

Ukraine's Economy Nears Post-Election Crunch Time

By [The Moscow Times](#)

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A woman carrying wood to burn for heating in the town of Makiyivka in eastern Ukraine. **Gleb Garanich**

MAKIYIVKA, Ukraine — Crumbling concrete pillars resemble ancient Greek temples, abandoned and overgrown, next to slag heaps that smell like piles of rotten eggs just a mile away from the center of the Ukrainian town of Makiyivka.

Once a showcase for communist industrialization accounting for more than a tenth of the Soviet Union's coal and steel output, the town of 400,000 today is a symbol of poverty and decay.

With its steel mill obsolete and state-run coal mines stagnating, Makiyivka is a stark symbol of the problems facing the economy as Ukraine approaches an Oct. 28 election: extreme vulnerability to external shocks and lack of reforms resulting in a dismal business climate.

Official statistics show that Makiyivka boasts one of the highest average wages in Ukraine

at about \$400 per month. But the town's aspect and its residents tell a different story.

Abandoned and looted buildings and frozen construction sites dot the town that has all but merged with Donetsk, the center of President Viktor Yanukovich's home region.

"I make 30-50 hryvnas (\$4-6) a day. ... We just barely get by," said Svetlana, 33, a single mother of three who now sells socks and slippers at an open-air market after she was made redundant at a local shoe factory two years ago.

Makiyivka's steel mill, which relied largely on outdated open hearth furnaces, was shut down in 2003 and has since been reduced to a rolling facility processing steel from another nearby mill.

Some facilities, such as furnaces, have been dismantled. Others, including temple-like circular water purifiers, have been left to rot. The plant's work force has been reduced to about 1,000 people from 7,500.

With demand for steel, Ukraine's main export, sagging due to the euro-zone crisis, other local producers are under threat as well. Ukraine's steel production fell 5.6 percent in January-September compared with the same period of 2011.

Just as in Makiyivka, the steel sector's troubles are having a knock-on effect on the wider economy across the country.

Ukraine's industrial output shrank 7 percent year on year in September after falling 4.7 percent in August, and some analysts say overall economic growth could be zero this year.

The problem is aggravated by the fact that the hryvna has been pegged to the dollar since early 2010, making Ukrainian exports less competitive and causing a domestic credit crunch as banks anticipate depreciation.

Analysts say the exchange rate policy was at least partly driven by political considerations and meant to demonstrate stability achieved under Yanukovich, who came to power in February 2010.

"A lackluster performance by the export sector and the tight hryvna-to-dollar peg are the key reasons why Ukraine's foreign trade and current account deficits have kept widening," HSBC said in a report Monday.

"The latter is approaching 10 percent of GDP, which we believe is hardly sustainable," the bank said.

Analysts say the question is not whether the hryvna will depreciate after the election but when exactly and by how much, although the authorities say it will remain stable.

Yanukovich's Party of the Regions, which seeks to retain a majority in the vote this weekend, has touted stability as its key accomplishment during the campaign.

Indeed, output has been stable and wages grew by several percentage points every quarter at Makiyivvuhillya, the state-run coal firm that is now the main industrial enterprise

in Makiyivka, for the last two years, local mining trade union official Anatoly Akimochkin said.

But no new mines are being built, and coal is now often being stockpiled rather than sold because of falling demand, he said.

This means that next year, when the company is scheduled for privatization along with hundreds of other state assets, investors are likely to break it up and close some facilities.

"Layoffs are inevitable," Akimochkin said.

Utilities are another sector where state policies have focused on preserving the status quo. Ukrainians are paying only a fraction of the market price for household gas and heating services, with the rest subsidized by the state budget.

The price of gas, which Ukraine imports from Russia, has been rising steadily, but the government has so far refused to raise household gas and heating prices, losing access to a \$15 billion International Monetary Fund facility as a result.

The fund, whose program could have provided Ukraine with much-needed fiscal and foreign exchange cushions, says price hikes are essential in order to cut the budget deficit and avoid falling into a debt trap.

Ukrainian officials now say they are making progress in talks on renewing IMF lending, although the fund has made no such indications and the government insists it will not raise utility prices.

Meanwhile, municipal infrastructure, plagued by inefficiency and under-financing, is falling apart. In large parts of Makiyivka, water flows from taps only a few hours per day.

"Last time hot water ran from my tap was in April 1997," Akimochkin said. "Sewers often leak into the streets."

With key reforms delayed and corruption remaining rampant, private investors — aside from Yanukovich's financial backers such as billionaire industrialists Rinat Akhmetov and Dmytro Firtash — are reluctant to put their money into Ukraine.

A business climate index based on a survey of more than 100 Ukrainian and foreign companies carried out by lobbying group European Business Association fell to a three-year low in the third quarter of 2012.

"Investors have been spooked by looming fiscal pressure, corruption, and general uncertainty in the run-up to October's parliamentary elections," the group said in a statement this month.

Uncertainty is the word that best matches the sentiment of Makiyivka's residents who see the relative stability of the last few years as stagnation.

"We are just treading water," Akimochkin of the trade union said.

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