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**Research Report**

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## “Deoligarchisation” in Ukraine

Promising Visions, Murky Realities

*Steffen Halling and Susan Stewart*

In 2015, Ukrainian President Petro Poroshenko announced a process of “deoligarchisation”. Not much has happened so far. Some of the oligarchs’ profit sources have run dry in the field of public procurement. Certain efforts have been made to curb the influence of oligarchs with respect to media legislation and financing political parties. However, these reforms have not yet been implemented effectively. In addition, measures in sectors that are fundamentally important to the oligarchs (the energy sector, in particular) have been extremely contradictory. As a result, the oligarchic system persists and is being supported and consolidated by the ruling elite. Unless external actors increase their influence, Ukraine is unlikely to free itself from the mire of corruption, despite its many reform endeavours.

The Maidan protest movement that brought about the 2014 overthrow of President Viktor Yanukovich called for the oligarchs’ influence on the politics and economy of Ukraine to be curtailed. Even President Poroshenko declared that, in the fight against corruption, “deoligarchisation” would be given top priority. However, unlike after the Orange Revolution of 2004, this process was to be ‘evolutionary’ and without the need for nationalisation or reprivatisation. Instead, the intention was to destroy existing monopolies, strengthen state control in the resource sector and reduce the political influence of the oligarchs. However, there are questions as to whether this process is actually taking place, especially since the President himself is an industrialist and arguably ranks among the oligarchs.

### Political influence of the oligarchs

Oligarchs in Ukraine are business magnates who have had considerable influence on the country’s politics since at least the end of the 1990s. They employ various means, but always with the primary aim of championing their own business interests. The considerable financial resources of the oligarchs are the result, but also the basis of their political activity. Generally, oligarchs employ three strategies of political activity: Informal (corruption) networks between oligarchs and the political elite, with the former securing economic profits and, in return, the latter providing political support, constitute the basis of their influence. These networks or cliques are found in all organs and institutions of the state – in parliament, but also in bureaucratic agencies,

such as the Customs Office or the Anti-Monopoly Committee. Furthermore, oligarchs in Ukraine frequently take on political office themselves. This not only consolidates their political relationships but also makes them immune from prosecution. The third way oligarchs in Ukraine exert political influence is through the media. Oligarchs have controlled the country's most important mainstream media for years – especially the key medium of television. Particularly in the context of elections, television gives oligarchs plenty of opportunity to garner support for their own political projects or political allies and weaken the opposition. In order to diversify and maximise their influence, they sometimes support multiple parties simultaneously.

Since the oligarchs in Ukraine compete against each other, their past political activities have tended to counteract any trends toward autocratic development. As a result, they also contribute to a certain political and media pluralism in the country. Nevertheless, their presence in the political system remains a formidable obstacle to Ukraine's democratisation. Firstly, they use their considerable financial resources to distort conditions between the actors in political competition. Secondly, they manipulate the process of shaping policies for their own benefit. And thirdly, they promote practices that are harmful to democracy, such as corruption and clientelism.

The symbiosis between politics and business promoted or personified by the oligarchs also has a massive economic impact because the oligarchs will usually only push through those economic reforms that maximise their incomes. In the past, this was particularly evident when it came to issues of privatisation or legal changes in the area of public procurement, government subsidies or energy trading. Moreover, monopolies created by the oligarchs in certain sectors of the economy further hamper the development of small and medium-sized enterprises (SMEs). Ultimately, the dominance of the oligarchs and their economic competitive advantages, coupled

with a lack of legal certainty and strikingly high levels of corruption, all have a negative effect on the willingness of foreigners to invest in Ukraine.

### **The oligarchs after Maidan**

The political and economic crisis that befell Ukraine during the Maidan protests placed the oligarchs under intense pressure. Almost all of the nearly two dozen oligarchs lost considerable sums of money in the deep recession. Possibly the best example is the wealthiest member of the group, Rinat Akhmetov. It is estimated that his fortune shrank from US\$12.5 billion in 2014 to US\$2.3 billion currently. The number of Ukrainian billionaires has also halved since 2014 from ten to five. Only President Poroshenko has managed to increase his assets. The value of his company holdings increased by an estimated US\$100 million last year.

In particular, those oligarchs with a close relationship to Yanukovich suffered an enormous loss of power. Their influence also decreased due to the collapse of the 'Party of Regions'. Serhiy Kurchenko, whose rise only began under Yanukovich's presidency, is, however, the only oligarch against whom criminal investigations have been launched in Ukraine. His holding company was confiscated. Just like other members of Yanukovich's innermost circle of power, he left the country after the fall of the regime, while Rinat Akhmetov managed to retain his oligarch status, even though he lost influence after the regime's collapse. Firstly, Akhmetov has limited access to separatist areas of the Donbas controlled by Russia. Secondly, although he is still in control of part of the Opposition Bloc, the importance of this political force as the de facto successor of the Party of Regions – formerly the strongest parliamentary faction – declined dramatically after severe losses in the 2014 elections. Akhmetov's reduced influence in post-Maidan Ukraine was immediately noticeable in the energy sector. In the years prior to the elections, the company he controlled, DTEK, became the largest private

electricity producer in the country. However, the National Energy and Utilities Regulatory Commission of Ukraine (NEURC), whose leadership was newly appointed under Poroshenko, decided to lower tariffs paid by the state for the purchase of electricity, which led to considerable losses for Akhmetov.

Another oligarch, Dmytro Firtash, who was considered an important supporter of Yanukovich and beneficiary of the kleptocratic system, also lost power after the coup in 2014. For several years, Firtash profited from a monopoly on gas imports. He is also supposed to have received gas for his own companies from Russia under special conditions and to have acted as a Kremlin stooge in Ukraine. After the change of government, he was initially arrested in Vienna on suspicion of corruption in the spring of 2014 at the request of a US court. He nevertheless continued to play a role in Ukrainian politics and business, apparently protected through informal agreements with Poroshenko and Vitali Klitschko (now the mayor of Kyiv). However, this did not prevent the Yatsenyuk government cancelling leases on two metallurgical plants and confiscating 500 million cubic metres of natural gas from his holding company, Ostchem.

The fall of Yanukovich and the ensuing marginalisation of his nepotistic clan, known as the 'family', created room for other cliques. Alongside Poroshenko, the oligarch Ihor Kolomoiskyi also gained a great deal of power. In March 2014, Kolomoiskyi was appointed governor of Dnipropetrovsk Oblast. He managed to ensure stability in the region bordering the Donbas. In the spring of 2015, however, a conflict surrounding his investments in the state oil and gas company Ukrnafta and in the pipeline company Ukrtransnafta escalated. Until then, it had been common practice for Kolomoiskyi to prevent a quorum at shareholders' meetings by using his blocking minority – meaning that, among other things, dividend payments to the state had to be negotiated with him. But a

new law put a stop to this practice. When the government removed Kolomoiskyi's crony from the Executive Board of Ukrnafta, he tried to take over the company by force, but failed. He finally had to relinquish the post of governor in early 2015. The subsequent dismissal of Ihor Palytsia, one of Kolomoiskyi's partners who had been governor of Odesa Oblast since May 2014, was a clear sign of his loss of power. The port city of Odesa is considered an important transit point for smuggling, and Kolomoiskyi profited from this with the aid of the local customs office.

### **The comeback of the oligarchs**

Despite the political dynamics described above and the temporary curtailing of the influence of some oligarchs, their role has hardly changed. This is evident from an examination of the current parliament, which has gained importance since Ukraine's return to the 2004 constitution and the re-introduction of a more parliamentary-dominated system of government. Although today there are undoubtedly more reform-oriented members of parliament in the Verkhovna Rada than ever before, the oligarchs' influence nonetheless remains undiminished. They recently managed to assert their influence even further, benefitting from the weakness of the ruling coalition, particularly in the wake of the government crisis in the spring of 2016. At the same time, however, Poroshenko also managed to gain additional power.

Both trends were clearly confirmed with the appointment of Volodymyr Hroisman as Prime Minister. Hroisman is a long-time friend of the President. He previously served as the mayor of Vinnytsia, Poroshenko's political home, before being elected into parliament on the party list of the pro-presidential Petro Poroshenko Bloc and becoming Chairman of the Verkhovna Rada. The dismissal of Yatsenyuk's government and the appointment of Hroisman in April 2016 marked a discernible shift in the bal-

ance of power within the Ukrainian executive in favour of the President. The dualism that had existed between the President, on one hand, and Yatsenyuk representing the strongest parliamentary faction, on the other, disappeared. But because the government coalition no longer had a majority due to the departure of the 'Fatherland' and 'Self Reliance' factions, the new cabinet was only elected thanks to votes from independent members of parliament and, in particular, the parliamentary groups 'People's Will' and 'Revival'. Independent members of parliament with no direct mandate are frequently considered to represent oligarchs' interests in Ukraine. This also applies to both the parliamentary groups mentioned above. While the Revival group is said to be influenced by Kolomoiskyi, the People's Will group consists mainly of former representatives of the Party of Regions, several of whom have connections to the state gas extraction company Ukrhazvydobuvannia. Yuriy Lutsenko, who was previously leader of the Petro Poroshenko Bloc and has no legal training, was ultimately appointed Prosecutor General of Ukraine with the votes of these parliamentary forces.

The transition to a new government in conjunction with Yatsenyuk's departure from the post of Prime Minister has seen more allowances made for the interests of the established oligarchs. For example, Akhmetov's energy company DTEK recently recorded considerable profits again. These profits are only possible because on 1st March 2016 the NEURC raised the previously lowered tariff on the purchase of electricity by up to 20 percent. This increase was accompanied by a rise of 25 percent in electricity prices for Ukrainian consumers. Moreover, the NEURC allowed electricity suppliers to raise their tariffs by up to three percent per month from January 2017. The price of coal was also recalculated in Akhmetov's favour and he controls large segments of the Ukrainian coal mining industry. The price is now based on the Rotterdam Coal Futures index, whereby fictitious delivery costs from Rotterdam to Ukraine

are added for energy sources mined locally. Also, the pressure on Kolomoiskyi has eased visibly in recent months. The National Bank of Ukraine agreed to reschedule debts owed by PrivatBank, which is the country's largest financial institution and part of Kolomoiskyi's Privat Group. Instead of insisting on a repayment of €641 million that was originally due in March 2016, the National Bank accepted a payment of only €22.6 million in April. Since 35 percent of deposits at PrivatBank are owned by Ukrainian citizens, Kolomoiskyi could potentially cause the Ukrainian banking system to collapse if his bank defaulted. In addition, the restructuring of Ukrnafta, a company he previously owned, is still not complete. Although the legal change to shareholder quorums mentioned above has allowed the state to regain control over the oil and gas company, newly appointed CEO Mark Rollins named Kolomoiskyi's cronies to important key posts. Other people in Kolomoiskyi's close circle have merely changed their positions rather than leaving the company.

### **Poroshenko's patronage network**

The government crisis that began with the resignation of the progressive Minister of Economic Development and Trade Aivaras Abromavičius in February 2016 has ultimately raised questions about the role of President Poroshenko and his circle. With support from civil society and from abroad, Abromavičius had pushed for the reform of public procurement and set up an electronic platform called ProZorro aimed at improving the transparency of the process for awarding public contracts. However, Abromavičius tendered his resignation in February 2016 on the grounds that people from the President's inner circle had pressured him and tried to exert direct influence on the ministry. His accusations were directed explicitly at member of parliament Ihor Kononenko, deputy head of the Petro Poroshenko Bloc. Kononenko is a long-time business partner of the President and is often referred to as a key link between par-

liament, the Prosecutor General's Office and the Cabinet of Ministers. He is said to control a number of state-owned companies through a network of front men. Among other firms, this is supposed to include Zentrenerg, which is responsible for supplying coal to other state enterprises and, under Yanukovych, favoured companies connected to his son Oleksandr. Today, Zentrenerg's state coal purchases are mainly handled through foreign companies whose ownership structures are largely opaque. However, journalists in Ukraine have recently revealed that coal from contested areas in Donbas had officially been declared as having originated in South Africa. This implies that Zentrenerg makes profits based on illegal transactions and false statements.

After accusations by the former Minister of Economic Development and Trade, the National Anti-Corruption Bureau (NABU) opened investigations against Kononenko, suspecting him of abusing his office. However, it soon dropped these investigations due to a lack of evidence. Nevertheless, the allegations against Kononenko and other close friends of the President still stand. But Poroshenko is not only in trouble because of these dubious relationships. The publication of the 'Panama Papers' also raised questions as to whether the President himself is involved in offshore transactions and tax evasion. The political leadership lost further credibility recently due to an attempt by the government to subordinate the state-owned company Ukrtranshaz, which controls the Ukrainian gas transit pipeline network, directly to the Ministry of Economic Development and Trade. Since the departure of Abramovičius and due to his accusations (see above), the ministry is widely suspected of being influenced by Poroshenko and his inner circle. Transferring Ukrtranshaz, a daughter company of Naftohaz, to the ministry would have undermined the promised "unbundling" of the energy sector, to which an independently administered Ukrtranshaz is intended to contribute.

## **Parties and the media**

Some minor 'deoligarchisation' successes have been achieved in the areas of party financing and the media. The system of party funding is particularly significant for the political influence of oligarchs since the lack of legal frameworks currently makes Ukrainian political parties highly dependent on contributions from individual donors. Furthermore, oligarchs have always been able to establish their own political forces. Recent examples of this include the Ukrainian Union of Patriots (UKROP) and Vidrodzhennia (Revival), both of which are considered Kolomoiskyi's political technology projects and appeared in the course of local elections in 2015. Meanwhile, smaller and more reform-oriented parties have found it very difficult to compete with financially powerful parties. As a result, the Ukrainian political party landscape is marked by a high susceptibility to corruption, a lack of consolidation and enormous fragmentation.

Legislation introducing state party financing which came into force on 1st July 2016 should help redress this imbalance. It provides for parties to receive state funding depending on their election results. Initially, however, this only applies to parties elected into parliament in 2014 and to those that achieve at least two percent of the vote in subsequent elections. Furthermore, the legislation also regulates the type and scope of private donations to political parties. Monetary and in-kind donations by natural and legal persons may not exceed a certain amount. In addition, party and election funds are separated to prevent donations to the party being transferred to election budgets. Parties are also required to create detailed financial reports and undergo internal and – if participating in elections – external audits. Additionally, the National Agency for the Prevention of Corruption (NAPC) will publish full audit reports on the Internet in order to increase transparency. It remains to be seen how these legal provisions will be implemented in practice.

Nevertheless, electoral law reform is still inadequate. For example, campaign fund-

ing and political advertising during elections are insufficiently regulated, leaving them open to influence from the oligarchs. In addition, current electoral law has always favoured the oligarchs – not only because half of all parliamentary seats are distributed via direct mandate, but also because the electorate are not given any say in the composition of party lists.

Given the importance of the media to the political influence of business magnates, reform of media laws could ultimately help restrict the power of the oligarchs. This is one of the objectives of legislation which came into force in October 2015 intended to increase the transparency of media ownership. It requires broadcasters to disclose their ownership structures in detail. Furthermore, companies and individuals registered in ‘offshore zones’ are not allowed to set up or operate broadcasting companies in Ukraine. The revised legislation was expressly welcomed by the Organization for Security and Co-operation in Europe (OSCE) Representative on Freedom of the Media, Dunja Mijatovic. She pointed out that ensuring transparency and preventing excessive concentration in the media sector are important prerequisites for freedom of expression and diversity of opinion. At the same time, however, there was criticism in Ukraine that violations of this law cannot be adequately sanctioned.

Even more important than increased transparency in the media landscape is the establishment of a public service broadcasting model similar to those found in Western Europe. Not only would this model represent a counterbalance to television broadcasters controlled by the oligarchs, it would also strengthen the independence of the media in general. Legislation on setting up public service broadcasting companies, which came into force in early 2015, ensures that existing state radio and television entities will be transformed into a public broadcasting company, which will be registered as a public limited company under state ownership. The highest controlling body is the supervisory board consisting

of one member from each parliamentary faction or group and representatives of various NGOs. These civil society representatives are guaranteed a majority vote by law. At present, the reform is far from meeting its intended purpose of establishing public service broadcasting as a real competitor to the commercial media sector controlled by the oligarchs. This is partly due to unresolved bureaucratic and legal issues surrounding the merger of existing state television and radio stations. In addition, broadcasting companies currently funded solely from state coffers are complaining of financial problems. The Director General of the National Television Company of Ukraine, Zurab Alasania, resigned recently, blaming political leaders for the lethargic implementation of the reforms, claiming they had little interest in establishing public service broadcasting that actually worked.

### **Weakening the oligarchs**

Nearly three years after the Maidan, the symbiosis of politics and business is far from passé. Most of the oligarchs that have been politically active for an extended period have remained influential, albeit weakened by the country’s economic problems and unfavourable international conditions. Newer players from Yanukovich’s ‘family’, however, have lost considerable power. At the same time, others have begun their rise to the top. They are closely linked to today’s elite, especially to the President, who has managed to strengthen his position in many areas.

Ukraine has taken steps in important spheres, such as party financing and the media, that could limit the power of the oligarchs in future. However, these measures have not yet been fully implemented. In other domains, particularly the energy sector, developments are considerably more contradictory. Here, elite representatives claim they are meeting the demands of the international community, while the spirit of the agreements reached is thwarted by

numerous actions. The same is true of the fight against corruption. This means that existing oligarchic structures are being strengthened rather than weakened. In addition, old and new players are currently consolidating their positions in order to be well placed for the next round of privatisations, for example. In short, future 'reform steps' will be implemented by a thoroughly 'oligarchised' elite and will therefore be largely undermined as a result. To avoid this happening, the EU and other actors should further develop and refine their current strategy, particularly with regard to conditionality and cooperation with civil society.

Both the EU and the IMF have significant influence on Ukraine because they provide the country with considerable funding. Moreover, Germany and France support the country politically through the Normandy format. However, the pressure exerted to date by these actors has clearly not been sufficient to substantially reduce the power of the oligarchs. New mechanisms should therefore be used to break the symbiosis of politics and business. The temporary presence of a number of competent members of government with foreign origins and experience (e.g. Minister of Finance Natalie Jaresko, Minister of Economic Development and Trade Aivaras Abromavičius and Deputy Minister of Internal Affairs Eka Zguladze) has shown that the impact of people who are familiar with other models of governance and are not trapped in Ukrainian power networks can be positive. Consequently, the EU and the IMF should make further financial aid conditional on the willingness of the Ukrainian leadership to allow foreign influence in key areas. To achieve this, it would be useful to bring together representatives of various organisations involved in the Ukrainian reform process, including the EU, the IMF, the OSCE, the Council of Europe and the Energy Community. Each actor could expand its activities in one or more areas in Ukraine depending on the content.

One idea would be to set up international commissions to monitor the work of key

Ukrainian institutions, such as the Customs Office, the Anti-Monopoly Committee, the State Fiscal Service, the State Property Fund, the Prosecutor General and the NEURC.

These commissions should receive extensive rights of access to oral and written communications and to the decision-making processes of these authorities. They would, however, merely be observing these processes, not intervening in the decision-making authority of Ukrainian entities. The commissions would report back to relevant international formats – to the EU-Ukraine Association Council, for example – with their findings and suggestions for more targeted forms of conditionality. In the case of the EU, the existing advisory mission could be given an extended mandate and corresponding budget to set up and operate such commissions. The OSCE could provide the Representative on Freedom of the Media with more support and accompany the process of establishing a public service broadcaster. The Energy Community could monitor the ongoing NEURC reform, the transparency and success of which are crucial for reducing oligarchic influence and corruption in the energy sphere. It is more difficult to exert external influence on parliament. Nevertheless, the OSCE Office for Democratic Institutions and Human Rights (ODIHR) and the Council of Europe could urge the adoption of legislation providing for full proportional representation and open electoral lists and monitor the implementation of legislation on party financing. Finally, Western actors could put substantially more pressure on Poroshenko to dispose of his companies as promised.

It will be paramount for the EU and IMF to agree to link their financial tranches to the establishment and satisfactory functioning of the proposed monitoring commissions. Otherwise the Ukrainian elite will lack sufficient incentive to permit the required level of observation. Even though there are now some reform-oriented officials in almost every Ukrainian agency who would welcome additional external control, resistance to greater transparency and ob-



jectivity is still significant among the top leadership.

For all the areas mentioned, there are competent individuals and civil society structures in Ukraine that can support foreign observers with expertise and élan. In particular, these include the “Reanimation Package of Reforms” initiative, which has already successfully pushed through important legislation with the help of reformist parliamentarians. In this context, specialised organisations can be consulted, for example ANTAC or Nashi Hroshi (Our Money) for the fight against corruption, Dixi Group for the energy sector, Detector Media for the media, OPORA and the Committee of Ukrainian Voters for party financing and electoral law.

Developments to date have shown that without tougher external monitoring the oligarchs will further consolidate their positions and eventually torpedo genuine changes in the political system. International insistence has already forced the Ukrainian leadership to take substantial steps towards fighting corruption and introducing economic reforms. Targeted initiatives from outside supported by civil society actors within Ukraine can significantly increase the likelihood of a “de-oligarchisation” actually taking place. Without increased external pressure, the reforms will most likely fail in the medium term and a new wave of political and social unrest will ensue.

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