Ukraine's recession continues to deepen

By David Levine
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National elections were held in Ukraine on Sunday as social conditions in the country continue to deteriorate due to neoliberal austerity policies imposed by a series of post-Soviet governments, and recently intensified under agreements with the International Monetary Fund (IMF) and other creditors of the near-bankrupt state. The recession has been further aggravated by ongoing fighting between government and rebel forces in the east of the country.

Industrial production in Ukraine in August had fallen by 21.4 percent compared with August 2013, and by 16.6 percent in September compared with September 2013. In Donetsk Province, the drop between September 2013 and September 2014 amounted to 59.5 percent, while in Luhansk Province it was 85 percent.

Imports fell by 23.5 percent over the first nine months of 2014 as compared to the analogous period of the previous year, while exports fell by 6.8 percent—despite the temporary favorable trade terms that the European Union (EU) is currently applying to Ukraine.

Coal production in Ukraine fell by 60 percent between August 2013 and August 2014. More than half of the country's mines are located in rebel-controlled territory in the provinces of Donetsk and Luhansk. Many of them have been flooded and will require months to restore.

Officials from Ukraine, Russia, and the European Union are currently involved in three-way talks in Brussels to resolve Ukraine's gas supply crisis. Russia stopped supplying gas to Ukraine in June over the latter's inability to pay a $5.3 billion debt to the Russian energy corporation Gazprom for gas already supplied. European Commission president José Manuel Barroso stated last Thursday that the European Commission would provide up to $1 billion to Ukraine for gas purchases from Russia, but no more.

About 70 percent of the electric power in Ukraine is produced from coal and gas. Thus, the country also faces a power supply crisis. Much of Ukraine, including the capital city Kiev, has been experiencing rolling blackouts of at least two hours per day.

As for heating, thermostats in Kiev residential buildings are to be set at 16-17° C (61-63° F) this winter due to shortages. Hot water supply in Kiev had been shut off for most of the summer, and has been turned back on only within recent weeks. As of October 24, 3 percent of Kiev residences remained without hot water. The situation is worse in much of the rest of the country.

The World Bank, which had previously predicted that the Ukrainian economy would contract by 5 percent this year, has revised that figure up to 8 percent. The European Bank for Reconstruction and Development has predicted a decline of 9 percent. Vitaly Vavrishchuk, chief analyst of the Ukrainian investment house SP Advisers, wrote in liga.net that his company predicts a fall of 9.5 percent in 2014 and a further decline of 4.3 percent in 2015. He also expects a decline of 30-35 percent in capital investments in Ukraine in 2014.

Since January this year, wage arrears owed by employers to employees has grown by 53 percent to 1.4 billion hryvnia ($110 million). This number is likely grossly understated because, according to the state Fiscal Service, 70-80 percent of Ukrainian employers pay their employees under the table. About half of Ukraine's workforce is working "illegally," according to Yury Ruban, head of the Presidential Administration's Humanitarian Policy Department.

According to the Ukrainian state statistical agency, the registered unemployment rate is currently a mere 1.6 percent. However, according to Serhiy Marchenko, director of development of the popular jobs web site work.ua, the labor market has fallen by 20-25 percent over the past year. The number of jobs posted to the web site has been declining since early 2013, while the number of résumés posted grows by about 20-30 percent per month. The number of jobs posted in Donetsk and Luhansk provinces have fallen over the past year by about 90 percent and 96 percent, respectively.

According to Ukrainian economist Oleh Bohomolov, the level of unreported unemployment is at least ten times the official rate. Bohomolov also notes that the unemployed in Ukraine are frequently compelled to participate in works programs that pay 1000 hryvnia (about $77) per month. "For that much money, its cheaper to stay at home," he noted.

Average real wages in the first eight months of 2014 were 3399 hryvnia, representing a 3.1 percent decline from the analogous period of the previous year. These figures are also likely very inaccurate, both for the reasons stated above and because the official inflation rate does not accurately reflect real increases in the cost of living.

According to the Ukrainian State Statistical Agency, inflation between September 2013 and September 2014 amounted to 17.5 percent, while the IMF and World Bank predict that total inflation in 2014 will amount to 19 percent.

In keeping with IMF requirements, the government has raised residential utility rates. In the 2013-2014 winter, gas for heating was sold at the level of 2.91-3.1 hryvnia per square meter, while in the 2014-2015 winter season it will be on the level of 10-11 hryvnia. Volodymyr Demchyshyn, head of the government agency for housing utilities, has noted that for the average two-room apartment this will amount to about 500 hryvnia per month—nearly one-third of the average monthly pension of 1670 hryvnia. Aggregate housing utility costs have risen by about 90 percent this year. Further rate increases of 40 percent are planned for 2015.

Inflation indexing of pensions has been frozen since last year. Despite modest nominal increases, pensions have therefore shrunk. Meanwhile, consumer medicine prices have risen by two to three times.

Retail gasoline prices have risen by approximately 35 percent since the beginning of the year—despite a drop in oil prices of approximately 20 percent. The rise is largely attributable to a decline in the national currency, the hryvnia. The dollar has risen by 58 percent against the hryvnia over the past year, from 8.17 to 12.95 hryvnia per US dollar.

The government is considering abolishing price controls over "socially significant" goods, including meat, fish, milk, eggs, sugar, and other basic groceries.

According to Ukrainian Deputy Prime Minister Volodymyr Hroysman, about 11.8 billion hryvnia ($911 million) will be needed to rebuild infrastructure destroyed in the embattled eastern provinces.

At a press conference organized by the Russian news agency *RIA Novosti,* Oleg Ustenko of the right-wing think tank Bleyzer Foundation noted that Ukraine is expected to have a budget deficit of about 11.5 percent, not far from the 13 percent that Greece experienced just before its government defaulted. "A country with an 11 percent budget deficit that is also undertaking military operations cannot function. This is well understood in Washington," he said.

In addition to Ustenko, commentators from countries on both sides of the Ukraine conflict have emphasized that Ukraine's solvency at present is dependent upon aid from the IMF. The IMF had calculated that Ukraine needed $35 billion in foreign aid in May, but revised that figure to $55 billion in September. As Dennis Lachtman of the American Enterprise Institute noted in a comment for *The Hill*, "if the repeated upscaling of the financing needs of the IMF-EU Greek bailout program is any precedent, one should not be surprised if the total official bailout cost for Ukraine came closer to $100 billion rather than the $55 billion that the IMF is now estimating."

Ratings agency Moody's has suggested that at the end of this year Russia will likely demand repayment of a $3 billion loan made last year (the loan is separate from and additional to Ukraine's gas debt to Gazprom mentioned above). "An acceleration of payments on this eurobond in turn could in our view trigger a cross-default event in all other eurobonds," Moody's stated. In other words, if Ukraine fails to pay its debt to Russia, it will set off a chain reaction of creditors demanding repayment of their loans from Ukraine, resulting in default.

These considerations shed light on the fact that, in spite of the anti-Russian orientation of the current Ukrainian regime, Moscow, as a major creditor and vital source of gas supplies, continues to wield immense potential political influence. As Kiev's financial desperation increases, so does its dependence on all of its creditors, including those in Russia. The anti-Russian project begun last November in Ukraine at the instigation of Western governments was predicated on the assumption that the IMF, the EU and other Western institutions would be able to lessen Ukraine's dependence on Russia. This assumption will be proven wrong in the event of a Ukrainian default.

The impact of a default will not only intensify the crisis of Ukraine's economy. By throwing the puppet regime of President Petro Poroshenko into crisis, it will provide the impetus for a further escalation in the ongoing conflict between Russia and the Western powers led by the United States and Germany.