

POLICY PAPER  
Number 13, March 2009

# Engaging Ukraine in 2009

STEVEN PIFER, ANDERS ASLUND  
AND JONATHAN ELKIND



POLICY PAPER  
Number 13, March 2009

# Engaging Ukraine in 2009

STEVEN PIFER, ANDERS ASLUND  
AND JONATHAN ELKIND



## ACKNOWLEDGMENTS

---

We are grateful to Daniel Benjamin, Zbigniew Brzezinski, Edward Chow, Keith Crane, Carlos Pascual, Theodore Piccone, Paul Stares, William Taylor, and Celeste Wallander for reviewing a draft of this paper and for the comments and suggestions that they provided. Olesya Favorska provided some very helpful research assistance. We would also like to express our appreciation to Gail Chalef and Ian Livingston for their assistance in the paper's production.

In preparing this paper, we drew on our work in earlier publications, including *How Ukraine Became*

*a Market Economy and Democracy* by Anders Åslund; “Where East Meets West: European Gas and Ukrainian Reality,” in the January 2009 edition of *The Washington Quarterly*, by Jonathan Elkind (with Edward Chow); and “Averting Crisis in Ukraine,” a January 2009 Council on Foreign Relations special report by Steven Pifer. We appreciate the support of the Brookings Center on the United States and Europe and the Peterson Institute of International Economics. Of course, the views and recommendations contained in this paper are our own.



# TABLE OF CONTENTS

---

INTRODUCTION AND SUMMARY ..... 1

U.S. INTERESTS IN UKRAINE ..... 3

FOUR MAJOR CHALLENGES FACING UKRAINE IN 2009 ..... 5

AN AGENDA FOR U.S. ENGAGEMENT WITH UKRAINE ..... 11

ENDNOTES ..... 17

ABOUT THE AUTHORS ..... 21



# INTRODUCTION AND SUMMARY

---

Ukraine and Ukrainians will be tested over the course of 2009. The global financial and economic crisis already has provoked a deep recession and falling living standards. Kyiv will need to make a real effort to strike a balance between integration into Europe and the Euro-Atlantic community and maintaining stable relations with Russia. Doing so will not be easy, as Russia regards Ukraine's pro-Western policy as inimical to Russian interests, and Ukraine's politics are subject to influence from Moscow. In particular, Ukraine must address its energy security situation, where it remains vulnerable to Russian pressure.

Ukraine is the most democratic state in the post-Soviet space, and its domestic debate is vibrant and open, but its politics are highly dysfunctional. The bitter political feud between President Victor Yushchenko and Prime Minister Yuliya Tymoshenko, former allies in the Orange Revolution, has paralyzed most policy-making. With a presidential election likely to be held in January 2010, the infighting will only get worse. Regions Party head Victor Yanukovich, the main opposition leader, has little incentive to work for good policies, as he stands to gain politically as disapproval of the president and prime minister grows.

All of this makes dealing with Ukraine difficult for the U.S. government, but it also makes working with Ukraine more urgent. It remains in America's interest that Ukraine continue its development as a stable, independent, democratic market economy, with growing links to Europe and the Euro-Atlantic community. In the circumstances of the coming year, however, engaging with Kyiv to advance that goal will prove no easy task.

Washington may be tempted to wait for the leadership in Kyiv to get its act together, given how divided it is. Certainly, President Barack Obama and his administration have plenty of competing demands on their foreign policy plate. But Washington does not have the luxury of waiting; absent strong U.S. engagement, the situation in Ukraine will likely worsen and require greater American attention at a future point. In order for the U.S. government to engage successfully, Ukrainian leaders must overcome some of their divisions, adopt a more coherent policy approach, and be prepared to take difficult decisions. Serious engagement by Washington, however, is necessary to press Ukraine's leaders to adopt such an approach. They are unlikely to do so on their own.

As it organizes its policy toward Ukraine, Washington should focus on four areas:

**Structure a bilateral dialogue to have maximum influence with Ukraine's leaders.** The Obama administration should establish a regularized, tough-minded dialogue with Kyiv. It needs to send an early high-level message, perhaps delivered by Secretary of State Hillary Clinton, of support and the need for Ukraine's leaders to cooperate with one another; she might travel with European Union (EU) Common Foreign and Security Policy High Representative Javier Solana to convey a joint U.S.-EU message. The administration should revive the binational commission that operated between 1996 and 2000, with the vice president chairing the U.S. side and Yushchenko and Tymoshenko co-chairing the Ukrainian side, if that can be made to work. Such a mechanism can deepen the U.S.-Ukrainian relationship, monitor progress on



agreed bilateral priorities and the December 2008 U.S.-Ukraine charter, and pass candid messages on sensitive issues. U.S. officials must be blunt: if Yushchenko and Tymoshenko cannot work together, U.S. efforts to help Ukraine cope with the economic crisis, strengthen its energy security, or develop closer relations with Europe will yield minimal results.

**Assist Ukraine in dealing with the financial/economic crisis.** Ukraine needs to be and stay in compliance with its International Monetary Fund (IMF) program. Even with help from the IMF, Ukraine will likely face a financing gap in 2009 of about \$5 billion. The U.S. government should work with partners such as the European Union, IMF, World Bank and others to address this as a matter of priority, with the objective of a donors' conference that would provide \$5 billion in additional financing this year. This should be linked to the established IMF standby arrangement and should have conditions that also link the additional financing to specific energy sector reforms. The U.S. government should consider providing financing as part of this. Washington should also press Ukraine to resume making vitally important economic reforms to position its economy for a faster recovery, and should consider reducing trade barriers to Ukrainian products.

**Promote serious actions to strengthen Ukraine's energy security.** Ukraine's leaders know what they need to do to improve the country's energy security situation but have steadfastly refused to act. Senior U.S. officials now must impress on them that there is no alternative but to push through reforms that have been thwarted by entrenched vested interests. These reforms include allowing energy prices to consumers to rise, at least to cost-recovery levels, in order to

promote energy efficiency and domestic production. Washington should continue programs to promote energy efficiency and advise the Ukrainian government on developing a program of targeted welfare assistance for those unable to pay the higher prices for energy. Given the inherent instability of the January 2009 gas agreements with Russia, the U.S. government and its European partners should undertake a systematic assessment of measures to help stabilize, strengthen, and increase the transparency of the gas operations of Naftohaz, the parastatal oil and gas corporation.

**Help Ukraine deepen its relations with the European Union and NATO while avoiding a crisis with Russia.** The administration should encourage the European Union to accelerate conclusion of the negotiation underway with Ukraine on an association agreement, including a free trade arrangement. Washington should lead in shaping NATO-Ukraine relations. Given the impossibility of securing Alliance consensus for a membership action plan (MAP), U.S. officials should assist Ukraine in developing an annual national program that contains most, if not all, of the content of a MAP, and work within the Alliance to secure approval of the program. Washington should be clear with Kyiv on how much support it can expect in a stand-off with Russia while cautioning Moscow that Russian efforts to destabilize Ukraine will risk its relations with the West.

This paper briefly discusses U.S. interests in a successful Ukraine and describes four key challenges currently facing Kyiv. It then discusses in more detail the above policy recommendations for strengthening U.S.-Ukrainian relations and for helping Ukraine to meet these challenges and continue its transformation into a modern, successful European democracy.

# U.S. INTERESTS IN UKRAINE

---

With everything else on the Obama administration's policy agenda, finding time to address Ukraine will be difficult. Over the past seventeen years, however, Washington has made a significant investment of time, energy, and assistance resources in Ukraine. It should remain engaged to promote that country's successful transformation into a modern European democracy.

Ukraine had the world's third largest strategic nuclear arsenal on its territory at the time of the Soviet Union's collapse in 1991. Kyiv's decision to give up those arms dramatically reduced the number of nuclear systems that could target America and provided a breathtaking success in the nuclear non-proliferation effort. However, by late 1993, U.S. officials had come to recognize that, while the nuclear weapons issue was extremely important, the United States had broader interests in Ukraine.

Clinton administration policy statements thereafter identified Ukraine's development as a stable, independent, democratic market economy, with growing links to Europe and the Euro-Atlantic community, as being in the U.S. interest. First, such a Ukraine was seen as likely to be a net contributor to shaping a wider, more stable and secure Europe—a high priority for the United States. Second, given Ukraine's decisions to give up nuclear arms and adopt responsible controls on its missile technology, Washington saw Ukraine as a partner in tackling key proliferation challenges. Third, with a population in the early 1990s numbering some fifty million, a reforming, economically growing Ukraine offered an attractive market for U.S. trade and investment. It was not sur-

prising, therefore, that then-Secretary of State Madeleine Albright designated Ukraine as one of four pivotal countries in the world whose development as a stable democratic partner for the United States deserved greater attention of time and resources from U.S. policymakers.

While Ukraine remains an important nonproliferation partner, and American business has become increasingly involved there (with cumulative direct investment of some \$1.5 billion in 2008), the primary reasons for engaging Ukraine remain geopolitical. A successful Ukraine promotes stability. Moreover, a democratic and prosperous Ukraine firmly anchored in Europe will offer a model that might encourage Moscow to pursue a more cooperative, integrative foreign policy and give up any thought of seeking to restore the Russian empire. A weak and unstable Ukraine, on the other hand, would not be an attractive partner for the European Union or NATO, would worry its Central European neighbors, could prove an unreliable energy transit country, and might tempt Moscow even further to interfere in its politics. Were Ukraine to plunge into severe crisis, become a "gray" security zone, or turn away from Europe back toward Russia, it would be a major setback for U.S. policy, particularly the objective of promoting a more stable and secure Europe.

Between the mid-1990s and 2008, U.S.-Ukrainian relations made significant progress. Washington and Kyiv created a binational commission chaired by Vice President Al Gore and President Leonid Kuchma in 1996. U.S. officials led the drafting of an Alliance policy that in 1997 produced a NATO-Ukraine

charter on a distinctive partnership and established a standing NATO-Ukraine Commission. The Orange Revolution and Yushchenko's assumption of the presidency in January 2005 gave U.S.-Ukrainian relations a new impulse. The April 2005 Bush-Yushchenko meeting produced warm atmospherics and a road-map for further developing U.S.-Ukrainian relations.

Over the course of the next year, U.S. and Ukrainian officials resolved most of the key questions on the bilateral agenda. At the start of 2009, few bilateral

problems burden the U.S.-Ukrainian bilateral agenda, and the two countries enjoy positive relations. This means that the Obama administration can focus on broader issues that affect Ukraine's ability to proceed down its reform path. Those questions include grappling with the consequences of the global financial and economic crisis, strengthening its energy security position, improving its investment climate, tackling corruption, and managing its foreign relations. The potential vulnerability of Central European states to an economic collapse in Ukraine gives the U.S. government an additional incentive to engage Kyiv.

# FOUR MAJOR CHALLENGES FACING UKRAINE IN 2009

---

Ukraine in early 2009 faces four major challenges. The first is the lack of political coherence in Kyiv, brought about primarily by the feuding between the president and the prime minister and their almost complete inability to work together. This is a problem in and of itself. It also complicates Ukraine's ability to deal with the other three challenges.

Second, as the impact of the global financial and economic crisis has deepened, Ukraine has plunged into a major recession. The country's financial stability will be severely tested.

Third, Ukraine's energy sector is dysfunctional and non-transparent, providing ample opportunity for economic rent-seeking through market manipulation and for Russian interference in Ukrainian politics. As demonstrated in January of this year, the Kremlin remains prepared to use energy as a political tool.

Fourth, Ukraine needs to develop its links with the European Union and NATO at a time when its relations with Moscow are tense and European states are striving not to provoke Russia.

## POLITICAL DISARRAY IN KYIV

Ukraine has gone through a gradual constitutional reform from a predominantly presidential system to a mixed presidential and parliamentary system, as agreed in the constitutional compromise of December 2004 at the end of the Orange Revolution. The result is that Ukraine today has neither a presidential nor a parliamentary system, but a hybrid. In this system, neither the president nor prime minister has been able to rule.

This constitutional problem is aggravated by personal tensions. Following his assumption of the presidency in 2005, Yushchenko appointed Tymoshenko prime minister. The two did not work well together, and she lasted just eight months in the job. Following preterm Rada (parliament) elections in September 2007, Our Ukraine and the Bloc of Yuliya Tymoshenko (BYuT) again were positioned to form a majority. They did so, with difficulty, and Tymoshenko became prime minister again that December.

Within weeks, the presidential secretariat, led by presidential chief of staff Victor Baloha, began to openly criticize Tymoshenko. By March 2008, relations between the president and his secretariat on one side and the prime minister and her cabinet on the other had completely broken down. In May, BYuT deputies blocked the rostrum in the Rada in order to prevent Yushchenko, their coalition partner's nominal leader, from delivering his annual presidential address.

In early September, BYuT aligned with the Regions Party to vote through several laws that would reduce the president's power. At the president's instruction, Our Ukraine withdrew from the coalition. In October, with the Rada lacking a majority coalition, Yushchenko ordered the Rada disbanded and called for early parliamentary elections in December. The mounting financial crisis forced Yushchenko to suspend his decree so that the Rada could convene to vote through the package of laws required by the IMF in order for Ukraine to receive a standby arrangement. By early December, talk of early elections had receded, and Our Ukraine and BYuT reconstituted a coalition, this time joined by the bloc headed

by Rada Speaker Volodymyr Lytvyn. The coalition, however, is fragile and can rarely mobilize a majority.

Meanwhile, the war of words at the top has raged on. On December 19, Tymoshenko called for Yushchenko to resign, charging that he sacrificed the national interest to personal ambition.<sup>1</sup> In February, Yushchenko compared the gas contract that Tymoshenko concluded to end the previous month's gas war and reports of a possible Russian loan to the Molotov-Ribbentrop pact.<sup>2</sup> The foreign ministry instructed Ukrainian embassies in Washington and EU capitals to share with host government officials the president's criticism of the prime minister's actions on energy security.<sup>3</sup>

Driving the tensions between Yushchenko and Tymoshenko have been concerns in the Yushchenko inner circle that Tymoshenko will challenge Yushchenko for the presidency. Baloha has seen one of his responsibilities as undercutting the prime minister's political image.<sup>4</sup> The president has been reluctant to attempt any reconciliation with Tymoshenko.

Opinion surveys throughout 2008 only fueled the Yushchenko camp's concern, as the polls consistently showed Tymoshenko running well ahead of the president and offering the only real challenge to Yanukovych. The respected Razumkov Centre polling on presidential preferences in February 2008 showed Tymoshenko leading with 28.2 percent, Yanukovych in second with 24.8 percent, and Yushchenko third at 15.7 percent. By October, Yanukovych had edged into first with 25.3 percent, Tymoshenko was second with 22.8 percent, and Yushchenko's support had collapsed to 5.4 percent.<sup>5</sup> A poll on presidential preferences conducted by FOM-Ukraine in early February 2009 reinforced this trend, placing Yanukovych first with 20.4 percent and Tymoshenko second with 17.5 percent; Yushchenko came in sixth, drawing just 1.9 percent.<sup>6</sup>

The infighting between Yushchenko and Tymoshenko, and between the presidential secretariat and the cabinet, has meant that the governmental authorities—the president, prime minister, and their staffs

together—have performed abysmally in addressing Ukraine's needs. Many had hoped at the start of 2008 that Yushchenko and Tymoshenko could work together to consolidate needed reforms. However, very little was accomplished over the course of the year.<sup>7</sup> A particular failing has been the lack of movement in consolidating economic reforms. The government carried out no major privatizations. Despite a large pro-business majority in the Rada, it passed few major pieces of economic reform legislation.

As noted, ambiguities in Ukraine's constitutional order add to the confusion. As one example, the constitution appears to grant to the prime minister and her cabinet primacy for management of the economy. Nonetheless, the president and his secretariat have persistently inserted themselves into operational considerations of economic policy, including on energy, privatizations, and macro-economic matters. No progress on constitutional reform or clearing up such ambiguities was made during 2008. The lack of a credible, functioning constitutional court compounds the problem.

## UKRAINE PLUNGES INTO FINANCIAL AND ECONOMIC CRISIS

As the global financial crisis has deepened, Ukraine has become one of the countries most severely hit. Ukraine, however, was not profligate in its public sector spending. In recent years, it has had a small budget deficit of around 1.5 percent of gross domestic product (GDP). As a result of fiscal discipline and the fact that real GDP grew by an average of 7.6 percent per year from 2000 to 2007, Ukraine's public debt dwindled to a relatively miniscule 12 percent of GDP in 2007.<sup>8</sup> Foreign direct investment grew to substantial levels, attaining \$9.9 billion, or 5.5 percent of GDP, in 2008.<sup>9</sup> In September 2008, the Ukrainian economy seemed to be in good health.

Unfortunately, the economy turned out to be highly vulnerable. First, the steel sector was a prime driver of GDP growth during 2000-2007. In the first half of 2008, steel accounted for no less than 42 percent of Ukraine's exports.<sup>10</sup> In the second half of the year, however, international steel prices and demand collapsed—and with them, Ukrainian exports.

Second, the National Bank of Ukraine insisted until spring 2008 on maintaining a fixed peg of the hryvnia to the U.S. dollar, something no other country in the region did. As a result, the hryvnia depreciated sharply in relation to the Euro, and the hryvnia's depreciation attracted short-term bank speculation. The short-term capital inflows, in turn, boosted Ukraine's money supply by 51 percent in 2007.<sup>11</sup> That aggravated inflation, which accelerated rapidly at the end of 2007 and peaked at 31 percent in May 2008, compared with a year earlier.<sup>12</sup> The speculative currency inflow caused Ukraine's current account deficit to widen to 6.6 percent of GDP in 2008, which increased Ukraine's private foreign debt.<sup>13</sup> Still, the Ukrainian economy did not appear that bad off, apart from high inflation. In August 2008, Ukraine's international reserves peaked at a respectable \$38 billion.<sup>14</sup>

The third cause was Ukraine's messy politics, in particular the constant clashing between the president and prime minister. International investors perceived Ukrainian politics as irresponsible and dysfunctional, blocking major investments and privatizations, and began to stay away.<sup>15</sup>

A run on the hryvnia started in late summer 2008, and international financial markets closed completely to Ukraine in September. Suddenly, it became virtually impossible for Ukrainian companies to refinance foreign loans, which meant that any requirement for major refinancing caused an enterprise failure.

The Ukrainian economy has experienced a major shock since October 2008. The three industries hit the worst have been steel, mining, and construction. By January 2009, industrial production had fallen by 34 percent compared to January 2008. The decline is broad-based, but the key industries are recording declines of approximately 50 percent.<sup>16</sup> Exports measured in U.S. dollars are projected to fall by almost 50 percent in 2009, and imports are expected to fall even more (the silver lining is that this should minimize the current account deficit).<sup>17</sup> Nobody can offer a precise forecast for GDP in 2009, but in January, GDP fell by 20 percent compared to January 2008.<sup>18</sup> Many analysts see a double-digit slump for the year as likely.

Fortunately, Ukraine approached the IMF as an early applicant for assistance in October 2008. The IMF Board adopted a two-year standby program, worth a potential total of \$16.4 billion, on November 5. It contained three main conditions. First, Ukraine had to let its exchange rate float to render the value of the hryvnia realistic. The hryvnia has depreciated by about 50 percent since last summer. With this new, more realistic value, the exchange rate appears to be bottoming out and stabilizing.

Second, the IMF insisted on a responsible fiscal policy. The negotiations within the Ukrainian government and with the IMF have focused on the scale of the budget cuts that will be necessary as the economy contracts and state revenues plummet. Budget cuts in an election year are difficult, and the president and his staff appear to relish the fact that Tymoshenko must make hard choices about curtailing some popular expenditures. Although the IMF standby agreement called for the 2009 budget to be in balance, the budget approved by the government and Rada included a 3 percent deficit of GDP, which the IMF reckons will realistically be a 5 percent deficit.<sup>19</sup> The IMF can accept a small budget deficit, but then the Ukrainian government needs to find other international financing. In February, disagreement over Ukraine's budget deficit stalled the second disbursement of IMF financing.

Third, the IMF demanded bank restructuring. Unlike most other countries, the National Bank of Ukraine has scrutinized most of the country's commercial banks and identified their bad loans, so bank restructuring is proceeding apace.

The negative impact on the real economy will be dramatic. A double-digit GDP decline could amount to a contraction in U.S. dollar terms by over 40 percent due to the hryvnia's fall. Perhaps two million Ukrainians will lose their jobs. An additional two million who work in Europe may have to return due to Europe's economic downturn. The economic situation is bound to fuel social and political tensions.

Ukraine, however, may well be able to escape default. Even if it receives only IMF funding this year, its own

reserves likely will stay above the \$20 billion mark. That is not good, but it is far from default. The greatest structural weakness is the state oil and gas company Naftohaz, which loses a couple of billion dollars a year due to adversely regulated prices (which means that Naftohaz cannot recover its costs in many sales), mismanagement, and corruption.

Looking to the longer term, there are reasons to believe the Ukrainian economy could recover rapidly, provided the global recession does not deepen too far. At present, Ukraine has a highly competitive exchange rate, which should help it expand exports faster than other states. With the decline of the steel sector, the Ukrainian economy is likely to become much more diversified; this could include expansion of its agricultural and machine-building sectors. As a member of the World Trade Organization, Ukraine has secured reasonable market access, although it is important to broaden its access further. The more quickly the government acts now to deal with the crisis, the more likely a faster recovery.

### THREATS FROM THE NEW GAS DEAL AND WEAK ENERGY POLICY

Ukraine uses energy prodigiously. Its economy is said to be the single most energy-intensive in the world. For example, it uses more than twice as much energy per unit of GDP as does Poland. Moreover, Ukraine imports most of its fuel, almost all of it from Russia. Although most analysts believe that Ukraine could significantly expand domestic extraction of natural gas and oil from on-shore and offshore deposits, price caps and government policies that interfere with market mechanisms have kept domestic production of energy well below what it should be. The price caps and government policies have also sustained excessive demand and contributed significantly to recurring energy-related tensions with Russia.

The January gas war between Russia and Ukraine drew broad attention to the weakness of Ukrainian energy policy, as well as to Ukraine as a vulnerable link in Europe's gas supply chain (through which Europe receives some 20 percent of its total gas needs). Russia stopped all gas flowing to Ukraine. The effect was to cut off consumers in Central and Western

Europe as well, thereby provoking a major European energy crisis. The matter was resolved only after several false starts and bitter recriminations. Two new agreements were signed on January 19, and by January 22, pipeline volumes were starting to return to normal in all the European countries whose supply had been affected by the standoff.<sup>20</sup> The new agreements are a significant departure from past Russian-Ukrainian practice,<sup>21</sup> but they include significant risks for Ukraine, and they only begin to address the longstanding shortcomings of Ukrainian energy policy.

The agreements include many provisions that were traditionally absent from Russian-Ukrainian gas deals, but that have long been essential elements of Gazprom's deals with its partners in Western Europe. Perhaps most significant are the terms for pricing and payment. As is typical for most contracts in the European gas market, the new agreement prescribes a formula to adjust the price of gas every quarter, based on publicly quoted prices of other fuels. As the price of the so-called marker fuels rise and fall quarter by quarter in Europe, the wholesale price of imported gas will rise and fall in Ukraine. For the first quarter of 2009, the price will be \$360 per thousand cubic meters (TCM), but it is projected to drop thereafter.

Ukraine is obliged to pay by the seventh day of each month the amount owed for gas delivered in the preceding month. If Ukraine fails to pay by the prescribed date, then from that moment on, Ukraine is obliged to pay in advance for the month ahead. This provision poses a very serious challenge to Naftohaz: a single, one-day delay in payment can trigger the change to month-ahead payments for the duration of the agreement. In fact, already in February 2009, Naftohaz announced that municipal heating companies owed it more than 4.5 billion hryvnia (in excess of \$600 million) for operations since the start of the heating season in late 2008.<sup>22</sup> In the past, Naftohaz has fallen regularly into arrears. Last year alone, the Rada provided more than \$2.5 billion dollars in bailout funding, and the company nonetheless remains in technical default on more than \$1 billion of Eurobonds.

More broadly, Ukraine's energy policies thrive on non-transparency, waste, and politicization. In the political year that is 2009, with the upcoming presidential election, the combination of the new deals and bad overall policy could prove highly destabilizing. Urgently needed reforms are again at risk, which could magnify the macroeconomic and political difficulties.

Ukraine's energy sector is far more complex and troubled than it needs to be.<sup>23</sup> The country has a long history of producing, processing, and transporting oil and gas. It has significant hydrocarbon deposits both on-shore and under the waters of the Black Sea. Its strategic location and extensive existing infrastructure give it great significance in the gas markets of Eurasia. Unfortunately, in the period since Ukraine gained its independence in 1991, the energy sector has served successive rounds of leaders as a political trophy and tool. Decisions regarding energy policy have traditionally been made to favor certain industrial and personal interests. Deals reached by one political leader are reversed when successors come to power.

Perhaps most significant of all, Ukraine is a country in which the price of energy—the most fundamental instrument that guides the allocation of resources—is thoroughly and deliberately subverted. The gas prices charged to retail consumers consistently fail to cover the cost of gas plus the services of distribution and marketing, because political leaders have been unwilling to take the unpopular step of raising prices.

In the first quarter of 2009, when Ukraine imported gas for \$360 per TCM, the prices paid by industrial users and consumers within Ukraine were substantially lower. The import price at the Ukrainian-Russian border (before value-added tax was applied) translated to a price of 2,772 hryvnia per TCM at the end of January (when the exchange rate was 7.7 hryvnia to the dollar). In January, the price of gas (including value-added tax) for industrial consumers was 2,570 hryvnia per TCM; for utility companies 873 hryvnia per TCM; and for households 650 hryvnia per TCM.<sup>24</sup> Consequently, each cubic meter of gas consumed contributes to a cascade of indebtedness, a situation that only worsens when gas bills are not paid.

Domestically-produced gas is treated worse than imported gas. Gas from Ukrainian wells is meant to be sold for use in the residential and institutional (government budget-supported) sectors, and the prices are capped far below the already-subsidized gas price for industrial consumers. This artifice only further misdirects market forces. It deters investment in domestic gas production and creates lucrative opportunities for corruption—such as when domestically-produced gas is resold to favored traders and re-labeled as “imported” so that it can be sold for higher prices.

As a result of weak energy policies and the new gas deal with Russia, energy will remain a major challenge throughout 2009 and beyond. In fact, throughout the entire period of negotiating the new gas deal, the presidential secretariat constantly attacked the actions of the government and accused it of acting counter to Ukraine's interest. Fighting over the gas arrangements by domestic political forces that seek financial advantages contributes to the instability of the contracts. Some analysts in Europe and the United States believe a new gas dispute could break out as early as this spring.

### THE TUG BETWEEN THE WEST AND RUSSIA

Although Kuchma first announced NATO membership as a goal in 2002, the prospect only began to appear serious following Yushchenko's election as president. While Kuchma sought a balance between the West and Russia, Yushchenko made integration into Europe and the Euro-Atlantic community, including ultimate membership in the European Union and NATO, his primary foreign policy goal. In April 2005, NATO and Ukraine launched an “intensified dialogue.” Many expected that Ukraine would receive a NATO MAP by the end of 2006. The country by then had implemented political, economic, and defense reforms comparable to those made by countries such as Albania and Romania when they received their MAPs in 1999. However, the selection of Yanukovich as prime minister in August 2006 derailed Ukraine's MAP prospects. He made clear that, while wanting good NATO-Ukraine relations, he did not favor a MAP.



Yushchenko reopened the debate in January 2008, when he, Tymoshenko, and then-Rada Speaker Arseniy Yatseniuk co-signed a letter to NATO Secretary General Jaap de Hoop Scheffer requesting a MAP at the April NATO summit. This time, Moscow became far more alarmed than it had over NATO-Ukraine relations in the past. Then-president Vladimir Putin suggested that Russia would target nuclear missiles at Ukraine, while other senior Russian officials pledged to do everything that they could to block Ukraine's integration into NATO. Meeting with allied leaders at the April NATO-Russia summit, Putin even called into question Ukraine's territorial integrity.<sup>25</sup>

Speaking in August in the aftermath of the conflict with Georgia, President Dmitriy Medvedev described five principles underpinning Russia's foreign policy. One was a sphere of "privileged interests" in the post-Soviet space, a formulation that appeared intended to assert for Russia a voice in the foreign policy choices of its neighbors.<sup>26</sup> Russian officials spoke of NATO enlargement as posing an existential threat to Russia.

While NATO leaders decided not to extend Ukraine a MAP in April, they did declare that Ukraine would be a member of the Alliance. NATO foreign ministers in December decided to develop NATO-Ukraine relations further on the basis of an annual national program and work in the NATO-Ukraine Commission, setting aside the MAP issue.<sup>27</sup>

Ukrainian-EU relations in 2008 focused on negotiation of an association agreement, which will include a free trade arrangement. However, unlike previous EU association agreements with other European countries, this one will not include language recognizing a membership perspective for Ukraine. This reflects longstanding EU reluctance to envisage the possibility that Ukraine might one day join the Union. The European Union also offered to develop relations with Ukraine through the EU's Eastern Partnership outreach to post-Soviet states, though some in Kyiv worry that this is an effort to sideline any prospect of Ukrainian EU membership.

Ukraine's relations with Russia, which have been tense since the Orange Revolution, became increasingly difficult over the course of 2008. In January 2009, the relationship between Kyiv and Moscow was at one of its lowest points since the collapse of the Soviet Union in 1991, reflecting the growing accumulation of difficult issues between the two.

Ukraine's integration into NATO tops, but by no means exhausts, the list of Moscow's problem issues with the Ukrainian government. Over the past year, Russian officials have also expressed concerns about: Yushchenko's support for Georgia and Ukrainian arms deliveries to that country; Ukrainian proposals that the two countries begin negotiating now on a plan for withdrawal of the Russian Black Sea Fleet from Sevastopol and Crimea in 2017; the status of the Russian language in Ukraine; and Kyiv's push for international recognition of the Holodomor (the 1930s' famine that killed millions of Ukrainians) as an act of genocide. Ukraine and Russia differ over demarcation of the sea boundary in the Kerch Strait and Sea of Azov. A new mini-crisis erupted in February 2009, when "unfriendly and openly undiplomatic" comments about Yushchenko by Russian Ambassador Victor Chernomyrdin led the Ukrainian foreign ministry to threaten to expel him.<sup>28</sup> And the January gas war demonstrated how destructive the Ukrainian-Russian energy relationship could be.

This tug between the West and Russia has a domestic angle within Ukraine. Internal frictions over geopolitical orientation, the future of the Black Sea Fleet, Crimea, and official status for the Russian language could worsen. Accelerating tensions could cause the east-west divide in Ukraine to reopen. Moscow has levers to influence these tensions and has an incentive to keep them going: the Kremlin sees a divided, politically incoherent Ukraine as making the country a poor candidate for NATO or the European Union and as offering a political model that will be unattractive to the populace in Russia.<sup>29</sup>

# AN AGENDA FOR U.S. ENGAGEMENT WITH UKRAINE

---

As the Obama administration defines its approach toward Europe and Russia, it should pay serious attention to Ukraine. Given the relative absence of bilateral problems on the U.S.-Ukrainian agenda, Washington can and should focus on broader issues that could accelerate, or hinder, Ukraine's development. A crowded foreign policy agenda and political incoherence in Kyiv may tempt Washington to wait to engage until Ukraine's political leadership can get its act together. But the U.S. government does not have that luxury; absent U.S. engagement, the situation in Ukraine will likely worsen—and later require significantly greater time and attention from Washington and European capitals.

## STRUCTURING A REGULAR, HIGH-LEVEL DIALOGUE

The Bush administration's high-level engagement with Kyiv was episodic. In 2001, it downgraded the binational commission that Gore and Kuchma had chaired, leaving in place the working groups without any overarching structure. Given concerns about Kuchma, there was little engagement with him. Following Yushchenko's assumption of the presidency, high-level contacts resumed haltingly over 2005-2008. The Obama administration should regularize a high-level dialogue with Kyiv. This means cultivating relations with senior Ukrainian political leaders so that U.S. messages and advice have greater weight and authority. In September 2008, President George W. Bush reportedly urged Yushchenko to end the infighting with Tymoshenko, to no avail. Had there been a better-established relationship, the president's advice might have had more impact.

Washington should send Kyiv an early high-level message, perhaps delivered by Secretary of State Hillary Clinton, of support and a "tough love" message on the need for Ukraine's leaders to cooperate with one another. For greater impact, the secretary might travel together with EU High Representative for Common Foreign and Security Policy Javier Solana to convey a joint U.S.-EU position.

Washington should also revive the binational commission that operated between 1996 and 2000 as a structure for managing U.S.-Ukrainian relations. The commission should oversee the existing bilateral working groups, which deal with foreign policy issues, economic and commercial relations, energy, and defense questions. Restoring the commission would ensure that senior political levels on both sides monitor the overall state of U.S.-Ukrainian relations and that they are positioned to intervene to break deadlocks at the working level. Vice President Joe Biden should chair the U.S. side.

As for the Ukrainian side, it made sense in the 1990s for Kuchma to be the Ukrainian chair, as the presidency then controlled the executive branch. In contrast, executive power in Ukraine today is shared by the president and prime minister. The foreign and defense ministers report directly to the president, while most other ministers report to the prime minister. This complicates determining the chair on the Ukrainian side: in the current political circumstances in Kyiv, if Washington proposes the Ukrainian chair be Tymoshenko, Yushchenko is unlikely to cooperate, and vice versa. The alternative is to suggest that the Ukrainian side be co-chaired by the president and

prime minister. Such a structure could—and should be intended to—have the effect of forcing Yushchenko and Tymoshenko to forge common positions. The drawback, of course, is that the commission's operations would be severely hampered if Yushchenko and Tymoshenko cannot agree (in which case the structure might not work effectively until after the presidential election in 2010; still, it makes sense to put it in place now). When the commission meets in Kyiv, it will also be important that the vice president see the leading opposition leader, at present, Yanukovych.

This structure would create a channel between the U.S. vice president and the Ukrainian president and prime minister that could be used to pass candid messages on reform and on sensitive issues, such as how Ukraine might deal with NATO and Russia. The vice president and other senior U.S. officials must be blunt: they need to make clear to Yushchenko and Tymoshenko that, if the two of them cannot work together, U.S. efforts to help Ukraine cope with the economic crisis, strengthen its energy security, or develop closer relations with Europe will yield minimal results. This message should be targeted foremost at Yushchenko, as he and the presidential secretariat bear the greater responsibility for the incoherence of Ukrainian policy over the past year.

### ASSISTING UKRAINE TO DEAL WITH ITS FINANCIAL/ECONOMIC DIFFICULTIES

Despite assistance from international financial institutions (IFIs), Ukraine likely will face a financing gap of about \$5 billion in 2009. A deepening crisis in Ukraine will be bad not just for the country's economy, but could have a deleterious impact on Central Europe. The U.S. government should lead in organizing an international donors' conference involving the United States, European Union, IMF, World Bank, European Bank for Reconstruction and Development (EBRD), and other IFIs and countries with the goal of raising \$5 billion in financial support for Ukraine in 2009 that would be linked to the IMF's current program. (Consideration should be given to including Russia in this effort.) This should be supported for one year, as the Ukrainian economy appears positioned to recover rapidly once it bottoms out, unless the global recession dramatically deepens.

While the IFIs should contribute the bulk of the additional financing, the U.S. government should consider contributing as well. This financing should be conditioned on Ukraine sticking with conditions agreed between the donors and the Ukrainian government, including those in the November IMF standby arrangement and specific new requirements concerning energy sector reform.

At the same time, the U.S. Export-Import Bank should intensify its lending to Ukraine, and the U.S. government should press the Ukrainian government to resolve the \$17 million debt owed by the ministry of defense to the Overseas Private Investment Corporation (OPIC) stemming from a 1999 investment claim. Resolution of this long-standing debt would allow OPIC to resume financing for Ukraine.

The U.S. government should also press the Ukrainian government to take other steps that would facilitate economic recovery and provide appropriate technical assistance. These actions include: abolishing the commercial code, whose outdated provisions on business contradict those in the more modern civil code and create a confused legal environment; allowing the free sale and transfer of agricultural land, which is key to establishing a land market and opening new private capital financing for Ukraine's agricultural sector; and modernizing the tax code. Washington also needs to continue technical assistance to facilitate crisis management, privatization, and other necessary structural reforms, particularly in the energy sector. For such assistance to be effective, the Ukrainian government must adopt and implement reforms. Here, too, senior U.S. officials, including on the binational commission, must be blunt.

Among other things, the binational commission should look at ways to promote greater political and academic exchanges between the United States and Ukraine, including funding to bring young Ukrainian political leaders, young professionals, and high school and college students to visit and study in the United States, including a target of college scholarships for 1,000 Ukrainian students per year. This can help Ukraine develop a larger cadre of key professionals with the skills to manage a modern economy and financial system.

The European Union and Ukraine are now negotiating an association agreement, which will contain a deep free-trade arrangement. The U.S. government should align its approach with the EU's by adopting measures to remove barriers to Ukrainian products. While politically difficult at present, Washington might also consider the possibility of negotiating a bilateral free trade agreement with Ukraine. For Ukraine, this would imply a substantial market opening; it would strengthen Ukraine's economic links to the West and the U.S. standing in Ukraine.

### PRESSING UKRAINE TO BITE THE BULLET ON ENERGY SECTOR REFORM

The year 2008 ended, and 2009 began, with what could be described as the cross-border equivalent of a barroom brawl—a ferocious confrontation over Russian-Ukrainian gas trade and transit that exploded into a full fledged energy crisis for Europe. The crisis had a particular impact in Slovakia, Romania, Bulgaria, and the Balkans, where the gas cut-off meant no heat in freezing apartments.

At this stage, the most important questions are where Ukraine stands in relation to its long-delayed energy reform agenda, and what it should do next. The January crisis starkly demonstrated that Ukraine's actions directly affect European energy security. The crisis also makes clear the dangers—to Ukraine and to the interests of the United States and its European partners—of not addressing that agenda. Ukraine has to embrace reforms that will make it a viable member of the Euro-Atlantic community, which Kyiv says it hopes to be.

The U.S. government must work hand-in-hand with the European Union and key member states to press Ukraine to engage in energy reform. First and foremost, Washington and its partners should secure a clear commitment from Ukraine to transition to rational energy pricing in an agreed, finite period—for example, within the next two years. This will be difficult to do, especially in the current circumstances, but the reluctance of numerous Ukrainian governments over the years to act on this is a primary reason for the weakness of Ukraine's energy sector. U.S. and European advisors should also work with Ukraine to

develop realistic projections of, and financing plans for, the subsidies that will be needed in the two-year period until pricing achieves cost-recovery levels.

The masking of real energy prices has the inevitable effect on the Ukrainian energy economy of promoting over-consumption. Many politicians in Ukraine have clung to the illusion that the country's industrial competitiveness is enhanced by artificially low energy prices. In fact, the opposite is true. Until and unless energy is rationally priced in Ukraine, and until political leaders engage in the painful task of educating the public about the dangers of artificially low energy prices, the country will continue with hugely inefficient production that is effectively subsidized by every taxpayer in the country. Reducing energy consumption also could have the effect of providing Ukraine with further greenhouse gas emissions credits that could be sold on international markets under the Kyoto Protocol and Framework Convention on Climate Change. To date, potential buyers have shown interest in Ukraine, though that interest has been tempered by the broader challenges of the Ukrainian investment climate.

The U.S. government should also work with its European partners to provide technical assistance that facilitates Ukraine's transition to market pricing. Support for greater energy efficiency is the logical place to start, and existing programs being undertaken by U.S. Agency for International Development in the area of residential district heating systems (which contribute more to the debt-buildup in Naftohaz than any other sector) can be scaled up relatively easily. Another component of enhanced technical assistance should focus on helping the Ukrainian government to develop a program of targeted assistance whereby it can help those households that legitimately cannot afford to pay true market prices for heat and electricity. This would be more sensible than the current system, under which Ukraine provides implicit energy subsidies to most if not all energy consumers. In a future scenario of more serious-minded energy reform, prices will provide an incentive to economize on consumption and to increase domestic production, and subsidies should be directed only to those who are genuinely unable to pay.

Given the inherent instability of the January 2009 gas agreements with Russia, the U.S. government and its European partners should undertake a systematic assessment of measures to help stabilize, strengthen, and increase the transparency of the gas operations of Naftohaz.

Getting Ukrainian leaders to adopt the necessary energy reform steps will be a tough challenge. Energy reform should be a key part of the agenda for a restored binational commission, and it should be at the top of the vice president's list of issues. Making firm actions on energy sector reform the conditions for additional international financing for Ukraine should provide leverage to press Kyiv to adopt those reforms.

### HELPING UKRAINE DEEPEN ITS LINKS WITH THE WEST WHILE AVOIDING CRISIS WITH RUSSIA

Yushchenko remains committed to integrating Ukraine into the European Union and NATO, and deepening those links is in the interest of the United States and Europe. Advancing that integration is difficult at present. The Ukrainian elite and a growing number of Ukrainians (who may now exceed a majority) favor Ukraine's integration into the European Union. NATO membership, however, remains controversial both among the elite and the public. Moreover, the Russians regard Ukraine in zero-sum terms and see any deepening in its relations with the West as representing a loss for Russia. And concerns in Europe about provoking Russia undercut support for a MAP for Ukraine. Equally damaging to Yushchenko's policy has been the feuding in Kyiv; the lack of coherence in the Ukrainian government severely weakened Ukraine's case for a MAP in the second half of 2008 as well as its ability to cope with the January gas dispute.

NATO ministers in December 2008 agreed that the annual national program and NATO-Ukraine Commission would be the mechanisms for now to develop NATO-Ukraine relations. European concerns about Russia and political turmoil in Kyiv mean that a MAP is not possible anytime soon. The Ukrainian government appears to understand this. Most, if not all, of the substance of a MAP—in terms of planned reforms, exercises, exchanges and other contacts with

the Alliance—could be put into an annual national program. (Here, too, however, the financial crisis may have an impact. Defense Minister Yuriy Yekhanurov told his NATO counterparts in February that limited budget resources might cause Ukraine to scale back some planned exercises.)

The U.S. government should counsel the Ukrainians to proceed on the basis of an annual national program and set aside their desire to receive a MAP. There is no reason now for Kyiv to get bogged down in an unrealistic attempt to secure a MAP, especially when it can develop its practical relations with NATO in an annual national program. Washington should also offer to consult privately with the Ukrainians as they develop their proposed program, so that the plan—which Kyiv hopes to share with NATO in the spring—is as robust as possible and crafted in terms likely to secure Allied support. The administration might suggest that the Ukrainians consult with the Polish government, which wants to help Ukraine thicken its relations with NATO. U.S. officials should work at NATO to win approval of a substantive annual national program.

In the run-up to the April NATO summit, U.S. officials should seek language for the summit statement that reaffirms the Bucharest language that Ukraine will be a member of the Alliance. U.S. officials should also press for language that makes clear that the Alliance does not accept the notion of a sphere of influence in the post-Soviet space or that Moscow's claimed "privileged interests" allow it to determine the foreign policy courses of other post-Soviet states, in order to reassure countries such as Ukraine.

Washington should also urge that the European Union maintain robust engagement with Ukraine. Given that MAP has been put on hold in large part due to the concerns of European allies about provoking Russia, U.S. officials should ask that EU engagement with Ukraine take up some of the slack to signal Kyiv that Western interest remains strong. Accelerated negotiation of the association agreement, and its free-trade arrangements, would send such a positive signal. The European Union should also use its Eastern Partnership to strengthen links with Ukraine.

More broadly, Washington should coordinate with the European Union on the key points to stress to Kyiv. Tough messages—for example, on the need for Ukrainian leaders to press reforms—will carry greater weight when delivered by U.S. and EU officials in unison.

To the extent that the Obama administration can improve U.S.-Russian relations and if there is parallel improvement in NATO-Russian relations, these will be positive developments for Kyiv. The Ukrainian government has historically had greater freedom of maneuver in the context of warmer relations between the West and Russia.

The U.S. government will want to monitor the tense relations between Kyiv and Moscow. On the one hand, it should advise the Ukrainian government not to provoke needless crises or fights with Russia. For example, it might make sense for the president not to press Moscow to begin negotiations now—in a fractious political year in Ukraine—on withdrawal of the Black Sea Fleet when its lease expires in 2017. Washington should also be clear with Kyiv as to the extent of—and limits on—American support the Ukrainian government can expect if a confrontation between Ukraine and Russia breaks out.

At the same time, Washington should be equally clear with Moscow on the risks for Russian relations with the United States and the West should Moscow fan internal tensions within Ukraine or provoke a crisis with Kyiv. Washington's desire to “reset” the relationship with Moscow likely would not survive a Russian-

Ukrainian crisis caused by the Russians. As appropriate, U.S. officials may wish to remind Moscow of the security assurances extended to Kyiv by the United States, Russia, and the United Kingdom in the 1994 Budapest memorandum regarding Ukraine's sovereignty, territorial integrity, and freedom from economic coercion.

## CONCLUSION

Dealing with Ukraine in its current state will not be easy for Washington, but it is important. A lack of attention to Ukraine now could well require far greater attention in the future, should the country go off track or become immersed in crisis. Ukrainian leaders of course must do their part. Robust U.S. engagement, however, could prove decisive in prompting them to act. Robust engagement includes tough messages delivered in full candor.

For all the frustrations of watching developments in Kyiv, it is not the time for “Ukraine fatigue.” It remains in the U.S. interest that Ukraine continue its democratic and market economy transformation, and that it avoid internal crisis—either political or economic—or confrontation with Russia. Establishing a high-level, political channel; assisting Kyiv in avoiding a financial calamity; pressing the Ukrainian government to take the long-needed steps on energy sector reform; and advising the Ukrainians on how to deepen relations with the West while avoiding crisis with Moscow should be central parts of the U.S. strategy to achieve these goals in the difficult circumstances of 2009.



## ENDNOTES

---

- 1 Kyiv Post, “Tymoshenko Demands Yushchenko’s Resignation,” December 20, 2008, <http://www.kyivpost.com/nation/32219>.
- 2 Kyiv Post, “Yushchenko Compares Talks on Russian Loan for Ukraine to Molotov-Ribbentrop Pact,” February 10, 2009, <http://www.kyivpost.com/nation/35239>.
- 3 Ukrainska Pravda, “MZC Doruchilo Poslam Poyasniti Svity ‘Brekhnyu’ Tymoshenko,” February 14, 2009, <http://www2.pravda.com.ua/news/2009/2/24/89643.htm>.
- 4 Co-author’s conversation with senior presidential administration official, June 2008.
- 5 Razumkov Centre, “If Presidential Elections were Held Next Sunday, How Would You Vote?” [http://www.uceps.org.ua/poll.php?poll\\_id=91](http://www.uceps.org.ua/poll.php?poll_id=91).
- 6 Ukrainska Pravda, “Yatseniuk Rapidly Gaining Steam with Russian Sociologists,” February 16, 2009, <http://www2.pravda.com.ua/news/2009/2/16/89728.htm>.
- 7 See Janusz Bugajski, Steven Pifer, Keith Smith and Celeste A. Wallander, “Ukraine: A Net Assessment of 16 Years of Independence,” Center for Strategic & International Studies, February 2008 for the kinds of recommendations that Western analysts advocated and thought possible in 2008. Few of the recommendations were implemented, as the same authors noted in a report entitled “Implementation of Key Tasks and Recommendations,” Center for Strategic & International Studies, February 2009.
- 8 State Statistics Committee of Ukraine online database, [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua) (accessed February 27, 2009); National Bank of Ukraine (NBU), [www.bank.gov.ua](http://www.bank.gov.ua) (accessed February 27, 2009), EBRD online database [www.ebrd.com](http://www.ebrd.com) (accessed January 28, 2009).
- 9 Dragon Capital, Monthly Macro Research, “Ukrainian Economy: Making Progress to Unlock IFI Lending,” March 4, 2009.
- 10 State Statistics Committee of Ukraine online database, [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua) (accessed March 4, 2009).
- 11 National Bank of Ukraine (NBU), [www.bank.gov.ua](http://www.bank.gov.ua) (accessed February 27, 2009).
- 12 State Statistics Committee of Ukraine online database, [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua) (accessed February 23, 2009).
- 13 Dragon Capital, “Ukrainian Economy: Making Progress to Unlock IFI Lending.”
- 14 National Bank of Ukraine (NBU), [www.bank.gov.ua](http://www.bank.gov.ua) (accessed February 27, 2009).
- 15 Anders Åslund, *How Ukraine Became a Market Economy and Democracy*, Peterson Institute for International Economics, Washington, D.C., 2009.
- 16 State Statistics Committee of Ukraine online database, [www.ukrstat.gov.ua](http://www.ukrstat.gov.ua) (accessed February 23, 2009).
- 17 Dragon Capital, Monthly Macro Research, “Ukrainian Economy: Bracing for Tough Year,” January 30, 2009.
- 18 Dragon Capital, “Ukrainian Economy: Bracing for Tough Year.”
- 19 Unian, “Verkhovna Rada Passed State Budget – 2009,” December 26, 2008, <http://www.unian.net/eng/news/news-292400.html>.
- 20 For a useful chronology of the crisis, see Simon Pirani, Jonathan Stern and Katja Yafimava, “The Russo-Ukrainian Gas Dispute of January 2009: A Comprehensive Assessment,” Oxford Institute for Energy Studies, 2009, <http://www.oxfordenergy.org/pdfs/NG27.pdf>.
- 21 Ukrainska Pravda published what it said were the agreed texts of the new agreements. This assertion was not officially confirmed, but neither was it contradicted. For the sales-purchase agreement, see Ukrainska Pravda, “Gazovoye Soglasheniye Tymoshenko-Putina – Polniy Tekst,” January 22, 2009, <http://www2.pravda.com.ua/ru/news/2009/1/22/87168.htm>, and for the transit agreement, see Ukrainska Pravda, “Kontrakt o Transite Rossiyskogo Gaza + Dopsoglasheniye ob Avansye ‘Gazproma’,” January 22, 2009, <http://www2.pravda.com.ua/ru/news/2009/1/22/87178.htm>.
- 22 Interfax-Ukraine, “Sharp Increase in Debts of Ukraine’s Housing and Utilities Sector Threatens Naftohaz-Gazprom Settlement – Naftohaz,” issue 65, number 3175, February 19, 2009.



- 23 This discussion draws heavily on analysis by Edward Chow and Jonathan Elkind, "Where East Meets West: European Gas and Ukrainian Reality," *The Washington Quarterly*, Center for Strategic & International Studies, vol. 32, number 1, January 2009.
- 24 Information provided to authors by IMF official, March 2009.
- 25 Unian, "Text of Putin's Speech at NATO Summit," April 18, 2008, <http://www.unian.net/eng/news/news-247251.html>.
- 26 President of Russia website, "Interview given by Dmitry Medvedev to Television Channel One, Rossia, NTV," August 31, 2008, [http://www.kremlin.ru/eng/text/speeches/2008/08/31/1850\\_type82912\\_type82916\\_206003.shtml](http://www.kremlin.ru/eng/text/speeches/2008/08/31/1850_type82912_type82916_206003.shtml).
- 27 NATO, Final Communiqué, "Meeting of the North Atlantic Council at the Level of Foreign Ministers Held at NATO Headquarters, Brussels," December 3, 2008, <http://www.nato.int/docu/pr/2008/po8-153e.html>.
- 28 Kyiv Post, "Ohryzhko: Foreign Ministry's Response to Chernomyrdin's Comments is Timely and Adequate," February 18, 2009, <http://www.kyivpost.com/nation/35710>.
- 29 See Steven Pifer, "Averting Crisis in Ukraine," Council on Foreign Relations Special Report No. 41, January 2009 for a fuller discussion of the internal frictions within Ukraine and tensions between Ukraine and Russia, as well as for recommendations on U.S. policy steps to alleviate those frictions.





## ABOUT THE AUTHORS

---

**ANDERS ÅSLUND** has been deeply engaged in Ukraine and its economic reforms since 1985, and he has published extensively. He predicted the fall of the Soviet communist system in his *Gorbachev's Struggle for Economic Reform* (1989), one of his nine books. He served as an economic advisor to the Ukrainian government from 1994 until 1997. He has co-edited *Economic Reform in Ukraine: the Unfinished Agenda* (2000) and *Revolution in Orange* (2006). Åslund joined the Peterson Institute for International Economics as senior fellow in 2006. He is co-chairman of the board of trustees of the Kyiv School of Economics. Previously, he was the director of the Russian and Eurasian Program at the Carnegie Endowment for International Peace, and he was founding director of the Stockholm Institute of Transition economics and professor at the Stockholm School of Economics. He earned his doctorate from Oxford.

**JONATHAN ELKIND** is a nonresident senior fellow on energy security issues at the Brookings Institution. He is also the founder and principal of East-

Link Consulting, LLC, an independent consultancy focusing on energy, environment, and investment. From 1998 to 2001, Elkind served on the staff of the National Security Council as director for Russia, Ukraine, and Eurasia. Between 1989 and 1998, he served in a variety of other government positions on the national security affairs staff of the vice president, at the Department of Energy, and at the Council on Environmental Quality.

**STEVEN PIFER** is a visiting fellow in the Center on the United States and Europe at Brookings. A retired Foreign Service officer, Pifer served more than 25 years with the State Department. His assignments included deputy assistant secretary of state with responsibility for Russia and Ukraine, ambassador to Ukraine, and special assistant to the president and National Security Council senior director for Russia, Ukraine, and Eurasia. He also served at the U.S. embassies in London, Moscow, and Warsaw, as well as in Geneva with the U.S. delegation to the negotiations on intermediate-range nuclear forces.



# BROOKINGS

THE BROOKINGS INSTITUTION  
1775 MASSACHUSETTS AVE., NW  
WASHINGTON, D.C. 20036  
[brookings.edu](http://brookings.edu)