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Ukraine Must Make Compromises and Radically Reform for IMF Funding to Continue

By The Moscow Times

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Ukraine's Finance Minister Natalia Yaresko attends a meeting to report on the work done during the first 100 days of the Ukrainian government in Kiev, March 12, 2015

With the first billions of dollars foreign aid in its pocket, Ukraine's government can now stay afloat long enough to embark on its radical reform drive, but the hard part is only just beginning.

Ukraine received the first $5 billion on Friday of $17.5 billion in aid promised by the International Monetary Fund. But to receive the rest, it must implement reforms that mean taking on vested interests including pensioners, public sector workers and some of the country's most powerful oligarchs.

Even if it manages to placate those groups and can start turning around the economy, all its

work could be undone by another nosedive in the hryvnia currency, or by a renewal of fighting with pro-Moscow separatists in eastern Ukraine.

"Without reforms today we will not have a tomorrow. Our government is fighting for tomorrow. The government isn't fighting for an approval or popularity rating," Prime Minister Arseny Yatseniuk said Wednesday.

Restructuring the energy sector is probably the most urgent task, but also potentially the trickiest in an economy still built on cheap fuel from its days as part of the energy-rich Soviet Union. Energy intensive industries are owned by powerful businessmen who influence political parties and the media.

"It will be very difficult to carry out reforms as there will be conflicts of interests," said Mykhailo Gonchar, the director for energy programs at the Nomos Center thinktank.

State natural gas firm Naftogaz collects far less from its customers than it pays to import gas, much from Russia, the country Kiev now sees as its mortal enemy. Naftogaz ran a 110 billion hryvnia deficit last year, now worth around $4 billion and equivalent to nearly 6 percent of the country's gross domestic product, according to the government.

To reduce the deficit, gas prices, long-kept far below the market rate, are set to triple. But even that won't fully sort out the problem, made worse by a complicated multi-level pricing structure, under which Naftogaz sells gas through around 25 regional companies that supply final customers, creating opportunities for middlemen to siphon off profits.

Regulations require Naftogaz to charge a lower wholesale price for gas for household use than for industrial customers.

"It's impossible to check if all that gas goes where it is meant to," Naftogaz chief executive Andriy Kobolev said at a briefing on Wednesday.

Conflicts Of Interests

Under proposed reforms, Naftogaz will bring retail and industrial prices closer to market rates, audit the regional gas firms and meter the flow of gas throughout the supply chain, according to a government document sent to the IMF.

In an example of the powerful interests that could be affected, stakes in several of the regional gas firms are held by billionaire industrialist Dmytro Firtash, who also controls a large chunk of Ukraine's chemical industry, among the biggest industrial consumers of gas.

Like other powerful businessmen, Firtash thrived under Viktor Yanukovych, the pro-Russian Ukrainian president ousted last year, but still retains political influence even though Yanukovych has been replaced by pro-Western leaders.

Firtash himself is currently living in Austria, where he is free on bail after being arrested a year ago at the request of U.S. authorities who accuse him of bribery over a business deal in India, a case he says is politically motivated. His representatives there were not available to comment.

A spokesman for his company, Group DF, confirmed it held stakes in regional gas firms but declined to comment on prices they charge customers. A spokesman for Regional Gas Company (RGC), a management firm for around 20 Ukrainian gas distributors which includes some owned or part-owned by Firtash, said no instances had been recorded of its firms selling gas for household prices to industry.

Firtash holds a controlling stake in Inter TV, Ukraine's leading broadcaster, along with a business partner, Serhiy Lyovochkin, who is also deputy head of a parliamentary faction called Opposition Bloc. The bloc, with 40 seats, is the third largest in parliament, where it is committed to trying to halt the government's energy sector reform plans.

In a statement, Lyovochkin's party denounced the government's proposed energy plans as "blind adherence to demands from the IMF".

"The government has no clear plan of reform for the country's energy sector and the decisions that have been taken will lead to the collapse of Ukraine's energy system."

Nervous Times

So far public opposition to the government's austerity drive has been muted. Many ordinary Ukrainians say they are ready to put up with pain if it means a stronger country in the long run.

Citizens' resolve will be tested.

The government has told the IMF it will cut the number of employees paid out of the budget by 3 percent in the course of this year, including a 20 percent reduction in the workforce in the civil service.

Kiev has also told the IMF it will cut benefits to pensioners who still work, and will gradually raise the retirement age for women by 5 years.

Former Economy Minister Pavlo Sheremeta, who quit the role last year over frustration at the slow pace of reform, said the new IMF-led programme is enough to stave off bankruptcy, but growth is unlikely if the war in the east does not end.

"A bailout is not enough for recovery, austerity is not enough for recovery. Ukraine needs investment, a lot of investment. Even local investors are very wary of investing in these uncertain, nervous times," he said.

Violence has lessened significantly in recent weeks as a new ceasefire deal shows signs of holding. But many Ukrainians still fear that Moscow-backed rebels could launch a fresh offensive in the spring to seize more territory.

The hryvnia currency plummeted 50 percent to record lows of over 30 to the dollar in February when rebels initially disavowed the peace agreement. It has since partly recovered after the central bank implemented stricter currency controls.

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