Ukraine’s economic crisis to intensify

By David Levine
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The Economic Association agreement signed between Ukraine and the European Union (EU) on Friday will exacerbate Ukraine’s social and economic crisis. Key provisions of the Deep and Comprehensive Free Trade Area (DCFTA) between Ukraine and the EU involve the elimination of all tariffs and customs duties, the reduction and elimination of industrial subsidies, the elimination of price controls, and measures for the enforcement of intellectual property rights. Under such conditions, Ukrainian businesses will be unable to hold out against better-established Western competitors and will soon be either driven out of the market or bought up.

On June 20, the Civil Initiatives Committee (CIC), an independent task force headed by former Russian Minister of Finance Aleksei Kudrin, presented a report on the expected economic impact of the Association Agreement. Kudrin is a pro-austerity critic of the Putin regime, who maintains close ties with the Kremlin and the liberal opposition.

According to the CIC’s findings, Ukraine will need $10 billion in 2014 to cover its budget and “quasi-budget” deficits, as well as an additional $18.6 to $42 billion to cover its balance of payments deficit. The country will need another $85 billion for the same purpose in 2015-2018. The CIC argues that without these sums, Ukraine will face default and economic collapse.

Before 2018, the country will also require $187 billion, mostly in the form of foreign investment, to ensure necessary capitalization of the economy. Another $300 billion is needed to overcome the lag in investment that has accumulated over the past 20 years.

Ukraine has received or will receive a total of $18.5 billion this year in loans and grants from the International Monetary Fund (IMF), World Bank, Bank for International Settlements, European Bank for Reconstruction and Development, European Investment Bank, Japan and the EU. Of these, only the EU is providing grants of any significant size. Expected loans in 2015-2018 from these sources are even further below the required amounts indicated above.

Ukraine’s foreign currency reserves, which have been used to deal with the country’s balance of payments deficit, have dwindled. They were estimated at $14.2 billion in May 2014, down from $34.6 billion in 2011 and $20.4 billion in January 2014.

The CIC report does not address the strings attached to the aforementioned loans and their social consequences. In particular, the IMF loans, which total $17.1 billion and are to be issued at intervals over a two-year period, require the deregulation of housing utilities. These policies have already begun to take effect.

According to the web site www.aif.ua, residential gas utilities have increased by 56 percent since May 1 this year, while electric power prices have risen since June 1 by 10 to 40 percent in various parts of the country. On average, cold water supply prices are to rise beginning July 1 by 85 percent, hot water by about 74 percent, and wastewater disposal by 105 percent.

Heating prices are to rise by an average of 40 percent throughout the country, and up to 74 percent in Kiev and 98 percent in Donetsk. An IMF mission arrived in Kiev on June 24 to verify compliance with the conditions of the IMF loan program.

The CIC report calculates that the Ukrainian economy will lose approximately $15 billion per year due to reduced trade with Russia and the Eurasian Customs Union, in addition to billions of losses from reduced remittances from Ukrainians living in Russia, increased prices for Russian gas, and decreased investment from Russia. Under the worst case scenario reviewed by the authors, the total losses for Ukraine will reach approximately $100 billion by the end of 2018.

The report also predicts negative outcomes for the Russian economy as a result of the EU-Ukraine DCFTA, as well as for Moldova as result of its respective DCFTA with the EU. Moldova and Georgia also signed analogous association agreements with the EU last Friday.

The CIC report, which relies primarily on publicly available macroeconomic data on Ukraine, maintains that other analyses that forecast a more optimistic outcome for Ukraine focus on long-term prospects as opposed to analyzing the near-term crisis facing the country. The CIC also asserts that others have failed to specify how exactly the large-scale structural transformations of Ukraine's economy necessary to implement the EU agreement are to take place.

While the CIC's work has been ignored by the Western mass media, many of its claims are substantiated by the World Bank's semiannual Global Economic Prospects report issued earlier this month. At the start of the year, the World Bank had forecast a 2.0 percent drop in Ukrainian gross domestic product (GDP) in 2014. In the latest report, that figure was increased to 5.0 percent.

The World Bank identifies loss of access to Ukraine's biggest export market, Russia, rising prices of imported gas, and falling prices for steel and grain products—two of the country's key exports—as the causes of the recession. The bank expects modest growth of 2.5 percent in 2015, with continuing problems associated with the devaluation of the hryvnia, which fell by 40 percent during the first four months of 2014. It also expects weak investment, rising fuel prices, the removal of domestic fuel subsidies, and reduced internal demand brought about by falling household incomes.

Thus, even key institutions promoting the Association Agreement are forced to acknowledge that large layers of the population will experience a sharp decline in their living standards in the near future as a result of the DCFTA.

There are other warning signs of the effects of the free trade agreement on the Ukrainian economy. Hryhoriy Nemyria, chairman of the Ukrainian Parliamentary Committee on European Integration, told the ICTV television network this week that Ukrainian state agencies are not yet ready to implement the DCFTA. One reason for Nemyria's nervousness is the fact that since April of this year, EU countries have been giving Ukrainian business a temporary economic boost by applying a reduced or zero export duty to Ukrainian imports, while Ukrainian duties on imports from the EU have continued to apply. This short-term economic advantage for Ukrainian producers will come to an end once the Association Agreement takes effect.

Furthermore, the free trade zone is predicated on a rapid reorientation of Ukrainian exports away from Russia and toward the EU. Ukraine's exports to Russia include machinery, vehicles, and chemical products, while its exports to the EU are mostly metals, agricultural goods, minerals and wood. This suggests that European integration will intensify the deindustrialization of Ukraine, a long-term trend set off by the restoration of capitalism in the early 1990s.

The EU-Ukraine Association Agreement is tentatively set for ratification in September of this year. It is slated to take effect in October.