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Ukraine

Economics and politics of an escalating war

- Debate - Ukraine -

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The costs of the war are mounting. Over one thousand people have been killed, more than three thousand injured, almost a quarter of a million forced to leave their homes. The overwhelming majority of people killed, injured and displaced have been civilians playing no part in the fighting at all. There has been widespread destruction to infrastructure, enterprises, public utilities and homes. The productive economy - that which makes possible the reproduction of human society - is shrinking as a result of the simultaneous contraction of civilian industries and the expansion of the industries supplying the war. Arms and munitions are consumed only by way of their destruction.

The economic decline continues

Prime Minister Yatseniuk predicts that GDP will fall by 6% in 2014, inflation will go up by 19.5% and nominal wages will fall by 6.3%. The rate of unemployment according to the IMF will be between 10 and 15% by year end. These are conservative estimates, but they still represent a further serious decline from an already grave economic position for the great majority of Ukrainian workers, small farmers, students and pensioners. The hryvnia has already devalued by 47% against the US dollar since the start of 2014 (\$1=12.2UAH). The combined impact of devaluation and inflation since the beginning of this year has cut the real income of workers by 50% and of middle class professionals by 30%.

Growth of a siege mentality

War inhibits protest against state policies: "All dissent is treason when the castle is under siege" (St Ignatius Loyola) So what will be the outlet for the inevitable social tensions and grievances generated by the economic crisis? Protest and political struggle or more war? Can there be both war and peace in Ukrainian society at the same time? Not for long. One will inevitably overwhelm the other. The "peaceful" area of Ukraine is increasingly on a war footing that will eventually make a democratic political process there unsustainable.

State budget

The revisions to the 2014 budget that were adopted by the Verkhovna Rada on 31 July were driven principally by the need to increase funding for the war effort. The main changes are as follows:

to increase the budget for the Anti-Terrorist Operation by 18bn UAH, which represents an increase of 28% on the original 2014 defense budget of 63bn UAH. If large scale military operations go on beyond the summer, this requirement will double;

- to introduce a 1.5% war tax on all wages and salaries;
- to cut public services responsible for enforcing standards of environmental protection, quality of medicines, food quality and occupational health and safety,
- ministries will at their own discretion to lay off public sector workers without pay for up to two months in order to

balance their budgets

- to decouple the rates of public sector pay, state pensions and student stipends from index linking to the rate of inflation,
- to freeze the minimum wage and official poverty line,
- to reduce workers' protection against unfair or arbitrary dismissal under the Labour Code,
- to reduce availability of HIV-AIDS treatment,
- to cut support for the resettlement of deported Crimean Tatars.
- to suspend in time of martial law the law on tendering for state contracts to supply the Armed Forces of Ukraine, "other military formations", law enforcement bodies and other institutions responsible for state security
- to increase the rents paid by businesses for oil, gas and iron ore extracted in Ukraine and destined for sale abroad.

These changes to the state budget were pushed through the Rada at the end of a week of high political drama. First, the parliamentary deputies refused to consider an original set of revisions put to them by Yatseniuk's government on 24 July, declaring publicly they would not support an "anti-social" budget. Svoboda and UDAR leaders then announced they were quitting the parliamentary coalition with Bat'kivshchyna that was holding up Yatseniuk's government. Yatseniuk duly resigned, and the country waited for the government to resign in turn, the parliament to be dissolved and new general elections to be called.

This course of events, however, was unacceptable to Poroshenko, because the country would be left without funding for the war while a caretaker government waited for new elections to parliament. Poroshenko persuaded Yatseniuk -or was he colluding with him all along?- to return to the parliament and try again. When a second, renegotiated version of the revisions was published and duly adopted by the Rada on 31 July it turned out the deputies had rejected the original version because it had been unacceptable to their oligarch sponsors, not because it was "anti-social". Though softened a little at the edges the harsh anti-social character of the revisions to the budget remained in place.

The Rada had refused to consider these July 24 revisions because - according to Minister of Finances Oleksandr Shlapak - they would have increased the rents on the extraction of oil and gas in Ukraine that is then exported to levels that were unacceptable to big business. The biggest loser of all would be Ihor Kolomoisky, governor of Dnipropetrovsk. Kolomoisky runs Ukrnafta, the majority shareholder of which is the state. It is highly profitable, and would have remained so even with the increased rents that were tabled on 24 July. But Kolomoisky did not want to be the fall guy. To make his point he closed all the petrol stations he owns in Ukraine for "stock taking".

The July 24 revisions did not increase the rent on extracted iron ore. Its rate had been increased just recently, in March. But iron ore is one of the main businesses of Renat Akhmetov, Kolomoisky's rival. And Akhmetov is viewed widely as a renegade oligarch who hedged his bets and secretly backed the separatist movement. Unlike Kolomoisky, Akhmetov does not control "his" province of Donetsk any more.

So the 31 July version that was voted through increased the rent of iron ore once again - at a cost to Akhmetov, Kostiantyn Zhivago (of Ferrexpo infamy) and ArcelorMittal. It also reduced the planned increase on rents of extracted and exported Ukrainian gas and oil and alternative fuels as a further concession to Kolomoisky. And these changes are to be in effect only until the end of 2014, rather than indefinitely.

Thus the battle over the revised state budget sees the oligarchs vying to relinquish the least of their super profits to finance the war effort. The Left Opposition in Kyiv concludes that "the burden of the war is being put fully on the backs of the workers while big business is quietly accumulating its profits". <http://gaslo.info/?p=5344>

Western support to Kyiv

Nor should it be forgotten that the Ukrainian state is on the verge of insolvency. Without the \$6bn it has received in loans and grants from foreign governments and their multilateral institutions, it could not hope to balance its budget in 2014 and to carry on the war in the east. Thus, the Western powers are in effect financing the Kyiv government's prosecution of the war, in addition to the intelligence, advisors, food provisions, bulletproof vests and night vision equipment they are also providing.

The IMF is prohibited by its own charter from lending to a country at war. Conveniently for the Ukrainian government the Russian government is pretending that it is not making war in Eastern Ukraine. President Poroshenko has taken a cue from Putin by not declaring war on Russia either, even as he dons military fatigues and stresses that the Kyiv government is not engaged in a civil war.

Elections in October

The Verkhovna Rada rejected Yatseniuk's resignation as it voted in the changes to the state budget. Now all the deputies can go to the electorate and say they have taken responsibility for financing the war effort and allowed the government to carry on discharging its functions. They will now prepare for general elections.

The present parliament is widely, if not universally, regarded as unrepresentative of post-Maidan society, inadequate to the tasks the country faces, and discredited by its deputies' association with the old regime.

So the present parliamentary deputies will seek ways to crawl under the wire into the new parliament with the least number of casualties. The election period will be reduced from 60 to 45 days. This for several reasons: officially to save money; unofficially to have elections before the beginning of the heating season - when heating costs go up. Possibly also, Kyiv is anticipating major advances on the battlefield before election day.

There is also talk in Kyiv about parliament backtracking on Poroshenko's election promise to hold the next general elections solely on the basis of proportional representation with open party lists. Doing away with single member constituencies as well as closed party lists reduces the opportunities for the rich buying a seat in parliament, either from local power brokers in the constituencies or from the party bosses/oligarchs.

Now the talk is about staying with the mixed system of one half proportional representation chosen from closed party lists and one half majoritarian election in single member constituencies. This was the system that gave the country the dirtiest, most corrupt election since independence and a parliament in 2012 that relinquished its powers to the presidency and made Yanukovich a near dictator. This system will help retain the status quo - as difficult as that might be. It might also prevent Oleh Liashko, the right wing populist allied to UNA-UNSO, from building a big fraction in the Rada.

There is no talk at all about lowering the 5% threshold for parties to enter the parliament on a proportional representation basis. This was another one of the democratic aspirations of the Maidan being left by the wayside.

The elections will most likely be announced on 24 August, Independence Day, and be held as soon as 12 October.

Elections will not touch the old regime

The old regime is still very much alive in the ministries, regulatory bodies, courts and tax authorities that make up the carcass of the Ukrainian state. Politician - public official - private businessman: this is the holy trinity that fears disruption by the current crisis. Elections could threaten its unity if there was a radical, progressive party - a genuine Workers Party - to contest them. But it has not yet appeared, while the forces of the far right both inside and outside parliament do offer the new/old Ukrainian regime a channel to divert the anger and frustration of the lower classes away from themselves. This is a real danger of the current situation.

Poroshenko escalates war

There is no doubt in my mind that both Poroshenko and Putin want to end the war. Each, however, has his own terms, and these terms are still too far apart for either side to stop fighting now. Many people voted for Poroshenko in May in the hope and expectation that he would enter into negotiations for a peace settlement. Indeed, Poroshenko and Putin both put forward their representatives and negotiations did begin - and are still ongoing even as the fighting escalates.

However, Poroshenko set about strengthening the Ukrainian armed forces in order to apply overwhelming conventional military power over what was still in May a lightly armed guerrilla force of some five thousand men with few seasoned fighters to lead them. Military victories against them would decisively strengthen Kyiv's position in any peace negotiations. That still seems to be the objective of the Ukrainian government as it uses heavy weapons on the ground and in the air, as it orders a second call up to relieve soldiers who have been in the field for four months, and as it expands the military budget.

Putin now builds an army, not an insurgency in Eastern Ukraine

Putin responded to Poroshenko in kind. He is no longer trying to stimulate an insurgency in Eastern Ukraine, which in Putin's original plan was to give birth to an autonomous statelet beholden to Russia. Rather, he is trying to match and surpass Ukrainian heavy weapons with Russian ones and to build an army. Russia has lots of surplus heavy weapons mothballed since the end of the Soviet Union. So, Putin is building up the equipment of a conventional army -armoured personnel carriers, tanks, vehicle mounted missile batteries. For such equipment one needs trained soldiers and specialists, hierarchical command, co-ordination and command centres - an army, not a guerrilla force. Where will this army's soldiers and officers come from? The DNR and LNR? Hardly. Either Putin has lost his bearings or he is planning to station an army under Russian command in Eastern Ukraine.

Putin is not about to back off. He is counting on being the last man standing. As long as he keeps the border open into eastern Ukraine Russia can supply the DNR and LNR forces indefinitely, and indeed build an armed force of considerable firepower. But if it wants to use this firepower to its full potential Putin will have to bring hundreds more, if not thousands of Russian servicemen over the border into Ukraine.

Negotiations, but on whose terms?

According to the Independent on 4 August Germany and Russia are in secret talks about political settlement. The proposals on the table include: the West recognising the annexation of Crimea by Russia; Russia withdrawing from eastern Ukraine; some autonomy for eastern Ukraine; \$1bn payment to Ukraine by Russia for the final lease of

Sevastopol port for its fleet; and gas supplies and gas transit prices to Ukraine guaranteed by Russia. Once again, the Russians and the Germans regard the transnationally mobile oligarchs as the keys to any deal between Ukraine and Russia:

"Central to the negotiations over any new gas deal with Gazprom is understood to be one of Ukraine's wealthiest businessmen, the gas broker, Dmitry Firtash. Mr Firtash - who negotiated the first big gas deal between Ukraine and Russia between 2006 and 2009 - is now living in Vienna fighting extradition charges from the Americans. But he has close relations with the Russian and Ukrainian leaders - he supported Mr Poroschenko - and has been acting as a go-between behind the scenes at the highest levels."

A Ukrainian government facing imminent general elections, insolvency, a deepening economic crisis, massive reconstruction costs in the east, and likely protests from various domestic quarters will have few options of its own: either to negotiate a peace with Russia that recognises the DNR and LNR as legitimate parties to further negotiations, or to carry on fighting them and the Russians.

However, Ukraine's government can match Russia's resources in the long run only with Western support, which will mean relinquishing more of its sovereign policy making power to Western governments and institutions. Which will in turn weaken its domestic and interstate authority.

An erosion of Ukrainian state capacity and authority may in turn force the western powers to become even more directly involved in the war in the east. And it will naturally increase the chances that the big powers - USA, Russia and Germany - will put together a "solution" of their own. Such a pessimistic scenario is brought to mind by the real forces and circumstances that have come together over the past three months.

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