business and the STA. “Taxation officials search the books for some discrepancy until one is
found. Their task is to raise money for the state budget or for themselves; they will do anything to get it.”(B1)
“[The tax inspectors] operate with full authority.”(B1) “The tax officials behave (pochuvayut’ sebe) more like
owners than inspectors or public servants.”(B1) “Tax inspectors have been unprofessional, but in Ukraine
that is expected.”(B5) “There is little consistency from government officials. Every official and every office
are different and one has to be prepared for whatever they want and whatever they say.”(B7) “Tax inspectors
cannot be contradicted and should not be vexed, or else they can take whatever they want." (B11) "If the officials are being too demanding, there are people we can call to get them off our backs. It is an expensive favour to call in even if you are paying for it, but sometimes there is no choice. (...) Even after a call like that though there are ways for the inspectors to get back at us." (B11) "The tax inspectors may not always be competent but they are always right." (B15) "It is not new in our society to have people come into an office to do a job and not know what they are doing." (B18) "It is harassment of the highest kind and we cannot avoid it." (B22) "They own us, and in real terms as well. They make decisions about how we survive. They own the business by that decision." (B23) "Most entrepreneurs feel that the STA is taking too big a part in the business. The inspectors are virtual partners in every business they visit." (B24) "I think that [the inspectors] are too busy to care about our futures as individuals. They want our tax money and they don’t care what it costs us." (B26)

Strategies of SIEs Towards Tax Inspection

Dealing with tax inspectors often requires particular skills or strategies. For many respondents such strategies are believed to be the only way to survive an inspection without significant consequences, such as more detailed revision of business documents or demands for greater payments. "Money is always kept in cash in case of surprise inspections." (B3) "It was suggested by a tax inspector I befriended, to make several minor but obvious errors, he even told me where and how to make them. For these errors I would be charged a small fine but I would not undergo a thorough inspection." (B3) "There was a time that we knew when the bank accounts were being verified, and we were able to take out most of the money in the account, wait for several hours and then put it back. The tax inspectors would only see the small amount and that is what was registered as our account holdings." (B3)
"The main strategy is to hide our profits. We are taxed on profits. We try to register our profits as [zero] or some small amount which will not attract too much attention."(B7) Anecdotally — "I was approached by a senior member of the tax Inspectorate who came to our business, I read his card and asked if it was time for me to [start baking crackers and packing my toothbrush (pykty sukhari i braty shchitku do zubiv)]. He told me they were not after people like me but for big fish (velyki rybly). (...) He came to enquire about the service our firm provides. I decided that we would provide the service free of charge. (...) It was our only recourse. I learned a long time ago that such people expect preferential treatment even though I am under no obligation to give it to him. (...) If I did not provide the services to him he might have made demands (pytensii) on me. My thinking was better to do this one for free and recoup my losses later rather than have long term hassle from the tax people."(B4) "The mentality of people here is based on how to avoid paying taxes."(B9) "The trick is to make them happy, get them involved in something on the periphery of the business and that way they are preoccupied but they don't find out the tricks of the trade."(B11) "I will generally keep about 1/3 of my business activity hidden, and pay tax on about 2/3. The 1/3 I keep hidden is to ensure that my workers get paid each month."(B13) "fooling many of these people is easy and it is more a question of occupying their time, then to give them some information that will make them look good in front of their managers. They get the chance to fine us a little and then the visit is over. (...) We all know that the inspector must go back to his office with some kopeks in his pocket to pass onto his manager, some to the office coffer and some for himself. Once these accounts have been satisfied, we are able to work on our business with no trouble."(B18)

"My strategy is to be nice to [the inspectors] and give them anything they want. They are powerful people and during the inspection they can have anything they want from you."(B21) "I talk as little as possible while they are doing their work. They can use it all to their favour if you say anything."(B26)
Some interactions demand a host of definitions of standards, regulations, and norms. Fire safety is one such interaction. Due to the unstructured nature of the risk of fires and the number of variables, compliance to all fire safety rules is virtually impossible. As a result, the fire risk of each specific site has to be weighed giving inspectors, as individuals, far reaching authority. In such a case, the fire safety organ is expected to follow properly set, clear and precise regulations on methods and procedures of inspection. Such guidelines for inspection, as with other interactions, need to be detailed in order for SIEs to adhere to them and to counteract what are often vague standards and discretionary methods of inspecting for fire risk.

Introduction

The interest of any state to protect population and property from hazards such as fire is self-evident and universal needing no elaboration here. The need for fire safety in times of transition is perhaps even greater. This is particularly so in situations where ownership of property is becoming a complex matter, where the general state of disrepair to many buildings is compounded by a poor economy and where there exists an environment in which few can afford the money or the time to renovate. Enterprises are making
improvements and renovating buildings in an effort to make them more suitable as work environments and more attractive for prospective clients/customers. Bound by its responsibilities, the state must survey the condition of each building and attempt to balance the risks of fire and the economic conditions of the population. Inspectors have the authority to inspect and survey properties with an eye for the potential problem spots and mete out instructions and orders for adjustments, repairs or improvements all aimed at lowering the fire risk.

Enterprises, unlike governmental and non-governmental organisations as well as citizens, are in positions where they are seen by authorities to be attracting customers, presumably making money. This in turn is taken to mean that adherence or partial compliance to fire code is possible and necessary repairs and renovations to their own or their rented properties can in theory, be made. The responsibility of the state also extends to protecting enterprise and its property from fire as well.

As said before, adherence to the fire code by anyone, let alone a newly set up enterprise is a complicated and often expensive undertaking given the number of requirements and duties of the enterprise. It is also unlikely that most companies anywhere would spend more than the minimal effort and cost to comply with code or take the necessary and recommended steps to ensure a high level of fire safety awareness among employees. In other words the place of fire safety in the list of priorities of a SIE is likely to be quite low. Nonetheless they still have an obligation to comply with code.
Background

The fire safety regime in Ukraine is a direct legal descendent from the Soviet set of regulations and norms. The collapse of the Soviet Union did not change the fire risks and therefore the fundamental principals of fire safety along with the operations of the various agencies were not changed either. During the Soviet period the Ministry of the Interior was responsible for matters of fire safety through its substructure, the State Fire Protection Service (SFP) (Державна пожежна охорона). Much of the SFP's structure has remained the same, and continues to operate under the jurisdiction of the Ministry of the Interior of Ukraine. The State Fire Safety Oversight Agency, as a branch of the SFP, is responsible for tasks associated with the inspection of premises and the investigation of fires. Within the Agency is contained the State Fire Safety Inspectorate (further 'Inspectorate').

The functions of the Inspectorate are described in the Law of Ukraine, On Fire Safety adopted in December 1993. This law, in conjunction with the Position Thesis On the State Fire Protection Service confirmed by the Decree of the Cabinet of Ministers of Ukraine, sets the fundamental structure of the fire inspection along with the rights and duties of Inspectorate. It also sets out the requirements and obligations of the enterprise regarding fire safety. The Regulation On Fire Safety in Ukraine (further 'Fire Code') set by the State Fire Safety Inspectorate and confirmed by the Ministry of the Interior in July 1995, details certain guidelines for the Inspectorate and specific details of the fire code itself, including particular requirements for enterprises.
The number of laws and regulations relevant to fire safety are few. Overall, while the content is substantial and detailed in matters such as rights and duties of personnel, information pertaining directly to fire safety inspection is quite limited. Three principal documents are relevant to this case.

The first, the Law Of Ukraine, On Fire Safety, delineates the responsibilities of the state fire safety authorities and the enterprises the law makes several points including:

- The guiding principle of fire safety in Ukraine stating that it is the responsibility of the enterprise and rests with its owners, directors or designated responsible people, unless otherwise stated in some formal agreement. Anything not noted in the Law of Ukraine On Fire Safety, is the responsibility of relevant bodies of the central government, the municipal and regional structures of central authorities, and organs of city and regional self-government.

- Any decision of the Ministry of the Interior (overseeing body responsible for the State Fire Protection Service) regarding questions of fire safety, is binding for all. The decisions include the results of inspections and surveys. Any decision and accompanying instruction must be complied with even in the event of an appeal. The

187 Ibid. 4
decision may only be appealed to the head of the division where the decision was made, or to the individual officer making the decision. Further details about the procedure of inspection are elaborated in Article 5 of the Law “Duties of enterprises with respect to fire safety”. In this article, the enterprise is duty bound to comply with fire detection norms, standards, regulations, and laws, as well as to comply with decrees, decisions and instructions of the State Fire Protection Service. The enterprise is also expected to submit upon request any documentation or evidence showing the state of fire safety of their premises.

- The Fire Safety Oversight Agency, which includes the Inspectorate, has full authority for fire safety in all places and over all entities regardless of form of ownership. No extended description is provided except in terms of explaining its functions.

A second principal document is the Position Thesis On State Fire Protection, confirmed by a decree of the Cabinet of Ministers of Ukraine, and the Regulations for Fire Safety in Ukraine set by the State Fire Protection Authority. There is one provision within that document on delivering information to enterprises. Section 5 paragraph 6 states that the State Fire Protection Authority is to “organise dialogue with enterprises on matters of fire safety and fire prevention techniques.”

The fire code itself makes no provision for the dissemination of information about fire safety inspections to enterprises.

---

188 Ibid. 5

263
Access

The normative regulations concerning fire safety are printed in their entirety in a published book called Fire Safety: Normative Acts and Other Documents. The book is printed in Ukrainian and in Russian.

Access to information by enterprises is elaborated in the Position Thesis On the State Fire Protection Service. Article 5 paragraph 26 states that the State Fire Protection Service has the responsibility to inform the public on matters of fire safety. This is done “through free use of state broadcasting and print media to inform the population of the spread of fire as well as to advertise fire prevention methods.” The documents make no mention of disseminating information and/or materials concerning fire safety regulations that apply specifically to enterprises.

Selection of Enterprises for Inspection

According to the law On Fire Safety all enterprises must undergo an inspection. The Law states in article 7 that the fire Inspectorate “Is to prepare, with the participation of other interested ministries and central organs of state administration a program of fire safety verification and inspection, obligatory for all enterprises, institutions, organisations and citizens.” The Position Thesis On the State Fire Protection Service reiterates the same point: the Fire Protection Service is to submit plans for work to the state bodies, municipal

189  Ibid. 36
191 Law of Ukraine On Fire Safety, 8

264
centres, to enterprises and others. This is the only provision that suggests a pre-planned selection process. The Fire Code makes no mention of the selection of enterprises.

According to one interview (G7) a work plan is submitted to the State Fire Safety Organ, the Ministry of the Interior, the Municipal authority as well as to the enterprise. The plan details the entities to be inspected for a particular area during that month. The Inspectorate draws up a roster of entities and distributes them among individual inspector teams who select the order of inspections on that list. No other selection process is implemented. "It is a question of administration. We have so many buildings to inspect and so many inspectors. We need to be methodical and efficient to get through all the work that has to be done in a month." (G7)

**Frequency of Inspections**

Article 7 of the Law on State Fire Safety makes reference about the frequency of inspections. It states that "The State Fire Safety Oversight Inspectors have the right to (...) conduct, at any time, technical fire inspections and investigations of an enterprise, in the presence of the owner or a named representative and to obtain explanations, materials and information."^192

**Notification**

The notification of inspection of enterprises is, according to the legal documents and the officials themselves, sent out as part of the monthly work plan as determined by article 7 of the Law on State Fire Safety. There is, however, no specific mention of a notification of
upcoming inspection sent out to enterprises and the Inspectorate is mandated to carry out inspections “at any time”. There are no provisions in any of the documents about the amount of advance notification to be given for the inspection. This is also corroborated by the interviews with officials.

*Surprise Inspections*

The evidence from the laws and regulations discussed in the previous sections suggest that all fire inspections are “surprise” inspections. In the Presidential Decree On Certain Measures On Deregulating Entrepreneurial Activity (July 1998, # 817/98) it was decreed that there shall be no more than one inspection per enterprise per annum, during which all state organs must co-operate on conducting all oversight in one visit. The Fire Safety Oversight Agency is also bound by the Presidential Decree.

A monthly plan is prepared by the regional fire Inspectorate and submitted to the local administration. This plan, “available to the public” (G7) shows what areas will be covered during a particular month. “Each has the responsibility of being aware of the coming inspection.” (G7)

*Arrival of Inspector(s)*

---

192 Ibid. 9
193 Ibid. 9

266
The arrival of inspectors is not detailed in any way in the legal documents. No provisions for warrants or identification are noted. The presidential decree of 1998 suggests that businesses have a registry of inspectors to be signed by any visiting inspection officials.

*Provisions for Inspector(s) (Duties of the enterprise during inspection)*

The law On Fire Safety identifies among the responsibilities of the enterprises, to comply with the instructions and decrees of the various state fire safety bodies. It also identifies that SIEs “submit, at the demand of fire safety authorities any information and/or documentation showing the state of fire safety of buildings and production.”

The fire code notes the same two specific requirements of the enterprise during inspections. Requirements described in the law are included verbatim in the fire code.

*Duration of Inspection*

None of the legal documents mention the duration of an inspection. There is no reference to the amount of time that an inspector may take to complete verification for compliance to all provisions of the fire code. Government officials note that the inspection should be done in one day as a result of a 1998 Presidential Decree, which also limits limiting the number of inspections allowed in a single year. Previously, the fire inspection could take up to several

194 Ibid. 7
days depending on the size of the enterprise and the number of buildings. "A large factory could take six to ten days if it had many buildings. A small enterprise should not take much time." (G7) “Inspections should take as much time as necessary. The important thing is to ensure that there is no fire risk. (...) If an enterprise has many violations, that process can take much time." (G8)

Repeat Inspections

Repeat inspections in this case are understood to be additional inspections within the space of a single year. Though repeat inspections were legally disallowed in 1998, the law On Fire Safety made no earlier mention of permissible repeat inspections. The same holds true for other available legal documents. Before the 1998 Presidential Decree, the Inspectorate would “investigate when we think there might be a new risk, or if something has changed in the enterprise.” (G7)

Fines and Penalties

The Law of Ukraine On Fire Safety is clear on the general provisions for penalties. In article 35, the law states that “Fines and penalties are imposed for violations of the fire code as established by law, for creating impediments to work done by the State Fire Safety Oversight Agency, or the non-compliance to orders/instructions. Owners, ranking officers of firms or other responsible individuals may also be held responsible for violations of fire regulations.”

---

195 Ibid. 25
The inspectors during as well as after the inspection determine fines and penalties for fire safety violations. During the inspection the State Fire Safety Inspector is to “apply fines and sanctions against enterprises for violations of the fire code, non-compliance to instructions and orders from the Fire Safety Oversight Agency.” The same provision is made in the Position Thesis On the State Fire Protection Service, section 10, paragraph 6, “Ranking officials of the State Fire Safety Oversight Agency have the authority to: (...) impose fines and penalties upon enterprises in the event of violation/s to the fire code, non-compliance to instructions and orders from officers of the Fire Safety Oversight Agency.”

In determining the penalties, inspectors are guided by limits of fines for particular violations. The Verkhovna Rada law states that “the maximum penalty amount to be paid for violations to the fire code cannot exceed 2% of the monthly earned income of an enterprise.” In addition to that the law also states that the amount and order of imposing fines “are indicated in the relevant laws of Ukraine.” The relevant law is the Codex of Ukraine, On Civil Violations whose article 188 states that “the non-compliance to orders/instructions set by the State Fire Safety organ, or the creation of impediments to its work, carries a fine of 3 to 7 non-taxable citizen’s income minimums (мінімуми). (...) for enterprise owners, directors, responsible persons (managers) from 5-10 non-taxable citizen’s income minimums.” Payments are made to the accounts of the local STA offices in the region of the SIEs’ registration.

196 Ibid. 10
197 Position Paper On the State Fire Protection Service, 39
198 Ibid. 25
199 Kodeks Ukrainy 'Pro administratyvni pravoponovinnia,' Kyiv: Vydavnytv "Pravo" (1998) 83
Article 18 of the Law on Fire Safety in Ukraine states that no one is to give orders to the inspectors while they are conducting investigations or verifications of premises. Only their immediate and direct supervisors are authorised to give instruction and change orders. “No one has the right to make demands of a fire safety inspector during his fulfilment of mandated tasks.” Among rights accorded to the Fire Safety Oversight Agency are the provisions of article 7 in the law On Fire Safety.

The points raised in Article 7 clearly set out five rights of the fire inspectors. These include conducting at any time a technical fire inspection and investigation of an enterprise in the presence of an enterprise owner. Instructions and orders can be given with respect to correcting or fixing violations to the fire code. With this investigative power also comes the authority to suspend operations until compliance is met. The Article also gives the inspector the authority to oversee the control over fire regulation compliance during any construction or renovation of property. Administrative responsibility can be brought against the owners of the enterprise in case of violations to the fire code and against those found tampering with fire protection equipment. Finally the Article gives the inspectors authority to determine fines and penalties. It is the ranking officials of the fire safety Inspectorate who carry full responsibility for fulfilling the duties mandated by the law.

---

200 Law of Ukraine, On Fire Safety, 15
Nearly all SIEs interviewed claimed that the fire inspection is one of the most difficult inspections to get through unscathed. No enterprise appears to be able to avoid the inspection or paying a bribe. The formal regulations are, according to interviews, regularly flaunted and in many cases those who inspect have little or no real training in fire safety. The procedure of inspection is generally seen as haphazard: the inspectors are viewed as incompetent, and the process as a charade where the inspector pretends to inspect but already has predetermined the problems and the amount of the fine. “Fire inspectors are impossible to please and they will find a reason to fine a business. Taxation is different because it is facts and numbers, while fire inspection is practical and they are able to find fault with anything.” (B1) “Who knows how the inspection is carried out, we worry more about when it will end. (...) What they do from the time they enter to the time they leave is a complete mystery.” (B9) “Of all the inspections or government bureaux, the fire inspection gives us most trouble.” (B10) “Fire inspection is a problem for us.” (B11) “I wonder who writes the manuals for these inspections, they seem to know lots about the causes of fire, but the inspectors I have spoken seem to have no formal training in fire-fighting or physics for that matter.” (B11). “[Fire Inspection] is the most frequent visit our businesses get. We have had incidents of inspectors visiting some enterprises are often as four or five times in a month.” (B14) “We get visited by inspections very often, even sometimes by the same individuals who think that they can find something in the office that can interest them even though they were here only a week ago.” (B18) “They have no training, they are unaware of the regulations and they come here knowing that they will leave with money in their pocket. This is an unbelievable process.” (B22) “Inspectors come in to our office they look around from their chair, make a few notes and present us with a bill, they don’t even pretend to know what they are doing.” (B23)
Some entrepreneurs believe that no matter what the preparation, violations will always be found. "Fire inspections happen often and there is always a problem discovered even if there isn't one." (B3) "All properties [here] violate the fire code in some way." (B15)

According to some, the written regulations are difficult to obtain, too vague, or they are seen as complicated. For many entrepreneurs the exercise of reviewing the laws as they are written is a pointless one. There seems to be a suggestion that the format in which the law is written is inaccessible to people. "I have tried to get the documents to help me prepare my business for the inspection. Since fire regulations come under different jurisdictions, it is difficult to read over all the materials and prepare our workplace against fire risk." (B4) "[Inspectors] could find a fire hazard in a water container if they wanted to. They would even be able to use the fire code to support their claim. (...) Here, rules are irrelevant." (B8) "One regulation can mean two opposing things." (B11)

Selection of Enterprises

The enterprises made little comment about the selection of enterprises. There is a sense that the inevitability of a fire inspection is accepted. The few who did comment suggested that there was no evidence of a procedure for selection. "[Inspectors] know which firm they will examine. They see the type of business and they choose the ones more likely to have obvious violations." (B2) "I think that they choose us based on who pays and who has money to pay." (B3) "There is no selection process. Every one of us is going to be inspected, some more, some less." (B4) "Certainly there is a selection process. They select every company and inspect them all." (B9) "I think some places are visited more than others." (B10) "I don't think there is a process to choose firms, they all get inspected. I have never met a businessman who has not had dealings with fire safety authorities." (B13) "There is no process, everyone gets
inspected.”(B14) “We are definitely a target for selection by the Inspectorate. The nature of our business makes it clear that we are interested in having our place fire proof.”(B21)

Frequency of Inspections

A number of enterprises felt that the frequency of inspections was related to the type of business. The people who work in offices tend to have less frequent visits from fire inspectors than do those in manufacturing or in high profile enterprise, such as shops and restaurants. Over all the frequency of fire safety inspection is felt to be quite high. “We are always being inspected. They used to come less frequently but now [March, 1997] it is almost once a week.”(B1) “Of course they come often, whenever they feel the need to.”(B3) “We get a few visits a year, more than we should according to the law.”(B4) “I hear that some people get inspected weekly. But it depends on the type of business. For us it is not that often.”(B5) “The Law says once a year, but [inspections] are happening more frequently than that.”(B6) “We don’t get inspected by [the fire Inspectorate]. We have a place on the street and we don’t sell fire equipment. I guess in that we are lucky.”(B7) “Often, very often.”(B8) “We are a bakery, everything about a bakery is at the same time about fire safety. (...) We get inspected about twice a month.”(B10) “[Inspectors] come several times a year.”(B11) “The evidence we have is that the firms which are producing goods get more frequent inspections than offices.”(B14) “We get visited only about twice a year.”(B14) “Fire inspectors come to me about four or five times in a year.”(B17) “Fire inspection is not one of our most frequent visitors. We are an office providing a service, here there is nothing to burn.”(B18) “In this area the inspections for fire safety occur frequently. There are some companies what get an inspection once a fortnight. Others not so often, but it is much more than the law allows.”(B19) “We get the fire inspector here every two or three months.”(B21) “[Inspectors] come often because they know they can. Who would stop them?”(B22) “There are frequent

273
fire safety visits. But how many, it is hard to say, a few times a year." (B23) “We don’t get as many as some firms. Maybe once or twice a year.” (B26)

Notification and Surprise Inspections

Few enterprises receive any warning of a coming inspection. Several note that if they are aware of the inspection, it is because they heard about the inspector being in the region. Enterprises note no official notification of inspection. “(...) [Inspectors] are rarely announced (...)”. (B1) “They are supposed to tell us, but I have not seen such a notice.” (B2) “Never.” (B4) “Notices are to be published, but they only print a general notice about the regions they will cover in the month. Who will pay attention to that?” (B6) “I don’t get any warning about this kind of inspection.” (B8) “They come so often they probably have decided that telling us would be a waste of time and effort.” (B10) “I am telling you that no notices about fire inspection have been sent to this firm.” (B11) “It is true that rarely does anyone get any notification of inspection. Some do, but the majority do not.” (B14) “[Inspectors] come unannounced.” (B22) “We have no notification of the inspection.” (B23) One enterprise did tell of a letter from the fire Inspectorate that was sent around his raion on the occasion of a regional fire safety day. The letter was a solicitation for ‘donations’, with the amount expected from each firm specified. According to the interview, most businesses in the area donated. “Refusal to donate was simply asking for trouble.” (B9)

The fact that so few receive notification of fire inspection suggests that fire inspection is by nature a surprise inspection and little advance preparation can be done. Most enterprises are resigned to the fact that the inspector will come eventually and that an inspection will be carried out. A regulation about notification procedure seems irrelevant to these enterprises.
"If they send it they send it, if not then so what?" (B4)  "I don’t think so, but if we did get such information it would not mean anything. The inspectors come whenever they want." (B13)  "I may get notices, but I am trying to run a business, not read notices about something that may or may not happen when it says that it will." (B17)  "We used to get notices, but now they just show up." (B21)  "No notices for fire inspection, they just arrive and inspect." (B22)  "No one cares if the notices are sent out. It is completely irrelevant to them. The inspector will come, that is fact." (B26)

Provisions for Inspector(s)

From sources speaking about another type of inspection, it was said that on occasion inspectors send an advance notice to companies being inspected. “This is possible. I’ve heard about such things more than once.” (B3) The notice indicated what should be prepared for the inspector including documents and materials, but also food and beverages. In interviews during discussion on matters concerning fire inspection, no such claims were made. The general understanding is that SIEs are expected to allow inspectors access to the premises and to any information regarding fire safety.

Duration of the Inspection

Several respondents noted the length of time taken for an inspection. Generally the amount of time was low and complaints few. “[Inspectors] spend a few hours (...).” (B1)  “Never more than a half day.” (B3)  “The inspection lasts for several hours but rarely all day.” (B10)  “[Inspectors] spend about two hours.” (B11)  “It depends on the size of the enterprise territory, but I would say a few hours [are spent on inspection] per firm.” (B14)  “Two or three hours are taken up by the fire inspections.” (B18)  “They then
spend several hours going over every square metre of the place." (B22) "Inspectors arrive and spend about an hour every time they come by." (B26)

The fact that it was not an issue for many of the enterprises suggests that the inspections do not last long and are not a great time burden, despite the fact that they occur often.

**Fines and penalties**

According to SIEs there are no set pattern for fines and penalties. Entrepreneurs seem certain that they will pay a fine or avoid a larger fine by paying a bribe. "Of all the bureaucrats, the fire inspection is the easiest to bribe." (B3) The difficult part about determining the cost of the procedure for fire inspection is that there are no evidently set prices for particular violations. Small fines are often suggested by the inspector, these being significantly less than either a large fine stemming from a reported violation or for the cost of fixing the violation.

"Inspectors tell us what amount will make them ignore certain problems. The amount is always less. But in the long run it may be the same or more than what the inspector wants us to repair." (B1) "Few firms pay an official fine. It would ruin most enterprises here." (B4) "The fire inspector wants a steel door to our bakery. I would rather pay the small fine because installing a new door is impossible right now. (...) If the inspectors never visited and I did not have to pay a fine every time they came, I would be able to have the door put in this year or next." (B10) "They fine us for not having a [fire] door. The fine is small, about 20 UAH, but we pay that every few visits. It is still more convenient to pay this than to get the door." (B11) "The fines vary for the infractions, but the fine is rarely more than 100 UAH." (B11) "Inspectors are paid a bribe to let certain things go unnoticed." (B14) "Raids are conducted and under the law the fire inspectors have to fine the owners. It is impossible that a fire code violation not be found. The fines however go to the municipal of regional budget. What is often done is that inspectors suggest that they will turn a blind eye if the owners were
to make a contribution to the fire department, a donation to the purchase of a new vehicle or for renovating the fire station or the offices.” (B15) “The fines are never the same. Every time they inspect the same violations come up. The fines however are never the same. We eventually reach an agreement about the payment.” (B21) “I will say that we don’t pay the full fine nor the full amount of repair. We do pay a small amount usually in cash.” (B23)

**Strategies for dealing with fire inspectors**

Enterprises have found ways of protecting themselves from the inspectors. One method is to pay the inspectors as they arrive in order to avoid a complete fire safety review of the firm. The subversion of due process creates and interdependency between the inspector and the enterprise. The enterprises can be fined or reported for offering bribes; inspectors know they can be reported for accepting them. “Corruption serves to protect both the enterprise and the inspector. Such a system allows the entrepreneurs to continue business as they wish. They pay the inspector a certain amount to avoid intrusive inspection. If the inspector asks for too much money or applies too much pressure, the entrepreneur can report him for taking the bribe. The inspector would then be out of a job. A balance is created.” (B9) “We pay the lesser fine which may, over the long run be more expensive but it is easier for us if we cannot afford one big payment.” (B2)

Others understand that there is no simple strategy in dealing with inspectors and say that the only way to prepare is to be ready for anything. “We cannot prepare for [the inspectors’] arrival, (...) we have no choice but to brace ourselves and hope for the best.” (B1) “We don’t have a strategy. There are too many variables in the relationship with inspectors. Whatever they have to throw at us, we need to be ready. It keeps us very nimble and the thinking has to be clear so that we can respond to whatever scheme they come
up with. They may have the law and the rules on their side, but there are many ways around those laws. That is our job.”(B18)

There is also a sense that without bribing certain officials, the likelihood of business success is low. “If a business does not pay bribes and decides to take the legal route, it is unlikely that their enterprise will succeed.”(B14)

Behaviour of officials

Some entrepreneurs say they feel that they are not working for themselves and that officials have not yet relinquished the notion that bureaucrats are the keepers of the state and everything within it. Interviews reveal a sense of frustration with this attitude among officials. “They have an attitude that they own us. They think we are there to serve them. This is leftover from the old times.”(B10) “Inspectors walking about as if the firm was theirs has to change or else we cannot do business here.” (B13) “They believe that they know everything. There is a sense of ownership, they forget who is working for whom.”(B18) “Fire inspectors know that their opportunity for taking money on the sly is nearly over. They are making the most of it now.”(B19) “Government officials seem to be the owners of everything. Maybe they are unsure of the laws that change so often and so they compensate by being arrogant.”(B20)
CHAPTER XII - SUMMARY AND IMPLICATIONS OF CASE STUDIES

This chapter presents the results of the analysis of the five cases of interactions between enterprise and bureaucracy. The chapter has two principal functions. The first is to evaluate the interactions against the propositions as set out in chapter five. The second is to relate the interactions to the framework of bureaucratic utility maximisation.

The intent is to address the following questions: Does the bureaucracy in Ukraine inhibit the growth of its SIEs through its interactions with the enterprise? Which characteristics of the legal/institutional environment affect the interaction and the officials within it? What elements are particularly obstructive to SIE development? And finally, where are the most blatant opportunities for bureaucratic corruption in the interactions?
The evidence indicates that the interactions themselves are not entirely obstructive and have both positive and negative elements within them. The negative elements however, play a significant role in discouraging the SIEs from undertaking the interactions; in many instances turning the SIEs away from the official economy. It is here that remedial attention is needed in order to reduce or eliminate obstruction, opportunities for corruption and consequently to contribute to the growth of civil society.

This chapter is divided into three parts. The first part provides a summary of the findings from each case and its elements. The second part takes a closer look at the elements of interactions. The third part discusses some of the implications.

Part 1. Case summary

This section summarises the findings from the five cases. As outlined in Chapter V, six propositions were determined and are used to provide a structure for the analysis. They include the following:

- Official information is unavailable to enterprise, or the existing information does not parallel the daily interaction between enterprise and officials.
- The official business fees are irrelevant. Paying informal fees to officials is a necessary part of business practice.
- Access to public services is straightforward through informal contact. Without this type of contact, it is very difficult to get business done.
- The amount of time spent with government officials either exceeds that designated by procedural regulations or is perceived to be excessive.
- It is difficult to get business done without paying bribes to officials.
- Behaviour of officials is detrimental to the completion of interactions with enterprises.

The general picture drawn by the data shows that despite some similarities among the cases, there are few consistent patterns among the elements or themes of the proposition. Yet, what emerges is a preliminary indication of an environment where there is a general tendency of bureaucracy (bureaucrats) obstructing the interactions and thereby obstructing SIE development.

Cases

Table VIII.a shows relative levels of case agreement and disagreement with propositions. Further, it shows which aspects of the cases are particularly problematic and which are relatively free of obstruction.

There are several points worth noting. First, more cases showed agreement with the various proposition statements, although only half of these ranked a “3” - highest level of agreement.
Table VIII.a: Case agreement with propositions with qualifications.

<table>
<thead>
<tr>
<th>Propositions</th>
<th>P1 (information and documentation)</th>
<th>P2 (Money and interactions)</th>
<th>P3 (Access)</th>
<th>P4 (Time spent with officials)</th>
<th>P5 (Bribery)</th>
<th>P6(a) (Behaviour – code of conduct)</th>
<th>P6(b) (Behaviour – public engagement)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registration</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>1**</td>
<td>0†</td>
<td>1</td>
</tr>
<tr>
<td>Certification</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>0</td>
<td>0†</td>
<td>0</td>
</tr>
<tr>
<td>Sales permits</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>N/A</td>
<td>0†</td>
<td>3</td>
</tr>
<tr>
<td>Taxation</td>
<td>2</td>
<td>2**</td>
<td>2</td>
<td>0*</td>
<td>1</td>
<td>0†</td>
<td>3</td>
</tr>
<tr>
<td>Fire Safety</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>0</td>
<td>3</td>
<td>1†</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>6</td>
<td>8</td>
<td>1†</td>
<td>7</td>
</tr>
</tbody>
</table>

"3" indicates agreement with proposition, "2" - intermediate agreement, "1" - low agreement, "0" - disagreement.

* Not a serious impediment to business activity. **In some regions this is a problem, in general however this is seen as a low obstacle to enterprise activity. ^ Attempts made to engage public but largely unsuccessful, little hope for improvement in this area. ^^ Obstructive. +Some improvements noted. Major difficulty continues to be frequency of inspection rather than the time taken per inspection. N/A Not applicable.
Second, only one case, on sales permits, shows disagreement with the propositions, i.e. only this case shows a strong correlation between the normative and the positive versions of the interaction. Moreover, it is the one case where the opportunities for corruption appear low while the bureaucrats’ utility maximisation is constrained, in part by a clear, transparent and relatively efficient framework of the interaction. Third, none of the propositions find unanimous agreement or disagreement with the cases. Only proposition {P6(a)} shows nearly unanimous disagreement with the case evidence. Yet, even here the evidence is inconclusive. The fire safety case shows moderate (1) agreement; for the sales permits cases, the proposition is not applicable; and in the case on registration, public engagement was pursued, but shows negligible results.

Individually the cases provide a number of salient points that should be noted. The case on registration shows that overall the interaction is not as straightforward as it should be, despite the fact that it is the first concrete interaction with officialdom faced by SIEs as they launch their business. This is particularly evident in regards to fees. These are shown to be difficult to ascertain, inconsistently levied and, at time, subject to further discretionary fee assignments. There are also indications that access to information or to the fair application of procedures is a problem area. Evidence suggests that informal payments are extracted from SIEs by creating additional application criteria including the exclusive use of affiliated notary offices for certifying documents. The data shows that the time element of the interaction is the point of greatest difficulties for SIEs. In particular, the timelines set by normative documents are flaunted. Delays are commonplace and used as a means of extracting ‘grease payments’. Finally, there are significant problems with the conduct of bureaucrats. Surprisingly however, there is widespread sympathy for the officials from
entrepreneurs extending even to a sense of understanding for professional misconduct. This was particularly notable in environments where officials are subject to possible remonstration and judgement from their peers, for bureaucrats working alone in the field there is far less sympathy.

The case on certification affirms some popular notions that the interaction is complex and filled with opportunities for obstruction. With respect to information, documents and access, evidence shows that most SIEs are forced to turn to third parties or informal sources for information about the interaction. Seeking alternative, often unreliable, sources creates more work and stress on SIEs, and on aggregate constitutes obstruction to development. As with the registration interaction, time and delays are shown to be serious impediments to the work of SIEs. Lengthy waiting for processing of documents and frequent visits to various testing and examination sites required for the certification constitute further deterrents to business and provide ample opportunity for corruption. In general, the evidence raised here was as expected, the low incidence of bribery in this interaction however, was a surprise. Although conditions for bribery are present, attestation to actual low bribery may be attributed to the constraints of behaviour due to publicly held certification procedures and interviews. The more likely explanation, however, is the discretionary setting of procedures and fees surrounding certification. As a result the bribes can be 'built in' to fees, creating something of a trade off between official exploitation and bribes. Finally, in this case, the behaviour of officials shows disagreement with the proposition. The evidence indicates that the behaviour of officials creates little or no obstruction to the interaction.
The case on sales permits, as noted earlier, provides evidence showing little obstruction to SIEs relative to other cases. It is the one case where the interaction is not viewed as a problem by SIEs and where data confirms strong correlation between normative and positive versions.

The case study on taxation inspection was expected to show that the interaction was a difficult one with significant obstruction and for the most part the data bears this out. There are problems with information and access to documentation; fines and penalties are high and further complicated by unclear regulation and inconsistent implementation. The evidence reveals some shocking claims about bribery and provision of gifts and favours despite significant anti-bribery mechanisms in place. The regulatory structure of the interaction undermines the intent of the latter. It appears that the main culprit is the barrage of constantly changing legislation, regulatory amendments and requirements, making compliance and enforcement difficult. In such an ever-changing environment SIEs cannot penetrate the mountain of legislation, and the inspectors are equally unprepared to enforce them. This makes the potential for extraction high and the alternatives to enterprise but to pay, low.

On the other hand there are two notable surprises emerging from the data on tax inspections. The first is the close correlation in the amount of time allowed by normative documents for the taxation inspection and the actual time spent on the interaction. This is not typical of evidence from other cases. The second is the level of public engagement by officials. Here, evidence shows strides being made towards public engagement. Although normative documents make no such requirement, engagement efforts have been made to
engage entrepreneurs in the public debate on revenue collection and issues of taxation. Despite the encouraging indications of public engagement, the general level of behaviour of officials is still regarded as poor.

The fifth case on fire inspection also shows evidence of widespread problems. Difficulties are seen in every area covered by the propositions with the exception of the time element and public engagement by officials.

The time element has two aspects: duration and frequency. The findings show that the amount of time prescribed in the normative version for an inspection is closely related to the duration of the inspections experienced in practice. The evidence affirms, however, that despite the upside of the correlation between the two versions, the frequency of inspections, not established previously in normative documents, are common. In turn, multiple inspections bring with them significant costs to SIEs including time lost to interacting with officials. The July 23, 1998 presidential decree limiting the number of inspections to one per year has improved the prospect for their diminishing frequency and time lost to inspections.

With respect to the public engagement of officials, evidence shows that public education and awareness campaigns do take place, but there is little to show that these efforts are well targeted or effective. The evidence can only be taken to indicate agreement with the proposition asserting that behaviour of officials is detrimental to the development of business.
Elements of interactions

Having summarised the findings from the cases in general, the focus turns to the examination of the elements of the interaction (documents and information, official costs, access, time, bribes, and behaviour of officials).

Documents and Information

The evidence from the cases shows that despite there being a substantial body of documentation covering most areas of interaction, serious gaps in normative information in the cases on certification, taxation, and fire inspection in particular still exist. This is further complicated by difficulties in finding correct documentation. This suggests that the regulatory framework in these three cases is incomplete or opaque to the point of being a hindrance to the interaction. Such difficulties not only affect the SIEs in their interactions with bureaucracy; the lack of legal or regulatory support impinges on the operational work of officials. Bureaucrats are left to operate in a regulatory vacuum, or to interpret the regulations in an ad hoc manner. This goes as far as setting their own remit thus leading to inconsistent implementation and flawed interactions. In the certification case, the entire interaction was abolished in 1999 as a result of complications in the relationship between enterprises and the bureaucracy.
Official Costs

The picture provided by the evidence showed that the official financial cost of doing business in Ukraine is clearly an area where difficulties require remedial policy attention. With the exception of the case of sales permits, all cases displayed opportunities for discretionary decision making, gate keeping and abuse of power. This was especially clear in the fire inspection case, where the discretionary assessment of fines and penalties serves as a disguise for extortion. In the certification case, conditions for such were present but the evidence was inconclusive in exposing existing problems. Evidence has shown that in the inspection cases as well as in registration, financial costs related to fines and fees are an aspect that cause difficulty and are obstructive to business operations. Overall the costs are high, unfairly or arbitrarily imposed and rarely reflective of the legally set amount. Moreover, the details of the mechanisms for calculating the costs are unclear leading to the perception that the charging of fees or fines is discretionary.

The arbitrariness of the official fees and payments indicates that this is also an aspect where the opportunity for corruption exists. Ongoing difficulties among interactions regarding fees and payments serve to maintain the slow development of entrepreneurial interest per se, motivated, among others, by the reluctance to engage with official structures. This holds true even if the problems with fees and payments are but perceptions.
Access

The effect of access in the interactions is inconclusive. While access to information and to the bureaux is shown to be limited in all but the sales permit case, the interaction is not perceived by enterprises nor shown in evidence to be a serious impediment to SIE development. The traditions of informal access, set in the past, may be key to explaining this contradiction.

Though not a serious obstacle according to the evidence, the lack of access has broader ramifications: it perpetuates informal contacts and access through the use of contact (svātī linãy). This undermines the process of building a civil society and discourages the development of a transparent regulatory environment.

Time

In both inspections and in the sales permit case, the issue of time involvement with officials indicates, surprisingly, that it is less of a problem than was suspected. In the cases related to inspections as well as the sales permit case, the amount of time spent with officials is not a major problem. Although there is some indication that inspections are frequent, there is a trend towards their diminishing frequency. Concern still remains, however, in the case on registration of firms. This is problematic because registration for many firms is the first contact with bureaucracy. Any delays at this stage of business development may have a negative impact on the levels of SIE entry into the official economy.
Bribes

The broad concern with bribery in Ukraine is borne out by the evidence from the cases. Inspection cases in particular show that bribery remains a serious problem, even where anti-bribery mechanisms are in place. The case on registration also indicates bribery activity. The pervasiveness of bribery points to two further underlying problems. The first is the obvious obstructive effect that it has and will continue to have on enterprises: SIE resistance to enter into the official economy or incentive to opt out after confronting too many obstacles. The second, is a comment on officials. The need to collect rents indicates a need for revenues, either for agency or personal use. The continued and pervasive presence of bribery in interactions combined with general revenue deficits in the state budget suggests that officials are simply unable to make ends meet on their existing salaries, or that agencies cannot make their own official budgets meet the demands of operations. The concern for the long term is that continued bribery activity undermines the transparency and fair application of regulations within interactions. Moreover, it raises the spectre of a state dependent on underpaid, self-sufficient, self-interested officials motivated by their own rather than the state’s interest: the growth of the rogue bureaucrat.

Behaviour of Officials

As indicated in the examination of the previous element, the behaviour of officials shows a strong indication that an overall re-configuration of work ethic and practices regarding
interactions between officials and the public is necessary. The interaction between officials and SIEs provides the least tangible but perhaps the greatest obstacle to enterprise development. Policy and regulatory restructuring may eventually address difficulties associated with other propositions, but the behaviour of officials requires a social change. As such, it is most difficult to fine-tune the laws and regulations that govern this aspect of interactions and a desired outcome is difficult to predict. Public engagement is still too tenuous to establish the success of these efforts.

The above examination of the elements shows significant areas of obstruction within the interactions as well as opportunities for misconduct for professionals. Together with the case studies, the combined findings suggest that the difficulties in the interactions are consequential, but the lack of consistency is also significant. Only one case (sales permits) showed a relatively simple procedure, implemented properly and resulting in a straightforward interaction, a near ideal, the others were much less so. Evidence from most of the cases was generally indicative of difficulties and obstructive interactions, but none of the findings were consistent across all cases. This may suggest that while any discussion of impediment to entrepreneurial development must be brought to a level of specific areas of difficulty within the regulatory structure of interactions, the more significant problems lie in the fundamental political, economic and social conditions of the bureaucracy.

291
Part 2. Results: A more general perspective

Evidence presented from the case studies shows that interactions create a variety of conditions and environments for SIEs in their interface with the bureaucracy. The earlier part of this chapter examined this evidence and sought to highlight some of the main findings. Part 2 revisits the theory in order to draw conclusions regarding the questions posed at the outset of this chapter and addressed by this study. These asked: which characteristics of legal or institutional environment affects the interaction and the officials within it, and alternatively, whether these interactions provide opportunities for corruption or whether they form foundations for an effective regulatory system?

Part 2 is divided into three sections. The first shows how the characteristics of the legal/institutional environment are reflected in the evidence. The second takes a closer look at the 'survival-mode functionality' of the bureaucrat. Finally, the evidence from the interactions themselves is used to determine whether a specific interaction provides an opportunity for corrupt behaviour or if it is part of a regulated system based on the rule of law.

Section 1 - Legal/institutional environments

Three environmental situations are gleaned from the theory; in the first, officials act as Niskanen's 'servants'. This is present in the in the sales permit case. In the second, where a
form of legalised abuse of power exists, the official is the ‘master’. The evidence is present in the case on certification and to some extent the registration case. Finally, in the third instance the legal/institutional environment sees officials acting in the role of ‘roving bandit’ or ‘rogue’, extorting bribes and treating the interaction as a personal enrichment opportunity. The inspection cases provide the evidence.

The evidence from the sales permit case shows an interaction that is relatively straightforward and effective. Indications show that the information about the interaction, the role of the officials and the access to that information is uncomplicated, and that the information is generally reliable. Access to the bureau itself is simple, and poses no real threat to the SIE, or access to the official bureau may be accomplished through a third party, again without exceptional cost to the enterprise. The servant environment is also one that is generally fair in terms of financial costs. The data shows that although there are costs involved in the sales permit interaction, the amounts are clearly stated and fairly charged. There are also no indications of bribery. As with financial costs, the time demanded in a servant environment is not excessive and repeat visits are limited and tolerable. Finally the behaviour of officials most closely matches an ideal code of behaviour. There is little or no indication of obstruction by officials and the manner in which the interaction is carried out is supportive of the SIEs purpose. As seen in the evidence the case on sales permits most closely matches such an environment.

---

201 Niskanen, 2
202 Olsen, 4
In a 'master'-type environment SIEs encounter a more problematic set of situations, where the level of obstruction is higher. The information and documentation needed to accomplish the interaction is available, however it is difficult to obtain or as a result of constant changes, may not be reliable. There is also evidence of information on duties of the officials being unclear to the SIEs and occasionally to the officials themselves. SIEs tend to seek out information from third parties. The issue of access to the information or to the bureau/officials is also more difficult. Inadequate information, complicated access procedures and costs make the interaction difficult. The evidence shows that the amount of time spent on interactions typical of the 'master'-type environment is burdensome. SIEs complain of increased delays, long queues, and frequent visits. Furthermore, the time spent often exceeds that allowed for in normative documents. Data suggests that the financial costs within 'master' environments are also high. Though the payments are couched in legal documents, these are often unclear, vague, complicated or difficult to obtain, making the interaction for SIE cumbersome and too often dependent on the unchecked word of the officials. In this environment, the level of bribery is generally shown to be low, however, there is some evidence that suggests that the exacting of additional costs are simply hidden in the normative procedures.

It is in the conduct of officials that the 'master' environment is firmly revealed. Indications are that officials feel a sense of ownership over the SIEs. A patronising overtone exists in the dealings between SIE and bureaucrat, something that is not always tangible but present nonetheless. In the master environment there is little evidence of effective public engagement or dialogue geared to improving the interaction procedures. This type of environment is likely to shows signs of corruption, although not across the entire
interaction, nor even in all regions. Evidence from the cases on certification and registration, show that the overt incidence of bribery, as an example, is relatively low, however, there are areas of the transaction that do lend themselves to corruption and abuse, albeit sometimes legalised.

The third legal/institutional environment is the 'roving bandit' or 'rogue'-type. The inspection cases fall into this type, particularly the fire safety inspection. In this environment the interaction is made exceedingly difficult because of lack of information, very poor access to documentation, and in general negligible access to the authorities that are responsible for the interaction. In such an environment, the duties of the inspectors are virtual secrets and the process of the inspection is effectively under the complete control of the individual official. The information available to the public is general in nature, and is distributed as a general awareness campaign, in the fire safety case, rather than as a directed, informative approach designed to explain to SIEs the requirements and expectations with regards to the interaction. The demands on enterprise time for completing the interaction is excessive by any standard. In this environment there is either no legally set time limit, or if there is it is simply disregarded. As well, the frequency of meetings between SIEs and officials is high, and even though the number of visits is limited, there is evidence to show that, in the case of fire inspections, they occur beyond the stipulated numbers.

The cost of the interaction in the 'roving bandit' environment is unpredictable. It is a key element; in that officials have the capacity to impose arbitrary penalties (as done in the tax and fire inspection cases) plus conduct the interactions between officials and entrepreneurs outside the company. These conditions facilitate corruption. The normative documents
provide little information for the SIEs to plan, to prepare, or to appeal any costs incurred. Data shows that in the inspection cases the costs are meted with absolute discretion, that informal arrangements for payment are a norm, that favours and gifts are not only expected but, in some situations demanded.

The behaviour of officials is a major obstacle to SIEs in such an environment. Not only is the patronising attitude of the 'master' environment present, evidence shows that in some instances the rogue environment prevents SIEs from operating or obstructs them to the point of forcing them into the shadow economy. The behaviour of officials in this environment is shown to be furthest from an ideal code of conduct. In this environment, the opportunity and indeed incidence of officials acting to fulfil their own interest is high. Moreover, the likelihood of endemic corruption within the bureaucracy is very high.

In cases such as the one on inspections the operational procedures may be vague, in some parts, due to the emphasis on political concerns of the legislative and policy framework rather than on efficiency and efficacy of the interaction per se. Further, the implementation of the regulations may be discretionary, or simply wrong according to normative procedures. The role of bureaucrats is often described while the detail of their duties is not. Such findings are not inconsistent with Raiser who argues that most transition economy reform tends to focus first on easier tasks leaving the more difficult administrative reform and policy implementation questions last. In the findings this is exemplified by adherence to existing traditions, powers and duties where the authority is entrenched and maintained while needed.

296

---

changes to policy and their implementation are not undertaken. The role taken on by bureaucracy in such cases is, for the most part, to dominate rather than serve.

Such findings agree with the assertion of Brunetti, among others, that there is a positive relationship between business perception of the credibility of official structures and their growth. Evidence of difficulties in the interactions shows parallel limitations within the activities of the SIEs. In most cases the provision of services and goods is done inefficiently reinforcing the bureaux monopolist position of providers of goods and services with the expected negative characteristics attributed to incumbents of such positions. This is evident in the perceptions by the SIEs of bureaucrats as being domineering, inconsistent in their application of regulations, discretionary with their powers. This behaviour is either associated with Soviet-era traditions or seen as the consequences of economic difficulties associated with the transition period.

Section 2 – The environment of subsistence

The Ukrainian context describes a situation where the government-bureaucratic relationship is under strain largely due to the ongoing effects of the revenue crises of the mid-1990s and the continuing difficulties in balancing the budget and paying off wage arrears in the public sector. The result has been that the bureaucracy, both as bureaux and as individuals, has been left in the main to its own devices. Bureaux seek out sources of extra revenues to fortify their paltry budgets; officials have had to seek out ways to gain then upper hand in
interactions in order to satisfy their own interests. The actions of officials take on characteristics of 'subsistence functionality'. In interactions with SIEs, the normative processes are not followed, the behaviour of officials prevents SIEs from accomplishing work, and bribery and corruption are present features. Though the evidence by no means suggests that these characteristics are present in every case, each case exhibits at least one such element where any or a combination of these characteristics exists. As a result the position of strength and power lies with the bureaucrat.

The evidence from the cases shows a predominant pattern of enterprises undergoing the procedures of interactions on bureaucracy's terms. The interactions offer little by way of public engagement, where they do it is inadequate. The normative procedure in cases on inspections and certification are unclear, inaccessible, and in some instances inconsistent. The SIEs are therefore left to the mercy of officials. In matters of payments the 'mechanism' for calculating fees is often opaque or simply ignored. This evidence lends support to Niskanen's assertion that attention to the interests of the public is based on the addition to the total revenue within the interaction.

The consequence for the public service contract is that the bureaucracy is less able to sustain its part of the contract due to lack of support from the government. Bureaucracy fails to live up to its side of the bargain. The evidence on proposition P2 (on official fees) and on P5 (bribery) shows that in most cases revenues above and beyond those officially prescribed are collected as compensation for the shortcomings of official remuneration or perquisites of office. This also gives rise to support for the possible existence of Olsen's 'roving bandit'

204 Brunetti et al., 8
bureaucrat. Where the evidence of such payments being made is slim or is absent, the procedures are either too straightforward, thus preventing this type of corruption, or there are effective mechanisms mitigating such behaviour.

The findings in the five cases dismiss Chang's view that officials can and do act altruistically. Most indications from the interactions seem to point to self-interest as the prime consideration of behaviour. Evidence suggests that where interactions are carried out according to normative versions, the behaviour of officials does not appear to be a response to 'public-spiritedness'. Rather, it is motivated by the lack of personal gain due to the nature of the straightforward interactions; by heavy public scrutiny, or by anti-corruption mechanisms.

Entrepreneur's actions are based on the needs of running a successful and efficient enterprise. As suggested in the theory chapter, the unhealthy economic conditions of the transition economy orient enterprises to short term business strategies. The characteristics of the interactions precipitate short-term SIE strategies designed to deal with the immediate: to negotiate a way around the obstructions and difficulties of interactions. Such short-term solutions fail to address the real issues and prolong the inappropriate official behaviour. Furthermore, limit access and scarcely any public consultation or lack of public pressure to change indicates that SIEs have little or no opportunity to participate in the improvement or development of the regulatory regime. Again, while this may not have serious implications

---

205 Olsen, 4
206 Chang, 23
for enterprise in the short term, the long-term prospects for development of SIEs is affected; the status quo prevails.

According to the theoretical construct posited in chapter 3, rationality and survival also guide the behaviour of firms. The evidence agrees and shows that behaviour exhibited by SIEs matches the type presented in the theory, but only to an extent. Where the interests of SIEs are blocked by the interactions, ‘rationality’ and ‘survival’ explain resulting actions. There are instances where the SIEs accept increased costs and obstruction in order to be able to participate in the official economy. Sometimes they succumb to devious behaviour themselves. The cases on inspections show that despite heavy costs, many SIEs are prepared to implement a ‘satisficing’ strategy. This allows them to hide parts of their activity while tolerating the rest to the abuses in the system. The significance is that for the sake of being able to participate in the official economy, these firms accommodate a certain degree of corruption or inconvenience, thus allowing their firms to remain part of the official economy.

Section 3 - Opportunities for corruption

Case findings do not suggest that interactions have been intentionally set up by the legislators to provide opportunities for corruption. There is however, evidence that within the cases there are areas as set out in the theory, that meet the conditions for corruption to take place. Even such cases as the fire inspections, they were developed during the Soviet period and have not been altered dramatically. The lack of competition for the services
along with insufficient deterrence mechanisms are conditions in which corruption thrives. In addition general features of the economic system with such characteristics as wage arrears crisis also contribute to corruption. Within the interactions themselves any gap, inconsistency or inaccuracy in the normative documentation provides an opportunity for corruption; as does the lack of access. The inspections, certification, as well as the registration case procedures provide evidence of such opportunities. On the other hand, opportunities for corruption, as set out in the theory, are mitigated by the presence of external factors. Among them, media attention and other forms of domestic as well as international public scrutiny. Foreign companies’ resistance to inappropriate behaviour helps as well. For instance, problematic dealings with the standards certification bodies, have exposed questionable dealings and may have, to a great extent, been responsible for preventing widespread corruption in that interaction. Inappropriate official behaviour, fortified by the lack of public engagement and general superior attitudes of officialdom creates an environment of SIE intimidation, where demands and whims of officials prevail and special treatment are in evidence.

The evidence agrees to a large extent with Kaufmann (1997) and Sutherland (1983), whose arguments imply that the interactions between enterprise and bureaucracy cannot be dismissed out of hand as being corrupt. The theory correctly asserts and the evidence supports the view that the relations between the bureaucracy and enterprises must be broken down to the finer interaction levels in order to understand the problem of corruption.

The roots of the corruption problem lie, in part, within the political, economic, and social context. The collapse of one economic system and the emergence of a new one creates a
period of economic uncertainty and a lack of confidence in the legal structure and institutions that give rise to opportunity and necessity for corrupt behaviour. Evidence shows that beyond the context it is essential to look specifically at the interactions between the state and the public.

Finally, the evidence is clear that where there are difficulties in communication between the significant groups and uncertain accountability of officials the opportunities for corrupt behaviour, as raised by Sutherland, do exist. In other words, corruption, it appears, occurs where the officials hold a position of superiority vis-à-vis the client, where there is occupational opportunity.207

Part 3. Implications and conclusions

The evidence from the cases shows that for the bulk of the interactions, SIEs in Ukraine face environments that are costly and obstructive, and occasionally hostile towards them. The data shows that for the most part the environment for SIEs in Ukraine is difficult and that these difficulties lie within the regulatory/institutional structures and with the officials mandated to implement them.

Bureaucracy in Ukraine is seen to lack the full support it requires from the government. As a result the institution and its members are left with little alternative but the skew the interpretation of the normative version of interactions with SIEs to meet their needs. This
has a consequence of meeting some of the obligations that the government cannot or will not meet itself. Moreover, such a system provides the cash strapped Ukrainian government with some relief from budget pressure, a motivation, albeit a negative one, for work being done, and a sense of authority and control for the disenfranchised officials.

The principal cost to Ukraine's enterprise sector, however, is considerable. The low levels of growth are testament to the difficulties faced in the environment created by the legal/institutional structure. According to the evidence firms have little interest in expansion rather they focus on surviving. Many face a short business life span, high costs and frustration at the interactions with officials. There is an overwhelming sense that the relationship between the two favours the officials.

Regulations are not clear for all concerned. The implication of the evidence is that lack of clarity, constant change, and unfairly or improperly implemented interactions hinder the environment and will have severe consequences on all concerned. The lack of transparency, stability and effective implementation noted in the cases studies show that most elements of the interactions are conducive to corruption. The Ukrainian enterprise environment has some distance to go before the conditions are improved and meet the expectations of SIEs in order to encourage them to grow.

This chapter began by exhibiting the findings from the case studies on five types of interactions between bureaucrats and enterprises in Ukraine. Two goals were set out, the first to evaluate the data from the cases against the study's propositions. And second, to

-------------------

207 Miller et al., 261
determine if the interactions are opportunities for bureaucratic dysfunctional behaviour. The chapter determined that bureaucracy's role in the development of SIEs in Ukraine through its part in interactions is, in many aspects, obstructive and an impediment on enterprise development. None of these cases are completely problem-free.

It may be concluded from evidence showing a lack of transparency, unfair application of regulations, discretionary implementation, limited public consultation, among others, that the opportunity for corruption in most interactions facing Ukrainian SIEs and bureaucrats is high.

The examination of the case studies placed the normative and the positive versions of the interactions with the aim of showing where there were deviations and where the data showed problems to be most acute. Each case examined analogous elements and attributes, all contributing to determining the outcome of the proposition structure. This allowed for the identification of elements and interactions obstructive to enterprise, either by increasing costs or by creating an environment not conducive to SIE development.
CHAPTER XIII - CONCLUSION

In his musings on the transforming of post-communist political economies, North suggests that the path to successful transformation of an economy requires an understanding of several fundamental factors. These he argues are often wrongly interpreted. The first are the fundamental beliefs held about the economic context. Second, the frameworks are built to deal with the economy; and third, the implementation and operationalisation of laws, regulations, and norms and the consequences that ensue. In particular, North makes the point that policies (programmes, projects, and so on) are merely formal rules whose performance is determined by the combination of these with informal norms and operationalisation and enforcement. This means that changing the formal rules does not imply that desired results will follow. The relationships that bind players in the economy must be understood as well. Their character plays a strong role in how the rules are applied. By seeing which relationships, formal or otherwise, play a significant role, it may be possible to improve the operational implementation of any policy, programme or project. This research orientation was adopted in this thesis.

---

209 North, 15
210 North, 16
Focus of the Thesis and its Contributions

The thesis has exhibited the relationship between bureaucracy and small independent enterprise in Ukraine within the context of their direct interactions. The results of the case studies justify the research method, i.e. delving deeper into the minutiae of such relations in order to determine the specific areas of difficulty. Niskanen along with public choice theory advocates provide a foundation by illustrating bureaucrats as self-serving rather than utopian, public spirited workers.\(^2\) Their argument follows the lines that within certain conditions the public servant will step back from duty and concentrate on self-interest, where the latter conflicts with the former. Thus, the study set out to explore the interactions in Ukraine to test the ideas put forth in Niskanen (1973), Williamson (1993), Etzioni-Halevy (1985), Mueller (1990) and Schram (2000).

Elements of the Niskanen theory as well as public choice theory are combined in chapter 3 with a concept of corruption. This results in a focussed explanation that the interactions between bureaucracy and SIEs in Ukraine are hampered by an unbalanced relationship between the two principals. A poor legal framework and a lack of familiarity of both sides with the new legal and market environment compound weak relations. On such a foundation and context, five dimensions of the firm-bureau interface are examined and provide empirical data about the relations between SIEs and bureaucracy in Ukraine.

The thesis set out a number of aims. The first was to place the role of bureaucracy in the development of small independent enterprises within the context of post socialist transformation. This has been accomplished by discussing the specific context of Ukraine’s economy, its communist legacy, the state of the bureaucracy, and lack of market evolution for enterprises. Several results have emerged. The general context of the interactions is seen to be an important factor in understanding the difficulties facing bureaucrats and consequently the SIEs. On the other hand, the contexts in which SIEs work are not consistent across regions or even bureaux. There are regions and indeed certain departments that do offer satisfactory treatment and service. Thus, while the general sense is that the current context for enterprise is difficult and obstructive in most areas, positive exceptions indicate that attitudes of regional bureaux may also have an impact.

The second aim is to show that the relationship between official structures and small businesses could be effectively examined through their direct relations. Moreover, that by observing such interactions, it would be possible to determine which aspects of the interactions are particularly obstructive to the procedures. In addition, a correct methodology is to break down interactions into analytical elements.

The third aim is to construct case studies of types of interactions based on the normative and the positive versions. The first versions were determined by using primary sources from laws, Ministerial publications, departmental documents, business publications. The second by observations in the field, as well as interviews with officials, entrepreneurs, and expert observers. That led to a research design where a structured version of the interaction that made each case comparable to the next, and provided a systematised format ensuring that
analysis was as consistent as possible. It enabled drawing out conclusions based on patterns (or lack of patterns).

Findings

This thesis has found that the imbalance between enterprise and bureaucracy in Ukraine is symptomatic of larger existing problems. Among them: economic feebleness, social backwardness, and possible political instability. The result of such difficulties is ultimately the high price paid by SIEs be it through various costs, a move to the shadow economy, or outright business failure.

Moreover, the thesis has arrived at a number of findings specific to the relations between SIEs and operational level bureaucrats: First, the inspection cases are particularly problematic for SIEs. They present the greatest obstruction and highest cost to SIEs. These interactions provide ample opportunity for corruption and require most remedial attention of policy makers. There is also a serious need for changing the bureaucratic culture in these interactions to allow for a more suitable environment for enterprise to flourish. The certification and registration interactions are somewhat less difficult to complete. There are difficulties that may be remedied by improving the regulatory structure, but they are likely to also require a change in psychology and mindset by bureaucrats that may be partly achieved by dedicated training and civic education programmes. On the other end of the spectrum of the interactions examined here, the process of obtaining a sales permit is the most
straightforward providing a positive normative benchmark of regulation and service provision for other interactions.

Second, among the elements, the most problematic overall is the matter of official costs. This is followed closely by the matters of access and bribery. Equally weighted but slightly less problematic were the elements of information and documentation, and behaviour of officials, and specifically their lack of professional conduct. The least problematic elements include that related to the time spent with officials, and behaviour of officials related to public engagement, the latter being an insignificant obstruction to SIE activity and development.

Third, the bureaucracy does not get the support it needs from the government. Remuneration is poor and the incentive system can be seen to be failing the operational level officials. This prevents officials from fairly exercising their authority. Officials turn to the opportunities provided within the law, in some cases or they create administrative laws and procedures themselves by interpreting legislated regulations to serve their own interests. This is continuity from the socialist period when such behaviour was endemic - law creation passed onto operational level officials thereby arbitrary.

In particular the general behaviour of officials shows that the bureaucracy does not feel that it is its place to provide information to the SIEs. This may be the result of poor wages or legal institutional support, or it may be partly due to the Soviet legacy, where the role of the bureaucracy was that of master, where the public made few demands on the officials and on the system.
Fourth, although the incidence of bribery is not as pervasive as it would have been thought the general level of corruption is high.

Fifth, for the most part, the SIEs are committed to remaining legal entities. The trappings of legitimacy are of interest to most entrepreneurs and many will maintain a foot hold in the legal economy by keeping part of their operations there while the rest is in the shadow.

Sixth, the small size of the entrepreneurial sector indicates that SIEs, in whole or in part within the shadow economy, are there because of the predatory behaviour of bureaucrats or the opaque nature of the regulatory system. That results in lower tax revenues for the state. In addition, an increase in the criminalisation of the economy is plausible. The job creation from an increase in small enterprise enjoyed by most market economies is unlikely to materialise, leading to the de-legitimisation of the market economy.

The results of research into the bureaucracy-SIE interface reflect more general characteristics of the post-socialist system: a lack of predictability in the relations; a lack of transparency in the interactions; complacency at the operational level of the interactions; and the alienation of the SIEs, the clients who rely on them. Legal and institutional mechanisms and behaviour established by legacy and through ongoing legal change and adjustment have obstructed SIE

The size of the entrepreneurial sector is qualified in an interview with Natalia Prokopovich, Head of the Department for the Support of Foreign Investment and Economic Activity of Entrepreneurship, State Committee of Ukraine for Entrepreneurship Development. "In 1997 there were just under 400,000 registered small firms in this country. Compare that to the 2.2 million in Poland, we have a small number of officially registered enterprises."
development making bureaucracy a weak agent ensuring a healthy environment for SIEs. SIEs are faced with the dilemma of grappling with the existing institutional framework, paying a heavy price along the way, or to forgo the trappings of legitimacy in the market for more complex, shadow economy rules. Regardless of the SIE choice, the onus of change lies with the bureaucracy and its patron (the central government). The bureaucracy can only implement the legal and regulatory framework if it is sound, transparent and stable. Moreover, the bureaucracy can only be effective if the incentives and remuneration are appropriate.

What is also clear is that the Ukrainian context, an economy with significant problems of revenue, budgeting, wage payments crisis, and a regulatory structure that requires improvement, provides an environment where the conditions can lead to rogue behaviour among agencies and individuals. The close examination of interactions provides the empirical evidence of unbalanced bureaucracy-enterprise relations, where the regulatory system often fails SIEs. Such failure results in high costs to entrepreneurs through their inability to access information, spending excessive time on what should be straightforward matters, repeating procedures, over paying, and occasionally paying bribes. Further, they lack constructive dialogue with bureaucracy and face behaviour that discourages normal or effective interaction.
REFERENCES

ACADEMIC LITERATURE


Banaian, King, *The Economy of Ukraine Since Independence* (Cheltenham: Edward Elgar, 1999)


Heha, P.T. *Правовий режим оподаткування в Україні* (Kyiv: Юринком, 1997).


Mishler, William and Richard Rose, Trust in Untrustworthy Institutions (Glasgow: Centre for the Study of Policy, 1998).


Rose, Richard, Distress as an Obstacle to Civil Society (Glasgow: Centre for the Study of Public Policy, 1994).


316


**REPORTS/BULLETINS**


TACIS, Ukrainian Economic Trends (Kyiv: European Centre for Macro-economic Analysis of Ukraine, 1995).


World Bank Regulatory Reform Project Report “Проблеми Інспектування в Україні” (Kyiv: January 1999).


NORMATIVE DOCUMENTS

Cabinet of Ministers Order, Порядок координації проведення планових виїзніх перевірок фінансово-господарської діяльності суб'єктів підприємницької діяльності контролюючими органами (витяг) Kyiv: Cabinet of Ministers of Ukraine (29 August 1999, #112).


Порядок Проходження документів у центральному апараті МЗЕЗторгу України для видачі ліцензії на право імпорту, експорт у спіртного етилового, коньчого і плодового, експорту, імпорту алкогольних напоїв та тютюнових виробів, 17-06-96, #343 (Київ: Держстандарт України, 1996).


INTERVIEWS/PRESENTATIONS

Danelevych, Orest, Director, Lvivinaudit, personal interview (Lviv: March 1998).

Freeman, Ron, Vice President European Bank of Reconstruction and Development, speech, Central and East European Review Summit (London: 12 April 1997).

Hosking, Geoffrey, Professor, SSEES, presentation, St. Catherine Conference (with permission) (Windsor: February 1997).

Kaufmann, Daniel, speech, EBRD (London: January 1997).

Kisilyova, Tatiana, Director, Derzhstandard, speech at the meeting of the American Chamber of Commerce in Ukraine (Kyiv: March 17, 1998).

