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THE FUTURE OF THE UKRAINIAN OLIGARCHS

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- forecasts changes and models possible scenarios for events in Ukraine;
- makes a competent assessment of the Ukrainian events;
- makes specific recommendations for actions;
- offers effective solutions;
- offers a platform for discussions on current topics.

It is a project of representatives of Ukrainian business, politics and the public sector.

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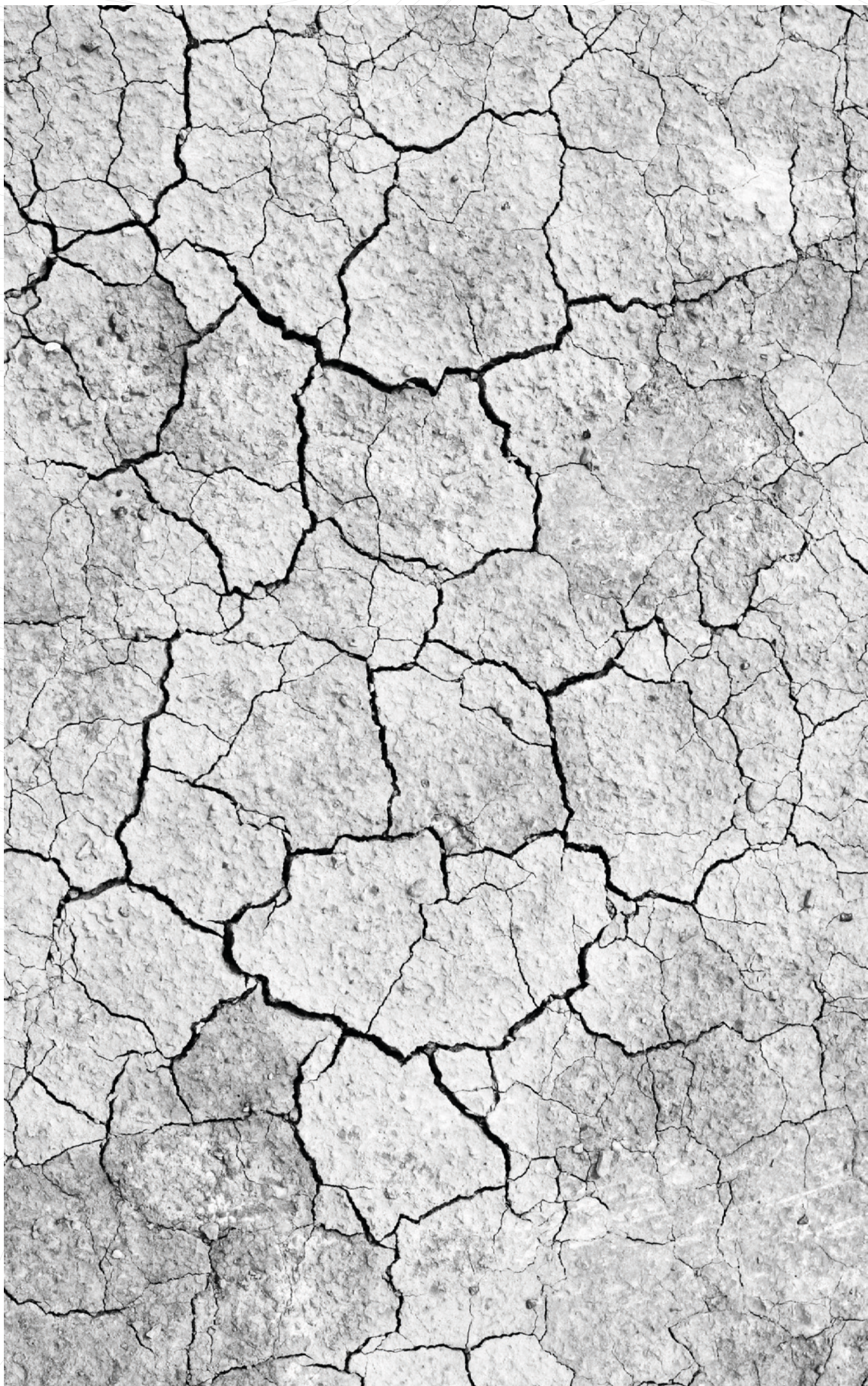
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INTRODUCTION: THE BRITISH DISEASE IN UKRAINE

After the fall of the Soviet Union, the starting conditions for economic development in Ukraine were advantageous. However, after 27 years of independence, we continue to be the most backward country of the post-Soviet bloc. Therefore, one of the most important questions that we must ask ourselves is: why is it that Ukraine fails?

There are a lot of answers to this question. Most of them can be justified by situations and circumstances beyond our control such as our history or geography but some are simply peculiar Ukrainian features such as our culture and mindset. If we look at history, it is very easy to see that the situation in Ukraine is not unique, and is common not only to new countries but also to world leaders.

After World War II, the West experienced a strange economic phenomenon: the United Kingdom was developing dramatically worse than the countries they helped defeat. Germany, Italy, Japan were experiencing an "economic miracle", while Britain was stuck in "stagflation" for decades. In the case of Ukraine a significant number of explanations were ascribed to the peculiar features of the country but they gave no opportunity or understanding of how to fix the economy. In 1982, the outstanding economist Mancur Olson published the book "The Rise and Decline of Nations" where he developed his own theory of the decline of countries, and specifically Britain. According to him the reason that hindered the development of the British economy was the existence of "old organizations with special interests" or "cartels", primarily represented by trade unions. In his opinion, any professional organization, association or union that exists for a long time in a particular sector of the economy forms "distributional coalitions" in order to block access to new players to any particular industry and to maintain the existing income situation. He stated that such coalitions use their influence on politicians to ensure the preservation of the status quo. The author called this phenomenon "the British disease". It results in a decline in production, fixing of prices, technological backwardness and so forth. Olson's work coincided in time with Margaret Thatcher's policy. Thatcher declared war on the trade union monoliths and initiated privatization of inefficient state property. The results of this policy are well-known.

Ukraine has apparently caught "the British disease". If we substitute the "British trade unions" with "oligarchs" we would recognize a situation very similar to that of post war Britain. Olson in his introduction to the Russian version of his book warned: in the course of time top-officials in different areas may join and collude with other small groups to satisfy their own interests even if it undermines economic growth aspired by a dictator or Politburo. (Is this a direct quote? – if so it must be in parenthesis) This was actually the case in Ukraine during the reign of President Leonid Kuchma who is considered to be "the father of the oligarchy". Ukrainian oligarchs received most of their assets from collusion with officials and via non-transparent privatization. Since that time, control over the political system continues to be a key aspect for saving their business. For many years oligarchs blocked the access to markets for foreign investors and created cartels within whole economic sectors. This led to tremendous social, economic and technological backwardness. Since oligarchs remain some of the most influential players in Ukraine we decided to conduct a deep analysis of the influence of oligarchs and assess their prospects. This report refers to their impact on energy industry, metallurgy, transport infrastructure, media, and politics. The report concludes with an analysis of three possible scenarios for the future of oligarchs. The future of Ukraine will depend significantly on the choice of one of these scenarios.

THE THEORY AND STRUCTURE OF THE UKRAINIAN OLIGARCHY



The establishment of the oligarchy in Ukraine began with small-number of Soviet criminal-oriented people. On gaining independence a near complete lack of knowledge about how an economy works was inherent to the majority of the 52 million population of the country. This helped the representatives of the criminal group who were never respected by the majority of citizens to make it to the surface. Despite being openly despised by the bulk of the population they took advantage of the general economic ignorance by actively using personal qualities and characteristics absolutely contrary to the principles of public morality of that time. They set out successfully to provide a living for themselves at a higher material standard than the mainstream population.

Ukraine's GDP amounted to about 80 billion USD in 1991, which would correspond to almost 200 billion USD in 2017 if we convert the prices. However, even the peak value of GDP that Ukraine reached in 2013 **was at least a quarter less the 1991 level.** So, if talking about the dollar equivalent of GDP the economy of Ukraine in its recent economic history has not even reached its starting values. The situation appears more dramatic if we take into account the untapped opportunities for economic growth. The difference between what could have been and what actually happened when considering then that the world economy showed an average annual growth of about 3 %, the current GDP of Ukraine should have been more than 400 billion USD by the end of 2017.

Thus, at the conclusion of 2018 Ukraine will be at the level of no more than 1/3 of its current potential. The country's 250 billion USD in GDP lost in 2018 is a high price paid by the people of Ukraine for an economic policy pursued in the interests of a very limited group of oligarchs. This policy has led to an extremely low standard of living. The gap between the standard of living of Ukrainians and Europeans is increasing, and the country is becoming the main "supplier" of labor to neighboring countries. These "deficiencies" are the price for the reluctance to move along the path of reforms that were made by the European neighbors of Ukraine in the 1990s to early 2000s. So instead of a 2018 GDP supporting a level of 2500 dollars per capita, which is lower comparably with many African and

Asian countries, we should be on 10,000 dollars enabling the people of Ukraine to be on a par with their successful Western neighbors. This is also without taking into account the purchasing-power parity, which could practically bring Ukraine to the level of many old EU members.

The behavior of all economic actors, including state institutions is always rational. You can argue about a specific goal. You can disagree with the methods of achieving it. You might not understand the logic of the economic actor but the lack of understanding of the logical chain of the organisation or individual does not mean that this chain does not exist. For some reason, and primarily because of the non-systematic nature of analysis and institutionalised lack of information, this logical chain is not always clear to the average citizen or analyst. But such under the surface logic certainly exists. With this in mind, it seems quite natural to ask who would benefit from driving an entire European country, which has had and still has considerable potential, into such "economic poverty"? The "narrow circle of persons concerned" took, and visibly still do take, significant benefits from the following factors:

The business climate in the country is unfavourable and has never been changed drastically during the recent economic history to ensure an economic breakthrough;

- The level of corruption in Ukraine (despite the intensified political rhetoric on this issue) is still not only the highest in Europe, but also significantly higher than the level of corruption in former Soviet Union republics;
- The level of competition is very low, and the level of monopolization in many economic spheres is very high;
- The shadow economy is so vast that it may even equal the size of the official economy;
- The barriers to business are so high that the small progress of the past few years seems insignificant and is below other post-Soviet European countries;

- The judicial system remains substandard and in large part, has the characteristics of the Soviet system with such abhorrent feature of allowing representatives of "the narrow circle of persons concerned" to influence judicial decisions;
- A significant part of business is still owned by the state, and privatization is blocked;
- The coalescence of capital and politics has reached such a scale that not only is no one surprised but it is already perceived as a completely normal phenomenon in the public consciousness.

This creates the illusion of a social agreement that makes it possible to preserve the formal features of democracy whilst openly neglecting it when business interests are paramount.

This list could be much longer, but it does not change the specified search parameters for identifying those who belong to this narrow group. By default, this circle acts according to quite rational logic.

Moreover, this logic is not burdened by ideological grounds. It is very primitive. The key task is to maximize one's own well-being. In the most simplified version, it takes the value of available assets and the amount of rent they provide. The sum of these two elements should be maximal. Therefore, in some periods it is acceptable to increase one of the components by reducing the other. It is important that their total amount does not decrease and in a longer-term perspective should grow.

So new ideas about the inclusiveness of economic growth actively discussed by international experts and within politics are consciously not noticed in Ukraine by this "elite". Acknowledging this discussion at all or actively supporting it will mean agreeing that:

A there are serious distortions in the current distribution of GDP,

B the level of polarization in the material standard of living (stratification) is very high,

C this situation is not created by the people of Ukraine but on the contrary, by a parasitic group of oligarchs.

This "narrow circle of persons concerned" even at the beginning needed serious political support. It was this political support that gave the opportunity to preserve the economic conditions that would allow them to pursue their own ambitions. The economy had to develop only in a way that was approved by them. Despite the complexity of implementation, when aided by a democratic deficit, this was not a daunting task. The initial capital available to representatives of "the narrow circle of persons concerned" was used to obtain political support. The institution of parliament was high-jacked. The country and political process lurched in the direction of so-called, "rent-seeking behavior"; in short, seeking all available opportunities to earn.

It is not difficult to test this idea by communicating with current members of Ukraine's supreme legislative body. At least several subgroups can be identified almost unmistakably among those, who belong to this group of "rent seekers":

A those who from the very beginning came to the Parliament as employees of the group;

B those who invested in themselves independently or had the luck to be elected to the Parliament, and only then successfully made an agreement with "the narrow circle of persons concerned", eventually started serving their interests whilst simultaneously trying to go into the business at the lower level;

C representatives of business and individual business groups who needed political support to ensure they could conduct work normally and did not wish to assume all the risks that existed for those who did business without such support and who were forced to spend additional funds purchasing it.

When the entire legislative foundation of the country is built for the benefit of a narrow circle of people then the main economic activity is conducted exclusively for this circle. That is why the valuable commodity sectors of the economy were actively developed. Purchasing "the admission ticket" was impossible without political support and the initial capital spending was at a low level. The entrepreneurial development of small and medium-sized businesses has been ignored or neglected in Ukraine. That is why almost no outsider could get into this circle. External competition to the group was avoided by representatives of the circle and was rooted out mercilessly. The ability of the group to influence the authorities made this task relatively easy to accomplish. It is clear that the judicial system of Ukraine, which according to almost all experts and representatives of civil society needs urgent change, is still the same. While its current state remains, it is possible to easily influence or remove those who pose a threat to the established order.

The desire to prevent competition coming from the outside explains the reluctance to allow access of foreign investors to the country. After allowing a foreign investor to enter, the group has to immediately accept the risk that the new investor will be more intelligent, more cunning and more far-sighted than a homegrown feudal lord. A foreign investor did not earn his capital by simply taking it away from his own population. The money was earned in fair and fierce competition in the market economy. Objectively this investor will be competitive and therefore able to violate the decade-long oligarchic pact.

When disputes arise, a foreign investor may submit conflicts (at least partially) to foreign courts that are not controlled by the Ukrainian group. This means that the probability of loss is high for them. This is

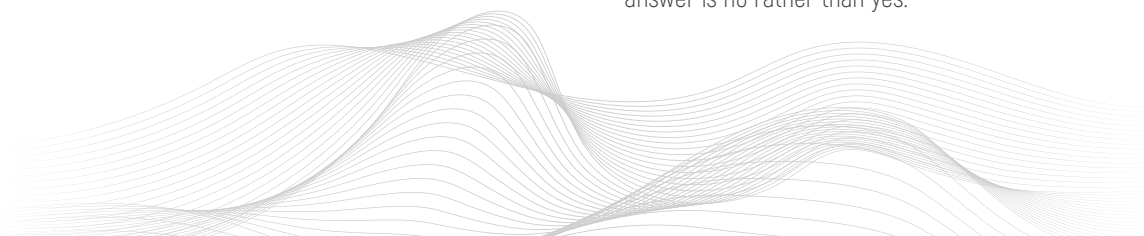
unacceptable. Given the fact that at some point almost all representatives of group began to understand that the system they built in Ukraine could actually rebound and pose a serious threat to them selves. So along with obtaining foreign citizenships they invested part of the rent received in Ukraine abroad. Such an investment is more than natural for each of them.

This however also means that "the narrow circle of persons concerned" are vulnerable to the whims of those bigger players to whom they are "nestling up" at the same time as they are trying to save themselves, relatives and allies from the fate they themselves prepared for ordinary Ukrainians. That is why the amount of officially registered outward investment during the entire period of recent economic history is greater than the amount of inward investment. That is also why "the narrow circle of persons concerned" cannot openly ignore all said by the representatives of those countries where they have already acquired new citizenship.

Representatives of the Ukrainian Parliament do not want to disclose their new (second and sometimes third) citizenship, but rather try to legalize the act. As with any self serving economic task they continue to act quite rationally. They need to protect only themselves and no one else.

The world is becoming very open. Whereas previously the wheel of world history made its turn during a year, now it can happen in a few days. Even in their worst dream none of those serving the interests of the elite group could imagine that the data on their offshore activities would become known to the public. It is quite understandable that with consolidated efforts they eliminated almost all the irritants of their tranquility.

Will they be able to continue doing the same in the future? This is an open-ended question and the answer is no rather than yes.



THE STRUCTURE OF THE UKRAINIAN OLIGARCHY

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We need an accurate definition of the "oligarchy". In recent years the concept of "oligarch" has acquired various attributes that do not necessarily reflect its essence. For example, one of the mandatory attributes is ownership of the media, but this reflects the use of one valuable political tool rather than the core essence of Oligarchy.

In this report, we will proceed from the basic definition of the oligarch as an entrepreneur who uses political influence in the interests of his own enrichment. Political influence should be understood as a wide range of tools that enable the oligarch to strengthen his own capital. This includes media, groups of members of parliament, and direct ties with authorities (friendship or family ties), a monopoly position in the market, and so forth.

Another popular stereotype about Ukrainian oligarchs is characterizing them as wealthy entrepreneurs, who enriched themselves at the expense of non-transparent privatization in the 1990s. This stereotype does not let us to take into account a significant number of new influential entrepreneurs, who are now actively developing their own infrastructure of influence on the government. Our analysis of the economic and political influence of oligarchs on the system of power allows us to distinguish three groups of the Ukrainian oligarchy:

**The old oligarchs — The young oligarchs —
The neo-feudalists**



— “THE OLD” ONES OR “TOO BIG TO FAIL”

When it comes to “the old oligarchs” we refer to those who gained their wealth mainly during the 90s and continued to be the richest people in the country for many years up until now. “Novoe Vremya” magazine defined 10 businessmen who remained in the top 20 richest people in the country for 11 years. They are those who can be considered “the old oligarchs”. They are Rinat Akhmetov, Victor Pinchuk, Kostyantyn Zhevago, owners of Privat Group (Ihor Kolomoyskyi, Gennadiy Bogolyubov, Oleksiy Martynov), Yuriy Kosiuk, Oleksandr Yaroslavsky, Dmytro Firtash and of course the current President, Petro Poroshenko.

This list is incomplete because Surkis brothers or Vadym Novynskyi appeared in such ratings much less frequently. However, the same principle of “enrichment during the 90s” should be applied to them. Therefore, they can also be categorized as “the old oligarchs”, as long as they maintain their wealth and influence on Ukrainian politics.

It is important to note that we do not include Serhiy Taruta, Yulia Tymoshenko and Viktor Medvedchuk in this list. Let us explain our logic. As a consequence of the armed conflict in the Donbas region, Taruta has lost the greater part of his most expensive assets, and, accordingly, he is no longer in the list of the richest Ukrainians. He has no serious instruments of influence on Ukrainian politics, except his own membership in parliament. In recent years his companies were not making money because of any influence on power. Therefore, from today's perspective, Serhiy Taruta should be considered an ex-oligarch.

Yulia Tymoshenko, undoubtedly, belongs to those who were enriched in the 90s and used power in the interest of her own business. However, unlike other oligarchs, Tymoshenko became a professional politician and lost her own business. As of today, power for its own sake appears to be the personal political goal for Tymoshenko, not a tool of self-enrichment. Undoubtedly, her campaign and political activity are financed by other oligarchs and allies. In the case of Tymoshenko's rise to power she will most likely create favorable conditions for particular financial and industrial groups. But for now despite public thinking otherwise she does not appear meet the strict definition above of “oligarch”.

Viktor Medvedchuk could be characterized as an oligarch, but in today's conditions, it is difficult to consider him to be one. The fact is that Medvedchuk is more a Russian tool of influence on Ukrainian power and politics. Therefore, in our opinion, it is inappropriate to consider him as an independent player, which is a typical feature of the old oligarchs. Considering the latest media information about Medvedchuk having an oil business in Russia, and his impact on the Ukrainian market of liquefied gas due to relations with Russia, it turns out that he should be called not a Ukrainian, but a Russian oligarch.

“The old oligarchs” today represent the most influential and organized power in the country. According to CES estimates, they own 13% of the Ukrainian economy. This makes them “too big to fail” or in other words, their clout and influence forces any power to compromise with them. In fact, “the old oligarchs” have determined the model of the Ukrainian economy and politics for the last 20 years.

— THE YOUNG OLIGARCHS

This category differs from the previous one in that its clout depends directly on the political or market situation. Sometimes it is the closeness to the changing political scenery that is the cause of their appearing and disappearing. Generally, young oligarchs upgrade from the category of small or

medium businessmen simply by political or economic chance, and it is difficult for them to remain after this chance disappears. Similar to “the old oligarchs”, “the young oligarchs” grow quickly because of the artificially created monopoly in any industry.

The most striking example of the young oligarch is Serhiy Kurchenko. Due to the support of "the family" (a term describing those close to Victor Yanukovych), he obtained a monopoly on the liquefied petrol gas market and very quickly converted it into billions of dollars. He could even afford to purchase a football club. This would have attributed him to the circle of old oligarchs. However as his business was a result of his political contacts, everything came to an end when Viktor Yanukovych fell.

Young oligarchs can be divided into two subgroups:

1. The political conjuncture subgroup

This includes those who transfer to the category of "the rich and influential" purely by political chance. Today they are Ihor Kononenko, Dmytro Kropachev, Arsen Avakov, etc.

2. The economic conjuncture subgroup

This group includes those who have become rapidly rich because of the economic situation; for example, agro-oligarchs Oleksiy Vadaturskyi and Andriy Verevskyi. The rapid growth of grain exports, which began in 2012, and the depreciation of the Ukrainian currency took them into the top-20 richest people in the country. Another example is the construction boom having a significant impact on the wealth of the Hereha family after 2015. They are now beginning to convert this into a serious local political influence. The young oligarchs completely replicate the behavior of "the old" ones in their activities. They try to monopolize certain sectors of the economy, form political power groups, put their people into the management of state enterprises and authorities and "arm" themselves with small media. However, the key problem for them is stability. Despite their considerable financial and political resources, they are very vulnerable to changing conditions and environment.

— THE NEO-FEUDALISTS

The oligarchs of a local scale belong to this category. In contrast to "the old" and "the young oligarchs", neo-feudalists are monopolizing not an economy sector but specific territory. As a rule, they use all oligarchic approaches, have significant resources, they "seize" local authorities, local law enforcement agencies and courts, and the local media within a certain territory. The clout of each of them separately is insignificant on a national scale. But all together they represent an influential stratum of society, which is an essential factor in the functioning of the political system.

One of the important instruments of neo-feudalists' influence is the vote of an elector. Due to the monopolization of a certain territory, they can provide high results to specific political forces, and thus make adjustments to national policy.

Examples of neo-feudalists are majority party members of parliament, mayors, owners or directors of the core enterprises, etc etc. In this research, we are not analyzing this category of oligarchs but their power should not be underestimated.



Photo: *Espresso.TV*

INFLUENCE OVER THE ENERGY INDUSTRY



THE ELECTRIC POWER INDUSTRY

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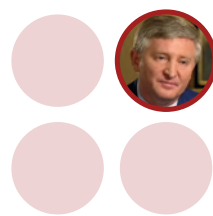
THE ELECTRIC POWER INDUSTRY

Redeployment of natural resources, rent and access to monopolies has always been the easiest way to enrich and accumulate primary capital. However, access to monopolies alone is not enough for the rapid development of an oligarch. Progress is almost impossible without "state assistance" in the form of the right decisions and "schemes".

There are not so many industries with the possibility of collecting natural resources and monopoly rents in Ukraine, and therefore energy has become one of the most common sources of enrichment and of corruption schemes. The energy sector of Ukraine is controlled either by the state (represented by large energy companies, which are often informally controlled by the authorities) or by big business, mainly from the sphere of influence of oligarchs. Rinat Akhmetov, Dmytro Firtash, Ihor Surkis, Kostyantyn Grigorishin, Ihor Kolomoyskyi – are representatives of "the old" oligarchy that control a significant part of the domestic energy sector.

One official who has his own often informal interests in the energy sector is Ihor Kononenko. He is considered to be the new "overseer" of state energy assets. Other officials have interest in the energy sector, for example, members of parliament Yuriy Boyko, Natalia Korolevska, Dubnevych brothers, Yulia Lyovochkina, Stepan Ivakhiv, The Minister of Internal Affairs Arsen Avakov (whose family owns gas production assets) and other less prominent persons. Several high-ranking officials of the ICU financial group have a significant impact on the energy sector. Its head, Makar Pasenyuk, was an adviser to Petro Poroshenko.

The mere existence of major players in the energy markets is not a problem. However, the proximity to the government and lobbying of the necessary decisions, and sometimes – corruption and criminal schemes, cause losses for individual businesses and for society as a whole.



AKHMETOV

1/4 OF THE ELECTRICITY MARKET

THE COAL AND POWER INDUSTRY —

Rinat Akhmetov is the major player in the coal energy industry. Akhmetov's DTEK holding company accounts for almost **1/4 of the electricity market**. Given that the largest market player NNEGC Energoatom accounts for more than **56%** of the produced electricity, the market is actually highly concentrated. At the same time Akhmetov's company controls the lion's share of production and supply of thermal coal: in 2017, the company accounted for **86%** of the production of this product in Ukraine. When the DTEK is importing coal, it is doing it through DTEK Trading S.A. registered in Switzerland. **According to energy expert Andriy Gerus, the price of this resource increases by 20-30% because of this scheme.**

At the same time, the most powerful energy oligarch

At the same time, the most powerful energy oligarch of Ukraine Rinat Akhmetov is interested not only in coal energy but also in gas production, solar and wind energy, transmission and distribution of electricity and municipal thermal power systems.

Of course, with the advent of the new government there will be new stakeholders. "Young oligarchs" are getting involved in the energy sector, pushing back the predecessors from the previous government. In 2017, Natalia Korolevska tried to sell her coal business – PJSC Lviv Coal Company. The entrepreneur Vitaly Kropachev was among the potential buyers. He is believed to be "overseer" of the coal industry appointed by the government representative Ihor Kononenko; considered to be "the curator" of the energy sector in general. Vitaly Kropachev now owns a significant amount of the coal assets previously withdrawn from the state.

The main state-owned company in the coal power generation sector is PJSC Centrenergo. In 2017, the company purchased coal from the USA, and it is believed that these purchases were part of a politically motivated scheme that was developed to establish ties with the US President Donald Trump.

This asset is in Kropachev's area of interest. Most often, Akhmetov DTEK is accused of lobbying the so-called Rotterdam+ formula – import parity price on coal used to calculate the price of electricity. And the state-owned Centrenergo benefits from with this approach to their pricing as well. Otherwise, the asset would be a much less interesting potential purchase for people close to the government.

NUCLEAR POWER —

Nuclear power and the nuclear industry are fully controlled by the state and are not controlled by any oligarchic groups. However, according to the investigative authorities, Ihor Kononenko, who is close to President Poroshenko, was involved in the schemes of enrichment at the expense of this sector.

Former member of parliament Mykola Martynenko,

was suspected of schemes with the company engaged in the extraction of uranium ore and its enrichment; The Eastern Mining and Processing plant (East MPP). Martynenko, who is close to current and former top officials like Petro Poroshenko and Arseniy Yatsenyuk is associated with "the interlayers" through which the purchases for the East MPP were made. According to NABU estimates, the plant overpaid **US \$ 17.29 million** for uranium raw materials because of such schemes. At the same time, the plant itself has systemic problems with upgrading the production facilities, and for this Martynenko is also suspected of participating in non-transparent purchases for NNEGC Energoatom.

RENEWABLE ENERGY —

Renewable energy is another separate area of business interests of oligarchs. Due to the guaranteed high tariffs, any business that invests in "green" energy will probably be selling until 2030 at a stimulating price. The guaranteed tariff level will be reduced after 2019 and again after 2024 and will then be cancelled in 2030. This leads to a keen interest in investing in the sector before 2020. Serhiy Klyuyev, who lobbied for high "green" tariffs and later for barriers to reduce access to the market for new players, was the pioneer among oligarchs in this industry.

The green energy market is less concentrated than others. In 2017, 377 companies produced electricity utilising the tariff scheme, often with several companies having the same owner. However, other oligarchs are interested in increasing their share in this sector. One of the main players in the market is Rinat Akhmetov, whose company is the leader in wind power. In particular, his company DTEK Renewables B.V. owns Wind Power, which manages the largest wind farm in Ukraine – the Botievo Wind Farm. In general, DTEK accounted for **30.5%** of all electricity produced from renewable resources in 2017. Currently the share of this energy in the total production remains valuable but scanty.

Among other oligarchs, Vasyl Khmelnytsky has a

great interest in investing in “green” energy. In addition to oligarchs, persons in power invest in renewable energy and specialized businesses often have informal lobbyists among officials. These include the Dubnevych brothers, Anatoliy Matviyenko (PPB), Taras Kozak, Yulia Lyovochkina and a number of other members of parliament have connections with representatives of business (including the relatives) in the field of renewable energy.

It is clear that the main players of the sector, including oligarchs, do not like discussions on reducing the level of feed-in tariffs because it highlights their revenues. Soon the system of “green” tariffs which are already much higher in Ukraine than in Europe will be changed to a system of auctions where players will compete with each other for the right to produce such energy at the lowest prices). In addition, oligarchs are trying to get other preferences within the industry.

ELECTRICITY DISTRIBUTION AND THE SALES MARKET —

A large number of different oligarchs have amassed around the market of the distribution and selling of electricity. Companies in this area are natural monopolies, in some cases they are partially owned by the state and additionally by one or two representatives of business including oligarchs. The state is, generally, a minority shareholder in regional electricity distribution companies. The ultimate owners of Ukrainian regional power distribution companies “oblenergos” are Kostyantyn Grigorishin, Ihor Kolomoyskyi, Rinat Akhmetov, Ihor Surkis, Yuriy Boyko whose share in Volynoblenergo is **75%**, as well as in ICU and VS Energy. Despite a large number of oligarchs involved in this sector, the market concentration is rather low, but this does not exclude the possibility of collusions in order to achieve their own goals.

It is clear that usually oligarchs are the owners of these enterprises not in a direct way, but through the

companies they are affiliated with. In some cases, there is no direct evidence of a particular oligarch's connection with a particular company. Often these companies are registered offshore allowing withdrawal of funds from the country and minimization of taxes paid in Ukraine.

Makar Pasenyuk, former financial adviser to President Petro Poroshenko, is the director of the investment company ICU. A number of ICU's former employees have moved to high state positions in recent years: former Chairwoman of the National Bank of Ukraine Valeria Gontareva, former Minister of Energy and Coal Industry Volodymyr Demchyshyn and former Chairman of the National Commission for State Regulation of Energy and Public Utilities (NCSREU) Dmytro Vovk).

In addition to Ukrainian oligarchs, the electricity distribution companies are owned by VS Energy, a company registered in the Netherlands and associated primarily with Russians from the post-Soviet space. In due time, VS Energy bought shares in Kiev- and Rivneoblenergo from beneficiaries from the United States. The company de facto owns shares in 11 regional power distribution companies. In addition to ownership, there was also financial control over enterprises majority-owned by the state.

A vivid example is the Surkis brothers' financial control over some regional power distribution companies in Mykolaiv, Kharkiv, Khmelnytsky, Cherkasy and Zaporizhiaoblenergo. This was through PJSC HC Energomerezha whose former director Dmitry Kryuchkov is a former MP from the Yulia Tymoshenko Bloc and an ex-member of the parliamentary committee on energy industry. The company redeemed the debts of regional power distribution companies, formed by the major buyers of electricity for amounts that were significantly lower than those debts using deferred payments. However the company did not later return the funds to energy distribution companies.

PJSC HC Energomerezha withdrew **2 billion UAH** from Zaporizhia, Kharkiv and Cherkasyoblenergo.

The biggest scandal happened with Zaporizhiaoblenergo. As a result of the withdrawal of funds from the company, NCSREU sanctioned it by applying the mechanism of work according to a zero algorithm. Regional power distribution companies could not then use the funds. This led to long-term non-payment of salaries.

According to estimates of the NABU, the financial frauds connected with OJSC Zaporizhiaoblenergo and the State Enterprise Energyrynok resulted in damages amounted to more than **\$ 346 million**. At the same time, the deputy from the Revival party close to Igor Surkis submitted a bill designed to solve the problem of Zaporizhiaoblenergo. In May 2018, the court declared bankruptcy of the company Energomerezha. Control over part or over all of the companies that Energomerezha worked with will go to Ihor Kononenko. Accordingly, Igor Surkis will lose his influence.

The high concentration of electricity assets in the hands of a small group of individuals, in theory, provides bigger market and non-market power. This means simplicity of achieving the goal of making decisions by state favorable for these individuals and companies.

At the beginning of 2015, DTEK began to demand an increase in the purchase price of coal to 1 500 UAH (at that time, the purchase price set by state mines was 1 100 UAH). In February 2015, SE Energyrynok banned paying for electricity produced on the

uncontrolled territory (the decision was supported by the current minister Volodymyr Demchyshyn). This decision affected three stations of DTEK Skhidenergo – Zuivska, Kurakhove and Luhansk power stations, as well as coal mining and trading business. DTEK stated that as a result of such actions and the lack of concessions in the company's favor, coal production may be reduced and several thermal power stations would be stopped. This could cause power outages around the country.

In April 2015, there were protests of the miners in front of the Presidential Administration demanding the resignation of the minister. Member of parliament Mustafa Nanyem reported that he had at his disposal the plan developed by DTEK in order to protect the company's interests, which, among other issues contained an information campaign and the data on the possibility of organizing mass strikes. Subsequently, DTEK got the desired favorable conditions, and eventually, the price of electricity began to be calculated on import parity of coal prices (so-called Rotterdam+ formula, which is accused of opacity and bias).

Much more opportunities open for representatives of the oligarchy when they have high-ranking officials among the partners. In 2012-2013, the state-owned Energoatom was reducing the electricity generation to increase the amount of electricity production by coal-fired power plants, which meant an increase in the profitability of the companies concerned.



NATURAL GAS

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NATURAL GAS

GAS PRODUCTION —

Oligarchs in Ukraine rather poorly control gas production. In 2017, state-owned companies were responsible for **78.3%** of production. The leader, as usual, was the company UkrGasVydobuvannya (member of the Naftogaz Group, complete state ownership, **15.3 billion cubic meters, 74.6 %**). Ukrnafta is one of the gas producing companies majority-owned by the state. For a long time, a minority shareholder Ihor Kolomoyskyi and his partner Gennadiy Bogolyubov were able to establish operational control over the company. Among a number of other abuses, minority shareholders introduced a scheme under which, contrary to the requirements, managed to sell the produced gas to non-industrial consumers. They were providing their own chemical production plants with gas (of course, at the price favorable for these investors).

Private companies produced only **4.1 billion cubic meters of gas** in 2017. The largest private gas producer is the Naftogazvydobuvannya, $\frac{3}{4}$ of which is owned by Rinat Akhmetov, and it is part of DTEK Oil&Gas. The DTEK produced **1.65 billion cubic meters of gas** in 2017, which is **8%** of the total production amount in the country. It is the Naftogazvydobuvannya that received record-breaking rescheduling of tax debts – **145, 1 million UAH** in 2016.

The founders of Naftogazvydobuvannya in 1999 were Mykola Rudkovsky and Petro Poroshenko, who later sold half of his shares to Nestor Shufrych. Subsequently, 25% of the company was sold to Rinat Akhmetov, who in April 2013 increased his share to almost 50%, having bought the share from Mykola Rudkovsky. In 2015, when relations between Akhmetov and President Poroshenko were quite tense (one of the manifestations of which was the above-mentioned conflict in the field of heat generation), the Prosecutor General's office and the SBU paid close attention to the company's activities, which may have been a manifestation of Poroshenko's attempts to regain control of the company. After the establishment of relations between Akhmetov and Poroshenko, the first one increased his share in the company to **75%**.

Whereas one of the ex-heads of the company claimed that Akhmetov bought it at the underestimated price.

The next largest gas producer is Burisma Group (includes 12 companies, **4.8%** of production in the country), controlled by Mykola Zlochevsky, Minister of Ecology during the presidency of Viktor Yanukovich. In January 2015, general prosecutor's office started criminal cases against Zlochevsky, and a number of his assets were arrested. In early 2017, the company announced the closure of criminal cases against it and its owner Zlochevsky. Before that Zlochevsky met Kononenko. And according to the runaway deputy Oleksandr Onyshchenko, negotiations on the closure of cases were conducted with Kononenko. In early 2018 Zlochevsky freely visited Ukraine. He bought gas assets from Yury Ivanyushchenko (a close associate of Viktor Yanukovich), and it was done in collaboration with Kononenko.

In fact, Mykola Zlochevsky has migrated from the cohort of small "young oligarchs" of Yanukovich's era to "young oligarchs" of Poroshenko's tenure.

Moreover, it happened with the participation of Kononenko, whom Zlochevsky knows for about 20 years. It is known that Zlochevsky's company supplied gas to enterprises related to Petro Poroshenko and

his immediate circle, including Ihor Kononenko.

The rest of the gas companies associated with the oligarchs account for a very small share in this sector. Therefore, neither the interest of oligarchs nor their influence on the sector is significant so far. Thus, the company Ukrnaftoburinnya, which is associated with Ihor Kolomoyskyi, Deputy Vitaliy Khomutynnik and, possibly, with businessman Pavel Fuks, accounts for small volumes of production (**390 million cubic meters** in 2017, **1.9%** of national production). In addition, Kolomoyskyi is related to Poltava Petroleum Company. Victor Pinchuk owns small gas companies Natural Resources and Eastern Geo Alliance. Vadym Novynskyi is the owner of Smart Energy Group.

Gas production also belongs to the sphere of interests of the Minister of Internal Affairs Arsen Avakov. However, the companies that are associated with him are extremely minor market players. In 2017, the LLC Aktyv Gaz Resource produced **9.452 million cubic meters**, LLC Sakhalinske – **2.63 million cubic meters**, LLC Energy-95 – **90.339 million cubic meters**, which cumulatively corresponds to **0.5%** of national gas production. There was the struggle for access to gas-bearing areas between Avakov and Kononenko already during their stay at the power, which Avakov has lost.

GAS DISTRIBUTION —

Unlike the natural gas extraction sector, gas distribution is almost entirely controlled by oligarchs, business groups and, partially, by individual officials. The main player in the gas distribution and gas sales sector is Dmytro Firtash, who owns the Regional Gas Company. In fact, Firtash controls the distribution and sale of natural gas in 20 regions of the country.

These same companies, according to some politicians, are associated with Yuriy Boyko and Serhiy Lyovochkin. The rest of the regional companies are mainly controlled by local business elites. In fact, only one company Kirovohradhaz is under the control of the state-owned NJSC Naftogaz.

Before the reform of the gas market, distribution and supply of gas were carried out by **42 companies** (city gas authorities and regional power distribution companies), that provided the delivery and sale of gas to end consumers. The introduction of the gas market provided for the prohibition of the delivery and sale of gas by one entity. Consequently, the owners of gas distribution companies have created separate entities that have started to sell gas to those end consumers who were previously serviced by gas distribution companies. In fact, an oligopoly with a high level of concentration was created at the market. In addition, the issue connected with gas distribution companies' payments for the use of relevant gas networks

remains unresolved. Today, in fact, these companies operate properties that do not belong to them without charge.

According to NJSC Naftogaz, regional gas companies controlled by Firtash are discarding part of the gas as sold to "ghost" buyers, using the resource for their own purposes, in particular, to ensure the operation

of assets in the chemical industry. They are also abusing manipulations with the real volumes of production and technological losses of gas, carrying out unauthorized pumping out of process gas from the networks. In addition, the companies systematically do not pay off Naftogaz for gas supplies, constantly increasing the volume of debt.

PETROLEUM PRODUCTS

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PETROLEUM PRODUCTS

The main oil producer in the country is Ukrnafta – an enterprise majority-owned by the state, however, as mentioned above, a minority shareholder Ihor Kolomoyskyi and his partner Gennadiy Bogolyubov were able to establish operational control over the enterprise and keep it for a long time. The remaining companies account for a very small share of oil production and have little heft in the sector. Production of petroleum products is carried out only at the Kremenchug Refinery (owned by PJSC Ukratnafta) and the Shebelynka GPP (owned by the state company UkrGasVydobuvannya).

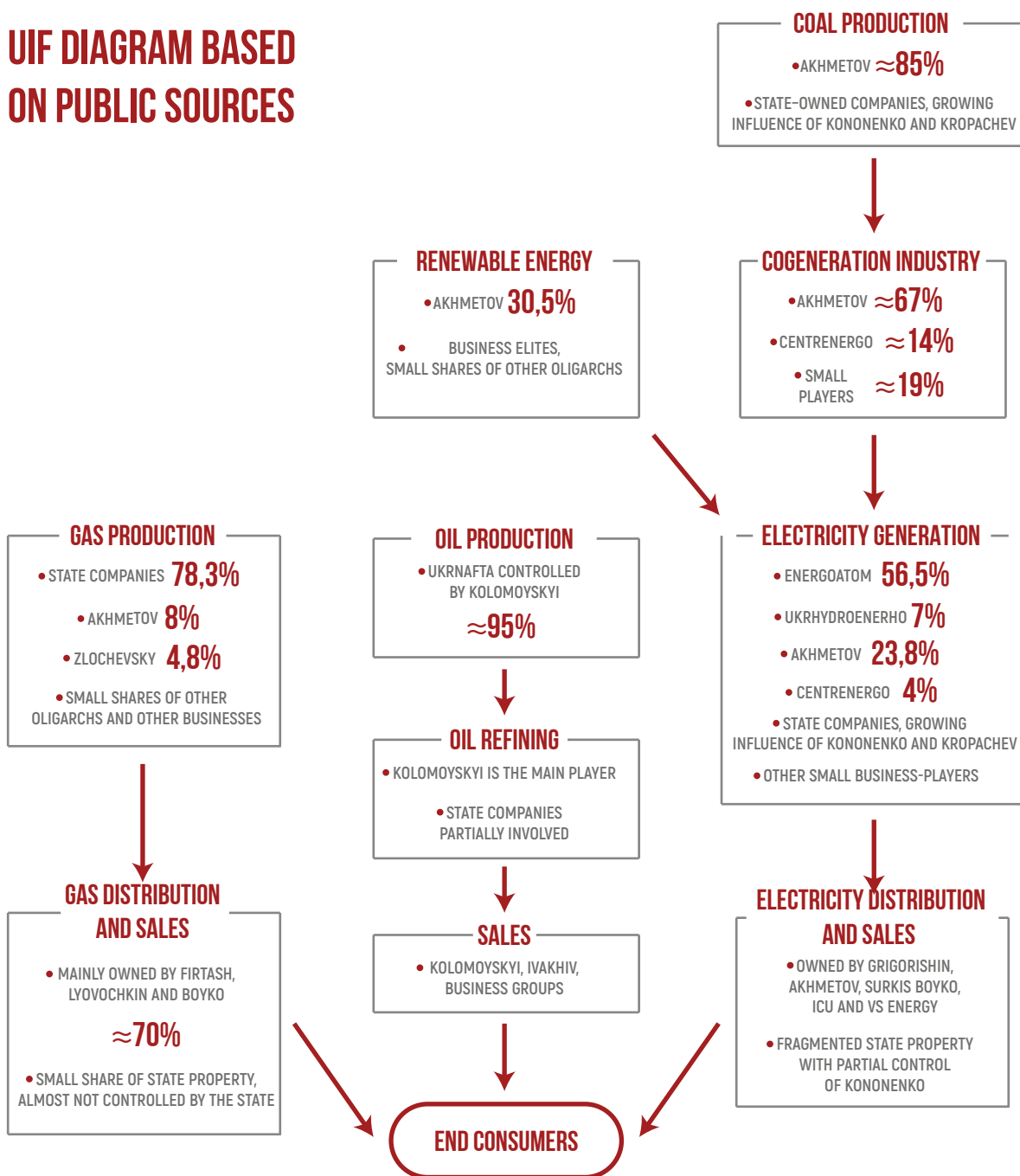
UkrGasVydobuvannya is fully controlled by the state. In Ukratnafta the state is a minority shareholder, and the company is actually controlled by Ihor Kolomoyskyi. The oligarch is still implementing schemes of withdrawal of funds from Ukrnafta. Only in 2015, approximately 15 billion UAH was withdrawn from the company. Kolomoyskyi repeatedly made attempts to strengthen his influence in the market of petroleum products in Ukraine, in particular in 2018.

Kolomoyskyi and Bogolyubov's Privat Group is one of the largest market players in retail trade of automotive fuel. Regularly re-registering of gas station and networks to other owners happened in order to avoid fines from the Anti-Monopoly Committee and other regulatory bodies.

First of all, such schemes are used by Kolomoyskyi companies. Other oligarchs, in fact, are not market players, although Ihor Yermeyev, Petro Dymynskyi, Eduard Stavitsky, Serhiy Kurchenko previously played a prominent role. Except for Privat Group, the businessman Vitaly Antonov (Galnaftogaz, OKKO),

People's Deputy Stepan Ivakhiv (Kontyniym Group, WOG) can be named among the significant current market players. These market participants also carry out the import of petroleum products, because Ukraine meets its fuel needs with its own production by more than **20%**.

UIF DIAGRAM BASED ON PUBLIC SOURCES



THE FUTURE OF POWER INDUSTRY AND OLIGARCHS

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THE FUTURE OF POWER INDUSTRY AND OLIGARCHS

The main threat to the domestic energy sector, and, accordingly, to the beneficiaries of energy assets, is the deterioration of energy assets and the decline in demand for their products. Speaking about the problems of the domestic energy sector (existing and potential, which the sector will face in the future), it should be understood that different groups of beneficiaries have different interests. "The young oligarchs", as well as officials who make money off the work of energy assets, withdrawing funds from them, are not too concerned about the future of the energy sector. Their main goal is to collect the largest rent while they have access to these assets. Oligarchs, who actually own such assets, should be most concerned about the future of energy industry – a possible reliable source of their income. Taking into account such differences in the interests of beneficiaries, as well as the current inability of the state to ensure transparent and efficient management of energy sector assets, it would be useful to introduce corporate management of state energy assets, as well as to stimulate the establishment of a competitive environment in the energy markets.

ELECTRIC-POWER INDUSTRY —

The reduction in sales of electricity in the electric power industry (and hence in the revenues of companies and their shareholders) may happen due to the decrease of industrial production and increase in immigration processes, which ultimately reduces the demand for electricity. This, in turn, will reduce the possibility of investment accumulation for the upgrading of electric power production assets. The reform of the electric power industry is designed to launch mechanisms that would increase the resource for reinvestment in energy assets. However, the reform and transition to market-based electricity pricing will lead to higher prices for industrial consumers and households, and then may be a factor for strengthening the processes of phasing out of industrial production (and its partial transfer to other countries).

A significant factor that could contribute to the establishment of real competitive fair electricity

prices in Ukraine, is the integration of the Ukrainian market into the European market (ENTSO-E) after the reform of the electric-power industry. The competition that will arise from the possibility of free import of electricity will force national producers not to drive up the price (accordingly, the pressure on the processes of phasing out of industrial production and emigration of the population, the main consumers, may ease). At the same time, the opening of the market after the reform may become an incentive for foreign investors to enter. Paradoxically, but the traditional energy industry (primarily coal-based) would have to be among the first to be interested in a free competitive market, and not in the pursuit of an annual increase in profits.

GAS TRANSIT —

Gas transit through the territory of Ukraine from Russia to the EU is out the sphere of the influence of oligarchs today. However, the future of the domestic gas sector is closely linked to the future of transit, which is now at threat due to Russia's targeted and consistent policy of building bypass gas pipelines. The complete loss of gas transit is equivalent to a drop in the country's GDP by 2.6–3 %, as well as the exclusion of Ukraine from the group of key players on the map of European gas supplies. This would open up opportunities for Russia to destabilize the situation in Ukraine including the launching of full-scale military operations.

This situation is, in fact, a consequence of the policy of neglecting the conjuncture and behavior of various players in the gas supply sector in Europe and Asia. At the same time, having the expectations that only blocking the construction of the Nord Stream 2 gas pipeline can preserve the role of the domestic transit potential may turn out to be another example of such neglect. According to many industry experts, the activities directed towards preserving transit through the conclusion of long-term contracts and cooperation with partners from Europe and Asia aimed at the use of domestic transit capacities should be a much higher priority rather than attempts to achieve banning the Nord Stream 2. Even if the construction of Nord stream 2 is be stopped, it

One of the ways to increase revenues, despite all the pathetic regarding environment protection and the need for energy transition, is to invest in renewable energy, which gives a guaranteed high income until 2030. Building "green" capacities, using high feed-in tariff will only increase the average price of electricity for consumers. And at the same time, it will "restrict capacities of nuclear power plants. A way out of the situation could be the creation of electricity storage capacities, development of capacities for maneuvering and balancing, as well as the above-mentioned integration of the energy market into the European one to facilitate the balancing and export of surplus electricity.

cannot be excluded that new gas pipelines bypassing Ukraine will appear, as well as new sources and routes for gas delivery to the EU (for example, an increase in the share of liquefied gas supplies). In addition, one should take into account the potential growth of Turkey's influence and its potential transformation into an important regional gas hub (and the subsequent conflict of interests with Ukraine in this area) and the growing role of the Eastern Mediterranean in gas supply. Consequently, the immutability of approaches to Ukraine's role in gas transit may become fatal for the future transit potential, the country's value in the region and the ability to guarantee its own security.

Ukraine has all the chances to increase gas production and turn the country into a country independent from gas imports. The role of oligarchs in this sphere is insignificant, which to some extent is a consequence of the imperfect system of stimulation of development of gas production. Those oligarchs who are associated with the gas distribution will be in a more difficult situation: the network is rather worn out. Further reduction of gas consumption (both due to the decrease in industrial production and population size and due to the replacement of gas by other fuels) will reduce the possibility of upgrading these networks (increasing accident incidence rate), as well as, potentially, their profitability.

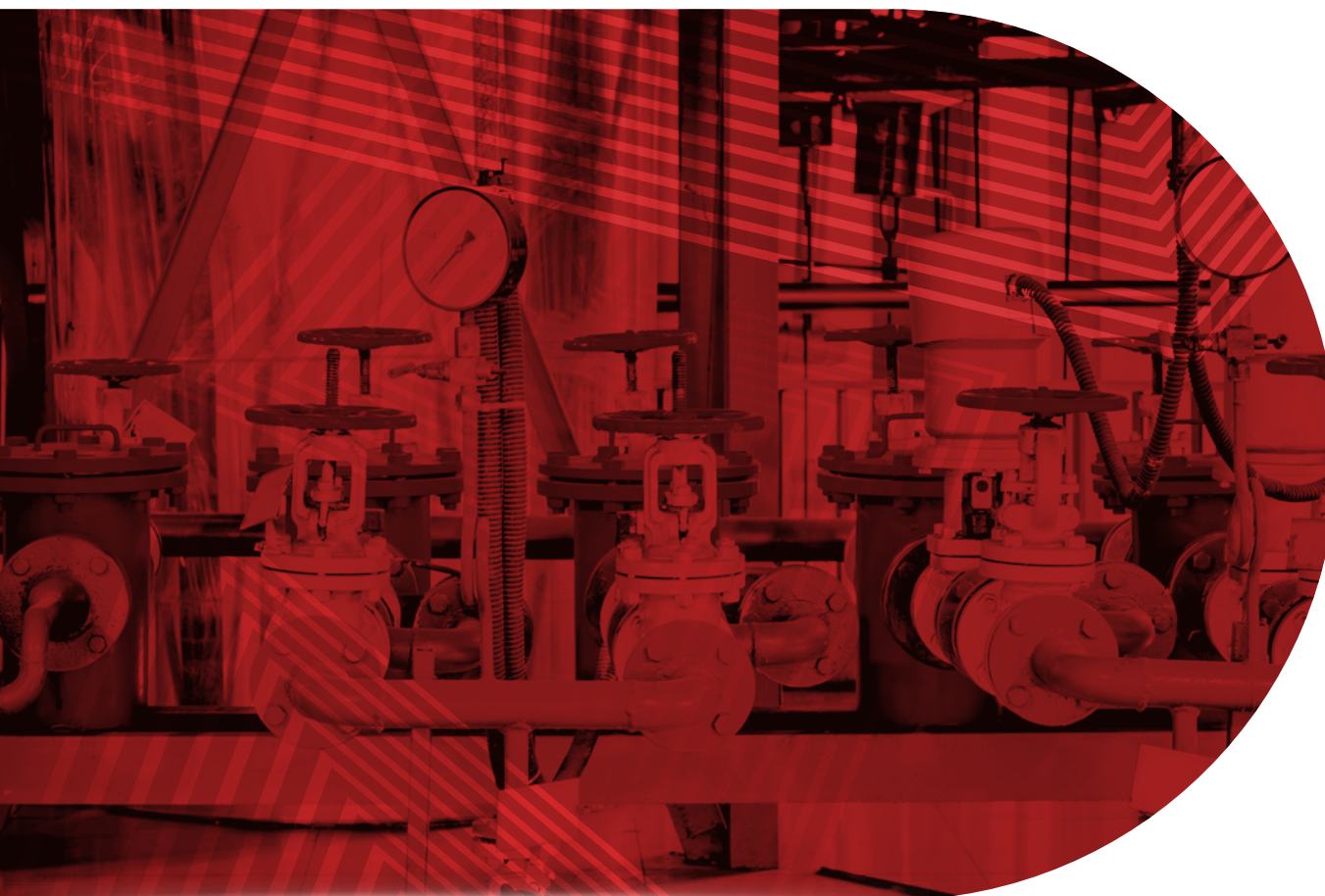
OIL PRODUCTION AND REFINING —

During several past years, there has been a clear trend of decline in oil production, that was actually mainly controlled by Ihor Kolomoyskyi.

According to the Ukrainian Institute for the Future, restoration of oil production and restoration of the oil refining sector to the level when they will be able to fully meet the needs of Ukraine will require 16 billion USD of investment. And now there are no grounds to

talk about the intentions of the oligarchs to invest in this sector to maintain their own positions and guarantee profits in the future.

At the same time, we can not exclude the fact that Kolomoyskyi is interested only in the fast collection of rent from the oil industry and the full use of the assets of Ukrnafta without ensuring the operation of enterprises and generating income in the future.



INFLUENCE OVER METALLURGY



Together with independence, Ukraine inherited a powerful metallurgical complex, which had its own resources: from ores to electricity and staff training system for the industry. The total amount of steel produced by the former Soviet republics was estimated at 116 million tons. The share of steel produced by **Ukrainian enterprises was 47 million tons.**

UKRAINIAN ENTERPRISES

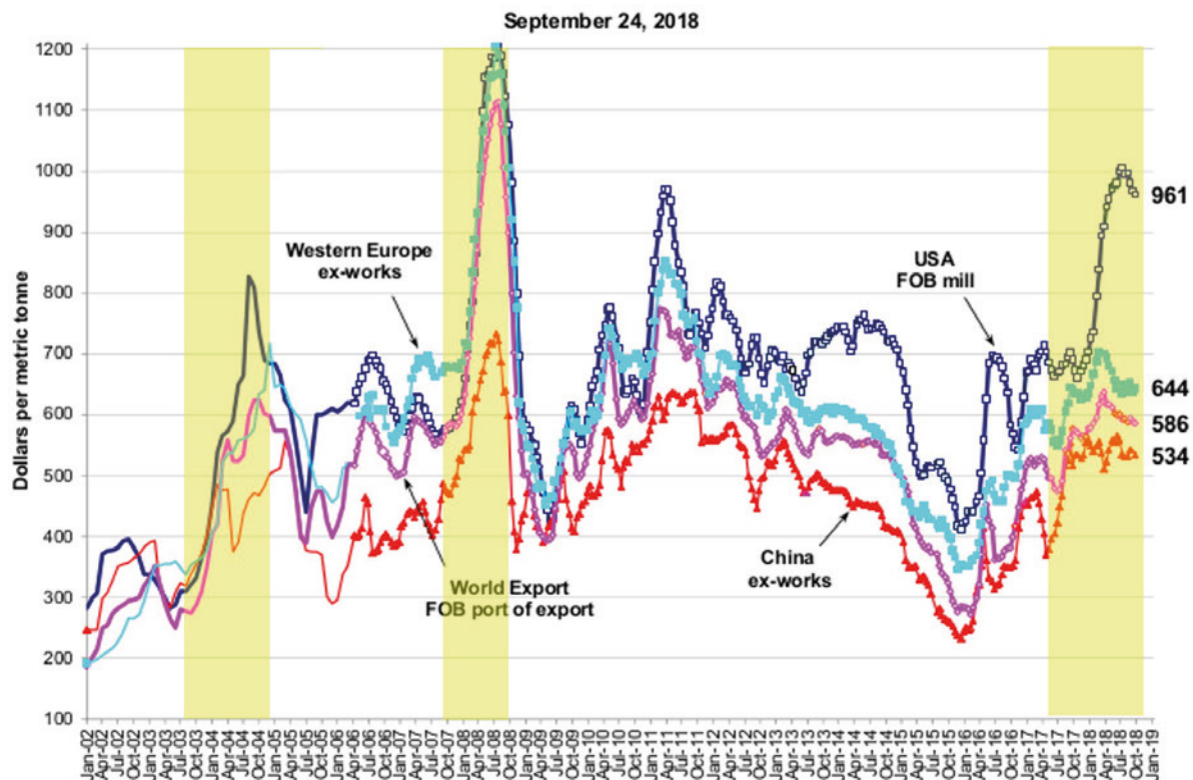
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MILLION TONS OF STEEL

The economic crisis of the first ten years of independence was a clear demonstration of the industry's capabilities: according to the results of 2000, the export of ferrous metals and their products amounted to **25 %** of the total merchandise exports of the country. Another **4.6 %** belonged to non-ferrous metallurgy. It is quite natural that such indicators made control over the industry to be one of the key goals for the financial and industrial groups that were formed.

The first redistribution of the property ended before 2002-2003 and marked the end of the era of "red directors" (term describing principals of big factories working before and after the Soviet Union collapsed).

Primarily it involved the ferrous metallurgy enterprises and, in particular, mining assets. As a result, already in 2004, against the backdrop of growth of metal prices, the new owners of enterprises were able to attract investment in the industry, increasing production capacity (in the mining and metallurgical complex in general) by **15-17 %**. Suffice it to say that the volume of investment in the industry in 2007 amounted to **10.5 billion UAH**. But, as the authors of the "Ekonomika ta derzhava" ("Economy and state") journal noted, there were no significant changes at the innovative level of production.

Despite this, the export revenues of Ukrainian steelmakers increased: 2004 was completed with **9.23 billion USD**, and in 2008 – already **21.1 billion**. The reason was a sharp increase in steel prices at world markets. The graph of changes in "hot rolling" steel prices since 1992, according to MetalMiner (Steel-Benchmark HRB Price) demonstrates it well.



The graph demonstrates that increase in revenues of Ukrainian metallurgists was due to sharp fluctuations in prices on world markets from **200-300 USD** per ton in 2002 to **720-820 USD** in the summer of 2004 and **1200 USD** in July 2008. Under these conditions, deep modernization of production has become an issue of secondary importance, i.e., the increase in output that was based on obsolete technologies and facilities enabled receiving good profits.

During the period of decline in prices globally, against the background of reduction in the cost of production, a significant part of the Ukrainian financial and industrial groups optimized costs in their own way, demanding (and receiving) additional benefits from the state. For example, the VAT refunds scheme, discounts for electricity prices. Of course, retrenchment affected the payroll budgets.

THE DEFEAT OF THE STATE AND THE RISE OF THE OLIGARCHS

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The state tried to change the situation by hitting the first link in the chain – obtaining assets at minimum prices. The results of the auction Kryvorizhstal auction were successfully appealed at the Commercial Court. The winner of the auction was the Investment and Metallurgical Union, founded by Rinat Akhmetov and Victor Pinchuk for the privatization purposes. At the second auction in 2005, the company's shares were sold to the Mittal Steel Company for **\$ 4.8 billion USD** (for reference, the result of the auction in 2014 was **4.6 billion, not USD, but UAH**). Along with the Kryvorizhstal, new owners got certain mines and Novokryvorizkyi ore mining and processing enterprise (MPP).

The sale of Kryvorizhstal was a turning point: on the one hand, oligarchic groups saw a threat to their assets, on the other – the ability to protect themselves by influence on the government. Unlike Leonid Kuchma, Viktor Yushchenko was unable to act as an arbiter in disputes between oligarchs and become a barrier, that would not allow financial and industrial groups to subdue political power. As a result, not only the revision of previous privatization was stopped. But obtaining control of oligarchs over metallurgical and raw materials enterprises (mining and processing plants) speeded up.





— Privat Group, owned by Ihor Kolomoyskyi and Gennadiy Bogolyubov, on the contrary, sold part of its metallurgical and ore assets to the Russian EVRAZ Group. In particular, the Sukha Balka MPP, Dniprodzerzhynsky Coke-chemical Plant (now Dnieper Coke-chemical Plant), Bagleykoks (now EVRAZ Pivdenkoks). A shareholding (50 %) of Southern MPP in Kryvyi Rih was another important purchase. The owner of the second-half of the shares was Vadym Novynskyi's company Smart Holding. Meanwhile, Kolomoyskyi didn't agree to sell Kryvyi Rih Iron Ore Combine, this way controlling process of transportation of outputs of Sukha Balka. This already in 2010 caused a conflict between the EVRAZ and Privat Groups, accompanied by the temporary shutdown of EVRAZ-Sukha Balka.



— In 2006 Rinat Akhmetov (SCM) and Novynskyi (Smart-Holding) decided to merge their metallurgical assets – Metinvest was founded. At the end of 2007, the company controlled the Northern, Ingulets and Southern Iron Ore Enrichment Works (part of the shares of the Russian EVRAZ Group) in Kryvyi Rih.



— The greatest success in the privatization of these assets was achieved by Kostyantyn Zhevago (Ferrexpo), who in 2005-2007 gained control over the Poltava Mining and Enrichment Complex and subsidiaries Yeristovo Mining and Belanovo Mining in the Horishni Plavni (former Komsomolsk-na-Dnipri). And in June 2007 Ferrexpo was the first Ukrainian company to place shares on the London Stock Exchange.

PESSIMISM REFLECTED IN NUMBERS

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Each FIG (financial and industrial group) began to build a vertical chain where the first stage was the extraction of raw materials and the closing stage was manufacturing of finished products. At the same time, bottom-level enterprises, due to the specifics of pricing, demonstrated minimal profitability or even losses, and last the link of the chain (most often being registered in offshore jurisdictions) accumulated profits from sales of finished products.

This enabled the domestic owners of Ukrainian metallurgy to withstand price competition in foreign markets. But the increase in business profitability, with minor exceptions, did not lead to an increase in investments in production and its development. The best way assess the processes it using the data on steel production. International organization World Steel Association (worldsteel) annually publishes analytical reports on the state of the industry – Steel Statistical Yearbook. And we will refer to these data below.

As of 2016 in Ukraine, 23 % of steel was smelted in open-hearth furnaces – the technology of the 19th century. This technological process is used by 0.4 % of all enterprises in the world. Except for our country and Russia (where the share of “open-hearth” steel is 2.4 %) this method of steelmaking is not used by ANYONE else in the world! The share of electric arc furnaces (electric smelting) is only 7 %. And this is despite of the developed nuclear industry in the

country. At the same time, the oxygen-steelmaking accounts for 70 %, respectively. For comparison, in Italy, which is responsible for similar amounts of steel smelting (23.3 million tons against 24.22 in Ukraine), the electric smelting accounts for 75.7%, in Turkey (33 million tons) – 65.9%, in Brazil (31 million tons) – 21.1%, in Iran (18 million tons) – 87% and, finally, in Russia – 30 %.

Below is the table reflecting the dynamics of changes in the share of “open-hearth” steel in total production since 1994

	1994	1996	1998	2000	2002	2007	2010	2014	2016
Ukraine	49,7%	49,5%	48,1%	50%	46,2%	44,8%	26,1%	20,5%	23%
Russian Federation	43,4%	35,9%	27,8%	27,3%	23,7%	16,4%	9,8%	2,8%	2,4%
China	15%	12,5%	8,9%	0,9%	0,1%	0%			
India	25,6%	15,2%	14,4%	9,3%	6,9%	0,9%	0,6%	0	

The source: *Steel Statistical Yearbooks, 1999, 2004, 2016, 2017*

In 2000, against the background of the first wave of privatization, the scheme of “maximum exploit” was used. Thus, the share of open-hearth smelting even increased. The same thing happened in 2016 when steel prices rose again. Please note that the data for 2016 include data on Donbas.

Ukrainian oligarchic groups, who are the owners of the metallurgical assets, as a rule, started modernization on the background of lowering prices and increasing pressure from competitors. However, we can mention two large-scale projects that were implemented during 2004-2014.

- **The Industrial Union of Donbas** began operating Alchevsk Metallurgical Combine. In the period 2004-2008, the first stage of modernization of the foundry production was carried out. The second was completed after the crisis of 2008-2009 by the launching of a new cooling system in 2014. In 2008-2011, the equipment of Alchevsk Coke-chemical Plant (that is part of the metallurgical complex) was upgraded. The total investment in modernization amounted to **2 billion USD**.

- Victor Pinchuk’s **Interpipe Group** in 2006 ordered a metallurgical plant to be built on a turn-key basis from the company Danieli. The contract for the construction was signed next year. Due to the crisis of 2008, the terms of the contract implementation were adjusted, and the new enterprise started operating in 2012 (previously planned for 2011). The total funding for the project was approximately **\$ 700 million USD**.

- **Metinvest Group** started the modernization of its enterprises later than the rest – the relevant plans were approved after the crisis of 2008. For example, the large-scale reconstruction of the company Azovstal, worth **1 billion USD**, was announced in August 2008. But in 2011, Metinvest’s management decided not to use open-hearth furnaces at the plant. And open-hearth shop at Illich Steel and Iron Works was closed only in 2015.

Despite several successful modernization projects, Ukrainian metallurgy industry (on average) lags behind the pace of technological improvement of production. For example, as of October 2017, there were 8 operating open-hearth furnaces in the



The technological gap would not be so noticeable if competitor countries did not increase the production. For example, Iran smelted **10 million tons of steel** in 2007. In 2016 – already **17 million tons**. China increased production from **489 to 808 million tons** during the same period. India increased production from **53 to 95 million tons**.

And there is a reverse trend in Ukraine – decrease from **42 million tons** in 2007 to **24-25 million tons** in 2016. In order to assess the decline of the Ukrainian metallurgy, you can refer to the data of the State Fiscal Service – the statistics on exports of goods from Ukraine.

Let's take 3 benchmarks to make the comparison: 2011, 2014 and 2017:

- **in 2011**, Ukraine exported ferrous metals worth **18,478 billion USD**, which amounted to **27,04 %** of the total volume of Ukrainian exports. Another **2.845 billion USD (4.16 %)** should be added for the ferrous metal products;
- **in 2014**, the situation changed slightly – metal exports amounted to **12.929 billion USD (23.92 % of the total)**, export of finished products declined to **1.707 billion (3.16 %)**;

- **in 2017**, the Ukrainian ferrous metallurgy had the following data: metal exports – **8,666 billion USD** (which is **20,03 %** of all exports from the country), and the export of finished products was estimated by the State Fiscal Service at **0.897 billion USD**.

The amount of deliveries in monetary terms declined compared to 2011:

- in the category "metals" by **2,13 times**;
- in the category "ferrous metal products" by **3.17 times**.

Despite this metallurgy is still one of the key export sectors of the country. But at the same time, changes in the production pattern are obvious – it becomes more primitive: the export of products with a low level of processing still exists and is growing. For example, as of 2004, when the existing system of "oligarch balance" or "oligarchic agreements" was finally formed, the export of those same pipes amounted to **2.2%** of total export. In 2016 – only **0.92%**. Decreasing the level of processing and reduction of production volumes led to an increase in ore exports: if local metallurgists do not use it, then foreign will. For example, in 2016, Ukraine exported iron ore amounted to **1.92 billion USD**. Whereas in 2004 it amounted to only **659 million**.

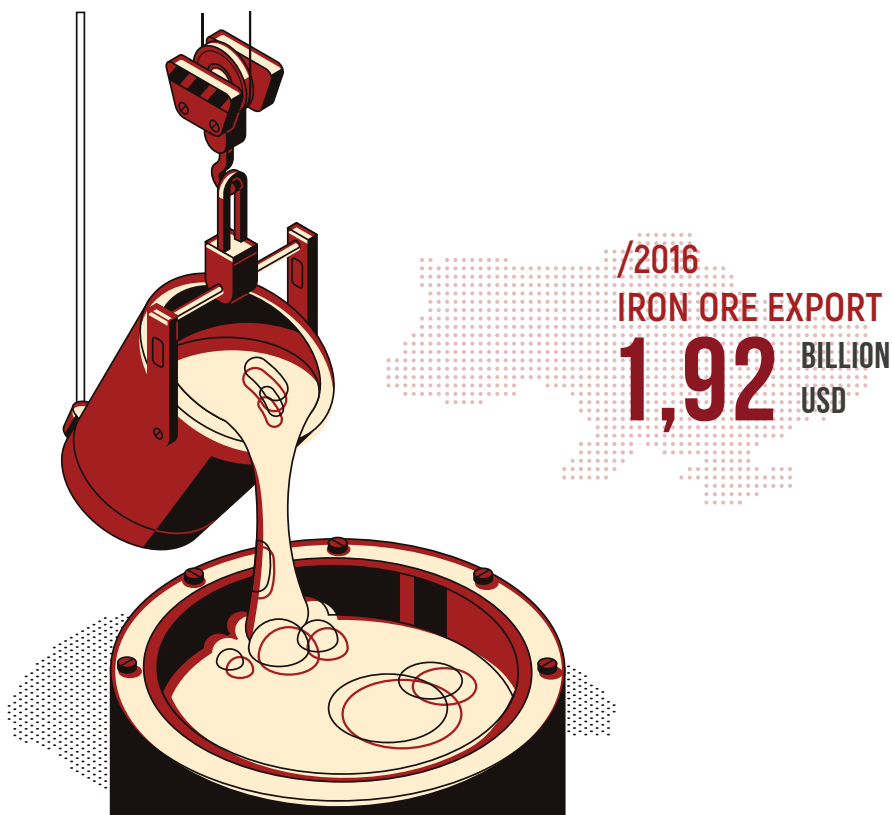


ILLUSTRATION OF PROCESSES IN THE LIGHT OF OWNERSHIP CHANGE

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In 2005, at the time of the final shaping of the Ukrainian oligarchic clans, when the state was unable to confront the political influence of some of the FIGs, the metallurgical complex was divided between several major players.

The largest player in the industry is the Metinvest Group, owned by Rinat Akhmetov, and in the middle of 2000s it took control of 3 mining and processing plants, several coal mines, metallurgical enterprises Azovstal (Mariupol), Yenakiyev Iron and Steel Works, Khartsyzsk Pipe Plant, Avdiivka Coke and Chemicals Plant, Dzerzhinsk Phenol Plant.

The Industrial Union of Donbas, which was created on the initiative of Vitaliy Haiduk and Serhiy Taruta, sold part of the business to Russian businessmen – owners of the EVRAZ Group. And already in 2010 ISD was only formally Ukrainian – the controlling stake belonged to the Russians.

Before this happened there were two parallel processes:

- Vitaliy Haiduk worked in the National Security and Defense Council of Ukraine (NSDC), and headed it in 2006-2007;
- During the same years the ISD, that he created, has gained control of Alchevsk Coke-chemical Plant and Alchevsk Metallurgical Combine, Dnieper Metallurgical Combine.

Ihor Kolomoyskyi's Privat Group controlled several mining and processing plants: former Ukrrudprom, Dneprospetsstal, Zaporizhzhia and Stakhanov Ferroalloy Plants. Kolomoyskyi struggled with Pinchuk, owner of Interpipe, to get influence over another one, the Nikopol Ferroalloy Plant. While Interpipe was focused on gaining control of pipe works in the Dnipropetrovsk region.

It is impossible to ignore another significant person – Kostyantyn Zhevago and his Ferrexpo. Ukrainian oligarch was a member of parliament representing of Yulia Tymoshenko's Bloc from 2006 to 2012.

It is impossible to ignore another significant person – Kostyantyn Zhevago and his Ferrexpo. Ukrainian oligarch was a member of parliament representing of Yulia Tymoshenko's Bloc from 2006 to 2012. And the years of the second "orange" premiership of Lady Yu (from 2007 to 2010) surprisingly coincide with the years of the creation of the group of iron ore assets owned by the Ferrexpo AG that is registered in Switzerland. Zhevago has successfully reorganized Poltava MPP, gained the right to develop Yerystivske, and Bilanivske and Galeschynske iron ore deposits.

Minor players also received metallurgical assets:

- **Serhiy Tihipko's** TAS Group owned Kremenchuk Steel Works in the middle of the 2000s, TEKO-Dneprodzerzhinsk (established by TAS Company). Another asset – Dniprodzerzhynsky Steelmaking Plant belongs to Dnirovagonmash that is part of the group, partially owned by close to Kolomoyskyi's people and companies. For example, 22% was owned by Viktoriia Korban – sister of the famous Dnieper politician;
- **Klyuyev brothers** gained control over Kostiantynivka Iron and Steel Works;
- **Dmytro Firtash** registered ownership of Zaporizhia Titanium & Magnesium Combine.

The inflow of foreign money is usually associated with the Indian businessman Lakshmi Mittal and the privatization of Kryvorizhstal. However, at the same time, on the verge of 2005-2010, the Russian EVRAZ Group rapidly entered the Ukrainian market. The Russians bought iron ore deposits Sukha Balka, Southern MPP (bought from the Privat Group). Alexander Babakov (former Deputy Speaker of the Duma of the Russian Federation in 2007-2011), in 2009-2010 obtained ownership of shares of the company Dneprospsststal. Victor Nusenkis, who later changed his citizenship from Ukrainian to Russian, gained control over coal mining assets, coke production, metal production (Donetsksteel) in Donetsk region.

Akhmetov's Metinvest, taking the opportunity of favorable political and economic situation, gained

control over the Ilich Steel and Iron Works (Mariupol). The company also started the process of modernization. However, it is impossible to talk about the policy of transition to a new technological level in this case – even as of the end of 2016, open-hearth furnaces have not been phased out at the enterprises of the holding.

In 2014 a new phase of decline in the industry has started. It is associated with the Russian aggression against Ukraine. An important factor in the development of the industry was the loss of control over metallurgical assets in the so-called DPR and LPR. At the end of 2017 the Industrial Union of Donbas, Metinvest and Donetsksteel Group lost control over part of their assets. The ISD dealt with the most considerable blow, whose key asset was the Alchevsk Iron and Steel Works (recently modernized). These events were among the factors that led to another redistribution of property in the Ukrainian metallurgy. Russian EVRAZ leaves the market, trying to minimize costs. This also applied to the Industrial Union of Donbas, where 50% +1 share belongs to Russian citizen Alexander Katunin. The reason is not only in the Russian-Ukrainian war but also in the problems that arose among the co-owners of ISD. For example, the Russian VTB Bank is seizing Katunin's assets around the world, trying to return previously issued loans. In early 2018 Oleg Mkrtchyan – business partner of Taruta and Katunin in ISD, was arrested in Moscow. The charge was the same – money laundering, withdrawal of credit funds to offshore.

The loss of control over assets at non-controlled territories and the need to repay loans to Russian banks hit the Viktor Nusenkis's Donetsksteel Group. Ukrainian company Investment Capital Ukraine, to which the Russian VTB transferred the right to claim the debt, won a payout of **2.7 billion UAH** from the industrial group in 2017.

As a result, Oleksandr Yaroslavsky's Development Construction Holding became the owner of EVRAZ-Sukha Balka and the Dnieper Metallurgical Plant, which belonged to the Russian EVRAZ Group before the war.

In 2017, Rinat Akhmetov began buying up assets of the

Industrial Union of Donbass and the Donetssteel Group. In addition, he bought the share in the EVRAZ Group enterprises from his partners in it.

It is noteworthy that the head of Metinvest is also interested in enterprises physically located on non-controlled territories (in the so-called DPR and LPR):

- **ISD** (the controlling stake belongs to EVRAZ) transferred control over the Dnieper Metallurgical Plant to Metinvest.
- **Metallotekhnika** (due to which EVRAZ had their part of the Southern MMP) transferred their shares to Metinvest. The Antimonopoly Committee of Ukraine

In August 2018 change in shareholders composition of the **Donetssteel** was announced. New owners – Dutch Metinvest B.V and 3 offshore companies associated with Rinat Akhmetov.

Thus, within the next 18-24 months, the process of the next redistribution of property in the metallurgical industry will be completed. This redistribution is connected with the partial exit of the ISD, Nusenkis and the Russian EVRAZ Group from the market. Players who remained (and became stronger), on the one hand, are increasing their profits against the background of high metal prices, on the other – face a whole range of problems that are increasingly arising in the industry.

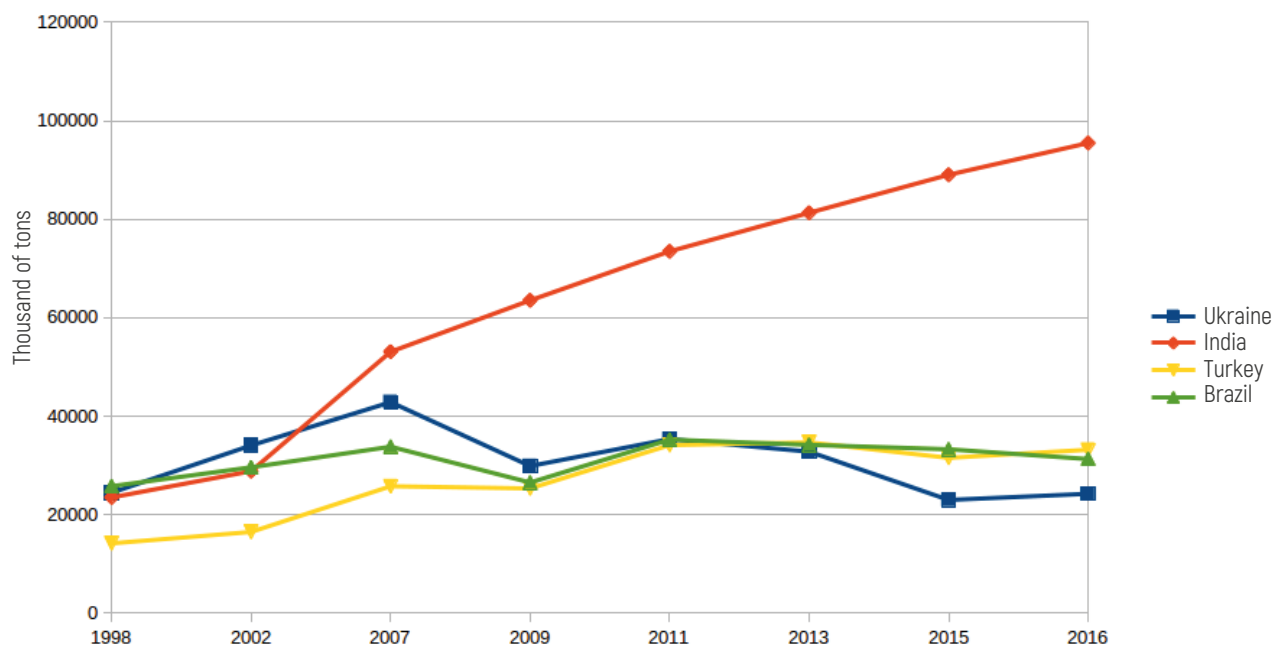


THE PROSPECTS OF THE DOMESTIC METALLURGY INDUSTRY

THE PROSPECTS OF THE DOMESTIC METALLURGY INDUSTRY

Unfortunately, the future of the domestic metallurgy industry is not optimistic at all. The decrease in production volumes and outdated technological process makes a significant part of the industry uncompetitive.

The example of China was mentioned above. China has significantly increased production volumes over the past 10 years: from **489 million tons** in 2007 to **808 million tons** in 2017. Similar processes are taking place in India, Turkey, and Brazil – countries with comparable starting conditions.



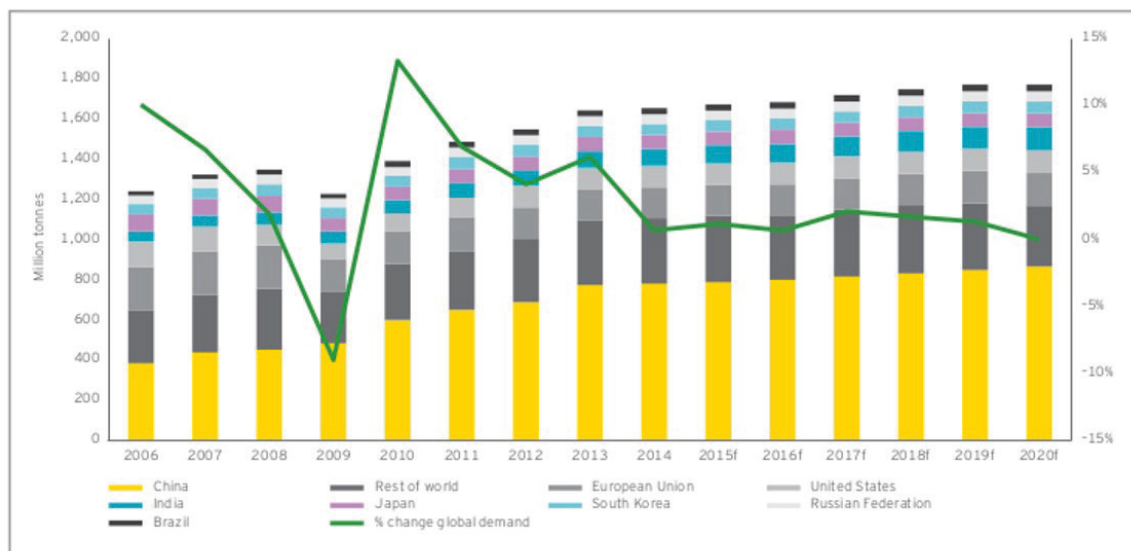
The source: *World Steel Association*

Ukraine is losing its position not only in terms of quantitative indicators. Thus, in 2017, the country imported flat products from China in the amount of **187.9 million USD (252 thousand tons)**. And this is not a fortuitousness – ferrous metals and ferrous metals products import from China has been increasing since 2010. And this is despite the fact that in 2006-2008 years, our country has been exporting the products to China.

The increase in steel production in China and other countries has enhanced competition in the global ferrous metals market. At the same time, its volume

will not grow rapidly in the coming years – this forecast was made by Ernst&Young analysts in their study **Global steel 2015-2016**:

Global steel consumption 2006-2020



Source: *Resources and energy quarterly*, Australian Chief Economist

The same opinion is shared by the analysts of the Korean POSCO Research Institute, who analyzed the development of the metallurgy industry in the Asian region and in the world. They believe that steel consumption will not exceed **1690 million tons** by 2025, and by 2030 – **1860 million tons**.

At the same time, the share of steel use (share in end products) in the automotive industry, shipbuilding, construction and energy industry will be gradually decreasing.

Forecast of Production and Steel Intensity of Steel-Consuming Industries

	Automobile		Shipbuilding		Construction		Energy	
	Production (mil. unit)	Steel Intensity	New Orders (mil. GT)	Steel Intensity	Investment (USD Tril.)	Steel Intensity	Investment (USD Tril.)	Steel Intensity
2015	92	100	79	100	9.0	100	1.8	100
2025	114	89	61	97	11.5	91	1.7	98
2035	127	80	109	90	13.4	84	1.7	99

Note: Steel intensities are normalized (2015 = 100)

Competition in ferrous metals market will be increasing in the coming years. There are several reasons for this:

A the new production technologies that use steel, the emergence of new materials increases the requirements for the quality of products of metallurgical enterprises;

B the emergence of new materials reduces the need for steel: increased consumption will be supported by the overall growth of industries in which ferrous metals are used as raw materials;

C the increased production capacities of the Chinese and, to some extent, Indian, Turkish, Brazilian metallurgy against the background of stabilization of demand will enhance price competition.

The winner will be the one who manufactures cheaper and better products. This can be achieved by improving the technological process and constantly training staff – without a skilled labor expanding the capacities does not make sense. The Worldsteel Association calls the shortage of workers one of the main challenges facing the industry. Automation of production requires new skills, the expenses for training workers. For example, in 2004, at the height of the modernization of old enterprises and the construction of new ones, the average time spent on staff training was **12.1 days** per year per worker. In 2014, it decreased to **6.4 days**, but in 2016 increased to **7**.

Ukrainian metallurgy faces the same challenges, only on a much larger scale:

- labor shortage in neighboring countries was the reason for the beginning of the policy of attracting labor migrants from Ukraine. Metallurgical enterprises are forced to raise wages, trying to keep the employee. But it deprives them of the advantage of cheap labor. So, at the beginning of 2017, **218.8 thousand people** worked in metallurgy. And as of September 2018, only **189.1 thousand** remained. The labor outflows stopped only in August 2018. Mainly due to the rising wages. For example, the company Interpipe Steel in 2016 increased the level of wages to comparable to Polish ones;
- retention of workers solves problems in the context of the crisis of vocational technical training system in the country. Metallurgical enterprises have to finance (or create) a system of training. But even the rapid infusion of large sums into education will not give an instant result due to the lack of trainees – neighboring countries, in addition to workers, are actively poaching students and even high schoolers;

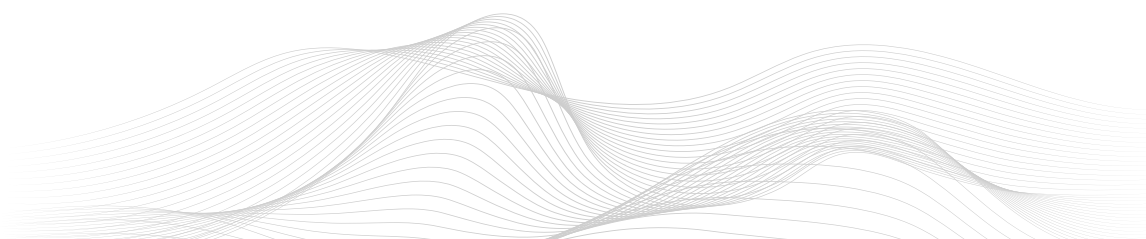
— part of Ukrainian enterprises started the process of modernization of production too. It involves considerable expenditure, but the attraction of cheap long-term money is complicated against the background of reduced profitability and general instability in Ukraine.

These negative factors are accompanied by the policy of the Russian Federation. On the one hand, Ukrainian FIGs lost control over certain assets in Donetsk and Luhansk regions. On the other hand, the problems with shipping in the Azov Sea increase the cost of the logistics for Ukrainian metallurgical enterprises of the South-Eastern part of the country.

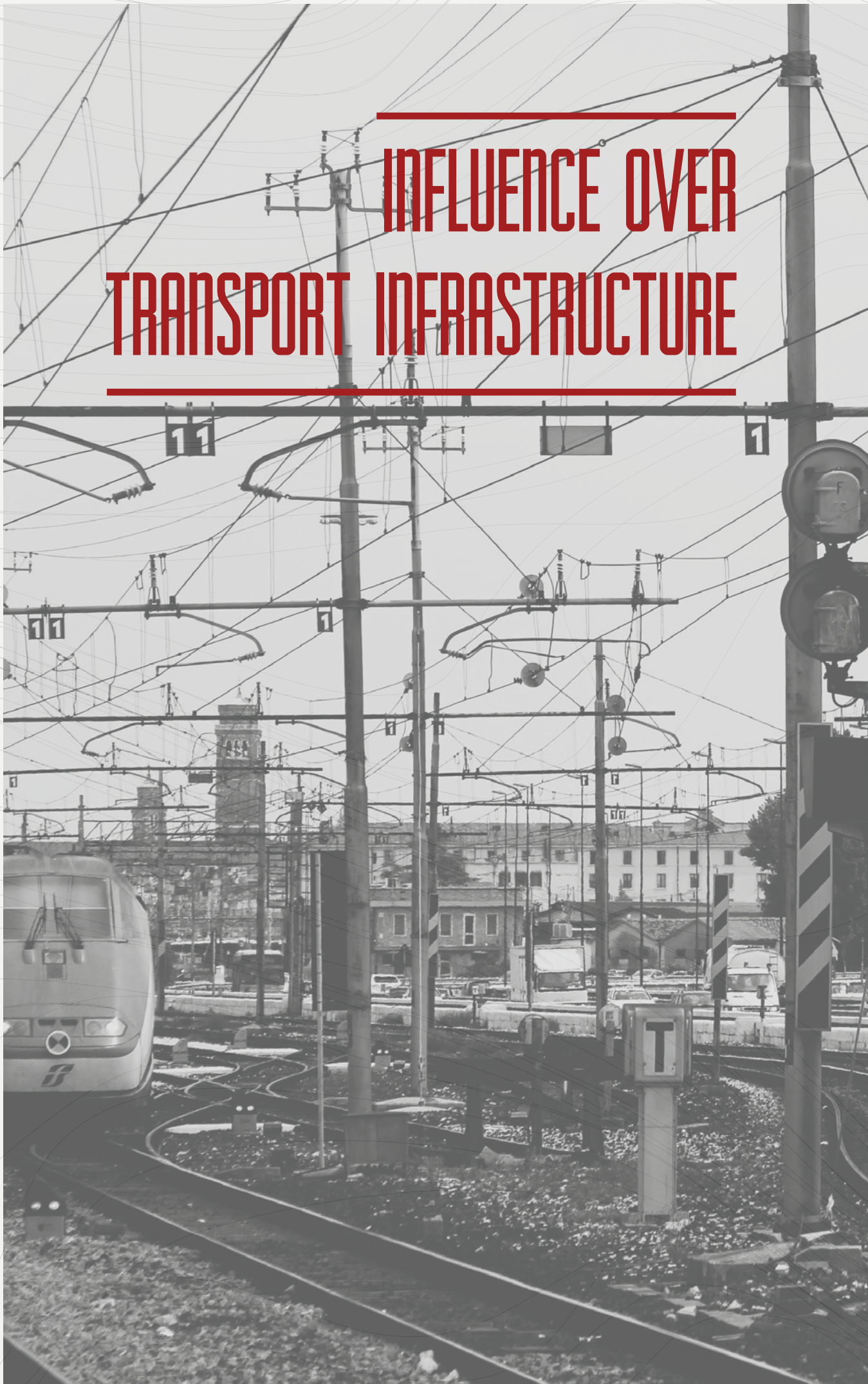
Against this background, oligarchic groups that own assets in the metallurgical industry will have a temptation to demand additional support from the state, including tax incentives. The desire to regain control over the lost assets in the Donetsk and Luhansk regions will push them to support the policy of compromises with Russia in matters relating to Donbas.

And even with the resumption of work of enterprises on the occupied territories and the preservation of high world prices, the Ukrainian metallurgy will be in a difficult situation. This will be connected with the need to finance modernization projects, training, creating reliable and least-cost routes for the delivery of products to the consumer. In this regard, reaching the production level of at least 2011 is not very possible during the next 4-5 years.

The mining business has relatively more prosperous future. Even against the background of decreasing demand for raw materials from Ukrainian metallurgists, there is a demand for iron ores on the world market. But it makes Ukrainian economy as a single system – more primitive.



INFLUENCE OVER TRANSPORT INFRASTRUCTURE



In a global competitive environment transport infrastructure is one of the drivers of economic growth. Those countries that have an updated transport infrastructure receive tangible advantages in the form of cheap logistics, and as a result – improved conditions for exporters, transit countries. This ultimately leads to GDP growth.

Ukraine does not have such advantages: depreciation of the transport infrastructure is at the level of 90-95%, which presents the significant risks of a decline in throughput and loss of GDP. One of the reasons for this situation is the activities of oligarchs, who due to their own commercial interests control state-owned companies through loyal management, "insiders" in departments of several ministries and through deputies.

Among the oligarchs who have the greatest influence in the transport infrastructure:

- **Akhmetov** has significant interests in
 - Ukrzaliznytsia, ports;
- **Poroshenko-Kononenko** – Ukrzaliznytsia, airports,
 - road infrastructure;
- **Avakov, Yatsenyuk** – Ukrzaliznytsia, ports, airports;
- **Kolomoyskyi** – airports, ports;
- **Grigorishin, Vadaturskyi** – the river infrastructure.

As a result of the oligarchs' activities, there are a number of corruption schemes in the transport infrastructure, which lead to direct losses, and this is up to 5 billion USD of GDP annually. According to our estimates, by 2023 GDP losses can grow by 3-4 times and amount to 20 billion USD annually. It would happen due to the decline in exports, due to the lack of investment in the transport infrastructure of Ukraine.

RAILROAD

RAILROAD

RAILROAD

RAILROAD



AKHMETOV

POROSHENKO—
KONONENKO

The railway is an object of strategic importance for the state and a priority mode of transportation of a large number of goods over long distances.

Ukrzaliznytsia is one of the largest employers (272 thousand employees), as well as one of the largest taxpayers. In 2017 it paid 5 billion UAH in taxes. In 2017 the railway monopolist controlled 82% of freight and 50% of passenger traffic in Ukraine.

The oligarchs influence on the Ukrzaliznytsia (UZ) through tariffs of UZ. In Ukraine, according to the current tariff system, transportation of raw materials is cheaper than transportation of goods with higher added value. For example, the cost of rail transportation of 1 ton of iron ore can be 2.2 times cheaper than the transportation of 1 ton of iron or cast iron at the same distance.

This approach is completely opposite to the world practice, where the price of transportation mainly depends on the weight and distance, and not on the type of cargo.

Another scheme is connected with the tariffs for the rent of state-owned rail cars, which can be significantly lower than the "private" price. The shortage of cars generates a significant demand, which is used by those who distribute rail cars, setting "surcharges" for their delivery. In 2018, the shadow tariff for the delivery of the rail car was almost 2,000 UAH.

The main beneficiaries of the current tariff system are System Capital Management (SCM) holding company owned by the richest Ukrainian Rinat Akhmetov, and Ferrexpo iron ore mining company owned by Kostyantyn Zhevago, millionaire and Member of Parliament.

— TARIFFS FOR FREIGHT TRANSPORTATION



AKHMETOV

The reluctance to raise tariffs to market levels leads to a constant lack of investment in the maintenance of rail cars, locomotives and infrastructure. Several attempts to adapt tariff levels that would cover UZ expenses have been blocked by oligarchs, mainly through various business associations, unions, chambers of commerce and government agencies. As a result, there is a huge long-term lag in the financing, a shortage of rolling stock, neglected infrastructure, which leads to the reduction of the speed of trains. There may remain a maximum of



ZHEVAGO

5 thousand km from the now available 20 thousand km of railroad tracks in Ukraine over the next 10-15 years. In 5 years there may remain a maximum of 200 locomotives from now available 1,900 units.

Therefore, the Ukrzaliznytsia income losses due to the oligarchs' schemes with tariffs is estimated at 900 million USD, while Rinat Akhmetov earns on tariffs (not paying enough to UZ) about 400 million USD per year.

— PROCUREMENTS

Procurements is a sphere of evident and painful funds outflow from Ukrzaliznytsia. Unfortunately, Prozorro, a transparent online procurement system introduced in 2015, creates only minor obstacles to well-organized influence and manipulation.

These oligarchs have the biggest impact on Ukrzaliznytsia's procurements:

- Akhmetov;
- Poroshenko-Kononenko;
- Dubnevychy.

— RAILS PROCUREMENTS



AKHMETOV

One of the areas Akhmetov's business interests is supplying Ukrzaliznytsia with rail profile. Only on one tender for procurement of 52.5 thousand tons of Azovstal rail profile, which took place in the II quarter of 2018, the company Metinvest-SMC (which is the only supplier of this type of product in Ukraine) earned **65 million USD**.

The remaining **\$ 10 million** was earned by Metinvest-SMC on the supply of baseplates and filler pieces for the fastening of tracks, as well as axles and sheet iron, which are used for the maintenance of wagons. Within 2 years Akhmetov's company became the leader in terms of supply volumes for Ukrzaliznytsia and broke the protracted leadership of the leading oil traders in the total volumes of procurements.

Victor Pinchuk is another "player" among the oligarchs. He has significantly strengthened his position in the Ukrzaliznytsia in recent years. His metallurgical company Interpipe specializes in supplying wheels for rail cars and locomotives. On the last tender sales volumes amounted to **15 million USD**.

— FUEL PROCUREMENTS



POROSHENKO—KONONENKO

The position of the oil traders in the Ukrzaliznytsia's procurements has considerably worsened during 2016-2017. Companies WOG and OKKO have the greatest influence in this area, but since 2016 they have been partially moved by the Trade Commodity Company, which is controlled by the Adamovsky and Hranovskyi group. The latter is a business partner of Kononenko and Poroshenko. Moreover, there were a number of corruption schemes connected with the procurement of fuel. Suppliers included all possible market risks into the prices, which were reflected in the procurement-applications. Beyond that, the usual situation when the winner of the fuel tender raises the delivery price (up to 10%) immediately after the tender. Such a price increase is often explained by market conditions and is always coordinated with the managers of UZ.

The widely used in a developed countries practices can become the solution to the problem of procurements. According to them, the purchase of fuel is carried out according to a formula that allows you to anchor the price of future supplies to the world

market price (PLATTS). Thus, the participants of the fuel tender actually cover their own market risk and compete in terms of margin.

The lower the risk the lower the mark-up of suppliers is, and, accordingly, the bid price.

Only in 2018, the above-mentioned formula was actually applied in practice as a result of the tender conducted under the new rules, where the company Anvitrade associated with Viktor Medvedchuk won. According to the pricing formula, taking into account PLATTS, at the time of signing the contract with Ukrzaliznytsia the price decreased. This is the first time in the history of public procurements in Ukraine when the winning company performed the contract at a price much lower than the one that had won the tender.

Another tender in July 2018 was won by LLC Torhovyy Dim Sokar Ukraina and LLC August Prom that will receive about **10 million USD** each. SOCAR Ukraina belongs to the State Oil Company of Azerbaijan Republic, August Prom is associated with the

scandalous Trade Commodity owned by Adamovsky and Hranovskyi. In total, since April 2016, the group of companies of Adamovsky and Hranovskyi has won tenders totaling **300 million USD**.

Thus, according to UIF, oligarchs' schemes with fuel supply lead to direct losses of Ukrzaliznytsia in the amount of about 10-12 million USD annually due to inflated prices. Losses from low-quality fuel can be even greater.

— PROCUREMENTS OF UNIQUE PARTS AND COMPONENTS



DUBNEVYCHY

The Chairman of the Verkhovna Rada Committee on Transport Yaroslav Dubnevych and his brother – MP Bogdan Dubnevych are among the influential “players” in procurements. They are the beneficiaries of schemes in the procurements of “unique” components and spare parts.

There is a Certification Institute in the structure of Ukrzaliznytsia. Companies that did not pass the certification test were excluded from the tender. Strangely enough, the certificate for delivery of rail profile – cross tie fastening had only one company – LLC Corporation KRT, where Dubnevychy brothers are beneficiaries. Due to having the monopoly, the company has set not market prices, but prices almost three times higher than European. According to UIF, Ukrzaliznytsia annually lost about \$ 2 million due to this scheme.

In June 2018, the Supreme Court of Ukraine decided to cancel the contract between Ukrzaliznytsia and KRT Corporation. NABU went to court because the KRT sold screws and holders for rails to Ukrzaliznytsia for about 6 million dollars. Then the amount of overpayment was \$ 1 million. The reason for such huge losses is the lack of tender, as UZ

negotiated with the KRT bypassing procurement procedures. Now Ukrzaliznytsia conducts a similar competition through Prozorro.

Also in 2018, the specialists of the Lviv department of the Large Taxpayers Office established the fact of the registration of tax invoices for the sale of fuel oil, while it was not purchased from the Corporation KRT.

Thus, virtual expenses and the tax credit on the value-added tax are formed. The loss in taxes for the state amounted to about 30 million USD. Therefore, devastation of the company is the result of 27 years of functioning of various corruption schemes within Ukrzaliznytsia. Monopoly, inefficient management and the influence of oligarchs lead to a loss of 2 billion USD in revenue annually. At the same time, the shortage of rail cars and locomotives in Ukrzaliznytsia may result in that such industries as metallurgy, agriculture and production of construction materials will be forced to reduce production volumes. Losses can range from 5-7% of GDP annually, which will total from 30 to 40 billion USD of GDP by 2023.

PORTS



AKHMETOV

PORTS



AVAKOV

PORTS



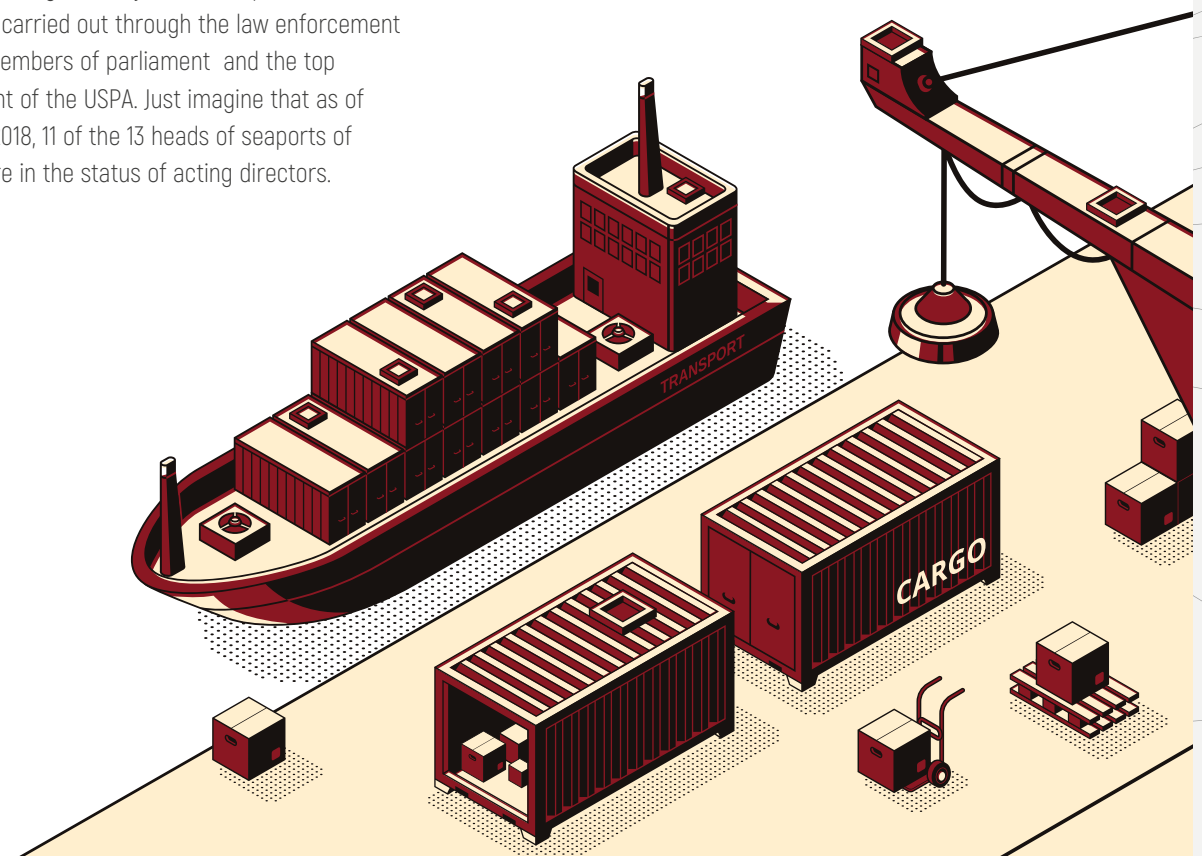
YATSENYUK

PORTS

Ukrainian seaports are strategically important objects for the state. Part of the imported coal and oil products arrives in Ukraine and grain and metal are exported through them.

Ports have always been in the sphere of interest of the oligarchs. There are now 13 seaports in Ukraine managed by the Ukrainian Sea Ports Authority (USPA) since 2013. It is clear that the control over this institution can significantly affect the ports. This influence is carried out through the law enforcement agencies, members of parliament and the top management of the USPA. Just imagine that as of November 2018, 11 of the 13 heads of seaports of Ukraine were in the status of acting directors.

Since the beginning of 2017, the Chairman of the state enterprise the Ukrainian Sea Ports Authority has also been working on the same conditions. In general, the maritime industry has 17 acting directors (putting in other words – controllable “domesticated” directors) from a total number of 25 enterprises subordinated to the Ministry of Infrastructure of Ukraine. **That is almost 70%!**



— THE UKRAINIAN SEA PORTS AUTHORITY (USPA)



AVAKOV
YATSENYUK

The USPA is controlled by Minister of Internal Affairs Arsen Avakov and former Prime Minister Arseniy Yatsenyuk. Earlier the Minister of Internal Affairs could influence through the MP from People's Front Serhiy Faermark. Except for Faermark, until 2017 control was performed by Andriy Amelin (before he was arrested by NABU) – ex-head of the USPA, the insider of Deputy Andriy Ivanchuk, who is a good friend of Arseniy Yatsenyuk. After his arrest, the port industry was entered by forces controlled by the System Capital Management Group. But the influence of Avakov, Yatsenyuk partially preserved.

One of the largest corruption schemes of the USPA is dredging. There are 8 people from the top management of SE USPA under NABU investigation. In 2015-2016 they realized the scheme connected with state procurements of services in the dredging of channels and water areas of the Berdyansk and Mariupol seaports. The case is about the implementation of anti-competitive actions in order to ensure the victory of a predetermined bidder, as well as the further increase in the value of the works performed. The losses for the state amount to **9 million USD**.

In 2018, the USPA is implementing dredging projects, the effectiveness of which is questionable. For example, dredging in the port Yuzhny under the existing berthing facilities for ore and coal **21 meters deep**. In 2018, no vessel that could need a depth of **21.5 m**. entered the Ukrainian Black Sea ports. And only one vessel needed a depth of **18.5 m**. Given that port charges were reduced by 20%, such a dredging project can be uneconomical.

— THE SEAPORTS



AKHMETOV

Seaports are one of the areas related to the business interests of Rinat Akhmetov. The influence is exercised through Portinvest, a company that manages the transport assets of SCM Group in the port business. The oligarch's interest in the port Yuzhny is simply explained: it will provide additional opportunities for the export of metallurgical products. Rinat Akhmetov wants to realize his interest through the concession of the port. For example, already now in the draft law №8125 "On concessions" there is a discriminatory provision on the permission for companies, which have previously used the capacities of state-owned enterprises, to have priority in claiming a concession.



KOLOMOYSKYI

One of these enterprises is the above-mentioned Portinvest. Under the new concession rules, a private investor will transform the format of "usage" of the port Yuzhny into a concession for 49 years.

Corruption scheme might look as follows: Portinvest enters the port on the rights of the concessionaire, artificially creates the losses withdrawing the money from the port and then receives compensation for damages from the state. In 2017, the port Yuzhny received a net profit of **\$ 50 million**, transferring **\$ 16 million** in taxes to the state budget. In 2018, the planned net income is in the amount of **\$ 70 million**.

Given this, it is important that the concession is beneficial to both stakeholders – the state and the private investor. The key assets of the Ihor Kolomoyskyi's Privat Group in the region are the oil processing capacities in the Odessa port. Economic activity in the sphere of oil production is carried out by three companies: Sintez Oil, Eksimnefteprodukt and Odesnefteprodukt. All three companies are controlled by Dnipro FIG Privat Group. Kolomoyskyi also has an influence on the seaport of Chornomorsk and is the owner of Illichivsk fishing sea port. Kolomoyskyi is interested in maintaining influence in the ports of Odessa and in the redistribution of financial flows from the state ports to Illichivsk fishing sea port.

Another scheme that oligarchs might be behind is the illegal activity of environment protection control of the State Ecological Inspection in sea ports of Ukraine. This scheme enables them to receive a considerable shadow margin. At the same time, the state lost **\$ 200 million** in GDP annually because of activities of inspectors of the State Ecological Inspection.

This is due to the termination of foreign economic contracts, the decline in quantitative and qualitative indicators of goods and minimal workload at the USPA berths.

As a result of public pressure in September 2018, the parliament adopted a law that abolishes eco-control in ports. But even so, environmental inspectors are still in ports and act arbitrarily there.

Thus, the sphere of influence of the oligarchs amounts to lobbying their business interests through the pressure on law enforcement authorities, the dredging, the rental of port infrastructure facilities and ports' assets management. The consequence of this is the loss of the investment image of Ukraine, the increasing risks for future investment projects with the involvement of foreign investors. We should note, that according to the UIF, Ukraine needs to invest about **30 billion USD** in ports by 2030 to ensure economic growth.



AIR TRANSPORTATION

AIR TRANSPORTATION

AIR TRANSPORTATION

Ihor Kolomoyskyi has a significant impact on the airports of Ukraine. He owns the largest airline company (in terms of passenger traffic) in Ukraine – Ukraine International Airlines (UIA). The oligarch has his insiders in the State Enterprise Boryspil that promote his business interests. Lobbying own interests takes place through airport charges. The biggest beneficiary of the changes in the procedure of calculation of airport charges for SE Boryspil aircrafts maintenance and of their reduction, that took place in June 2017, is the UIA. The airline company has improved commercial conditions, despite the fact that the changes would be applied to all companies, including low-cost airlines.

The visa-free regime and the entry into the Ukrainian market of the airline company Ryanair forced the largest carrier in Ukraine UIA to reduce prices for a number of key destinations flights and introduce the so-called "low-cost offer". This testifies to the inflated prices of the monopolist and its ability to reduce the price. The consequence of the visa-free regime and the growth of air traffic was also an increase in demand for aviation fuel. This is where the oligarchs' influence exists.

There are two sources of aviation fuel supply in Ukraine. The first is the Kolomoyskyi's Kremenchug Refinery, which provides about 30% of aviation fuel in Ukraine. Aviation fuel is supplied to the airports Boryspil, Dnipropetrovsk, where it goes to the tanks of Privat's airlines UIA, Dniproavia and Windrose. The second source is import, which is 70% of the total amount. If in 2010-2015 the supply was coming mainly from Russia and Belarus, in 2016 the import is much diversified. Now the main supply countries are Lithuania, Italy, Saudi Arabia.



КОЛОМОЙСЬКИЙ КОНОНЕНКО ІВАНЧУК

The largest importer is the company Trade Commodity, which is part of Ihor Kononenko's sphere of influence. This company makes up more than 30% of all gas imports since 2016.

In August 2018 Trade Commodity was preparing to enter the aircraft refueling market under the brand SKY Avia. The application was filed on behalf of LLC Nafta Capital Group (part of the Trade Commodity Group). The main corruption scheme is connected with the fact that kerosene can be mixed with diesel fuel (DF) and sold under the guise of DF. Mixing fuel makes economic sense because of the sevenfold difference between the excise tax on DF (139.5 EUR per thousand liters) and the excise tax on aviation fuel (21 EUR per thousand liters). According to the rating of 5000 most dynamic companies in Europe, Trade Commodity took the 267th position. Its annual income is 121.6 million EUR, and the dynamics of growth is 1500%.

It should also be reminded that MP from the People's Front Andrii Ivanchuk, who is interested in having Duty Free on the gross leasable areas of the airport Boryspil, has certain influence also.

Thus, the result of the oligarchs' activities in the field of air transportation is the reduction of competition in the air carriage market of Ukraine, the potential supply of more expensive aviation fuel, the creation of additional barriers to entry of low-cost airlines into Ukraine.



THE ROADS



KONONENKO

THE ROADS
THE ROADS
THE ROADS
THE ROADS
THE ROADS



Ihor Kononenko, Poroshenko's business partner, has the greatest influence on the public road system. He exercises it through tenders for the construction and repair of roads.

The State Road Fund of Ukraine started functioning since 2018. This gives new opportunities to all participants of road construction because they received not only guaranteed sources of funding, but also the prospect of planning for the future. At the same time, it provides new opportunities for corruption schemes.

The main basis for the schemes is the possibility of patching works and roadway replacements without granting of guarantee of quality and warranty for defects for more than three years. This leads to the fact that the contractor is not actually responsible for the results of own work. This is what companies that "technically" win the tenders through Prozorro are actually using. For comparison, European companies provide a guarantee for their work for a period of 10 years.

The second is the use of asphalt-concrete technologies without independent quality control of the conducted work.

The third is the lack of national component in the construction and reconstruction of roads.

The use of asphalt technologies provides for the import of bitumen, from the Russian Federation as well, which accounts for from **56% to 67%** of the cost of road reconstruction. In this situation, the main stakeholder is "the bitumen mafia", which can additionally launder funds through "gray" imports coming through Belarus. An alternative to bitumen is the use of cement-concrete technologies in the construction of roads, as Ukraine is fully resourced with domestic materials. An additional advantage of such roads over asphalt ones will be their durability – more than 15 years. According to UIF estimates, the construction of 1,000 km of cement concrete roads per year can provide GDP growth of up to **20 billion USD by 2030**.

The fourth is that the priorities in the reconstruction of roads, which Ukravtodor has set for 2018, are not developed under the principle of importance for the country, but under the principle of importance for those people who determined where these roads lead. The reconstruction program does not take into account most of the roads leading to the ports (Odessa, Kherson, Mykolaiv), while it is very important from the point of view of economic flows. Consequently, the commercial interests of oligarchs and local lobbyists are the main obstacles to economic growth and the increase of Ukraine's GDP in the amount of **20 billion USD** by 2030 or up to **2 billion USD** annually due to the unsatisfactory reconstruction of roads.

THE RIVER INFRASTRUCTURE

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According to the UIF, the greatest influence on the development of river transport and infrastructure is exercised through existing tariffs of Ukrzaliznytsia and their beneficiaries-oligarchs. Artificially low tariffs for cargo transportation lead to the fact that price for river transportation has competitive disadvantage as compared to railroad transportation, and this significantly reduces demand. This problem can be solved quite simply. It is necessary to create a national regulator of transportation rates, which would establish economically reasonable market tariffs taking into account the development of alternative modes of transportation.

River transportation in Ukraine is an example of oligopoly: only two companies significantly affect the market. These are UKRRICHFLOT and NIBULON. While UKRRICHFLOT operates on the Dnieper, NIBULON transports cargo on the main river artery of Ukraine and on the Southern Bug. Key types of cargo: grain, ferrous metals and building materials.

Other but less powerful players are agri-corporations, Zaporizhstal, SCM Group, Ferrexpo, and in the future – the owners of the ship-building yards. JSSC UKRRICHFLOT has the river fleet, which compris-



GRIGORISHIN VADATURSKYY

es about 400 vessels. The company carries out 40% of river transportations of export cargoes. The majority shareholder of UKRRICHFLOT with 66% of shares is the Fifth Venture Investment Fund, which works for Energy Standard Group of the Russian businessman Kostyantyn Grigorishin. As of the beginning of 2018, 12% of the shares of UKRRICHFLOT belonged to the Cyprus company Culata Limited, which is controlled by the deputy from Opposition Bloc Serhiy Lyovochkin. UKRRICHFLOT also owns 5 of 12 river ports in Ukraine: Dnipropetrovsk, Zaporizhzhia, Nikopol, Mykolaiv and Kherson river ports.

An important player in the market of river transport is the agricultural corporation NIBULON, which belongs to Oleksiy Vadaturskyy. Today, water transportation accounts for only 5% of the export transportation of grain and oilseeds. By 2030, this figure may rise to 35-50% due to Ukrzaliznytsia's shortage of rail cars/locomotives. Therefore, the influence of "young oligarch" Vadatursky on river transportation and infrastructure will increase. The logistics sector of the company already includes 69 barges and tugboats. The company transported more than 2 million tons of products by inland waterways using their own cargo fleet, which is about a quarter of all domestic waterborne freight in 2017.

The state share in river transportation is represented by several enterprises: SE Ukrvodshliak, which owns the main river infrastructure (river gates), commercial enterprise SE the Administration of the River Ports, etc. The "sea oligarchs", who are interested in the redistribution of the market, can exert influence through the Verkhovna Rada Committee on Transport, The Ministry of Infrastructure and newly created State Service for Maritime and River Transport of Ukraine.

Disputes between Vadaturskyy, representatives of UKRRICHFLOT and the state are happening around the new Law "On inland waterway transport". There are two draft laws in the Verkhovna Rada: the first draft law №2475a, which is supported by the Ministry of Infrastructure, the second №2475a-3 – by Ukrainian agricultural company NIBULON.

Grigorishin's goal is to preserve economic flows, to enable further privatization of river ports and to prevent the increase in the influence of Vadaturskyy in the sphere of river transportation. In turn, Vadaturskyy's goal is to reduce the cost of transportation of agricultural products and to continue the gradual monopolization of the market. The main stumbling rock in this situation is the introduction of river charge and the admission or non-admission of a foreign fleet. It is here that there are many myths that UIF dispelled back in 2017. According to UIF's assessment, the adoption of draft law №2475a is economically feasible for the state, but even in the case of adoption, there are risks of non-market fees for pilotage, the risks of corruption on behalf of oligarchs in the newly formed Administration of the River Ports.

A significant drawback of the draft law №2475a-3, which is pushed by NIBULON, is the non-admission of the foreign fleet – in fact, Ukraine will not be able to reach the full potential of river transportation. The adoption of this draft law is a definite step back in the creation of a competitive market and the establishment of market prices for grain transportation. However, the full boundless opening of the rivers for everyone will not contribute to the Ukrainian shipbuilding. Therefore, the middle ground is the introduction of a 5-year period of restriction on the admission of all flags. During this time, businessmen will have an opportunity to develop the Ukrainian shipbuilding and to develop the Ukrainian river fleet by 2023.

In 2018, The Ukrainian Danube shipping company (UDP) is also in the zone of influence of oligarchs. The first danger for the UDP is the scheme of withdrawal of the money for the rental of the UDP fleet (time charter) bypassing the company. The second and more global is the schemes due to which Ukraine lost

the Black Sea fleet during the presidency of Leonid Kravchuk. The essence of the scheme is as follows: the concluded contract for the lease of the vessel indicates that the repair costs borne by the lessee are included in the cost of leasing. After that, the vessel goes to distant countries, and acts for repairs, the cost of which can be millions of dollars, are sent to Ukraine. Often, if the vessel costs **2 million USD** the invoiced repair bills can reach **3 million USD**. After refusing to pay, the vessel is being arrested and confiscated.

Since the end of 2017, the enterprise Ukrainian Danube shipping company is headed by Dmitro Chaly, who replaced Dmitro Barinov, the insider of Vinnytsia oligarchs.

Thus, the short-sighted policy of the state regarding the development of river transport and constant lobbying of own interests by the oligarchs led to:

- the river passenger transportations decreased by : 40 times during 27 years;
- the volume of transported goods decreased from : **66 to 8 million tons**;
- commercial river fleet of Ukraine decreased by : **80%**;
- the share of river transportations in the cargo : traffic in Ukraine is **0.2%**;
- transportation is monopolized and is expensive.

Oligarchs have a significant impact on the transport infrastructure and are pursuing their own short-term commercial interests. Their main goal is to obtain additional logistical advantages for their products through administrative resources, to secure a monopoly position in the market, and to accumulate cash flows through schemes. The ultimate goal of the oligarchs is to increase the value of assets, but the consequence of this approach is the damage to the economy up to **5 billion USD** annually in GDP. After 3-4 years GDP losses can reach up to **20 billion USD** annually, provided that the investment program of Ukrzaliznytsia is not completed and the pressure of law enforcement agencies in ports continues. This situation may become a threat to the national security of Ukraine and oligarchs in particular.

[illegible]

One of the attributes of oligarchs is ownership of media, in among which is at least one news channel. The key difference from the usual media business is that the oligarchic model of media management does not provide for essential profitability. In Ukrainian conditions, it most likely means support of an unprofitable TV-channel (at least when it comes to news broadcasting). And it is not about the formation of a public opinion. But about either the usage of their own means of presenting information to the consumer in order to gain political benefits of getting into power by individuals and groups (parties), related to the oligarchs or the shaping of a stable public opinion on issues important for the oligarchic business.

The first and major assets of the largest financial-industrial groups of the country quite predictably

became television channels – the most popular source of sharing information among the population. However, already in 2007-2008, it was obvious that other types of media would be also needed to form a stable opinion on certain issues, to influence key groups of the population.

Gradually, the interest of oligarchs has spread to key printed media, and with increase of internet coverage and usage – to a significant number of online resources. It can be affirmed that today the FIGs control what information and in what form goes to the majority of voters. Thus, electoral preferences and preponderances are easily formed. It is easy to verify having analyzed the share of oligarchs in the Ukrainian media market.

TELEVISION

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Television remains the main source of information for the population of Ukraine: according to the IRI study, 79 % of citizens think so. At the same time, no more than 25 % consider it to be a reliable source of truthful information. However, it is the television that to a large extent forms the image of the future Verkhovna Rada.

On the one hand, of course, there is the explicit and implicit advertising of individual politicians, parties and blocs. On the other hand, there is the shaping of persistent stereotypes, the attitude of citizens to a particular phenomenon. In the first case, it is most likely done with the help of news blocks. In the second – entertainment content, TV-shows, thematic programs that “guide” and develop the opinions of the audience in an appropriate manner, form stable positive and negative connotations. In addition, against the background of reduced confidence in television as such, entertainment programs are retaining the viewer – most people are scarcely ready to watch only the news. However, they are willing to spend time watching the TV and talent shows. And during the breaks they are watching news rather than switching the channel.

Ukrainian oligarchs noticed this particular feature in 2006-2007 and since then have been spending incredible money to adapt the most successful foreign entertainment formats to Ukrainian conditions, or to create their own content.

The result is the domination of their channels in the information space. To prove this we present the data of regular audience measurement, carried out by the Television Industry Committee (TIC). The data on the end of July and the beginning of August 2018 has been chosen.

AUDIENCE SHARE OF MAIN UKRAINIAN TV CHANNELS (AVERAGED DATA ON FIRST 7 MONTHS OF 2018) — LIST OF LEADERS

TV Channel "Ukraine"	14,24	Akhmetov
Inter	9,37	Firtash, Lyovochkin
1+1	8,71	Kolomoyskyi
ICTV	7,27	Pinchuk
STB	7,04	Pinchuk
Novyi	4,6	Pinchuk
2+2	3,3	Kolomoyskyi
NTN	3,26	Firtash, Lyovochkin
TET	3,17	Kolomoyskyi
Plus-Plus	2,22	Kolomoyskyi
K1	2	Firtash
NLO-TV	1,73	Akhmetov
Enter-Film	1,66	Firtash
Pixel-TV	1,58	Firtash
112	1,4	Podschypkov (probably Arbuzov, Medvedchuk)*
Bigudi	1,27	Kolomoyskyi
Mega	1,25	Firtash
M1	1,18	Pinchuk
NewsOne	1,05	Murayev*
Indigo TV	0,8	Akhmetov

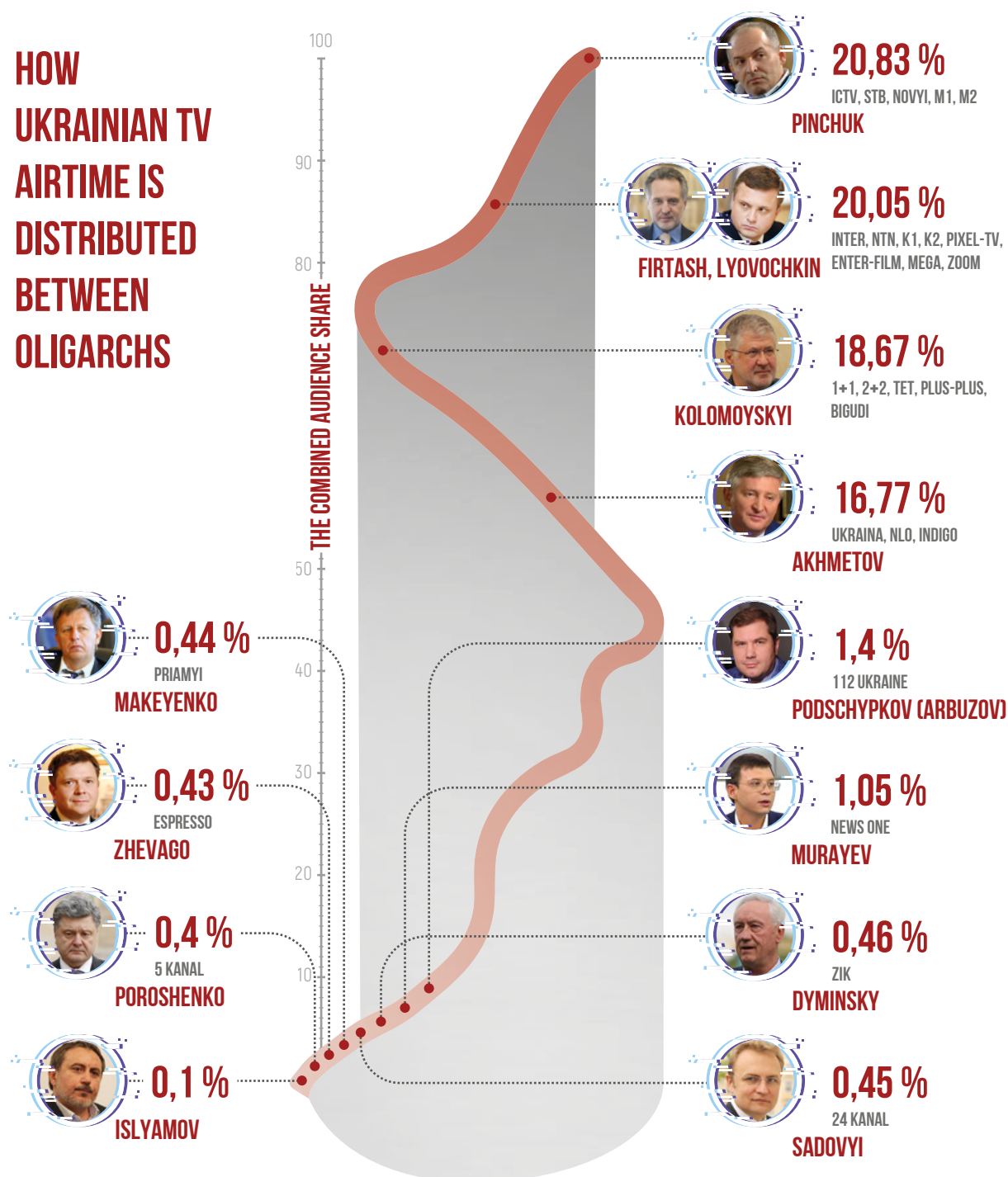
* After this material was written Medvedchuk took control over 112 and News One TV channels



Information of the largest 40 channels with a share of not more than 0.1% and grouped by the owners is

presented in a Table "How Ukrainian TV airtime is distributed between oligarchs".

HOW UKRAINIAN TV AIRTIME IS DISTRIBUTED BETWEEN OLIGARCHS



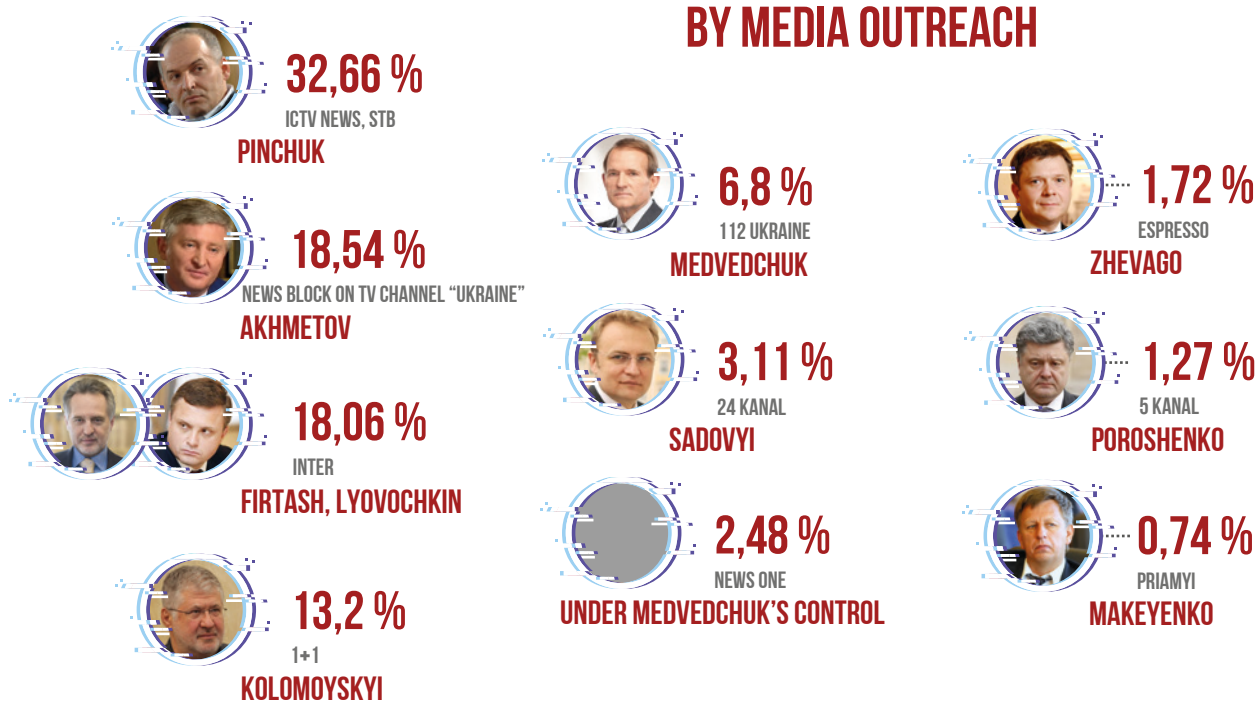
Thus, "the old" oligarchs and those, trying to replace them, control 80.5% of the Ukrainian television audience. Among these, four largest financial and industrial groups in the country reach 76.2% of the audience.

To compare, the state-owned channels (UA: Pershyi, TRK-Kiev) reach 0.71% of the audience in total, that is almost 100 times less than the channels of the largest oligarchs. With this ratio, it is quite natural that the owners of the main channels can form any

public opinion on any topic. The balance of their spheres of influence can be illustrated with the example of parties that have passed to the Verkhovna Rada. If taking into account the regional popularity of channels (for example, Inter is more popular in the South-East, 1+1 has a large audience in the Center and in the West), it is possible to formulate theses that politicians are playing Eastern Ukraine off against Western.

Turning to the tactical level – the shaping of attitude to today's events, the recent past, or plans for the future – it is necessary to assess the outreach of news blocks. For clarity, let's consider the statistics of the TIC on the evening news block for August 1, 2018, grouped by channels and their owners.

THE DISTRIBUTION OF TV AIRTIME BY MEDIA OUTREACH



Almost 100% of viewers who watched the news on August 1, in fact, received information out of the hands of the oligarchs. 80% – from "the big four" (Pinchuk, Akhmetov, Firtash-Lyovochkin, Kolomoyskyi), that have consolidated their media assets a long ago, developed a joint information policy of holdings, where each channel, radio, printed or Internet media complements the rest. Today, we are witnessing the process of consolidation of another holding company, when a number of media are trying to create one group for the upcoming elections. We are talking about the NewsOne, 112 and ZIK TV channels,

which formally belong to Murayev, Podschypkov and Dyminsky. Over the past 2-3 months, the information that they are fully or partially bought by Medvedchuk is spreading quite actively. There is no documentary evidence, as well as no information about the nature of the change of ownership (this is a short-term infusion before the elections or the creation of a new holding on a permanent basis). Taking into account the specifics of the channels, the potential "TV holding" has a total outreach of about 3%, while in the "night news" its share reaches 9.3% – the figures that allow to compete with the channels of "the big four".

REGIONAL TV AND RADIO OLIGARCHIC SCHEME AT THE REGIONAL LEVEL

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The level of regional and satellite TV channels is not so consolidated. Having analyzed the influence of the FIGs and regional elites, active use of the scheme where media resources are used as an important lever of influence on decision-making and personnel changes become obvious. On the one hand, it is a way of protecting the business by local entrepreneurs, as, for example, the Odessa businessman Adnan Kivan with his 7 channel. On the other hand, as long as there are elections under the majority system, the control over the local press is important to ensure influence at the national level.

The scheme of the national level oligarch, when business is based on the use of the country's resources, and media and political assets are the guarantees of the existence of the system, is well used at the level of regions and large cities. For example, the Rinat Akhmetov's holding company owns Sigma channel in Mariupol – the situation is predictable, given the presence of assets in this city. The oligarch's interest in the Dnieper was fulfilled through the purchase of 34 channel. This regional center is interesting because the local TV channels are distributed among the oligarchs of "the group of four" – except Akhmetov TV channels are owned by Victor Pinchuk (11 channel) and Ihor Kolomoyskyi (9 channel).

In Odessa the situation is somewhat different – the influence is divided between representatives of local elites. For example, political "unsinkability" of Hennadiy Trukhanov and Serhiy Kivalov is ensured by media resources. The former head of the Central Election Commission of Ukraine, who became known thanks to the word "pidrahuy" (literally "count it", assonant to obscene word), controls 4 regional TV channels (Reporter, 3rd digital, Academiya, Zdorovya) and several printed media. Trukhanov has influence (or partial ownership) in the Glas tele-radio company, Odessa+. Trukhanov shares control over rather popular TV channels Grad and UTB with the deputy from PPB Hennadiy Chekita.

Trukhanov's opponent, the PPB deputy Oleksiy Honcharenko, wouldn't be the nationally significant politician without powerful media base represented by the periodical Dumskaya and the eponymous TV

Trukhanov's opponent, the PPB deputy Oleksiy Honcharenko, wouldn't be the nationally significant politician without powerful media base represented by the periodical *Dumskaya* and the eponymous TV channel.

Thus, Odessa is a good example of how regional elites, having copied the oligarchic system of existence at the local level, can feel relatively safe, regardless of who is in power in Kiev. Petro Poroshenko, being an oligarch and understanding (and accepting) the scheme of influence through media, is inclined to come to an agreement with Trukhanov rather than starting the conflict. The latter, in turn, can count on 3-4 seats in the Parliament after the elections under the majority system. It can be his own people, or, of course, for good compensation, he can delegate "the combat soldiers" to another political party, for example, Fatherland or Petro Poroshenko Bloc.

The media market of Kharkiv also demonstrates how oligarchs of local level provide themselves with levers of political influence through the distribution of media space, including the opportunity to become "young oligarchs" of national scale. **The media market of the "capital of the East" is rigidly divided between:**

- **Arsen Avakov**, who controls the ATN, A/TVK TV channels and the portal Golovne;
- **Hennadiy Kernes**, who ensures his position through 7th channel (which is formally owned by the daughter of Mykhailo Dobkin), the holding company Kharkivky Visti, two "independent" Internet portals.

Evgeny Muraev and his Kharkiv asset represented by TRK Robinson, and the local businessman Oleksandr Davtyan ("Objective" media group), who smoothly drifted from party Front for Change (and respectively its Kharkov part) to being a member in Petro Poroshenko Bloc, are trying to enter Kharkiv media market.

We should also mention the radio broadcast stations of Ukraine. Despite the fact that most of them are

regional, they are used in a similar way as the local press and television: to ensure influence on a clearly defined target group in a particular region. At the same time, radio stations are not an independent (and not the key one for achieving the goal of political influence) resource due to the minimal outreach and the relatively expensive cost of broadcasting. However, it is necessary to highlight the powerful position of Serhiy Kurchenko and Victor Pinchuk on the national level. They control more than 50% of radio broadcast stations with national outreach. The first owns Retro FM, Nashe Radio, Voice of the Capital, Avtoradio, Radio Pyatnica. The latter controls Radio Roks, Russian Radio. Ukraine, Kiss FM, Radio Relax, Hit FM.

The rest of the oligarchs are not interested in national radio stations. On the contrary, there is a fierce struggle of regional elites and "young oligarchs" for local radio stations (as well as for local TV channels), as such resources give a competitive advantage in the fight for single-mandate districts. Regional elites perceive control over local media as a necessary condition for maintaining their position. For this reason, there is a de facto powerful self-censorship at the level of regional TV companies. Any criticism of the owner of the channel or his protégé by the journalist is equivalent to dismissal. The illusion of "freedom of speech" is created owing to the presence of political opponents on the media market. They do not bring up the topics, dangerous for their owners, but ruthlessly criticize others. It is difficult to imagine that even a formal agreement on non-interference of the owner in the editorial policy (following the model of national channels) can be concluded.

The party Novi Oblychchya and the mayor of Irpin Volodymyr Karpolyuk can serve as an example of the fact that the media resource in the system of oligarchic agreements is perceived as a tool for influence on population, rather than a tool for receiving profit from selling objective information. After receiving support in the elections in the basic regions, but facing resistance in such matters as control over the town Kotsiubynske near Kiev, the political force began to expand media support. Owing to the successful negotiations with several former

PRINTED MEDIA WORKING FOR THE REGIONS AND FOR THE ... ELITES

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The position of traditional media, newspapers and magazines, gradually weakens in the media field of Ukraine. However, the newspaper format was and remains one of the key and easiest ways to convey the message to the target audience. Before the elections, as well as during the PR campaigns that are accompanied by the confrontation of the FIGs, one-day newspapers appear around one or several resources, and they are often not registered as the media. However, the segment of periodical "paper" editions remains important for those who work for residents of small settlements, elderly. A regular newspaper, unlike a campaign leaflet, can gradually form the opinions of the target audience.

Similar motivation (the gradual formation of opinions) is used by the owners of weekly tabloids of "popular" political or economic analytics. These include several newspapers that publish "complex texts" and thus claim a reasonable audience that likes to read. Circulation of such periodicals rarely exceed 100 thousand copies (which is not enough for Ukraine), but they are designed for the middle class and managers. 30 thousand copies per week would be enough to reach this category of population.

As of early 2018, most of the national printed media market is also divided among oligarchic groups. But, unlike TV channels, here the competition is tougher and there are players invisible in other segments. Here is a short list of oligarchs and their "paper" assets.

- **Rinat Akhmetov** owns Segodnya media holding, which has developed from the most popular the same newspaper. It includes a number of regional newspapers, in particular, Donetsk Novosti, Priazovsky Robitnyk, Vechirnij Donetsk and the newspaper RIO (temporarily not released in the paper version, as it transformed into a network of "independent" regional news portals). The proper presentation of materials and preparation of the audience to the reception of future political slogans have repeatedly yielded results in the form of additional percentage points in the elections.
- The second successful political newspaper project of the oligarchs is the Vecherniye Vesti, which for



more than 10 years delivers the position of **Yulia Tymoshenko** to her loyal electorate and potential (undecided yet) voters. This, at first glance, insignificant periodical has sufficient influence, especially in small towns in the Central part of the country. In addition, the newspaper *Vecherniye Vesti* has its own network of "grannies-distributors" who sell the newspaper, for example, in suburban trains, even in the inter-electoral period. *Fatherland* also has a number of regional projects. The most successful is *Vysoky Zamok* in city of Lviv – the newspaper and the eponymous site.

● **Victor Pinchuk**, who exercises influence in the field of electronic media, also controls a number of printed assets. These include the periodical *Delo*, the newspaper and the website *Delovaya Stolitsa*, the popular newspaper *Fakty i Kommentarii* and the political tabloid magazine *Fakty*. There is information that Pinchuk influences the popular periodical *Levyi Bereg*.

● **Yulia Tymoshenko**, a former "young oligarch" of Yanukovich era, has retained most of his printed media. He controls *KP in Ukraine*, *Argumenty i Fakty*, *Telendeleya*, *Korrespondent*, *Forbes Ukraine* (no longer part of the international network of magazines) that are very popular in the Center and in the East.

● **Viktor Medvedchuk** controls the *Newspaper 2000* and the newspaper *Vesti*, that are distributed free of charge. At first sight, this is not very important, but during mobilization, the competent distribution of these two mass media yields a result. If we add the *Stolichnye Novosti* controlled by Vadim Rabinovich here, we get a fairly powerful media holding.

● **Surkis brothers** owned the newspaper *Kiev Vedomosti* for at least 20 years and retained influence on their former asset – the newspaper *Den*.

And finally, the newspaper *Dzerkalo Tyzhnia* is quite popular among the public, politicians and officials. The periodical is edited by Yulia Mostova – Anatoliy Hrytsenko's wife and, probably, is partially financed by Mykhailo Brodsky, the owner of *Oglyadach*.

Thus, the majority of the national newspapers and magazines are owned by well-known Ukrainian FIGs, interested in politics.

A similar situation is observed in the regional printed media market, where local "mini-oligarchic" clans are trying to gain control over the local press.

On the other hand, there are success stories of independent periodicals in the printed media segment. Their owners tend to stay away from oligarchic groups, or at least not to give them ownership share. The most successful holding is *Express Media* that developed from the Ihor Pochinok's newspaper *Express*. We may recall the new project of former journalists of *Korrespondent* the magazine *Novoe Vremya*, magazine *Ukrainskyi Tyzhden* and others.

However, a small number of "independent" resources do not guarantee a neutral or balanced presentation of information before the elections: the practice of placing one or more materials reflecting the customer's view is quite common in the country.

ELECTRONIC MEDIA A GREAT CHOICE, BUT ALSO A GREAT INTEREST

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Changing of the structure of the information market and increasing share of online media, of course, could not be ignored by the largest financial and industrial groups of Ukraine. The relatively low cost of starting your own project is also quite important and makes it possible for new media to appear. The market of electronic media is, therefore, the most dynamic. At the same time, it is difficult to strictly separate this segment from the traditional printed media or television: the old media resources actively promote own websites, portals and often run the risk of becoming "appendage" to their electronic subsidiaries.

Of course, the lion's share in this segment belongs to the players already mentioned above – these are Internet sites of leading channels, news portals and electronic versions of newspapers and magazines.

For example:

- **Rinat Akhmetov** owns the Segodnya newspaper and the eponymous portal, controls the portal Kommentarii. His important resources include a network of regional news portals that have emerged as a result of the reorganization of the RIO newspaper.
- **Ihor Kolomoyskyi** is the owner of the network of Internet resources built around the TV channels of 1+1 Group, as well as the portal of the TSN news service, which is "freewheeling" now, the site Glavred and the portal of the UNIAN news agency.
- **Victor Pinchuk** owns the sites of the Star Light Media Group channels (ICTV, ICTV facts, STB, Novyi), the site and the newspaper Fakty i Kommentarii, has an impact on the policy of the portal Levyy Bereg.
- **Andriy Sadovyi** is the owner of the Channel 24 website and a popular web-resource Zahid.net
- **Yulia Tymoshenko** controls the party's newspaper Vechirni Visti and the same name website. The printed version of the periodical addresses to the traditional target group of "Yulia's grannies", gazetavv.com (Russian-language site that does not have a Ukrainian version) – to a younger audience.

- **Viktor Medvedchuk**, who is attributed to having control over the holding Vesti (the same name newspaper, radio, Internet portal), also owns the portal 2000, UNN news agency.
- **Dmytro Firtash** and **Serhiy Lyovochkin** are the least active in the field of electronic media. They own the Ukrainian News Agency and the site Podrobnosti, which remains to be just an electronic appendage to the eponymous information program on the Inter channel. The reason is the age of the target group the information and political projects of oligarchs are focused on. The popularity of electronic media is the lowest among people aged 45+ (or even 50+).

Note that a significant share in the segment of electronic media belongs to "the young oligarchs" of Yanukovych's era. For example, Serhiy Kurchenko controls a group of resources that can be compared with all the assets of Ukrainian oligarchs by its audience reach. Here is a short list: Forbes Ukraine (website), Correspondent (magazine and portal), Argumenty i Fakty. Ukraina (newspaper and portal), Komsomolskaya Pravda in Ukraine (website and newspaper), sites Groshi, Poglyad, Capital (the latter is owned jointly with Serhiy Arbuzov).

Other notable and influential players are:

- **Mykhailo Brodsky**, who controls the Obozrevatel portal (and the Obozrevatel TV channel), finances newspaper Zerkalo Nedeli, where the editor-in-chief, as already was noted, is Anatoliy Hrytsenko's wife Yulia Mostova.
- **Yuri Butusov** and his project CENSOR as an example of entering the national level TOP without the obvious participation of large financial and industrial groups.

Another feature of the electronic media is a significant proportion of foreign organizations. Some of the major players are the BBC Ukraine, the project Radio Svoboda (eponymous site, Crimea. Realities, Donbas. Realities), "Apostrophe", Nashi Groshi, Ukrayinska Pravda funded through grant programs. The latter on the one hand actively uses the money of EU grant programs, and on the other – is supported by the Russian oligarch Kostyantyn Grigorishin.



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The Ukrainian media market is part of the system of balances of the influence of oligarchic groups. Instead of developing the ideas of freedom of speech and doing business based on the selling of objective information, a significant part of the resources works in a different paradigm: provides the visibility for certain political forces, thus modeling the scheme of oligarchs' influence on decision-making in the country. Changing citizens' preferences in the choice of sources of information will soon cause a fierce struggle for electronic media, groups in social networks. Since, unlike traditional media, electronic media does not require significant start-up capital, the number of new independent players is constantly increasing. This encourages large FIGs, on the one hand, to develop their own projects, buying promising "newcomers", and on the other – to strengthen censorship on the Internet, up to blocking individual sites, groups of portals, etc.

The struggle for regional media will intensify at the local level, as they enable to achieve several goals at the same time:

- **to make a profit** (political dividends as well as real money) from supporting a particular candidate for the presidency; whilst it is possible to play in a reverse way and take money for not publishing compromising material;
- **to create good starting conditions** for own candidates to the Verkhovna Rada on the elections under the majority system;
- **to maintain control** over the public opinion in local communities, which is very important for obtaining power in the newly formed territorial communities. Unfortunately, the situation in the Ukrainian media market can hardly be characterized as "freedom of speech". This is the most striking example of how the system of oligarchic agreements distorts the essence of the basic values of democracy and performs the function of substitution of notions.

INFLUENCE OVER POLITICS



Ukraine, at least since 2004, exists in the regime of "oligarchic consensus" – a system of balances, agreements and mutual deterrence of interests of big business, aimed for ensuring control, both in its sector of influence and in the economic and political systems of the state as a whole. In this format, political parties are regular assets, such as a factory, land or even landfill sites. You can buy a controlling stake, you can buy a blocking stake, you can disband, throw away, or you can just create a new project within a couple of months. However, the formation of a system of puppet parties never happened over the years. There are several reasons for this.

Political leaders learned well how to play "the game" in an attempt to form their own financial and industrial clan and to get to "Top League" of Ukrainian oligarchs by using the received levers of the political power. This way "the young oligarchs", businessmen who are rapidly breaking into the group of the richest and most influential Ukrainians, appear. But when the political regime changes, most of them lose their power or even disappear.

However, there are success stories. The supreme example is Victor Pinchuk, who at the time of coming to politics was already a multi-millionaire, but since 1997, the period of development of the political project Labor Ukraine and living in a common-law marriage with the daughter of the President of Ukraine, has significantly strengthened his position.

Another approach is providing their political power to serve as a political platform for the oligarchs or their sponsors. The top echelon of a political party thus solves the problem of finding the resource base, and due to the presence (and balance of forces) of different groups, ensures the future of their leader. The most successful example is Yulia Tymoshenko and Fatherland (Batkivshchyna). At different times Vitaliy Haiduk (the founder of the Industrial Union of Donbass), Kostyantyn Zhevago, Tariel Vasadze, Buryak brothers and others were sponsoring her and her party.

Business empire of the politician, who aims to become "the young oligarch", at some point of its development is trying to enter somebody else's sphere of influence and change the existing balance, the system of agreements between the major financial-industrial groups of the country. Competition with one or two clans (but not with the majority) leads to an aggravation of political struggle, the development of a new project. If there is a conflict with several influential oligarchic groups, there comes a deep political crisis, which may end with Maidan. The most recent example is the growing influence of Yanukovych's "family", which was conflicting with the majority of oligarchs until 2013, including sponsors of the Party of Regions (PR), Rinat Akhmetov, Dmytro Firtash, Serhiy Lyovochkin. The crisis that exists against the background of control over the main political players leads to a change in the balance of power, to updating of agreements, but not to a complete "rebooting of the government".

OLIGARCHS AS AN IMPEDIMENT TO THE DEVELOPMENT OF THE POLITICAL SYSTEM

Considering the importance of political support for their business, the largest FIGs prefer hedging risks on the eve of any election campaign. This approach was honed during the presidency of Viktor Yushchenko and lies in the fact that each oligarchic clan tries to ensure the influence on several parliamentary factions. For example, Konstantin Grigorishin, who is known as a long-time partner of Poroshenko, was one of the key sponsors of the Communist Party. Or another interesting fact: the data on the "shadow funds" of the Party of Regions contains information that makes it possible to suspect that PR was sponsoring Svoboda party, which in turn declared an uncompromising struggle against

"regionalists" (term describing The Party of Regions headed by Yanukovych).

On the one hand, influence on individual parties is ensured by the commitment of party leaders in exchange for media and financial support. But, as it was stated above, institutional memory is not inherent to Ukrainian politicians, so oligarchs place their people in parties (often whole groups), who perform the role of "overseers" and, if necessary, can quickly form a faction or even establish a new party. The business of "buying" positions in the lists of those who pass to parliament appeared during the presidency of Leonid Kuchma, but ran rampant already during times of Victor Yushchenko who also was not above providing places in the Our Ukraine–People's Self-Defense Bloc to representatives of oligarchic clans.

Such an approach to party building and to forming party lists, as an external manifestation of processes, by definition cannot lead to the creation of ideological parties, the formation of a real multiparty political system. If the backbone of any faction consists of lobbyists for the interests of individual financial and industrial groups, there is no chance of any ideology – approaches vary depending on the business interests of the owners.

Ukraine is dominated not by parties, but by projects designed to seize and hold power for a certain time. And yesterday's opponents can easily work in the same parliament faction after the next election. But there is an exception even from this rule. For example, autocracy parties (not to be confused with projects such as PPB or Our Ukraine), which include Fatherland, Radical Party of Oleh Lyashko, Svoboda and several small groups that did not receive needed percentage points in the elections of 2014. Formally, these are political organizations with a long history, but even they do not have a comprehensive ideology. The root of this is in the fact that political leaders use the same oligarchic clans' model of purchasing and selling political assets. The leaders of such parties are well aware that having the "institutional core" and "faithful bayonets" increases their political heft, their price in negotiations with various FIGs. At the same time, due to the same "organized nature",

they can afford greater independence compared to individual politicians who enter the Parliament with the support of oligarchs. A typical example from the past is Volodymyr Lytvyn and his projects. Suffice it to recall the slogan "the country needs Lytvyn". The Lytvyn Bloc successfully cooperated with various financial groups, while still being needed and important for the formation of a majority in Parliament. In among today's parties, there is the Radical Party that successfully survived the change of partner. Oleh Lyashko and his colleagues came to Parliament with the support of Serhiy Lyovochkin and Dmytro Firtash, and in 2017 Rinat Akhmetov becomes the main "partner", who affects the behavior of this party's MPs.

Autocracy type parties (with the exception of the Fatherland – see below), have another key difference – their own major region. This is the basis of their existence. Without their own large financial resources, they can secure their future only by building a system of influence within a relatively small area and properly working with the voter, including active use of populism as the main mechanism of influence. After all, when you are "perpetual minority" in Rada, you can promise anything, and can blame any deterioration of the situation on the "terrorist state" and even on "oligarchs". Bringing up "major regions", another lever of the influence of oligarchs on the formation of political power should be mentioned. That is the local administrative resource, single-mandate districts and local business elites.

In the context of the weakness of the central government (and it cannot be strong in the above scheme) interests of any financial and industrial group include ensuring the stability and manageability of key regions – the territories in which their assets are located. Therefore, it is quite logical that, in addition to national political projects, oligarchic clans form local "fiefdoms" with fully controlled local authorities. Of course, regional administrative power can be used in the elections, because FIGs will be against the abolition of elections under the majority system to the bitter end. After all, in single-mandate districts the local administrative resources can turn into a few seats in the Parliament in the easiest way.

At the same time, other processes are taking place at the local level. They can be characterized as “the formation of local oligarchic clans” – local business in the regions, which came out of the sphere of interests of the largest FIGs, begins to subjugate the power and local media. Strong positions in the regions determine their ability to influence national policy. So they can try to play the role of “local allies” for the big clans. The typical example is Oleksander and Halyna Hereha in Khmelnytskyi region. And Petro Poroshenko was supported solely by the Vinnytsia region for a long time. The process of decentralization, which has begun in the country, strengthen hands of local elites, because it gives to local “mini-oligarchs” financial resources of local budgets, reduces the ability of the center to influence the formation of the local political system.

After increasing their influence on the political, economic and social processes in the target region, local elites have, basically, three options:

- 1** To follow the example of the current President (or look at the early history of the Party of Regions) and try to get to the national level as a new oligarchic clan and political project, a necessary tool of influence on the state policy and protection of their interests.
- 2** To use the experience of Yulia Tymoshenko, Andriy Sadovyi, or Oleh Lyashko and go to the national level with own political project that has guaranteed percentage points in an election. This format is less conflictual and can get several financial-industrial groups interested, ensuring that party and local elites will have own group in Parliament.
- 3** To become an indispensable partner for any government, offering administrative resources in elections and formal loyalty in the inter-electoral period in exchange for expanding the resource flow coming from the center. Today such a policy is conducted by Trukhanov in Odessa, Kernes in Kharkiv, Baloha brothers in Transcarpathia.

The analysis of groups of influence in the Verkhovna Rada can be the best illustration of the problems that

OLIGARCHS AND TODAY'S AUTHORITIES

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The analysis of groups of influence in the Verkhovna Rada can be the best illustration of the problems that the system of oligarchic consensus creates for the development of the country. On the one hand, there is the Parliament, and only it should be adopting laws that are binding on all.

The Parliament should be creating a framework for the existence of the country, where it will be extremely difficult (ideally impossible) to have income from government securities, to force the state to serve the interests of a single FIG. After the Maidan in 2004 Ukrainians expected that the new authorities will start building the system independent from oligarchic clans. The opposite occurred during Yushchenko's presidency.

In 2011-2012, Yanukovich launched an offensive against the interests of almost all the FIGs of the country (creating his own, the “family” one). This led to the fact that in 2013 the majority of oligarchs were opposed to Yanukovich, and this was one of the basic prerequisites for further events on the Maidan. Oligarchs played a key role in the Maidan events and therefore became beneficiaries after the defeat of Yanukovich.

In 2014, the slogan "deoligarchization" emerged and became one of the dominant ones on parliamentary elections in the fall. As a result of the formation of party lists, elections under the majority system, there was a new balance of MPs that were lobbying oligarchic clans. Another feature is the appearance of new people, trying to solve their business

problems and who can be called "the young oligarchs".

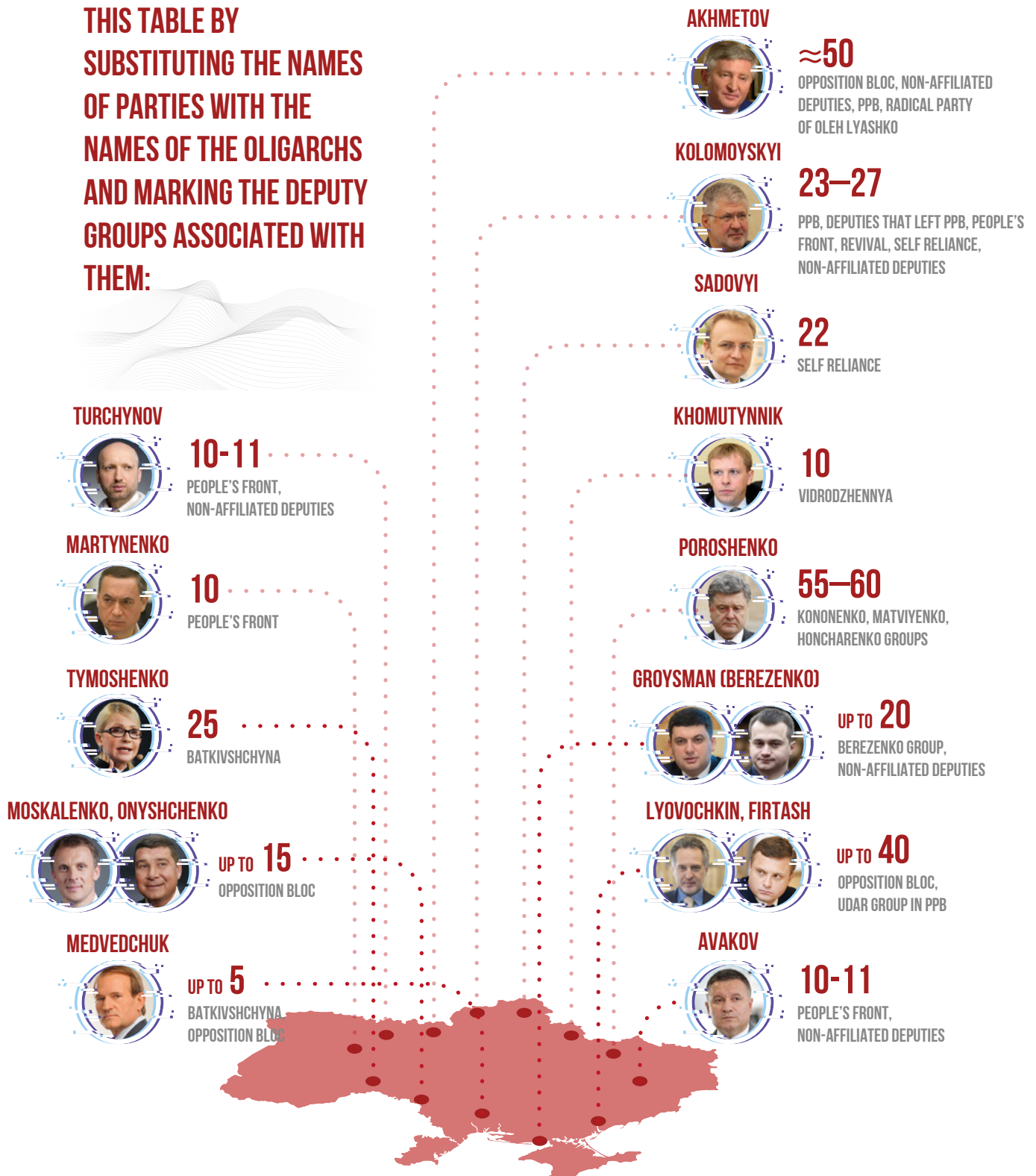
In order to give a complete picture, the table below shows the existing parliamentary groups in the Verkhovna Rada and the degree of influence of oligarchs (old and new) on each of the political forces.

Faction	Number of members	Pressure groups	Estimated number of group member	Annotations
Petro Poroshenko Bloc "Solidarity"	135	Kononenko (Hranovskyi, Vadaturskyy)	Up to 25	A group of businessmen (including agricultural and "young oligarchs"), "working" for the President.
		"UDAR" group (Prodan)	Around 15	The remnants of the once powerful UDAR group. After Poroshenko poached the majority of deputies, mainly those who at different times were associated with the political activity of Firtash or Lyovochkin remained there.
		Vinnytsia group (Berezenko)	20	The group, to a large extent, consists of protégées from Vinnytsia, who, in addition to political ambitions, may have business interests. In the confrontation between the President and Prime Minister, this group is closer to Groysman.
		Matviyenko group	15	The most predictable group headed by the President's fellow townsman
		Tretiakov group, or "Donetsk people"	10	The group includes a number of large businessmen with a controversial history of business development. In case of reformatting of the power this group would be the least loyal to Petro Poroshenko Block (PPB)
		Group of "young" headed by Honcharenko	15	
		Kolomoyskyi's people	3–5	Part of MPs from PPB who actively participate in political projects of the former owner of Privat Bank. There were more of them, but some left the PPB faction in 2016–2017

Faction	Number of members	Pressure groups	Estimated number of group member	Annotations
People's Front	81	Yatsenyuk group	20	The long-time political collaborators of Yatsenyuk, his friends, sponsors. However, over the past 18 months, the group has lost at least a third of members due to the increased influence of Avakov
		Avakov group	20	Friends, political collaborators and business partners of Avakov are the backbone of the group – 10 people. However, in the past year, Avakov has increased his influence in the People's Front owing to politicians from the Yatsenyuk's coterie.
		Turchynov group	10	The group of politicians and businessmen who in due time joined the BYuT together with Turchynov.
		Martynenko group	9–10	Martynenko is a longtime friend and sponsor of Yatsenyuk, the group includes primarily businessmen
		Parubiy group	6	
		Kolomoyskyi's people	5–6	People who helped to implement Kolomoyskyi's projects during 2015-2017
Opposition Bloc	43	Akhmetov group	20–24	Entrepreneurs, politicians, former managers of Akhmetov's businesses, whom he helped to enter Parliament according to party lists and the elections under the majority system
		Firtash & Lyovochkin group	19	
		Medvedchuk's people	2	
Self Reliance (Self Help)	25	Sadovyi Lviv group	20–24	
		Bereziuk group	8	
		Kolomoyskyi's people	2–3	

Faction	Number of members	Pressure groups	Estimated number of group member	Annotations
Batkivshchyna	20	Kuzhel-Nemyria group ("battle-tested")	8	The long-time political collaborators of Tymoshenko who have been supporting her during several election campaigns
		Lutsenko-Krulko group ("young staff")	8	New leaders of the Fatherland, who joined the party during the last 5 years. They intend to strengthen their influence within the party, squeezing "the old guard"
People's Will	19	Moskalenko, Onyshchenko		The group was created by the late MP Ihor Yeremeyev. After his death it is controlled by MPs Yaroslav Moskalenko. The group "backstops" the coalition in the Verkhovna Rada by their votes. Runaway MP Oleksandr Onyshchenko still has some certain influence on MPs of the faction
Vidrodzhennya	24	Khomutynnik group	10-14	The group is associated personally with the head of the faction
		Khomutynnik group	10	In spite of the fact that the Khomutynnik can be perceived as Kolomoyskyi's "colleague", the oligarch has the group loyal personally to him in party.

**WE CAN RE-STRUCTURE
THIS TABLE BY
SUBSTITUTING THE NAMES
OF PARTIES WITH THE
NAMES OF THE OLIGARCHS
AND MARKING THE DEPUTY
GROUPS ASSOCIATED WITH
THEM:**



In total, we have from **275** to **305** deputies that can be called the stooges of the Ukrainian oligarchy. In this format, it would be easier to perceive all possible "parliamentary coalitions" as agreements between oligarchs rather than as a manifestation of political struggle.

For example, "Kolomoyskyi's coalition" (taking into account Self Reliance and the whole party Revival) today has **55-60 votes**. Akhmetov's fraction – **50**, Firtash's – **40**, Poroshenko's (his people, but not "list" part of PPB) – up to **60**. That is, the easiest way to form the "democratic" parliamentary majority is doing it through Kolomoyskyi, Poroshenko, Akhmetov,

adding Tymoshenko or one or two "young oligarchs". This scheme is what we witnessed in 2014. The coalition of "reaction", of "the revenge on the regionalists" might look as follows: Akhmetov, Firtash, Kolomoyskyi (using Khomutynnik and "his" deputies from PPB), Onyshchenko, plus "young oligarchs" or indispensable Tymoshenko.

Such an approach is more understandable from the point of view of the analysis and forecast of the actions of the ruling coalition, since it immediately rejects political demagoguery, allowing to rely on the interests of financial and industrial groups that created the coalition.

CONCLUSIONS

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The presence of different groups of influence within the parties is normal. But when one or several oligarchic clans have their deputies in various, formally even competing political groups, there is nothing to say about the development of the political system and party-building plans for 10 years ahead. The Petro Poroshenko Bloc or the People's Front are not ideological parties as much as coalitions of various groups of influence created to obtain and retain power.

The creation of ideological parties is also hampered by the regular change of the source of resources for their activities. For example, it is difficult to assess the ideological backbone of the Radical Party of Oleh Lyashko. Or let's consider Fatherland. In 2008, being Prime Minister of Ukraine, Yulia Tymoshenko submitted the draft law № 2143 "On the market for

land" to the Parliament, which was enabling the free sales of agricultural land. In 2018, she acts as an opponent of the free sales of land.

The implication is that any attempts to reform the country, the creation of a system with equal conditions for business, without parasitizing on the remains of public resources by individual groups, are doomed to failure if the approaches to the formation of the legislature will not be changed.

Another challenge is, paradoxically, decentralization and the formation of local clans that combine business, politics and parasitism on the budget, which is growing in the provinces. A significant part of these regional FIGs will soon try to reach the national level, which will attract new players to the scheme of confrontation of the old oligarchic clans.



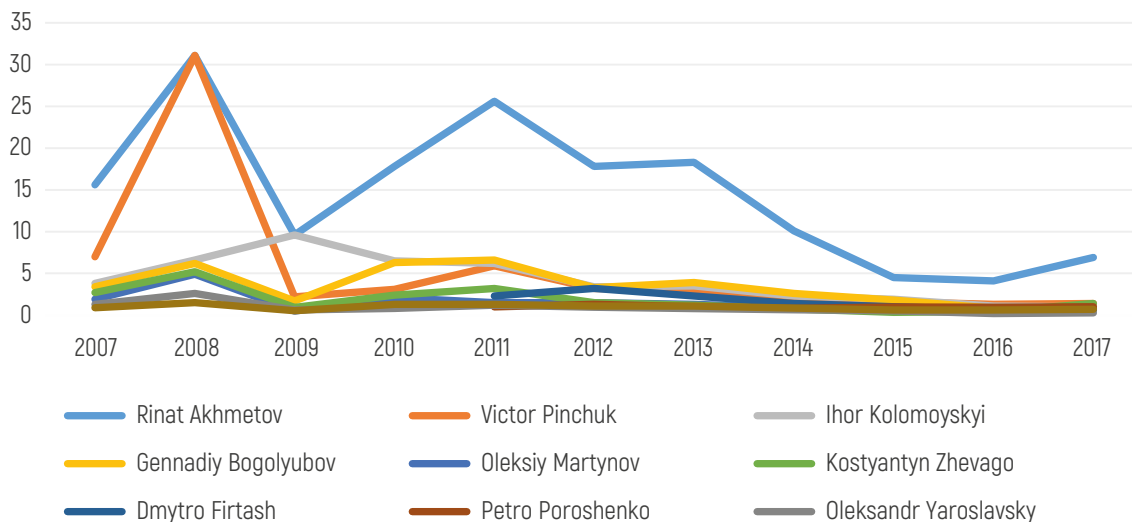
THREE SCENARIOS FOR THE FUTURE OF THE OLIGARCHS



Despite the enormous influence and capital, Ukrainian oligarchs remain dependent on the overall dynamics of the Ukrainian economy. All the stresses and shocks that Ukraine is experiencing are causing tangible blows to the value of their assets.

A simple graph of the dynamics of capitals of the richest people in the country shows that huge financial losses fell to 2008 (global financial crisis) and 2014 (the beginning of hostilities in the Donbas).

THE DYNAMICS OF OLIGARCHS' CAPITALS



The source: according to the project "Golden hundred" of magazines *Korrespondent* and *Novoe Vremya*

Analysis of the energy, metallurgy and transport infrastructure sectors already shows negative growth trends in the short term.

We highlight the most important of them that show the end of the existing business model for oligarchs.

FISCAL CRISIS AND THE END OF THE BUDGET INSURANCE

The classical model of conducting oligarchic business is connected with compensating the losses at the expense of the budget. As a rule, the companies of this or that oligarch win procurements, or receive direct subsidies (for example, Yuriy Kosiuk's business receives **1,4 billion UAH** a year on average, or already mentioned preferential tariffs of UZ for Akhmetov's business).

The new model of enrichment at the expense of the budget, is tariffs raised by the government. Thus, the increase in electricity prices creates huge debts for the part of energy companies, which in the end are paid from the state budget. A classic example is the Akhmetov's Kyivenergo.

The debt in the amount of **750 million UAH** was covered this year at the expense of the state budget.

The above graph shows that since 2016 Akhmetov's capital is again increasing. There are many reasons to believe that the notorious Rotterdam+ scheme has contributed to such dynamics. It envisages the calculation of the price of electricity for consumers by taking into account the price of coal in Europe and including the costs of its delivery to Ukraine. It is clear that domestically produced coal is cheaper. As a result, the price of electricity has increased, and electricity producers received large revenues. Only in 2018, the EBITDA of DTEK holding grew by **2.6 times** compared to the previous year.

There are many different withdrawal schemes. One of them that is worth attention – tax deferral. This is probably the most cynical scheme, as it proves that the oligarchic business does not bring any benefit to the budget. In particular, from 2015 to 2017 the SFS issued tax deferral amounted to almost **18 billion UAH**. The lion's share of them belonged to the businesses of Rinat Akhmetov, Ihor Kolomoyskyi, and immediate circle of Petro Poroshenko. As you can see, for many years the state budget has served oligarchs as insurance against the crises. It was always possible to earn on it and stay afloat.

However, we predict that starting from 2019 the situation will begin to change dramatically due to the following factors:

- 1 The peak debt repayments.** About 40% of the budget of Ukraine for 2019 is provided for debt repayments. And this is **417 billion UAH**, of which **145 billion UAH** – debt service payments. From 2018 to 2023, Ukraine should pay about **40 billion USD** in total. This is despite the fact that the gold and foreign currency reserves of the NBU amount to only **16 billion USD**.
- 2 The growing Pension Fund deficit.** Despite the reform, the deficit of the Pension Fund for 2019 (**166 billion UAH**) increased by **30 billion** compared to 2018 (**139 billion UAH**). Analysis of the demographic situation and the crisis with the massive outflow of labor force and, accordingly, of payments to the Fund shows that in the next 10 years this deficit will continue to grow. And it will be financed from the budget.
- 3 The increased defence expenditures.** Defence and security expenditures increased by **73 billion UAH** from 2017 to 2019. However, this amount is not enough to cover all the defence needs of Ukraine connected with the threat from the Russian Federation.

Thus, the "budget pie" will seriously decrease in the next 5 years for oligarchs and will not give them the opportunity to fully cover the needs of their businesses, regardless of their political heft and influence.

THE NEW GLOBAL FINANCIAL CRISIS AND CHALLENGING INTERNATIONAL MARKETS

According to international analysts, 2019 may be the beginning of a new financial crisis. As we saw on the chart of capitals, the crisis of 2008 seriously devalued the oligarchs. Already being at a much lower level than in 2008, in 2019 Ukrainian oligarchs can turn from billionaires into millionaires. The decline of international markets, the dramatic reduction in exports of raw materials can cause irreparable damage to their businesses, which can no longer be covered by the budget.



Current trends are negative. It is known that the increase in the rate of the US Federal Reserve, first of all, strikes the raw materials markets and developing countries. In 2018 alone, the Fed raised the rate three times (**to 2% -2.25%**), and also forecasts to raise it during 2019-2020 **to 3.4%**.

THE OUTFLOW OF THE WORKFORCE

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Taking into account that the export of metals amounts to **26.7%**, and agricultural products to **37%** in the exports in 2018, a sharp decline in prices for these types of goods can cause the collapse of the GDP and, accordingly, the profits of oligarchs.

Labor migrants from Ukraine have always had a positive impact on the Ukrainian economy. It was their transfers that increased foreign exchange proceeding and closed the gap in the trade balance. They perform this role now too. Thus, according to various estimates, the total amounts received from Ukrainian "gastarbeiters" in 2018 should be about **11.5 billion USD**. This factor helped to keep the \$/UAH rate stable enough. However, this relatively positive thing is a disaster in the medium term.

The outflow of the labor force from Ukraine has reached catastrophic proportions. Low rates of economic growth, low wages, as well as the large-scale opening of foreign labor markets for Ukrainian workers entail enormous negative consequences for the Ukrainian economy. National Bank of Ukraine experts NBU declare that the outflow of labor force can cause inflation and decline in economic growth.

In addition to the internal causes of labor force outflow, there are also serious external prerequisites for this. To understand the scale of "poaching of the labor force", we can cite the example of Poland, which in 2013 issued **256 thousand** work permits, and in 2017 **1 million 941 thousand**. In 2018, it was planned to issue **3 million permits**. The situation may become even worse due to the opening of Germany's labor market for Ukrainians, where according to preliminary estimates **2 million** workers are needed. Ukraine already feels the negative consequences of the outflow of workforce. Thus, in Poland, **300 thousand** Ukrainians make official payments to social funds. In fact, these are the amounts that were not received by Ukrainian funds, and the created deficits are covered by the budget.

However, this is especially harmful to oligarchs whose large businesses need a significant number of workers who would work for low wages. For many years, it was the low wages that allowed them to compete in international markets. After the mass outflow of workers, they will be forced to gradually raise wages, which will significantly increase the cost of their products.

DEFAULT RISK

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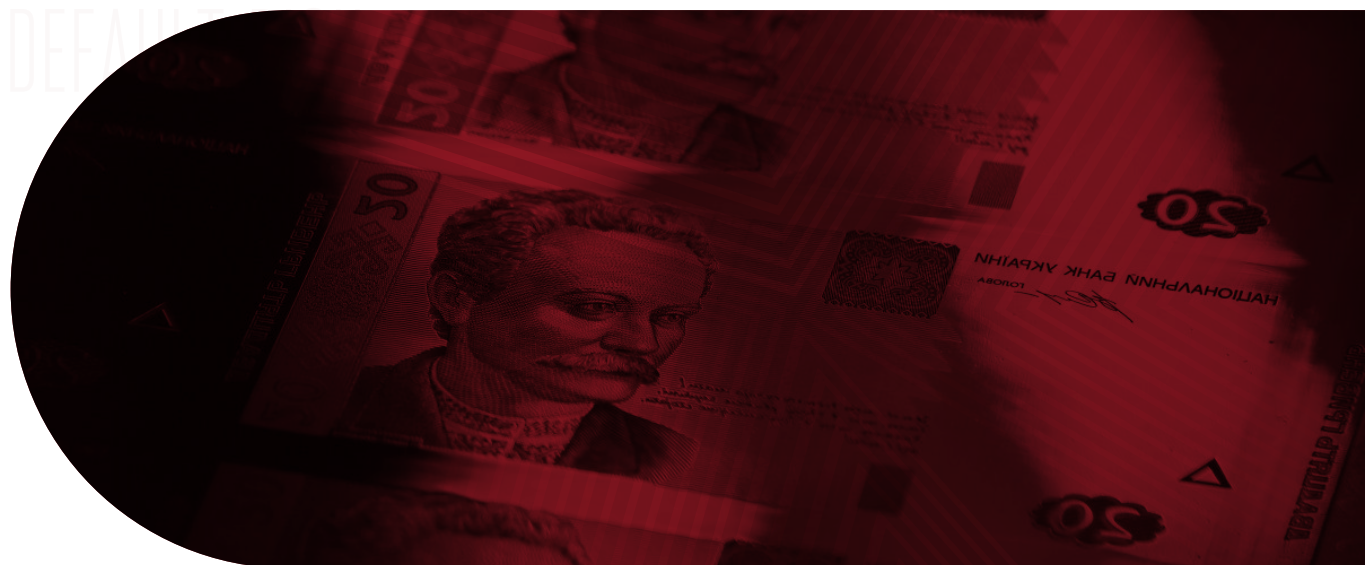
DEFAULT RISK

DEFAULT RISK

An alternative way would be to modernize production, which would significantly reduce the need for labor. However, this requires significant credit resources or own investments, which, unfortunately, are not provided for in their "predatory" approach to business.

Intimidations about the default turned into reality. In September 2018, Prime Minister Groysman publicly stated that the failure to receive another IMF tranche would put Ukraine on the brink of default. It was about Western aid in the amount of **1 billion USD**. That is, according to the Prime Minister, such a relatively small amount was keeping Ukraine from the default. The general situation in the economy remains critical, which makes Ukraine completely dependent on cooperation with the IMF.

Although the UIF analysis shows that the experience of defaults had predominantly positive consequences for the growth of economies in other countries. But the consequences will be extremely negative for the oligarchs. A default would mean the blocking of access to external borrowing, the blocking of foreign assets, the outflow of investors, and the depreciation of the shares of Ukrainian companies on the stock markets. All this can lead to a devaluation of the business capitalization of oligarchs, their ability to invest, to re-credit, to find investors or buyers for their businesses.



EXTERNAL PRESSURE AND WAR

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Ukrainian oligarchs repeatedly had problems with Western systems of justice. Primarily because they like to sort out their relationship in London court. However, recent Western trends indicate that their problems will become more serious.

Dmitry Firtash can become the first major "victim" of European justice. He is under investigation and cannot leave Austria since 2014. So far, he has successfully avoided extradition to the United States. However, the risk of suffering the same destiny as Pavel Lazarenko is quite high.

Ihor Kolomoyskyi faced serious problems as well. Thus, in December 2017, the High Court of Justice in England has frozen his assets around the world. And in the fall of 2018, according to media reports, he had to move from Switzerland to Israel because of an FBI request. Now Kolomoyskyi managed to fend off this attack, but given the number of lawsuits and the seriousness of the cases, his problems will still gain momentum.

Rinat Akhmetov has received a wake-up call as well. At the beginning of this year, **820 million USD** of his assets were frozen under the decision of the Cyprus court, and the oligarch was not allowed to spend more than **20 thousand EUR** per month. Even his luxury apartment in London could have been frozen. As a follow-up to this, a similar decision to freeze assets was pronounced by the court of the Netherlands. Six months later, the lawyers of the Systems Capital Management managed to fend off the seizure of assets. However, the situation is very symptomatic.

In addition to their own problems, unfavorable for the oligarchs, there is a general pressure on Ukraine. Thus, the IMF's rigid positions on the fight against corruption, macro-stabilization, the market for land, etc. – all this also limits the ability to "do business in the usual way". The poor economic situation forces the government to listen to these demands, otherwise, there will be the default. This also reduces the options for saving business at the expense of the state budget.

The real serious challenge to the oligarchs is aggression of the Russian Federation. Due to the conflict in the East and Crimea oligarchs lost a significant part of assets, and some of them (like Serhiy Taruta) are no longer in the list of the richest people of Ukraine. The graph clearly shows how, since 2014, there has been a serious devaluation of the oligarchs' capital. It should also be noted that many of oligarch's productions depended on the Russian market and, with the beginning of aggression, lost access to it. Uncertain plans of Russia and the possibility of further escalation of the conflict continue to be a big problem for the oligarchs and for the country. Thus, the blockade of

the Azov Sea causes serious damage to the Akhmetov's factories located in Mariupol. It is obvious that Russia can also use the vulnerability of oligarchs to achieve its political interests in the territory of Ukraine.

However, this is not a complete list of trends that prove that the oligarchic business model has outlived its usefulness. Analysis of these trends clearly shows that with the present model of behavior there is no promising future for oligarchs. The conducted analysis makes it possible to proceed to the development of three scenarios for the future of oligarchs: conservative, revolutionary and moderate.

● THE CONSERVATIVE SCENARIO

This scenario assumes that the situation remains as it is. Oligarchs continue to conduct business "as usual". They are trying to put their political factions to parliament during the elections, make agreements with the candidates for the presidency. And then they convert their influence into budget support for their own businesses. Access to the policy continues to be closed due to the control over the media space.

We forecast that such a scenario can be applied for 3-5 years without significant changes. Additional favorable factors for this should be the following: state debt restructuring, favorable configuration in foreign markets, stable support of Western partners. Today, this situation seems unlikely.

In the context of the decline in resources, the oligarchs will start a tough conflict between them, in which they will be destroying one another. The situation apparently will begin to destabilize, given the catastrophic shortage of money for social benefits, the rise of populists and radicals. The

authorities will be reacting to the situation by printing money and can cause hyperinflation and default. In many ways, everything can be similar to the beginning of the 90s.

The implementation of the conservative scenario is catastrophic for both Ukraine and the oligarchs. During this period, millions of workers will be lost, and we will not be able to recompense it by means of labor from other countries, as the level of wages and economic development of Ukraine will be among the worst in the world. In fact, Ukraine will become a nominal state, which will maintain its independence on the surface, but any opportunities for development will be emasculated. Independence will be the result of agreements between various external players.

Such a Ukraine will be like Bosnia and Herzegovina that is de facto externally managed.

● THE REVOLUTIONARY SCENARIO

This scenario presupposes radical removal of oligarchs from power and deprivation of control over economic sectors. Several sub-scenarios are possible here.

01 BRITISH

In the wake of the elections, politicians who violate agreements with the oligarchs come to power. Having the support of Western partners, they begin a tough process of deoligarchization and the restoration of free competition. It resembles the English scenario of the mid-eighties implemented by the English Prime Minister Margaret Thatcher who fought with trade unions that monopolized influence on politics and the economy in the industrial sector. However, such a scenario seems unlikely, as Thatcher had effective law enforcement and parliamentary institutions, while Ukrainian institutions are fully controlled by oligarchs.

We must admit that the oligarchs are the basis of a centralized post-Soviet system, in which they replaced the function of the Politburo. Therefore, even with the emergence of such power, it will have limited capacities to take tough actions against oligarchs. A good example of this is the creation of anti-corruption bodies. Despite the active support of international institutions and the relevant legislative framework, NABU, SAPO and other anti-corruption institutions are more likely to defend themselves rather than battle corruption and oligarchs.

02 THE REVOLT OF THE MIDDLE CLASS

This scenario entails the mobilization of the middle class, followed by the creation of its own political force and bringing it to power through large-scale protests. The defeat of the oligarchs will clear the space for active actions of the new government and will allow to form new institutions. The new government will have enough capacities to implement a tough program of deoligarchization and demonopolization due to public mobilization.

However, this scenario today has little chance for success as well. The fact is that a highly centralized economy creates inequality on such a scale that the total amount of resources of the oligarchs far

exceeds the capabilities of the Ukrainian middle class. The basic problem of the latter is the lack of self-organization.

The middle class must create its own organization to effectively confront an organized system of oligarchs. However, on the one hand, having a large number of people that need to agree among themselves, and on the other – the need to consistently resist the financial and industrial groups of oligarchs, makes this task impossible. It can be implemented only with the appearance of a strong leader or a group that can mobilize others.

03 EXTERNAL INTERFERENCE

This scenario looks realistic, although the probability of its implementation remains low. Growing geopolitical tensions between the West and Russia might turn Ukraine into a strategic "vanguard". Thus, the introduction of radical reforms and the creation of an effective counteraction to Russia can force the West to actively intervene in the situation in the country.

It can be expressed in direct pressure on oligarchs with the aim of further removal from politics or making them to be loyal to specific political groups.

The weakness of this scenario lies solely in the absence of such groups ideologically close to Western values and in the lack of popular support.

● MODERATE SCENARIO OR "THE POLISH ROUND TABLE"

The third and most realistic scenario is "the Polish round table". In 1989 the confrontation between the opposition and the government reached the peak in Poland, but both sides realized that neither of them will have an absolute victory. The Communists remained strong enough to remain in power, and the Solidarity Union gained massive support among the Poles to avoid compromising. The results of the roundtable did not meet the expectations of any of the parties, although, according to its results, each party declared victory. The government retained power, and Solidarity ensured fair elections. However, another thing was important – communication and the emergence of trust between the parties.

This played a key role in further events: the communists peacefully transferred power to Solidarity, and the Union guaranteed their safety. This "informal" agreement continued until the death of former communist leader Wojciech Jaruzelski (25 May 2014). Despite repeated attempts to bring him to justice, no one succeeded.

This model is eminently suitable to the conditions that have developed in Ukraine. A number of factors

indicate that there are prospects for its successful implementation.

Firstly, the experience of the presidency of Yanukovich and Poroshenko proves that every head of state since the 90s was trying to become the largest oligarch in expense of others. The problems with the redistribution of property and privatization that regularly arise gradually make it clear to the oligarchs that honest rules of the game are better than the backroom dealing.

Secondly, the influence and heft of the oligarchs today remain too big to make an easy and unambiguous victory over them to be possible. It is almost impossible to open access to policy without their consent and compromise. On the other hand, the trends described above prove that without radical changes in Ukrainian politics and economy they have no future. Therefore, opening politics corresponds to the aim of their survival.

In fact, we can already see positive changes in this direction. Thus, the ICTV channel, owned by Victor Pinchuk, launched the TV-show "New leaders" aimed

to popularize public personalities and activists. Rinat Akhmetov's team is actively developing Mariupol under the leadership of the young progressive mayor. According to media reports, he was even considered as a possible candidate for the presidency. Ihor Kolomoyskyi develops several independent projects – Oleksandr Shevchenko and Volodymyr Zelensky and supports Yulia Tymoshenko.

The key issue of interest to oligarchs is security.

This cannot be guaranteed by the old politicians because of the conflict of interests in the business. They also cannot get security guarantees from each other, because of the lack of trust between them and because they are in the state of permanent internecine conflict. They also have no confidence in the future as trends prove that they simply do not have this future. Therefore, the option of sitting down at the negotiating table with an understandable political actor who can provide security guarantees to their assets in exchange for opening up access to

policy and implementing radical reforms is one of the most optimal. Ukrainian oligarchs gradually moved to the category of "settled" and begin to understand that it is better to have equal rules of the game than the grueling war of all against all.

They have already demonstrated their readiness for such a roundtable. In 2015 Serhiy Taruta initiated the meeting of Ukrainian oligarchs in the Hyatt Regency Kiev. According to media reports, the purpose of the meeting was to discuss the economic crisis and ways out of it. Taruta himself has repeatedly stated that the experience of his bankruptcy due to war should become a valuable lesson for other oligarchs who should look after the interests of the country, not only after their own.

Thus, there are enough signals about the readiness of oligarchs to come to the negotiating table.

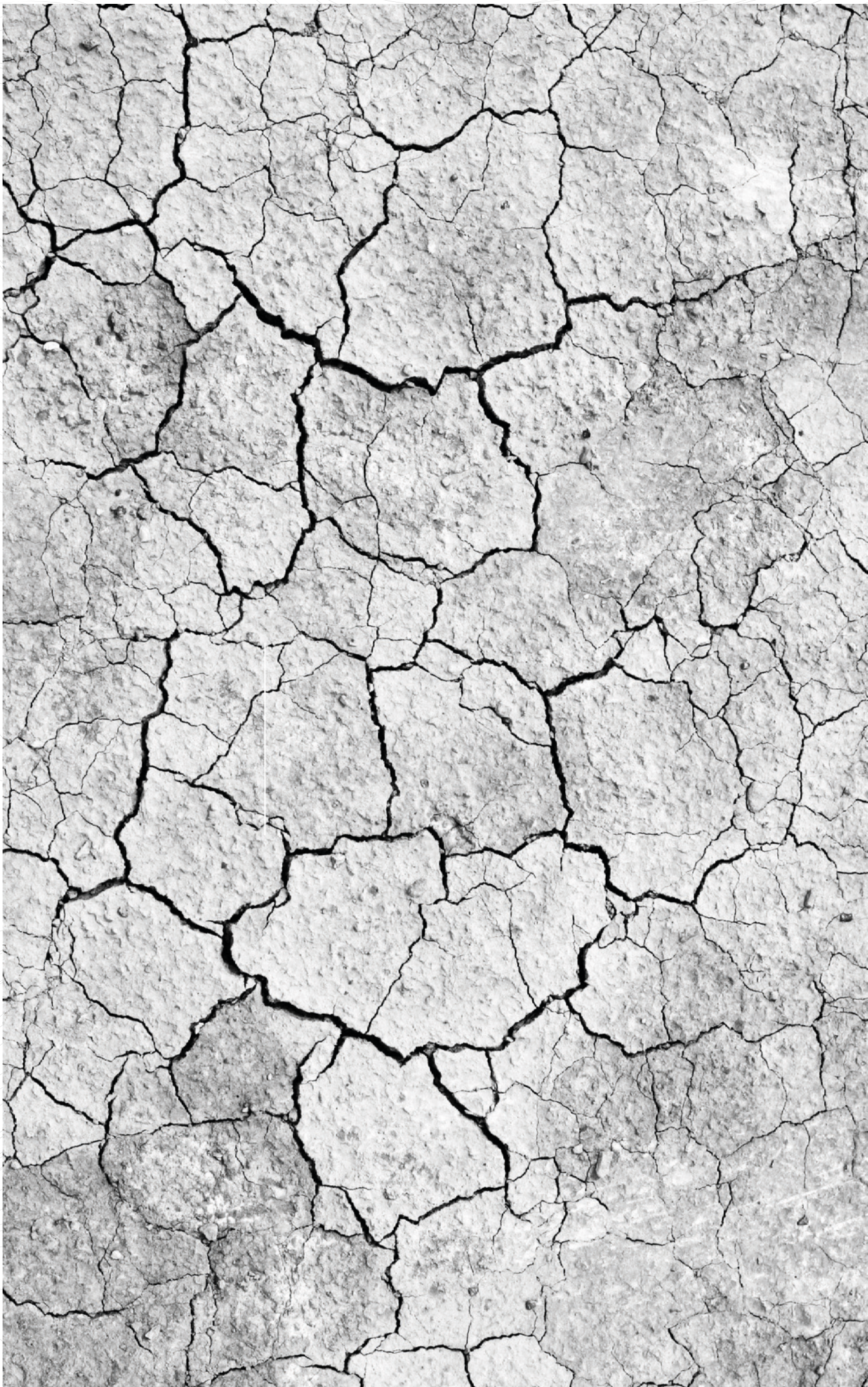
Only one question still remains unanswered by the Ukrainian society:

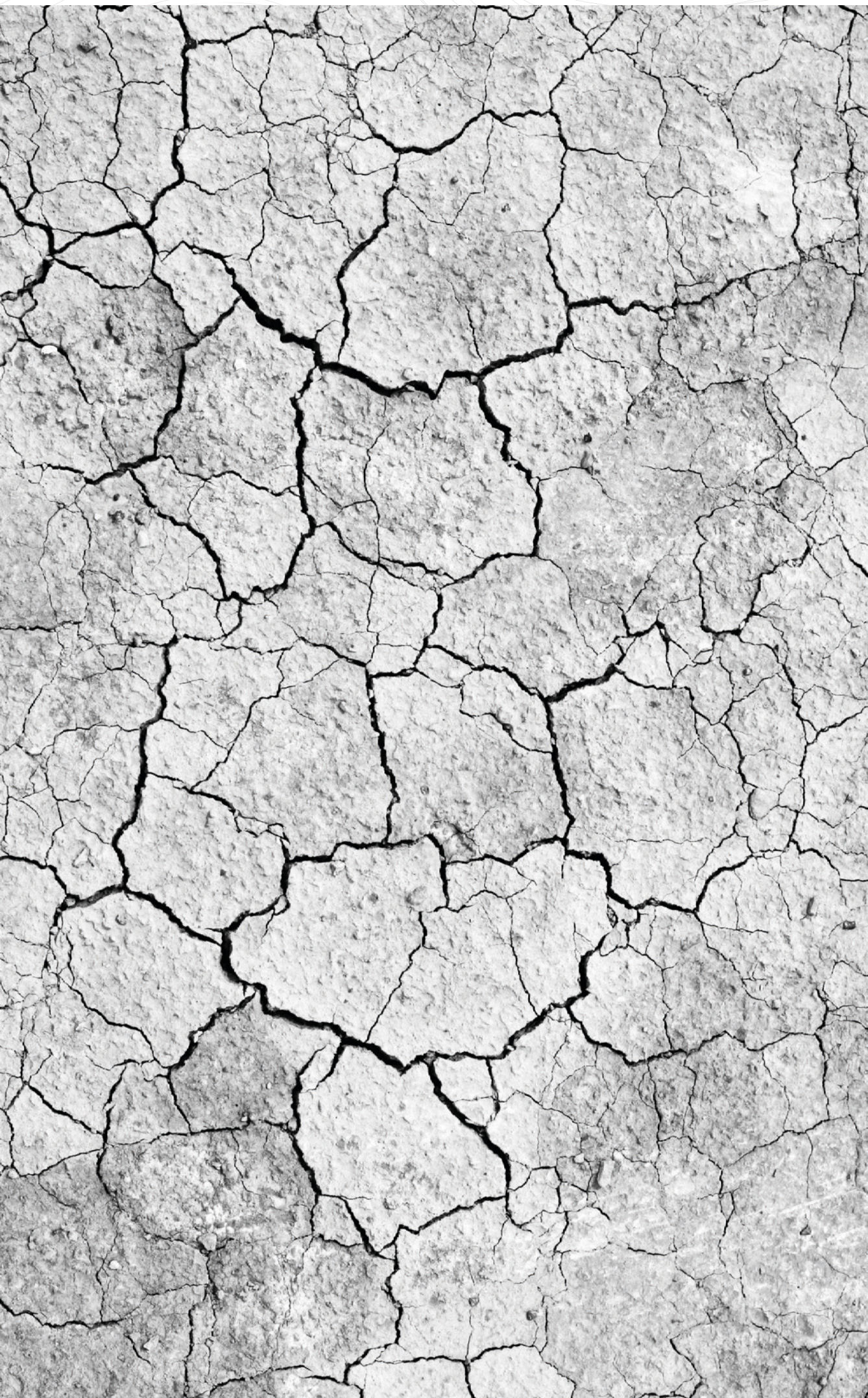


WHO WILL SIT DOWN ON THE OTHER
SIDE OF THE NEGOTIATING TABLE?

FOR NOTES









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