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Heiko Pleines

**The Political Economy of
Coal Industry Restructuring
in Ukraine**

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1. Introduction

The coal industry was vital for the rapid industrialisation of the Soviet Union in the 1920s and 1930s. In the 1950s, coal still accounted for more than half of the Soviet production of primary energy resources. With the development of Siberian oil and gas fields this situation changed in the 1960s. Coal was increasingly substituted with gas and oil. When the Soviet Union collapsed in 1991, coal contributed a mere 15% to the total production of primary energy resources whereas the share of natural gas and oil taken together stood at more than 75%. However, the Soviet command economy never reacted to this change. The coal industry was heavily subsidised and miners were hailed as the elite of Soviet workers. No measures were taken to restructure or at least modernise the industry which was centred in the old industrial areas of the Donbas and the Kuzbas.

When Ukraine became independent in 1992, the national government in Kiev assumed responsibility for most of the Donbas, which consists of the two Ukrainian regions of Donetsk and Luhansk and the Russian region of Rostov. The introduction of market-oriented reforms put the Ukrainian coal industry under heavy pressure. Most coal mines were operating at loss and could survive only with the help of state support. In its economic dimension this crisis of the Ukrainian coal industry is similar to the problems experienced by West European and North American coal regions since the 1960s (like e.g. the Ruhr area in Germany or the North East of England) and by other East European coal regions in the 1990s (like e.g. the Kuzbas in Russia or Upper Silesia in Poland). The coal industry in all these regions faced heavy competition from low-cost producers of coal in other countries and from alternative primary energy resources. As a result most coal mines in these regions were unable to generate a profit and became dependent on state support.

Economists have already long ago developed an answer to the crisis of the coal industry in these regions. The coal industry has to restructure, whereby restructuring includes all measures that aim to render the coal industries competitive and profitable on an international scale. For the old industrial coal regions this means that capacities have to be reduced, as most of the coal produced is not competitive. At the same time those mines able to generate a profit have to be modernized. In order to decide which mines have a long-term perspective, competition has to be introduced. State subsidies have to be phased out, prices have to be liberalized and mines operating at loss have to be closed. Profitable mines should be privatized in order to promote efficient, profit-oriented management.

The downsizing and modernization of the coal industry necessarily leads to massive lay-offs. As the coal industry is for geological reasons centered in a small number of regions, these regions experience a strong rise in unemployment and with that severe social problems. Governmental restructuring programmes therefore normally include not only measures to raise efficiency and profitability of the coal industry but also measures to mitigate the social consequences of restructuring.¹

¹ For a concise overview of restructuring tasks and programmes see for example: Simon Walker: Experience of coal industry restructuring, London 2001 and World Energy Council: Restructuring and privatisation of the coal industries in Central and Eastern Europe, London 2000.

Though general concepts have to be adjusted to individual cases the clear advice of economics to the problems of old industrial coal regions is market-oriented restructuring.² However, politicians regularly meet stiff resistance when they try to implement this advice. In Western and Eastern Europe alike coal miners are among the social groups with the highest protest potential. In actually all cases they have organized mass protests against restructuring (often accompanied by acts of civil disobedience, like the blockade of railroads and highways). In addition a coalition of coal mining companies, major coal consumers (like electricity producers and metallurgical enterprises) and further interest groups has in most countries concerned organized an influential lobby against restructuring.

Accordingly the main problems faced by national governments trying to solve the crisis of their country's coal industry are not related to the economic details of the restructuring plan but to its implementation against the resistance of influential interest groups. This has been realized and there is a considerable body of academic literature on the political economy of coal industry restructuring focusing on Western industrialized countries.³ There are also several analyses dealing with East European countries.⁴

However, most of the studies concentrate on the conflict between workers and state. By doing so, they ignore the role of an industrial lobby interested in cheap coal supplies. As a rule, they also do not pay much attention to the conflict between different state actors, as in most cases there is not a government single-mindedly implementing a restructuring programme, but rather a multitude of state actors with different interests. In summary most of the publications do not analyse the political economy of coal industry re-

² For Ukraine, for example, the World Bank has suggested a generally sound restructuring programme: World Bank: Ukraine. Coal industry restructuring sector report, Report No. 15056-UA, Washington 1996 (www.worldbank.org). See also chapter 3.6 of this working paper.

³ Good examples are: Mike Parker: *The politics of coal's decline. The industry in Western Europe*, London 1994; Gerald Feldman, Klaus Tenfelde (eds.): *Workers, owners and politics in coal mining. An international comparison of industrial relations*, New York 1990. On Great Britain see also: Mike J. Parker: *Thatcherism and the fall of coal*, Oxford 2000; Adrian Murton: „Bucking the trend“? Restructuring and strike activity in the British coal mining industry 1974–1992, Dagenham 1995; David Reed: *Miners strike 1984–1985. People versus state*, London 1985. On Germany see for example: Gerd Koehler (Hg.): *Das Ruhrgebiet im Umbruch; Freiburg 1988*; Martin Parnell: *Politics, policy and the West German coal industry. A study of West German 'corporative/organised capitalism' in historical perspective*, Liverpool 1987. On the United States see: H.M. John (ed.): *The United Mine Workers of America. A model of industrial solidarity?* University Park 1996; John R. Bowman: *Capitalist collective action. Competition, cooperation, and conflict in the coal industry*, Cambridge 1989; John Gaventa: *Power and powerlessness. Quiescence and rebellion in an Appalachian valley*, Oxford 1980. Examples of analyses dealing with other countries are: Patricia Latorre Pallares: *Der Kumpel – „Held der Arbeit“ und „geborener Rebell“? Kultureller Machtkampf um die Arbeit im asturischen Kohlerevier*, Frankfurt/M. 2001; Suzanne Culter: *Managing decline. Japan's coal industry restructuring and community response*, Honolulu 1999; Simon Pirani: „Bread, peace, democracy“. *The Turkish miners' strike 1991*, Newcastle-upon-Tyne 1991.

⁴ See for example: Marian Radetzki: *Poland's hard coal industry. Prospects after completed restructuring*, Stockholm 1994; Stephen Crowley: *Hot coal, cold steel. Russian and Ukrainian workers from the end of the Soviet Union to the post-communist transformations*, Ann Arbor 1997; Rob Ferguson: *Will democracy strike back? Workers and politics in the Kuzbass*, in: *Europe-Asia Studies* 3/1998, pp.445–468; Petr Bizyukov et.al.: *Bergarbeiterproteste im Kuzbass. Das Jahr des Schienenkrieges in Fallstudien*, Köln 1999; Heiko Pleines: *Down, out and forever desperate? The role of coal miners' protests in Russian politics*, in: S. Harter et.al. (ed.): *Shaping the economic space in Russia*, Aldershot 2000, pp.127–146; Stephen Crowley: *Between a rock and a hard place: Russia's troubled coal industry*, in: Peter Rutland (ed.): *Business und state in contemporary Russia*, Boulder 2001, pp.129–150.

structuring in full, but stand in a tradition of trade union and labour studies. For the Ukrainian case the situation is even worse as there is only one longer academic analysis, which – as it covers the late 1980s and the early 1990s – is already outdated.⁵

Accordingly one can state that whereas the economic side of coal industry restructuring in Ukraine has been well studied and sound concepts are available, the political side of the problem has so far been neglected in academic analysis. This study has the aim to add the focus of political economy to the present debate about coal industry restructuring in Ukraine.

The following part gives a brief overview of the economic situation of Ukraine's coal industry which is necessary to understand the political conflict about restructuring. It offers a short description of the major coal producing regions and an outline of the economic development of the Ukrainian coal industry, concentrating on the economic and social dimension of the post-Soviet crisis.

The third part of this paper consists of portraits of the main actors with an interest in coal industry restructuring. On the side of the economy these are the coal miners with their unions, directors of coal enterprises and industrial coal consumers, coming from the metallurgical industry and electricity production. On the side of the state relevant actors are the administrations of coal mining regions and the central government. At the regional as well as at the national level the role of additional political actors is discussed and conflicts between different camps within the state executive are taken into consideration. Finally the strategy of the World Bank as an external actor, promoting market-oriented restructuring as part of its mission, is portrayed.

The fourth part then aims at presenting a full picture of the political economy of coal industry restructuring. First the interaction between the relevant actors on the political scene is analysed. Thus the rules of policy making for coal industry restructuring can be described. Second, based on the logic of these rules an outlook is given, presenting three scenarios for the future of coal industry restructuring in Ukraine.

2. The economic situation of the Ukrainian coal industry

2.1 The coal producing regions

Ukraine's coal industry is centred in the Donbas (short for: Donetsk Coal Basin), consisting of the regions of Donetsk and Luhansk in eastern Ukraine. Coal was discovered in the Donbas at the beginning of the 18th century. The first primitive coal pits appeared at the turn of the 19th century. The commercial exploitation of the Donbas coal began in the middle of the 19th century. In 1912 Ukraine's share in the coal production of the Russian empire stood at nearly 80%.

In the Soviet Union the now nationalized coal industry of the Donbas was of great relevance for the rapid industrialization of the country. Ukraine's coal production rose from 23 mn tons in 1913 to 84 mn tons in 1940. In the mid-1950s the Lviv-Volyn Coal Basin (Western Ukraine) and the Dnieper Lignite Coal Basin (Central Ukraine) began to be

⁵ Stephen Crowley: Hot coal, cold steel. Russian and Ukrainian workers from the end of the Soviet Union to the post-communist transformations, Ann Arbor 1997.

developed and produced a little more than 10% of Ukraine's coal. In the late 1960s Ukraine's total coal production already amounted to 200 mn tons per year. At that time Ukraine accounted for one third of total Soviet coal production. The production level of about 200 mn tons was kept until the crisis of the Soviet economy in the late 1980s caused a decline.

As a result of the post-Soviet crisis Ukrainian coal production collapsed. In 1996 it stood at a mere 71 mn tons per year. In the late 1990s annual production stabilized at about 80 mn tons. With that the decline of production in the coal industry was below the average of Ukrainian industry. Accordingly the share of the coal industry in total industrial output rose during the 1990s (see table 2-1). However, as a result of the sharp drop in production the share of coal in Ukraine's primary energy consumption went down from a third in the mid-1980s to a quarter in the 1990s.

Table 2-1: Ukraine's coal production 1990–2003

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
production (mnt)	165	136	134	116	95	84	71	77	77	82	81	83	82	80
share in industrial output	7%	7%	8%	8%	10%	10%	10%	12%	12%	12%	11%	10%	na	na

Note: Net production (washed coal) is gross production of coal (raw coal) minus coal directly used or lost during coal production. That means whereas gross production indicates how much coal has been taken out of the seams, net production shows how much coal was available for sale.

Source: State Statistics Committee of Ukraine. Share in industrial output according to Ukrainian Economic Trends, Quarterly issue March 2002, p.18.

<http://www.ueplac.kiev.ua/eng/publications/trends/2002/>

The decline in coal production in the 1990s has not altered the regional distribution of Ukrainian coal production significantly (see table 2-2). The Donbas remained dominant, accounting for 85% to 95% of total production. Accordingly Donetsk and Luhansk are the by far most important coal producing regions of Ukraine with a share of more than 50% and more than 25% respectively. Also of some importance for Ukraine's coal production is Dnipropetrovsk. The eastern part of this region covers Donbas reserves and since the mid-1990s accounts for about 12% of Ukraine's coal output.

In the north-western part of the Dnipropetrovsk region brown coal is being produced from the Dnieper Lignite Basin. Coal from this basin is also being produced in the Kirovohrad region. This is the only brown coal production in Ukraine. Its share in total coal production has been shrinking since the end of the Soviet Union, falling from 7% in 1990 to 2% in 2002.

The third coal basin of Ukraine is situated in the regions of Lviv and Volyn on the western border of the country. Since the end of the Soviet Union the basin has regularly contributed 3–4% to total production.

Table 2-2: Regional composition of Ukraine's coal production 1990–2003

Region (coal basin)	1990	1995	2000	2003
Dnipropetrovsk (Donbas)	6%	12%	11%	12%
Donetsk (Donbas)	49%	55%	55%	53%
Luhansk (Donbas)	32%	25%	27%	30%
Total Donbas	87%	92%	93%	95%
Dnipropetrovsk (Dnieper Lignite)	2%	3%	2%	1%
Kirovohrad (Dnieper Lignite)	5%	1%	1%	1%
Total Dnieper Lignite	7%	4%	3%	2%
Lviv (Lviv-Volyn Basin)	5%	3%	3%	2%
Volyn (Lviv-Volyn Basin)	1%	1%	1%	1%
Total Lviv-Volyn Basin	6%	4%	4%	3%
Total Ukraine	100%	100%	100%	100%

Source: own calculation based on data from State Statistics Committee of Ukraine.

2.2 The post-Soviet crisis

After the end of the Soviet Union Ukraine's coal industry did not only experience a fall in output by about 50%, but was also faced with a low profitability. This crisis, which peaked in the mid-1990s, was due to a number of disadvantages of the Ukrainian coal industry:

- The coal reserves of the Donbas have already been commercially exploited for 150 years. As a result coal extraction has become increasingly expensive because of worsening geological conditions. New seams must be sought at greater depths and their thickness is rather low. In addition Ukrainian coal is of lower quality due to high sulphur and ash contents.
- The employment of outdated Soviet technology further increases production costs. In the mid 1990s the technical equipment of the mines had already been in use for up to 25 years, over 60% of fixed assets were worn out and only 9% of mining plants and equipment met world standards. Nearly 80% of Ukraine's coal mines had been operating for at least 20 years without any appreciable modernization or renovation.
- The mines were still managed by old Soviet-type directors who spent their time lobbying for subsidies from the government. Mines were not privatized and remained within a highly bureaucratic state administration. The coal market remained highly regulated.
- The mines employed considerably more miners than needed for production due to social and political considerations. In addition coal enterprises were forced to finance a wide variety of social services from health care to kindergartens for their employees.

- Ukraine's economic policy aimed at monetary stability kept the exchange rate of the Ukrainian currency high and thus made Ukrainian coal more expensive in comparison with imported coal.
- The general economic crisis in the former Soviet Union considerably reduced demand. Exports of Ukrainian coal nearly ceased. Main domestic consumers were the power sector (53% in 1995), ferrous metallurgy (21%) and residential heating (18%).

As a result of the unfavourable production conditions a Ukrainian miner produced an average of 105 tons of coal a year in the mid-1990s, compared with 400 tons in Poland and 2,000 tons in the United Kingdom.⁶ Together with the unfavourable macroeconomic conditions this led to a situation where Ukrainian coal was completely unable to compete with imported coal. In the extreme average production costs of Ukrainian coal were close to 50 USD per ton in 1997, compared to a world market price of 35 USD per ton. In Poland production costs stood at 40 USD and in Russia at 37 USD per ton.⁷

As a result of high production costs most Ukrainian coal enterprises were unable to generate a profit and were, therefore, dependent on state support. Ukrainian coal was sold on the domestic market below production costs and the state covered the resulting losses. Though direct subsidies were considerably reduced in the second half of the 1990s (see table 2-3), rising indirect subsidies, consisting first of all of overdue payables to the state budget, manipulated non-cash settlements and cross-sector subsidies, provided some compensation.⁸

Table 2-3: State subsidies to the coal industry 1992–2003

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
USD mn	625	1 241	1 215	259	760	990	900	410	348	348	348	500
% of GDP	2.6	3.8	3.2	0.7	1.6	2.0	2.1	1.3	1.1	0.9	0.9	1.2

Note: Total subsidies are subsidies actually paid out. This amount can differ considerably from the sum of subsidies foreseen in the state budget for the respective year. The total amount of subsidies in national currency has been converted into the USD value using the average exchange rate for the respective year. Due to hyperinflation in the first half of the 1990s and the devaluation of the national currency in 1998/99 USD values are not directly comparable between the years. The figure for subsidies as share of GDP is a better indicator of their economic relevance.

Sources: DIW (Berlin); World Bank (Kiev office).

When state subsidies were drastically reduced in 1995 the coal industry became a central part of the Ukrainian non-payment crisis. At the end of 1996 the debt of coal enterprises stood at 4.7 bn UAH (at that time 2.6 bn USD). In turn coal enterprises were

⁶ World Bank: Ukraine. Coal industry restructuring sector report, Washington 1996 (www.worldbank.org), p.1.

⁷ I. Lunina, K. fon Khirshkhauzen (Chr. v. Hirschhausen): Restrukturizatsiya ugol'noi promyshlennosti. Evropeiskii opyt i situatsiya v Ukraine, in: Voprosy ekonomiki 5/1998, pp.90–102, here: p.95.

⁸ For a detailed analysis see: Nina Legeida: Implicit subsidies in Ukraine, IER Working Paper 10 (2001) (www.ier.kiev.ua).

owed 2.5 bn UAH (at that time 1.4 bn USD) by their customers. Until 2003 the industry's accumulated debts had risen to 10.5 bn UAH (at that time 2.0 bn USD), while accounts receivable stood at 4.4 bn UAH (at that time 0.9 bn USD).

In addition to the non-payment crisis barter, i.e. non-cash transactions, posed considerable problems in the second half of the 1990s. As a consequence of non-cash payments coal enterprises were short of cash and could not fulfil transactions demanding cash payments, i.e. first of all wage and tax payments. In the coal industry the share of non-monetary transactions stood at nearly 80% in 1997. In the following years it was continuously reduced, down to less than 20% at the end of 2002.⁹

The crisis of the coal industry had social consequences as well. Three aspects are of special importance: lay-offs, wage arrears and finance of social infrastructure. The decline in coal production and related restructuring processes led to a considerable reduction in employment (see table 2-4). Programmes to create new jobs in coal-mining areas and to retrain miners had only a very limited impact. As a result the social consequences of massive lay-offs of coal industry workers were not effectively mitigated.¹⁰

Table 2-4: Number of workers employed by the coal industry 1990–2002 (annual average) in thousands

	1990	1995	1996	1997	1998	1999	2000	2001	2002
Total	626	561	467	436	416	412	407	391	367
miners	na	419	378	344	324	315	303	253	240

Sources: State Statistics Committee of Ukraine; Ukrainian Ministry of Fuel and Energy.

Wages in the coal industry have traditionally been relatively high. The average monthly wage stood at 564 UAH (106 USD) in 2002, compared to 485 UAH (92 USD) in industry in general and 376 UAH (71 USD) in the economy in general. However, arrears reduced the de facto income of miners and made income less predictable. At the end of 1998 overdue wage payments in the coal industry had accumulated to 2.2 bn UAH (at that time 0.9 bn USD). At the end of 2003 wage arrears still stood at 1.1 bn UAH (at that time 0.2 bn USD), equal to an average debt of six monthly wages.

Since most social infrastructure was attached to coal mines and not to municipalities, the financial crisis of the coal industry led to a deterioration of social services. In the mid-1990s the coal industry employed 75 000 people and had to spend 150 mn USD annually to take care of social infrastructure. Only in 2001 was a larger part of these facilities transferred to municipalities. However, municipalities, too, lacked the financial means to take care of the facilities.

⁹ Data according to State Statistics Committee of Ukraine. In the steam coal market non-monetary forms of payments had a share of about 30% in 2002, in the market for coking coal they were actually non-existent.

¹⁰ The most comprehensive and detailed analysis is provided by: Andreas Wittkowsky et.al.: *Neue Wege geberfinanzierter Arbeitsmarktpolitik in der Ukraine*, Berichte und Gutachten des Deutschen Instituts für Entwicklungspolitik, Berlin 2000 (www.die-gdi.de), pp.55–75. Case studies of two Donbas mining towns are presented in: Michael Haney, Maria Shkaratan: *Mine Closure and its Impact on the Community. Five Years After Mine Closure in Romania, Russia and Ukraine*, World Bank Policy Research Working Paper No. 3083, Washington 2003 (<http://www.worldbank.org>).

Another negative consequence of the unfavourable production conditions, namely outdated technology and complicated geological conditions, was a deterioration in mine safety leading to the world's highest rate of injuries and occupational diseases. Over 90% of Ukraine's mines are unsafe in terms of gas, 70% in terms of coal dust explosions. Since the mid-1990s the average number of accidents per year has gone down from 19 000 to 12 000, but still causing on average 200 to 300 deaths per year. Almost 30% of coal industry workers are recipients of entitlement payments on account of stable disability.¹¹

The coal industry also poses a number of environmental problems. Mine sewage pollutes subterranean and surface waters. Coal mines are responsible for more than 10% of total industrial contaminated sewage discharge to surface reservoirs. In the Donbas subterranean water is polluted by coal mines down to 20–30 meters. In addition the coal industry contributes about 20% to industrial emissions into the atmosphere. Moreover, rock dump from coal mines occupies an area of more than 5,000 ha.¹²

2.3 Consolidation at a low level

In the late 1990s the situation of Ukraine's coal industry improved considerably. This was due to two factors. First the macroeconomic environment became more favourable for the coal industry. The devaluation of the national currency in 1998/99 increased the competitiveness of Ukrainian coal in relation to US-Dollar denominated imports of energy resources, namely Polish coal and Russian natural gas.¹³ Since 2000 considerable economic growth¹⁴ improved the situation of main coal consumers, namely ferrous metallurgy and electricity production. Accordingly cash-backed demand for coal increased.

Second restructuring of the coal industry reduced the social burden of coal enterprises. Employment went down considerably and social infrastructure was partly transferred to municipalities. This development contributed to an increase in labour productivity of 80% from 1995 to 2001.¹⁵

As a result of these positive factors, Ukrainian coal became more competitive. Production costs stood at about 25 USD in 2001 (compared to a maximum of nearly 50 USD in 1997). The surge in coal imports, expected in the mid-1990s, did not take place and

¹¹ Center for Economic Development, Coal Consulting Center, Donetsk Analytical Center: The major problems of development of the coal sector and the Donbass region, Concise report, draft version, Kiev 2003 (www.worldbank.org), pp.15–16; Ukrainian Ministry for Fuel and Energy: Analitichna dovitka pro rabotu vugil'noi galuzi, Kiev 2003 (<http://mpe.energy.gov.ua>).

¹² TACIS: Business guide to the energy sector of Ukraine, 1997, pp.52–54; Clifton Associates: Ukraine Coal Mine Closure Opportunities for a More Cost Effective Process, Saskatoon 2000 (www.worldbank.org), pp. 5–13.

¹³ Compared to the US-Dollar the Ukrainian Hryvna lost two thirds of its value from 1997 to 2000. On the Ukrainian market coal was 30% cheaper than natural gas in 2002, when measured in reference fuel, i.e. comparative thermal effectiveness (Center for Economic Development, Coal Consulting Center, Donetsk Analytical Center: The major problems of development of the coal sector and the Donbass region, Concise report, draft version, Kiev 2003 (www.worldbank.org), p.4).

¹⁴ Ukraine's GDP grew by 6% in 2000, 9% in 2001, 5% in 2002 and again 9% in 2003.

¹⁵ Center for Economic Development, Coal Consulting Center, Donetsk Analytical Center: The major problems of development of the coal sector and the Donbass region, Concise report, draft version, Kiev 2003 (www.worldbank.org), p.14.

Ukrainian coal production stabilized. At the same time state subsidies to the coal industry could be reduced considerably. However, a number of vital problems remain, namely geological conditions, outdated technology and lack of market-oriented management. The relevance of these problems is indicated by the fact that 145 out of 165 Ukrainian coal mines continued to operate at loss in 2002, with total losses amounting to 1.7 bn UAH (at that time 0.3 bn USD).¹⁶ Social problems caused by mine closures have not been solved and environmental problems remain pressing, though fairly unnoticed by Ukrainian authorities.

3. Actors of coal industry reform in Ukraine

3.1 Coal miners and their unions

Compared with other social groups in post-Soviet Ukraine the coal miners' protest potential has been extremely high. Though they represent less than 5% of the total workforce, in most years they accounted for more than half of all strike activity in Ukraine (see table 3-1 on the following page) and they were the only ones to stage regular demonstrations in front of government and parliament buildings in Kiev.

An important factor explaining this high protest potential and mobilisation is the miners' unity for which a number of reasons can be found. First, because of their glorification in Soviet times and their special working conditions, miners have more than other workers developed a sense of solidarity and an "elite" consciousness. Second, the geographical concentration of the coal industry in the Donbas contributed to a sense of unity and made it easier to develop organisational ties. A third factor promoting the miners' unity was the state ownership of actually all coal enterprises. It made the central government the main negotiating partner for all miners.

Four phases of coal miners' protest actions can be distinguished:

- Mass strikes of the late Soviet period (1989–91);
- Mass strike after independence (1993);
- Mass strikes in reaction to restructuring (1995–98);
- Protest actions by a radicalized minority and more moderate union actions (since 1999).

¹⁶ Ukrainian Ministry for Fuel and Energy (<http://mpe.energy.gov.ua>).

Table 3-1: The dimension of coal miners' strikes 1994–2003

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of workers taking part in strikes ('000)	24	48	109	49	51	25	19	5	2	4
Share of coal industry in Ukrainian total	19%	83%	64%	42%	52%	60%	90%	71%	19%	68%
Working hours lost through strikes ('000)	568	1 424	12 712	5 567	6 831	2 819	2 161	183	65	62
Share of coal industry in Ukrainian total	20%	88%	74%	57%	65%	80%	96%	62%	51%	15%
Production lost through strikes (mn USD)	5	15	77	51	47	15	6	1	0,3	1
Share of coal industry in Ukrainian total	27%	98%	89%	91%	93%	96%	99%	87%	100%	96%

Source: State Statistics Committee of Ukraine, own calculations.

In the final years of the Soviet Union coal miners in Ukraine, Russia and Kazakhstan reacted to the economic crisis with mass strikes. Twice, in 1989 and in 1991, they brought work to a halt in all big coal basins. Since the official trade union was discredited as part of the Soviet system, the miners founded their own trade unions, called Independent Miners' Union (Nezavizimy profsoyuz gornyakov – NPG, Ukrainian acronym: NPH).

In 1993, reacting to drastic government-ordered price increases, Ukrainian miners organized another mass strike in the Donbas, demanding first of all the abolition of the price increases as well as wage increases and lower taxes for workers. The strike was supported by the NPG, which soon assumed the role of the main organizing force, and with limited enthusiasm by the successor to the Soviet trade union, the Union of Coal Industry Workers (Profsoyuz robotnikov ugol'noi promyshlennosti – PRUP), which was afraid of discrediting itself among the miners by a soft stance. The directors of coal en-

terprises and the political elite of the Donbas supported the strike and added their demands, mainly increased state support for the coal industry and regional autonomy, to the miners' demands. After extensive strikes Yukhym Zvyahilsky, at that time mayor of Donetsk and a former director of one of the biggest Donetsk mines, became prime minister in 1993. In the wake of Zvyahilsky's appointment a number of politicians from the Donbas were promoted to influential posts in Kiev.¹⁷

When the government developed a restructuring programme for the coal industry in 1995, a new wave of mass strikes was started. Only after more than two years of extensive strike activities by the miners, did the central government succeed in isolating the radicalised minority of the coal miners and in preventing further mass strikes. In June 1998, after two months of extensive protests, the central government reached agreement with the NPG and the PRUP in separate negotiations. PRUP leaders were promoted to government positions, including the post of a deputy minister for the coal industry. The head of PRUP later became a parliamentary deputy as member of the pro-presidential party "Regions of Ukraine". Moreover the PRUP was provided with additional state funds for its activities.

Whereas the government tried to incorporate the moderate PRUP, it put pressure on more radical miners. From 1996 to 1998 some strike leaders were regularly brought to courts, though only few of them were sentenced. The leader of the NPG, Mykhaylo Volynets, repeatedly claimed that state agencies were observing him and threatening his family. As a result the NPG turned political. In August 2001 the NPG joined the political bloc of Yuliya Tymoshenko, one of the main opposition leaders. Volynets became a member of the bloc's parliamentary faction. The NPG continued to support radical protest actions, like the picketing of state buildings in Kiev and the hunger strike of coal miners in summer 2002.¹⁸

Since Ukrainian miners failed to reach organisational and programmatic unity they were unable to put permanent pressure on the relevant decision-makers, i.e. first of all on the central government. In post-Soviet Ukraine planned and well-organised mass strikes of miners took place only in 1993 and 1996. Moreover, the miners were unable to control the implementation of government promises due to the lack of an efficient organisation which could represent their interests. Low level instruments such as regular consultations or improved public relations, suitable to put permanent rather than stochastic pressure on the relevant decision makers were not at hand. Consequently, a real bargaining process between the political leadership and the miners did not materialise and the only possible resort to voice complaints were protests and the use of increasingly radical methods of protest in order to attract attention.

Since the miners' unions were divided and since the influence of miners on political decision making-processes was not institutionalized, protest actions of the miners could

¹⁷ On the 1993 miners' strike see: Stephen Crowley: *Hot coal, cold steel*, Ann Arbor 1997, pp.173–181; Vadim Borisov: *Zabastovka kak forma aktivnosti trudyashchikhsya v period provedeniya ekonomicheskikh reform (na primere zabastovki v Donbasse, 1–20 iyunya 1993 g.)*, Moscow 1993 (www.csv.warwick.ac.uk/fac/soc/complabstuds – article1.doc)

¹⁸ On the strategies of the trade unions see: Boris Dodonov: *Can trade unions protect Ukrainian miners' rights?*, RFE/RL (Un)Civil Societies 04 September 2002 (www.rferl.org); Kerstin Zimmer: *The captured region. Actors and institutions in the Ukrainian Donbass*, in: Melanie Tatur (ed.): *The making of regions*, vol.2, Wiesbaden 2004, pp.231–348, here: pp.296–307 and 317–320.

be instrumentalized by other actors with better access to central decision makers and the capacity to act unilaterally. These actors, namely enterprise directors and regional political elites, in many cases tried to use the political pressure created by the miners to promote their own interests.

3.2 Directors of coal enterprises

In the Ukrainian coal industry it was the main interest of most enterprise directors to increase state subsidies to their enterprise. Workers' protests could effectively be used for that purpose. In many cases additional government funds did not reach the miners but were embezzled by the management.¹⁹

As a report to the World Bank stated: The state support system "functions in the mode of total support for the coal industry as a vehicle for addressing urgent problems at individual mines or clearance of back wages or payment for the delivery of coal to the power sector. The arbitrary allocation of funds, the absence of control, and chronic underfinancing are typical of this system. As a result, the state support system is becoming a disincentive to increased efficiency of mine operations, fostering a parasitic attitude in the managers."²⁰ Counting on the state support system the management of coal enterprises often tried to extend a conflict with workers beyond the enterprise in order to move it onto the political stage. Instead of admitting its own responsibility for wage arrears, the management could blame the political leadership. This strategy has often worked, forcing the central government to accept the responsibility and to transfer more funds to the enterprise.

However, when protest actions escalated, seriously hurting operation of coal enterprises, and proved unable to impress the central government, enterprise directors turned against striking miners. When the central government started to isolate radical miners and to incorporate the moderate PRUP in the mid-1990s, the central government and the Donetsk regional administration encouraged enterprise directors to follow the same strategy. As a result coal enterprise directors repeatedly brought striking miners to court. At some enterprises strike leaders and NPG leaders were put under pressure.

Though the central government had the power to appoint and dismiss the directors of coal enterprises, it has never been able to establish full control over their activities. First, – as mentioned above – enterprise directors engaged in asset stripping activities which deprived the owner, i.e. the state, of considerable income. Second, many directors in fact boycotted the integration of their enterprises into state-controlled holdings.

¹⁹ Kateryna Fonkich: Rent Seeking and Interest Groups under Institutions of Transition: The Case of Ukraine, paper to the International Conference on Institutions in Transition, Slovenia, 22–24 June 2000, pp.29–32. In 2002 about 1 300 cases of embezzlement were uncovered in the coal industry. The loss for the industry amounted to 4.7 mn USD. Out of 507 convicted persons 123 were managers of coal enterprises. (Den' 17 January 2003)

²⁰ Center for Economic Development, Coal Consulting Center, Donetsk Analytical Center: The major problems of development of the coal sector and the Donbass region, Concise report, draft version, Kiev 2003 (www.worldbank.org), p.10.

3.3 Industrial coal consumers

The power sector and ferrous metallurgy account for about three quarters of Ukraine's coal consumption. Accordingly enterprises from these sectors try to influence developments in the coal industry. Since the power sector buys cheaper steam coal whereas ferrous metallurgy relies on higher-quality coking coal, the coal markets for these two sectors are rather separated.

In the early 1990s there were more than 1 000 coal traders active in Ukraine. These intermediaries in fact took over the function of Soviet state planning organs, organising coal deliveries from producers to consumers. Since these traders often made considerable profits and in addition sometimes engaged in embezzlements in collaboration with the management of coal enterprises, the state as well as coal consumers tried to get rid of these traders. As a result most of them disappeared until the mid-1990s. The cash-strapped market for steam coal was to a large degree taken over by a state company and the market for coking coal was divided between five major traders, four of which were controlled by industrial holdings owning coke plants. At the end of the 1990s the market share of independent coal traders had gone down to less than 5%.²¹

Because of their desperate financial situation power generating companies were first of all interested in continued coal supplies despite of accumulating payables to the coal industry. Moreover, the state-run enterprise Energorynok operated a centralized payment system for coal supplied to the power sector. Accordingly power generating companies had only very limited relationships with coal producers. One result of this situation was that coal supplied to thermoelectric power stations was often of dubious quality.²² As a result of the poor financial situation of the power sector, closer cooperation with the coal industry has remained an exception. Only two cases are of relevance: In 2000 companies reportedly close to the holding Industrial Union of Donbas, which cooperates with a number of coal mines, acquired three power stations in the Donbas region and received a license for electricity distribution.²³ In 2003 the West Ukrainian electricity producer Zapadenergo merged with the coal company Lvivugol in order to improve coal supplies.²⁴

Cooperation between coal producers and consumers has been much closer in the coke coal market. Since 1998 major industrial holdings have tried to increase vertical integration along the line coal-coke-metal. (see table 3-2). These holdings provided credits to coal enterprises for mining equipment. The mining equipment was often provided by these companies and sold at extremely high prices. As a result the coal enterprises are heavily indebted to the trading companies. This financial dependence is used to purchase coal at preferential prices. In cases of resistance from coal enterprises bankruptcy procedures are initiated. As a result these traders and the industrial holdings to which they belong have considerable influence on coal mines without actually owning any

²¹ InvestGazeta 19 November 2002, p.12; Vlast I Politika 31 January 2003 (Interview with energy minister Serhiy Yermilov).

²² V. Gaiduk: Razvitie toplivno-energeticheskogo kompleksa Ukrainy kak osnovy ee ekonomichskoi bezopasnosti, in: Ekonomika Ukrainy 5/2001, pp.4-7, here: p.6; Zerkalo Nedeli 14 December 2002.

²³ Oleg Bogatov: Recent Developments in the Donbass' Coal Industry, analysis for the University of Sunderland, Kiev 2001 (<http://www.sunderland.ac.uk/~os0hva/bog.htm>)

²⁴ NewsBase Energo 16 April 2003 (www.newsbase.com).

stake in them. In many cases they have installed a new management at coal mines they cooperate with.²⁵

All these industrial holdings as major coal consumers have an interest in state subsidies to the coal industry, since these state subsidies considerably reduce the price they have to pay for coal deliveries. Cheap coal supplies are an important contribution to the competitiveness of Ukrainian metal producers on world markets. At the same time these holdings have only a very limited interest in acquiring stakes in coal mines. This would reduce the likelihood of state subsidies, since the holdings are financially potent, and it would burden the holdings with responsibility for the social and environmental problems of the coal industry. Accordingly these industrial holdings want to acquire only the most attractive coal mines and gain influence over the coal industry first of all through the indirect means of credit agreements for equipment supplies.²⁶

Table 3-2: Major industrial holdings with an interest in the coal industry (as of 2003)

Holding (headquarter)	Coal mines	Traders in coking coal	Coke plants	Metallurgical plants
ARS (Donetsk)	Komsomolets Donbas mine	ARS	Avdeevsky KKhZ Donetskkoks Zaporozhkoks Kharkovsky KKhZ	Strategic partnership with System Capital Management
Industrial Union of Donbas (Donetsk)	None	Donetsk Industrial Union	Alshevsky KKhZ	3 steel mills 2 pipe plants
Kontsern Energo (Donetsk)	Krasno- armeiskaya- Zapadnaya mine 2 Russian coal mines	Kontsern Energo	Yasinovsky KKhZ	Donetskstal'
Privatbank (Dnipropetrovsk)	none	None	Bagleikoks Dneprokoks Dneprodzer- zhinsky KKhZ	4 still mills
System Capital Management (Donetsk)	None	Danko Strategic partner- ship with Embrol	Markokhim Strategic partnership with ARS	Stakes in 6 metallurgical plants

Sources: InvestGazeta: Top 100, Kiev 2003 (leaflet "Finansovo-promyshlennie gruppy Ukrainy"); InvestGazeta 22.10.2002, pp.12–13 (on coke plants); InvestGazeta 26.11.2002, p.13 + Delovaya stolitsa 28.7.2003, p.8 (on Kontsern Energo).

²⁵ Institute for Economic Research and Policy Consulting: Price distortions in the Ukrainian coal sector and how to overcome them, Policy Advice Paper O21, Kiev 2001 (www.ier.kiev.ua), pp.10–12; InvestGazeta 19.11.2002, p.12; Oleg Bogatov: Recent Developments in the Donbass' Coal Industry, analysis for the University of Sunderland, Kiev 2001 (<http://www.sunderland.ac.uk/~os0hva/bog.htm>).

²⁶ A concise analysis of this strategy is given in: InvestGazeta 13 May 2003, p.13.

Since the industrial holdings active in the coal/coke chemical industry are all situated in the Donetsk region, they have first of all developed contacts with the regional administration. When the regional political elite gained representation at the national level in 1993/94 and again in 2002, these holdings, too, were able to promote their representatives to national political decision-making bodies.²⁷

From 1992 to 1994 it was first of all Kontsern Energo, at that time still a coal trading company, which had good political connections at the regional level. In the second half of the 1990s other holdings became more influential in Donetsk regional politics, namely the Industrial Union of Donbas (ISD) and – since 2000 – System Capital Management (SKM). In the coal industry these two holdings cooperate with ARS, like Kontsern Energo a coal trading company of the early 1990s which later acquired stakes in coke plants. ARS provides coke for the metallurgical plants of SKM. Leading members of SKM are represented at the board of directors of ARS companies. The head of ARS, Igor' Gumenyuk, calls the owner of SKM, Rinat Akhmetov, his "best and closest friend".²⁸ In 2000 ARS and ISD united their plants producing coal mining equipment in the commonly managed holding Ukrglemash. The new holding became the leading provider of equipment to Ukrainian coal mines. SKM and ISD are coordinating their activities in the metallurgical industry and co-own some metallurgical plants.²⁹

When Viktor Yanukovich became governor of Donetsk in 1997, the regional administration started to promote the interests of ISD (and later SKM as well). The result was a close symbiosis between political and business elites. When Yanukovich was appointed prime minister in late 2002, the interests of the Donetsk industrial holdings gained representation at the national level.

3.4 Regional administrations

There are only three regions with relevant coal production in Ukraine: Donetsk (accounting for more than 50% of Ukraine's coal production), Luhansk (more than 25%) and Dnipropetrovsk (more than 10%).³⁰ Nevertheless, the coal industry is not dominating the economies of these regions, having a share in regional GDP of about 15% in Luhansk, 10% in Donetsk and less than 5% in Dnipropetrovsk. However, the regional relevance of the coal industry is also defined by its role for other parts of the regional economy. Whereas Donetsk and Luhansk are centres of heavy industry, the regional economy of Dnipropetrovsk is dominated by machine-building enterprises. As a result, the coal industry is of very limited relevance for the economy of Dnipropetrovsk and its lobby has been unable to gain influence. In Donetsk, however, the metal industry domi-

²⁷ See the following section on the role of the regional administration.

²⁸ Interview in *Donetskiye Novosti* 19 December 2002.

²⁹ For portraits of these holdings see: Kerstin Zimmer: *The captured region. Actors and institutions in the Ukrainian Donbas*, in: Melanie Tatur (ed.): *The making of regions*, vol.2, Wiesbaden 2004, pp.231–348, here: pp.270–272; *InvestGazeta* 19 November 2002, pp.12–13 (on ARS), 26 November 2000, p.13 (on Kontsern Energo), 25 March 2003, pp.12–13 (on SKM); Oleg Bogatov: *Recent Developments in the Donbas' Coal Industry*, analysis for the University of Sunderland, Kiev 2001 (<http://www.sunderland.ac.uk/~os0hva/bog.htm>).

³⁰ See table 2.

nates, contributing 30% to the region's GDP. Accordingly coal is an important factor in the regional economy. A similar situation can be found in Luhansk.³¹

That means the only regions of Ukraine with a political interest in the coal industry are Donetsk and Luhansk. Since Donetsk is the by far more powerful region, producing 20% of Ukraine's industrial output and 50% of its coal output compared to 7% and 25% respectively in the case of Luhansk, Donetsk has dominated regional representation of the coal industry in national politics and has also gained considerable influence over the heavy industry of Luhansk.

As a result of the miners' strikes of the late Soviet period the directors of coal and metal enterprises (so-called red directors) had risen to political power and dominated regional politics in Donetsk. When Ukraine became independent in 1992, they were trying to get far reaching political autonomy from the centre. One result was, that responsibility for the Ukrainian coal industry was in fact transferred to the Donbas. The State Coal Committee was located in Donetsk and staffed with former coal enterprise directors. In 1993 the political elites of Donetsk cooperated with the miners' unions in order to pursue their political and economic interests. After the mass strike in the coal industry Yukhym Zvyahilsky, at that time mayor of Donetsk and a former director of one of the biggest Donetsk mines, became prime minister.

When Leonid Kuchma won the presidential elections in July 1994 the so-called Donbas clan was pushed out by the regional elite from Kuchma's home base Dnipropetrovsk. In Donetsk the fall of Zvyahilsky brought a new group of businessmen to political power. A member of this group, Vladimir Shcherban', became governor of Donetsk in 1994. However, due to internal power struggles and the conflict with the Dnipropetrovsk elite this group was not able to consolidate power. Accordingly the Donetsk regional elite was unable to influence national politics. In late 1996 Shcherban was dismissed by President Kuchma and replaced with coal minister Yuri Polyakov, a close associate of Lazarenko.³² With that the Donetsk regional elites had even lost power at the regional level and the coal industry was no longer represented in politics.³³

In 1997, when Lazarenko was sacked as prime minister, Viktor Yanukovich was appointed as successor of Polyakov. Yanukovich, who had a good working relationship with Kuchma, succeeded in ending the power struggle with the elites from Dnipropetrovsk. He was also able to end the conflicts within the regional political and business elites of Donetsk. On the side of the business elites red directors – among them coal enterprise directors – as well as traders lost influence in regional politics to the newly

³¹ For economic profiles of these regions see: Evgen Kachan (ed.): *Rozmishchennya produktivnikh sil Ukraini*, Kiev 2002. On the Donetsk coal industry see: A.I. Amosha et.al.: *Analiticheskaya zapiska o rabote ugol'noi promyshlennosti Donetskoi oblasti v 2002 godu i perspektivakh ee raboty v 2003 godu*, Donetsk 2003.

³² It has to be noted here, that the political pressure exercised by the centre had only become possible after Kuchma had attained the right to appoint and dismiss regional governors, who had under his predecessor, president Leonid Kravchuk, been chosen as result of regional elections.

³³ On the political role of the Donetsk regional elite 1994–96 see: Kerstin Zimmer: *The captured region. Actors and institutions in the Ukrainian Donbas*, in: Melanie Tatur (ed.): *The making of regions*, vol.2, Opladen 2004, pp.231–348, here: pp. 270–272 and 274–294; Oleg Varfolomeyev: *Rival Clans mix Business, Politics, and Murder*, in: *Transition* 04 April 1997.

emerging industrial holdings. As a result the regional political elites of Donetsk promoted the integration of coal mines into these holdings.

Accordingly, the regional administration of Donetsk accepted the need for restructuring of the coal industry. Only the most promising mines, i.e. those of interest to the industrial holdings, should receive state support. This position implied that the remaining coal mines would be closed down. According to the concept of the Donetsk regional administration, the state should organize the sale of coal to industrial customers, ensuring stable supplies with the help of long-term agreements and low prices for coal through subsidies.³⁴ As a consequence of this new concept and also of the new cooperation with the central government the regional administration of Donetsk no longer supported miners' strikes.

In 1999 Yanukovich together with the regional industrial holdings was able to organize strong political support for Kuchma in the presidential elections. As a result Kuchma gained a third of the Donetsk votes in the first round and a majority in the second round, an unexpectedly strong result in a region thought to be a communist stronghold. This success, in a region where about 10% of the Ukrainian electorate live, helped Yanukovich to gain access to national politics. Since 1999 he was a member of advisory councils to the president and the central government.

In 2001 the Party of Regions was founded in Donetsk, in fact representing the region's political elites. In the 2002 parliamentary elections this party, which had joined the pro-presidential bloc "For a United Ukraine", was able to gain 37 seats in the national parliament (equal to 8% of the deputies) because of its strong performance in Donetsk. The rise of the Donetsk elites in national politics continued, when Yanukovich was appointed prime minister in November 2002.³⁵ With that the Donetsk elite was again represented in the central government. However, as the Donetsk elite was closer to the industrial holdings it did not represent the coal industry lobby as did the first "Donbas government" in 1993/94.³⁶

3.5 Central government

Concerning their ideas for the coal industry Ukraine's political actors can roughly be divided into two camps. The first camp wants to continue with a policy of muddling through, opposing any drastic restructuring of the industry and advocating large subsi-

³⁴ For official versions of this strategy see: L.V. Baisarov et.al.: *Privlechenie investitsii v ugol'nyu promyshlennost' Ukrainy. Sostoyanie, problemy i puti resheniya*, Kiev 2002, pp.24–27 [The book was edited by Yanukovich, who at that time still was governor of the Donetsk region. The authors include A.V. Korzun a high ranking state official at the energy ministry, who had earlier worked at a Donetsk coal mine and S.V. Yanko a former coal minister who had made his career in the Donetsk coal industry.] V.F. Yanukovich: *Ugol'naya promyshlennost' v sisteme rzhnochnykh preobrazovaniy bazovykh otraslei regiona*, in: *Ugol' Ukrainy* 6/1999, pp.3–6 [Yanukovich was at that time governor of the Donetsk region] and more detailed V. Grinev, A. Vovchenko: *Ugol'naya otrasl' Donetskoï oblasti na puti k rynochnym otnosheniyam*, in: *Ekonomika Ukrainy* 8/1999, pp.79–81 [Vovchenko was at that time head of the department for the coal and energy industry at the regional administration of Donetsk].

³⁵ His deputy Anatoly Bliznyuk became his successor as governor of Donetsk.

³⁶ On the political role of the Donetsk regional elite since 1997 see: Kerstin Zimmer: *The captured region. Actors and institutions in the Ukrainian Donbas*, in: Melanie Tatur (ed.): *The making of regions*, vol.2, Wiesbaden 2004, pp.231–348, here: pp.272–273.

dies. The second camp demands a market-oriented restructuring of the coal industry, which should lead to a considerable downsizing of the sector and with that of state subsidies to the sector.

Opponents of market-oriented restructuring have two core arguments. First, downsizing of the coal industry causes considerable social problems. These problems burden the state with costs and can cause social unrest. Especially in the first half of the 1990s it was feared that protests of coal miners would promote separatist movements in the pro-Russian eastern part of Ukraine. Second, coal is of strategic importance for Ukraine. Reducing domestic coal production will increase dependence on Russia, which provides most of Ukraine's oil and gas. Accordingly the conversion of gas-fired thermal power stations to coal is being advocated.

Proponents of market-oriented restructuring concentrate on three main points. First, they assert, that the central government does not have the financial means to support the coal industry under the present conditions, as is indicated among others by wage arrears and the poor state of mining equipment. Second, they believe that market-oriented restructuring will ensure stable coal supplies in the long run and thus contribute to Ukraine's social stability and energy security. In addition it is sometimes pointed out that energy saving measures could be used to reduce the dependence on Russian energy supplies.

In the central government direct responsibility for the coal industry rests with the energy ministry (in 1992–94 the State Committee for the Coal Industry and in 1994–99 the Ministry for the Coal Industry). However, some further state agencies have an interest in the coal industry. The work of the coal and the energy ministry, respectively, is coordinated by a deputy prime minister with responsibility for the energy sector. In addition the finance ministry is responsible for the state budget, which includes state subsidies to the coal industry. The industry or economic ministry can deal with the coal industry as part of its overall economic policy programme. The State Property Fund is responsible for the privatization of coal industry enterprises. All these state agencies with responsibility for the coal industry are formally subordinated to the prime minister. The prime minister in turn is heavily dependent on the president, who can appoint and dismiss the government. In addition a number of important measures related to the coal industry, like the amount of subsidies to the coal industry included in the annual budget, have to be confirmed by parliament.

In fact, however, decisions on coal industry reform were always taken within the central government. Here the energy ministry (and before 2000 the coal ministry) was of central relevance. But the final decision lay with the prime minister, who most of the time actively dealt with coal industry reform. President Kuchma has made it clear, that he considers coal industry reform to be a matter of the government and the prime minister personally. Accordingly the president himself did not engage in coal industry reform. The parliament was in most cases circumvented by the government. The restructuring of the coal industry was based on governmental decrees. State subsidies to the industry, which had to be approved by parliament as part of the annual state budget, were in most years not paid out in line with the budget provisions but according to bureaucratic decisions by the government. As a result the formal political decision on coal industry reform was the outcome of a power struggle within the executive.

In the 1990s the coal ministry was a stronghold of the Donbas-based coal lobby. All six coal ministers had made their career in the Donbas coal industry, five in Donetsk and one in Luhansk. All but one had in the late 1980s reached the position of a director. Three of them had been working in the state administration responsible for the coal industry of Soviet Ukraine. As a result the coal ministry favoured continued state subsidies for the sector and opposed market-oriented restructuring. When opposition to this policy became stronger within the government, “arranging barter trades and bombarding the finance ministry and Cabinet with requests for additional investment funds and production subsidies became the main occupation of the coal ministry.”³⁷ In the 1990s the deputy prime ministers with responsibility for the coal industry did not have real influence on related government policies. Accordingly the influence of the coal lobby, as represented in the coal ministry, was dependent on the prime minister.

Table 3-3: Ministers and deputy prime ministers with responsibility for the coal industry 1992–2004

Committee Head/Minister	Deputy prime minister
Mykola Surgai (July 1990 – Nov. 1994)	Oleh Slepichev (Dec. 1991 – Nov. 1992)
	Vasil' Yevtukhov (Nov. 1992 – July 1994)
Viktor Poltavets (Nov. 1994 – Dec. 1995)	Anatoly Dyuba (July 1994 – June 1995)
Serhiy Polyakov (Dec. 1995 – July 1996)	Vasil' Yevtukhov (July 1995 – July 1996)
Yury Rusantsov (Sept. 1996 – July 1997)	Vasil' Durdinets (June 1996 – July 1997)
Stanislav Yanko (Sept. 1997 – June 1998)	Anatoly Holubchenko (Aug. 1997 – Jan. 1999)
Serhiy Tulub (June 1998 – June 2000)	Volodymyr Kuratchenko (Jan. 1999 – July 1999)
	Anatoly Kinakh (Aug. 1999 – Dec. 1999)
Serhiy Yermilov (July 2000 – Feb. 2001)	Yulia Tymoshenko (Dec. 1999 – Jan. 2001)
Stanislav Stashevsky (Feb. 2001 – Nov. 2001)	Oleh Dubyna (Jan. 2001 – Dec. 2002)
Vitaly Hayduk (Nov. 2001 – Dec. 2002)	
Serhiy Yermilov (Dec. 2002 – March 2004)	Vitaly Hayduk (Dec. 2002 – Dec. 2003)
Serhiy Tulub (March 2004 – Dec. 2004)	Andrij Kljuev (Dec. 2003 – Dec. 2004)

Source: Khto e khto v Ukrainy, Kiev 1997, 2001 and 2003.

When regional elites of Donetsk were appointed to the central government in the wake of the miners' strike of summer 1993, the post of prime minister was given to a member of the coal lobby. As a result subsidies to the coal industry were doubled and a government programme for the coal industry was adopted, which saw the coal industry as main area for state investment and economic development.

When Leonid Kuchma became president in 1994, he started to push the Donetsk elites out of the central government. Instead of the Donetsk elites, who represented coal mining and heavy industry, Kuchma favoured elites from his home region of Dnipropetrovsk, who represented machine building and especially the arms industry.

³⁷ Laszlo Lovei: Coal industry restructuring in Ukraine, Viewpoint No.170 (Dec. 1998), p.5 (www.worldbank.org).

In order to increase control over the coal industry, the responsible state committee was transformed into a Kiev-based ministry. The coal ministry was assigned the task to draft a market-oriented restructuring programme for the industry. In order to gain support for this programme within the government, negotiations with the World Bank were started. The World Bank offered considerable financial support and at the same time external pressure could be used as an excuse for adoption and implementation of the programme. In 1995 state subsidies to the coal industry were reduced by three quarters compared to the previous year. In 1996 the government agreed on a market-oriented restructuring programme for the coal industry.³⁸

However, the programme met stiff resistance from the coal lobby. Within the government the coal ministry heavily criticized the programme. Its position was supported by miners' strikes as well as by coal enterprise directors and the Donbas regional elites, who did everything to block implementation of the programme. As a result the restructuring programme was watered down and was only partly implemented. State subsidies to the coal industry rose considerably in 1996 and 1997, though they did not reach the level of 1993/94.

Another real reform effort was started in early 2000 after Viktor Yushchenko had been appointed prime minister. Energy reform became a prime task of the government. In order to weaken the coal lobby, the coal ministry was incorporated into the energy ministry. As a result the minister with responsibility for the coal industry was no longer a member of the coal lobby. The three energy ministers who have been in charge from summer 2000 until the end of 2003 had no links to the coal industry prior to their appointment. In addition one deputy prime minister became responsible solely for energy policies. Accordingly this deputy prime minister has exerted a heavy influence on the government's policy in this area.³⁹

As a result of reform efforts by the central government the amount of arrears and barter arrangements in the energy sector was considerably reduced. Social infrastructure was transferred from coal enterprises to municipalities on a larger scale. Two mines were privatized. State subsidies to the sector were further reduced. Negotiations with the World Bank about a new loan for coal industry restructuring were started. However, opposition to the government's reforms was rising. When Yulia Tymoshenko was sacked as deputy prime minister with responsibility for the energy sector in January 2001 she blamed the coal lobby for her dismissal.⁴⁰ Four months later prime minister Yushchenko was dismissed, too.

The succeeding government of Anatoly Kinakh immediately stopped negotiations about a World Bank loan for coal industry reform. Instead it started to work out a programme of increased state support for the development of the coal industry until 2010.⁴¹ How-

³⁸ See the following part for a more detailed analysis of the role of the World Bank. See table 3 on state subsidies to the sector.

³⁹ Table 7 gives an overview of Ukraine's coal ministers and the deputy prime ministers responsible for the energy sector. Biographical information was taken from *Khto e khto v Ukrainy*, Kiev 2001 and 2003.

⁴⁰ Anders Aslund: *Why has Ukraine returned to economic growth?*, IER Working Paper No.15 (www.ier.kiev.ua), p.8.

⁴¹ Programme "Ukrains'ke vuhillya" ("Ukrainian coal"), adopted by the Cabinet of Ministers on 19 September 2001.

ever, it was unable to provide finance for this ambitious programme. Accordingly, the central government adopted a policy of muddling through. Neither did it implement market-oriented reforms nor did it provide the financial support necessary to maintain an unreformed coal industry.⁴²

At the same time the Donetsk regional elites, who had gained strength under governor Yanukovich, entered the central government. Of relevance for the coal industry was the appointment of Vitaly Hayduk as energy minister in November 2001.⁴³ Hayduk has made his career in the regional administration of Donetsk and – as a co-founder of the Industrial Union of Donbas – he is close to the Donetsk industrial holdings and their interests in the coal industry.⁴⁴ In December 2002 the governor of Donetsk, Viktor Yanukovich, was appointed as prime minister. At the same time Hayduk was promoted to the position of deputy prime minister with responsibility for the energy sector. With that the regional elites from Donetsk became responsible for Ukraine's policy of coal industry restructuring. When Hayduk was sacked in December 2003 he was replaced by Andriy Kljuev, who had before been responsible for the coal industry in the Donetsk regional administration. In spring 2004 Serhiy Tulub, who had lobbied for the coal industry against Yushchenko's reforms was again made energy minister.

Though people from Donetsk dominate the government's energy policy, they do not represent the coal lobby as much as the interests of the Donetsk industrial holdings. That means the government is first of all interested in cheap and stable supplies to industrial coal consumers. As a result the central government under Yanukovich is willing to close some mines and to partly privatize others. Partial privatization of coal enterprises is likely to transfer control to industrial holdings, if they decide take part in the privatization auctions. As part of its efforts to keep coal prices low the government is increasing control over coal enterprises in order to reduce rent-seeking. The intention to close mines has allowed for negotiations with the World Bank. However, reluctance to liberalize has made an agreement impossible. The government has instead chosen to increase state subsidies to the coal industry in order to keep coal prices low.⁴⁵

3.6 World Bank

Due to its commitment to market-oriented reforms the World Bank was only willing and able to support a drastic restructuring of the coal industry but not the policy of permanent state support, preferred by the Ukrainian coal lobby. Accordingly, negotiations about World Bank support for coal industry restructuring could only start, when representatives of the coal lobby had lost influence. This was the case in summer 1994, when the "Donbas government" was replaced after Kuchma had won the presidential elections. For those political forces aiming at coal industry reform World Bank support was of vital importance. First, the World Bank promised to provide substantial funding to

⁴² Whereas the government programme for the coal industry foresaw 6 bn UAH in state support to the coal industry in 2002, the state budget provided 2.8 bn UAH for the industry.

⁴³ Hayduk had already served as first deputy energy minister from January 2000 to March 2001.

⁴⁴ Taras Kuzio: Ukraine begins looking to the post-Kuchma era, RFE/RL Newline 08 January 2002. For biographical information on Hayduk see Khto e khto v Ukrainy, Kiev 2003. On the Donetsk industrial holdings see part 2.3.

⁴⁵ According to the state budget subsidies to the coal industry will amount to 510 mn USD in 2003 compared to annual subsidies of 350 mn USD in the preceding years.

mitigate the social and environmental consequences of mine closures. Second, the World Bank could be used as a scapegoat for unpopular reform measures, i.e. the restructuring of the domestic coal industry could be blamed on pressure from international financial organizations.

In early 1995 the World Bank started negotiations with Ukraine about a coal industry sector adjustment loan (Coal SECAL). The World Bank conducted extensive research on the Ukrainian coal industry and developed a comprehensive project for reforms.⁴⁶ The resulting report provided the government with an alternative source of policy advice thus undermining the position of the coal lobby. At the same time the UK Know-How Fund provided direct advice and assistance to the Ministry for the Coal Industry. As Swain summarizes: “In these ways the World Bank was able to enlist support for the reforms from a small number of key people within the Ukrainian government and at the same time prepare medium ranking officials in the coal ministry for their implementation before confronting more hostile interests.”⁴⁷

In May 1996 the World Bank agreed to the “coal pilot project loan” of 15.8 mn USD, which provided finance for the closure of three unprofitable mines. In December 1996 the coal SECAL, worth 300 mn USD to be disbursed in two equal tranches, was finalized. The corresponding agreement between the World Bank and the Ukrainian government included a number of conditions to be met prior to the release of the second tranche in mid-1997.

In the following years implementation of the programme encountered a number of obstacles. These obstacles were mainly due to three key problems. First, the central government had been able to take the formal decision on coal industry restructuring. But implementation of the programme demanded the support of other key actors, namely regional administrations, coal enterprise directors and workers. It took the central government considerable efforts and time to deal with these actors. Second, the central government was not fully committed to coal industry restructuring as designed by the World Bank. Instead coal industry reform was used as a pretext to weaken the regional elites of Donetsk. In addition the central government needed financial means to pay wage arrears in the coal industry. It seems that part of the World Bank loan, meant for mine closures, was misused to reduce wage arrears.⁴⁸ Third, realization of the coal industry reform programme encountered a number of organizational and technical problems.⁴⁹

⁴⁶ The resulting report was later published: World Bank: Ukraine. Coal industry restructuring sector report, Report No. 15056-UA, Washington 1996 (www.worldbank.org).

⁴⁷ Adam Swain: Institutions and regional development. Evidence from Hungary and Ukraine, Sussex European Institute Working Paper 28 (1998), p.20.

⁴⁸ In early 2000 the Ukrainian Accounting Chamber accused the finance ministry of mismanagement of the World Bank coal SECAL loan. The latter denied the charges. (Ukraine Investment News Weekly 7 March 2000) In November 2000 Yuliya Tymoshenko, at that time Ukrainian deputy prime minister with responsibility for the energy sector, stated that the funds provided by the World Bank „were used ineffectively, or sometimes simply stolen.“ (Eastern Economist Daily 22 November 2000).

⁴⁹ For a brief summary of the main organizational and technical problems see: Adam Swain: Institutions and regional development. Evidence from Hungary and Ukraine, Sussex European Institute Working Paper 28 (1998), pp.21–25.

As a result of these problems implementation of the coal industry reform project was delayed and the original plan was substantially altered. In mid-1997, when disbursement of the second tranche was due, only three of the eight conditions set out in the agreement on the loan had been fully met. As a result the World Bank decided in 1998 to divide the second tranche into four parts. Thus it became possible to react to smaller improvements with the disbursement of parts of the second tranche. Some of the original conditions were completely dropped, others were softened.⁵⁰ Negotiations about a third World Bank loan to the Ukrainian coal industry, 100 mn USD for the “coal mining improvement project”, did not lead to agreement.

The coal pilot project and the coal SECAL were finished in 2000. The World Bank assessed the outcome of both projects as “satisfactory”: “The three mines in the Pilot Project were efficiently closed, with care taken to fully implement the agreed environmental mitigation measures. During implementation of the SECAL, more than 70 coal mines were closed (through the end of 2000) and the worst of the social consequences of the mine closure program were mitigated.”⁵¹

However, the World Bank conceded that “the SECAL was unsuccessful in its efforts to establish a mechanism for maintaining the social infrastructure that had previously been the responsibility of the closed mines. Nor was it successful in supporting the creation of a sufficiency of new long-term employment opportunities.” And even more importantly, “political conditions have led the government to step back from its commitment to a sector restructuring program. Thus the new sector policies leave in doubt the long-term sustainability of the sector restructuring program.”⁵² Accordingly, no agreement on a new World Bank loan to support coal industry restructuring was reached.⁵³

Only in 2003, when the Ukrainian government developed the new restructuring programme, did the World Bank start another effort to support coal industry restructuring in Ukraine. It commissioned a report on the state of the sector to Ukrainian experts.⁵⁴ On the basis of this report the World Bank published a note in spring 2003, laying out its “vision for advancing coal sector restructuring”. The World Bank focused on four key issues: governance in the coal sector, coal pricing, state subsidies, social and environmental impacts.⁵⁵

Whereas in 1995 the World Bank had reached agreement with the central government and then presented the programme to other actors involved, in 2003 the World Bank tried to win the support of all crucial actors involved before agreeing on a programme.

⁵⁰ World Bank: Project performance assessment report. Ukraine. Coal pilot project and coal sector adjustment loan, Washington 2002 (www.worldbank.org), pp.4–5.

⁵¹ *ibid.*, p.1 (memorandum).

⁵² *ibid.*, pp.1–2.

⁵³ In early 2001 there had been negotiations with the government of Viktor Yushchenko on a 100 mn USD loan to mitigate consequences of coal industry reform. However, after the government was replaced in spring 2001, the new cabinet, led by Anatoliy Kinakh, refused to continue talks on the project.

⁵⁴ The report was published: Center for Economic Development, Coal Consulting Center, Donetsk Analytical Center: The major problems of development of the coal sector and the Donbass region, Concise report, draft version, Kiev 2003 (www.worldbank.org).

⁵⁵ World Bank: The coal sector and mining communities of Ukraine. Advancing restructuring to the benefit of all, Washington 2003 (www.worldbank.org), quote: p.2.

In summer 2003 the World Bank organized a number of round tables, discussing its suggestions for coal industry restructuring. World Bank specialists from the Kiev office and from Washington met with officials of the regional administrations of Donetsk and Luhansk, the local administrations of coal mining towns, the management of coal enterprises, representatives of trade unions and representatives of the mining communities. Only after that did the World Bank prepare proposals for a possible new programme, which were then discussed with the central government.⁵⁶ However, an agreement could not be reached before the presidential elections of October 2004.

4. Conclusion

As has been laid out in the introduction, this study has the aim to add the focus of political economy to the present debate about coal industry restructuring in Ukraine. This aim is based on the assessment that whereas the economic side of coal industry restructuring in Ukraine has been well studied and sound concepts are available, the political side of the problem has so far been neglected in academic analysis. This conclusion tries to present a full picture of the political economy of coal industry restructuring. It consists of two parts. First the interaction between the relevant actors on the political scene – as it has developed since Ukrainian independence in 1992 – is analysed. Thus the rules of policy making for coal industry restructuring can be described. Second, based on the logic of these rules an outlook is given, presenting three scenarios for the future of coal industry restructuring in Ukraine.

4.1 Interaction of relevant actors 1992–2004

Directly after Ukrainian independence in 1992 the central government did not intervene in the coal industry. The organizational structure of the industry remained unchanged and was supervised by a state committee controlled by the lobby of coal enterprise directors. However, as a result of the general economic crisis state subsidies were limited and the economic situation of the coal industry deteriorated rapidly.

In this situation all relevant coal industry actors demanded increased state support. Accordingly the miners' strike of summer 1993 was supported by coal enterprise directors and the regional administration of Donetsk. The strike promoted regional elites from Donetsk to the central government and allowed them to determine the national policy on coal industry issues. The result was increased state support to avoid restructuring. During this period state subsidies to the coal industry amounted to nearly 4% of the country's GDP.

In 1995/96 after the new president Leonid Kuchma had implemented his team in the central government, an attempt was made at market-oriented restructuring. For this attempt support from the World Bank was gained. State subsidies to the coal industry were drastically reduced and the organizational structure of the industry was reformed.

The reform attempt met with heavy resistance from all other relevant actors. Like in 1993 miners' strikes were supported by coal enterprise directors and the regional administration of Donetsk. However, due to differing ideas about the nature of state sup-

⁵⁶ World Bank press release 29 July 2003 (www.worldbank.org.ua).

port and due to a low degree of organization these actors were unable to form a stable coalition. At the same time the central government was in a much stronger position than in 1993. First, separatist tendencies in Eastern Ukraine – which in the eyes of many observers had made the miners' protests of 1993 a threat to national security – were no longer on the agenda. Second, the president had assumed the power to appoint and dismiss regional governors. Third, regional elites from Dnipropetrovsk had consolidated their control over the central government and pursued a consistent strategy, among others aimed at pushing Donetsk elites out of power.

Thus the central government was able to neutralize the regional administration of Donetsk by appointing candidates loyal to the prime minister and the president. The central government was also able to weaken the miners' protests by incorporating one of their major unions. However, miners continued to protest and coal enterprise directors, profiting from the power struggles, were able to act rather autonomously. The result was a stalemate. Donetsk regional actors were unable to gain control over the central government and the central government was unable to force through its policy of market-oriented coal industry restructuring. Reforms were watered down and a policy of muddling through was adopted.

For the coal industry the reform government of prime minister Viktor Yushchenko marked a short interim period which did not leave a lasting impact. The financial situation of the coal industry improved somewhat – as much as a result of general economic growth as of reform attempts aimed at improved financials of the power sector, a major consumer of coal. However, the organizational structure of the coal industry remained unchanged, because the government was sacked before further reforms could be implemented.

With that two other developments became more important for the coal industry than political concepts. First, a new group of actors, major coal consumers united in Donetsk industrial holdings, developed an interest in the coal industry in the late 1990s and was able to win the support of the regional administration of Donetsk. Second, the political elites from Donetsk returned to the central government.

Since the regional elites from Donetsk now represent the interests of industrial holdings more than those of the coal industry, they are interested in reforms aimed at cheap and stable coal supplies to industrial consumers. But they do not support a full restructuring as suggested by the World Bank.

Based on this assessment of the political coalitions shaping Ukraine's policy toward the coal industry, their support base and means of influence, scenarios of the future development of coal industry restructuring in Ukraine will be developed in the following concluding part.

4.2 Outlook

Summarizing the second part of this working paper, we can state that the Ukrainian coal industry is still in crisis, though the situation of the industry has improved somewhat during the last years. Most coal mines still operate at loss, are in urgent need of modernization and have accumulated heavy debts. This clearly indicates that the government's policy of limited state subsidization without real restructuring efforts is not sustainable in the long run. Looking at the prospects of the coal industry from a political

economy point of view, three medium term scenarios for the development of the coal industry can be distinguished:

Scenario 1: Renewed crisis

The Ukrainian government is clearly not able to finance the necessary modernization of the coal industry. According to the government's own estimate current state subsidies to the industry are less than half of the sum actually needed. That means as long as the coal industry is unable to find alternative sources of finance, its decline will continue. Under such a scenario the net debt position of coal enterprises will continue to rise. Production, which has stabilized at around 80 mn tons in recent years, might decline again, going down to 70 mn tons over the next years. The insolvency of coal enterprises would lead to a further worsening of the safety situation of mines and of the social and environmental situation of mining towns.

This scenario 1 will materialize if the government neglects the coal industry or will not be able to act as a result of power struggles. Scenario 1 would emerge if rivaling factions within the government, would block each other, leaving the government unable to implement any policy for the coal industry or if a reform-minded president would confront opposition from parliament – or after constitutional reform – from an independent-minded government.

Scenario 2: Muddling through

Being aware of the financial problems, the government could try to implement limited reforms with support from the World Bank. Such reforms include market-oriented elements like the closure of inefficient mines, partial privatization and measures to fight rent-seeking in the coal industry (while at the same time favouring rent-seeking by industrial holdings). Such reforms also include state intervention in price setting, including heavy state subsidies, to keep coal prices low.

If the World Bank agrees to financially support this policy of limited reforms, the chances of the central government to realize such coal industry reforms are much higher than they were in 1996. First, the new reform plan is much more moderate than the one adopted in 1996. Accordingly it can be presented as a compromise. Second, the miners' unions and other political forces opposed to reform have already been weakened.

Accordingly the government should have a fair chance to carry out such a coal industry reform programme, if it decides to do so. However, such a reform is unlikely to lead to a lasting recovery of the coal industry due to its half-hearted character. As a result key actors may be disappointed and withdraw their support. The neglectance of price liberalization and the lack of consequent downsizing of the industry would make another reform effort necessary. The result would be a classical case of muddling through. Those coal enterprises de facto integrated into industrial holdings would remain stable, the others would face insolvency. Social and environmental consequences would be partly mitigated with the help of a World Bank loan. There would be no funds available for a thorough modernization of coal mines.

In order to avoid a return to a full-fledged crisis, the Ukrainian government would always be dependent on World Bank support. This is a considerable risk. First, the World Bank may push for more radical reforms, withdrawing support for a long-term strategy of muddling through. Second, government officials may be tempted to misuse World

Bank funds. This, too, would most likely force the World Bank to end support for coal industry restructuring. In summary, scenario 2 does not offer a sustainable long-term perspective for the Ukrainian coal industry.

Scenario 3: Successful restructuring

Radical restructuring of the Ukrainian coal industry would be the best solution in economic terms. In a market-oriented restructuring process unprofitable mines would be closed, the labour force would be reduced and production in the remaining enterprises would be modernized. The result would be a considerably smaller coal industry able to operate without state support. Such a solution would not only gain support from the World Bank but would also attract private investment on a larger scale. Under such a scenario the worst social and environmental problems could be mitigated as part of a World Bank programme. Private investment would help to stabilize coal production at a sustainable level. State subsidies to the coal industry could gradually phase out.

This scenario can only materialize if the national government is fully committed to market oriented reforms. However, even a government fully committed to successful restructuring of the coal industry will face considerable obstacles. As the experience with the prior reform efforts has shown, balancing the differing interests of relevant actors would be the main challenge for the central government during the implementation of radical coal industry restructuring. Three groups are especially likely to deny support. First, the regional elites from Donetsk would oppose market-oriented restructuring because it reduces their possibilities for rent-seeking. Second, the directors of those coal enterprises threatened with bankruptcy in a market environment are likely to fight in order to keep their enterprises going. Third, when the government speeds up the process of mine closures, discontent among miners may again force PRUP, the moderate miners' union, to support strikes.

This means in order to realize scenario 3, i.e. to implement a radical market-oriented restructuring programme for the Ukrainian coal industry, a central government would be necessary which not only fully committed to these reforms but also able to win over or neutralize important interest groups opposing such reforms. Accordingly this scenario seems to be highly unlikely. However, it should be noted that in a situation similar to the Ukrainian one, Russia has rather swiftly implemented a radical coal industry restructuring programme in the last years. The Russian case clearly demonstrates that even in a post-Soviet environment a committed state executive, i.e. a national government supported by the president, is able to realize radical restructuring in a short period.

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