

The European Union: Stability Despite Challenges*

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Abstract: *The European Union has remained stable despite all its past and current challenges. This essay explores the reasons for that. We argue that the secret behind its stability lies in its system of negotiation. Against this backdrop, we analyse two recent challenges of the European Union. First, we show how domestically bound European governments were able to bring about a stable internationally negotiated solution for what became known as euro crisis. By means of game theory we boil down why the European Union remained stable even after havoc struck. Second, we analyze the dynamics behind the failed negotiations with Ukraine that have led to the current conflict. Thereby, the role of vested interest in negotiations for stability is emphasized. We prognosticate that due to the very same vested interests that led to the failure of the negotiations, Ukraine will remain united and return to stability in the mid-term. Finally, we conclude that, despite challenges like these, the European Union never experienced a crisis in terms of system theory since it never fell short to fulfil its purpose which is to allow for peaceful cooperative solutions.*

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1. What would be a crisis?

Recent economic and political developments within the eurozone became known as the ‘euro crisis’ in media and academia. As a matter of fact, this titling rather leads astray. A glance at the history of the European Union reveals that it was nearly permanently subject to challenges of similar or maybe greater severity such as the Empty Chair Crisis, the British rebate, the wars in Bosnia and Kosovo or the failure of the constitution of Europe to name but a few.

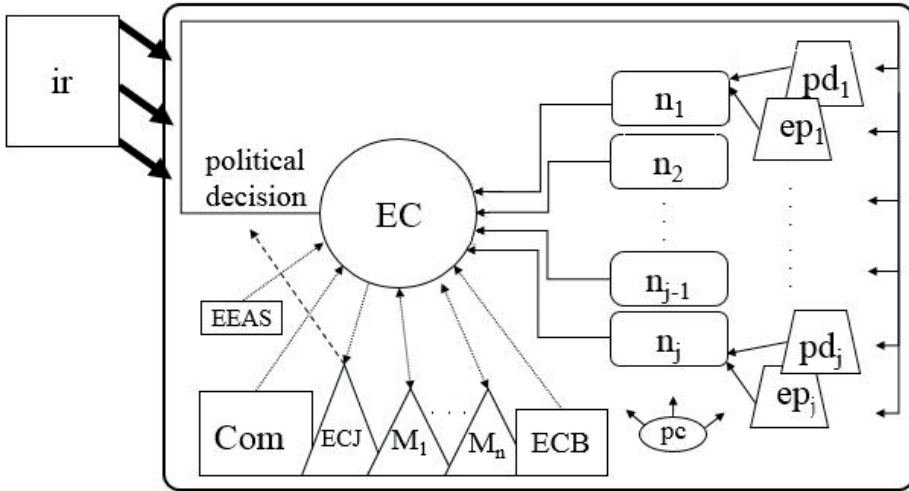
Besides, it is doubtful whether such challenges were ‘crises’ for the European Union as a system in the first place. Science must not borrow the vague use of the word ‘crisis’ from the newspapers as a more timely and sensational synonym for ‘problem’ or ‘challenge’. Due to a lack of a serious definition, empirical patterns are being used to fit to self-made indicators. To sort out this problem it proves to be useful to look at system theory. According to German system theorist Luhmann (1995), a system would be defined by a boundary between itself and its environment. The interior of the system would be a zone of reduced complexity, whereby the criterion of ‘purpose’ would serve as a differentiator. A system *crisis* would occur whenever the system would not be able to fulfil its purpose anymore.

But what is the purpose of a system? The purpose of biological systems is to survive. After a crisis they are dead. But what about political ones? When is a political system dead? Is the European Union dead? According to all the crisis believers this would have to be the case. But it is not. The European Union is a negotiated system for further negotiation (Bolle & Draeger, 2013). Thus, its purpose is to allow for peaceful cooperation to settle conflicts. Despite all trouble, the European Union never got off this track that turned out to be a path to success. Our claim is that the secret behind its stability lies in its system of negotiation. In this respect, the matter of our paper is twofold. First, we will theoretically examine what constitutes this very system. Second, we will apply the outlined analytical framework to a homemade challenge, namely the ‘euro crisis’, and an external one, namely the recent turmoil in Ukraine. While the latter challenge is in all probability about to be mastered, the first has been already overcome as we will show.

2. Why there were no crises

The secret of the European Union's survivability lies in its system of negotiation. The following section (Bolle & Kanthak, 2013) examines this very system. In its core it is characterized by negotiations between its Member States (n_1, \dots, n_j) that take place in a special institutional setting that is by itself the outcome of past negotiations. At the same time, they are engaged in international relations (ir), whereby some foreign relations are intended to go beyond external cooperation in the long term. In this regard, the Eastern Partnership is of particular importance. Within the EU negotiations take place in a specific institutional setting that is by itself the outcome of past negotiations. These institutions (in general, M_1, \dots, M_n) operate as "constraints that structure political, economic and social interaction" (North, 1991, p. 97). These constraints can take different forms, such as the general rules and procedures prescribed by the treaties or the more specific outputs of the political system of the European Union, which is shaped by different voting procedures in the Council (*EC*) and input from a range of secondary actors such as the Commission (*Com*), the European Central Bank (*ECB*), the European Court of Justice (*ECJ*) or the European External Action Service (*EEAS*). These institutions can be powerful actors in some fields. However, they receive their power from a conditional grant of authority which can be revoked through treaty change. It is thus an agent, the Member States being its principals.

Major institutional reforms of the European Union are still determined by international negotiations in which Member States play the key role and EU supranational organizations are marginalized to subservient roles. Member States' governments are, therefore, the primary actors in the current process of institutional reform. This is, however, not to say that European-level actors do not matter at all. They may inform, attempt to influence, comment on, informally propose or even support these changes. The point is that they are at the sidelines when it comes to actual decision making. The following insert illustrates the afore-outlined.



To understand the process of negotiations properly, one needs to understand the involved actors and their respective priorities, or preferences. Actors behave in a way that they believe is in their own interests. Political actors are first of all interested in remaining in office and therefore need to govern in a way that secures a sufficient support from their electorate, that is, the group(s) that decides about their maintenance. Vested interests can play a decisive role. When *governing* means, as in the EU, the negotiation between several governments who all have to secure the support of different domestic audiences, Putnam's (1988) work on two-level games provides a useful tool for analysis. The international and the domestic level are interlinked. Domestic political decision (pd_1, \dots, pd_j) in general and domestic economic policies (ep_1, \dots, ep_j) in particular. Governments are constrained but also able to take advantage of this setting: They can make strategic use of domestic constraints at the international level and vice versa. Though political consulting (pc) can advocate for efficiency, the rationale of self-serving politicians must not be underestimated. As cooperation at the international level is frequently endangered by the potential gains politicians might derive from defection, finding a way to punish such behaviour in repeated strategic interactions becomes paramount. Therefore, tit-for-tat is the prevailing strategy. This way, concessions are rewarded by cooperative behaviour while defectors can expect to get punished by means of non-cooperation. In certain strategic situations, cooperation can therefore be obtained by adopting a piecemeal approach that trades minor concessions between parties. The political decisions that the EU yields this way are often anything but efficient. But they are highly likely to be part of a self-sustaining political condition since a consensual negotiation solution is needed to implement the respective policies

in the first place. In terms of economics, one call such self-sustaining situations 'Nash equilibria' (Nash, 1950). In politics, a situation like this is distinguished by incentives for all the relevant actors to comply with the rules agreed on.

3. A challenge called 'euro crisis'

With regard to what became known as the euro crisis, the initial design of the European Monetary Union, for instance, had such self-sustaining qualities. Governments of economically competitive countries like Germany were able to take political advantage of a constant account balance surplus and opportunities for investments with high risk-adjusted returns. Governments of less competitive countries such as Greece or Portugal gained access to cheap credits that allowed for generous economic policies that were not advisable in terms of long-term efficiency but too tempting to be declined by democratic leaders who constantly have to struggle for sufficient support. Short-term, all signs were pointing to success. In 2003, Greece was able to register a real GDP growth rate of 5.9 per cent. Germany's account surplus steadily grew from 2 per cent of its GDP in 2002 to 7.4 per cent in 2007. No relevant actor had an incentive to deviate from his strategy. Accordingly, the reforms of the Stability and Growth Pact 2005 actually had a rather symbolic content and did not efficiently eradicate Europe's Soft-Budget-Problem that should later lead to what became known as the euro crisis.

But this state of harmony was soon disrupted by the burst of the U.S. housing bubble in 2007. Banks in Europe were facing severe liquidity problems and became increasingly risk averse. Governments found themselves under high pressure as international markets abruptly blocked the way to the fresh money needed to repay debts. Interest rates for government bonds rocketed upwards. According to OECD data, Greece's long term interest rate was 22.5 per cent on average in 2012. Rescue payments for afflicted savers had to be decided upon to protect national governments from the worst. Fiscal transfers, credit alleviation and bailout funds helped to buy time. The European Central Bank played its part in containing the fire, by announcing of purchasing government bonds of threatened euro countries on secondary markets as of September 6, 2012 within the scope of the OMT programme. Short-term alleviating policies provided space for negotiations about the policies needed for the long-term stability of the eurozone. As such, the ESM was established on September 27, 2012. Additional financial support in the form of financial rescue packages was

attached to economic reforms in the shape of austerity programmes. In April 2013, the sixth reform package was enacted by the Greek government. Without such conditions, the enacted programmes would not have been politically viable in donor countries like Germany, where policy-makers had to find feasible ways in international negotiation to not be engulfed into either the economic or political abyss in their home country. Since the exit option would have been associated with immense costs of unknown extent, a devaluation of national currencies was not possible for obvious reasons and doing nothing would have been political suicide, complying with even severe reforms became the equilibrium choice for policy-makers in countries in trouble.

The relevant dynamics behind the stability of the European Union even in midst of the euro crisis can be boiled down to a complex game-theoretically generalized argument that we will develop in the following. We can assess that no relevant party defected. For instance, the German government approved all the necessary bailout packages while the changing Greek governments complied with the demanded reform programmes even though they were painful. Why is that so? Game theory offers a complex framework where even parties with conflicting interests successfully cooperate in repeated strategic interactions. Consider a two-player game where each player can either *defect* or *cooperate*. If a player chooses to cooperate and his opponent does so as well, both will earn payoff r . If one player chooses to cooperate while his opponent opts to defect, he will earn s while his opponent receives d where $d > r > s$. If both opt to defect, both will earn s . In this set-up, *defect* would be the dominant strategy and *[defect; defect]* the only Nash equilibrium since it is the only situation in which each party could only be worse off by unilaterally deviating. This changes if we infinitely repeat the game—after all, the EU has no expiration date—and factor in how much the players then value the outcomes of future interactions. Therefore δ is introduced as a discount factor where $0 \leq \delta \leq 1$. The closer one player's δ is to zero, the smaller is his net gain from future interactions. Now it becomes relevant which strategies the players utilize. Most of the EU institutions suggest the conclusion that *tit-for-tat* is the prevailing strategy among the actors in the negotiation system. For instance, the financial aid packages were linked to very specific conditions that their recipients had to comply with if they did want to enjoy the benefits of cooperation. If a player chooses *tit-for-tat*, he will always cooperate but punish every opponent's defection with a defection of his own and then only returns to cooperation in case his opponent has refrained from defecting before. If now an actor contemplates to play sneaky (always cooperate and then change to always defect from in round k) he has to weigh if the associated result is profitable for him. If he would always cooperate, as for example two tit-for-

tit-for-tat players would in a match, he would gain $\sum_{t=1}^{\infty} \delta^{t-1} r$. Playing sneaky would earn him $\sum_{t=1}^{k-1} \delta^{t-1} r$ +. A cooperative outcome without defection would then occur if $\sum_{t=1}^{\infty} \delta^{t-1} r > +$. If an actor's δ would equal 1 he would clearly prefer the cooperative solution since $r > s$. But tit-for-tat not only proves to be superior against other strategies. Axelrod (1984) demonstrates the general superiority of the tit-for-tat strategy in a simulated tournament between different strategies with fixed values for δ and s . Obviously, the chances for successful cooperation *decrease* the lower the value of δ and the higher the value of s .

We cannot say much about the *genuine* time preference of the relevant political actors in the European Union. Indeed, political leaders are often not long-lasting in times of severe trouble, as for instance Greece's Prime Minister Pikrammenos, who only served about one month. Nevertheless, the decision speed that the negotiation system required to cope with the financial havoc in 2013, for instance, would even urge political actors with shortest time horizons to cooperate. This way, pressing challenges even stimulate cooperation.

In addition to that, the costs associated with defection (determining s) are often incalculably high in the European Union. This has various reasons. First, markets proved to react swiftly and grimly. Second, the greater the benefits of European integration become for domestic issues, the higher the opportunity costs for ending international cooperation, for example by exiting the European Union (perceivable as constant defection from round k). For instance, defectors would have to cope with the aforementioned market reactions on their own. Third, since the Member States are embedded in the same system of negotiation in different policy matters, the costs of political credibility losses are especially high. To sum up, the European Union fosters governmental cooperation by keeping the costs of defection high and incentivizing to choose long-term solutions. It thereby ensures highest measures of stability even if it is jarred by severe challenges at home.

4. Turmoil in Ukraine

But how is the system of the European Union capable of dealing with *external* crisis? We will answer this question in reference to the recent turmoil in Ukraine. Ukraine and the European Union are linked by the European Neighbourhood policy, namely the Eastern Partnership. As one of its priority partners and potential candidate country in the future, Ukraine is directly embedded in the system of negotiation we look at. In Ukraine civil war-like scenes took place in the aftermath of the Revolution in February 2014 that took place after Ukraine's ex-President Viktor Yanukovych declined the Association Agreement in favour of the 17 December 2013 Ukrainian-Russian action plan. This decision was heavily disputed and sparked heavy protests in Kyiv. Initially, the European Union aimed for a negotiated outcome that would have been mutually preferable in economic terms. The Association Agreement was designed to reduce instability by means of economic and political reforms (Coy *et al.*, 2014). Given the devastating economic situation of Ukraine that is due to decades of Soviet rule, corruption and mismanagement, those reforms would have been needed. The political actors within the EU would have profited by securing their gas and grain imports as well as the new market opportunities (Moskowitz, 2014). Despite all that, the deal was not made. We argue that this was due to powerful vested interests in Ukraine. Influential business tycoons, known as oligarchs, dominate the political system of the Ukraine (e.g., Wilson, 2005; Horn, 2014). After all, the 50 richest people in Ukraine have at their disposal a fortune amounting to 85 per cent of the GDP (Kuzio, 2008). As we show, strong evidence suggests that the oligarchs, on whom rested the power of Yanukovych, must have been earnestly concerned about their profits. But those very profits are also endangered in war-like settings without secured property rights. We prognosticate that this time they will therefore have to play off their power in a way that is beneficial for the country and allows for a stable and peaceful negotiated solution.

The first piece of evidence for that emerges in the comparison of the Deep and Comprehensive Free Trade Agreement of 2011 that was embraced by Yanukovych's clique but rescinded by the European Union in 2012 with the amended offer Yanukovych declined in 2013. What has changed? In 2012, the European Union jumped off due to concerns regarding the rule of law in the country. Hence, incisive political and legal reforms were demanded in the revised offer. Notably, the release of allegedly unjustly convicted Yulia Tymoshenko, a political enemy of Yanukovych, was demanded. But besides that, Ukraine was standing at the crossroads. In August 2013, Putin declared that Russia would

adopt protective measures in case Ukraine signed the agreement (*Ria Novosti*, 2013). To make this threat credible, oligarchs like current President of Ukraine Petro Poroshenko, Dmitry Firtash, or Igor Kolomoisky were made to suffer severe losses by hampering their export business with Russia under different pretexts (Sommerbauer, 2013). Russia's authorities utilized the rules of the political game in Ukraine for their own purposes by threatening, business-wise, the ones who have anyway no genuine interest in reforming the corrupt system that made them wealthy and powerful.

Observation of the inner circle of Yanukovych and the contents of the Ukrainian-Russian action plan reveals the second piece of evidence. The leading oligarchs who backed Yanukovych had close ties with the energy industry or energy-intensive industries, such as metal production. The richest man in Ukraine, Rinat Akhmetov was one of the main financiers of Yanukovych's campaign in 2010 according to the Heinrich Böll Foundation (Savin & Stein, 2010) and served as a Member of Parliament for his party. According to its webpage, Akhmetov's investment company System Capital Management controls over 100 businesses. These businesses dominate the East-Ukrainian steel, coal, transportation and food industry. Another oligarch who was closely linked to Yanukovych is Dmitry Firtash, his well-known friend and political ally, who co-owns RosUkrEnergo, a leading intermediate gas trading company, 50 per cent of which is owned by Gazprom. Also associated with Yanukovych is Andriy Klyuyev. He is the alleged owner of Ukrpidshipnyk, as well as of other companies that mainly build coal mining machinery, and a friend, business partner and a political ally of Yanukovych (e.g., Leshchenko, 2011). From the perspective of these oligarchs, the treaty with Russia involving a decrease of the gas price from over 400 USD per 1.000 cubic metres to 268 USD (Sandford, 2013) was clearly preferable as it would have directly boosted their revenues. All these facts suggest that Yanukovych, himself one of the richest oligarchs, declined the Association Agreement for the sake of his peers and his political sustainability.

But this was the last straw. People took it to the streets. A tripartite alliance between Vitali Klitschko's party UDAR (supported by the German Konrad Adenauer Stiftung), the All-Ukrainian Union 'Fatherland' of later released Yulia Tymoshenko's and Oleh Tyahnybok's party All-Ukrainian Union 'Swoboda' became the driving political force behind the protests. Soon, the limited foreign policy capacities of the European Union became increasingly visible. After visiting the scene in December, condemning the brutality of state security forces and demanding clearance, High Representative of the Union for Foreign Affairs and Security Policy Catherine Ashton played a minor part. In a leaked phone conversation with Yanukovych, U.S. diplomat Victoria Nuland found rather

undiplomatic words to describe those shortcomings: “Fuck the EU!” After all, the EU has got itself a telephone number at Kissinger’s suggestion. But the calls were soon directed to the answering machine. National Foreign Policy came to the fore. For instance, the foreign ministers of Germany, France and Poland put forward an agreement among the relevant actors to end the crisis that was signed the very day Yanukovych fled. Putin seized the moment to annex Crimea, the traditional naval base of Russia’s Black Sea Fleet. He thereby gained approval at home and eliminated the chance to be strategically blackmailed as the then President Yushchenko tried during the 2008 Georgia conflict (Åslund, 2010). Since then the country was shaken by escalating events and civil war-like unrests in its eastern part. To provide security for the eastern EU countries, NATO had to take over. Surveillance flights and military presence were increased in Poland and the Baltic countries.

Propelled by the escalating course of events such as the still not cleared downing of Malaysian Airlines Flight 17, speculations have gone wild about how the conflict will turn out. Commenters and analysts gave warnings of a coming split of the country or even predicted one as in *Forbes* magazine (Hallen, 2014), for instance. The EU with its limited foreign policy capacities has nothing to oppose the vandalizing Pro-Russian separatists. President Obama’s constraint is twofold: While the American constituency is tired of fighting wars, Islamist arch-fundamentalists are trying to fill the power vacuum the U.S. has left behind in Iraq by forcefully setting up a sharia state. And, indeed, the country is divided along ethnical and political lines as the poll turnouts of 2004 suggest.

Despite all that, Ukraine will regain stability in the mid-term and remain united. Our assessment showed that it was the vested interests of the Ukrainian oligarchs that triggered the conflict. Yet, the same vested interests will cause stability again, since instability is also harmful for the oligarchs’ business perspectives. Rinat Akhmetov, a former Yanukovych’s supporter and the richest man in Ukraine, based in Donetsk, is threatened by supporters of the self-appointed People’s Republic of Donetsk to either comply with their demands or face the nationalization of his companies. He changed sides, called the pro-Russian activists’ armed thugs in a video address and called his workers up for strikes and patrols throughout the region (Karatnycky, 2014). His companies employ around 300,000 people. Initiatives like this will play a major role in regaining stability. Thus, civil society will play a distinct role. Across the political camps, oligarchs became companions in fate. As mentioned above, current President Petro Poroshenko is heavily involved with Russia as a businessman. Yet, he proves himself to be a pragmatist with pro-European positions. After all, Europe also bears significant market opportunities for him and his peers. These

intertwined interests make good conditions for a fruitful compromise. At the same time, Putin's ambitions in Ukraine were slowed down by the diminishing economic perspectives in Russia due to sanctions and market responses to the looming instability in the region. The balance of payments and the ruble-dollar exchange rates deteriorated significantly throughout the conflict. Investors became increasingly reluctant. Against this backdrop, it is not surprising that Putin distanced himself more and more from the separatists, even though he cannot back off immediately without suffering from domestic audience costs (Tomz, 2007). Politics by dreadful symbols will continue to accompany the developments at the cost of people suffering. Still, the best prerequisites exist for a peaceful solution that will allow for stability in a united Ukraine.

5. Conclusion

The European Union remains stable due to its system of negotiation. As long as its challenges are internal, the domestically bound national governments within the union will be able to bring about outcomes within the scope of the rules agreed-on that no relevant actor has an incentive to deviate from the choice given to the others. To put it briefly, they constitute a Nash equilibrium. This is due to the opportunity costs of non-cooperation in repeated strategic interactions and the ongoing decision-making process that incentivizes even self-interested politicians with short-time horizons to cooperate when things get rough. This way, even painful but necessary reforms can be implemented. Until stable long-term cooperative outcomes are found, such as the ones that were necessary to cope with the euro challenge, European institutions, such as the ECB, are able to provide short-term relief from market pressure on decision makers by means of provisional help.

Still, as far as external challenges are concerned, as in the case of the Ukraine conflict, the capacities of the European Union are rather limited. Since unanimity is required in common external policy, delicate matters are still mainly approached by national foreign policy. In this regard, the case of Ukraine was no exception. But above all it demonstrates the significance of vested interest within the system of negotiation. In contrast to agreement offered in 2011 which was withdrawn by the EU, the oligarchs rationally had to oppose the revised one under the conditions and circumstances it was at stake in 2013. Regarding the last two attempts, an EU Association Agreement with Ukraine failed because of the EU decision makers' disregard for what was politically rational for the

Ukrainian government. One might draw the conclusion that it is not sufficient to solely focus on the economic, legal and bureaucratic efficiency of an agreement as it also has to be implemented. This is a lesson that is especially important in regard to the Eastern Partnership which, after all, deals with post-Soviet states. Concerning Ukraine, our assessment suggests that in the mid-term a stable solution will be found since the actors who proved to be powerful enough to decide about the nation's fate have no interest in a state of turmoil that would lead to a split of the country.

Given our system theoretical understanding of what a crisis would be constituted of, neither the euro challenge nor the turmoil in Ukraine constitutes a crisis as such for the system of the European Union because a peaceful and stable solution is either already found or is foreseeable, as in the case of the latter. There is reason for hope since it helps to put an end to human sorrow.

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