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# Ukraine's Oligarchs Distance Themselves from the Protest Movement

**Ievgen Vorobiov**

*On 19 January 2014, the protests in Kiev turned violent and clashes between the police and protestors resulted in dozens of injuries on both sides. The chances for political compromise have decreased in comparison to December 2013 as Ukraine's oligarchs have continued to ensure parliamentary support for Yanukovych and his increasingly authoritarian rule. A deal concluded with Russia on 17 December 2013 provided the major oligarchs with temporary protection against the risk of increased taxes or other measures to fill up the state budget. In its diplomatic efforts towards Ukraine, the EU can no longer count on the oligarchs' active support for the country's Westward movement.*

**Oligarchs Change Stance.** So far, Ukraine's parliament, in which the majority is controlled by members of the Party of Regions and the Communist Party, has proved ineffective as a platform for seeking political compromise. On 16 January 2014, MPs from these parties not only passed the annual state budget but also voted for a package of 11 laws that limit freedom of speech, assembly and movement. These bills, introduced in direct violation of established parliamentary procedures, contradict basic constitutional guarantees and undermine democratic institutions. Parliamentarians that represent the major oligarchs in Ukraine[1] voted in favour of these bills, although some later claimed that they had not known the content of the laws they had helped to pass. The coverage of the political situation on the four major TV channels owned by the major oligarchs ("Ukraina," owned by Rinat Akhmetov; "Inter" under Dmytro Firtash; and "ICTV" owned by Viktor Pinchuk) has changed drastically. What was a balanced delivery of information at the beginning of the EuroMaidan protests was replaced by an openly pro-government stance at the end of December. Finally, the dismissal of the head of the presidential administration and the land army chief on 17 January 2014, signalled the strengthening of a "hawkish" group in Yanukovych's entourage and the subsequent weakening of the oligarchs' influence on the key decision-maker.

**Promises and Risks of the New Budget for Oligarchs.** Ukraine's new budget will reward oligarch groups that support the government with public procurement contracts. As the state budget contains a 6% increase in state expenditures in comparison to the previous year (despite the economic stagnation of 2013), Ukraine is likely to boost public procurement volumes. The companies belonging to the Akhmetov and Firtash groups disproportionately benefitted from government contracts in 2013. An increase in financing of regional budgets in the 2014 budget will help keep the loyalty of MPs from these groups elected in first-past-the-post electoral districts. Finally, the amount of planned revenues from privatisation programmes (declared to be about $2 billion) may signal the authorities' intent to sell some large enterprises to the oligarch groups.

However, the increase in budget expenses will also require a raise in revenues to partially balance the huge fiscal imbalances in the planned state budget ahead of the 2015 presidential election. The 2014 budget contains a deficit of $8.5 billion (about 5% of the country's actual GDP), which will have to be covered by external financing and increases in tax collection.

[1] For more on the influence of the oligarch groups on Ukraine's government, see: P. Kościński, I. Vorobiov, "Do Oligarchs in Ukraine Gain or Lose with an EU Association Agreement?," *Bulletin PISM*, no. 86 (539), 19 August 2013.

Therefore, in addition to potential benefits for the oligarchs, the budget introduces instruments threatening their economic interests: promissory notes and transfer-pricing controls. According to the law signed by the president in July 2013, promissory notes can now be issued by the government instead of paying the outstanding value-added tax (VAT) to Ukrainian exporters. However, such an instrument can be used arbitrarily: by issuing promissory notes, the government could effectively delay a tax refund for five years.

The regulations on transfer pricing also may be another pressure tool on the oligarchs. At the end of 2013, Ukraine's tax authorities were reported to have increased inspections of oligarch-owned companies trading via off-shore subsidiaries. A law on transfer prices entered into force on 1 September 2013, despite resistance from some of the oligarch groups. This law will give the tax authorities instruments to fine large exporters, including the introduction of controls on transactions involving Ukrainian companies with off-shore agents in order to prevent tax reduction schemes. Although such reform could indeed help tackle the problem of massive capital flight from Ukraine (estimated at about 7% of GDP), the risk of the selective application of the fines is a direct threat to the oligarchs. This type of control could be used as a pressure tool against the oligarchs to keep them in line when it comes to voting for bills in parliament and coverage of political events in the media.

**Useful deals with Russia.** An option to temporarily postpone the implementation of these risky measures was offered by Yanukovych to the oligarchs in the president's arrangements with Russia on 17 December 2013. Ukraine's government secured short-term financing to cover Ukraine's fiscal deficit and received promises of better export conditions for those Ukrainian oligarchs whose businesses were hit in the trade war with Russia last year.

The lower gas price reached under the arrangement with Russia is a "mixed blessing." The agreement that was signed between Russian giant Gazprom and Naftogaz, Ukraine's state company, allows the former to decrease the price of natural gas for Ukraine by 30%. Although the price has to be set on a quarterly basis, Akhmetov's steel mills or Firtash's chemical plants could see a moderate decrease in energy costs.

Russia's promise to purchase two-year bonds from Ukraine worth $15 billion decreases the likelihood of new tax pressure on the oligarchs in Ukraine. Having obtained the first $3 billion in January and expecting more to come, Ukraine's government will be able to cover at least part of the budget deficit in 2014 without increasing regulatory pressure on the oligarchs' businesses amidst the current political turmoil. Russia's further purchases of bonds will serve as temporary assurance to oligarchs that the laws on promissory notes and transfer pricing will not be applied to cover the budget deficit. The legal basis for using external sources of financing was set forth in the 2014 draft budget: it gives the Finance Ministry the right to issue new government bonds. The threshold for the national debt, which limits the issuance of bonds, was increased by 20%. At the same time, the oligarchs realise that Russia's purchase of Ukrainian bonds only delays the budgetary shortfall until after 2015.

Finally, the "trade roadmap" signed between the two governments in Moscow is supposed to reopen access to Russia's market for Ukraine's exporters which had been hit by the customs and sanitary restrictions unilaterally imposed in 2013. The format of the trade "normalisation" insisted upon by Russia relies on a gradual removal of these barriers, and therefore it is contingent on Russian political will. By using the selective elimination of barriers, Russia's leadership may target particular Ukrainian exporters.

**Conclusions and Recommendations.** The major oligarch groups in Ukraine have been reassured that the country's budget deficit will be financed at the expense of Russia through the purchase of Ukrainian government bonds rather than increased pressure on the oligarchs' businesses. However, the short-term nature of the bond-purchase arrangements and the gradual elimination of trade barriers with Russia might well prop up the oligarchs' interest in continuing talks with the West.

This dual interest—continuing Russia's bond purchases and the need to engage with the EU for the sake of retaining access to Western markets—will steer the ambivalent positions of the major oligarch groups in Ukraine. On the one hand, they are increasingly unlikely to explicitly support the protest movement. On the other hand, they will need to keep the communication channels with the opposition open, due to the lingering uncertainty over the long-term regulatory conditions.

The EU Member States, including Poland, should take into account the diverging interests of the major oligarch groups and their impact on Ukraine's parliament. With avenues for political dialogue in Ukraine closing fast, EU officials should be more outspoken in communicating the potential for punitive measures to representatives of the major oligarch groups, given the risks of entry into force of further repressive regulations in Ukraine.