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The Rule of Law and Corporate Actors

Podcast with Dr. Dmytro Vovk

About the oligarchic economy, the privatized state, as well as the importance of the consensus of political elites for the transition from a model built on privileges to a model built on the rule of law, respect for property, and judicial independence.

The Rule of Law in the Oligarchic Economy

Olena Uvarova:

Hello! Our today's podcast guest is Mr. Dmytro Vovk, Director of the Rule of Law and Religion Research Centre at the Yaroslav Mudryi National Law University, a person who studies, teaches and consults on the issues of rule of law in Eastern Europe and the post-Soviet area. And my first question to Mr. Vovk is: What comes to your mind when you hear about the rule of law and business?

Dmytro Vovk:

There is a classic aspect, which is that government regulation of businesses is an element of how we measure the rule of law, how we assess its prevalence in a country. For instance, authorization procedures, ease of licensing, business regulation efficiency, and so on. All these are taken into account when we say whether the rule of law is upheld in a given country or not. Meanwhile, there is another aspect, which I believe to be more important for understanding what exactly the rule of law is and when it arises. The problem is that a country may have a prevalent business model, a certain economic system that may be more or less compatible with the rule of law. For example, we do know that Ukrainian economy is often called 'oligarchic' in the sense that it's not just very large businesses we've got here, but very large businesses having a huge political influence and converting this political influence into extra revenues, privileges or benefits. Such a system is poorly compatible with the rule of law, because the actors, whose business models are largely built around close relations with the government, are far less interested in the rule of law to be in place. While in Poland, for example, economic power is much more dispersed, no business so large can be



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controlled single-handedly, like in case of Rinat Akhmetov prior to the full-scale war, controlling one-third of the country's GDP and a half of foreign currency revenues. They have no such thing in Poland. So, their system is much more likely to accept the rule of law as part of political system. It's very interesting. When you compare the top 10 richest Poles and Ukrainians in 2021, you'll see that the richest person in Poland in 2021 was worth about \$4.5 billion, while the richest Ukrainian, Rinat Akhmetov, was \$10 billion worth. The tenth place for Poland is around \$500 million, but for Ukraine it's nearly \$1 billion. This is despite the fact that Polish economy is seven times larger. And of course, these are completely different businesses, regimes, economic systems, so the extent of their exposure to the rule of law is different too.

Policy-making, corruption and business

Olena Uvarova:

Thanks a lot. So, my next question in this respect is how to measure the impact of businesses on the rule of law. I mean what indicators can be used to make such measurements? Of course, there are official ways for business to influence decision-making on the government level, and our Western colleagues study lobbying institutes or official methods of communicating businesses' opinions on certain issues to legislators or to the European Commission. But in our context, what indicators can we use to tell how much businesses influence government decision-making?

Dmytro Vovk:

It's a rather complex question. Firstly, I guess, it's obvious that the level of corruption in the economy is such an indicator. I mean, the higher the economic corruption is, the worse the situation is with the rule of law and the more likely such a corrupt regime is to be exploited by both businesses and authorities to gain some profit, and by businesses to also reduce their expenses. But then I'd say that we probably should still draw upon this local context here. The rule of law is not just about the economy. The economy is a major component explaining why the rule of law in a certain country is also related to policy-making and, perhaps, primarily to specific policies, culture, religion, history and so on. So, once again, getting back to large businesses, we have a case of so-called chaebols in Korea. Once again, large conglomerates that were key engines for Korean development, or all these zaibatsu, huge corporations that were drivers of economic growth in Japan. They all had corruption issues, especially similar entities in South Korea and in the Philippines, but apparently the whole thing worked much better in Korea and Japan and the problem of corruption, albeit still present, was much smaller. So, we have to stick to some local context. And I guess that here in Ukraine, it's the combination of a quite heavily corrupted political system with large corporate businesses that is exactly what we call oligarchic economy. It's what creates this case of undue influence, not just an influence of businesses on the economy, but this phenomenon of economic corruption, the so-called privatized state. So, a possible sign indicating that Ukraine has a more established framework for sustainable development of the rule of law would be dispersal of businesses, that is, dispersal of economic power.

The transition from the privilege-based model to the rule of law

Olena Uvarova:

But how to make sure this dispersal takes place when it's clear that neither the government nor businesses are interested in it? They've merged together and mostly function as a single mechanism. Then who can be the power that changes the situation?

Dmytro Vovk:

Globally, no one. I mean, we have to admit in general that transition to the rule of law will be extremely hard in this situation. But if we look at some studies, then there is a known work *Violence and Social Orders* by Douglass North, which shows that the rule of law is a precondition for transition to an open-type society. It's a more or less constitutional democracy with a market economy, and this transition to the rule of law may take thirty to fifty years, depending on the case. Perhaps, it can happen faster today, but it's a pretty much random process in the sense that it's a long process of building various political coalitions that comprise the actors willing to promote the rule of law. Those can be quite different actors, like businesses, and politicians, and civil society, and even some external powers, which is relevant in our case, because we have donors providing assistance here, and if they all can make up some powerful coalition, if there is this synergy, then, maybe, it will let us transit to the rule of law. But my point is that we have to switch from the privilege-based model to a model based on the rule of law, respect for property, independence of justice, having no consensus within the political elite. But transition to the rule of law won't happen without such a consensus.

Another matter is that all the stakeholders can encourage each other to promote this transition. For instance, our external partners, our donors, can encourage the political elite through various mechanisms to reach such a consensus. Civil society can put pressure on politicians too, so that politicians are more interested in promoting the required reforms, the required changes in the political system to achieve the rule of law. But let's be honest, this transition for the most part is still quite random. You may look at the post-Communist history of Eastern Europe to see that the trajectories are basically quite different. We can compare the experience of Poland that has established the rule of law rather quickly and efficiently, but now there is a certain rollback, related to these liberal trends. We can mention Hungary where the situation differs greatly towards authoritarian rule. We can mention Romania or Bulgaria where the corruption problem is bigger and the economy is less efficient, with fewer achievements in the area of law, and so on. There are countless possible variations, actually.

Olena Uvarova:

By the way, I have this hypothesis, not yet verified though, that a business can have a rather serious political influence, causing certain economic disparity inside the country with all the consequences. But at the same time, in terms of human rights, this influence comes along with not using forced labour, child labour, creating rather safe working conditions, non-discrimination, and so on and so forth. Basically, it can even be a model of best practices. How much do you think this hypothesis is plausible in the Ukrainian context? I mean, when we have a powerful political influence and this influence causes social disparity, but at the same time, in terms of criteria we use today to assess the effect on human rights, this business is respectable.

Dmytro Vovk:

It kind of makes sense, but I still think that it's, to some extent, linked to the Western business. When we take non-Western businesses, say, big Chinese companies or big Indian companies entering some countries in Africa, then they obviously don't care too much about human rights issues and there are basically no complaints even about the political regime as a whole. It's like, "Just don't eat people, then we can keep working with you." So, basically, they're more or less bound to the frameworks set by local governments. Still, the rule of law remains a state-driven category in the sense that it's harder for Western companies if a government sets a framework where human rights can be ignored. But there will always be players ready to take that risk and we

know all those stories about Apple using, let's say, not quite voluntary labour in China and things like that. That's one thing.

Here's another thing. It still seems to me that there is a structure of sorts, I mean, if a business generates disparity by, say, paying extremely low wages while making extremely high profits because a government has created such opportunities, then no progress in the human rights area can compensate that, let alone some severe violations like forced labour. But introduction of equality policies, for instance, ensuring women are promoted to certain higher positions and so on — all of that is useful and necessary. But nonetheless, all of that exists only where businesses are socially responsible and social disparity isn't much of an issue. When people are gaining extremely low wages, then all those various policies will have extremely little effect on them. This is an important issue. Mr. Fukuyama writes in his book about identities that we have switched this “left-wing discourse” towards discussions about various identities and protecting the right to be ourselves, and it's important. But imagine a situation when basic social needs aren't met, when people earn very little, when the average wage, say, in Ukraine is four to five hundred dollars, but there are companies here able to make enormous profits while paying fairly low wages. Discussing identities in a situation like that seems a bit too early to me.

The “Business case” for the Rule of Law?

Olena Uvarova:

Thank you. Extending the question about the powers that can change that. We often hear about small and medium-sized businesses joining efforts. Can some associations of small and medium-sized businesses be such a power, and can we see them as actors interested in the rule of law?

Dmytro Vovk:

Firstly, I don't think any business in principle is an inherent supporter of the rule of law in the sense that a business a priori, by definition, is interested in the rule of law. Businesses will operate in any environment, under any regime. Another thing is that business climate will be unfavourable overall, for instance, when a regime is deeply corrupt, the economy will be inefficient and stuff, but there always will be players willing to enter and work in given circumstances. What's more important, I guess, is a situation when there are multiple competing groups, like small and medium-sized businesses united in a variety of associations, as well as big companies competing with one another and unable to turn the country into some joint stock company where they have a share or, say, a majority stake, so they can influence decision-making while politicians can exploit this system to engage in corruption for their own profit. When you have such a system of a constant competition in place, then the interest in having some rules of the game followed by everyone will definitely grow. In fact, it's a classical transition to the rule of law that took place in Great Britain in the 18th century. When there is no such competition, then the motivation to create rule of law mechanisms will naturally be much lower.

We can actually draw a certain parallel with political pluralism here because, let's be honest, no political regime created by any of Ukrainian presidents was much interested in democracy, competitive elections or pluralism. And we can see that competitive elections in different periods had an extremely low level of competition. Just compare later Kuchma or Yanukovich with Poroshenko or Zelenskyy. But it's clear that here in Ukraine, we have a situation where there is political diversity, real political pluralism, real competing groups (I won't evaluate how they have contributed to corruption and stuff right now), but that's a fact that these groups never formed a

single hierarchy like, say, in Russia or in Georgia or in Central Asian countries. That's basically a market of political offers. Even with the fake ones, with politicians deceiving their voters, it still creates powerful incentives to preserve democracy. Once you take away one, the other is gone. The same goes for the rule of law.

Olena Uvarova:

Speaking about Central Asia, it was literally today when I heard that their governments intensified control over corruption in business specifically. So, they are creating new control mechanisms, and here in Ukraine, we basically do the same: if we take a look at the policies most prevalent among businesses, especially state-owned businesses, including through government influence, those are corruption prevention policies. Do you think the not-to-bribe tactics work for businesses? Do they have any effect on corruption reduction?

Dmytro Vovk:

The short answer is no or hardly. The detailed answer would be rather complex. There was a Nobel economist who once said that the only thing worse than an inefficient corrupt state is an inefficient non-corrupt state. It's a joke, of course, but only partially, because really, in the short run, especially from an individual business's standpoint, corruption in a situation where public administration is inefficient is just an alternative way to achieve some business goals. When you need to import some highly demanded goods and you can't do so because the customs office is blocking them, it's easier for you to give a bribe just to keep production or trade running. At the same time, it's obvious that corruption has a very strong and a very negative impact on the economy in the long run. Once again, let's take Ukraine and Poland. It's a complex story. Of course, they were supported by the European Union and all that. But there is a striking contrast, a striking difference between the two economies that started from roughly equal size in early 1990s.

So, answering the question if you can make people refrain from bribery by paying high wages to public officials and so on, it really depends on the type of corruption you have in your county, because there can be different types of corruption, like creating artificial market restraints. For instance, by introducing some extra permits for businesses or creating situations where it's impossible to obtain a permit. It can be solved rather simply, by cancelling all those permits. Yes, just by automating certain processes so that businesses don't find themselves in situations where they need to give a bribe. There can also be so-called corruption based on public policy distortion, when the government intends to achieve some positive outcome, but it's distorted due to this corruption component. Say, you stimulate green energy production. And then you buy it really expensive using budget funds. So, the purpose is basically good, to implement some environmental initiatives, but the corruption component screws it all up. So, basically, here we have the type of corruption that can be addressed rather effectively through various corruption prevention agencies. For instance, by initiating criminal proceedings, by amending legislation and so on. But there can be even worse regimes.

Like, there can be political corruption, when a country is de facto privatized and works for the benefit of specific individuals at every level of power instead of public interest, and those individuals have links with certain economic actors, so the state is basically defined as a network of family relations, with certain clans or groups in place, which construct power verticals and those power verticals are simply siphoning resources. It's their core characteristic. I mean, they do carry out some management functions, but the main purpose is gaining economic resources using corruption and similar tools.

Interestingly, it's pretty much the reality of Ukrainian history after its independence. Such a state quickly starts dumping various functions that are not related to gaining these resources or benefits. Like social functions, when it shifts the burden of education on citizens, meaning it's formally free, but you have to buy your own textbooks, to buy presents for your teachers or to do something else. The same goes for healthcare, when it's formally free as well, but the only thing that is actually free is a horrible hospital building. You need to go there, and then you need to pay a doctor, because he earns a meager wage, to pay for medicines and so on. There are even more extreme options. Such as predatory corruption, when public authorities and influential political actors use force and violence to take all the assets, all the economic resources for themselves and other members of the ruling group, which is the case, for example, for Islam Karimov's Uzbekistan or Turkmenistan or similar regimes. So, when we talk about political corruption, about predatory corruption, then, obviously, creation of NABU, NACP, HACC, all this alphabet soup of agencies, it doesn't help much. I mean, it does have some effect. We can see a certain effect from NABU's activities, but I think that we're still moving towards political corruption, and nothing ever really changes at large. I mean, in order to succeed in a serious fight against corruption in a situation of predatory or political corruption, the whole political system needs to be changed, and that's the job for politicians, not some abstract NABU agents.

Now about refraining from giving bribes. It's more of a romantic Kantian story about starting with yourself. But I think that in the area of business, when there is political corruption, only IKEA or McDonald's can afford that, because they are like entering some 137th market. Yes, it's important, but not really. Secondly, they themselves are great global powers that can afford certain behaviour by default. But if you're an average entrepreneur who needs to carry out a certain economic operation, like investing money or getting a refund, you can just end up losing your business with this kind of strategy. This reminds me of a situation with delaying travel passport issuance in Ukraine. It was a long-time story when they nearly legalized a de-facto corruptive payment of 200 hryvnias that wasn't provided for in any law. You had two options: either you pay and get your passport done in two months or you don't pay and then spend years in lawsuits. You won't get your passport anyway, because when you bring them the court order, they would just say "we have to receive this payment anyway, it's written in some regulation." And you keep going circles. Can we demand from a person to be a hero and spend years trying to obtain a travel passport when he or she needs to go to Poland for work in a month? No, we can't. Expecting this is an absolute, unjustified romanticism. Here is the same thing. Fighting corruption is a phenomenon associated with public authority. Corruption means using public authority for private purposes. It's exactly the public authority that is subject to changes in this situation, or some influential political actors, but not an individual who has to bribe a police officer, a doctor or a business. Besides, this situation is not about household corruption. It's an important issue, but not the main one. The main focus should be on political corruption, fighting corruption within the government machine, and economic corruption that impacts doing business.

Corporate power and its impact on legal systems

Olena Uvarova:

You mentioned big transnational companies. What about their corporate power and the entire phenomenon of transnational companies? Because it's a kind of a landmark thing for the concept of business and human rights that has its effect on legal systems.

Dmytro Vovk:

It's an interesting question too, because we know all these dystopian novels or movies where a company's power can escalate into a state-like power and companies eventually become quasi-states. Basically, it's a remake of the West India Company in a futuristic setting. Creating this phenomenon of an enormous corporation that becomes a public authority by itself. It's an exaggeration, of course, because today's transnational companies are still following the rules set by local governments, for the most part, even in non-key countries of the world. We can recall an example of YouTube trying to reconcile with the Turkish Government about some content. In other words, YouTube, the corporation able to cut off the entire global information flow, and Turkey, an important country, but not so much of a big player, but they made YouTube (I don't really remember how it ended) enter into negotiations on this matter. By the way, we can see the same in businesses that keep operating in Russia or the ones having taken so long to leave Russia: it shows that their governments have certain instruments in place that can have a significant effect on transnational companies' decisions.

Of course, on the other hand, especially when it comes to Western transnational companies, they also can greatly affect national political regimes, when political elites are more or less interested in that. Once again, an example of Uzbekistan we've mentioned. The new President of Uzbekistan after Islam Karimov's death, Shavkat Mirziyoyev, came to office declaring reforms. He came as a leader willing to reform the country and open it to the world. I suspect, for purely economic reasons. To increase foreign investments into the country, increase the presence of Western businesses, and it requires better relations with Western countries. Uzbekistan has changed its system quite a lot, especially in terms of respect for human rights. Because, for instance, they had this Jaslyk Prison back in Islam's times, well-known to human rights activists, where they kept political dissidents and those labelled by the government as religious extremists. Apparently, torture was widespread there, up to reports about people being boiled to death. And they shut that prison down. I don't know if this example is good enough, but even apart from that prison, Uzbekistan has really made several big steps towards improving the situation with human rights, and their motivation as far as I see was mostly and primarily economy-related. But that doesn't really work for the transnational companies that come from outside the West, because they can be much more tolerant to such things and they even might be interesting in the current regime being maintained, because it might be better for their business model. That's one thing.

Another thing is that, of course, it's less economic and, perhaps, more constitutional thing for transnational corporations. Especially when we talk about information-related businesses (Facebook, YouTube, TikTok) that can actually introduce what is called pluralization of legal system, because when you look at the Facebook standards regarding freedom of speech, you'll see that these standards are quite different from those enacted by the First Amendment to the U.S. Constitution, meaning they treat the freedom of speech in a more restrictive manner than the U.S. Supreme Court does. The impact of social media is so strong now that having no access to social media, when you're engaged in content creation, can be a key factor making it impossible for you to share your content and fulfil yourself as an artist, a content creator, a political journalist, a politician or anything. This raises the question: what to do in this situation? Are government regulations really working? Of course, a person can still go to court. But how many people of those using Facebook when creating some content or any other information will actually go to court? I think a few per cent, maybe, but most people won't. It means that the rules set by Facebook will actually be binding for those people, and not the regulations established by their governments.

Another template example is how large businesses make use of the situation when they basically forcibly transfer their customers to ADR — alternative dispute resolution. When a Ukrainian signs a contract when buying an iPhone, an insurance or anything, such a contract or a user agreement you agree with has fine print according to which all the disputes shall be resolved by an arbitration court located, let's say, in Pryluky, Chernihiv region. And, of course, if you live, say, in Kharkiv or Lviv, you'll hardly want to go to Pryluky to take legal action in that arbitration court only because you're not satisfied with service. Plus you'll need to check if that court really exists. And the same goes for everything else. This situation raises another question: to what extent do state regulations on access to justice actually work?

Lastly, one more thing, mostly futuristic. Apparently, there's going to be more of these transnational business that can possibly contribute to collapse of the state in its current form, as we know it. That's why there is a futuristic scenario that the world will actually change from 200 countries to about 600 regions or even cities that will be basically independent political entities. Because the economic links concentrated in those cities or those regions inside each country will differ significantly from each other. In fact, it might just be inconvenient for those entities to stay in the same zone. It's not a story for the nearest future and maybe it will never actually happen. Because we can see, for example, one of the lessons learned from this Russo-Ukrainian war is that states are getting stronger and that states are actually needed because such an existential threat can arise, and only a state is capable to address it. Even supported by civil society, even when people are greatly involved, we still need some public authority structure that will be responsible for national security. But scenarios that are being considered, figuratively speaking, for the next 100 years, take into account that changes of economic models, economy transformations, may lead to reconfiguration of political actors in the world.

Olena Uvarova:

Thank you. Well, on this futuristic note, I'd like to conclude today's conversation. You gave us a lot to think about. Thank you for joining our podcast.

Dmytro Vovk:

Thanks for the invitation.