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**NAVAL
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MONTEREY, CALIFORNIA

THESIS

**THE EVOLUTION OF THE DEFENSE BUDGET PROCESS
IN UKRAINE, 1991-2006**

by

Roman Milesenko

June 2006

Thesis Advisor:
Second Reader:

Richard Doyle
Frank Barrett

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**THE EVOLUTION OF THE DEFENSE BUDGET PROCESS IN UKRAINE,
1991-2006**

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Submitted in partial fulfillment of the
requirements for the degree of

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from the

**NAVAL POSTGRADUATE SCHOOL
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ABSTRACT

This thesis describes the evolution of the defense budget process in Ukraine, from independence to 2006. It identifies and evaluates factors that directly affected the development of the defense budget process and determined the distribution of power in that process and examines the efficiency of defense budgets as policy tools. This study contributes towards an understanding of the relative power of the executive versus the legislative branch in shaping defense policy. It concludes that important but limited progress has occurred in the defense budget realm in Ukraine since independence. The absence of a clear political guidance, deficiencies of defense legislation, and insufficient levels of co-operation between the executive and the legislative branch of the government are key problems involved in defense budgeting and reform in Ukraine. Certain improvements and overall intensification of efforts occurred as a result of the NATO-Ukraine Action Plan in 2002. Actions undertaken by the Ukrainian government during the period from 2002 to the beginning of 2006, including the introduction of the law On Organization of the Defense Planning in 2004, had a minimal impact because of insufficient interest at the legislative level.

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I. INTRODUCTION

A. BACKGROUND

Defense funding is an important indicator of the attitude of a state towards its armed forces, and the processes of appropriation and allocation of funds for national security are vital, especially when resources are scarce.

The Armed Forces of the independent Ukraine emerged from the portion of the Soviet Army left in its territory after the collapse of the Soviet Union: 780,000 military personnel and tons of armament and military equipment, including nuclear weapons.¹ These assets not only provided a sufficient base to build the Armed Forces of Ukraine, but also forced the new government to deal with the wide array of difficult issues associated with supporting and reforming those forces.

One of the primary issues was the development of the defense budget process. This aspect of the state budget did not exist in the budget of the Soviet Ukraine, as defense itself was a prerogative of the federal government of the Soviet Union. The laws “On Defense of Ukraine” and “On the Armed Forces of Ukraine” passed by the Verkhovna Rada (the parliament of Ukraine) in December 1991 were among its first legislative acts and were intended to provide support for the formation of armed forces in line with a commitment to democracy in the country. These laws established a legal foundation for the development of the armed forces, including authorities of the state institutions regarding defense budgeting.

The Ukrainian Armed Forces have gone through a significant transformation. So has the budget of the Ministry of Defense of Ukraine (MOD), which was represented by

¹ Ministry Of Defense Of Ukraine. The history of the Armed Forces of Ukraine. Online. Internet. Available <http://www.mil.gov.ua/index.php?lang=en&part=history&sub=history> (15 February 2006).

one line in The Law on the State Budget of Ukraine in 1992². Since that time, it has evolved in more detailed forms. However, the reality of defense budgets of the independent Ukraine is that they were barely able to support the survival of one of the biggest armies in Europe. Funds appropriated for defense were not sufficient to accomplish any of the projects initiated by the MOD aimed towards the modernization and reformation of the Armed Forces, including the downsizing of the military. In the period of 2003-2004, the military reform challenge raised the issue of the appropriate size of the military and how to finance its reform. Additionally, aspirations to join NATO, declared by President Kuchma in 2002, raised the issue of conformity of Ukrainian military structures and processes with NATO standards.

Efforts to solve the Gordian knot of Ukrainian defense reform resulted in a number of measures, including the “Law on Organization of the Defense Planning”, passed by the parliament in June, 2004. It was intended to regulate decision making in the defense realm involving different participants in the process and, in effect, to be the first step towards creation of a cohesive defense planning and budgeting system. Adoption of this law was intended to fulfill a number of commitments made by Ukraine in 2002 when it signed the NATO-Ukraine Action Plan. This initiative was designed to “increase transparency in defense planning and budgeting procedures; transition to modern NATO defense programming, budgeting and financing principles”, “reform financial planning and funding procedures in support of defense reform and the transformation of the Armed Forces into a professional force,”³ as well as other objectives related to the development of an efficient defense resource management system in Ukraine.

² The first budget legislation of independent Ukraine.

³ NATO. NATO – Ukraine Action Plan. Online. Internet. Available <http://www.nato.int/docu/basic/txt/b021122a.htm> (15 February 2006).

Most recently, in his radio address to the nation on December 10, 2005, President Yushchenko stated,

I am confident that 2006 will be a year of a breakthrough in the development of the Armed Forces. The defense budget is increasing by 51%. . . . I appreciate the Parliament for legislative support to strengthening the Ukrainian military. It is important that all the factions of the Verkhovna Rada care about the development of the Armed Forces.⁴

This thesis will analyze the history of the defense budget process in the independent Ukraine, identify the factors which influenced the process during its development, and examine the distribution of power among various participants within the process with a focus on the role of parliament. Also it will examine the efficiency of the defense budget as a policy tool of the government of Ukraine in the defense realm in the past as well as at the current stage of the defense reform.

B. OBJECTIVES

The purpose of this research is to describe the evolution of the defense budget process in Ukraine and assess the role of parliament in the process during its development. It is intended:

- To identify and evaluate those factors that directly affected the development of the defense budget process in Ukraine and determined the distribution of power in the process as it has unfolded since independence;
- To discuss the current state of the defense budget process in Ukraine and recent issues related to its development.

C. RESEARCH QUESTION

The primary research question to be addressed in this thesis is: How has the role of the Verkhovna Rada in budgeting for defense in Ukraine changed from independence to 2006?

⁴ Ministry Of Defense Of Ukraine. Speeches and Interviews of the Senior Leadership. President Yushchenko, Radio address. Available <http://www.mil.gov.ua/index.php?lang=ua&part=appearance&sub=read&id=6315> (16 February 2006).

Subsidiary research questions include the following:

- What significant changes occurred in the defense structures of Ukraine since 1991?
- What were the main determinants of the defense budget process in Ukraine during the period from 1991 to 2006?
- To what degree was the defense policy of Ukraine supported by spending during the period 1991 - 2006?
- How does co-operation between Ukraine and NATO influence developments in the Ukrainian defense budget process?
- What is the current structure of the defense budget process in Ukraine?
- What are the possible problems and outcomes of implementation of the “Law on Organization of the Defense Planning”?

D. METHODOLOGY

This thesis will identify the key changes in legislative authority including actions and events regarding the defense budget process in Ukraine in a historical perspective. Data will be obtained from literature reviews of books, journal and newspaper articles, websites, academic databases, and other information resources.

E. ORGANIZATION OF STUDY

This thesis is organized as follows. The first chapter explains the rationale for and logic of this thesis. The first section of this chapter provides a brief background on the development of the Armed Forces and the defense budget process in Ukraine since independence. It is followed by the objectives of this thesis, the list of the research questions to be addressed and a description of the methodology to be employed to produce answers.

The second chapter describes the history of the development of the Armed Forces of Ukraine and the political environment in which this process has occurred. It also identifies major changes in the Ukrainian defense structures and provides a picture of defense spending during the period since independence to 2005.

The third chapter describes the evolution of the defense budget process in Ukraine and arrangements within the government related to this. The chapter is subdivided into three main sections. The first part examines defense budgeting during the period between independence in 1991 and the adoption of the Constitution of Ukraine in 1996. The second part discusses the process from 1996 to 2004. The roles of the executive and legislative branches will be considered. The third part focuses on the mechanisms available to the legislature to control defense spending.

The fourth chapter covers developments in the defense realm during the period 2004 -2006 and examines how they have affected defense budgeting in Ukraine. Special attention will be given to the impact of co-operation with NATO in the sphere of defense resource management. Specifically discussed will be the Strategic Defense Bulletin (the “White Book” of Ukraine) and the new Law on Organization of the Defense Planning. These are the first steps towards practical implementation of NATO planning and budgeting standards in Ukraine. Next, it will describe future plans for defense reformation in Ukraine and discuss their budgetary implications. An overview of the 2005 and 2006 defense budgets will be included.

The fifth chapter will conclude the thesis with an overall picture of the evolution of the defense budget process in Ukraine followed by the author’s observations and conclusions, and recommendations for further research.

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II. LEGAL AND STRUCTURAL CHANGES BETWEEN 1991 AND 2006

A. INTRODUCTION

This chapter provides a brief historical overview of the political environment in which the Armed Forces of Ukraine (AFU) were established and developed. Such an overview is helpful to understand the primary driving forces and figures behind the decisions made by Ukrainian leaders on the defense issues including those regarding the defense budget. The chapter starts with select comments on 20th century Ukrainian history, followed by a description of major political developments from 1991 to 2006 followed by a summary of structural reforms in the AFU and an overview of defense spending in Ukraine during this period.

B. POLITICAL ENVIRONMENT AND INSTITUTIONAL REFORMS

1. History Lessons

With collapse of the Russian Empire in 1917 the Ukrainian people for the first time in their centuries-old history had a chance to have their own state. As the news about the collapse of the tsarists' regime reached the Ukrainian capital – Kyiv – three major organizations emerged from the chaos which followed the February revolution in Petrograd. Former city officials formed an executive committee to maintain order and to act as an extension of Petrograd's Provisional Government. The radical left was represented by the Kyiv Soviet of Workers' and Soldiers' Deputies which acted on behalf of the Bolsheviks' party. However, the strongest support among the Ukrainian population was generated by the Central Rada ("council" in Ukrainian). Prominent representatives from the Ukrainian liberal intelligentsia, who initially formed the Central Rada, were immediately joined by Ukrainian Social Democrats and Socialists.

The initiative gained popularity and legitimacy. A Ukrainian National Congress, convened in Kyiv on 19 April 1917 and comprised of 900 delegates from all over Ukraine and Ukrainian communities throughout the former empire representing the various segments of Ukrainian society, elected 150 representatives to the Central Rada. A

Congress of Ukrainians serving in the army which was held on 18 April in Kyiv also affirmed the Central Rada's leadership. It was supported as well by the congresses of the Ukrainian peasants and workers. Even though smaller groups of the Ukrainian society like Jews and Russians were disturbed by the rise of the Central Rada, they later joined it, attracted by the promise of far-ranging cultural autonomy.

On 23 June 1917 the Central Rada issued its First Universal (manifesto) which claimed the right of the Ukrainian people to govern their land. It proclaimed the establishment of the Ukrainian People's Republic (UNR) without a complete separation from Russia. By this act, the Central Rada intended to gain recognition as the highest political authority in Ukraine. It also formed the General Secretariat, the executive branch of the government which took over responsibility for the administration of Ukraine.

Success of the Central Rada seemed to be complete when the Russian Provisional Government, which did not have sufficient resources to enforce its authority in former imperial territories, was forced to recognize the administrative authority of the General Secretariat. However, newly-fledged Ukrainian politicians soon found themselves caught up in revolutionary rhetoric and ideological arguments, disregarding the major practical needs of the republic, including the need for a strong and centralized administration.

Their attitude towards the military was noteworthy. These liberal romantics argued that the revolution eliminated the need for standing armies and favored the creation of "people's militias". That is why, in the summer 1917, when about 300,000 Ukrainian soldiers spontaneously reorganized themselves into all-Ukrainian units that swore allegiance to the Central Rada, this force was rejected. In a similar fashion the Central Rada did not accept an offer by General Pavlo Skoropadsky who placed at its

disposal an Ukrainized corps of 40,000 disciplined and equipped men. However, it soon became apparent that without an army a government was impossible.⁵

Following the October Revolution in Petrograd the Bolsheviks' offense forced the republic's leadership out of Kyiv by February 1918. The UNR was temporarily restored by the Germans in March within the boundaries agreed to by the treaty of Brest-Litovsk but then replaced by a "Hetmanate" in April.⁶ The "Hetmanate" was a conservative Ukrainian government headed by Hetman Pavlo Skoropadsky (the title of Hetman was recalled from the Cossack era and associated with early stages of Ukrainian statehood).

During less than eight months of his rule, Skoropadsky, a former tsar general, achieved significant progress in restoring order in the country, building an administrative apparatus and "ukrainianising" education. Despite the Germans who discouraged the development of a large Ukrainian military force that might challenge their overwhelming influence, Skoropadsky created an army of 65,000.⁷

However, the situation in Europe and the political interests of the great powers did not favor an independent Ukraine at this time. Compromised by the German protectorate, Skoropadsky was overthrown by the rebellion of radical Ukrainian nationalists who reestablished the UNR in December 1918. However, the military performance of the Ukrainian government's troops was as disappointing as it had been a year earlier.⁸ A sequence of different revolutionary and occupational governments ruled Kyiv until 1921, when the Bolsheviks ultimately took control over Ukraine.

⁵ Orest Subtelny . Ukraine: A History. Second Edition. University of Toronto Press, 1994, pp. 345-350.

⁶ Andrew Wilson. The Ukrainians: Unexpected Nation. Yale University Press, 2002, p.123.

⁷ Ibid., p.127.

⁸ Orest Subtelny. Ukraine: A History. Second Edition. University of Toronto Press, 1994, p.362.

The Ukrainian nation lost a historical chance to create an independent Ukrainian state early in 20th century. It did so for a number of reasons including its neglect of a capable military structure. As Ukraine's former foreign minister Anatoliy Zlenko noted shortly after independence in 1992,

The decision to set up Ukrainian Armed Forces springs not from any aggressive intent but from our tragic history... At the beginning of this century, Ukraine lost her independence because she had declined to maintain her own army. Bitter experience has taught us not to repeat that mistake.⁹

2. The Ukrainian Parliament and Transition to Independence

By the end of the 20th century (1991), the Ukrainian parliament had played a central role in the political process which eventually resulted in "one of the three major geopolitical events of the twentieth century" – the appearance of an independent Ukraine.¹⁰ The role of the Verkhovna Rada (the parliament of Ukraine) was determined by unintended results of "Perestroika" and "Glasnost".

Not only were President Gorbachev's reforms for the Soviet economy and administrative system not given sufficient thought, they also met resistance from the party apparatus and government officials whose interests they threatened. At a time when scarce food and consumer goods caused increasing frustration among the population, freedom of expression became a means for the nationalities of the USSR to voice their grievances and aspirations.¹¹ For those who had alternative beliefs and ideologies, the parliament and local councils were the only accessible avenues to the realization of their ideas, since other governmental structures were either occupied or controlled by the

⁹ Anatoliy Zlenko. Independent Ukraine: Risk of Stability? RUSI Journal, April 1992, p.39 (quoted in: Taras Kuzio. Ukrainian Security Policy. Westport, 1995, p.11).

¹⁰ This is the view of Zbigniew Brzezinski, national security advisor to President Jimmy Carter. The other two, according to Brzezinski, were the collapse of the European empires in 1917-18 and the appearance of the Iron Curtain). Andrew Wilson. The Ukrainians: Unexpected Nation. Yale University Press, 2002, p. 316.

¹¹ Orest Subtelny. Ukraine: A History. Second Edition. University of Toronto Press, 1994, p. 574.

conservative communist elite. In Ukraine, the Verkhovna Rada was the governmental institution through which Ukrainian democrats could participate in the political process.

The first relatively free parliamentary elections in Ukraine were held in March 1990. They brought 90 of a total of 450 seats in the Ukrainian parliament to the Democratic Block which was composed of several non-Communist forces. Even though the communists, who won 239 seats, remained a majority for the first time they had to face a legal opposition in the parliamentary seating.¹² Meanwhile, the deteriorating economy and paralysis of the existing political system were pushing crucial decisions to the forefront.

Many in Ukraine, including the Rada's deputies, saw the causes of the economic collapse as the inability of Moscow officials to rule the country and believed that increased decentralization would be a key solution to the problem. In July 1990, the Verkhovna Rada passed the Declaration on the State Sovereignty of Ukraine. The document did not declare Ukraine as an independent state but it was the first move towards self-determination. The Declaration proclaimed the right of the Ukrainian people to control their land and natural resources, guaranteed freedom of cultural development to all nationalities, made provision for distinct Ukrainian citizenship, and provided for separate armed forces and a security service for Ukraine.¹³

This development generally matched with Gorbachev's fundamental plans for restructuring the Soviet Union which were designed to provide the republics with greater power. These plans, however, were averted by a group of the top Soviet leaders who launched a preventive coup in Moscow on 19 August 1991. Their efforts, which were undertaken to preserve the country, triggered irreversible political changes. Reformist

¹² Orest Subtelny. *Ukraine: A History*. Second Edition. University of Toronto Press, 1994, p. 577.

¹³ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, p. 5.

forces quickly realized that the initiators of the coup had neither a clear action plan nor decisiveness to go far enough to apply violent measures to their opponents and took advantage of the situation to prove the inability of the communists to rule the state. Boris Yeltsin, president of the Russian Republic, promptly mobilized his supporters and ruined the plans of the plotters. With de facto acquired power in Moscow, Yeltsin began to seek a formal means of eliminating the remaining authority of the Soviet President Gorbachev.

The reaction of the Ukrainian leaders to the events in Moscow was to wait-and-see. By 21 August it became clear that the coup had failed. The Communist party was compromised and began to lose its members including some Ukrainian parliamentarians. Illegitimate actions of the top Moscow leadership created an opportunity for those who were dissatisfied with central rule to reject it. On 24 August the Verkhovna Rada proclaimed the independence of Ukraine by an almost unanimous vote. With only one vote against, even hard line communists voted in favor of independence; however, a provision was added to require a referendum to be held in December among Ukrainian citizens to confirm the decision. Several days later the Communist majority announced its self-dissolution, thereby shifting the balance of power to the democratic forces. On 29 August the parliament passed a resolution which banned the Communist party altogether on the basis of evidence that its leadership supported the coup attempt in Moscow.

The referendum was scheduled on 1 December 1991, on the same day as presidential elections. The results were beyond the most optimistic expectations of the democrats: 84.2 per cent of the electorate turned out to vote and over 90 per cent of voters supported independence.¹⁴ Especially important was the fact that this overwhelming percentage included not only Ukrainians but also Russians and other nationalities, which in 1991 composed 27 percent of the population.¹⁵ Leonid Kravchuk,

¹⁴ Bohdan Harasymiw. Post-Communist Ukraine. Canadian Institute of Ukrainian Studies Press, 2002, p. 8.

¹⁵ Encyclopedia Britannica. Ukraine. Internet. Online. Available <http://www.britannica.com/eb/article-30102> (9 March 2006).

the chairman of the Verkhovna Rada, the most popular and capable political institution of that time, became the president of Ukraine.

Disintegration of the USSR began when three Baltic republics withdrew themselves from the Union. The Ukrainian referendum added momentum to the process. When the leaders of Russia, Ukraine and Belarus secretly met at the party's elite hunting resort near the Belarusian city of Brest on 7 December, Russia already had proclaimed independence and President Kravchuk attended the summit just after the Ukrainian referendum. Claiming the right to dismantle the Soviet Union as their three republics were its original founders,¹⁶ Yeltsin, Kravchuk, and the Belarusian leader Shushkevich signed a treaty which formally dissolved the USSR and put in place the Commonwealth of Independent States (CIS) as a transitional structure opened for other former Soviet republics to join. Although the summit's authority was controversial and many subsequent issues had been left unresolved, the Ukrainian proclamation of independence became a political reality.

Nonetheless, all the power structures – the Ministry of Defense, Soviet Security Service (KGB), and the Ministry of Interior – remained under formal control of the Union center. Not until 25 December when Gorbachev resigned from the post of the President of the Soviet Union¹⁷ was it clear that a threat of using violent methods against Ukraine by the Union center had passed.¹⁸

3. The First Steps towards the National Defense Structure

In essence, some members of the parliament had begun the actual work towards creation of the Ukrainian Armed Forces even before 19 August. Members of the Rukh, a nationalistic wing of the Democratic Block, had contact with military officers who shared

¹⁶ Andrew Wilson. *The Ukrainians: Unexpected Nation*. Yale University Press, 2002, p.170.

¹⁷ Gorbachev Resigns As the Soviet Union Breaks Up. *On This Day*. BBC News. Internet. Online. Available http://news.bbc.co.uk/onthisday/hi/dates/stories/december/25/newsid_2542000/2542749.stm (9 March 2006).

¹⁸ Andrew Wilson. *The Ukrainians: Unexpected Nation*. Yale University Press, 2002, p.171.

democratic and nationalistic ideas and used them as a medium to inquire about attitudes within the officer corps. They even managed to organize a number of active duty and retired officers, mostly from the Western Ukraine, into the Union of Officers of Ukraine (UOU), an organization which was thought to provide expertise and to be a nucleus for formation of the Ukrainian military.¹⁹ However, it was important to enlist support from Soviet military leadership – the commanders of military districts and armies stationed in Ukraine.

Because of the Ukraine's strategic location, a disproportionately large number of the Soviet military personnel were stationed in its territory. The military also had access to and control over enormous stockpiles of armaments, including nuclear weapons. This potentially dangerous force was a great concern for the democrats. On 27 August 1991, the speaker of the parliament, Leonid Kravchuk, arranged a meeting with senior military commanders to exchange opinions about the future of the Ukrainian military. Most of the generals were rather pessimistic about the very possibility of creating and maintaining armed forces subordinated to the Ukrainian government. They argued that it would be too costly and overall impossible to tear such a big chunk out of the integrated Soviet military structure. The only one who came up with a plausible idea about what a new Ukrainian army would look like and how it would be structured was the commander of the 17th Air Army, General Kostiantyn Morozov. His idea was to maintain the general Soviet military structure but subordinate it to the Ukrainian political leadership, with some components contributing to the joint Union defense system and then gradually reduce and reform it to an appropriate size which would fit within the state's capacity to support it and be sufficient to ensure security of Ukraine.²⁰

¹⁹ Konstantyn Morozov. *Above and Beyond: From Soviet General to Ukrainian State Builder*. Harvard University Press, 2000, pp. 133-136, 225.

²⁰ *Ibid.*, pp.133, 143-146, 152.

The Verkhovna Rada undertook the first steps towards creation of state institutions in July 1991 when two laws created a national bank and the presidency.²¹ As momentum in favor of independence had been growing in the fall of 1991, the parliament accelerated its efforts to put in place as many state attributes as possible. On 3 September, General Morozov was appointed by the parliament to be the first Ukrainian Minister of Defense. On 11 October, the Rada adopted a resolution called the Conception of Defense and Development of the Armed Forces of Ukraine, in which it denoted the government's agenda for the creation of the Ukrainian military.

The document stated the intent of the Rada to create strong, capable, but appropriately sized Armed forces on the basis of military units located in the Ukrainian territory and a legal base for their functioning; it also stressed the Rada's commitment to achieve a neutral, non-nuclear status for Ukraine, but not at the expense of its security considerations. Among other provisions, the conception contained prerequisites for development of a defense budget system and allocation of authorities within the defense process. The right to approve and control defense budgets was reserved for the parliament. The Conception emphasized a need for a constant modernization of military doctrine, equipment, and a priority of funding for this process.

During the fall of 1991, General Morozov and his staff, located in six rooms in one of the parliamentary buildings, put together an informal network for monitoring developments in the military districts of Ukraine still subordinated to Moscow. Their work was primarily focused on finding personnel positively motivated, capable, and experienced in military planning and restructuring at the level at which they were about to operate.²²

²¹ Andrew Wilson. *The Ukrainians: Unexpected Nation*. Yale University Press, 2002, p.167.

²² Konstantyn Morozov. *Above and Beyond: From Soviet General to Ukrainian State Builder*. Harvard University Press, 2000, pp.168-172.

The adoption of the laws on the Armed Forces of Ukraine and on the Defense of Ukraine set the legal precedent for the development of the Armed Forces. Both laws were passed on the same day, 6 December 1991, a day before the historical summit in Belarus.

The referendum of 1 December legalized the Ukrainian minister of defense. The CIS treaty and resignation of Gorbachev removed the last obstacles for him to act. In January 1992, General Morozov and his team took over the headquarters of the Kyiv Military District, administered the oath to officers, shut down the communications system linking the district to Moscow, and fired the commanders of the three military districts.²³

The time since the parliamentary elections in 1990 and up to the end of 1991 with all its dramatic developments was one of a few periods when the Verkhovna Rada was able to make timely, consolidated and independent decisions. Moreover, guided by the Democratic Bloc, the Rada was the only institution which had a clear understanding of a direction in which it was moving in the highly ambiguous environment of rapid Soviet decline. The Rada's end goal was an independent Ukraine.

4. An Overview of Ukrainian Politics from 1992 to 2005

The fact that Leonid Kravchuk, the Rada's speaker, was elected the first Ukrainian president, and that independence became a tangible reality at the end of 1991, reduced the momentum towards solving the most relevant problems of the society and economy, shifting parliament's focus towards power-seeking politics. Newly-elected president Kravchuk advocated for a strong executive branch which, according to his opinion, was needed by the Ukrainian state in its time of transition. Initially, he saw a powerful presidency as a means to overrule potentially dangerous communist hardliners in the Parliament. The December election results, when people voted for independence and gave more than 62 percent of their votes to Kravchuk as a president, provided

²³ Konstantyn Morozov. *Above and Beyond: From Soviet General to Ukrainian State Builder*. Harvard University Press, 2000, p.172.

legitimacy for his position.²⁴ The parliament, however, did not support the idea of a strong presidency which led to a conflict among the two institutions of government. The main achievements of the early period of Kravchuk's presidency were foreign recognition and international positioning of Ukraine as a developing democracy whose stability was one of the major factors in the European security.

Kravchuk's internal policies were not as successful. Although the institution of the presidency contributed to the building of the Ukrainian integrity and prevented separatism, it failed to introduce more fundamental reform for the economy and the state apparatus. As a result, much of the Soviet Ukrainian economy simply collapsed when it was exposed to outside competition and/or required to find markets on its own. Economic mismanagement led to catastrophic consequences, the black market flourished and inflation soared to an unthinkable 5,371 percents in 1993.²⁵

Meanwhile, the parliament continued to regard the presidency as a threat to its power and was undertaking considerable efforts to weaken it by using the parliamentary veto over presidential decrees. The Verkhovna Rada rejected proposals to consolidate presidential rule by allowing the executive to head the government and determine its members.²⁶ Kravchuk's failure to organize political support for the presidency, lack of reforms and extremely bad economic record led to the victory of the Communist Block in the parliamentary elections in March 1994 and ultimately to the loss of the presidency in the summer of 1994.

The unsatisfactory state of the defense sector during his presidency was a part of the general reform failure. A presidential decree established the National Security

²⁴ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, pp. 100-101.

²⁵ Andrew Wilson. *The Ukrainians: Unexpected Nation*. Yale University Press, 2002, pp. 253-254.

²⁶ Taras Kuzio. *Ukrainian Security Policy*. Westport, 1995, p.27.

Council on 1 July 1992 as an advisory body attached to the president. It was designed to advise and consult on all aspects of policy dealing with national security in the broadest sense and included six permanent members (the president, the state advisor on national security, the prime minister, the chairman of the Security Service, and the defense and foreign ministers). Other cabinet members and state officials significant for national security could be called to its meetings without a voting right.²⁷ The President and his administration, however, were not able to find consensus over national interests, nor were they able to introduce a cohesive plan for defense reform. Even though creation of the Armed Forces is often referred as one of the major accomplishments of Kravchuck's presidency, the presence of a huge and redundant military segment also contributed to the economic catastrophe.

Several issues aggravated problems with formulation of a national security policy. First, a potential territorial dispute with Russia over Crimea and Russian claims on the Black Sea Fleet and some other Soviet assets in the Ukrainian territory were causing ambivalence regarding the reduction of military personnel. Second, growing on the soil of economic stagnation and ethnic diversity, regionalism and even separatism (in Crimea) pushed the government to maintain large internal forces, i.e., police and the National Guard. Third, Ukraine inherited from the USSR the third largest arsenal of nuclear warheads in the world (after those of the USA and Russia). The initial declaration of a non-nuclear status by the Ukrainian parliament was welcomed by the international community and was a crucial factor for the international recognition of Ukraine. Yet Russian-Ukrainian tensions and economic crisis caused Ukrainian political elite to look at the nuclear weapons as an insurance against encroachments upon Ukrainian integrity and even upon economic security. Additionally, the issue was complicated by differences in vision by the parties involved (the USA, Russia and Ukraine) on the disarmament process

²⁷ Taras Kuzio. *Ukrainian Security Policy*. Westport, 1995, p. 30.

and the amount of financial compensation which Ukraine could receive if it would agree to forgo any nuclear aspirations.²⁸

In 1994, led by the top Crimean leadership and fueled by populists in the Russian parliament, separatists' forces in Crimea mobilized considerable support from the population for some form of union with Russia.²⁹ However, they did not receive any significant backing from the Russian government which they were counting on. On the other hand, the central government declared the Crimean officials' actions as unconstitutional and competently applied economic leverage which allowed for resolution of the crisis without the use of force. At the same time the status of the Black Sea Fleet located in Crimea with the headquarters and main base in the city of Russian glory-Sevastopol-remained a problem. The parties were not able to reconcile the argument over the jurisdiction over the fleet, yet neither of them was eager to escalate further conflict. Ukraine appealed to the CIS treaty, according to which it owned all assets within its administrative boundaries at the moment of the dissolution of the USSR. Russia threatened to raise oil and gas prices or even shut down energy supplies due to the Ukrainian energy debt. Eventually, both countries agreed to divide the Black Sea Fleet 50:50 and left the question of the status of the Russian portion outstanding. Despite the equitable agreement, Ukraine declared its intent to absorb as much of the fleet as required for its strategic needs, and then to sell the rest back to Russia.³⁰

Ukraine's position on the nuclear weapons issue was shaped by several factors. Even though the Ukrainian state was only theoretically able to support strategic nuclear forces, it actively played its nuclear card in international politics. When the USA, Russia,

²⁸ Taras Kuzio. *Russia – Crimea – Ukraine: Triangle of Conflict*. Research Institute for the Study of Conflict and Terrorism, January 1994, p. 16. See also: Kuzio. *Ukrainian Security Policy*. Westport, 1995, pp. 116-121.

²⁹ In March 1994, a referendum called by the Crimean president Meshkov produced a 78.4 percent for a vaguely defined "sovereignty" and 82 percent for establishment of dual Russian-Ukrainian citizenship. See: Anatol Lieven. *Ukraine and Russia: a Fraternal Rivalry*. Washington, 1999, pp. 113-119.

³⁰ Taras Kuzio. *Ukrainian Security Policy*. Westport, 1995, pp. 103-108.

and Great Britain provided security guarantees demanded by Ukraine in exchange for non-nuclear status, the Ukrainian parliament ratified START 1 and the Nonproliferation Treaty on February 4, 1994. Additionally, the US agreed to pay for nuclear disarmament and doubled its aid to Ukraine.³¹ The decision to give up nuclear weapons not only significantly improved the international image of Ukraine, but also demonstrated the positive economic implications of a consistent national security strategy.

In March 1994, Ukraine had its first parliamentary elections since it became independent. By then the Ukrainian parliament elected back in the Soviet era had lost much of its credibility and was regarded as an inefficient and corrupted institution. Despite widespread opinion that the 1990 elections did not accurately reflect the allocation of political preferences within the society, the Rada resisted holding a new election before the end of its four year term. Thus Ukraine lost a chance to elect reform-oriented legislature during the so called “window of opportunity” following the banishment of the Communist party.

The Verkhovna Rada was divided between conservatives from the former Communist party and a coalition of nationalists and reform-oriented deputies. Such a composition of political forces neither promoted national unity and civil consensus nor supported desperately needed economic reforms. In June 1993, facing growing resentment of the population, the Rada agreed to hold a referendum on confidence in the parliament and President Kravchuk in September of the same year. On 24 September 1993, the parliament canceled the referendum in favor of early elections. The elections were to be held in March 1994 (parliamentary) and in June 1994 (presidential).³²

³¹ Taras Kuzio. *Ukrainian Security Policy*. Westport, 1995, pp. 116-119.

³² Taras Kuzio. *Ukraine under Kuchma*. New York, 1997, p. 6.

Key issues which voters were concerned with on the eve of the 1994 parliamentary elections were the economic crisis, crime, and relations with Russia. Only in Kyiv and Western Ukraine did potential voters identify as a priority the armed forces, territorial integrity and support for religion. Western Ukraine and the south around Odessa also supported economic reform as a high priority. In Eastern and Southern Ukraine and Crimea (the most populated industrial areas), the fight against crime was given top priority.³³ Overall, both 1994 election campaigns were conducted against the background of societal distrust in the government and state institutions, as evidenced by the data in Table 2.1 below.

Table 2.1 Pre-election Poll of Public Confidence³⁴

Armed Forces	20%
Militia (Police)	6%
President	4%
Cabinet of Ministers	2%
Local Councils	2%

The first round of the parliamentary elections was held in March-April 1994. Only 324 out of 450 representatives were elected.³⁵ A highly confusing electoral law adopted in 1993 not only opened doors for numerous violations but also led to interminable run-offs to fill the vacant seats. A total of 393 deputies had been elected by September 1994. In the end, voter turnout was extremely low due to multiple and redundant polls which were inefficiently held. In some regions voters “suffered” from elections until March 1996 when the parliament came to the realization that Soviet-style

³³ Jacob Kipp. Ukrainian and Belarus Presidential Elections: Prelude to a Crisis in the Western Borderlands of Russia (an Immediate Aftermath of Elections). Foreign Military Studies Office. GlobalSecurity.org. Internet. Online. Available <http://www.globalsecurity.org/military/library/report/1994/ukrelec.htm#5> (13 March 2006).

³⁴ Taras Kuzio. Ukraine under Kuchma. New York, 1997, p.7.

³⁵ Ibid., p.27.

electoral system was not working and passed a one-year moratorium on by-elections in those areas which failed to elect a deputy twice owing to lack of a majority vote.³⁶

The Verkhovna Rada was divided into two camps over the question of reform with the conservative left wing, comprised of Communists, Socialists, Agrarians and some unaffiliated deputies, dominating the parliament (See table 2.2 for the political affiliation of the Ukrainian political parties in the 1994 convocation of the Verkhovna Rada). Nevertheless, the Rada found ways to cooperate over the key questions which divided voters during the election campaign. It peacefully resolved constitutional conflicts between the legislature and the executive branch³⁷ which intensified in 1995 and lasted through the first half of 1996.

³⁶ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, p. 259.

³⁷ *Ibid.*

Table 2.2 Division of Parliament According to Political Orientation and Affiliation to Political Parties (5 April 1996)³⁸

Faction	Membership	Political Party
<i>Radical Left</i>		
Communist	89	KPU
Agrarians	26	SelPU
Socialist	24	SPU
Total	139 (33.41%)	
<i>Social Democratic/Centrist/Liberal</i>		
Center	31	None
Social-Market Choice	30	LPU
MRBR	29	MRBR
Independents	25	None
Agrarians for Reform	25	None
Unity	24	None
Total	164 (39.42%)	
<i>Center-Right/Nationalist</i>		
Reform	31	People's Democratic Party of Ukraine & Rukh
Statehood	29	URP & DPU
Rukh	29	Rukh
Total	89 (21.53%)	

The significance of the 1994 parliamentary elections was in the peaceful transition from a parliament elected in the Soviet era to the first parliament elected in the independent Ukraine, a factor that undoubtedly contributed to the country's democratization. Also the adoption of the Constitution of Ukraine in 1996 was certainly the most positive achievement of the 1994 parliament.

³⁸ Bohdan Harasymiw. Post-Communist Ukraine. Canadian Institute of Ukrainian Studies Press, 2002, p. 37.

1994 was rich in opportunities to further extend democratic processes in Ukraine. Seven candidates entered the presidential race before the June elections, two of which were clear favorites – then President Leonid Kravchuk and former Prime Minister Leonid Kuchma, backed by the Ukrainian industrial elite. In the second round, Kuchma won by 52 per cent, with a 71 per cent turn-out.³⁹

Kuchma's electoral platform included closer economic and political ties with Moscow and the need for implementing market reforms in Ukraine. However, his following two terms in the Presidential office proved that he was also listening to the wishes of twelve million voters mostly from the Western Ukraine and Kyiv who gave their ballots to nationalistic oriented Kravchuk.⁴⁰ It was specifically reflected by the stand Kuchma took on the Ukraine's defense and national security policies.

Under Kuchma's administration, Ukraine continued official policy on building up its own Armed Forces. However, a need to balance between the army's requirements with the state's abilities to satisfy them was pointed out by the Defense Minister Valery Shmarov, a civilian appointed by Kuchma shortly after elections. Shmarov was also in favor of improved bilateral military-technical co-operation with Russia. During 1995 the two countries signed several economic and technical agreements which provided for spare parts and technology for the AFU in exchange to a transfer or lease of some Soviet military equipment and facilities to Russia.⁴¹

Kuchma's presidency was accompanied by serious changes in foreign aspects of the national security agenda. Ukraine began to look for its place in the international security system. It increased, on a select basis, its participation in CIS defense structures;

³⁹ Elections... Elections... and More Elections. The Ukrainian Weekly. December 25, 1994. Internet. Online. Available <http://www.ukrweekly.com/Archive/1994/529406.shtml> (13 March 2006).

⁴⁰ Taras Kuzio. Ukraine under Kuchma. New York, 1997, p. 64.

⁴¹ Ibid., p. 214, 218-219.

overall, Ukraine continued to maintain minimal levels of co-operation. As opposed to that, under Kuchma, Ukraine adapted integrative policies towards NATO.⁴² Even before the elections, in February 1994, Ukraine joined NATO's Partnership for Peace program, and during the next eight years, NATO-Ukraine relations culminated in a NATO-Ukraine Action Plan in 2002 which was aimed towards Ukraine's eventual membership in the alliance. The co-operation with NATO and its impact on defense planning and budgeting in Ukraine will be discussed in Chapter IV. Here it is necessary to note that defense reform was a primary focus of the NATO-Ukraine relations since 1997 when they signed the NATO-Ukraine Partnership Charter on Distinctive Partnership.⁴³

In 1999, with difficult competition from the leftist candidates, Kuchma was re-elected for his second term in the office. During his first tenure he launched privatization of state-owned assets and economic reforms. Both processes, however, were shaped in a way oriented to deliver benefits to a very narrow circle of individuals and clans close to those in power and did not bring significant improvement to the economy. Inflation and budget deficits were still high and GDP continued to decline. Parliamentary elections held before the presidential campaign in March 1998 were conducted under a new electoral law adopted in 1997 which lowered the requirement for a majority of electors to attend the polls from the previous 50 percent to 25 percent, and instituted a mixed electoral system. In the new parliament, 225 deputies were elected by proportional representation (PR) and 225 by simple plurality in single-member districts (SMD). On the PR side, parties were required to win 4 percent of the vote to receive representation.⁴⁴

⁴² Taras Kuzio. Ukraine's Relations with the West: Disinterest, Partnership, Disillusionment. Internet. Online. Available http://www.taraskuzio.net/academic/ukraine_west_relations.pdf (14 March 2006).

⁴³ Leonid Golopatuk. Z chem Ukraina Stremitsya v NATO. Interview to BBC, 8 April 2004. Internet. Online. Available http://news.bbc.co.uk/1/hi/russian/news/newsid_3611000/3611519.stm (15 March 2006).

⁴⁴ Bohdan Harasymiw. Post-Communist Ukraine. Canadian Institute of Ukrainian Studies Press, 2002, p. 280.

Out of thirty political parties registered for the elections, eight managed to attain the 4 per cent threshold. The Communists had a leading position with 24.7 percent of the vote, followed by Rukh (9.4 percent) and the Socialist Peasant block (8.6 percent). On the SMD side, the picture was different but not dramatically so. The big winners were the independents, who took 114 seats. The remaining seats were allocated among members of twenty one different parties. The Communists again had the strongest position, with 39 seats. In the newly elected parliament deputies re-organized themselves into nine factions. The Communist party was a clear winner and had the largest faction of 119 representatives or 28.8 percent of the total number.⁴⁵ The factional organization of the Ukrainian parliament elected in 1998 is represented in Table 2.3.

Table 2.3 Registered Factions in the Parliament of Ukraine (14 May 1998)⁴⁶

Name	Number of Deputies	Percentage of Total Registered Deputies
Communist Party of Ukraine	119	28.8
PDP	84	20.3
Rukh	47	11.4
Hromada	39	9.4
Left Center (Socialist Peasant Block)	35	8.5
Green Party	24	5.8
SDPU(O)	24	5.8
Unaffiliated	24	5.8
PSP	17	4.1

The political composition of the new Verkhovna Rada appeared to be hostile to the executive branch. Although the anti-presidential wing did not have an overwhelming majority to pass a vote of non-confidence in the government, they took extremely

⁴⁵ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, pp. 280-287.

⁴⁶ *Ibid.*, p. 287.

aggressive and implacable stands towards the executive. Not only did they sabotage the work of the government by persistent blocking of bills and budget proposals, they also came into open confrontation with the presidency when the Rada “issued an appeal to the Ukrainian people in October 1999, urging them not to vote during the presidential election for the incumbent Leonid Kuchma in order to insure democracy”.⁴⁷

After Kuchma’s victory in the second round of the presidential election, pro-governmental forces managed to organize a majority in the parliament. Yet it was not to last. The government enjoyed parliamentary cooperation until the end of 2000 and was able to get several key measures approved. Even the 2001 budget was passed by the Rada before the start of the new year (for the first time since Soviet era). However, then the presidential majority disintegrated and the parliament again became belligerent to the government.⁴⁸

A short “honeymoon” of two governmental institutions produced the first economic improvement since 1991. Appointed by Kuchma, a new Prime Minister Victor Yushchenko introduced a set of measures which eliminated some shadow economic schemes and made monetary mechanisms work. These policies brought a 6 percent GDP growth in 2000⁴⁹ and ensured steady increases thereafter.⁵⁰ Despite these achievements, Yushchenko was forced out of office when his rising popularity made him a threat to the president and the clan of businessmen around him.⁵¹ The interests of Kuchma, concerned with preservation of the power, coincided with the populist aims of the Communist

⁴⁷ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, p. 291.

⁴⁸ *Ibid.*, p. 298.

⁴⁹ Andrew Wilson. *The Ukrainians: Unexpected Nation*. Yale University Press, 2002, p. 278.

⁵⁰ See: The World Bank. *Ukraine. Country Brief*. Internet. Online. Available <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/UKRAINEEXTN/0,,menuPK:328543~pagePK:141132~piPK:141107~theSitePK:328533,00.html> (16 March 2006).

⁵¹ Jason Bush. *Victor Yushchenko*. *Business Week Online*, 30 May, 2005. Internet. Online. Available http://www.businessweek.com/magazine/content/05_22/b3935404.htm (16 March 2006).

coalition in the parliament which criticized Yushchenko for his pro-western orientation and voted to remove him in April 2001.⁵²

During his ten year presidency, Kuchma was working with three convocations of the Verkhovna Rada. The third one was elected in March 2002 and was the first Rada where the communists did not have the largest faction. Yushchenko was able to use the interval between his dismissal and parliamentary elections to organize his electoral block, “Our Ukraine”, which obtained 110 seats in the new parliament, more than any other party.

Table 2.4 The Official Election Results (31 March 2002)⁵³

Political Parties	% of vote	Number of seats (PR)	Number of seats (SMD)	Total
Our Ukraine	23.7	70	40	110
Communist Party	99.98	59	7	66
For a United Ukraine	11.77	35	66	101
Timoshenko Block	7.26	22	--	22
Socialist Party	6.87	20	2	22
SDPU (O)	6.27	19	5	24
Democratic Party of Ukraine	0.87	--	4	4
Block “Unity”	1.09	--	3	3
Party of National Economic Development	--	--	1	1
Ukrainian Sea Party	0.11	--	1	1
Independents	--	--	93	93
Total	--	225	222	447

⁵² EU worried by Ukraine PM dismissal. CNN.com/World, 27 April, 2001. Internet. Online. Available <http://cnnstudentnews.cnn.com/2001/WORLD/europe/04/26/ukraine.premier.05/index.html> (16 March 2006).

⁵³ Ukraine Parliamentary Elections 31 March 2002 Final Report. OSCE. Office for Democratic Institutions and Human Rights. Internet. Online. Available http://www.osce.org/documents/odihr/2002/05/1293_en.pdf (17 March 2006).

The Verkhovna Rada of 2002 was more fragmented than ever before (See Table 2.4 for the list of the political parties represented in the Ukrainian parliament of 2002). The presidential administration faced two oppositions—the communists and the shaky coalition of Socialists, the Timoshenko Block and Yushchnko’s Our Ukraine. The former, however, regarded Kuchma as a smaller evil than “pro-western and nationalistic” Yushchenko and his ally Timoshenko. Divisions also took place even within the opposition camps, which had a dramatic effect over the course of the constitutional reform preemptively launched by the president to weaken Yushchenko in case of his victory in presidential elections in 2004. With support from Socialists and the Communist Party, the president’s camp was able to pass the reform which provided for a proportional representative electoral system and transferred some presidential powers to the parliament and prime minister.⁵⁴

To summarize, since 1992 Ukrainian governmental institutions were involved in a contest for power initially aggravated by the absence of a new constitution which might have provided guidelines for democratic behavior. The Armed Forces were definitely not involved as they proved themselves a politically neutral, stable and reliable institution. Yet defense and security issues appeared to be an important variable in Ukrainian international politics. It was the international security environment and economy which dictated a need for structured defense planning. The next section will summarize the development of the AFU from 1991 to 2005 and assess the financial aspects of this process.

C. DEVELOPMENT OF THE ARMED FORCES OF UKRAINE

Confronted with a potentially dangerous situation after the break up of the Soviet Union, the Ukrainian government managed to maintain moderate political stability and to avoid the ethnic and regional conflicts which broke out in a number of former Soviet republics. An important constituent of this success came from the ability to reorganize

⁵⁴ Taras Kuzio. Regime Type and Politics in Ukraine under Kuchma. *Communist and Post-Communist Studies*, 38 (2005), pp. 181-183.

approximately 780,000⁵⁵ former Soviet troops into a Ukrainian Army. Nationalization of almost the entire (with the exception of the Black Sea Fleet) portion of the Soviet military machine in Ukrainian territory did prevent the continued presence of Russian military bases in Ukraine, an essential factor in the event of domestic strife and separatist initiatives.⁵⁶

In accordance with the Soviet military-administrative organization, Ukraine was divided into three military districts which altogether had one rocket army, three armies of combined forces and two tank armies, one army corps, four Air Force armies, and a separate Air Defense army. Additionally, the Black Sea fleet was stationed in Crimea and in several other Ukrainian Black Sea ports. Thus Ukraine inherited more than enough resources to equip a large armed force. In 1991 it had 6500 tanks, about 7000 combat armored vehicles, 1500 combat aircrafts, more than 350 ships, 1272 strategic nuclear warheads for intercontinental ballistic missiles, and 2500 tactical nuclear missiles.⁵⁷

This defense “heritage” was obviously unsuited for Ukraine’s independent needs. By October 1991, the Verkhovna Rada had established much of the legal basis for setting up Ukraine’s own armed forces. Although a need for downsizing and military reform was recognized by the Ukrainian leadership, external as well as internal security considerations prohibited the introduction of profound measures. Resistance to radical military reform can be explained by two main reasons. First, possession of a large military and nuclear weapons might prevent possible encroachments upon Ukrainian territorial integrity. Second, the Ukrainian leadership strived for stability within the large officer corps which could be disturbed by the cuts. Thus the first stage of the AFU

⁵⁵ Ministry of Defense of Ukraine. The chronicle of independent Ukraine. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=en&part=history&sub=chronicle> (17 March 2006).

⁵⁶ Taras Kuzio. Ukrainian Security Policy. Westport, 1995, p. 102.

⁵⁷ Ministry of Defense of Ukraine. The history of the Armed Forces of Ukraine. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=en&part=history&sub=history> (18 March 2006).

development may be regarded mostly as a nationalization or initial establishment of the Armed Forces.

However, actively establishing itself as a European country and a member of the international community, Ukraine was determined to observe its international obligations. In accordance with the requirements of the Conventional Forces in Europe Treaty and under an agreement signed in May 1992 as a member of the CIS, Ukraine began to reduce the number of both weapons and personnel.⁵⁸ The economic crisis which the Ukrainian MOD was facing from the first days of its existence accelerated the rate of reduction.⁵⁹ By 1996, Ukraine had cut its military personnel to 400,800,⁶⁰ driven by the same considerations that led the Ukrainian parliament to abandon nuclear weapons, i.e., they not only carried prohibitively high costs but were also an obstacle to receiving international financial aid.

However, except for the reduction of forces, little had been done to implement reform. In 1992-1995, Ukrainian armed forces remained basically the same as the Soviet model from which they had originated in their organization.⁶¹ Chronic underfunding meant that such a structure was unable to carry out its tasks and was a great burden for the state budget. The evidence of a crisis was obvious: not a single exercise at divisional level had been held since 1991. By 1995, 40 percent of Ukraine's fighter aircraft were out of operation because of shortages of fuel and spare parts. Pilots and tank drivers only trained at 20-30 percent of the required minimum in their field. Similar problems were

⁵⁸ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, p. 403.

⁵⁹ Konstantyn Morozov. *Above and Beyond: From Soviet General to Ukrainian State Builder*. Harvard University Press, 2000, p. 217.

⁶⁰ Active duty servicemen and women (including conscripts and long-term assignments from reserve). Source: *The Military Balance 1996/97*. Oxford University Press, 1996, p.101.

⁶¹ Taras Kuzio. *Crisis and Reform in Ukraine – Part 2*. *Jane's Intelligence Review*, 1 November 1996, Volume 008/011, p. 496. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

evident for literally all components and aspects of combat preparation. Even staff activities could not be carried out properly because power supplies and communication lines were often switched off by providers due to non-payment of debts.⁶²

The appointment of Valery Shmarov as a civilian minister of defense was made by President Kuchma in 1994, simultaneously with the introduction of market reforms and privatization. It was aimed to bring developments within the MOD in line with the governmental economic program. In addition, a new administration was reassessing Ukraine's threat environment which had to be reflected by the defense reform. Shmarov's proposed reform program met resistance from a group of top military leadership led by chief of the General Staff Anatoliy Lopata. The program called for cardinal restructuring of the AFU (corps-brigade and regional command structure as opposed to existing division-regiment and military district structure), further cuts in personnel and a number of other measures including a new system of operational strategic planning. Lopata was advocating the existing structure of the Armed Forces and argued for the need to possess sufficient forces and armaments to obtain victory over the enemy—not merely to rebuff him.⁶³ At the same time, the General Staff lobbied parliamentary factions on the issue of troop reductions.⁶⁴ Lack of clear division of functions between the MOD and the General Staff became especially apparent during the conflict of civilian and military authorities and worsened the issue. When the argument became public, both the Minister of Defense and the Chief of General Staff were dismissed by the President.

⁶² Taras Kuzio. Crisis and Reform in Ukraine – Part 1. Jane's Intelligence Review, 1 October 1996, Volume 008/010, p. 448. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

⁶³ Taras Kuzio. Crisis and Reform in Ukraine – Part 2. Jane's Intelligence Review, 1 November 1996, Volume 008/011, p. 496. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

⁶⁴ Pavel Baev. Europe, Ukraine's Army under Civilian Rule, Jane's Intelligence Review, 1 January 1996, Volume 008/001, p. 8. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

A new program for the further development of the armed forces to the year 2005 adopted by the government at the end of 1996 appeared to be a compromise between the two conflicting approaches. The program took into account Ukraine's economic conditions and the current international context. It retained the existing force structure – land forces, navy, air force and air defense – but replaced the Soviet era military districts with three operational commands – western, northern and southern.⁶⁵ The appointment of Lieutenant General Olexander Kuzmuk, previously commander of the National Guard, to replace Shmarov articulated Kuchma's intend to continue defense reforms but emphasized that it may be too early for civilian control of the armed forces.

Meanwhile, increasing social costs threatened the defense reform. Social legislation, designed to attract military officers to the Ukrainian armed forces in 1992-1993, became a significant problem for the implementation of the reform. For example, a number of officers could not be released from the service without apartments being allocated for them, therefore posing a burden for the defense budget.⁶⁶ It also was less stressful for the budget to pay them regular salaries than the considerable retirement benefit packages to which they were entitled in case of dismissal due to downsizing.

But the most significant impact on the defense reform was made by the government when it substantially cut funding of the defense sector six months after the introduction of the reform program. As a result, during the first stage of the reform (1997-99), the MOD could only afford actions which required no or few funds (see table 2.5).⁶⁷ In September 1997, President Kuchma asked the parliament for a two-fold

⁶⁵ Bohdan Harasymiw. *Post-Communist Ukraine*. Canadian Institute of Ukrainian Studies Press, 2002, p. 409.

⁶⁶ Taras Kuzio. *Crisis and Reform in Ukraine – Part 1*. *Jane's Intelligence Review*, 1 October 1996, Volume 008/010, p. 448. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

⁶⁷ National Security and Defense. January 2000, p. 21. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=1 (19 March 2006).

increase in defense spending purposely for the implementation of the reforms.⁶⁸ The MOD, however, obtained only an 8 percent increase in nominal hryvnias in 1998⁶⁹ which was hardly enough to cover inflation⁷⁰ and suggested that defense reform was not a priority for the Verkhovna Rada. Moreover, the defense spending was also reduced by the Ministry of Finance so that Ukraine could qualify for the loans from the IMF, which required cuts in government expenditure.⁷¹ Table 2.5 demonstrates dynamics of the defense funding as a percentage of GDP.

Table 2.5 Funding of Ukraine's Armed Forces 1992-99⁷²

	1992	1993	1994	1995	1996	1997	1998	1999
Defense Budget, % of GDP	2.4	1.57	1.46	1.8	1.9	1.35	1.35	1.4

Similar trends remained until 2004; furthermore, real allocations of funds to the MOD were actually below budget figures even after the beginning of growth of the economy in 2000. Figure 2.1 indicates a large and persistent gap between requirements for defense spending and actual expenditure between 2000 and 2005. For purposes of this figure, “required” and “minimum required” budgets are interpreted as the defense budget requirements submitted by the MOD.

⁶⁸ Kiev Seeks Spending Increase to Meet Reforms. Jane's Defense Weekly, 3 September 1997. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

⁶⁹ The data obtained from calculations based on Ukraine's 1997 and 1998 budgets. 1997 law on the state budget of Ukraine available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi> , 1998 law available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi> (19 March 2006).

⁷⁰ Inflation data obtained from <http://www.clevelandfed.org/research/Inflation/World-Inflation/index.cfm#chart> (19 March 2006).

⁷¹ Avoid Ukraine. Foreign Report. Jane's Intelligence Review, 25 February 1998, Volume 000/2533. Internet. Online. Available <http://jir.janes.com/docs/jir/search.jsp> (19 March 2006).

⁷² National Security and Defense. January 2000, p. 21. Internet. Online. Available http://www.uceps.org/additional/NSD1_eng.pdf (19 March 2006).

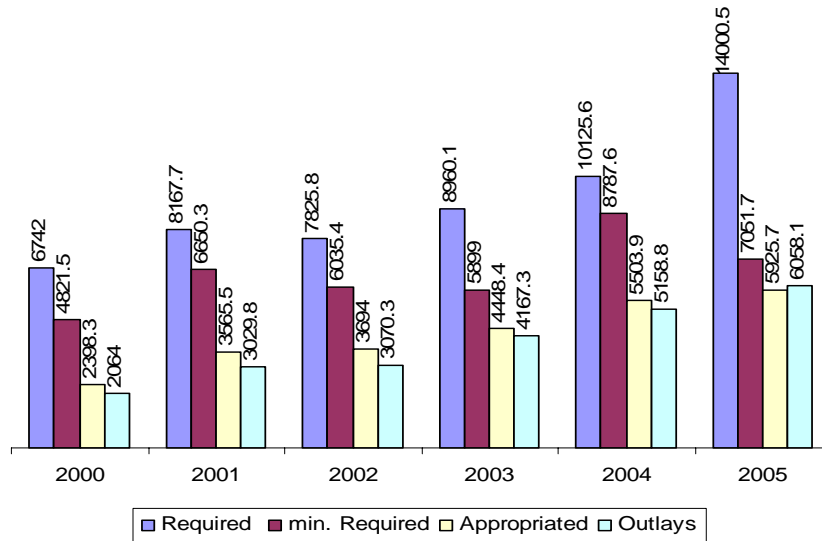


Figure 2.1 Funding of the Armed Forces of Ukraine 2000-2005, UAH millions⁷³

In 2000 the plans for the defense reform were corrected and a new “State Program for Reform and Development of Armed Forces of Ukraine” was adopted. This program was developed for the period from 2000 to 2005 and took into account changes that occurred in Ukraine and in the world at the end of the 20th century. A brief overview of this program and the results of its implementation in regard to defense planning and budgeting will be provided in Chapter IV. Overall the 2000 program for defense reform provided for improvements in defense legislation, in the structure of the Armed Forces and in their operational control system. It included further reduction of personnel and equipment, enhancement of the combat preparation system, and a shift to manning on a contract basis.

However, the situation in the Armed Forces continued to deteriorate. Out of all main objectives of the reform program, the only notable progress was made by the MOD and the Verkhovna Rada in terms of adoption of a sufficient legal base for the functioning of the Armed Forces in a changing political environment. These new laws

⁷³ The White Book 2005: Defense Policy of Ukraine. Kyiv, 2006, p.99. Internet. Online. Available http://www.mil.gov.ua/ua/white_book/1.pdf (19 March 2006).

included amendments to legislation on social protection of military personnel and additional options which were made available to personnel in 2004. It gave greater flexibility to the MOD and allowed accelerated downsizing of the Armed Forces. By the end of 2005, the number of active duty personnel was reduced to 180,000.⁷⁴ The year 2005 was also notable because it was the first year when the Ukrainian MOD received the full amount of funds allocated by the budget, which allowed Ukrainian defense officials and President Yushchenko to talk about a qualitative shift in the defense reform and about a budget of development for 2006.

D. CONCLUSIONS

Although Ukrainian policymakers learned from early Ukrainian history and devoted considerable effort to the creation of the armed forces, little has been done to sustain the initial success. The first initiatives stemmed from the ambiguity of the external threats to the Ukrainian statehood and the importance of control over the armed forces to prove the very validity of a new government. In addition, legislative attention to the military was necessary to ensure internal stability since military personnel and family members were a significant portion of the Ukraine's fifty two million population and the armed forces possessed enough material and organizational resources to destabilize the country.

However, the effective work which had been done by the government to fulfill these objectives did not result in the originally planned building of the Ukrainian armed forces on the principles of "a substantiated adequacy of the numerical force and structure as well as of the equipment"⁷⁵ to meet the strategic needs of Ukraine and its ability to support the military. As the factors initially pursued to stabilize and modernize the military became less relevant and the deteriorating economy became a primary concern

⁷⁴The White Book 2005: Defense Policy of Ukraine. Kyiv, 2006, p.13. Internet. Online. Available http://www.mil.gov.ua/ua/white_book/1.pdf (19 March 2006).

⁷⁵ The Conception of Defense and Development of the Armed Forces of Ukraine. 10. 11. 1991. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?user=a#Find> (1 April 2006).

of the population, the government essentially abandoned the Armed Forces. This attitude towards defense was shown by the extremely low defense budgets during the period 1992-2004.

Equally negative for the development of the armed forces was the absence of a consolidated national security agenda and correspondingly, the lack of a cohesive defense reform plan to use those scarce resources efficiently. The composition of the Verkhovna Rada was too fragmented to come to a common opinion on this matter. Moreover, the Rada's role in the decision-making process was rather limited in comparison with that of the President, which consequently provided few incentives for the parliament to be involved in defense processes. Basic needs of the Armed Forces were largely neglected, as the legislative and the executive branches of the government were preoccupied with a contest for power. Until 2004, Ukrainian defense reform consisted of the downsizing of the military caused by the economic crisis and international obligations of Ukraine. The next chapter will describe how the Ukrainian legal mechanisms were designed to support the national defense. It will discuss the evolution of the defense budget process in Ukraine and arrangements within the government related to this.

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III. GOVERNMENTAL STRUCTURE AND THE DEFENSE BUDGET PROCESS, 1991 – 2004

A. INTRODUCTION

Under the Soviet Union, defense was a prerogative of the central Soviet government, as a result of which, neither the Ministry of Defense nor the General Staff had branches in the republics. Defense activities were financed entirely from the union budget. Even though “strengthening of the defense capability of the country” was among the functions to be executed according to plan and budget by provincial governments at all levels, locally financed projects (e.g., aerodromes of local importance) and other expenditures (e.g., promotion of physical culture) had minor or indirect significance for defense overall.⁷⁶

The first Law on the State Budget of Ukraine was passed by the Verkhovna Rada in 1992. Defense expenditures in that document were represented by a single number which combined funds allocated to the MOD, the National Guard, the Border Troops, the Staff of Civil Defense, and the educational organizations of the Society for Assistance the Defense of Ukraine. It is not clear how the shares of this “security” budget were allocated among the individual agencies, and how priorities were set. Progress in defense budget legislation is demonstrated by the fact that the defense budget in 2004 was subdivided among 28 programs. The third chapter of this thesis will discuss formal aspects of the evolution of budgeting for defense in Ukraine. It will examine who had power to decide how much funding national defense would receive, and how it was affected by legal developments such as introduction of the Constitution in 1996.

This chapter consists of three main sections. First, it will describe the evolution of the defense budget process from 1991 to 1996. It will then discuss budgeting for defense after the introduction of the Constitution and Budget Code in the period from 1997 to

⁷⁶ Raymond Hutchings. *The Soviet Budget*. State University of New York Press, 1983, pp. 42-43.

2004. Finally, the Role of the Verkhovna Rada in the processes of defense planning and control over the execution of the defense budget will be considered.

B. THE EVOLUTION OF DEFENSE BUDGET AUTHORITY DURING THE PERIOD FROM 1991 TO 1996

During the period from 1991 to 1996, the Ukrainian budget system was regulated by the Law on the Budget System of Ukraine passed by the Verkhovna Rada in December 1990.⁷⁷ Adoption of this law, on one hand, was intended to emphasize separation from the union budget system. On the other hand, it was the first attempt to separate the powers and responsibilities of the legislative and executive branches of the government.⁷⁸ It provided basic principles and guidelines for the development of the state budget and envisaged defense as a separate and distinct category of the budget. According to Article 7 of the 1990 version of the Law on the Budget System of Ukraine, the Council of Ministers “submits to the Verkhovna Rada of the Ukrainian Soviet Socialist Republic (Ukrainian SSR) projects of:

- The budget for the republic with explication of the main sources of income and main categories of expenditure;
- The proposal for the amount of circulating cash in the budget for the republic”.⁷⁹

In accordance with the same article, a procedure and terms for the development of the budget project for the upcoming year were determined by the Council of Ministers.

⁷⁷ This law was adopted by the Verkhovna Rada of the Ukrainian Soviet Socialist Republic on 5 December 1990 and (as amended in 1995) remained in force through 21 June 2001, when the Budget Code of Ukraine was adopted.

⁷⁸ Program of Assistance for the Parliament of Ukraine. The University of Indiana. Budget and Financial Authorities of the Verkhovna Rada. Internet. Online. Available http://pdp.org.ua/prn_view.php?a=184 (13 April 2006).

⁷⁹ Ibid.

Article 8 stipulated the role of the Verkhovna Rada in the budget process. In particular it stated:

The project of the budget for the republic, submitted by the Council of Ministers of the Ukrainian SSR, is preliminarily examined by the Commission on Planning, Budget, Finances, and Prices and by other standing commissions of the Verkhovna Rada of the Ukrainian SSR.

After the examination, the standing commissions prepare and present their conclusions and recommendations.

The Verkhovna Rada approves:

- The amount of circulating cash in the republican budget;
- The ceiling of the budget deficit and sources for its compensation.⁸⁰

The function of oversight over execution of the budget of the Ukrainian SSR, in accordance with this law, was entrusted to the same entity which was responsible for the execution of the budget-the Council of Ministers.⁸¹

As a result, the very essence and form of the 1990 Law on the Budgeting System of Ukraine practically excluded real parliamentary oversight over its execution. The articles of the budget were represented by very large sums, without clarification of particular categories of spending. As a result, government ministries and agencies could and did spend budget funds without consideration of parliamentary priority. At that time Ukraine had no legislation or other regulations designed to provide order and transparency to governmental expenditure. Consequently, ministries and agencies, as well as individual government officials, were not held accountable for the use of budget funds.⁸²

⁸⁰ Program of Assistance for the Parliament of Ukraine. The University of Indiana. Budget and Financial Authorities of the Verkhovna Rada. Internet. Online. Available http://pdp.org.ua/prn_view.php?a=184 (13 April 2006).

⁸¹ Ibid.

⁸² Ibid.

In 1990, an attempt was made to impose parliamentary control over the execution of the budget by the Rada. The Ukrainian parliament declared the intent of Ukraine to have its own armed forces in the Declaration on the State Sovereignty of Ukraine, passed on 16 July 1990. The first document which had practical significance for the development of the Armed Forces of Ukraine was the Conception of Defense and Development of the Armed Forces of Ukraine, adopted in October 1991, following the independence of Ukraine proclaimed on 24 August 1991 (See Chapter II). This document had several provisions regarding financing of the military.

In particular, it provided that “obsolete equipment which the units of the Armed Forces of Ukraine are armed with, and location of many maintenance facilities outside of Ukraine require considerable budget funds for defense and development of own military production”.⁸³ It then assigned the right to approve the defense budget and to control its execution to the Verkhovna Rada. It also stipulated roles of the President, the Ministry of Defense, and the General Staff in the defense planning and control over the military, and provided for the Defense Council of Ukraine to be the highest government body to control national security and the defense sphere in Ukraine. The composition of the Defense Council had to be approved by the Verkhovna Rada. However, the role in budgeting for defense was not specified for either of these bodies.

A separate section of the document was called “Financial-Economic Support” (to the AFU). With respect to the budget, it stated that “Military reform and development of the Armed Forces of Ukraine required new approaches to the formation of defense budget during the period of transition to the market economy”.⁸⁴ Specification of those “new approaches” was not provided. It also stated that the AFU were to be funded

⁸³ The Conception of Defense and Development of the Armed Forces of Ukraine. 10. 11. 1991. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?user=a#Find> (6 April 2006).

⁸⁴ Ibid.

entirely from the state budget and the amount of funds was based on the number of troops, “which should not exceed 0.8-0.9 per cent of the population (400-420 thousand)”.⁸⁵

The notion that the defense budget was to be a function of the number of troops illustrates an ambiguity within the Conception of Defense and Development of the Armed Forces of Ukraine. First, because the population of Ukraine in 1991 was 51.7 million,⁸⁶ one tenth of a percent represents a very large range. Second, the range 400-420 thousand troops provided by the Conception does not match the 0.8-0.9 percent range, which should be 410-460 thousand. Finally, the funding of the Armed Forces based on the number of troops does not correspond with the need for modernization of military doctrine and equipment which were also stressed in the document.

The declarative nature and ambiguity of the Conception of Defense and Development of the Armed Forces of Ukraine can be explained by the character of the historical period during which it was adopted (See Chapter II). Rapidly unfolding events and lack of expertise in the national security realm did not allow for development of sophisticated legal acts. Although the Conception of Defense and Development cannot pretend to be called the first program for development or reform of the Ukrainian armed forces-which in fact, did not officially exist until 6 December 1991-this document was extremely important to support efforts to nationalize the military, especially as it expressed the commitment of the new government to develop and finance defense.

⁸⁵ The Conception of Defense and Development of the Armed Forces of Ukraine. 10. 11. 1991. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?user=a#Find> (6 April 2006).

⁸⁶ Statistical data was obtained from U.S. Census Bureau, International Data Base. Internet. Online. Available <http://www.census.gov/ipc/www/idbprint.html> (4 April 2006). See also State Committee of Statistics of Ukraine. Internet. Online. Available <http://www.ukrstat.gov.ua> (4 April 2006).

A package of legal acts, passed by the Rada on 6 December 1991, set a legal precedent for the development of the Ukrainian Armed Forces. It was comprised of the laws of Ukraine on the Armed Forces of Ukraine and on the Defense of Ukraine. The Law on the Defense of Ukraine established legal principles for the defense of Ukraine and regulated authorities and responsibilities of governmental agencies, organizations, officials and individual citizens in the defense sphere. Regarding funding of defense, it stated that “the needs of the national defense of the state shall be financed solely at the expense of the State Budget of Ukraine within limits annually set by the Law of Ukraine ‘On the State Budget of Ukraine’ providing for proper accomplishment of defense tasks, but no less than three per cent of the planned gross domestic product volume.”⁸⁷

Although this law set a minimum of three percent of GDP for defense spending, it did not explain which categories of the budget expenditures belong to defense. Absent this clarification, officials from the Ministry of Finance could argue that the three percent limit should include all categories attributed to defense by effective law, including pensions for retired military personnel. One expert concluded that “Such a situation causes heated discussions in the Verkhovna Rada every year in the process of the defense budget approval, and in the end often, makes the amount of defense expenditures unpredictable.”⁸⁸

Since its adoption, the Law on the Defense of Ukraine has been amended several times. Because only the latest version of this law⁸⁹ was available during the writing of

⁸⁷ This translation was taken from: Polyakov, Leonid. An Analytical Overview of Democratic Oversight and Governance of the Defense and Security Sector in Ukraine. Geneva, January, 2005, p. 41. Internet. Online. Available http://www.dcaf.ch/publications/Working_Papers/152.pdf (4 April 2006).

⁸⁸ Leonid Polyakov. An Analytical Overview of Democratic Oversight and Governance of the Defense and Security Sector in Ukraine. Geneva, January, 2005, p. 41. Internet. Online. Available http://www.dcaf.ch/publications/Working_Papers/152.pdf (4 April 2006).

⁸⁹ The version from 5 October 2000. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=1932%2D12&text=%EF%F0%EE+%EE%E1%EE%F0%EE%ED%F3> (6 April 2006).

this thesis, this section will provide only a general overview of the implications of the Law on the Defense of Ukraine. In particular, the law provided the following:

- 1) The Cabinet of Ministers of Ukraine determines the need for defense funding and provides for execution of the portion of the State Budget of Ukraine approved by the Verkhovna Rada regarding the defense sphere;
- 2) The Ministry of Defense of Ukraine participates in the development of the defense budget and reports to the Cabinet of Ministers of Ukraine on the use of the appropriated funds; and,
- 3) The General Staff determines the need for personnel, armaments and equipment and for other resources (including financial resources) necessary for proper accomplishment of tasks by the Armed Forces of Ukraine and other military structures, and controls receiving of these resources.

The law also provides for the coordination and control role for the National Security and Defense Council which was introduced by the Law on the National Security and Defense Council in 1998. This body will be discussed in the next section, as well as the roles of the Verkhovna Rada and the President which are referred to the Constitution of Ukraine introduced in 1996.

The Law on the Armed Forces of Ukraine deals specifically with the AFU and determines their functions, structure, and the legal basis for their organization, functioning, location and control. Financing of the Armed Forces is defined in very general terms in this law. It indicates that the Armed Forces of Ukraine shall be financed at the expense of the State Budget of Ukraine and that control over execution of the State Budget regarding financing of the AFU is conducted in accordance with “a legal procedure”. However this procedure is not defined within the law. Interestingly, the Law on the Armed Forces of Ukraine also says that “expenses of the MOD to carry out its tasks ... are financed by the Cabinet of Ministers of Ukraine at the expense of the funds

appropriated for these tasks by the legal procedure, or additional funds (inpayments).” This statement appears to contradict the Law on Defense of Ukraine by providing for the possibility to fund defense by means other than “solely at the expense of the State Budget of Ukraine.”⁹⁰

Altogether, from 1991 to 1996, the three legal acts discussed above comprised the main body of Ukrainian defense legislation. Consequently, the legal aspects of budgeting for defense were not developed during this period. This allows one to conclude that the defense budget process was basically regulated by rules produced within the executive branch of the government and within the MOD in particular. The idea of the Defense Council found in the Conception of Defense and Development of the Armed Forces of Ukraine was not implemented in reality. Therefore, the Verkhovna Rada did not develop its initiative to assume the coordinative role in the defense process.

The structure of defense expenditures in Ukrainian budgets from 1992 to 1995 consisted of the expenses for the MOD, the National Guard, the Border Troops, and for the Staff and Troops of Civil Defense. This structure did not undergo any significant change during this period. In 1992, the defense budget, as already noted, was a single number for all these security structures;⁹¹ however, budgets from 1993 to 1995 were not much different, in that defense budgets consisted of a single sum assigned to each organization.

Even though it is hard to assess the effectiveness of the process which the government was using to plan and execute defense budgets without having access to the actual documents, the apparent degradation of the Ukrainian defense capabilities in the

⁹⁰ The Law on Defense of Ukraine. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=1932%2D12&text=%EF%F0%EE+%EE%E1%EE%F0%EE%ED%F3> (10 April 2006).

⁹¹ In addition to this, the 1992 defense budget included the educational organizations of the Society of Assistance for the Defense of Ukraine.

mid 1990s suggests that defense should have been given more attention by the government including legislative elaboration of the defense planning and budgeting processes. The next section will discuss further development of the legal basis for budgeting for defense in Ukraine.

C. GOVERNMENTAL SYSTEM AND BUDGET PROCESS DURING THE PERIOD FROM 1996 TO 2004

In June 1995, the Law on the Budget System of Ukraine was amended to strengthen the role of the Rada in the development and execution of the state budget, and to provide for more transparency in the budget.⁹² For example, a requirement for detailed clarification of any budgetary item which exceeded 0.1 per cent of total State budget spending was included. However, it took several years to implement these changes within actual budgets.

The introduction of the Constitution of Ukraine in June 1996 and the Budget Code of Ukraine, which replaced the Law on the Budget System of Ukraine in June 2001, affected the Ukrainian budget system and budgeting for defense in particular. This section will describe the defense budget process as it was shaped by these developments and by other initiatives intended to enhance budgeting for Ukraine.

1. Structure of the Defense Budget, 1996-2004

Before discussing the process of developing the defense budget within the government and the Ministry of Defense, the structure of defense expenditure should be examined. Beginning in 1996 the part of the Ukrainian state budget called National Defense included only funds spent by or through the Ministry of Defense. Until 1999 they were segmented in a few basic categories such as maintenance of the AFU,⁹³ procurement, research and development, and several other categories which differed from year to year.

⁹² Program of Assistance for the Parliament of Ukraine. The University of Indiana. Budget and Financial Authorities of the Verkhovna Rada. Internet. Online. Available http://pdp.org.ua/prn_view.php?a=184 (13 April 2006).

⁹³ "Maintenance" included all kinds of day-to-day support.

A resolution of the Verkhovna Rada passed in July 1996 introduced a system of budget expenditure classifications. However, it was not until 1999 that the State Budget actually took more detailed form. In accordance with the functional classification of the budget, defense expenditures were subdivided into six major categories, some of which were additionally portioned into subcategories. The structure of defense budgets from 1999 to 2001 is represented in Figure 3.1.

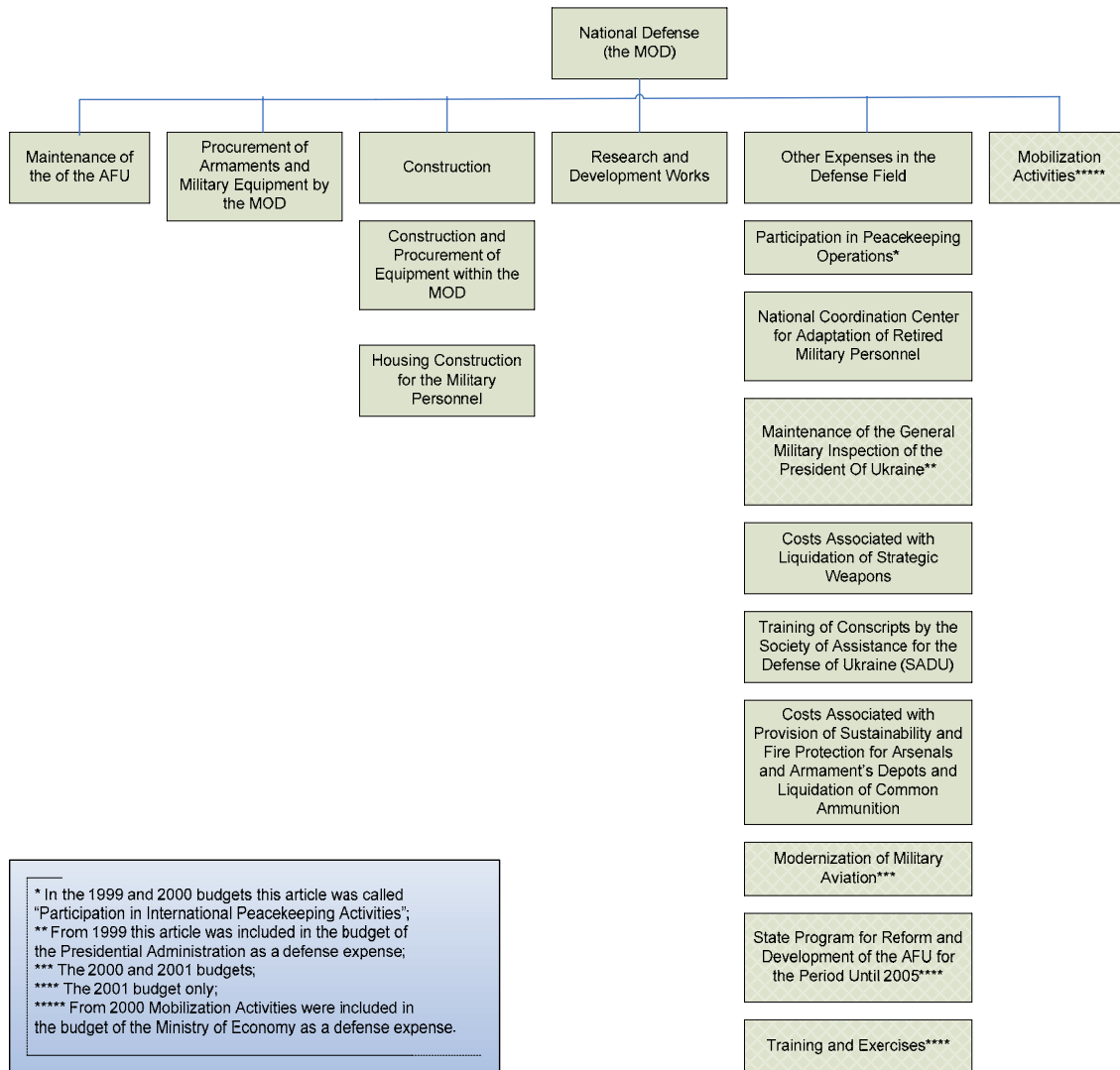


Figure 3.1 General Structure of Defense Budgets, 1999-2001⁹⁴

⁹⁴ Source: Developed from data found on the website of the Verkhovna Rada of Ukraine (Laws on the State Budget of Ukraine, 1999-2001). Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi> (16 April 2006).

The next important development was the introduction of program budgeting in the 2002 budget. The essence of program budgeting was a transition from budgeting by organization to an emphasis on real results from the use of budget funds. In order to measure and estimate these results, budget expenditures should be approved as a budget programs that had a unit responsible for execution, goals, and performance criteria. Due to the development of a state program budget structure, based on which the 2002 budget was prepared, functional budget expenditure classification was intended to become an analytical and statistical tool used for consolidated budget formulation, macroeconomic forecasting and international budget comparisons.⁹⁵

The structure of the defense budget from 2002 to 2004 did not remain exactly the same. Some programs were removed or added, but the basic format prevailed. The general structure of defense budgets during this period is represented in Figure 3.2. Therefore, with the introduction of program budgeting, the Law on the State Budget of Ukraine became an instrument to reveal the main financial implications of the governmental defense policy. This progress was initiated by the legislature and was to be implemented by all participants of the budget process. However, the MOD did little to improve its internal budgeting procedures, as will be illustrated by the description of the budgeting cycle within the Defense ministry in the next subsection.

⁹⁵ The 2002 Budget in Brief: Ukraine. United States Department of Treasury, Office of Technical Assistance. Internet. Online. Available http://www.ustreasury.hu/budget/documents/ukr_budg_brief.pdf (14 April 2006).

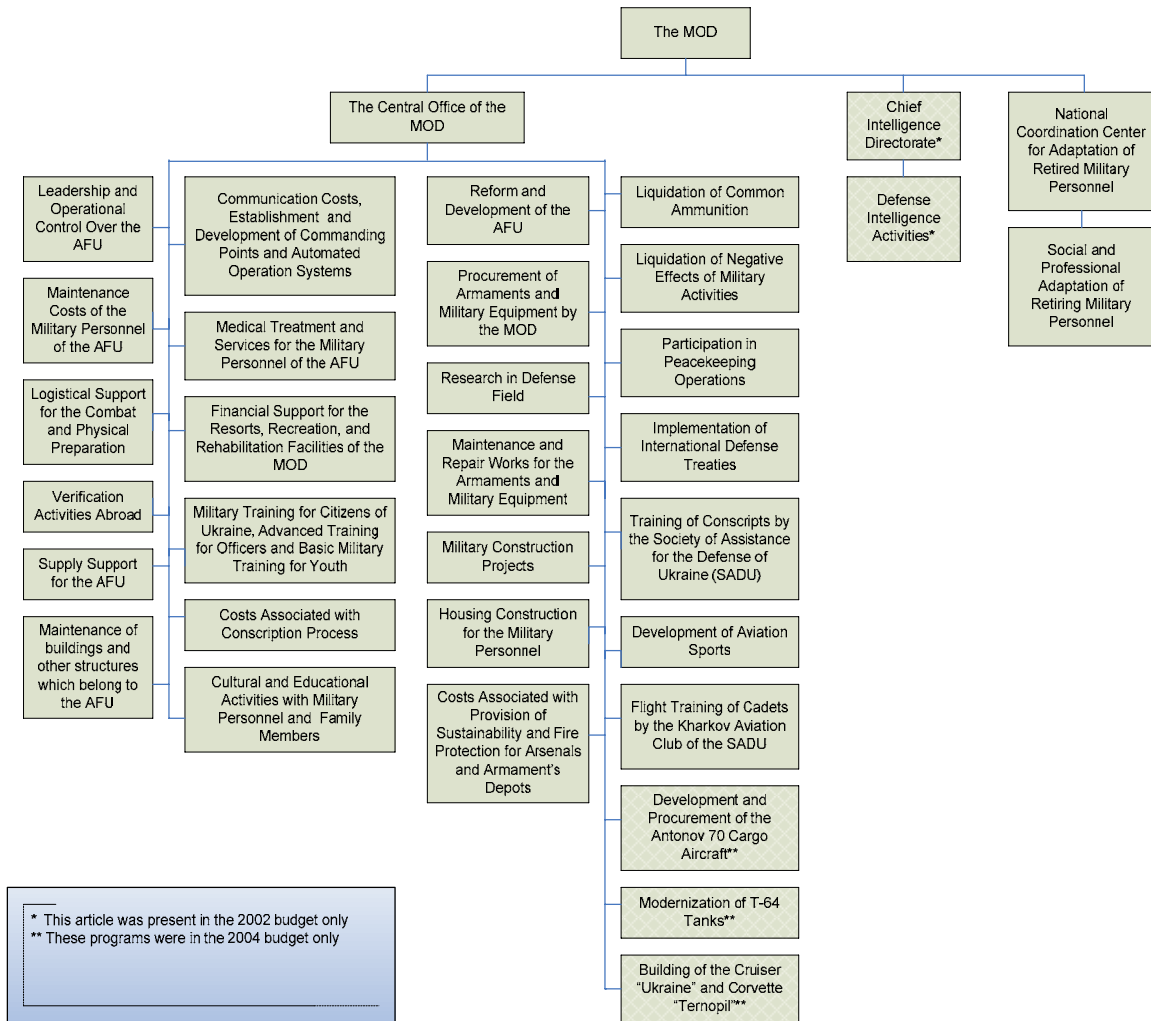


Figure 3.2 General Structure of Defense Budgets, 2002-2004⁹⁶

⁹⁶ Source: Developed from data found on the website of the Verkhovna Rada of Ukraine (Laws on the State Budget of Ukraine, 2002-2004). Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi> (16 April 2006).

2. Development of the Defense Budget within the Ministry of Defense and Activities within the Government⁹⁷

The processes of financial planning and budgeting within the MOD are carried out under the coordination and supervision of the Chief Financial and Economic Directorate (CFED). It is included in the organizational structure of the Central Office of the MOD (COMOD) and subordinated directly to the Minister of Defense. The CFED is the executive body through which the defense minister exercises his authority over spending budget funds.

The MOD budget process is designed to meet the requirements of the Budget Code and provide the Cabinet of Ministers with a defense budget proposal on a timely basis. To achieve these objectives, the following procedure is employed.

The Budget Code of Ukraine provides the time frame and other requirements for all participants in the budget process. In addition to this, a resolution is issued annually by the Cabinet, as well as recommendations by the Ministry of Economy and European Integration. These documents set targets and limits, and provide guidelines for the development of planning documents. In accordance with these guidelines, the MOD releases papers which regulate the budget process within the defense ministry.

Subordinate directorates of the COMOD submit their budget estimates to the CFED at the designated time. The CFED revises these estimates, determines MOD's financial requirements for the upcoming year, and prepares consolidated estimates of the MOD's income and expenses. The MOD budget request is then reported to the Minister of Defense.

⁹⁷ This subsection was developed based on the information provided on the Ministry of Defense of Ukraine's website: MOD Chief Financial and Economic Directorate, Financial Planning. Internet. Online. Available <http://www.mil.gov.ua/index.php?part=department&lang=ua&sub=gfeu> (12 April 2006).

Once it is approved by the Minister of Defense, the budget request is submitted to the Ministry of Finance for revision and standardization. It then becomes a part of the Cabinet's budget proposal which is presented to the President and to the parliament's budget committee for final scrutiny. After considering remarks submitted by the President and the Budget Committee, a proposed Law on the State Budget of Ukraine is submitted by the Cabinet of Ministers to the Verkhovna Rada for readings and approval.

3. Budgeting for Defense within the Parliament

Budgeting activities within the Verkhovna Rada are regulated by the three basic documents: the Constitution, the Budget Code, and the Procedural Regulations of the Verkhovna Rada. This subsection will review the budget process as it is conducted by the parliament and discuss the arrangements within the Verkhovna Rada designed to budget for defense.

Article 85 of the Constitution of Ukraine, adopted on 28 June 1996, contains key powers of the Verkhovna Rada. Perhaps, the most important of such powers is the right of "approving the State Budget of Ukraine and introducing amendments to it; controlling the implementation of the State Budget of Ukraine and adopting decisions in regard to the report on its implementation."⁹⁸

The budget cycle for the upcoming year in the Verkhovna Rada begins after approval of the presidential report on the implementation of the previous year's budget. Based on this report and a socioeconomic forecast for the upcoming year, standing committees of the Verkhovna Rada develop recommendations regarding the future budget and send them to the Budget Committee no later than 20 May of the current year.

⁹⁸ This translation was taken from: Leonid Polyakov. An Analytical Overview of Democratic Oversight and Governance of the Defense and Security Sector in Ukraine. Geneva, January, 2005, p. 24. Internet. Online. Available http://www.dcaf.ch/publications/Working_Papers/152.pdf (4 April 2006).

The Budget Committee develops a proposed Budget Resolution for the upcoming year and submits it to the Verkhovna Rada no later than 15 June of the current year. The Budget Resolution emphasizes the budget policy priorities for the upcoming year and provides guidelines for the development of the budget proposal to the government of Ukraine and for consideration of the budget and other laws which affect the flow of the budget funds to the Verkhovna Rada. The Budget Resolution is to be passed by the Rada no later than 1 July. No law regarding fiscal policy or budget spending for the upcoming year may be adopted by the parliament before the Budget Resolution is approved.

Pursuant to the Constitution of Ukraine, the Cabinet of Ministers submits a proposed Law on the State Budget of Ukraine for the upcoming year no later than 15 September. A report on the implementation of the State Budget of Ukraine for the current year is submitted to the Rada, together with this project.

The budget proposal is presented to the parliament by the Minister of Finance. It is then considered by the standing committees which provide their amendments to the Budget Committee. If a committee or a deputy proposes an increase in spending or a decrease in revenues, they are obligated to propose a corresponding increase from other sources or a cut in spending for other items.

The Budget Committee considers amendments in accordance with the Procedural Regulations of the Verkhovna Rada and prepares its report. The report of the Budget Committee opens the first reading of the project of the Law on the State Budget. After approval of the Budget Committee's report, the Cabinet of Ministers has two weeks to implement the amendments and recommendations of the Rada in its project of the budget and submit it to the parliament for the second reading.

The second reading begins with the report of the Minister of Finance. If the Cabinet's proposal has a budget deficit, the ceiling of the budget deficit shall be approved first. Next, the Rada approves the project of the budget clause-by-clause. If the clause-by-clause voting does not effect essential changes to the amount of the budget deficit or the deputies agreed to reduce spending proportionately,⁹⁹ the Cabinet may propose and the Rada may agree to vote for the budget in whole. Otherwise, the project of the budget is handed over to the Budget Committee for revision. Standing committees and deputies have three days to submit their amendments to the Budget Committee which then has five days to consider amendments and provide deputies with its conclusions no later than three days before the start of the third reading.

The third reading begins with a report of the Chairman of the Budget Committee and co-report of the Minister of Finance. If the deputies agree on the proposed amendments to the budget, the Verkhovna Rada votes for the budget in whole. If not, the budget expenses are reduced proportionately.

If the Law on the State Budget is not passed by 2 December of the current year, the parliament passes a resolution on financing of urgent expenses until approval of the Law on the State Budget.

As noted above, the Budget Committee is a key structure responsible for all aspects of the budget cycle within the Verkhovna Rada, including those pertaining to the defense budget. The National Security and Defense Committee (NSDCOM) is the committee which deals specifically with issues regarding defense. The NSDCOM considers draft legislation, prepares preliminary overviews of issues pertaining to national security and defense, participates in reviewing and adopting the State Budget

⁹⁹ In this case, all articles of the budget are subject to the same percentage reduction except so called "protected" budget articles. A list of protected articles is approved by the Verkhovna Rada and included in the Law on the State Budget.

and controls the use of the State Budget funds for defense. Control over execution of the defense budget is an important aspect of parliamentary participation in the budgeting for defense and will be discussed in the next section.

4. The Presidency and the Defense Budget

Once it has been approved by the parliament, the Law on the State Budget of Ukraine is signed by the Chairman of the Verkhovna Rada and immediately forwarded to the President of Ukraine. The President has fifteen days to sign it or refer the budget to the parliament for a second consideration.

If the president does not sign the budget during those fifteen days, it is considered approved by the president and must be signed and officially released.

If after a second consideration the Verkhovna Rada votes for the budget by no less than two thirds of its constitutional composition, the president is obligated to sign the Law on the State Budget and officially release it within ten days.¹⁰⁰

To coordinate activities in the defense realm the President of Ukraine utilizes the National Security and Defense Council (NSDC). Originally established in 1992 by a presidential decree as the National Security Council,¹⁰¹ this government body was finally secured in the Constitution and by the Law on the National Security and Defense Council, adopted in 1998. Pursuant to the Constitution,

¹⁰⁰ The Constitution of Ukraine. Article 94. Internet. Online. Available <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=254%EA%2F96-%E2%F0#Find> (16 April 2006).

¹⁰¹ A presidential decree established the National Security Council (NSC) in 1992, as an advisory body attached to the President. In reality, the NSC not only influenced many Presidential decisions, but also indirectly aligned the activity of the Ukrainian Cabinet of Ministers, as well as military and security organizations. The NSC changed its status in 1994, when the President, by decree, legalized this situation granting the council the organizational and coordinative functions (Oleksiy Syvak. The Role of the National Security and Defense Council of Ukraine in Political Decision-Making Process. Naval Postgraduate School, Monterey, March 2003, pp. 26-27). See also Chapter 2.

The NSDC is the coordinating body to the President of Ukraine on issues of national security and defense. The National Security and Defense Council of Ukraine coordinates and controls the activity of bodies of executive power in the sphere of national security and defense. The President of Ukraine is the Chairman of the National Security and Defense Council of Ukraine. The President of Ukraine forms the personal composition of the National Security and Defense Council of Ukraine. The Prime Minister of Ukraine, the Minister of Defense of Ukraine, the Head of the Security Service of Ukraine, the Minister of Internal Affairs of Ukraine and the Minister of Foreign Affairs of Ukraine, are ex officio members of the National Security and Defense Council of Ukraine. The Chairman of the Verkhovna Rada of Ukraine may take part in the meetings of the National Security and Defense Council of Ukraine. Decisions of the National Security and Defense Council of Ukraine are put into effect by the decrees of the President of Ukraine.¹⁰²

On the defense budget side, The Law on the National Security and Defense Council of Ukraine stipulates that the NSDC develops and considers decisions regarding national security and defense, including proposals on the project of the Law of Ukraine on the State Budget of Ukraine. Also, the NSDC has the authority to carry out day-to-day control of executive organizations; it uses state officials and analysts of all government departments and utilizes research institutions and organizations of both private and public form of property to analyze necessary information;¹⁰³ and initiates development of regulations and documents on national-security-and-defense-related issues and controls their implementation. Chairmen of the parliamentary committees, other deputies and high officials and other persons who are not members of the NSDC may take part in its meetings with a formal invitation from the Head of the National Security and Defense Council.

D. CONTROL OVER THE EXECUTION OF THE DEFENSE BUDGET

The Constitution gave the parliament broad authority over the security sector; however, due to many deficiencies which persisted in defense legislation, the Rada was

¹⁰² The functions and composition of the NSDC are defined in Article 107 of the Constitution of Ukraine. This translation was taken from: Oleksiy Syvak. The Role of the National Security and Defense Council of Ukraine in Political Decision-Making Process. Naval Postgraduate School, Monterey, March 2003, p. 27.

¹⁰³ Oleksiy Syvak. The Role of the National Security and Defense Council of Ukraine in Political Decision-Making Process. Naval Postgraduate School, Monterey, March 2003, p. 28.

not extensively involved in the development of the Armed Forces. This section will focus on some aspects of parliamentary participation in the defense processes related to the control over the execution of the defense budget. It will assess how the parliament is exercising its rights to oversee the execution of the defense budget and analyze its effectiveness as a tool to ensure efficient utilization of budget resources. The situation discussed in this section was shaped by the introduction of the Constitution in 1996. Some efforts made to improve it in 2004 will be discussed in the next chapter.

The parliament exercises its supervisory powers through the Accounting Chamber, which controls the use of funds of the State Budget, and through standing committees of the Verkhovna Rada. To deal with certain urgent issues, the Verkhovna Rada may establish temporary investigative and ad hoc (special) commissions.

Provided by a broad constitutional mandate, parliamentary control might be an important tool to ensure proper and efficient use of the state resources in the defense sector. However, the real power of the Rada for the allocation and spending of the defense budget funds is rather limited and significantly less than that of the President.¹⁰⁴

In the case of adoption of legislative acts and the defense budget, the real role of the parliament is conditioned by the interests of the Government and the President who can veto parliamentary initiatives. To overcome a veto by the President, a constitutional majority of 300 votes is required. In case of approval of state programs for the reform or development of security structures—an aspect which has direct budgetary implications—the parliament has neither real powers nor any real independent capacity. Ukraine's constitution does not require the State Program for Reform and Development of the Armed Forces and similar programs to be discussed and approved by the parliament,

¹⁰⁴ Leonid Polyakov, *An Analytical Overview of Democratic Oversight and Governance of the Defense and Security Sector in Ukraine*, Geneva, January 2005, p.26. Internet. Online. Available http://www.dcaf.ch/publications/Working_Papers/152.pdf (28 March 2006).

leaving the right of approval solely to the President. However, if such programs contain changes to be made to the numerical strength or structure of the Armed Forces, they must be approved by the parliament in accordance with the Constitution. Providing strong presidential influence over the Verkhovna Rada, the latter usually (but not always) approves the new parameters. However, because the parliament is not involved in the development of the defense programs, it has few incentives to be involved in their implementation, including the funding process. As a result, none of the defense reform programs proposed by the executive branch received sufficient legislative support and proper funding to be fully implemented.¹⁰⁵

Another constrain on the Rada's ability to control execution of the defense budget is the structure of the document itself. Despite the improvements made since 1992, it is still limited to a one year term and does not provide detailed clarification of all expenditures, which complicates oversight and requires considerable expertise on the part of members of the parliament. Although funding has been a major issue of defense development in Ukraine, neither the Budget Committee nor the NSDCOM has a subcommittee to deal specifically with the defense budget. Currently the NSDCOM has a secretariat which includes thirty experts but it is not clear how many of them specialize in the budgeting sphere.¹⁰⁶ The excessive secrecy which surrounds the defense sector aggravates the problem of providing budgeting oversight. The status of a people's deputy allows access to any MOD data; however, the complicated procedure involved makes deputies unwilling to utilize this access.¹⁰⁷ These security considerations also make the structure of defense spending unavailable to the media and the general public, minimizing the possibility that they could then bring issues to the attention of the parliamentarians.

¹⁰⁵ Leonid Polyakov, *An Analytical Overview of Democratic Oversight and Governance of the Defense and Security Sector in Ukraine*, Geneva, January 2005, p.27. Internet. Online. Available http://www.dcaf.ch/publications/Working_Papers/152.pdf (28 March 2006).

¹⁰⁶ *Ibid.*, p. 26.

¹⁰⁷ David Bertz. *Comparing Frameworks of Parliamentary Oversight: Poland, Hungary, Russia, Ukraine*, Geneva, July, 2003, p.13. Internet. Online. Available <http://www.ciaonet.org/wps/bed04/bed04.pdf> (28 March 2006).

On the MOD side, there are no legal provisions which require it to report to the Verkhovna Rada on its resource management activities, apart from the annual government budget report. The MOD reports on the implementation of the State Budget quarterly and annually to the Accounting Chamber, which, in turn, reports to the parliament. However, the Accounting Chamber itself does not pay much attention to the financial business of the Armed Forces. A review of the Accounting Chamber's activities revealed that during the period from 1998 to 2004, it initiated only a few inspections of the MOD's financial structures and activities.¹⁰⁸

Also, the Ukrainian parliament has a right to question witnesses from the military as part of the budget approval process and to oversee its execution through a parliamentary committee.¹⁰⁹ Unfortunately, the author of this thesis was not able to find publicly available evidence that this right has been utilized by the Rada.

Despite powerful constitutional provisions, sustained and detailed budgetary scrutiny of the defense sector by the Ukrainian parliament does not occur. Several factors account for this. Among them are lack of precision within the legislation governing the participants in the defense budget process, lack of expertise and support available to the parliament to effectively deal with defense budget issues, the broad structure of the defense budget, and the reluctance of the Rada to exercise powers which are already at its disposal.

E. CONCLUSIONS

Even taking into account that budgeting for defense, as well as many other defense aspects in Ukraine, was developed literally from scratch and that this development took place in an unfavorable political and economic environment, the

¹⁰⁸ For more information see http://www.ac-rada.gov.ua/achamber/control/uk/publish/article?showHidden=1&art_id=47327&cat_id=34761&ctime=1100703499452 (28 March 2006).

¹⁰⁹ Defense Economics: Reform, Restructuring, Realignment. A report of the George C. Marshall European Center for Security Studies Conference, March, 2000, p. 18. Internet. Online. Available <http://www.ciaonet.org/conf/sma01/sma01.pdf> (28 March 2006).

progress made in the defense budgeting field over the years from 1991 to 2004 may be considered low. Ten years from the crude defense budget of 1992 to the program oriented, but still rough budget of 2002, is a too long of a period during which the country lost many opportunities to improve efficiency of the armed forces by consolidating defense and budget policies.

Defense budgets during this period did not reflect the reform and reorganization processes which desperately needed purposeful funding. By providing detailed and reform oriented budgets, the Verkhovna Rada might have assumed a credible position to control implementation of military reform; however, it preferred not to be involved in the management of defense resources. Neither did the parliament develop a capacity to monitor execution of the defense budgets proposed by the government.

The capabilities developed by the executive branch (e.g., the NSDC framework) basically excluded participation of the legislative branch and therefore could not fully utilize their potential. The MOD itself did not adopt an efficient budgeting system, which might be explained by a desire to have greater flexibility over use of the budget funds. However, in reality it led to inefficiency and corruption.¹¹⁰ The next chapter will cover developments in the defense realm during the period 2004-2006 and examine how they have affected budgeting for defense in Ukraine.

¹¹⁰ The problem of corruption within the Ukrainian MOD is beyond the scope of this study. For an overview of the situation with respect to corruption and inefficient use of resources by the MOD of Ukraine which occurred through 2004, see Anatoliy Grytsenko. Interview. Mj Neochikuvalj Takjkh Mashtabiv Porushen' i Bezvidpovidalnosti Kerivnikov Vjstchoi Lanki. The Ministry of Defense of Ukraine. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=ua&part=news&sub=read&id=4948> (17 April 2006).

IV. 2004 - 2006: THE STRATEGIC DEFENSE BULLETIN AND THE LAW ON ORGANIZATION OF THE DEFENSE PLANNING

Our experience reveals that rational defense resource management is a fundamental precondition for implementation of any reforms. And that realistic approach and achievability of plans are necessary prerequisites for the development of an army of a new type, which is able to carry out joint missions shoulder-to-shoulder with our partners to provide peace and security for the European nations.

Evgen K. Marchuk¹¹¹

A. INTRODUCTION

By the end of 2004 the only tangible results of the Ukrainian defense reform were a significant reduction of the number of military personnel and a change of the structure of the Armed Forces. In June 2004 the Air Defense Troops were merged with the Air Force. After that the AFU consisted of the General Staff, Land Forces, Air Forces, Naval Forces, and units of central subordination, e.g. training units and military institutions. By functional purposes, the AFU are structured into the Joint Rapid Reaction Forces (JRRF), Main Defense Forces, and Reinforcement Forces. At the beginning of 2004, the Ukrainian Armed Forces had 355,000 personnel, including 265,500 military servicemen and 89,500 civilians.¹¹²

Military reform failed to provide significant improvement of combat capabilities, which remained rather low. Defense structures remained oversized, especially in terms of command and control, support elements, and resource consumption.¹¹³ Huge piles of ammunition stored on Ukrainian territory were waiting for decommission and remained a

¹¹¹ The Strategic Defense Bulletin of Ukraine for the Period through 2015. Foreword by the Minister of Defense. Internet. Online. Available http://www.mil.gov.ua/index.php?part=def_planning&lang=ua (25 April 2006).

¹¹² Ibid., p.25

¹¹³ Andrii Smorodin. Euro-Atlantic Integration-Ukrainian Security Options in the Twenty-First Century: Origins and Developments. Naval Postgraduate School, Monterey, March 2005, p. 56. Internet. Online. Available <http://library.nps.navy.mil/uhtbin/hyperion/05Mar%5FSmorodin.pdf> (27 April 2006).

constant source of danger. Due to limited resource allocation, the main emphasis in combat training was on the units assigned to the Joint Rapid Reaction Forces. However, even these forces could not maintain a proper level of professionalism.¹¹⁴

Large portions of military equipment became obsolete and literally all machinery and facilities which still remained operational required considerable investments in maintenance and repair. The MOD Expert Commission, which in accordance with a presidential decree conducted a defense review in Ukraine from April 2003 until June 2004, concluded that as of 2004, the Armed Forces of Ukraine could not fully carry out their tasks due to chronic underfunding.¹¹⁵ The Commission recommended a fundamental shift in military reform aimed, inter alia, towards enhancement of planning practices within the MOD. Official results of the defense review were presented in the Strategic Defense Bulletin (SDB) issued by the Ukrainian government. The government acknowledged an urgent need to fix this situation in the defense sphere. It also stressed the vitality of the processes of appropriation and allocation of funds for Ukrainian national security.

The aspirations of Ukraine to join NATO, declared by President Kuchma in 2002, were among the major factors which triggered this shift in attitude towards defense. In the course of increased co-operation with the Alliance, the issue of conformity of Ukrainian military structures and processes with NATO standards became especially relevant.

¹¹⁴ A series of military catastrophes, which took place in Ukraine during the period from 2000 to 2004, tragically emphasized the disastrous situation in the Armed Forces. They included explosions of ammunition dumps and fatal mistakes during military exercises. For more information see: Askold Krushelnycky. Ukraine: Depot Blast Latest in Series of Tragic Blunders by Army. Radio Free Europe/Radio Liberty, 20 May, 2004. Internet. Online. Available <http://www.rferl.org/featuresarticle/2004/5/FFA81476-77DA-41D2-8DD1-2B8C3ABFFA9C.html> (27 April 2006).

¹¹⁵ The Strategic Defense Bulletin of Ukraine for the Period through 2015, p. 32. Internet. Online. Available http://www.mil.gov.ua/index.php?part=def_planning&lang=ua (25 April 2006).

Chapter IV will cover development of the NATO-Ukraine relations as well as recent developments in the defense realm during the period 2004 to 2006 and examine how they have affected budgeting for defense in Ukraine. This chapter consists of three main sections. The first section will discuss development of NATO-Ukraine co-operation in regard to defense resource management in Ukraine. The second section will include descriptions of budgetary implications of the Strategic Defense Bulletin and in the new Law on the Organization of Defense Planning. It will describe future plans for defense reform in Ukraine and discuss how they are supported by financial considerations. Finally, the third section will provide an overview of the 2005 and 2006 defense budgets.

B. IMPACT OF CO-OPERATION WITH NATO

Since Ukraine was established as an independent country, the West attached particular attention to developments within the new state. This special interest was caused by several factors, the most important of which were the large size and strategic geographical location of the country, and its possession of nuclear weapons. The constructive position of the new Ukrainian government during international talks on the issue of nuclear disarmament of Ukraine and its commitment to establish democracy helped to integrate Ukraine into major frameworks for international co-operation in the security sphere, including the United Nations, the OSCE, and the Partnership for Peace Program (PFP). Ukraine also signed a partnership agreement with the European Union (EU) in 1994, being the first CIS country to sign such a document. In 1995 Ukraine was admitted to the Council of Europe.¹¹⁶ However, the strict criteria and inflexible approach which these organizations exert on their partners resulted in a modest level of co-operation between Ukraine and European structures, as Ukraine could not satisfy their requirements due to its political and economic weaknesses. Although membership in the EU remains a foreign policy priority for Ukraine, a relationship with NATO appears to be the best way to construct links with Europe.¹¹⁷

¹¹⁶ Andrii Smorodin. Euro-Atlantic Integration-Ukrainian Security Options in the Twenty-First Century: Origins and Developments. Naval Postgraduate School, Monterey, March 2005, p. 14. Internet. Online. Available <http://library.nps.navy.mil/uhtbin/hyperion/05Mar%5FSmorodin.pdf> (27 April 2006).

¹¹⁷ Jennifer Medcalf. NATO: A Beginner's Guide. Oxford, 2005, p. 158.

1. The Partnership for Peace

The PFP was designed as a program for practical bilateral co-operation between individual partner countries and NATO. This initiative was aimed towards bringing countries of the former Warsaw Pact and Soviet Union closer to the Western democratic institutions through co-operation in the defense and security sector. It allows each partner country to build up an individual relationship with NATO, choosing their own priorities.¹¹⁸

The PFP provides partner countries with a number of benefits in terms of expert and technical assistance performed by NATO according to each country's specific interests and needs. Co-operation encompasses a wide range of defense-related issues, focusing on defense reform and managing the consequences of defense reform, but touches on virtually every field of NATO activity, including defense policy and planning, civil-military relations, education and training, air defense, communications and information systems, crisis management, and civil emergency planning. Through the Euro-Atlantic Partnership Council, NATO and Partner countries engage in regular consultations on all aspects of their collaboration. Issues of defense reform, budgeting and planning are among those which require extensive technical exchanges to achieve practical results.¹¹⁹

The relationship between Ukraine and NATO commenced immediately upon achieving independence in 1991 when Ukraine joined the North Atlantic Co-operation Council (later renamed the Euro-Atlantic Co-operation Council). A few years later, in 1994, Ukraine became the first of the CIS countries to join the PFP. By signing the PFP Framework Document, Ukraine, inter alia, committed to the facilitation of transparency in its national defense planning and budgeting processes.

¹¹⁸ NATO Topics. Partnership for Peace. Internet. Online. Available <http://www.nato.int/issues/pfp/index.html> (29 April 2006).

¹¹⁹ NATO Topics. NATO's Co-operation with Partners: What Does It Mean in Practice? Internet. Online. Available http://www.nato.int/issues/cooperation_partners/index.html (29 April 2006).

During the 1990s, Ukraine participated in hundreds of activities carried out under the PFP program. Those included training and military exercises conducted abroad as well as in the Ukrainian territory, participation in peacekeeping operations in the Balkans, and other activities such as conferences and international exchanges. The Ukrainian Armed Forces were able to gain a lot of experience at the operational and tactical levels in terms of familiarizing Ukrainian military specialists with NATO standards and procedures, and improving cross-cultural understanding.

However, on the Ukrainian side, it did not result in building effective military co-operation structures and procedures. The main reason for the lack of a positive outcome was the continuous instability inside the Ukrainian military, precipitated by the failure of the country's leadership to provide clear political guidance, as well as by persistent reorganizations and budget reductions. During this period, Ukrainian strategic level documents were too unspecific to provide clear guidance for defense planners on policy priorities and allocation of resources.¹²⁰ Consequently, they could not identify areas of interest in this sphere which might be addressed by NATO experts to improve Ukrainian practices. Moreover, middle and top level Ukrainian military leaders often perceived international military co-operation as a means to conduct combat training at the expense of the Western partners, disregarding the actual purposes of their initiatives.¹²¹ This attitude minimized absorption of NATO planning methods and budgeting practices since the Ukrainian military was less involved in managing financial and other resources for co-operation than for consuming them at the final stage.

In sum, Ukraine was an active PFP participant from the earliest stage of this initiative; however, planning and budgeting was not on the list of Ukraine's priorities for

¹²⁰ Leonid Polyakov. U.S.-Ukraine Military Relations and the Value of Interoperability. Strategic Studies Institute of the U.S. Army War College, December 2004, pp.22-23. Internet. Online. Available <http://www.strategicstudiesinstitute.army.mil/Pubs/display.cfm?PubID=590> (29 April 2006). See also Chapters 2 and 3.

¹²¹ Ibid., pp.30-31.

co-operation under the PFP at that time. This is shown by the analysis of the development of defense budgeting in Ukraine during 1990s, which reveals that the changes that occurred at the governmental level were determined by other causes (See Chapter III). The limited public availability of information on budgeting within the Ukrainian MOD also demonstrates that the objective of facilitating transparency in national defense planning and budgeting processes was not completely fulfilled. Nevertheless, the PFP became Ukraine's main path to advance expertise in the defense sector and to work with the West. It helped to identify areas of the NATO-Ukraine co-operation which required specific attention and implementation of these findings into other co-operation mechanisms as the partnership was progressing.

2. The Charter on Distinctive Partnership

By 1997 Ukrainian political leadership recognized many advantages of a Western orientation in foreign policy. The Ukrainian contribution to international security was also acknowledged by NATO. On 9 July 1997, at the Madrid Summit, NATO and Ukraine signed the Charter on Distinctive Partnership. The Charter asserted the importance of an independent, stable and democratic Ukraine to European stability, recognized the “solid progress... across a broad range of activities” between NATO and Ukraine, and aimed to “promote further stability and democratic values in Central and Eastern Europe.”¹²² The Charter did not offer membership or extend Article 5 protection to Ukraine, but it assured Ukraine an increased consultative voice through the NATO-Ukraine Commission (NUC), and set out principals and arrangements for the further development of NATO-Ukraine relations, identifying areas for consultation and co-operation.¹²³

¹²² NATO. Charter on Distinctive Partnership between the North Atlantic Treaty Organization and Ukraine, Madrid, 9 July, 1997. Internet. Online. Available <http://www.nato.int/docu/basicxt/ukrchrt.htm> (1 May 2006).

¹²³ Clarke Cramer. The Great Orange Hope: Ukraine, NATO, and the Dilemma of European Integration after the Orange Revolution. Naval Postgraduate School, Monterey, December 2005, p.28. Internet. Online. Available <http://library.nps.navy.mil/uhtbin/hyperion/05Dec%5FCramer.pdf> (2 May 2005).

A broad range of topics for co-operation were covered in the Charter, including the following:

- Civil-military relations, democratic control of the armed forces, and Ukrainian defense reform;
- Defense planning, budgeting, policy, strategy, and national security concepts.

The Charter established joint seminars and joint working groups as the primary mechanisms for consultations in the identified areas.

The NATO-Ukraine Joint Working Group on Defense Reform (JWGDR) was organized in 1998, under the auspices of the NUC. It is the primary focus for NATO-Ukraine co-operation in defense and security sector reform. The JWGDR serves as a tool through which the Allies can provide assistance. It also provides the institutional basis for co-operation with ministries and agencies involved in supporting defense and security sector reform in Ukraine. These include the NSDC, Ministry of Foreign Affairs, MOD, Verkhovna Rada and others.¹²⁴

All NATO member states and Ukraine are represented at meetings of the JWGDR. The meetings are chaired by NATO's Assistant Secretary General for Defense Planning and Operations. The JWGDR meets quarterly at the expert level and annually at the Senior Level when high-ranking officials are involved. Once a year, the JWGDR organizes informal consultations where issues of defense and security reform are discussed at the level of Allied and Ukrainian Defense Ministers, with involvement of key defense and security experts.¹²⁵

¹²⁴ NATO Topics. NATO-Ukraine Joint Working Group on Defense Reform. Internet. Online. Available <http://www.nato.int/issues/nato-ukraine/jwgd.html> (3 May 2006).

¹²⁵ Ibid.

3. NATO-Ukraine Action Plan

In May 2002, President Kuchma announced a decision made by the Ukrainian National Security and Defense Council, to seek eventual NATO membership for Ukraine. This step logically continued the progressive development and deepening of Ukraine's co-operation with NATO.¹²⁶ It ended the epoch of the "multi-vector" foreign policy which held little promise for Ukraine in the post-September 11th world.¹²⁷ NATO's positive response to the Ukrainian initiative led to the development of a NATO-Ukraine Action Plan-adopted at the meeting of NATO foreign ministers in Prague in November 2002.

The purpose of the Action Plan is "to identify clearly Ukraine's strategic objectives and priorities in pursuit of its aspirations towards full integration into Euro-Atlantic security structures and to provide a strategic framework for existing and future NATO-Ukraine cooperation."¹²⁸ The NATO-Ukraine Action Plan provides for Annual Target Plans (ATP) to be developed to support jointly agreed principles and objectives. Annual Target Plans consist of specific measures for Ukrainian and NATO-Ukraine joint actions. The attainment of the goals of the Action Plan and NATO-Ukraine Target Plans became the main priority in Ukraine's co-operation with NATO.¹²⁹ Soon after adoption of the Action Plan, Ukrainian Foreign Minister Anatoly Zlenko said "We are well aware

¹²⁶ Anatoly Zlenko. Interview. The National Security and Defense Magazine. Ukrainian Center for Economic and Political Studies, #7, 2003, p. 2. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=43 (8 May 2006).

¹²⁷ Clarke Cramer. The Great Orange Hope: Ukraine, NATO, and the Dilemma of European Integration after the Orange Revolution. Naval Postgraduate School, Monterey, December 2005, p. 33. Internet. Online. Available <http://library.nps.navy.mil/uhtbin/hyperion/05Dec%5FCramer.pdf> (2 May 2005).

¹²⁸ NATO. Prague Summit. NATO-Ukraine Action Plan, 22 November 2002. Internet. Online. Available <http://www.nato.int/docu/basic/txt/b021122a.htm> (3 May 2006).

¹²⁹ Anatoly Zlenko. Interview. The National Security and Defense Magazine. Ukrainian Center for Economic and Political Studies, #7, 2003, p. 3. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=43 (8 May 2006).

that the results and degree of accomplishment of the planned events will be critical for NATO's perception of Ukraine as a potential member of the Alliance.”¹³⁰

The resource implications are addressed in Subsection C of Section II (Security, Defense and Military Issues) of the NATO-Ukraine Action Plan. It suggests implementation of resource management systems which follow NATO methodology and draw on international experience in defense budgets. The objectives for actions in resource area are as follows:

- II.C.1 Increase transparency in defense planning and budgeting procedures; transition to modern NATO defense programming, budgeting and financing principles;
- II.C.2 Reform financial planning and funding procedures in support of defense reform and the transformation of the Armed Forces into a professional force;
- II.C.3 Train personnel in resource management, budgeting and defense finance issues;
- II.C.4 Restructure production, procurement, financing and tendering processes in the Defense Industrial Complex, to reflect Ukraine's Euro-Atlantic orientation and goal of becoming a fully functioning market economy. This will include adaptation to NATO standards in the Defense Industrial Complex.

¹³⁰ Anatoly Zlenko. Interview. The National Security and Defense Magazine. Ukrainian Center for Economic and Political Studies, #7, 2003, p. 3. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=43 (8 May 2006).

4. Annual Target Plans: 2003-2005

a. 4.1 Content of the Annual Target Plans Regarding Resource Matters: 2003-2005

The actions on resource matters drafted in the NATO-Ukraine Annual Target Plans encompassed a wide range of issues from development of transparent defense resource planning and budgeting procedures, to adoption of legislative acts supporting efficient and transparent defense planning. Special attention was given to educational and academic activities and consultations with NATO experts. Portions of activities of this sort have increased since the first 2003 ATP which focused more on the development of technical aspects of defense budgeting. This shift suggests that Ukrainians realized the importance of international experience and expertise available through NATO-Ukraine co-operation mechanisms. The MOD of Ukraine, in collaboration with other governmental organizations, was responsible for the implementation of actions pertaining to the resource matters outlined in NATO-Ukraine Action Plans.

b. 4.2 Implementation of the Annual Target Plans

During the period from 2003 to 2005, the Ukrainian MOD performed a number of actions in order to fulfill objectives of the NATO-Ukraine Action Plan, including those on defense planning and budget matters. In 2003, MOD representatives participated in a NATO international symposium in Kyiv, titled “Economic Aspects of the Euro-Atlantic Integration”. The MOD also began preparations for training of the defense planning specialists in the National Defense Academy. It prepared and submitted to the Ministry of Finance proposals on the methodology of detailed calculations of the need for financing in order to insure performance of tasks of international co-operation with NATO states. Experimental operation of the Defense Resource Management Model (DRMM) was started in order to develop proposals on introducing a comparable system in Ukraine. The model was provided by the U.S.¹³¹

¹³¹ Report on the Implementation of the NATO-Ukraine Target Plan for 2003 Regarding Actions Performed by the MOD of Ukraine. Prepared by the Directorate of Euro-Atlantic Integration of the General Staff of the Armed Forces of Ukraine.

Besides these actions, the Law on Democratic Civilian Control over Military Organization and Law Enforcement Bodies of the State was adopted by the parliament in June 2003. Adoption of this law contributed to the fulfillment of the Ukrainian commitment to strengthen democratic civilian control over the Armed Forces made in the NATO-Ukraine Action Plan.¹³² It specified and widened authorities of the Verkhovna Rada regarding defense. On the budgeting side, it required the Rada to provide detailed specification of defense spending in the state budget. Therefore, the parliament now is obligated to request such a specification from the Cabinet. This law stipulates that the Rada should consider execution of the defense budget when it conducts hearings on execution of the state budget. It also provided parliamentarians with a right to consider and approve State programs on reform and development of the Armed Forces.

In 2004 the Law on Organization of the Defense Planning was elaborated and passed by the Verkhovna Rada on 18 October. An information-analytical system called “Resource” was developed and began functioning. This system provides the MOD with comprehensive estimates of maintenance costs throughout the Armed Forces. The National Defense Academy completed preparations for training of specialists in defense planning and conducted an educational course on defense planning in June 2004 with the support of the NATO School in Oberammergau, Germany; one representative of the General Staff completed seven days of training in Germany in May 2004.¹³³

During 2005, the MOD specialists participated in two international conferences on defense planning which took place in Kyiv. Seminars and consultations with NATO and NATO Member States on planning and budgeting issues were conducted on a regular basis. The “Resource” system was upgraded to operate in accordance with NATO standards and procedures. One Ukrainian officer enrolled in an internship

¹³² Objective I.1.A.7

¹³³ Report on the Implementation of the NATO-Ukraine Target Plan for 2004 Regarding Actions Performed by the MOD of Ukraine. Prepared by the Directorate of Euro-Atlantic Integration of the General Staff of the Armed Forces of Ukraine.

program at the NATO Department of Defense Policy and Planning. Twenty four Ukrainian officers enrolled in internship programs provided by Poland to study the Polish experience of integration to NATO.¹³⁴

5. The Law on Organization of the Defense Planning

The Law on Organization of the Defense Planning is intended to regulate decision making in the defense realm involving different participants in the process and, in effect, is the first step undertaken by the Ukrainian government towards creation of a cohesive defense planning and budgeting system. This law defined defense planning as a component of the state strategic planning and resource operating system. It established three categories of defense planning:

- Long-Term Planning (12 year plans);
- Medium-Term Planning (6 year plans);
- Short-Term Planning (2 year plans).

The Law on Organization of the Defense Planning is aimed towards increasing transparency in defense planning and budget processes and adoption of modern systems for development defense programs and budgets in accordance with practices existing in NATO countries. It defines general principles of defense planning and responsibilities of governmental bodies within this process. However, the provisions of this law are not sufficient to establish a comprehensive defense planning system for Ukraine. That requires development of certain procedures within each governmental entity which participates in defense planning. A discussion which emerged in the Armed Forces after adoption of the Law on Organization of the Defense Planning is focused on finding a rational way of planning within the military control and command structures and incorporation of commands of all levels into the defense planning system. One of the major issues involved is the allocation of responsibilities between the MOD and the General Staff.¹³⁵

¹³⁴ Report on the Implementation of the NATO-Ukraine Target Plan for 2005 Regarding Actions Performed by the MOD of Ukraine. Prepared by the Directorate of Euro-Atlantic Integration of the General Staff of the Armed Forces of Ukraine.

¹³⁵ M. Denezkin. Proposals on Improvement of the Defense Planning System. Central Research Institute of the Armed Forces of Ukraine, 9 March, 2005, p.1.

To summarize, the Ukrainian MOD introduced a number of measures in order to fulfill the objectives of the NATO-Ukraine Action Plan regarding resource matters. The most notable progress took place in educational activities and exchanges at the expert level. Full implementation of the actions outlined in the ATPs was difficult due to insufficient funding and the long process of approval of the ATPs by the Ukrainian government. For example, the 2005 ATP was signed by the President on 21 April 2005, but only 49 percent of the funds appropriated for its implementation were received, most of them at the end of the fiscal year, making implementation difficult.¹³⁶ Nevertheless, the Law on Organization of the Defense Planning introduced a basis for a system of defense planning for Ukraine. Now more specific regulations must be elaborated in order to synchronize all aspects of the defense planning, including budgeting.¹³⁷

However, the 2004 defense budget was not much different from the 2003 defense budget, as it was demonstrated in Chapter III. Moreover, the 2004 budget provided for funds to continue building the missile cruiser “Ukraine”, a war ship which Ukraine received unfinished when the Black Sea Fleet was divided. It was unsuitable for Ukraine’s military doctrine and, if commissioned, would generate excessive costs.¹³⁸

The 2005 budget was not much different from 2003. It contained 32 items (by contrast U.S. defense budget contains 3000-4000 detailed items) and, consequently was also far from the common NATO budget practices.

¹³⁶ Report by the Directorate of Euro-Atlantic Integration of the General Staff of the Armed Forces of Ukraine.

¹³⁷ A draft of the Guidance on Organization and Financing of Strategic Planning, Including Defense Planning was prepared by the Cabinet of Ministers of Ukraine in 2005. The MOD has the Temporary Guidance on Organization and Conducting of Defense Planning in the Armed Forces of Ukraine.

¹³⁸ Anatoliy Grytsenko. Interview. Umovnostei v Boiovii Pidgotovtsi ne Bude. The Ministry of Defense of Ukraine. Internet. Online. Available. <http://www.mil.gov.ua/index.php?lang=ua&part=appearance&sub=read&id=7003> (7 May 2006).

NATO influence has encouraged the work towards establishing responsible budgeting within the Ukrainian MOD. However, the process is still very new and requires co-operation and support from the executive as well as from the legislative branch of government. An overview of the situation with respect to the 2006 defense budget will provide some background in this regard later in this chapter. The next section will describe future plans for development of the Armed Forces of Ukraine as outlined in the Strategic Defense Bulletin and discuss their budgetary components.

C. CHANGES TO THE DEFENSE STRUCTURE TO BE IMPLEMENTED BY 2015

Ukrainian experiences in defense reform, changes which occurred in the Ukrainian political system, new foreign and national security policy priorities of Ukraine, and certain dynamics of the world security environment all suggest that the armed forces of NATO countries are the most suitable model for the future development of the Armed Forces of Ukraine. Implementation of such a model will provide Ukraine with armed forces which will correspond to Western security requirements, will be well equipped and trained, able to protect the country and contribute to peace and stability in the European region.¹³⁹ The experience gained by NATO member states in defense reform and restructuring of armed forces may assist Ukraine in achieving these objectives.

In 2003, the President of Ukraine made the decision to conduct a defense review in Ukraine to elaborate a model and define priorities for the future development of the Armed Forces. This initiative was undertaken based upon an analysis of practices recently used by the most advanced European countries and the U.S.¹⁴⁰ The Strategic Defense Bulletin, published by the Ukrainian government in 2004, contains the results of the defense review and recommendations based on these findings. It is a basic document to be used to draft more detailed programs for reform and development of the Armed

¹³⁹ Ukraine: Strategic Priorities. Defense Reform in Ukraine. The National Institute of Strategic Studies. Internet. Online. Available http://www.niss.gov.ua/book/2004_html/005.htm (8 May 2006).

¹⁴⁰ V. Leonov. The Defense Doctrine of Ukraine and the White Book of Ukraine: Programs for Reform of the Armed Forces. National Institute of International Security. Internet. Online. Available http://www.niisp.gov.ua/vydanna/panorama/issue.php?s=vpip1&issue=2004_4 (8 May 2006).

Forces. The SDB delineates tasks for the Ukrainian Armed Forces and their organizational structure as it should be in 2015. It also provides financial estimates of costs for reform and defines how they should be allocated from 2004 to 2015.

According to the Strategic Defense Bulletin, in 2015 Ukraine will have a new type of armed forces.¹⁴¹ They will be flexible, highly mobile and able to react to any emergency. An improved structure, a sufficient level of defense capabilities and total strength between 90,000-100,000 personnel (70,000-75,000 military and 20,000-25,000 civilian) will provide the capability to deal with low- and medium-intensity conflicts. Moreover, they will be able to effectively participate in international operations, provide assistance to civilian authorities and maintain sufficient mobilization capacity to respond in case of a high-intensity conflict.

The Armed Forces of Ukraine will continue to be divided in organizational and functional components. Organizationally, the AFU will consist of the General Staff of the Armed Forces of Ukraine, the Land Forces, the Air Forces, the Naval Forces, as well as military units and organizations of central subordination. Functionally, the AFU will be divided in the Joint Rapid Reaction Forces, Main Defense Forces and Reinforcement Forces.

The JRRF will be the most capable and well equipped component of the Armed Forces, manned at 90-100 percent of their designed strength. Their operational readiness timeline will be less than 30 days. Main Defense Forces will be the most numerous functional component of the AFU, with operational readiness within 90 and 120 days. They will constitute the basis of the state defense. Their manning will be at 60 to 70

¹⁴¹ The following part of this section was developed based on the review and analysis of the Ukraine's Strategic Defense Bulletin until 2015 provided by the National Security and Defense Magazine published by the Ukrainian Center for Economic and Political Studies, #8, 2004, pp. 8-12. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=56 (8 May 2006).

percent of their designed strength. Reinforcement Forces will consist of units that are mobilization capable and will be able to reach operational readiness within 120 and 180 days.

A significant amount of equipment and armaments will be removed from the military's inventory. Extensive infrastructure will be reduced and an adequate ratio between combat and support units will be achieved. Procurement of armaments and military equipment of domestic and foreign origin, as well as modernization, are planned to meet the challenges of modern warfare. Significant changes will be implemented in the logistical support system. It will be decentralized to increase cost-effectiveness and attain greater flexibility. The provision of certain types of support such as food supplies, housing, and non-military internal functions, to a great extent, will shift to civilian contractors. The number of existing logistical bases and other units of logistical support will be considerably reduced.

Implementation of the 2015 Armed Forces model is attainable only on the condition of adequate financial and resource support for this process. The Ukrainian government estimated the costs of defense reform and development at UAH 124.794 billion through 2015. This number takes into account future forecasts of all major economic variables significant for this process. Expert and technical facilities developed within the Ukrainian MOD, including the Resource information-analytical system, were employed to generate these estimates.¹⁴²

The SDB provides MOD annual budget projections through 2015 (see Table 4.1) as well as distribution of costs for procurement and modernization of equipment and armaments, and construction of infrastructure among branches of the AFU (see Figure

¹⁴² The Strategic Defense Bulletin of Ukraine for the Period through 2015. Financial and Economic Grounds of Reform and Development of the 2015 Model of the Armed Forces of Ukraine, p. 83. Internet. Online. Available http://www.mil.gov.ua/index.php?part=def_planning&lang=ua (25 April 2006).

4.1). Shares of transitional period programs in total projected funding (see Figure 4.2) and other estimates are also included.

Table 4.1 MOD Budget Projections through 2015, UAH millions¹⁴³

2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
4137.4	6077.5	7140	7824	8722	9764	10708	11678	12660	13786	15064	16446

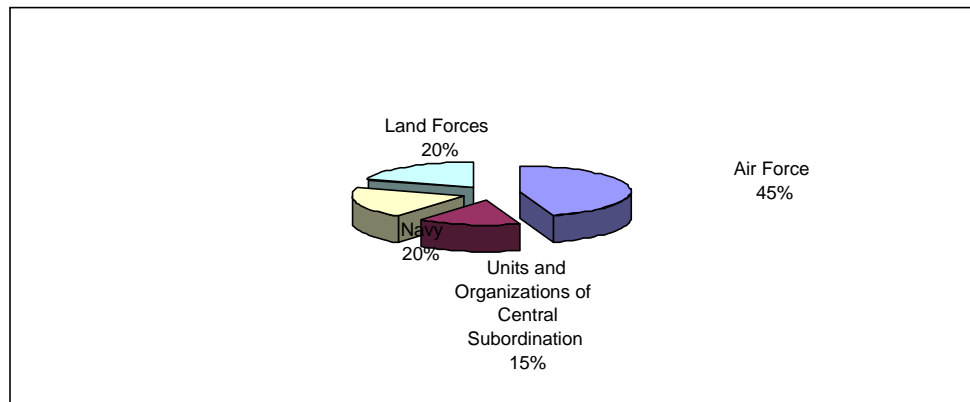


Figure 4.1 Distribution of Costs for Procurement and Modernization of Equipment and Armaments and Construction of Infrastructure among Branches of the AFU during the Transitional Period from 2004 to 2015, Percent of Total¹⁴⁴

¹⁴³ The Strategic Defense Bulletin of Ukraine for the Period through 2015. Financial and Economic Grounds of Reform and Development of the 2015 Model of the Armed Forces of Ukraine, p. 84. Internet. Online. Available http://www.mil.gov.ua/index.php?part=def_planning&lang=ua (25 April 2006).

¹⁴⁴ Figure 4.1 and Figure 4.2 were developed based on the data found in Ukraine's Strategic Defense Bulletin until 2015: Brief Review and Comments. The National Security and Defense Magazine. Ukrainian Center for Economic and Political Studies, #8, 2004, p. 12. Internet. Online. Available http://www.uceps.org/eng/section/National_Security_and_Defence/?cur_nomer=56 (8 May 2006).

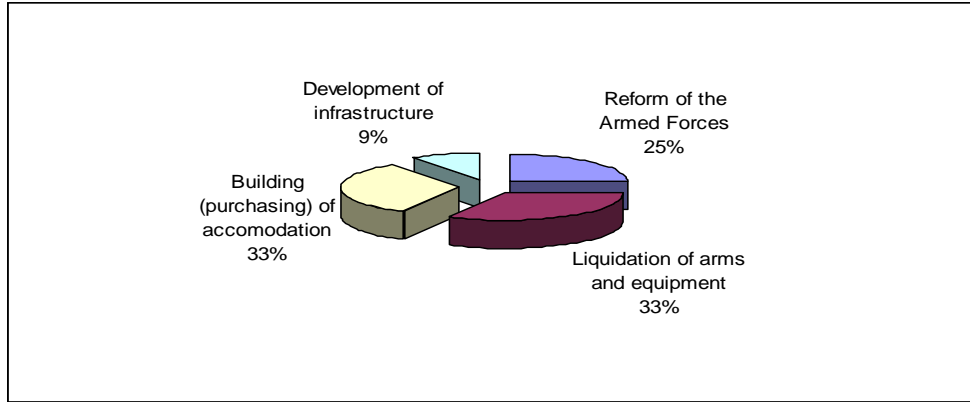


Figure 4.2 Financing of the Transitional Period Programs, Percent of Total

As is demonstrated by Table 4.1, Ukrainian defense expenditures are expected to reach UAH 16.4 billion in 2015 or four times more than provided in 2004. Calculated as defense budget expenditures per serviceman (almost UAH 170,000 or over \$30,000), this will bring Ukraine close to Poland and some other East European states that joined NATO.

The authors of the SDB concluded that the planned funding of the Armed Forces of Ukraine will ensure their reform and development and the achievement of the model planned for 2015. Their assessments were based on a comprehensive analysis of major economic indices which demonstrated positive trends and suggested that future Ukrainian economic potential would be strong enough to ensure the planned level of financing. At the same time, they concluded that reducing defense expenditure even by 0.1-0.3 percent can result in non-implementation of the plans for reform and development of the Armed Forces by changing the implementation terms of the major programs such as defense research and development programs, procurement, housing construction, training, etc. Taking this into account, consistent support to the Armed Forces in terms of financing within estimated limits will be the main task of the state. It will be subject to the influence of the Ministry of Finance, the Budget Committee of the Verkhovna Rada, the Accounting Chamber of Ukraine and other state organizations having responsibilities for the defense sphere.

Estimates shown in the Strategic Defense Bulletin reveal an optimistic scenario for Ukrainian economic development and the financing of the Armed Forces. Meanwhile, defense budgets for 2005 and 2006 demonstrate a gap between planned and actual levels of funding for some important defense budget items. The next section will provide an overview of the 2005 and 2006 defense budgets and discuss some related budget issues.

D. DEFENSE BUDGETS 2005 AND 2006

By the end of 2004 Ukraine had developed an impressive record of NATO participation. Ukraine's military co-operation efforts established an encouraging climate for future integration. However, political shortcomings were the main obstacle on the way towards desired NATO membership.¹⁴⁵ The peaceful 2004 Orange Revolution and ensuing democratic election of Victor Yushchenko reinforced Ukrainian prospects to join the Alliance. A new administration clearly delineated the national security priorities of Ukraine and declared NATO membership the end goal of Ukraine's Euro-Atlantic integration. It genuinely committed to political reform aimed to meet NATO democratic requirements. Allies welcomed these promising initiatives at a meeting of foreign ministers in Vilnius, Lithuania on 21 April 2005 when NATO and Ukraine launched an Intensified Dialogue on Ukraine's aspirations to NATO membership.

On 27 June 2005, during the NATO Secretary General's visit to Kyiv, the Ukrainian government formally presented an initial discussion paper. This document addressed key issues outlined in the 1995 Study on NATO Enlargement and 1997 Membership Action Plan Document, addressing domestic and foreign policy, defense and security sector reform, as well as legal and security issues. A package of short-term actions was also launched in Vilnius, designed to improve NATO-Ukraine co-operation in areas vital to success of the democratic transformation: strengthening democratic institutions, enhancing political dialogue, intensifying defense and security sector reform,

¹⁴⁵ Clark Cramer. The Great Orange Hope: Ukraine, NATO, and the Dilemma of European Integration after the Orange Revolution. Naval Postgraduate School, Monterey, December 2005, p. 36. Internet. Online. Available <http://library.nps.navy.mil/uhtbin/hyperion/05Dec%5FCramer.pdf> (2 May 2005).

improving public information, and managing the social and economic consequences of reform. These were highlighted as priorities for the new Ukrainian government.¹⁴⁶

However, that was an uneasy time for Ukraine. During the period 2005-2006, the country experienced several political scandals which, coupled with the poor economic performance of the new government, had a harmful impact on the image of the Orange Revolution and its supporters. The rush toward the 2006 parliamentary election shifted the NATO membership issue towards the sphere of political speculation. The Verkhovna Rada sent mixed signals to the Alliance when it refused to approve NATO-Ukraine initiatives on NATO utilization of Ukrainian strategic airlift capabilities and on admission of foreign troops in Ukrainian territory to participate in international military exercises. The President signed a decree on implementation of the 2006 NATO-Ukraine Target Plan only in April 2006, after the March parliamentary election.

However, Ukraine did fulfill a number of commitments made in Vilnius. Particular progress was made in the realm of defense reform. Key leadership positions in the Ministry of Defense were filled by civilians. Plans for reduction of the Armed Forces were corrected by decreasing the rate of reduction and shifting to the elimination of arsenals and ammunition depots. Implementation of the plans for transition of the Armed Forces to manning on a contract basis was intensified. Significant changes were made to the structures of the MOD and the General Staff to increase efficiency of command and control and introduce a clear division of functions between the two. A new MOD leadership began to reform the procurement system in the Armed Forces. Processes of combat preparation and training were also intensified.¹⁴⁷

¹⁴⁶ NATO Topics. NATO-Ukraine Relations. Intensified Dialogue. Internet. Online. Available http://www.nato.int/issues/nato-ukraine/intensified_dialog.html (11 May 2006).

¹⁴⁷ The White Book 2005: Defense Policy of Ukraine. Kyiv, 2006, pp. 17-20. Internet. Online. Available http://www.mil.gov.ua/ua/white_book/1.pdf (19 March 2006).

The main factor which made these results possible was a satisfactory level of funding. Although fund allocations for defense in the 2005 budget were below the level set in the Strategic Defense Bulletin (UAH 5.9 billion compared to UAH 6.08 billion according to the SDB), the Armed Forces were able to implement a majority of the planned objectives since they received these funds in full and on timely basis. This happened for the first time since independence. Additionally, the MOD received UAH 100 million from sales of excess military equipment and armaments, appropriated by the Verkhovna Rada for MOD needs (see Figure 2.1).¹⁴⁸ This established a basis for further improvement of the situation in the defense sector and demonstrated that when stable funding is available (even though at a minimal level), good management can bring credible results. A new State Program of Development of the Armed Forces of Ukraine was elaborated by the Cabinet of Ministers, Verkhovna Rada, MOD and General Staff for the period from 2006 to 2011. This program took into account resource limitations and introduced a more efficient approach to resource planning within the AFU.

However, the design of the 2006 defense budget endangered subsequent implementation of the plans for development of the Armed Forces. According to the 2006 Law on the State Budget of Ukraine, UAH 2 billion out of 8.9 billion appropriated to the MOD had to come from the sales of excess military equipment, armaments and property and from other sources such as sales of natural gas supplied to the National Stock Company “Naftogas of Ukraine” by the Russian Federation as payment for the military equipment transferred to Russia and revenues received from participation of Ukrainian troops in peacekeeping operations.¹⁴⁹ Historical trends suggest that these funds were not likely to be received in full.¹⁵⁰ Moreover, they had to be allocated to the

¹⁴⁸ The White Book 2005: Defense Policy of Ukraine. Kyiv, 2006, p. 19. Internet. Online. Available http://www.mil.gov.ua/ua/white_book/1.pdf (19 March 2006).

¹⁴⁹ Georgii Kruchkov. On the Issue of Defense Budget. The National Security and Defense Committee of the Verkhovna Rada of Ukraine. Internet. Online. Available http://www.rada.gov.ua/~k_obor/news/20060117news0110.htm (10 May 2006).

¹⁵⁰ Anatoly Kinakh. Letter to the Head of the National Security and Defense Committee of the Verkhovna Rada of Ukraine. Internet. Online. Available http://www.rada.gov.ua/~k_obor/news/20060117news0110.htm (10 May 2006).

so called special fund, a budget account controlled by the Ministry of Finance and often used to cover shortcomings in the budget. According to the 2006 budget, programs of modernization and procurement of military equipment, reform of the Armed Forces, and international military co-operation should be financed from these funds. Furthermore, the schedule of financing was set up such that the MOD was expected to receive budget funds in the second half of the year, eliminating the possibility to use them as planned if official financial regulations are observed.¹⁵¹

According to Ukrainian Minister of Defense Anatoly Grytsenko, such a situation became possible due to a lack of transparency in the decision-making process within the Cabinet of Ministers. In particular, he pointed out that the Ministry of Finance adjusts budget parameters without taking into account the recommendations of other ministries. The budget proposal is then presented to the parliament on behalf of the Cabinet. In the case of the 2006 defense budget, the Ministry of Finance ignored not only the opinion of the Minister of Defense but also a decision of the National Security and Defense Council which set parameters for the defense budget in December 2005. The Minister of Defense also admitted that there was little interest in the situation in the defense sector on the part of key officials in the government.¹⁵²

The Law on the State Budget of Ukraine for 2006 was approved by the parliament in December 2005. Although a majority of the deputies voted for the Cabinet's proposal, the National Security and Defense Committee, in co-operation with the NSDC, undertook considerable efforts to defend the interests of the Armed Forces and the national security interests of Ukraine. As a result, in February 2006 the Verkhovna Rada amended the Law on the State Budget. The Ministry of Finance was obligated to direct funds assigned to

¹⁵¹ The Ministry of Defense of Ukraine. News. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=ua&part=news&sub=read&id=6765> (25 April 2006).

¹⁵² Bila Kniga z Chornou Vidznakou. Interview of the Minister of Defense. The Ministry of Defense of Ukraine. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=ua&part=appearance&sub=read&id=6763> (25 April 2006).

the MOD immediately to its accounts.¹⁵³ Nevertheless, this amendment did not guarantee the actual money would be received by the Armed Forces.

The NSDCOM also supported the initiative of the Minister of Defense to provide the MOD with a credit which then would be paid by the revenues received from the sales of military equipment, MOD property, etc. However, as of March 2003 the status of this issue was left unresolved.

E. CONCLUSIONS

During the period from 2004 to 2006, an institutional base necessary for the creation and functioning of a defense resource management system has emerged in Ukraine. Adoption of the Law on Organization of the Defense Planning and completion of the Defense Review are among important arrangements pertaining to this process. Programs for the reform and development of the Armed Forces designed during this period were supported by financial considerations and forecasts. NATO-Ukraine cooperation has gained effectiveness. NATO and Ukraine have jointly put together a list of specific activities (courses, seminars, expert exchanges, workshops). These provide valuable learning opportunities for the Ukrainian defense specialists and help to increase awareness about the significance of resource support for defense reform among Ukrainian officials.

The beginning of an effort to enhance Ukrainian defense budgeting provides additional empirical data to evaluate the state of the NATO-Ukraine integrative process, as real defense budgets are objective and comparatively easy to quantify. In this regard, developments surrounding the 2006 defense budget revealed that bureaucratic inertia is still strong. It can and does thwart policy objectives, even those set at the presidential level. This suggests that defense reform issues should be introduced to more Ukrainian

¹⁵³ Bila Kniga z Chornou Vidznakou. Interview of the Minister of Defense. The Ministry of Defense of Ukraine. Internet. Online. Available <http://www.mil.gov.ua/index.php?lang=ua&part=appearance&sub=read&id=6763> (25 April 2006).

government officials involved in supporting defense and security sector reform. NATO-Ukraine co-operation mechanisms have great potential in this regard.

On the positive side, support given to the MOD by the Verkhovna Rada's National Security and Defense Committee indicates growing involvement of the parliament in the defense budget process. By and large, the recent period illustrated limited but real improvement in the process of budgeting for defense in Ukraine.

V. SUMMARY

A. INTRODUCTION

Not only should a good budget allocate money in an efficient fashion to support implementation of plans drafted for a budget period, it should also be an instrument for oversight and evaluation of funded programs. In the case of defense budgets, these requirements are especially relevant since defense programs can be extremely expensive. It is also the case that the costs to society of a failure in the security realm can be even higher.

Europe's hostile security environment of the early 20th century suggested maintaining a capable army for a young Ukrainian Republic. The loss of independence by Ukraine is largely attributed to the fact that the Central Rada deliberately ignored the defense issue.

The subject of this thesis was the evolution of the defense budget process to support the development of the Armed Forces in the independent Ukraine of the late 20th century. It provided an overview of the roles of the executive branch as well as the Verkhovna Rada in shaping military policy and budgets. It identified those factors that directly affected budgeting for defense in Ukraine and determined the distribution of power in this process as it has unfolded since independence. Policy developments that occurred in the Ukrainian defense sector in the period from 2004 to the beginning of 2006 relevant to the defense budget process were also discussed.

A budget is also a historical record as well as a strategic document. It contains information on how the government spent money in the past and how it proposes to spend funds in the future. Summarizing the historical record provided in previous chapters, this chapter will address the question of whether Ukrainian defense budgets serve their strategic function. It will also examine some issues associated with the process

of budgeting for defense in Ukraine and suggest some recommendations for further research.

B. OBSERVATIONS, CONCLUSIONS AND RECOMMENDATIONS

At the beginning of the 1990s, the Ukrainian Parliament initiated the nationalization of the portion of the Soviet Armed Forces located in Ukrainian territory. It acted promptly to establish an institutional base for the development of the Ukrainian Armed Forces. But as control over the security sector of the country shifted to the President, the parliament's involvement in the development of the Armed Forces decreased dramatically. Several attempts to introduce defense reform and development programs undertaken by the executive branch during 1990s failed due to constant lack of financial resources for their implementation.

This situation was rooted in severe and lasting economic crises and aggravated by the continuous alteration of the Ukrainian national security agenda which required corresponding changes to related programs. In other words, funding for defense reform made little practical sense since reform itself was encapsulated in ambiguity. But this is the case only from a historical perspective. For many years after independence the Ukrainian government simply failed to create a cohesive and coherent process to produce well considered defense programs and control their implementation. One of the reasons for this failure is that the executive branch of the government was acting unilaterally on defense issues, including budgeting. Legislative support and oversight was either pro forma or non existent. This led to deterioration of the ability of the Ukrainian Armed Forces to fulfill the tasks they were assigned. Despite a significant reduction in military personnel which occurred during the period from 1991 to 2004, the Ukrainian MOD still maintained excess infrastructure and inefficient logistical systems.

The main body of Ukrainian defense legislation was developed and adopted by the Verkhovna Rada in 1991. It consisted of the Conception of Defense and Development of the Armed Forces of Ukraine, the law of Ukraine on the Armed Forces of Ukraine, and

the law of Ukraine on the Defense of Ukraine. All of these legislative acts contained rather general provisions regarding budgeting and financing of the Armed Forces. The overall budgeting system in Ukraine was regulated by the 1990 Law on the Budgeting System of Ukraine. This law provided almost no parliamentary oversight over the execution of the state budget. Defense budgets during the period from 1992 to 1996 were represented by lump sums, without clarification of particular categories of spending. Moreover, those budgets were barely sufficient to cover the basic needs of the Armed Forces. Taking into account the absence of a constitution in Ukraine until 1996, one might conclude that the defense budget process during the period from 1992 to 1996 was basically regulated by rules produced within the executive branch of the government and within the MOD in particular.

The introduction of the Constitution of Ukraine in 1996 and the Budget Code of Ukraine in 2001 refined the process of budgeting for defense in Ukraine. In 1996 the Verkhovna Rada adopted a resolution on a system of budget expenditure classifications. After 1999, defense and other programs in the state budget were subdivided into several major categories, some of which were additionally portioned into subcategories.

With the introduction of program budgeting in the 2002 Ukrainian state budget, defense budgets took on even more detailed forms. However, the MOD did little to improve its internal budget process which was not performance oriented and involved only a selected portion of the top MOD bureaucracy. Moreover, involvement of the parliament in budgeting for defense remained rather limited at all stages of the process.

The period from 2004 to the beginning of 2006 brought about several positive developments in the Ukrainian defense budget process. These are attributed to the NATO-Ukraine integrative processes and their increased focus on defense reform and development. Even before the introduction of the NATO-Ukraine Action Plan in November 2002, which stipulated Ukraine's policy objectives in the field of defense

resource management, NATO and Ukraine established co-operation mechanisms which were utilized to implement partnership goals. By performing the activities identified within the Annual Target Plans, Ukrainian officials were able to learn, test, and eventually implement some of the most efficient international budget practices. The work on financial substantiation of the Strategic Defense Bulletin completed in 2004 is a good example of this. Furthermore, financial considerations became a key component of defense programs drafted thereafter.

Even though the funds allocated to defense in the 2005 state budget were somewhat below the amount required to fulfill reform goals for that year, the MOD leadership managed to achieve significant results because the funds were appropriated on a timely basis. Unfortunately, the deceptive structure of the 2006 defense budget proposed by the government revealed that a formal commitment to fund defense at a sufficient level made by the President of Ukraine in his December 2005 radio address and implemented in a decision of the NSDC was not enough to make bureaucrats react and make changes to implement the new policies. Making defense an effective priority of the government requires substantial changes in the bureaucratic culture of the Ukrainian government.

These changes should be made in a form of well elaborated legislative acts considered by all branches of the government. Adoption of the Law on Organization of the Defense Planning might be one of such measures. This law, however, contains only general provisions for the organization of defense planning and budgeting. It does not impose a mechanism to make governmental bureaucracy accountable should it fail to implement plans approved by a higher authority. This suggests that the Ukrainian legislature still leaves too much power to an executive branch which is not always effective in the implementation of its own programs. As a result, Ukrainian defense budgets do not work as strategic documents linked to the accomplishment of long-term plans.

C. SUGGESTIONS FOR FURTHER RESEARCH

This thesis provided a historic overview of the development of the defense budget process in Ukraine, including issues that occurred as recently as 2006. A chronological sequence of the important events associated with this process and discussed in this paper is included in the Appendix. The main problems encountered during the writing of this thesis included limited availability of fiscal information on defense spending in Ukraine and the mechanisms through which it is conducted.

This suggests a possibility for further research. That said, an analytical description of the MOD of Ukraine's budget procedures would be useful for the improvement the defense budget process in Ukraine. Furthermore, a comparison of the legal regulations on defense budgeting adopted by the countries which were recently accepted for NATO membership (e.g., Poland, Romania, etc.), would be an interesting topic, as Ukraine currently strives for the same goal. Finally, further studies could assess which particular measures might be priorities for the Ukrainian MOD in order to implement efficient budgeting. Would an introduction of some type of a Planning, Programming, Budgeting and Execution System common for many NATO countries be relevant for Ukraine at this moment? Or should it first improve accounting procedures and practices within the MOD to fight corruption and mismanagement?

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**APPENDIX. CHRONOLOGY OF IMPORTANT EVENTS
ASSOCIATED WITH DEVELOPMENT OF THE DEFENSE
BUDGET PROCESS IN UKRAINE**

Date	Event
16 July 1990	The Verkhovna Rada passed the Declaration on the State Sovereignty of Ukraine.
5 December 1990	The Law on the Budget System of Ukraine passed by the Verkhovna Rada of the Ukrainian Soviet Socialist Republic. As amended in 1995, it remained in force through 21 June 2001, when the Budget Code of Ukraine was adopted.
24 August 1991	The Verkhovna Rada proclaimed the independence of Ukraine.
27 August 1991	The speaker of the Parliament, Leonid Kravchuk, arranged a meeting with senior military commanders to exchange opinions about the future of the Ukrainian military.
3 September 1991	General Morozov was appointed by the Parliament to be the first Ukrainian Minister of Defense.
11 October 1991	The Verkhovna Rada adopted the Conception of Defense and Development of the Armed Forces of Ukraine, in which it denoted the government's agenda for the creation of the Ukrainian military.
6 December 1991	The adoption of the Law on the Armed Forces of Ukraine and the Law on the Defense of Ukraine set the legal precedent for the development of the Ukrainian Armed Forces.
27 July 1994	Procedural Regulations of the Verkhovna Rada adopted
June 1995	The Law on the Budget System of Ukraine was amended to strengthen the role of the Verkhovna Rada in the development and execution of the state budget, and to provide for more transparency in the budget.
28 June 1996	Approval of the Constitution of Ukraine, establishing budget authority for the Verkhovna Rada
12 July 1996	A resolution of the Verkhovna Rada introduced a system of budget expenditure classifications.
9 July 1997	NATO and Ukraine signed the Charter on Distinctive Partnership.
1998	The NATO-Ukraine Joint Working Group on Defense Reform was organized.
21 June 2001	The Budget Code of Ukraine replaced the Law on the Budget System of Ukraine.
2002	Introduction of program budgeting in the 2002 state budget of Ukraine.

22 November 2002	Adoption of a NATO-Ukraine Action Plan at the meeting of NATO foreign ministers in Prague.
April 2003-June 2004	Expert Commission conducted review of defense.
19 June 2003	Adoption by Verkhovna Rada of the Law on Democratic Civilian Control over Military Organization and Law Enforcement Bodies of the State.
2004	Publication by the Ukrainian government of the Strategic Defense Bulletin. It contains the results of the defense review and recommendations based on these findings. It is a basic document to be used to draft more detailed programs for reform and development of the Armed Forces. It also provides financial estimates of costs for reform and defines how they should be allocated from 2004 to 2015.
18 October 2004	Verkhovna Rada approved the Law on Organization of Defense Planning.
21 April 2005	NATO and Ukraine launched an Intensified Dialogue on Ukraine's aspirations to NATO membership.

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