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The IMF's New Cold War Loan to Ukraine

Losing Credibility

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In April 2014, fresh from riots in Maidan Square and the February 22 coup, and less than a month before the May 2 massacre in Odessa, the IMF approved a $17 billion loan program to Ukraine's junta. Normal IMF practice is to lend only up to twice a country's quote in one year. This was eight times as high.

Four months later, on August 29, just as Kiev began losing its attempt at ethnic cleansing against the eastern Donbas region, the IMF signed off on the first loan ever to a side engaged in a civil war, not to mention rife with insider capital flight and a collapsing balance of payments. Based on fictitiously trouble-free projections of the ability to pay, the loan supported Ukraine's hernia currency long enough to enable the oligarchs' banks to move their money quickly into Western hard-currency accounts before the hernia plunged further and was worth even fewer euros and dollars.

This loan demonstrates the degree to which the IMF is an arm of U.S. Cold War politics. Kiev used the loan for military expenses to attack the Eastern provinces, and the loan terms imposed the usual budget austerity, as if this would stabilize the country's finances. Almost nothing will be received from the war-torn East, where basic infrastructure has been destroyed for power generation, water, hospitals and the civilian housing areas that bore the brunt of the attack. Nearly a million civilians are reported to have fled to Russia. Yet the IMF release announced: "The IMF praised the government's commitment to economic reforms despite the ongoing conflict."[1] A quarter of Ukraine's exports normally are from eastern provinces, and are sold mainly to Russia. But Kiev has been bombing Donbas industry and left its coal mines without electricity.

This loan is bound to create even more dissension among IMF staff economists than broke out openly over the disastrous $47 billion loan to Greece – at that time the largest loan in IMF history – prompted a 50-page internal document leaked to the *Wall Street Journal* acknowledging that the IMF had "badly underestimated the damage that its prescriptions of austerity would do to Greece's economy." staff economists blamed pressure from eurozone countries protecting their own "banks [that] held too much Greek government debt. … The IMF had originally projected Greece would lose 5.5% of its economic output between 2009 and 2012. The country has lost 17% in real gross domestic output instead. The plan predicted a 15% unemployment rate in 2012. It was 25%.[2]

The IMF's Articles of Agreement forbid it to make loans to countries that clearly cannot pay, prompting its economists to complain at last year's October 2013 annual meeting in Washington that their institution was violating its rules by making bad loans "to states unable to repay their debts." In practice, the IMF simply advances however much a government needs to bail out its bankers and bondholders, pretending that more austerity enhances the ability to pay, not worsen it. Ukraine looks like a replay of the Greek situation with an exclamation mark! One official last year called its Debt Sustainability Analysis, "'a joke,' a [European] commission official described it 'a fairy tale to put children to sleep' and a Greek finance ministry official said it was 'scientifically ridiculous.'"[3]

John Helmer's *Dances with Bears* calculates that "of the $3.2 billion disbursed to the Ukrainian treasury by the IMF at the start of May, $3.1 billion had disappeared offshore by the middle of August."[4] This raises the question of whether the IMF's loan is legally an "odious debt," being made to a military junta and stolen by government insiders. The IMF acknowledged that the central bank was simply turning money over to the kleptocrats who run the country's banks as part of their conglomerates (as well as funding the government's military attack on the East, largely on behalf of the leading kleptocrats behind the Maidan coup). "The proportion of government securities and loans to banks increased from 28 percent of NBU total assets at end-2010 to 56 percent at end-April 2014." The financial situation is getting so much worse that to stave off insolvency, Ukraine's leading banks are reported to need another $5 billion over and above the IMF's $17 billion commitment.

In preparation for October's scheduled elections, the eastern provinces are in no condition to vote, and the junta has banned the Communist party as well as TV and media reporting that it does not like (mainly in the Russian language). The leading pro-war parties are polling very low even in the West (as of early September), prompting warnings of a coup by the Right Sector and allied neo-Nazi Ukrainian nationalists, headed by the oligarch Igor Kolomoyskyy, who fields his own private army.

A defeat in war frequently leads to regime change. The spectre of a coup is once again roaming the streets and squares of Kyiv. Surviving National Guard fighters are threatening to turn their weapons on Poroshenko. A third Maydan [Independence Square protest movement] is taking shape, which is to sweep aside the present regime. The instigators of this Maydan are militants from the punitive battalions created with Kolomoyskyy's money. It is obvious that the oligarch is playing his game against Poroshenko. Subordinate to him Kolomoyskyy has quite a strong private army capable of carrying out a coup.[5]

IMF and US-backed privatization plans for Ukraine

Ukraine's main problem is that its debt is denominated in dollars and euros. There seems only one way for Ukraine to raise the foreign exchange to repay the IMF: by selling its natural resources, headed by gas rights and agricultural land. Here the shadowy figure of Kolomoyskyy resurfaces, with support from the United States. Recent Senate Bill 2277 "directs the U.S. Agency for International Development to guarantee loans for every phase of the development of oil and gas" in Ukraine, Moldova and Georgia.

Vice President Joe Biden's son, R. Hunter Biden, recently was appointed to the board of Burisma, a Ukrainian oil and gas company registered in Cyprus, long a favorite for post-Soviet operators. The firm has enough influence over Kiev politics to make prospective gas-fracking lands a military objective. "Ukrainian troopers help installing shale gas production equipment near the east Ukrainian town of Slavyansk, which they bombed and shelled for the three preceding months, the Novorossiya news agency reports on its website citing local residents. Civilians protected by Ukrainian army are getting ready to install drilling rigs. More equipment is being brought in, they said, adding that the military are encircling the future extraction area."[6]

One report notes the extent to which "pro-Russian" means opposing a gas grab:

The people of Slavyansk, which is located in the heart of the Yzovka shale gas field, staged numerous protest actions in the past against its development. They even wanted to call in a referendum on that subject. … Countries like the Czech Republic, the Netherlands and France have given up plans to develop shale gas deposits in their territories. Not only them but also all-important Germany, which two weeks ago announced it would halt shale-gas drilling for the next seven years over groundwater pollution concerns.[7]

U.S. and IMF backing seems intended to help reduce European dependence on Russian gas so as to squeeze its balance of payments. The idea is that lower gas revenues will squeeze Russia's ability to maneuver in today's New Cold War. But this strategy involves a potentially embarrassing U.S. alliance with Kolomoyskyy, reportedly the major owner of Burisma via his Privat Bank. He "was appointed by the coup regime to be governor of Dnipropetrovsk Oblast, a south-central province of Ukraine. Kolomoysky also has been associated with the financing of brutal paramilitary forces killing ethnic Russians in eastern Ukraine."[8] The term "ethnic Russian" is a kakaism for local protest against fracking by kleptocrats privatizing the economy's natural resource wealth.

It will be expensive to restore power and water facilities that have been destroyed by the Kiev forces in Donetsk, which faces a cold dark winter. Kiev has stopped paying pensions and other revenue to the Eastern Ukraine, all but guaranteeing its separatism. Even before the Maidan events the local population sought to prevent gas fracking, just as Germany and other European countries have opposed it.

Also opposed is the appropriation of land and other properties by Ukrainian kleptocrats and especially foreigners such as Monsanto, which has invested in genetically engineered grain projects in Ukraine, seeing the country as Europe's Achilles Heel when it comes to resisting GMOs. A recent report by the Oakland Institute, *Walking on the West Side: the World Bank and the IMF in the Ukraine Conflict*, describes IMF-World Bank pressure to deregulate Ukrainian agricultural land use and promote its sale to U.S. and other foreign investors. The World Bank's Investment Finance Corporation (IFC) has "advised the country to 'delete provisions regarding mandatory certification of food in the listed laws of Ukraine and Government Decree,'" and "to avoid 'unnecessary cost for businesses'" by regulations on pesticides, additives and so forth. [9]

Yet neither Russia nor many European countries accept genetically engineered foods. It would seem that the only way Ukraine can export GMO crops is if U.S. diplomats pressure Europe to drop its GMO labeling. This would drive yet another wedge between the United States and European NATO members, much as U.S. pressure to impose sanctions on Russia ("Let's you and him fight") has done.

U.S. stratagems to save Ukraine from having to pay its debts to Russia

The "inner contradiction" in the IMF loan is that Ukraine owes the entire amount to Russia for gas arrears and current needs as winter nears, and also for the euro loan by Russia's sovereign wealth fund on strictly commercial terms with cross-defaults if Ukrainian debt rises above 60 percent of GDP. The U.S. Cold War response is to try to craft a legal argument to minimize payments to Russia out of IMF and NATO "reconstruction" lending. The Peterson Institute for International Economics has floated a proposal by former Treasury official Anna Gelpern to deprive Russia of legal means to enforce its claims on Ukraine. "A single measure can free up $3 billion for Ukraine," she proposed. Britain's Parliament might pass a law declaring the $3 billion bond negotiated by Russia's sovereign wealth fund to be "foreign aid," not a real commercial loan contract worthy of legal enforcement. "The United Kingdom can refuse to enforce English-law contracts for the money Russia lent," thereby taking "away creditor remedies for default on this debt."[10]

The problem with this ploy is that Russia's sovereign wealth fund lent Ukraine euros with strict financial protection aimed at limiting the country's overall debt to just 60 percent of its GDP. If debt rises above this level, Russia has the right to demand full immediate payment, triggering cross-default clauses in Ukraine's foreign debt.

As recently as yearend 2013, Ukraine's public debt amounted to just over 40 percent – a seemingly manageable $73 billion. But in view of the fact that Ukraine had only a B+ rating – below Russian sovereign fund normal limit of requiring at least an AA rating for bond investments – Russia acted in a prudent financial way by inserting protection clauses precisely to distinguish its investment from general purpose aid. Unlike foreign aid, Russia's loan gives it "power to trigger a cascade of defaults under Ukraine's other bonds and a large block of votes in any future bond restructuring. This is because all of the government's bonds are linked among themselves. When one bond defaults, the rest can do the same."

What the U.S. Government classifies as foreign aid also typically takes the form of loans to be repaid, and insists on matching funds in local currency, *e.g*. for Public Law 480 food exports. Congress insisted already during the Kennedy Administration that the U.S. balance of payments, and specifically its farm exports, must benefit from any such "aid."[11]

Waging civil war is expensive, and Ukraine's currency is rupturing. The black market exchange rate already is reported to have plunged by one-third. If recognized officially (once the kleptocrats have moved their money out at IMF-supported hernia rates), this would raise the country's debt/GDP ratio to the 60 percent threshold making the debt to Russia payable immediately.

"Governments do not normally sue one another to collect their debts in national courts," Prof. Gelpern points out. But if this should occur, the *pari passu* rule would prevent some debts from being annulled selectively. She therefore raises another possibility for how to prevent IMF and NATO credit from being paid to Russia for its bondholdings and gas arrears. Ukraine may claim that its debt to Russia is "odious." This applies to situations where "an evil ruler signs contracts that burden future generations long after the ruler is deposed." She adds that "Repudiating all debts incurred under Yanukovich would discourage lending to corrupt leaders."

The double standard here is that instead of labeling Ukraine's entire series of post-1991 kleptocratic governments odious, she singles out only Yanukovich, as if his predecessors and successors are not equally venal. But an even greater danger in trying to declare Ukraine's debt "odious": It may backfire on the United States, given its own support for military dictatorships and kleptocracies.

In contrast to IMF loans to support the kleptocrats' banks and new Cold War asset grab from the Eastern border provinces with Russia, Ukraine's sale of bonds to Russia's sovereign debt fund and its contracts signed for gas purchases were negotiated by a democratically elected government, at prices that subsidized domestic industry and also household consumption. Unlike the case with Greece, there was no removal of a national leader to prevent a public referendum from taking place over whether to approve the loan or not. If the Ukrainian debt is deemed odious, what of Eurozone loans to Ireland and Greece or U.S. loans to Argentina's generals installed under Operation Condor? Gelpern acknowledges that Ukrainian refusal to pay the bonds by invoking the odious debt principle "is fraught with legal, political and market risks, all of which would play into Russia's hands." Indeed!

This leaves the most promising solution to hurt Russia to be the above-mentioned ploy for Britain's Parliament to pass a sanctions law invalidating "the Yanukovich bonds." Such a sanctions law would reduce Russia's "ability to profit from selling the debt on the market" simply by denying Russia legal rights to grab Ukrainian assets. It also would destroy London as a leading global financial center.

Gelpern concludes her paper by suggesting a universal principle: that contracts “used to advance military and political objectives … should lose their claim to court enforcement.” I love this suggestion! It certainly would open a can of worms in view of the fact that “[t]he United Kingdom and the United States have both used military force in the past to collect debts and influence weaker countries. Is it legitimate for them to punish Russia for doing the same?” Are not the vast majority of inter-governmental debts either military or political in character?

On this logic, shouldn’t most inter-governmental debts be wiped out? Do not Gelpern’s arguments cited for not paying Russia serve even more to provide a legal basis for nullifying Ukraine’s debt to the IMF and subsequent NATO loans on terms that force it to forfeit its natural resource rights for gas and land to foreign investors?

Prof. Gelpern’s legal review ostensibly seeking reasons to isolate Russia economically thus has the seemingly ironic effect of showing the legal and political difficulties in trying to achieve this. If Ukraine borrows from the IMF and/or EU, and then breaks up – with the East becoming independent – who will be obliged to pay? Certainly not the East, attacked by the military coup leaders.

So we are brought back to this month’s financial news in preparation for next month’s IMF annual meeting: Where then does the Ukrainian loan leave the IMF’s credibility?