



# The Mortgaging of Ukraine's Independence

James Sherr

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## Summary points

- In signing the Kharkiv Accords with Russia in April 2010, President Yanukovich compromised important elements of Ukraine's independence for the sake of internal consolidation and short-term economic and political gains. These concessions have increased Russian pressure rather than defused it.
- The gas subsidy and the accompanying agreement to prolong the lease of the Black Sea Fleet in Crimea ensure that Ukraine's relations with Russia will continue to be structured by opaque practices, economic dependency and limited diplomatic and geopolitical options for Ukraine, and make it more difficult to pursue urgent reforms. At the same time Ukraine's security cooperation with NATO has been downgraded, and there are worrying infringements of democratic and civil freedoms.
- The European Union, the US and NATO should not confuse respect for Ukraine's sovereign right to choose its political course with indifference to the consequences both for Ukraine and European security. The short-sightedness of Ukraine's current approach will soon become evident to Yanukovich and his advisers.
- The EU and international institutions should stand ready to offer a convincing package of alternatives. At present, however, the US and Europe lack a clear definition of interests *vis-à-vis* Ukraine, a set of concrete aspirations and a strategy for promulgating and realizing them.
- The IMF has set a model of tough but constructive conditionality that others should follow. Above all, the EU should consider offering Ukraine a long-term membership perspective on a similar tightly conditional basis and revise its position on visa liberalization.

## Introduction

With a breathtaking combination of wilfulness, myopia and haste, Ukraine's new president (elected on 7 February 2010) and government (formed on 11 March)<sup>1</sup> have set in motion a process of internal and external change that surpasses their understanding and will be exceedingly difficult to manage. Unless several premises of President Viktor Yanukovich's policy are reconsidered and amended, Ukraine could find itself uncomfortably dependent on Russia, a country that regards its independence as a historical aberration. Unless the new government is reconfigured and broadened, it will lack the means to pursue the reforms it knows are inescapable. Even in the short term, the country faces economic trial, the sharpening of increasingly fraught regional divisions, the further corruption of a flawed political system and fresh hardships for a fragmented and disillusioned society. So far, the West is responding to this challenge with an uncertainty (and in some quarters, complacency) that bears no resemblance to its earlier conviction that Ukraine's independence is a 'pivot' of European security. This is not only altering the position of Ukraine. It is altering Russia's evolution in ways that Brussels and Washington have scarcely begun to consider.

Within weeks of taking office, Yanukovich and his Stability and Reforms coalition were governing with determination and self-confidence. The signing of the two gas-for-fleet agreements with Russia on 21 April enhanced the coalition's domestic popularity and exposed the frailties of an already shattered opposition. Yet the self-confidence and cohesion of the new authorities are declining. Bold concessions intended to defuse Russian pressure for integration have instead increased

it. The IMF has imposed conditions of assistance that are unpalatable but almost impossible to reject. Corporate interests that see no alternative to Ukraine's integration into Europe have little idea what this means in practice or how to achieve it. The fusion between power and money obstructs every necessary change in the country. In each of these spheres, the authorities face intolerable choices, and they are beginning to realize it.

That realization is paradoxical, because many outside the country equate Yanukovich's election with the emergence of a stable and reliable Ukraine.<sup>2</sup> Over the months ahead, this expectation will be severely tested. In place of economic recovery, internal consolidation, a balanced foreign policy and a pragmatic approach to national interests, the future is just as likely to be shaped by economic pressure, compromised institutions, interregional discord, assaults on hard-won liberties, the asymmetric ambitions of neighbours and the dominance of sectoral interests over national ones. The passing of the confusion and administrative disorder of the post-Orange Revolution years and the emergence of a coherent government authority are positive elements in this picture. But they do not form the whole picture.

## The culture of power

The 'question of power' has been as dominant a theme in the newly independent states of the former Soviet Union as it was in the Soviet Union itself.<sup>3</sup> To an impressive degree in appearance and to a lesser degree in reality, the Soviet system was based upon cohesive authority. The wreckage of that system has made the consolidation of authority a pressing, not to say myopic preoccupation for post-Soviet elites and the economic

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- 1 In former Soviet states there is a strict distinction between the country's 'leadership' (president & prime minister) and 'government' (prime minister and cabinet). The Western equation of the two causes misunderstanding in Russia and Ukraine, and it sometimes does damage. (When Ukraine's 'government' was criticized during the Orange years, Prime Minister Yulia Tymoshenko thought that the West was singling her out for criticism and exempting President Viktor Yushchenko.) Therefore this paper uses a variety of synonyms except when talking strictly about the 'government': hence, 'leadership', 'authorities', 'decision-makers'.
  - 2 For a particularly cogent presentation of this thesis, see Bruce Jackson, 'Why We Need a Reset', in Bruce Jackson and James Sherr, *Ukraine After the Presidential Elections: How the West Should Respond*, in the German Marshall Fund of the USA series, *On Wider Europe*, March 2010, p. 3, [http://www.gmfus.org/cs/publications/publication\\_view?publication.id=168](http://www.gmfus.org/cs/publications/publication_view?publication.id=168).
  - 3 For a sterling analysis along these lines, see Alexander Bogomolov, in Alexander Bogomolov, James Sherr, Arkady Moshes and F. Stephen Larrabee, *Quid Ukraine's Strategic Security?*, EU Neighbourhood Policy ESF Working Papers (Paris: Centre for European Policy Studies, 2007), <http://www.ceps.eu/book/quid-ukraines-strategic-security>.
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interests that both define and support them. The gap between society and state – between *miy* (us) and *oni* (them) – has also survived, and the ‘totalitarian project’ of suppressing civil society has never fully disappeared in post-Soviet conditions, however formally democratic.<sup>4</sup> These conditions have confirmed the validity of Lenin’s axiom that ‘there is no more erroneous or more harmful idea than the separation of foreign from internal policy’.<sup>5</sup>

The Kharkiv accords – the gas-for-fleet agreements concluded between Presidents Yanukovich and Dmitry Medvedev on 21 April 2010 – have significant geopolitical implications. Not only do they signify a reversal of the policies adopted since 2005 by former president Viktor Yushchenko, they amount to a fundamental revision of the course that Ukraine has pursued since acquiring independence in 1991. In signing these agreements, Yanukovich and Prime Minister Mykola Azarov have displayed a conspicuous lack of apprehension regarding Russia’s intentions, an artless lack of caution in allowing that country’s leverage to be strengthened and a casual (if, lamentably, better grounded) faith that the West will welcome them as a further step towards ‘stability’. For their part, Medvedev and Prime Minister Vladimir Putin, without international opprobrium or loss of life, have secured greater geopolitical dividends than were realized as a result of victory in the Georgian war. Inside as well as outside Russia, critics of the neo-imperial paradigm have been dealt a heavy blow.

Yet for Yanukovich the accords, first and foremost, are a means of consolidating the authority of the new leadership and its support in Ukraine. Their scope, the absence of debate regarding their provisions, and the swiftness of their adoption and ratification testify to his determination to derive maximum advantage from his slim (3.47%) majority in the February election in order to secure swift and irreversible changes

while the fragmented opposition is still reeling. In essence, the accords amount to a mortgaging of some of Ukraine’s independence to secure internal consolidation and, over the longer term, scope for international manoeuvre in Europe.

In narrow terms, Yanukovich has emerged as a figure with far more acumen than many thought he possessed. Those observers (including this author) who believed that he would ‘not be able to use power effectively unless he shares it’<sup>6</sup> had their hopes dashed on 9 March when the *Verkhovna Rada* (parliament) amended its own regulations, which had been designed to preserve electoral mandates, maintain the integrity of factions and, not incidentally, close off an avenue of corruption in the coalition-building process. By means of this expedient (and apparently unconstitutional) step, Yanukovich was able to attract enough defections from the opposition to secure a Stability and Reforms coalition between his Party of Regions, the Communists and the politically androgynous bloc of the parliamentary Speaker, Volodymyr Lytvyn.<sup>7</sup> Simultaneously, inside the Party of Regions itself, the more Europe-orientated wing, rather simplistically associated with industrial magnate Rinat Akhmetov, was trounced by the gas lobby and other interests threatened by European integration rather than lured by it. Now that these two political thresholds have been crossed, the art of the possible has changed in Ukraine. Yanukovich has secured his ‘vertical’ of power not only in parliament, but in the power ministries, the Procurator General’s Office and, it would appear, the country’s Constitutional Court.

As a result, five well-established paradigms about Ukraine and its governing elite need to be reconsidered. First, in contrast to Presidents Leonid Kravchuk and Leonid Kuchma, who both governed from the centre, and even to the much stigmatized Yushchenko (who

4 John Gray, ‘Totalitarianism, Reform and Civil Society’, in *Post-Liberalism: Studies in Political Thought* (London: Routledge, 1993).

5 See E. H. Carr, *Socialism in One Country, 1924-26*, vol. III, Part 1 (London: Macmillan, 1964), p. 3.

6 James Sherr, ‘Ukraine’s Elections: Watershed or New Stalemate?’, Chatham House Programme Paper, February 2010, [www.chathamhouse.org.uk/research/russia\\_eurasia/papers](http://www.chathamhouse.org.uk/research/russia_eurasia/papers).

7 Article 83 of the May 1996 Constitution, as amended in December 2004, states that ‘factions’ rather than individual deputies form a coalition.

appointed Yanukovich as prime minister in August 2006), Yanukovich is governing a divided country in a divisive spirit and is apparently unbothered by the fact. Vladimir Putin, whose base of support is well distributed across Russia, is far more in step with the mood of his country as a whole. Those like Viktor Baloha, Yushchenko's former Chief of Staff, who worked tirelessly to secure a grand coalition with Yanukovich were as affronted by the latter's approach as his inveterate opponents.

Second, hitherto prevalent assessments of Yanukovich need amendment. Now that he holds the reins of power, he is turning out to be quite different from the supposed pragmatist who was on display as a subordinate (to Kuchma, whom he served as prime minister in 2002–04) and at moments of weakness (as Yushchenko's prime minister). His tenure as governor of Donetsk Region (1997–2002) provides a far better picture of his approach to power. The premise behind that approach, recognizable to any student of Soviet politics, is that the purpose of power is to gain more of it. Even had Yanukovich won the election with a margin of 0.3%, he would most likely be conducting himself as he is now, possibly with even greater determination. He does not just preside over an 'oligarchic dictatorship'. He leads it.

Third, the understanding of civil society in Ukraine must be amended. The trend towards a civic-minded polity that was developing since Ukraine's independence (and with impressive momentum in the years preceding the Orange Revolution) has been dealt two heavy blows in the past five years. The first was the confusion and disillusionment that characterized much of Yushchenko's and Prime Minister Yulia Tymoshenko's period in office and their contentious relationship. The second was the financial crisis, which cost Ukraine 15% of its gross domestic product in 2009. That these misfortunes coincided with a conspicuously pro-European and pro-NATO foreign policy has not helped matters. A large proportion of Ukrainians were

inclined to blame the West, as well as their own leaders, for the country's ills. According to a poll conducted by Russia's Levada Centre and the Ukrainian institute KMIS in January 2010, 63% support joining the Russia-Belarus Union State, as opposed to 53% supporting EU accession. Nevertheless, according to the same poll, 66% of Ukrainians believe that Ukraine and Russia should remain independent states.<sup>8</sup>

Fourth and no less significantly, Yanukovich inherits a less professionalized state than Yushchenko did from Kuchma. Many of the architects of Ukrainian statehood had a weak national tradition but a strong state and administrative tradition, which they passed on to their younger, more visionary and democratically minded *protégés*. In contrast, Yushchenko and his circle belonged to a strong national tradition and to a relatively weak state tradition. Their coming to power humanized the ethos of many state structures. It opened hitherto inert institutions to the benefits of collaboration with Western officials and experts. But it also led to the 'personification' of key institutions and, in time, the departure of many talented and principled individuals from state service. The result is that Yanukovich faces few administrative checks on his power.

Fifth, members of the outgoing authorities do not constitute a cohesive opposition and may not form a credible one again. In office their fractiousness further damaged the legitimacy of a flawed political order. They have only begun to draw lessons from their defeat and come to terms with the shift in public attitudes that has taken place. Protests against the new authorities attract gatherings rather than crowds (e.g. the demonstration called by Tymoshenko on 11 May against the Kharkiv accords mustered only 2,000).<sup>9</sup> The leaders of other factions, even those of high calibre, lack a grassroots following and the personal charisma needed to mobilize ordinary people.

This is not a combination of factors that bodes well for Ukraine. For a president whose understanding of

<sup>8</sup> *Inside Ukraine*, No. 8, May 2010 (Kyiv: International Centre for Policy Studies), p. 10.

<sup>9</sup> AFP (*Agence France Presse*), 11 May 2010.

democracy is shallow and commitment to it questionable, current conditions provide more temptations than constraints. Whether out of instinct or to test the waters, the new leadership has already encroached upon liberties that few had questioned over the past five years. It is also transforming the state from accomplice of corruption to the source of it. Six developments should command attention:

- the postponement, without cross-party agreement, of local elections from May to October 2010;
- the use of administrative pressures to induce parliamentarians to desert Orange factions, with the apparent aim of forming a majority sufficient to amend the country's constitution;
- new forms of pressure against the media, which have prompted 533 journalists as well as 132 NGOs to sign a 'Stop Censorship' appeal;
- the re-emergence of administrative and SBU (security service) pressure on universities to curb protests and monitor dissent, which provoked an open letter of condemnation from the rector of the Ukrainian Catholic University;
- the reopening of the criminal case against Tymoshenko and her summons to the Procurator General's office on 12 May, in contrast to the record of President Yushchenko, who did not harass his opponents;
- the reappearance of an intrusive and arbitrary inspection regime by the State Tax Service and, as noted in a recent private-sector survey, a worsening of customs regulations and technical barriers to trade – all of which stifle entrepreneurship and enhance the rent-seeking potential of the state.<sup>10</sup>

These expedients are not destroying democracy in Ukraine, as the opposition alleges, but they will erode it unless they are exposed and checked. The artfulness

of the state's manoeuvres might make this difficult. Outright violation of law by the state evokes outrage, but its selective and biased application might not. Punishment creates heroines and martyrs, but bribery and *kompromat*<sup>11</sup> create accomplices. Censorship provokes defiance, but the reallocation of broadcasting frequencies provokes technical arguments. The suborning of judges arouses condemnation, but not so emphatically when one's predecessor has done the same, even if less brutally and with an arguably superior purpose.

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Thus far, the public and institutional response to the authorities' actions has not been robust. There are many voices of protest but few echoes. Seven Constitutional Court judges protested against the court's dubious ruling on the legality of the coalition, but the street was quiet. Media self-censorship is assuming more worrying proportions than censorship. Only two of the approximately 170 universities of Ukraine protested against SBU intimidation.<sup>12</sup> More people seem impressed by the case against Tymoshenko than by the double standards of those who reopened it. Yanukovych's 'right-hand man', Prime Minister Azarov, had been accused during his tenure as head of the State Tax

<sup>10</sup> European Business Association, 10 June 2010, pp. 1–2.

<sup>11</sup> Compromising information, either genuine or fabricated, used to exert pressure on an individual.

<sup>12</sup> See <http://www.ucef.org>.

Administration (1996–2002) and first deputy prime minister and minister of finance (2002–04) – not least by Valeriy Khoroshkovskiy, the newly appointed chairman of the SBU – of misappropriating state funds and applying financial pressure against journalists and politicians.<sup>13</sup> Yet Trout Cacheris, the American firm engaged to conduct an investigation of Tymoshenko's finances, has not been asked to audit the accounts of Azarov or others once accused of impropriety and now in senior state posts.

It is prudent, therefore, to ask whether changes considered irreversible after the Orange Revolution might be more fragile than supposed. Ukrainian society appears to have returned to the post-Soviet pattern of cynicism, apathy, distrust of others and loss of interest in anything unrelated to family and self. But for how long? The growth of civic self-confidence has been a theme of Ukraine's development as an independent state. There are substantial ways in which Ukraine's political culture differs from Russia's: a congenital tendency towards pluralism, an instinctive distrust of power, the coexistence of four religious traditions, a large (if now diminishing) measure of ethnic and linguistic tolerance, and the Polish-Lithuanian and Habsburg inheritance of at least a third of the country.<sup>14</sup> The upsets of the past five years have submerged these traditions but are unlikely to have extinguished them. A key question is when this heritage will be resurrected, and how.

### A poisoned-gas pill

With the signing of the two gas-for-fleet agreements by Ukraine and Russia on 21 April 2010, the nostrum that Russian energy policy serves strictly economic ends has had its most ostentatious refutation to date. The gas-supply agreement might not render Ukraine's accession to the EU-sponsored Energy Community Treaty impossible but is likely to make it irrelevant. Moreover, the Black Sea Fleet accord, partially supplementing

and partially supplanting the three intergovernmental agreements of May 1997 – and extending the basing terms from 2017 to 2042 – could preclude any further integration into the Euro-Atlantic security system for many years.

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The Kharkiv gas supply agreement, an Addendum to the 19 January 2009 contract concluded between Prime Minister Putin and then Prime Minister Yulia Tymoshenko essentially annuls the latter while preserving much of its substance. The announcement of further agreements has established a dynamic that Russia plainly hopes will place Ukraine's energy sector and several other leading sectors of its economy under its own ownership or management. This became clear as early as 30 April when Prime Minister Putin proposed merging Gazprom and its state-owned Ukrainian counterpart, Naftogaz Ukrainiy, on terms which, according to prime ministerial spokesman Dmitry Peskov, would afford the latter a 5% stake in the merged entity. Since then, Kyiv has begun to resist Moscow's proposals for closer integration. But the key question is how successfully it will preserve its autonomy after ceding significant ground.

In order to understand the Kharkiv agreement, one must first understand what the January 2009 contract (and the subsequent agreement of 19 November)

<sup>13</sup> Serhiy Rudenko, 'Mykola Azarov: Yanukovich's Right-Hand Man', RFE/RL 12 March 2010.

<sup>14</sup> As acknowledged by the Russian political scientist, Dmitriy Furman, 'Kuchma dostalsya ne tot narod' [Kuchma has got the wrong people], *Vremya MN* [The 'Times' of Moscow News], 15 October 2002.



achieved and failed to achieve. The January contract was the first to establish a European-based pricing formula for Ukraine's gas imports. It also removed RosUkrEnergo, the intermediary company originally established by Presidents Kuchma and Putin in 2004, from the gas trade. For both of these reasons it was welcomed by the EU. It served as a stimulus to the EU-led gas transit modernization initiative of March 2009; it strengthened IMF confidence about its decision to grant a standby facility for Ukraine; and it helped strengthen EU opposition to Gazprom's take-or-pay clauses, which oblige consuming countries to pay for volumes of gas contracted, irrespective of how much they actually import – an arrangement that Gazprom itself refuses to accept when it imports gas from Turkmenistan.

But the contract also contained serious flaws, reflecting the fact that by the end of the 2008–09 gas crisis, Tymoshenko had to settle the dispute with Russia under duress. Under its provisions, Ukraine's transit fees (one-third to one-half of the EU average) were not allowed to rise in accordance with the so-called 'market' principles that were invoked to increase prices. Moreover, the pricing formula itself was inequitable. Germany's base price for imported Russian gas (net of transit fees) was actually lower than that which Ukraine was obliged to accept. These higher prices – \$360 per thousand cubic metres (tcm) in January 2009 compared to \$179.50 in 2008 – contributed materially to Ukraine's economic downturn in 2009, the worst since 1992. Yet to Ukraine's benefit, they also sharply reduced gas imports to 26.6 billion cubic metres (bcm) in 2009, despite a contractual requirement to purchase 40 bcm, while allowing Ukraine to retain 25 bcm of gas in storage, almost as great a volume as that held by the entire EU.

By late 2009, the presidential election contest was stimulating a search for revisions, which duly appeared in a second agreement between Putin and Tymoshenko concluded in Yalta on 19 November. The revisions brought the Ukraine–Russia gas trade one step closer to international best practice. They suspended (but did not eliminate) the take-or-pay clauses, and they provided for a 60% rise in Ukraine's transit fee. But

these concessions by Putin came at a price, widely rumoured to have included a promise to extend the lease of the Black Sea Fleet: a promise that Yanukovich has not only made but signed into law.

On the surface, the new gas supply agreement of 21 April 2010 is highly favourable to Ukraine. The country will receive a discount of 30% on the existing pricing formula, but not greater than \$100 per thousand cubic metres. Over the ten-year duration of the accord, it is claimed that this will save Ukraine \$40 billion, which dwarfs the recently announced \$15.8 billion IMF standby facility as well as the once mooted \$3.8 billion from the EU for modernizing the Gas Transit System (GTS).

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In narrow terms, the substance of this agreement is politically and economically to Yanukovich's advantage. After experiencing the worst economic collapse since the early 1990s, Ukraine's electorate is in no mood to put abstractions about national security ahead of food on the table. Apart from the immediate economic benefit of the gas discount, Yanukovich, Prime Minister Azarov and Deputy Prime Minister Serhiy Tyhypko were hopeful that the reduction in expenditure would create the macro-economic stability needed to secure a new Stand-by Arrangement (SBA) from the IMF. Three months later, the latter expectation was borne out. On 28 July, the IMF approved a \$15.8 billion two-and-a-half year SBA.

Yanukovich also calculated that his concessions to Russia would do his internal opponents no good at all. When the opposition insisted, with good reason,

that extending the lease of the Black Sea Fleet required amendment of the constitution, backed by a referendum, Yanukovich adroitly seized on the word 'referendum' and dismissed any need to amend the constitution itself. If he wants the public's approval of the agreement, he is all but certain to get it. According to the extensive poll conducted by the Research and Branding Group in May, 58.7% of the population had a generally positive view of the gas-for-fleet agreements, a striking contrast to their attitude in November 2006, when only 10% supported concessions to Russia in exchange for cheaper gas.<sup>15</sup> Yanukovich now has four props of legitimacy for the accords he has concluded: parliament's ratification on 27 April, public endorsement of the gas-for-fleet deal, the verdict of the Constitutional Court and IMF support.

Yet the accords are profoundly problematic for Ukraine. They provide the illusion of relief at a substantial economic and political cost. When so primary a commodity as energy is subsidized, economic decisions risk becoming divorced from commercial reality. In Ukraine, the new agreement is more likely to entrench than remedy core economic problems: a level of energy consumption grossly disproportionate to the size of the economy and one-third to one-fifth as efficient as the EU's newest members, a lack of domestic and foreign investment capital, the absence of the legal conditions that would attract such capital, a failure to develop domestic energy sources, and a malign symbiosis between business, shadow business and the state. When this subsidy is granted by a foreign power, a second cost is incurred: political dependency. Ukraine has now reinforced its dependency upon a country that suffers from many of its own problems, whose energy sector operates under acute financial constraints, whose reliability as a supplier is questionable, that politicizes economic relationships and that regards dominance of Eurasian energy markets as a core national interest.

Finally, the subsidy entrenches the interests and practices that block Ukraine's integration with Europe and the ability to participate in an efficient, innovative and diversifying energy market.

In more specific terms, the accord is problematic as well. First, the gas discount is not a grant. It is to be calculated as debt, to be offset against an equivalent increase in the Black Sea Fleet's rent of \$98 million per annum for facilities in Crimea after 2017. By this sleight of hand, Russia has acquired a powerful financial deterrent against revision of the fleet agreement. If a future government annuls that agreement, it will be obliged to repay any discount received.

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Second, Gazprom's transit fee, which under the provisions of the 19 November 2009 agreement between Tymoshenko and Putin had been scheduled to rise by 60%, will now be maintained at its former level, despite the fact that it is pegged at one-third to one-half the level charged by member states of the EU.

Third, whereas Kyiv had expected that the fleet extension would secure additional quid pro quos from Russia, Moscow has not budged on any point of contention. Although Yanukovich campaigned on the assurance that a privileged energy relationship would remove the rationale for the South Stream pipeline, Medvedev insists that the pipeline will remain a 'priority project', irrespective of any steps that Ukraine takes. By the same token, Putin and Gazprom's CEO

15 Not surprisingly, the same poll notes significant regional variations, with only 21.4% viewing the accords positively in the west and 81.4% in the south and east; see [www.rb.com.ua](http://www.rb.com.ua). According to some observers, the Research and Branding Group is in the pocket of the Party of Regions, but its results do not diverge very much from those of other polling organizations. The 2006 figures come from a Razumkov Centre poll of November 2006, [www.razumkov.org.ua/ukr/poll.php?poll\\_id=218](http://www.razumkov.org.ua/ukr/poll.php?poll_id=218).



Alexei Miller have brushed aside Yanukovych's position that Gazprom should guarantee transshipment of a minimum volume of at least 120 bcm of gas to Europe via the GTS. This in itself casts doubt on Putin's assurance to Yanukovych on 27 April that South Stream is intended to supplement rather than replace volumes shipped across Ukraine, which currently transports 80% of the gas that Europe imports from Russia. So does Putin's insistence in every other European capital that bypassing an ostensibly unreliable Ukraine is South Stream's primary purpose.<sup>16</sup>

Fourth, Gazprom's take-or-pay clauses are in limbo – neither in place nor conclusively annulled. Upon signing the April 2010 Addendum to the gas contract of 19 January 2009, Alexei Miller stated that 'the price formula and the provision, "take or pay" in the contract remain without changes'.<sup>17</sup> Yet Point 4 of the agreement that Miller signed explicitly 'excludes' these provisions (Points 6.5 and 6.6 in the January 2009 original). At the same time, the agreement still obliges Naftogaz to purchase set volumes of gas without stipulating how that obligation will be enforced. Whether these contradictions amount to calculated ambiguity or an ongoing conflict between Gazprom and the Kremlin is currently impossible to say.<sup>18</sup>

Fifth, Ukraine's potential to re-export gas is also in limbo. The amended contract requires it to purchase 36.5 bcm in 2010 (up from 33 bcm under the Tymoshenko–Putin contract) and 52 bcm every year thereafter until the end of 2019, with permission to defer take-up of 20% of this volume. It is far from certain that the economy will require such high volumes of imports. It is even less certain that they can be paid for unless a large part of the unconsumed gas is re-exported. Ukraine has traditionally relied upon re-export to increase national revenue as well as 'administrative resources'

for domestic political purposes. For its part, Gazprom has opposed the re-export of its gas as a matter of principle. Why should Russia's customers sell at a mark-up the gas that Russia supplies at a discount? Ambiguity about re-export can well lead to further tension.

Sixth, the discount will not eliminate the problem faced by Ukrainian industry. Once VAT and internal tariffs are taken into account, the discounted gas price will still be \$100 per tcm above what the biggest industries currently pay. According to BG Capital, chemicals, metals, mining and other industries pay anywhere from \$198 to \$237 per tcm, whereas, under Ukraine's onerous tax regime, the breakeven sale price for Naftogaz is \$327 per tcm.<sup>19</sup> Over the years, this subsidy from Naftogaz has rendered it insolvent. When Putin proposed the merger of Naftogaz with Gazprom, he was well aware of this fact. No doubt he was also aware that pressure on Ukraine's industry will worsen if and when the oil price (against which gas prices are calculated) rises above the current average of \$75 per barrel.

A wild card was thrown into this mix by the 8 June decision of the Stockholm International Court of Arbitration in favour of the gas intermediary, RusUkrEnergo (RUE) in its long-running dispute with Naftogaz. The January 2009 gas contract, which removed RUE from the supply chain, also resolved its \$1.7 billion debt to Gazprom by transferring RUE ownership of some 11 bcm of gas stocked in reservoirs to Naftogaz. The court has now instructed the latter to return 12.1 bcm (11 bcm plus penalties and interest) to RUE, even though it is obvious that Naftogaz has no means of doing so. Worse, there is reason to believe that the singularly weak defence of Naftogaz's position in Stockholm by the Ukrainian legal team was no accident.<sup>20</sup> Yuriy Boyko, the Minister of Fuel and Energy, and Serhiy Levochkin, the Head of the Presidential Administration, have been the most

16 Vlad Socor, 'Austria Joins Gazprom's South Stream Project' and 'South Stream Is Not a Ukraine Bypass Project', *Eurasia Daily Monitor*, 30 April 2010, vol. 2, issue 84, 30 April 2010 (Washington, DC: Jamestown Foundation), brdcst@jamestown.org.

17 As paraphrased by *Vedomosti*. See Aleksey Nikol'skiy, 'Remaining on Base' [*Ostalis' na baze*], *Vedomosti*, 22 April 2010.

18 The texts of the January 2009 contract and April 2010 addendum were published in Russian by *Ukrainskaya Pravda*. See, respectively, <http://www.pravda.com.ua/articles/2009/01/22/3686613/> and <http://www.pravda.com.ua/rus/articles/2010/04/22/4956389/>.

19 According to Nicholas Redman of the Economist Intelligence Unit, internal tariffs amount to \$25/1000 tcm, and 20% VAT is added to the aggregate sum.

20 Arnaud Dubien, 'The RosUkrEnergo Saga Continues', *Eurasia Intelligence Report*, no 1, June 2010.

consistent promoters of RUE, whose principal shareholder, Dmytro Firtash, is a member of Yanukovich's inner circle and a leading contributor to the Party of Regions. Since Naftogaz is unable to honour the court's terms, RUE will have to be compensated by other means. It remains to be seen whether these means are transparent, open to scrutiny and beneficial to Ukraine's economy.

In mitigation of Yanukovich, he is not acting in an unprecedented manner. Previous governments did not show any serious interest in breaking the pattern of dependency, opacity, rent-seeking and preferential pricing – which is another way of saying that they were unwilling to sever the link between business and power. For 20 years, proposals showing how Ukraine could reduce waste and dependency and become more self-sufficient have fallen on deaf ears.

This has had deleterious consequences. The leverage secured by Russia's cut-off of oil supplies between December 1999 and April 2000 drove Kuchma into a number of economic and political concessions, including the dismissal of his foreign minister and head of defence intelligence.<sup>21</sup> Yushchenko's flawed resolution of the 2006 gas crisis not only damaged Ukraine's European prospects, but also set the stage for a series of confrontations with Russia that culminated in the far more serious 2008–09 gas crisis. By conceding Russia's core demand – the extension of the Black Sea Fleet's deployment – in advance, Yanukovich plainly hopes to avoid similar consequences. But this calculation is already proving to be mistaken.

First, instead of diminishing Russia's ambitions by virtue of pre-emptive concessions, Yanukovich has only whetted them. At the close of the summit in Kyiv on 17 May, Medvedev described the accords thus far

concluded as 'only the beginning', adding that 'No one expects that we will immediately resolve all problems, but what's most important is not to lower the pressure, not to reduce our rate of delivery'.<sup>22</sup> When Yanukovich said that 'it is impossible to work in this way ... through seven meetings in so short a period

‘ Instead of diminishing Russia's ambitions by virtue of pre-emptive concessions, Yanukovich has only whetted them ’

and drive the heads of working groups to accelerate the pace of preparing different decisions', Medvedev replied, 'work in this way – we must!'<sup>23</sup> Yanukovich was given fair warning of Moscow's approach. On 22 February, five days before his inauguration, the head of Medvedev's presidential administration, Sergey Naryshkin, arrived in Kyiv with a list of demands. On 26 April, only five days after the conclusion of the Kharkiv accords, Prime Minister Putin presented Kyiv with a draft agreement that would afford Russia *de facto* control over Ukraine's gas production, transmission systems, internal gas trade and export, as well as nuclear power generation. On 30 April he added the merger of Naftogaz and Gazprom to this list. The package brought by Medvedev on 17 May, designed to 'synchronize the development of [Russian and Ukrainian] socio-economic relations', went even further.<sup>24</sup> Steel, chemical, shipbuilding, aviation and nuclear enterprises are now under pressure from Russian buyers, ostensibly private, but backed by state

21 James Sherr, 'The Dismissal of Borys Tarasyuk', *Occasional Brief* (Camberley: Conflict Studies Research Centre, Royal Military Academy Sandhurst), 6 October 2000.

22 'Medvedev: It's only the beginning' [*Medvedev: Eto tol'ko nachalo*], *Glavred*, 17 May 2010, [www.glavred.info](http://www.glavred.info).

23 'Yanukovich: "it's impossible to work so quickly", Medvedev: "we must"' [*Yanukovich: "tak bystro rabotat' nel'zya"* Medvedev: 'Pridyotsya'], *Glavred*, 17 July 2010.

24 Vlad Socor, 'Medvedev's Second Visit Pulls Ukraine Closer to Russia', *Eurasia Daily Monitor*, vol. 7, issue 99, 21 May 2010 (Washington DC: Jamestown Foundation).

lines of credit.<sup>25</sup> Were this not all, Russia is conducting a massive cultural-cum-religious offensive in Ukraine designed, *inter alia*, to liquidate the Kyiv Patriarchate of the Orthodox Church (with Yanukovych's apparent support).<sup>26</sup>

Second, developments in the energy sector and additional agreements under discussion with Russia are jarringly at variance with the priorities set out in the government's Programme of Economic Reforms.<sup>27</sup> Although the programme emphasizes deregulation, competitiveness, transparency and energy efficiency, regulation and tax policy are moving in the opposite direction, penalizing small business and creating bottlenecks throughout the economy. In areas ranging from customs clearance to defence and security cooperation, second and third echelon figures who once made real decisions are now displaying a timidity reminiscent of the Brezhnev era. Sclerosis is now the rule.

Third, current trends are also at variance with the dynamics of European integration. Thanks to reforms undertaken during the EU accession process, Romania, Bulgaria and Slovakia can afford the European energy prices that Yanukovych and Azarov term unaffordable. Without institutional reform and major industrial restructuring, these countries would not be EU members. Had the Orange team eliminated subsidy and multi-tier pricing in energy and other commodities after 2005, Ukraine would still, in all likelihood, be outside the EU in 2010. But the preconditions would have been set for the elimination of intermediaries from the internal gas market, a transformed investment climate, the attraction of external finance for new energy sources, industrial restructuring and the unchaining of private entrepreneurship. The greater efficiencies also would have reduced gas imports. But the configuration of power in Ukraine, which made

such steps possible after 2005, is far more discouraging now. So are the country's demographics, because it is in eastern and southern Ukraine, where the bulk of heavy industry is concentrated, that the greatest support for the Party of Regions is to be found.

Nevertheless, it is hard to see how some measure of reform can be avoided. First, as noted above, the gas discounts provide only temporary and partial relief. Several major industries have seen the writing on the wall and have begun to submit to the pain of restructuring and modernization. Second, IMF conditionality has, in effect, become pre-conditionality. The conditions are well targeted, tightly sequenced and unforgiving. The initial tranche of \$1.9 billion will be disbursed only after the government honours its commitment to raise household utility prices by 50%. Linkages for subsequent disbursements are likely to be equally unequivocal and severe. Third, Russian demands are now threatening Yanukovych's one red line – the protection of his party's business interests – and the government has begun to defend them.<sup>28</sup> Squeezed not for the first time between the East, the West and its own domestic lobbies, Ukraine will manoeuvre, but at some point it may show the boldness that has surprised its neighbours in the past. Unfortunately, the country's capacity for manoeuvre and boldness has been compromised by the geopolitical quid pro quo that has paid for Russia's dubious concessions.

### A geopolitical turn

The multi-vector policy of Leonid Kuchma, with which Yanukovych's policy is often compared, operated in different conditions and on very different principles from those visible today. It was a transitional and dynamic policy designed to bring Ukraine, by stages, into the Euro-Atlantic system but on terms consistent

25 John Marone, 'Akhmetov, Russians clash over Ukrainian steel mills', *Kyiv Post*, 30 July 2010.

26 Pavel Korduban, 'Vladimir Putin, Moscow Mayor and Patriarch Kirill Promote Russian Interests in Ukraine', *Eurasia Daily Monitor*, vol. 7, issue 145, 28 July 2010.

27 *Prosperous Society, Competitive Economy, Effective State: Programme of Economic Reforms 2010-2014*, Committee on Economic Reforms under the President of Ukraine, 2 June 2010.

28 Marone, 'Akhmetov, Russians clash over Ukrainian steel mills'.

with a mutually beneficial 'strategic partnership' with Russia. In the mid-1990s, this meant a Euro-Atlantic system dominated by an outward-looking NATO and partially hindered by an EU that at the time was more intent on 'deepening integration' of existing members than expanding its definition of Europe. In those years, Russia meant Yeltsin's Russia: an actor equally conscious of its strengths relative to Ukraine and its weaknesses relative to the West. In those years too, the greater part of Russia's political establishment saw the West, even NATO, as problematic but unthreatening. Finally, the multi-vector policy reflected Ukraine's condition as a newly independent state, burdened by the mental and economic inheritance of the USSR, yet developing state institutions that, in the national security area at least, were able to formulate and implement policy in the national interest. In these conditions, Ukraine could count on Western assistance, a deepening Western presence and a Western readiness to counterbalance Russian pressure. Although the Yeltsin leadership equated good relations between Ukraine and Russia with coordination of policies and closer integration, this combination of conditions made it realistic to hope that Russia would come to see a friendly and independent Ukraine as the best of all possible worlds. The May 1997 Treaty of Friendship, Cooperation and Partnership between Russia and Ukraine and the intergovernmental accords on the Black Sea Fleet represented the high point of this policy and its vindication.

Yanukovich's 'balanced' policy is not designed to bring Ukraine into the West. It is a policy of equidistance designed to make Ukraine a 'bridge between East and West' on the basis of a 'non-bloc' policy. Its dynamic is conflicted: established by internal priorities and interests, rather than strategic calculation and long-term planning. Thanks to the events of 9/11 and the 'peaceful rise' of China, the Euro-Atlantic system is preoccupied by events very far from Europe. It is

also less cohesive and self-confident than it was in the immediate post-Cold War years and it no longer defines the rules of the game in the 'common neighbourhood' that lies between the EU, NATO and the former USSR. Russia is the Russia of the Medvedev-Putin tandem, convinced that it has humbled the West, intent to 'fill vacuums' left in the wake of the West's apparent retreat<sup>29</sup> and resolved to establish a 'sphere of privileged interests' to which it believes it is entitled, by virtue of 'shared common history' and the 'affinity of our souls', if not by divine right.<sup>30</sup> In the first few months of his administration, Yanukovich's 'balanced' policy was more conspicuous for reversals of course and unceremonious treatment of traditional partners than for any balances struck.

‘The greatest difference between the policies of Yanukovich and Kuchma is that the former has jettisoned the counterweights that made partnership with Russia feasible and safe’

Yet the greatest difference between the policies of Yanukovich and Kuchma is that the former has jettisoned the counterweights that made partnership with Russia feasible and safe. For Kuchma and his national security team, NATO was the essential counterweight to a country that has always believed that 'Ukraine will never be able to stand alone', and it began to serve this purpose in 1994, eight years before Ukraine's National Security and Defence Council declared NATO membership the 'ultimate goal' of Ukraine's policy. In July

29 'As soon as any vacuum emerges, the temptation arises to fill this vacuum with something. ...This is why Europe and NATO showed an absolutely calm reaction to our agreement with Ukraine to extend the presence of Russia's naval base in Sevastopol. This is wise.' Dmitry Medvedev, interview on *Russia Today*, 17 May 2010, cited by Vlad Socor, 'Medvedev's Second Visit Pulls Ukraine Closer to Russia' in *Eurasia Daily Monitor*, vol. 7, issue 99, 21 May 2010.

30 Dmitry Medvedev, remarks at Valdai Club lunch, September 2008.

1997, three years after joining NATO's Partnership for Peace, Ukraine concluded a Charter on a Distinctive Partnership with the organization. Not only did the charter formalize an intensity of cooperation unprecedented between NATO and a non-candidate state, it established new mechanisms of cooperation (such as the Joint Working Group on Defence Reform) that did not exist between NATO and any non-member. By the end of the decade, this growing matrix of cooperation had produced a significant measure of cultural change in what had only recently been a Sovietized military establishment. Despite false starts and erratic implementation, by the time Yushchenko came to power, the first serious steps had been taken to bring commitments, force structures and budgets into balance: steps rapidly consolidated and intensified by Yushchenko's first minister of defence, Anatoliy Grytsenko. Where defence reform was concerned, Ukraine's military leadership saw no similar impetus coming from Russia and no models to emulate.

This cooperation, reinforced by high-level political support, instilled in Moscow the perception that Ukraine was falling ever more closely into NATO's orbit. When President Kuchma, Polish President Alexander Kwasniewski and the presidents of the three Baltic states signed a communiqué in May 1997 outlining their 'common position that NATO should remain open for all countries aspiring for membership', this vindicated the position of a newly appointed reformist government in Moscow that Russia's obduracy was 'pushing Ukraine towards NATO'. The result, the 14 interstate and intergovernmental agreements concluded at the end of that month, unfroze Ukrainian financial assets in Russia, normalized trade and energy relations, conclusively endorsed Ukraine's full sovereignty over Crimea (including Sevastopol) and finally put the deployment of Russia's Black Sea Fleet on a legal basis, tied to a 20-year lease to 2017, renewable for a further five.

Yet despite assurances to US Secretary of State Hillary Clinton and others that NATO-Ukraine cooperation will continue – and even despite the parliament's authorization on 18 May of the 2010 Ukraine-NATO Sea Breeze exercise – Yanukovich's government appears to be stripping the relationship of soul and

‘Yanukovich's government appears to be stripping the [NATO] relationship of soul and substance’

substance. On 2 April, the country's six specialized structures coordinating NATO-Ukraine integration were dissolved by decree without any consultation with NATO or public discussion. While the authorities argue that Ukraine's abandonment of membership aspirations makes these structures irrelevant, they have failed to note that their dissolution deprives Ukraine of any interagency mechanism for coordinating what is still an interagency relationship.<sup>31</sup> The Euro-Atlantic Integration Coordination Bureau under the Cabinet of Ministers may have been renamed, but what can be gained by dissolving it? If continuation of cooperation were a serious aim, why dismiss the 200 civil servants who worked for these bodies, many of them highly expert? The NATO Information and Documentation Centre and NATO Liaison Office continue to work normally, but how much useful work can they do without knowledgeable collaborators? It is indicative of the change of direction and mood that Ukraine has invited the Russian-dominated Collective Security Treaty Organization (CSTO) to establish offices in Kyiv and that the parliament has

31 The structures are the Coordination Bureau for European and Euro-Atlantic Integration of the Cabinet of Ministers, the National Center for Euro-Atlantic Integration of the Presidential Administration, the Interagency Commission on Preparation for NATO Membership (led by the Ministry of Foreign Affairs), the National Institute for International Security Problems and the Institute for National Security Problems.



set up a commission to examine the case for Ukrainian membership of the CSTO. In May, NATO's intelligence adviser, who had hitherto enjoyed a close working relationship with former SBU Chairman Valentyn Nalyvaichenko, was peremptorily summoned by his successor, Valeriy Khoroshkovskiy, and told that her contract would not be renewed. Russia is now filling this gap. On 19 May, the SBU concluded an agreement with Russia's security service, the FSB, designed to establish a full spectrum of cooperation with that service, including industrial counter-intelligence and the return of counter-intelligence officers (expelled by Nalyvaichenko) to Crimea.

‘The new leadership is intent to show that Ukraine faces threats on all fronts and that a “non-bloc” policy best suits its national interests’

The national security team now in place provides a good indicator of how threats will be assessed and countered in future. The deputy prime minister for security issues, Volodymyr Sytkovych, ‘has close ties to Russian intelligence services’ according to former Minister of Defence Anatoliy Grytsenko. As head of the parliamentary investigatory commission concerned, Sytkovych concluded that allegations about Yushchenko's poisoning were part of the ‘US conspiracy’ responsible for the Orange Revolution. Minister of the Interior Anatoliy Mokhylev, in his previous incarnation as head of the Crimean Electoral Commission, defended the 1944 deportation of the Crimean Tatars.<sup>32</sup> SBU Chairman Khoroshkovskiy has already shown himself to have a tough approach to Western partners who take Ukraine's friendship for granted: most recently

in ordering the 10-hour detention of Nico Lange, Head of the Kyiv office of the Konrad Adenauer Stiftung, at Kyiv's Borispol Airport on 26 June. Finally, those who view Romania as a potential adversary have been elevated to more important positions. The new leadership is intent to show that Ukraine faces threats on all fronts and that a ‘non-bloc’ policy best suits its national interests.

The situation, however, remains highly fluid, and not all changes are detrimental. After 13 years of close cooperation, the armed forces are reluctant to discard NATO as Ukraine's priority partner: if not necessarily at the geopolitical level, then at the military-technical one. The commitment made under Yushchenko for Ukraine to participate in NATO's Rapid Reaction Force has been reconfirmed. Several commitments that fell by the wayside in the second half of Yushchenko's tenure – notably measures to improve the safety of weapon storage sites – are now being implemented. But the spirit of the relationship has undeniably changed.

The Ukrainian leadership's most robust retort to charges that it is turning to Russia is the claim that NATO's prominence is being supplanted by that of the EU. Yet no serious steps have been taken in this direction. The new law of 2 July on domestic and foreign policy priorities which, for the first time since independence, obliges Ukraine to maintain a ‘non-bloc status’ also enshrines EU membership and partnership as a priority goal alongside partnership with Russia. But that is very different from a strategy to join the EU, let alone establishing the necessary reforms and mechanisms. In the case of NATO membership, such mechanisms had already been developed over many years. Thus far, Ukraine's political leadership is treating the EU as a geopolitical formation – and business as a source of markets – rather than a community committed to shared values and standards. Instead of examining how the country might implement the EU's *acquis communautaire* in the

32 Taras Kuzio, ‘Ukraine's New Old Siloviki’, *Eurasia Daily Monitor*, vol. 7, issue 63,1 April 2010.



years ahead, Ukraine's negotiators are seeking to strike deals about which provisions Ukraine must implement before accession. Negotiations over the Deep Free Trade Area have become so mired in argument and confusion that EU negotiators have told their Ukrainian opposite numbers to go away and think. Rhetoric about 'EU integration' does not establish a counterbalance to anyone. Moreover, the EU has yet to match NATO's open-door policy with one of its own. In the absence of an effective counterweight, Ukraine must rely on its own wits and assets to fend off Russian pressure, both political and economic.

In the national security arena, such assets are conspicuously limited. Even a well-advanced European course will not substitute for collective security and defence, and until Yanukovich came to power, every Ukrainian president had understood as much. NATO provides each member with not only security guarantees but collective capability. Even the United Kingdom, with a GDP eight times greater than Ukraine's and a defence budget notionally 11 times as great, calculates that it would be exceedingly difficult to finance an equivalent level of security on the basis of national resources alone.<sup>33</sup> Although Ukrainian defence needs are appreciably more modest, they are not insignificant. Ukraine borders seven countries, has an unresolved conflict on its borders in Transnistria and is in the vicinity of conflict zones in the Caucasus. It is the northern littoral of the Black Sea and is likely to face disputed claims over offshore energy resources. Moreover its still extant Law on National Security outlines a worrying menu of internal security difficulties, not least in Crimea. To date, no work is being carried out to give the 'non-bloc policy' intellectual substance. Instead, Yanukovich pretends to place his trust in Medvedev's draft European Security Treaty, which no other European country regards as a serious basis for discussion.

## A meddlesome guest

The Kharkiv accords not only extend the lease of the Black Sea Fleet by a further 25 years beyond 2017; they also lock in place all the deficiencies of the 1997 agreements. Although Yulia Tymoshenko is rumoured to have promised Putin a lease extension in November 2009, she did not promise to give these deficiencies iconic status, let alone stampede the arrangement through parliament without due process of law. By no reading of Ukrainian national interests can this extravagant extension of a flawed status quo be justified. The verdict of Yevhen Marchuk, a former minister of defence, SBU chairman and prime minister, is to the point: 'The argumentation put forward regarding both the economic and security parameters of this agreement is weak and incomprehensible.' He adds:

My knowledge of the Russian elite is not bad at all, and I conducted many different negotiations with them. I would say that these are negotiators of a very high class, who have the qualifications to defend their own national interests. They precisely and carefully consider all possible variants. The intellectual level of the majority of our elite lacks expansive instincts, not in the military understanding of this term but with regard to the enlargement of our sphere of influence. I have seen it more than once.<sup>34</sup>

The three 1997 Black Sea Fleet agreements provided a remarkably enlightened escape from an apparently untenable situation. But they were a compromise and an interim solution that failed to resolve key issues, which have become more serious with the passage of time. The most acute military concern regarding the fleet has been the possibility of its employment in contingencies at variance with Ukraine's national interests. While the 1997 accords oblige the fleet command to 'notify' Ukraine about naval movements, Ukraine's consent is not required. Already in the late 1990s,

<sup>33</sup> Given the fact that Ukraine's armed forces receive less than 40% of the funds authorized, the actual discrepancy in budgets is far greater.

<sup>34</sup> 'The truth according to Yevhen Marchuk' [*Pravda Evgeniya Marchuka*], *The Day* [*Den*], 21–22 May 2010.

there were two points of contention: the training of Russian naval infantry units in Crimea for combat duty in Chechnya and, at the start of the 1999 NATO bombing campaign against Yugoslavia, the dispatch of an intelligence vessel (and the readying of six surface combatants for transit) to the Adriatic. Yet these incidents pale in significance when compared with the prominent role played by the fleet in August 2008 war against Georgia, a fellow member of GUAM (the geopolitical grouping comprising Georgia, Ukraine, Azerbaijan and Moldova) and a country with which Ukraine then maintained a cordial level of defence cooperation. A scarcely less significant concern is that the basing agreements in Sevastopol and elsewhere in Crimea do not afford Ukraine sufficiently attractive basing facilities for its own navy, which is for the most part co-located with Russian units. Moreover since the demise of the Conventional Forces in Europe (CFE) accords (which always worked imperfectly with respect to the fleet), special purpose forces, advanced missile systems and even nuclear armaments can be deployed in Crimea without accountability or verification.<sup>35</sup>

Equally important, the fleet is *de facto* the largest single economic actor in Crimea, well integrated into many of the 'shadow structures' that dominate the peninsula's economy. It owns over 18,000 hectares of land, of which only about 3,000 are located in Sevastopol. Highly valuable assets, including resorts, real estate and profitable businesses, are controlled by the fleet or its affiliates, much of it outside the national tax regime and on terms well below market rates. Although the fleet is Sevastopol's largest employer, its annual rent of \$97m is regarded by Ukrainian experts as a risible level of compensation for these holdings.<sup>36</sup> So long as the fleet and its partners maintain this economic position, the malign fusion between politics, business and crime in Crimea cannot be properly measured, let alone broken.

The 1997 agreements preserved ten Russian intelligence and counter-intelligence detachments subordinated respectively to the GRU (Main Intelligence Directorate of the General Staff) and

‘Very serious concerns exist about the covert financing of groups undertaking provocations against the local Tatar population’

the FSB which, in continuation of the Soviet practice, are responsible for military as well as civil counter-intelligence and security. Yet rather than focus primarily on protecting the fleet from criminals and terrorists, in practice, according to former SBU Chairman Nalyvaichenko, 'Russian counter-intelligence have undertaken on our territory unfriendly actions, including the covert collection of ... secret information.'<sup>37</sup> Of the two services, the GRU is the more expansive in its activities (not only in Crimea but throughout Ukraine) and harmful. Both services have been linked to the financing of pro-Russian politicians, separatist activities and anti-NATO propaganda and protests. Very serious concerns exist about the covert financing of groups undertaking provocations against the local Tatar population. The counter-intelligence officers expelled by Nalyvaichenko have been re-admitted by the SBU with no questions asked.

Therefore, the Russian fleet is not, as is widely presumed, a deteriorating mass of old hulks destined for the scrap heap but a shelter for and initiator of activity that three Ukrainian presidents have regarded as harmful to their country's interests. What balance is maintained by renewing its lease and licence?

<sup>35</sup> See, for example, Wolodymyr Derzko, 'Nuclear Arms Threat in Crimea' *The Ukraine List No. 448*, 2 July 2010 (compiled by Dominique Arel, University of Ottawa).

<sup>36</sup> Timofey Nikitiuk, 'Ukraine sponsors the deployment of the Russian Federation's Black Sea Fleet' [*Ukraina sponsiruєt prebyvanie ChF RF*], *The Day [Der]*, 21–22 May, 2010.

<sup>37</sup> Kuzio, 'Ukraine's New Old Siloviki'.

## Where is the West?

The governments of the EU and North America have only begun to question the assumptions that dominated Western thinking before the legal machinations of 9 March freed Yanukovich of the necessity to 'share power in order to exercise it'.<sup>38</sup> At the time of his inauguration, both Washington and Brussels were prepared to think of him as a centrist political figure, a 'pragmatist', a 'balancer', a unifier and a harbinger of stability in Ukraine, and also in the relationship between Ukraine, Russia and the West. Developments since March have given the West's official representatives in the region and experts a more sober understanding of the impulsiveness, ignorance and inner tensions that lie at the heart of Yanukovich's establishment. These developments have also reminded Western representatives that democracy is a system of governance, not only a system of elections.

That is not to say that leading Western governments will take these insights on board. When countries have vexing and urgent priorities – global in the case of the United States, more introverted in the case of Europe – their approach towards lesser issues tends to follow the maxim 'the wish is father to the thought'. Today Ukraine is clearly a less prominent issue than it was in the 1990s. Yet it remains an important issue for European energy security, for the future of Russia, for the safety of other states in Russia's neighbourhood, for the recovery of self-confidence among the newer members of the European Union and for the health of the democratic project in Europe as a whole.

If Western governments are aware of these interests, what should they do? Governments that have allowed Ukraine to slip from their field of vision should not be surprised when Ukrainians draw conclusions and seek to accommodate those who voice their interests with determination and make their power felt. So long as the EU fails to present Ukraine with credible European membership prospects, it will be on dubious ground

in lecturing Ukrainians about European standards. So long as visa liberalization remains a convoluted process, the EU will have an equally difficult task persuading Ukrainians of the need to implement their own commitments. To right this situation, Europe might think of copying NATO's 2008 Bucharest formula: 'Ukraine will be a member of the EU'. Not only will it then have an authority that it lacks now, but it will force Ukrainians to understand that the path to membership depends primarily on Ukraine. So long as Washington simply states that the 'reset' with Russia does not come at the expense of its neighbours, the Obama administration will fail to face up to its real deficiencies: not 'deals' and 'betrayals', but inattentiveness, tardiness and a piecemeal approach to what ought to be coherent pursuit.

‘ So long as the EU fails to present Ukraine with credible European membership prospects, it will be on dubious ground in lecturing Ukrainians about European standards ’

Today it is easier to say what should not be done than what should. On 6 May, the European Commissioner for Energy, Günther Oettinger, stated that the EU took no view on Russia's proposal to merge Naftogaz with Gazprom.<sup>39</sup> What was left unsaid was more important: that the Ukraine–Russia energy relationship is of direct importance to the energy security of Europe. Plainly, his Ukrainian interlocutor, Yuriy Boyko, wished him to say as much, because even this arch-defender of Ukraine–Russia energy cabals was beginning to feel that Ukraine was coming under pressure from its great neighbour. Does the articulation of good intentions

<sup>38</sup> Sherr, 'Ukraine's Elections'.

<sup>39</sup> 'Gazprom-Naftogaz deal is a matter between Kiev and Moscow, EU says', DPA, 6 May 2010.

towards Ukraine and Russia matter more than the articulation of Europe's interests? When does acceptance become indifference?

On 3 July, Hillary Clinton told a largely student audience in Kyiv that the United States welcomed Yanukovich's efforts to rebalance relations between Russia and the West, and that it did not view Ukraine's friendship with Russia as anti-American. Do such pieties absolve Washington of the obligation to ask what the substance of Ukraine–Russia friendship might be and articulate such concerns as it has, particularly at a time when a large number of Ukrainians are asking these very questions? In both Oettinger's case and Clinton's, the articulation of principles seems to have become a substitute for policy. Largely missing is a definition of interests, a set of concrete aspirations and a strategy for promulgating and realizing them. The contrast between the West and Russia in this regard could not be more pronounced, and the consequences could not be more dramatic. If Medvedev is wrong to say that the West has created vacuums and does not mind that Russia now seeks 'to fill them with something', how can the West make him realize that he is mistaken?

Fortunately, there are also some examples to follow. The IMF is showing that there are mistakes that can be avoided and positive steps that can be taken. By presenting significant incentives, by tireless networking and by means of tough conditionality, the IMF mission is obliging the Ukrainian authorities to confront the problems they have inherited as well as the problems they are creating for themselves. The EU's negotiating team on the Deep Free Trade Area, a number of bilateral defence advisers and a growing number of potential investors are adopting the same constructive, painstaking and no-nonsense approach.

No less significantly, so is the German government. The SBU Chairman's order to detain Nico Lange (on grounds never properly explained) demonstrated an almost lunatic disregard of the relationship between the Konrad Adenauer Stiftung, Chancellor Angela Merkel and Ukraine's prospects in Europe. Not incidentally, it also demonstrated ignorance, if not contempt, of how

democracies and their respective political institutions interact with one another. In 2000, Austria elected a government verging on the far right, and the EU established a cordon sanitaire in response. Although these measures, brief as they were, were deeply unpalatable to Jörg Haider's government and supporters, not a single foreign journalist, scholar or foundation head had the slightest worry about visiting Austria, meeting with opposition figures and making their concerns felt – and this despite the fact that Austria is hardly the oldest democracy in Europe. Berlin's reaction – private, coordinated and tough – made its mark on President Yanukovich, and it would be surprising if this did not have some effect on his subordinates and their methods.

‘ Even in the unlikely event that Russia's more ambitious schemes of integration succeed, Ukraine will remain a sovereign state, and it must be treated as one ’

If the West is to restore some balance between new global challenges and perennial European interests, it will also need to study the effects that Russia's apparent breakthrough in Ukraine has on Russia itself. In the 1970s, geopolitical advance and East–West détente postponed the Soviet leadership's inevitable reckoning with the dysfunctions of the Soviet system. Should a similar combination of factors arise today, an outmoded model of post-Soviet development might be given a new and equally deceptive lease on life. The casualties are likely to go well beyond energy-sector reform in Russia and Ukraine. At the least, it is time for Western governments to grasp that, whatever the differences between President Medvedev and Prime Minister Putin over modernization and legal reform, when it comes to their country's 'sphere of privileged

interests', they are 'of one blood'.<sup>40</sup> This might make the 2012 presidential elections less significant than many assume.

Even in the unlikely event that Russia's more ambitious schemes of integration succeed, Ukraine will remain a sovereign state, and it must be treated as one. The current authorities have a right to establish a different course from that of their predecessors. They have the right to diminish cooperation with the West or even end it, with or without consultation. But sovereignty does not confer a right to act without regard for the consequences. Without preaching or table pounding, the West needs to demonstrate that misguided policies will deprive Ukraine of the support and stimuli it needs to prosper, modernize and integrate with the rest of

Europe. To do this, the West needs to remind itself that these goals serve its own interests. It also needs a policy. Of late, policy has suffered, and that fact will doubtless diminish the Western ability and readiness to speak with purpose and effect over the short term. The insularity and truculence of Ukraine's new authorities will also diminish the West's ability to do so. Yet for the reasons set out above, the present situation in Ukraine is likely to be rather more short-lived than many today suppose. Internal and external conditions are already proving far less forgiving of the short-sightedness of Ukraine's new authorities than they were when they came into office. Sooner rather than later, Yanukovych's government will be willing to listen. The question then is whether the West will have something to say.



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40 The phrase that Putin used to describe his relationship to Medvedev at the Valdai Club lunch, 11 September 2009.



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**James Sherr** is Head of the Russia and Eurasia Programme at Chatham House.

Chatham House  
10 St James's Square  
London SW1Y 4LE  
[www.chathamhouse.org.uk](http://www.chathamhouse.org.uk)

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## The Russia and Eurasia Programme

The Russia and Eurasia Programme at Chatham House brings together the best thinking on the changing dynamics of the countries of the former Soviet Union and the implications for the West and the wider world. The Programme comprises both in-house staff and an international network of Associate Fellows, all leading country and subject experts – a combination that provides maximum geographical and thematic coverage of the region. The Programme provides original, informed research to policy-makers and the wider public, and through its wide range of events it acts as a forum for the exchange of analysis and information on the region.

### *The Means and Ends of Russian Influence Abroad*

This major research project will lead to a series of publications in early 2011 on the following topics:

- *The Means and Ends of Russian Influence Abroad* (James Sherr)
- *Russia's Approach to Energy Diplomacy and Business Promotion* (Andrew Wood and John Lough)
- *Russian Responses to NATO and EU Enlargement* (James Greene)
- *Russian Influence in the Baltic States* (Agis Baranaukaite)
- *Russian Influence in Ukraine* (Alexander Bogomolov, Alexander Lytvynenko)
- *Russian Influence in Central Asia and the South Caucasus* (James Nixey)