Ukraine Denouement. From the Military Battlefield to the Arena of International Finance

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The fate of Ukraine is now shifting from the military battlefield back to the arena that counts most: that of international finance. Kiev is broke, having depleted its foreign reserves on waging war that has destroyed its industrial export and coal mining capacity in the Donbass (especially vis-à-vis Russia, which normally has bought 38 percent of Ukraine's exports). Deeply in debt (with €3 billion falling due on December 20 to Russia), Ukraine faces insolvency if the IMF and Europe do not release new loans next month to pay for new imports as well as Russian and foreign bondholders.

Finance Minister Natalia Yaresko announced on Friday that she hopes to see the money begin to flow in by early March.[1] But Ukraine must meet conditions that seem almost impossible: It must implement an honest budget and start reforming its corrupt oligarchs (who dominate in the Rada and control the bureaucracy), implement more austerity, abolish its environmental protection, and make its industry "attractive" to foreign investors to buy Ukraine's land, natural resources, monopolies and other assets, presumably at distress prices in view of the country's recent devastation.

Looming over the IMF loan is the military situation. On January 28, Christine Lagarde said that the IMF would not release more money as long as Ukraine remains at war. Cessation of fighting was to begin Sunday morning. But Right Sector leader Dmytro Yarosh announced that his private army and that of the Azov Battalion will ignore the Minsk agreement and fight against Russian-speakers. He remains a major force within the Rada.

How much of Ukraine's budget will be spent on arms? Germany and France made it clear that they oppose further U.S. military adventurism in Ukraine, and also oppose NATO membership. But will Germany follow through on its threat to impose sanctions on Kiev in order to stop a renewal of the fighting? For the United States bringing Ukraine into NATO would be the *coup de grace* blocking creation of a Eurasian powerhouse integrating the Russian, German and other continental European economies.

The Obama administration is upping the ante and going for broke, hoping that Europe has no alternative but to keep acquiescing. But the strategy is threatening to backfire. Instead of making Russia "lose Europe," the United States may have overplayed its hand so badly that one can now think about the opposite prospect. The Ukraine adventure turn out to be the first step in the United States losing Europe. It may end up splitting European economic interests away from NATO, if Russia can convince the world that the epoch of armed occupation of industrial nations is a thing of the past and hence no real military threat exists – except for Europe being caught in the middle of Cold War 2.0.

For the U.S. geopolitical strategy to succeed, it would be necessary for Europe, Ukraine and Russia to act against their own potential economic self-interest. How long can they be expected to acquiesce in this sacrifice? At what point will economic interests lead to a reconsideration of old geo-military alliances and personal political loyalties?

The is becoming urgent because this is the first time that continental Europe has been faced with such war on its own borders (if we except Yugoslavia). Where is the advantage for Europe supporting one of the world's most corrupt oligarchies north of the Equator?

America's Ukrainian adventure by Hillary's appointee Victoria Nuland (kept on and applauded by John Kerry), as well as by NATO, is forcing Europe to commit itself to the United States or pursue an independent line. George Soros (whose aggressive voice is emerging as the Democratic Party's version of Sheldon Adelson) recently urged (in the newly neocon *New York Review of Books*) that the West give Ukraine $50 billion to re-arm, and to think of this as a down payment on military containment of Russia. The aim is old Brzezinski strategy: to foreclose Russian economic integration with Europe. The assumption is that economic alliances are at least potentially military, so that any power center raises the threat of economic and hence political independence.

The *Financial Times* quickly jumped on board for Soros's $50 billion subsidy.[2] When President Obama promised that U.S. military aid would be only for "defensive arms," Kiev clarified that it intended to defend Ukraine all the way to Siberia to create a "sanitary cordon."

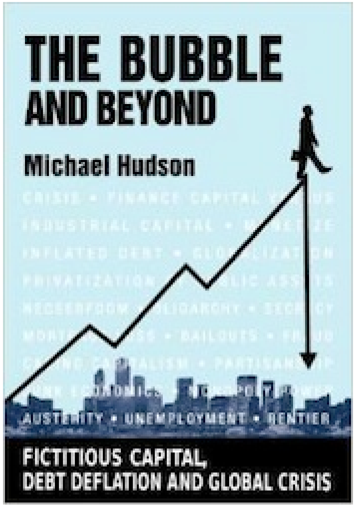
First Confrontation: Will the IMF Loan Agreement try to stiff Russia?

The IMF has been drawn into U.S. confrontation with Russia in its role as coordinating Kiev foreign debt refinancing. It has stated that private-sector creditors must take a haircut, given that Kiev can't pay the money its oligarchs have either stolen or spent on war. But what of the €3 billion that Russia's sovereign wealth fund loaned Ukraine, under London rules that prevent such haircuts? Russia has complained that Ukraine's budget makes no provision for payment. Will the IMF accept this budget as qualifying for a bailout, treating Russia as an odious creditor? If so, what kind of legal precedent would this set for sovereign debt negotiations in years to come?

International debt settlement rules were thrown into a turmoil last year when U.S. Judge Griesa gave a highly idiosyncratic interpretation of the*pari passu* clause with regard to Argentina's sovereign debts. The clause states that all creditors must be treated equally. According to Griesa (uniquely), this means that if any creditor or vulture fund refuses to participate in a debt writedown, no such agreement can be reached and the sovereign government cannot pay any bondholders anywhere in the world, regardless of what foreign jurisdiction the bonds were issued under.

This bizarre interpretation of the "equal treatment" principle has never been strictly applied. Inter-governmental debts owed to the IMF, ECB and other international agencies have not been written down in keeping with private-sector debts. Russia's loan was carefully framed in keeping with London rules. But U.S. diplomats have been openly – indeed, noisily and publicly – discussing how to "stiff" Russia. They even have thought about claiming that Russia's Ukraine loans (to help it pay for gas to operate its factories and heat its homes) are an odious debt, or a form of foreign aid, or subject to anti-Russian sanctions. The aim is to make Russia "less equal," transforming the concept of *pari passu* as it applies to sovereign debt.

Just as hedge funds jumped into the fray to complicate Argentina’s debt settlement, so speculators are trying to make a killing off Ukraine’s financial corpse, seeing this gray area opened up. The *Financial Times*reports that one American investor, Michael Hasenstab, has $7 billion of Ukraine debts, along with Templeton Global Bond Fund.[3] New speculators may be buying Ukrainian debt at half its face value, hoping to collect in full if Russia is paid in full – or at least settle for a few points’ quick run-up.



The U.S.-sponsored confusion may tie up Russia’s financial claims in court for years, just as has been the case with Argentina’s debt. At stake is the IMF’s role as debt coordinator: Will it insist that Russia take the same haircut that it’s imposing on private hedge funds?

This financial conflict is becoming a new mode of warfare. Lending terms are falling subject to New Cold War geopolitics. This battlefield has been opened up by U.S. refusal in recent decades to endorse the creation of any international body empowered to judge the debt-paying capacity of countries. This makes every sovereign debt crisis a grab bag that the U.S. Treasury can step in to dominate. It endorses keeping countries in the U.S. diplomatic orbit afloat (although on a short leash), but not countries that maintain an independence from U.S. policies (*e.g*., Argentina and BRICS members).

Looking forward, this position threatens to fracture global finance into a U.S. currency sphere and a BRICS sphere. The U.S. has opposed creation of any international venue to adjudicate the debt-paying capacity of debtor nations. Other countries are pressing for such a venue in order to save their economies from the present anarchy. U.S. diplomats see anarchy as offering an opportunity to bring U.S. diplomacy to bear to reward friends and punish non-friends and “independents.” The resulting financial anarchy is becoming untenable in the wake of Argentina, Greece, Ireland, Spain, Portugal, Italy and other sovereign debtors whose obligations are unpayably high.

The IMF’s One-Two Punch leading to privatization sell-offs to rent extractors

IMF loans are made mainly to enable governments to pay foreign bondholders and bankers, not spend on social programs or domestic economic recovery. Sovereign debtors must agree to IMF “conditionalities” in order to get enough credit to enable bondholders to take their money and run, avoiding haircuts and leaving “taxpayers” to bear the cost of capital flight and corruption.

The first conditionality is the guiding principle of neoliberal economics: that foreign debts can be paid by squeezing out a domestic budget surplus. The myth is that austerity programs and cuts in public spending will enable governments to pay foreign-currency debts – as if there is no "transfer problem."

The reality is that austerity causes deeper economic shrinkage and widens the budget deficit. And no matter how much domestic revenue the government squeezes out of the economy, it can pay foreign debts only in two ways: by exporting more, or by selling its public domain to foreign investors. The latter option leads to privatizing public infrastructure, replacing subsidized basic services with rent-extraction and future capital flight. So the IMF's "solution" to the deb problem has the effect of making it worse – requiring yet further privatization sell-offs.

This is why the IMF has been wrong in its economic forecasts for Ukraine year after year, just as its prescriptions have devastated Ireland and Greece, and Third World economies from the 1970s onward. Its destructive financial policy must be seen as deliberate, not an innocent forecasting error. But the penalty for following this junk economics must be paid by the indebted victim.

In the wake of austerity, the IMF throws its Number Two punch. The debtor economy must pay by selling off whatever assets the government can find that foreign investors want. For Ukraine, investors want its rich farmland. Monsanto has been leasing its land and would like to buy. But Ukraine has a law against alienating its farmland and agricultural land to foreigners. The IMF no doubt will insist on repeal of this law, along with Ukraine's dismantling of public regulations against foreign investment.

International finance as war

The Ukraine-IMF debt negotiation shows is why finance has become the preferred mode of geopolitical warfare. Its objectives are the same as war: appropriation of land, raw materials (Ukraine's gas rights in the Black Sea) and infrastructure (for rent-extracting opportunities) as well as the purchase of banks.

The IMF has begun to look like an office situated in the Pentagon, renting a branch office on Wall Street from Democratic Party headquarters, with the rent paid by Soros. His funds are drawing up a list of assets that he and his colleagues would like to buy from Ukrainian oligarchs and the government they control. The buyout payments for partnership with the oligarchs will not stay in Ukraine, but will be moved quickly to London, Switzerland and New York. The Ukrainian economy will lose the national patrimony with which it emerged from the Soviet Union in 1991, still deeply in debt (mainly to its own oligarchs operating out of offshore banking centers).

Where does this leave European relations with the United States and NATO?

The two futures

A generation ago the logical future for Ukraine and other post-Soviet states promised to be an integration into the German and other West European economies. This seemingly natural complementarity would see the West modernize Russian and other post-Soviet industry and agriculture (and construction as well) to create a self-sufficient and prosperous Eurasian regional power. Foreign Minister Lavrov recently voiced Russia's hope at the Munich

Security Conference for a common Eurasian Union with the European Union extending from Lisbon to Vladivostok. German and other European policy looked Eastward to invest its savings in the post-Soviet states.

This hope was anathema to U.S. neocons, who retain British Victorian geopolitics opposing the creation of any economic power center in Eurasia. That was Britain's nightmare prior to World War I, and led it to pursue a diplomacy aimed at dividing and conquering continental Europe to prevent any dominant power or axis from emerging.

America started its Ukrainian strategy with the idea of splitting Russia off from Europe, and above all from Germany. In the U.S. playbook is simple: Any economic power is potentially military; and any military power may enable other countries to pursue their own interest rather than subordinating their policy to U.S. political, economic and financial aims. Therefore, U.S. geostrategists view any foreign economic power as a potentially military threat, to be countered before it can gain steam.

We can now see why the EU/IMF austerity plan that Yanukovich rejected made it clear why the United States sponsored last February's coup in Kiev. The austerity that was called for, the removal of consumer subsidies and dismantling of public services would have led to an anti-West reaction turning Ukraine strongly back toward Russia. The Maidan coup sought to prevent this by making a war scar separating Western Ukraine from the East, leaving the country seemingly no choice but to turn West and lose its infrastructure to the privatizers and neo-*rentiers*.

But the U.S. plan may lead Europe to seek an economic bridge to Russia and the BRICS, away from the U.S. orbit. That is the diplomatic risk when a great power forces other nations to choose one side or the other.

The silence from Hillary

Having appointed Valery Nuland as a holdover from the Cheney administration, Secretary of State Hillary Clinton joined the hawks by likening Putin to Hitler. Meanwhile, Soros's $10 million on donations to the Democratic Party makes him one of its largest donors. The party thus seems set to throw down the gauntlet with Europe over the shape of future geopolitical diplomacy, pressing for a New Cold War.

Hillary's silence suggests that she knows how unpopular her neocon policy is with voters – but how popular it is with her donors. The question is, will the Republicans agree to not avoid discussing this during the 2016 presidential campaign? If so, what alternative will voters have next year?

This prospect should send shivers down Europe's back. There are reports that Putin told Merkel and Holland in Minsk last week that Western Europe has two choices. On the one hand, it and Russia can create a prosperous economic zone based on Russia's raw materials and European technology. Or, Europe can back NATO's expansion and draw Russia into war that will wipe it out.

German officials have discussed bringing sanctions against Ukraine, not Russia, if it renews the ethnic warfare in its evident attempt to draw Russia in. Could Obama's neocon strategy backfire, and lose Europe? Will future American historians talk of who lost Europe rather than who lost Russia?

Michael Hudson's book summarizing his economic theories, "The Bubble and Beyond," is now available in a new edition with two bonus chapters on Amazon. His latest book is Finance Capitalism and Its Discontents. He is a contributor to Hopeless: Barack Obama and the Politics of Illusion, published by AK Press. He can be reached via his website, mh@michael-hudson.com

Notes:

[1] Fin min hopes Ukraine will get new IMF aid in early March – Interfax, http://research.tdwaterhouse.ca/research/public/Markets/NewsArticle/1664-L5N0VN2DO-1

5:40AM ET on Friday Feb 13, 2015 by Thomson Reuters

[2] "The west needs to rescue the Ukrainian economy," *Financial Times*editorial, February 12, 2015.

[3] Elaine Moore, "Contrarian US investor with $7bn of debt stands to lose most if Kiev imposes haircut," *Financial Times*, February 12, 2015.

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