

# CRS Report for Congress

## Ukraine: Current Issues and U.S. Policy

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## Summary

In January 2005, Viktor Yushchenko became Ukraine's new President, after massive demonstrations helped to overturn the former regime's electoral fraud, in what has been dubbed the "Orange Revolution," after Yushchenko's campaign color. The "Orange Revolution" sparked a good deal of interest in Congress and elsewhere. Some hoped that Ukraine might finally embark on a path of comprehensive reforms and Euro-Atlantic integration after nearly 15 years of half-measures and false starts. However, infighting within his governing coalition hampered economic reforms and led to disillusionment among Orange Revolution supporters. The victory of the opposition Party of Regions in August 2006 parliamentary elections led to further political conflict and deadlock.

New parliamentary elections on September 30, 2007 confirmed the Party of Regions as the largest party in the parliament, but the party of former Prime Minister Yuliya Tymoshenko performed well. On December 18, 2007, the parliament approved by a razor-thin majority a new coalition government of pro-Western, "Orange" parties, with Tymoshenko as Prime Minister. Political conflict between Tymoshenko and Yushchenko soon resumed however, jeopardizing reform efforts.

After taking office as President, Yushchenko said that Ukraine would seek integration into the global economy and Euro-Atlantic institutions. Ukraine joined the World Trade Organization (WTO) in May 2008. In the longer term, Yushchenko seeks Ukrainian membership in the European Union and NATO. Relations with Russia have at times been tense over such issues as Ukraine's NATO aspirations and energy supplies. Yanukovich and the Party of Regions oppose NATO membership, are less eager to conduct reforms in pursuit of EU membership, and are more favorable to closer ties with Russia, especially in the economic sphere. Conflict between Ukraine's political forces has led its foreign policy to appear incoherent, as the contending forces pulled it in pro-Western or pro-Russia directions or simply neglected foreign policy as less important than domestic political combat.

U.S. officials supported the "Orange Revolution" in Ukraine in late 2004 and early 2005, warning the former regime against trying to impose fraudulent election results, and hailing Yushchenko's ultimate victory. U.S. officials have remained upbeat about Ukraine's successes in some areas, such as securing WTO membership, as well as in holding free and fair elections and improving media freedoms, while acknowledging difficulties in others, such as fighting corruption, establishing the rule of law, and constitutional reforms. The United States strongly supported granting a Membership Action Plan to Ukraine at the NATO summit in Bucharest in April 2008, a key stepping-stone to NATO membership. However, opposition by Germany, France, and several other countries blocked the effort. On the other hand, the Allies surprised many observers by confirming that Ukraine will join NATO in the future, without specifying a timetable. This report will be updated as needed.

# Contents

Background .....	1
Current Political Situation .....	3
Current Economic Situation .....	5
Ukraine's Foreign Policy .....	6
NATO .....	7
European Union .....	8
Russia .....	9
Energy Issues .....	9
NATO Membership .....	11
U.S. Policy .....	11
Congressional Response .....	13

# Ukraine: Current Issues and U.S. Policy

## Background

Ukraine, comparable in size and population to France, is a large, important, European state. The fact that it occupies the sensitive position between Russia and new NATO member states Poland, Slovakia, Hungary, and Romania, adds to its geostrategic significance. Many Russian politicians, as well as ordinary citizens, have never been fully reconciled to Ukraine's independence from the Soviet Union in 1991, and feel that the country should be in Russia's political and economic orbit. The U.S. and European view, especially in Central and Eastern Europe, is that a strong, independent Ukraine is an important source of regional stability.

From the mid 1990s until 2004, Ukraine's political scene was dominated by President Leonid Kuchma and the oligarchic "clans" (groups of powerful politicians and businessmen, mainly based in eastern and southern Ukraine) that supported him. Kuchma was elected President in 1994, and re-elected in 1999. He could not run for a third term under the Ukrainian constitution. His rule was characterized by fitful economic reform (albeit with solid economic growth in later years), widespread corruption, and a deteriorating human rights record.

Ukraine held presidential elections on October 31, November 21, and December 26, 2004. The oligarchs chose Prime Minister Viktor Yanukovich as their candidate to succeed Kuchma as President. The chief opposition candidate, former Prime Minister Viktor Yushchenko, was a pro-reform, pro-Western figure. International observers criticized the election campaign and the first and second rounds of the election as not free and fair, citing such factors as government-run media bias in favor of Yanukovich, abuse of absentee ballots, barring of opposition representatives from electoral commissions, and inaccurate voter lists. Nevertheless, Yushchenko topped the first round of the vote on October 31 by a razor-thin margin over Yanukovich. Other candidates finished far behind.

After the November 21 runoff between the two top candidates, Ukraine's Central Election Commission proclaimed Yanukovich the winner. Yushchenko's supporters charged that massive fraud had been committed. Hundreds of thousands of Ukrainians took to the streets, in what came to be known as the "Orange Revolution," after Yushchenko's chosen campaign color. They blockaded government offices in Kiev and appealed to the Ukrainian Supreme Court to invalidate the vote. The court invalidated the runoff election on December 3, and set a repeat runoff vote on December 26. Yushchenko won the December 26 re-vote, with 51.99% of the vote to Yanukovich's 44.19%. After court challenges by Yanukovich were rejected, Yushchenko was inaugurated as President of Ukraine on January 23, 2005. On February 4, 2005, the Ukrainian parliament approved President Yushchenko's appointment of Yuliya Tymoshenko as Prime Minister of Ukraine by

a vote of 373-0. Tymoshenko is a charismatic, populist leader with a sometimes combative political style who campaigned effectively on Yushchenko's behalf. She is a controversial figure due in part to her alleged involvement in corrupt schemes as a businesswoman and a government minister during the Kuchma regime.

The "Orange Revolution" sparked a good deal of interest in Congress and elsewhere. Some hoped that Ukraine could finally embark on a path of comprehensive reforms and Euro-Atlantic integration after years of half-measures and false starts. However, subsequent events led to a certain amount of disillusionment among Orange Revolution supporters. Yushchenko's efforts were hampered by infighting within his governing coalition. In September 2005, Yushchenko dismissed Prime Minister Tymoshenko's government. The atmosphere between the two leaders was poisoned by accusations of corruption lodged by supporters of each against the other side's partisans, including over the highly lucrative and non-transparent natural gas industry. The two leaders also clashed over economic philosophy, with Tymoshenko favoring populist and statist methods in contrast to Yushchenko's preference for a more orthodox free-market approach.

In order to secure support for a new government, Yushchenko then made a political non-aggression pact with his opponent from the presidential election, Viktor Yanukovich, and promised not to prosecute Yanukovich's key supporters for electoral fraud and other crimes. Some supporters of the Orange Revolution viewed the move as a betrayal of one of the key principles of their movement. Some even began to question whether the new government was better than the old regime, given ongoing government corruption scandals and the perception that the Orange Revolution might be reduced to squabbling over the redistribution of property among the "old" oligarchs and would-be, new "Orange" ones.<sup>1</sup>

On March 26, 2006, Ukraine held parliamentary elections. The largest vote-getter in the elections was the Party of Regions, headed by Yushchenko's former presidential election rival Viktor Yanukovich. After the failure of protracted attempts to reconstitute the Orange Revolution coalition, the Socialist Party, formerly part of it, changed sides and formed a coalition with the Party of Regions and the Communists, which put forward Yanukovich as its candidate for Prime Minister. Yushchenko reluctantly appointed Yanukovich as Prime Minister, and the Ukrainian parliament approved the new government on August 4, 2006. Yanukovich's government and the parliamentary majority, led by the Party of Regions, worked steadily to whittle away at Yushchenko's powers and political influence. The government and parliament removed ministers appointed by Yushchenko and rejected his proposed candidates to replace them. The government refused to implement Yushchenko's decrees.

Hoping to stem the threat to his power, President Yushchenko dissolved the Ukrainian parliament on April 2, 2007, claiming that the defection of individual members of the opposition to the majority (as opposed to a whole faction) made the ruling majority illegitimate. Prime Minister Yanukovich condemned Yushchenko's

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<sup>1</sup> Jamestown Foundation, *Eurasia Daily Monitor*, September 9, 2005; RFE/RL *Belarus, Ukraine, Moldova Report*, September 16, 2005.

decree as unconstitutional and called on the government and parliament to ignore Yushchenko's decree and keep working. On May 27, after weeks of political and legal turmoil, Yushchenko, Yanukovych, and parliament chairman Oleksandr Moroz agreed that new parliamentary elections would be held on September 30, 2007, to end the crisis.

According to many observers, this political crisis underlined the fact that the country still needs to make substantial progress in developing a smoothly functioning democracy. The poorly defined separation of powers in Ukraine's constitution has invited conflict and needs to be clarified. Another key problem is the persistence of a post-Soviet political culture in which "winner-take-all" attitudes and unscrupulous tactics take precedence over a genuine respect for the rule of law.

## Current Political Situation

On September 30, 2007, Ukraine held early parliamentary elections. The Party of Regions remains the largest party in the new legislature. It won 34.37% of the vote and 175 seats in the 450-seat parliament. The Yuliya Tymoshenko Bloc, which won 30.71% and 156 seats, is the second largest. Our Ukraine-People's Defense came in a distant third, with 14.15% and 72 seats. The Communist party received 5.39% of the vote and 27 seats. The Lytvyn Bloc was the only other party to reach the 3% vote barrier for representation in the parliament. It won 3.96% of the vote, and secured 20 seats.

These results were not a dramatic departure from the results of the March 2006 election. The Party of Regions lost 11 seats, but its Communist allies gained six. The Our Ukraine bloc lost nine seats. However, its former Orange Revolution partner, the Yuliya Tymoshenko Bloc, gained 27 seats. The Socialists, perhaps

### Ukraine's Main Political Groups

**Party of Regions:** The largest party in Ukraine's parliament. It draws its support from eastern Ukraine, where suspicion of Ukrainian nationalism is high and support for close ties with Russia is strong. It defends the economic interests of powerful oligarchic groups in eastern Ukraine.

**Yuliya Tymoshenko Bloc:** Mainly a vehicle for the ambitions of the charismatic Tymoshenko, it has little ideological cohesion of its own. It is the second largest group in the Ukrainian parliament largely because many Ukrainians see Tymoshenko as the most stalwart defender of the populist, anti-corruption ideals of the Orange Revolution.

**Our Ukraine-People's Self Defense bloc:** The main political group supporting President Yushchenko. It favors free market economic reforms and a pro-Western foreign policy. It draws its support from western Ukraine, where Ukrainian nationalism is strong.

**Communist Party:** Now a shadow of its former self, overtaken by the Party of Regions in its eastern Ukraine strongholds and faced with an aging electorate. It strongly opposes market economics and favors strong ties to Russia.

**Lytvyn Bloc:** A centrist bloc headed by Volodymyr Lytvyn, former top official in the Kuchma regime. Lytvyn has changed sides several times in Ukraine's political struggles, backing the side with the upper hand at the moment.

punished by the electorate for betraying their former Orange allies, fell below the 3% and lost all of their parliamentary seats. The Lytvyn Bloc was not represented in the previous parliament, as it fallen below the 3% threshold.<sup>2</sup>

As has occurred in elections since Ukraine became an independent country in 1991, support for the parties was heavily regionalized. The Party of Regions was dominant in eastern and southern Ukraine, but did poorly in western and central Ukraine. Support for the Communists was also concentrated in the east and south. Our Ukraine-People's Self Defense did well in western Ukraine, but poorly in the east. The Yuliya Tymoshenko Bloc is strongest in western and central Ukraine, beating Our Ukraine-People's Self Defense in all districts of these regions but one. The Tymoshenko Bloc is much weaker in eastern and southern Ukraine, but made moderate inroads there as compared to the previous election just over a year earlier, perhaps opening the way to a future as democratic Ukraine's first truly country-wide party.

Negotiations over a new government were protracted. On December 6, the parliament approved Arseniy Yatsenyuk as chairman of the Rada. Yatsenyuk, from Our Ukraine-People's Self Defense, was formerly Ukraine's foreign minister. President Yushchenko nominated Tymoshenko as his candidate for Prime Minister. The parliament approved Tymoshenko as Prime Minister on December 18 by a vote of 226-0. The parliament then approved Tymoshenko's government. The Party of Regions, Communist Party and Lytvyn Bloc did not take part in the votes.

The extreme fragility of her majority has made Tymoshenko's task as Prime Minister difficult. In mid-January 2008, the Party of Regions and the Communist Party blocked the parliament from meeting. Their ostensible reason was Yatsenyuk's signature on a letter with Yushchenko and Tymoshenko to NATO Secretary General Jaap de Hoop Scheffer requesting a Membership Action Plan (MAP) for Ukraine at the NATO summit in Bucharest on April 2-4, 2008. They said Yatsenyuk had no right to speak for the parliament on such a controversial issue without their consent. The parliament resumed operations on March 6, 2008, after it passed a resolution stating that the parliament would consider legislation to join NATO only after a public referendum approved NATO membership.

Another problem has been escalating tension between Tymoshenko and Yushchenko. Yushchenko has often criticized Tymoshenko's policies, including her privatization plans, efforts to renegotiate energy relations with Russia, and alleged failure to fight rising inflation. He has pressed for constitutional reforms giving the Presidency greater powers over the government. Yushchenko appointed a (now former) high-ranking leader from the Party of Regions as secretary of the National Security and Defense Council, to the surprise of Yanukovych. Analysts say that Yushchenko may be building bridges to pragmatic elements in the Party of Regions (especially key businessmen such as Rinat Akhmetov) in order to balance Tymoshenko's power. Persons close to Yushchenko have created a new party called

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<sup>2</sup> For the 2007 Ukrainian parliamentary elections results, see the Ukrainian Central Election Committee website, [<http://www.cvk.gov.ua/vnd2007/w6p001e.html>].

United Center that may be designed to attract support from such “centrist” forces in eastern Ukraine.

Tymoshenko has hit back by calling for constitutional amendments to create a “parliamentary republic” that would weaken the presidency. Given that the Party of Regions and other parties in parliament also favor a parliamentary republic, Tymoshenko could join forces with them to put the plan into action. These moves suggest early jockeying for power in advance of presidential elections in 2010 (in which Yushchenko and Tymoshenko could both be candidates) and could threaten the stability of the government. At present, Yushchenko appears to be in the weaker position as opinion polls have consistently shown him to be much less popular than Tymoshenko.

On June 6, 2008, two parliamentary deputies, one from the Tymoshenko Bloc and one from Our Ukraine, issued statements saying that they were leaving the governing coalition. The move may deprive the government of its parliamentary majority, as it appears to have 225 seats, instead of the required 226. The Party of Regions has called for talks with other parties on creating a new governing majority. Regions’ leaders say that they may ask the Constitutional Court to rule on whether the current government continues to have a majority. If the current coalition fails, Ukrainian political analysts believe Tymoshenko could bring the Lytvyn Bloc into the government. Alternatively, Our Ukraine could form a coalition with the Party of Regions, in order to thwart Tymoshenko’s possible presidential ambitions.

## Current Economic Situation

Ukraine is experiencing strong economic growth. GDP grew by 6.2% in the first quarter of 2008, on a year-on-year basis. However, consumer price inflation rate spiked to 31.1% in May 2008, year-on-year. Ukrainian real disposable income is increasing rapidly (nearly 20% in the first quarter of 2008, year-on-year), but most Ukrainians remain poor; the average Ukrainian wage is only about \$10 per day, which is only a little more than half that of Russia’s. Ukraine’s total stock of foreign direct investment (FDI) was low, at \$21.2 billion in January 2007, but net FDI inflows are rising rapidly. Net FDI for 2007 was a record \$9.2 billion. Foreign investment has been particularly strong in the banking and insurance sectors.<sup>3</sup>

A key priority of the Tymoshenko government is to master Ukraine’s rapidly rising inflation. On the other hand, Tymoshenko made populist promises during the campaign that will increase government spending, such as a commitment to reimburse Ukrainians for money frozen in Soviet-era savings accounts. Tymoshenko and her supporters blame other factors, such as price-fixing by retailers and the National Bank of Ukraine’s (NBU) pegging of Ukraine’s currency to the weak dollar. The NBU has tried to ameliorate the problem by a modest revaluation of the hryvnya against the dollar and by tightening monetary policy. In June 2008, President Yushchenko vetoed price controls legislation proposed by the government.

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<sup>3</sup> Economist Intelligence Unit Country Report: Ukraine, June 2008.



Tymoshenko plans to rapidly privatize key firms such as the telecommunications monopoly Ukrtelecom and the Odesa Portside Plan chemical firm, in part to pay for her plan to compensate Soviet-era savings account holders. However, Yushchenko has blocked Tymoshenko's privatization efforts, claiming he is opposed to a hasty sell-off. The two leaders are fighting for control of Ukraine's remaining state property. The conflict appears to be another facet of the ongoing power struggle between the two leaders.

In April 2008, Prime Minister Tymoshenko cancelled a production sharing agreement (PSA) with the U.S. firm Vanco and several partners to exploit the large Prykerchenska oil and natural gas field in the Sea of Azov. She claimed that the field was too large for the group to exploit, that the terms of the PSA were too generous, and that the license holders were planning to sell control of the field to Gazprom. Tymoshenko may also have been upset that one of Vanco's partners is Rinat Akhmetov, a powerful oligarch and political opponent of Tymoshenko. U.S. Ambassador to Ukraine William Taylor criticized Tymoshenko's move, saying that it would hurt prospects for foreign investment in Ukraine, as well as Ukraine's energy security. In May 2008, President Yushchenko's Security and Defense Council ordered the government to rescind its cancellation of the group's PSA.

Prime Minister Tymoshenko has pledged to battle corruption in Ukraine, which many experts and U.S. officials view as a key problem hindering Ukraine's economic development. In March 2008, the parliament repealed a state procurement law that had been widely criticized for promoting corruption. The government says that a crackdown on tax evasion and customs fraud has substantially increased government revenues.

## **Ukraine's Foreign Policy**

Until Yushchenko's election in 2005, Ukrainian foreign policy was characterized by an effort to balance ties with Russia with those with the United States and Western countries. Previous leaders gave lip service to joining NATO and the European Union, but did little to meet the standards set by these organizations. Ukrainian leaders also promised closer ties with Russia in exchange for Russian energy at subsidized prices, but balked at implementing agreements with Russia that would seriously compromise Ukraine's sovereignty, such as ceding control over Ukraine's energy infrastructure to Moscow.

After taking office, President Yushchenko put integration into the global economy and Euro-Atlantic institutions at the center of Ukraine's foreign policy. One key foreign policy goal has been for Ukraine to join the World Trade Organization (WTO). Ukraine joined the WTO in May 2008. In addition to helping Ukrainian exporters, WTO membership may give Ukraine political leverage over Russia, given that the consent of Ukraine (and every other WTO member state) is necessary for Russia to join the organization. In the longer term, Yushchenko wants Ukraine to join the European Union and NATO. Ukraine has sought to retain good ties with Russia, but relations have been troubled since Yushchenko took power.

Conflict between Ukraine's political forces has led its foreign policy to appear incoherent, as the contending forces pulled it in pro-Western or pro-Russia directions or simply neglected foreign policy as less important than domestic political combat. Yanukovich and the Party of Regions are less eager to pursue rapid integration into Euro-Atlantic institutions and more favorable to closer ties with Russia, especially in the economic sphere.

## **NATO**

Ukraine currently has an "Intensified Dialogue" with NATO, but President Yushchenko has sought a Membership Action Plan (MAP), a key stepping-stone to joining the Alliance. The MAP gives detailed guidance on what a country needs to do to qualify for membership.

The Ukrainian government favors NATO membership for Ukraine. In the past, Prime Minister Tymoshenko has not viewed NATO membership among her top priorities. Nevertheless, on January 15, 2008, she joined President Yushchenko and parliament speaker Arseniy Yatsenyuk in sending a letter to NATO Secretary General Jaap de Hoop Scheffer requesting a Membership Action Plan for Ukraine at the April 2-4 NATO summit in Bucharest, Romania. On March 17, President Yushchenko and Prime Minister Tymoshenko sent letters to De Hoop Scheffer, German Federal Chancellor Angela Merkel, and French President Nicolas Sarkozy reiterating Ukraine's request for a MAP.

The Party of Regions and the Communists are strongly opposed to a MAP for Ukraine. They responded to the first letter by blocking the functioning of the parliament. Yanukovich threatened to hold public demonstrations against the government's request for a MAP. Public opinion polls have shown that less than one-quarter of the population supports NATO membership. Both President Yushchenko and Prime Minister Tymoshenko have launched a public information campaign to educate Ukrainians about NATO. They have also agreed that Ukraine's entry into NATO would have to be endorsed beforehand by a public referendum. Perhaps in an effort to defuse domestic and Russian criticism, President Yushchenko has said that Ukraine will not allow the establishment of NATO bases on Ukrainian soil. He has noted that the Ukrainian constitution does not permit the establishment of foreign military bases, with the temporary exception of Russia's current Black Sea naval base, the lease for which runs out in 2017.

NATO declined to offer Ukraine a MAP at the Bucharest summit, despite strong support from the United States and almost all central European NATO members. Germany and France played the leading role in blocking the effort. They raised questions about Ukraine's qualifications for a MAP and also expressed concerns that granting a MAP to Ukraine would hurt relations with Russia. However, the Allies agreed that Kiev could receive a MAP as early as the NATO Foreign Ministers' meeting in December 2008, if remaining questions over its application are resolved. In a move that surprised many observers, the summit communique also contained an unqualified statement that Ukraine (and Georgia) "will become members of NATO," without specifying when that might happen.

The ambiguous result of the summit caused varying reactions within Ukraine. President Yushchenko and the Ukrainian government hailed the summit as a key stepping-stone on Kiev's path toward NATO membership, pointing in particular to the commitment made to admit Ukraine into the Alliance. In contrast, Yanukovich and the opposition applauded the denial of a MAP at the summit, viewing it as a blow to Yushchenko's pro-NATO policy.

## European Union

Ukraine seeks to open talks on an Association Agreement with the European Union that would clearly state Ukraine's status as a candidate EU member. Many countries in the EU have been cool to Ukraine's possible membership, perhaps because of the huge burden a large, poor country like Ukraine could place on already-strained EU coffers. Indeed, EU officials have tried to dissuade Ukraine from even raising the issue. However, not all EU states are reluctant to consider Ukraine's eventual membership. Poland and the Baltic states have advocated Ukraine's joining the EU, in part because they see a stable, secure Ukraine as a bulwark against Russia. Nevertheless, even supporters of Ukraine's EU membership acknowledge that it could be more than a decade before Kiev is ready to join, but believe that formal EU recognition of Ukraine's candidacy could speed the reform process in Ukraine.

Ukraine currently has a Partnership and Cooperation Agreement (PCA) with the EU, as well as a Ukraine-EU Action Plan within the context of the EU's European Neighborhood policy. The agreements are aimed at providing aid and advice to assist Ukraine's political and economic transition and to promote closer ties with the EU. At an EU-Ukraine summit in December 2005, the EU announced that it would grant Ukraine market economy status. The move makes it easier for Ukrainian firms to export to the EU without facing antidumping duties.

In March 2007, the EU and Ukraine announced the opening of negotiations on an Enhanced Agreement to replace the current PCA, which is scheduled to expire in 2008. EU officials say that talks on an EU-Ukraine free trade area can begin, now that Ukraine is a member of the WTO. The EU plans to spend 494 million Euro (\$658 million) from 2007-2010 to support reform in Ukraine, in such areas as energy cooperation, strengthening border controls, bolstering the judiciary and the rule of law, and addressing environmental concerns.<sup>4</sup>

In June 2008, the EU agreed to set an Eastern Partnership program within the context of their European Neighborhood policy, which also includes non-European countries. However, it is not clear whether the new initiative will have much actual content in addition to current efforts, let alone whether it will offer Ukraine and other eastern European countries a perspective of EU membership.

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<sup>4</sup> "Commissioner Ferrero-Waldner Announces Substantial Increase in Financial Assistance to Ukraine," EU press release, March 7, 2007.

## Russia

Ukraine's most difficult and complex relationship is with Russia. President Putin strongly backed Yanukovich's fraudulent "victory" during the 2004 presidential election campaign and reacted angrily at the success of the Orange Revolution. Russian observers with close ties to the Kremlin charged that the Orange Revolution was in fact a plot engineered by the United States and other Western countries. For his part, President Yushchenko offered an olive branch to Moscow, calling Russia a "permanent strategic partner" of Ukraine.<sup>5</sup> Nevertheless, relations have been rocky. Russia has been irked by Yushchenko's efforts to support greater democratization in the region and impose tighter border controls on Transnistria, a pro-Moscow, separatist enclave within neighboring Moldova.

Ethnic Russians make up 17.3% of Ukraine's population, concentrated in the southern and eastern parts of the country. Moreover, ethnic Ukrainians in these same regions tend to be Russian-speaking, are suspicious of Ukrainian nationalism, and support close ties with Russia. Russian officials have tried to play on these regional and ethnic ties, not always successfully, as demonstrated by the 2004 Ukrainian presidential election.

**Energy Issues.** The most severe crisis in Russian-Ukrainian relations in recent years occurred in January 2006. In 2005, the Russian government-controlled natural gas monopoly Gazprom insisted on a more than fourfold increase in the price that it charges Ukraine for natural gas. When Ukraine balked at the demand, Russia cut off natural gas supplies to Ukraine on December 31, leading also to cuts in gas supplies to Western Europe. The gas supplies were restored two days later after a new gas supply agreement was signed. In early 2007, with the more pro-Russian Yanukovich government in power, Russia and Ukraine agreed to gradually increase the price of Russian natural gas to Ukraine over the next five years, at which time it will reach the world market price. Gazprom announced a natural gas price of \$179.50 for 2008, a significant increase over the \$130 Ukraine paid in 2007, but still well short of world market levels.

Another issue is the involvement of a shadowy company, RosUkrEnergo, as the nominal supplier of Russian natural gas to Ukraine. Some analysts are concerned about possible involvement of an organized crime kingpin in the company, as well as corrupt links with Russian and Ukrainian officials. The U.S. Justice Department has reportedly investigated the firm.<sup>6</sup>

Perhaps more troubling for Ukraine, the 2006 accord with Gazprom called for the creation of UkrGazEnergo, a joint venture between RosUkrEnergo and the Ukrainian state-controlled gas firm Naftogaz that grants the former access to one-half of Ukraine's domestic market. Ukraine's intelligence service reportedly believes the

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<sup>5</sup> Jamestown Foundation, *Eurasia Daily Monitor*, January 25, 2005.

<sup>6</sup> Glenn R. Simpson, "U.S. Probes Possible Crime Links to Russian Natural-Gas Deals," *Wall Street Journal*, December 22, 2006, 1. For background on the gas crisis, see CRS Report RS22378, *Russia's Cutoff of Natural Gas to Ukraine: Context and Implications*, by Bernard Gelb, Jim Nichol, and Steven Woehrel.

owners of RosUkrEnergo are using their control over energy supplies to secure ownership of energy intensive industries such as fertilizer plants and a titanium plant.<sup>7</sup> Naftogaz has teetered on the verge of bankruptcy, in part because UkrGazEnergo has been allocated more solvent customers in the industrial sector, while Naftogaz has been left with less well-off residential consumers.

Prime Minister Tymoshenko has sharply criticized the presence of RosUkrEnergo as a middleman from the Ukrainian natural gas market. In January 2008, she sharply reduced the amount of gas UkrGazEnergo can sell to Ukrainian consumers. The role of middlemen in the Ukrainian gas market may also be reduced by market forces. RosUkrEnergo's profits are based on selling cheap Central Asian gas at higher prices to Ukraine. As Central Asian countries demand that prices for their gas move closer to market rates, the intermediary's margins may be squeezed. Tymoshenko is also reportedly seeking a steep rise in transit fees from Gazprom. Russian President Dmitri Medvedev expressed support for removing RosUkrEnergo as an intermediary, but it still remains unclear whether Russia supports a genuinely transparent energy relationship with Ukraine.

On March 3-5, 2008, Gazprom reduced gas supplies to Ukraine by 50%, alleging non-payment of debts by Ukraine. Ukrainian gas company officials warned that they might divert gas intended for Western Europe to make up the difference. The two sides reached agreement on the debt on March 5 and supplies were restored. On March 12, the two sides agreed to eliminate UkrGazEnergo from the domestic gas trade, but gave Gazprom direct access to the most lucrative part of Ukrainian's domestic market – supplies to large enterprises. The agreement said the fate of RosUkrEnergo would be determined by future negotiations. However, Tymoshenko appeared dissatisfied with parts of the accord. She remains determined to eliminate RosUkrEnergo as soon as possible. The Ukrainian government made significant unilateral changes to the agreement, including barring RosUkrEnergo from the profitable practice of re-exporting Central Asian gas from Ukraine to other markets.

Gazprom has said that Ukraine will have to pay world market prices for its gas in 2009, as a result of Gazprom's agreement with Central Asian countries to pay full price for their supplies. This could cause the price Ukraine pays for gas to double next year, dealing a heavy shock to Ukraine's economy, which is already suffering from high inflation. Tymoshenko is likely to try to resist a sharp price increase and is seeking a steep rise in transit fees from Gazprom. The clash could result in further "gas crises" later this year.

Russia still hopes to achieve its long-standing goal of owning a controlling stake in Ukraine's natural gas pipelines and storage facilities. At present, more than two-thirds of Russian gas exports to Europe (a critical source of revenue for the Russian government) transit Ukraine. In February 2007, Putin announced that he and then-Prime Minister Yanukovich had agreed on joint Russian-Ukrainian control of Ukraine's natural gas assets, in exchange for a Ukrainian stake in Russian natural gas fields. However, this statement provoked a strongly negative reaction in Ukraine,

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<sup>7</sup> Roman Kupchinsky, "Russia/Ukraine: Pipeline Conflict Resurfaces," Radio-Free Europe Radio Liberty Newswire, June 28, 2007.

and in February 2007 the parliament approved a law banning any transfer of control of the pipelines by a vote of 430-0. Russia has tied possible support for building new pipelines in Ukraine to greater Gazprom ownership of Ukraine's pipeline system. Russia is also working on developing new energy export routes through the Baltic Sea (Nord Stream) and the Balkans (South Stream) to western Europe that could bypass Ukraine in four to five years, at least in part. If successful, these efforts could reduce Ukraine's leverage over Russia on energy issues.

**NATO Membership.** Russian-Ukrainian relations have been strained by Kiev's desire to join NATO. Russian leaders were angered when the April 2008 NATO summit in Bucharest said that Ukraine will join NATO at some point in the future. According to Russian press accounts, President Putin reportedly told President Bush and NATO leaders at Ukraine was not a real state, given its regional heterogeneity, and that Ukraine would cease to exist if it joined NATO.

On April 8, 2008, Russian Foreign Minister Sergei Lavrov said Russia would do all that it could do to prevent NATO membership for Ukraine. On April 11, Chief of the Russian General Staff General Yuriy Baluyevsky warned that Russia would take military and "other measures" if Ukraine joined NATO.<sup>8</sup> Non-military measures could include economic sanctions and efforts to encourage secessionist or other centrifugal forces in eastern and southern Ukraine, especially the Crimea. Russia could make territorial claims against the city of Sevastopol in Crimea (where Russia has a naval base) or the Crimean peninsula as a whole. Russia is upset that Ukraine has rejected Russian proposals to extend the Russian Black Sea Fleet's stay in Crimea beyond 2017. On the contrary, Ukraine wants to start talks on preparing for the withdrawal of the Fleet, so as to prepare a smooth transition in 2017.

In June 2008, the Russian Duma (lower house of the parliament) passed a resolution asking the government to consider suspending the 1997 friendship treaty between Russia and Ukraine, if Ukraine receives a MAP. Such a move could be perceived as withdrawing recognition of Ukraine's borders by Russia. Also in June, Deputy Russian Prime Minister Sergei Ivanov during a visit to Sevastopol warned that Ukrainian membership in NATO would lead to a severing of military ties, reduced trade and industrial cooperation, and the introduction of visas for Ukrainians traveling to Russia.

## U.S. Policy

U.S. officials supported the "Orange Revolution" in Ukraine in late 2004 and early 2005, warning the former regime against trying to impose fraudulent election results, and hailing Yushchenko's ultimate victory. President Yushchenko visited the United States from April 4-7, 2005 and had meetings with President Bush and Secretary of State Rice. Yushchenko's address to a joint session of Congress on April 6 was interrupted by several standing ovations. U.S. officials have remained upbeat

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<sup>8</sup> Jamestown Foundation Eurasia Daily Monitor, April 14, 2008, Radio Free Europe/Radio Liberty Daily Report, April 9, 2008, and Agence France Presse wire dispatch, April 11, 2008.

about Ukraine's successes in some areas, such as finishing the steps needed to join the WTO, holding largely free and fair elections, and improving media freedom, while acknowledging difficulties in others, such as fighting corruption, establishing the rule of law, and constitutional reform.

President Yushchenko withdrew Ukraine's troops from Iraq in December 2005, in fulfillment of a campaign pledge, but promised to continue participation in Iraqi troop training efforts. Ukraine has not contributed troops to Afghanistan, at least in part due to bad public memories of the Soviet occupation of Afghanistan in the 1980s, but has supported a provincial reconstruction team.

The United States has taken steps to upgrade its economic relations with Ukraine. On January 23, 2006, the United States reinstated tariff preferences for Ukraine under the Generalized System of Preferences (GSP). Ukraine lost GSP benefits in 2001 for failing to protect U.S. intellectual property, particularly CD and DVD piracy. U.S. officials hailed Ukraine's efforts to improve its record on this issue. On March 6, 2006, the United States and Ukraine signed a bilateral agreement on market access issues, a key step in Ukraine's effort to join the WTO. U.S. officials said that Ukraine committed itself to eventual duty-free entry of U.S. information technology and aircraft products, as well as very low or zero duty on chemical products. U.S. firms will also receive more open access in such areas as energy services, banking and insurance, telecommunications, and other areas. The bilateral agreement addressed other key concerns such as protection of undisclosed information for pharmaceuticals and agricultural chemicals, imports of information technology products with encryption, the operation of state owned firms based on commercial considerations, and reduction of export duties on non-ferrous and steel scrap.

The Administration was sharply critical of Russia's behavior during the January 2006 natural gas standoff between Russia and Ukraine. State Department spokesman Sean McCormack criticized Russia for using "energy for political purposes." He stressed that while the Administration supported a gradual increase in prices to market levels, it disagreed with a "precipitous" increase and cutoff. Secretary of State Condoleezza Rice likewise on January 5 stated that Russia had made "politically motivated efforts to constrain energy supply to Ukraine."<sup>9</sup> In May 2006, Vice President Dick Cheney characterized Russia's energy policy toward vulnerable countries as "blackmail" and intimidation."<sup>10</sup> A State Department spokesman reiterated U.S. opposition to the use of energy supplies as a political weapon after the March 3-5, 2008 gas supply incident.

The United States has favored helping Ukraine and other countries reduce their dependence on Russian energy supplies. The United States has advocated extending an existing oil pipeline that currently runs from the oil terminal at Odesa in Ukraine

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<sup>9</sup> The State Department. Statement, January 1, 2006; Daily Press Briefing, January 3, 2006; Secretary Condoleezza Rice, Remarks at the State Department Correspondents Association's Breakfast, January 5, 2006.

<sup>10</sup> "Vice President's Remarks at the Vilnius Conference," May 4, 2006, from the White House website [<http://www.whitehouse.gov>].

to Brody, on the Polish border. This pipeline could then be extended to Gdansk in northern Poland. However, the project remains stalled due to a lack of financing.

U.S. officials called on Ukrainian leaders to resolve peacefully the political crisis caused by President Yushchenko's April 2, 2007, decree dissolving parliament and calling new elections. The State Department issued a statement welcoming the May 2007 agreement to hold early parliamentary elections on September 30, 2007 as demonstrating the "resiliency of Ukrainian democracy," but stressed that the country still needed to clearly define the roles of the executive, legislative, and judicial branches of government. U.S. officials said they agreed with OSCE assessments that the September 2007 parliamentary elections were conducted mostly in line with international standards.

President Bush visited Kiev on April 1, 2008. He offered "strong support" for Ukraine's request to receive a Membership Action Plan from NATO at the Bucharest summit. He praised Ukraine for its contributions in Iraq, Afghanistan, and Kosovo, noting that Ukraine is the only non-NATO country supporting every NATO mission. He praised Ukraine's commitment to democratic values and open markets, and offered continued U.S. support to fight corruption, support civil society groups and strengthen Ukraine's institutions. The two sides also signed a "roadmap" for strengthening bilateral ties in many areas, including trade and investment, energy security, defense cooperation, technology and space cooperation, among other issues.<sup>11</sup>

Although the United States was unsuccessful in persuading NATO to give Ukraine a MAP at the Bucharest summit, Administration officials said that they hoped Ukraine would receive a MAP as early as the NATO foreign ministers meeting in December 2008. They hailed NATO's commitment in the summit communique to grant Ukraine membership in the future.

## **Congressional Response**

During the Ukrainian presidential election campaign and during the ensuing electoral crisis, the 108<sup>th</sup> Congress approved legislation calling for free and fair elections in Ukraine and urged the Administration to warn Ukraine of possible negative consequences for Ukraine's leaders and for U.S.-Ukraine ties in the case of electoral fraud. The 109<sup>th</sup> Congress passed resolutions after President Yushchenko was inaugurated. On January 25, 2005, the House passed H.Con.Res. 16 and the Senate passed S.Con.Res. 7 on the 26<sup>th</sup>. The identical resolutions included clauses congratulating Ukraine for its commitment to democracy and its resolution of its political crisis in a peaceful manner; congratulating Yushchenko on his victory; applauding the candidates, the EU and other European organizations and the U.S. Government for helping to find that peaceful solution; and pledging U.S. help for Ukraine's efforts to develop democracy, a free market economy, and integrate into the international community of democracies.

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<sup>11</sup> Transcript of Bush-Yushchenko press conference, April 1, 2008, from the White House website at [<http://www.whitehouse.gov/news/releases/2008/04/20080401-1.html>].



Congress has also dealt with the issue of U.S. aid to Ukraine. The FY2005 Iraq-Afghanistan supplemental appropriations bill (P.L. 109-13) provided \$60 million in aid to help the new government in the run-up to the March 2006 parliamentary election. Including funds appropriated in FY2005 foreign operations appropriations legislation, Ukraine received \$156 million in U.S. assistance in FY2005.

The FY2006 foreign operations appropriations legislation (P.L. 109-102) provided \$84 million in Freedom Support Act (FSA) funds to promote reforms in Ukraine. Five million of that amount was earmarked for nuclear safety initiatives and \$1 million for mine safety programs in Ukraine. Total FY2006 U.S. aid to Ukraine was \$100.1 million. In addition to Freedom Support Act funds (\$82.16 million were actually allocated in FY2006, according to the Administration), Ukraine received \$2.18 million in Child Safety and Health (CSH) funds; \$10.89 million in Foreign Military Financing (FMF); \$1.75 million in IMET military training funds; and \$3.1 million in NADR funding to fight terrorism and proliferation.

Congress did not pass an FY2007 foreign operations bill, instead approving a continuing resolution (P.L. 110-5). In FY2007, U.S. aid to Ukraine was \$96.5 million. Of this total, \$80 million was in FSA funding, \$9.5 million in FMF, \$2.17 million in Child Survival and Health funding, \$1.86 million in IMET, \$1.36 million in NADR, and \$1.63 million in Global HIV/AIDS Initiative funding. The Administration estimates FY2008 funding for Ukraine at \$82.9 million. Of this amount, \$72.4 million is in FSA, \$4.7 million in FMF, \$2.1 million in NADR, \$1.81 million in IMET, and \$1.9 million in CSH. For FY2009, the Administration requested a total of \$86.48 million in aid for Ukraine. Of this amount, \$67.58 million is slated for FSA, \$8 million for FMF, \$5.4 million for CSH, \$1.8 million for NADR, and \$1.75 million for IMET.

U.S. aid to Ukraine is focused on anti-corruption and rule of law efforts, stopping trafficking in persons, media and civil society development, energy sector reform, and fighting HIV/AIDS. Aid will help Ukraine prepare for presidential elections in 2010 and improve local governance, particularly in eastern and southern Ukraine. The United States also seeks to increase exchange programs between the two countries. Other programs include efforts to help Ukraine implement WTO accession, encourage the growth of small business, strengthen export and border controls, assist defense reform and interoperability with U.S. and NATO forces. In 2005, the Millennium Challenge Corporation (MCC) selected Ukraine for Millennium Challenge Account (MCA) Threshold status. MCC funding in Ukraine is focused on fighting the country's severe corruption problem. In November 2006, Ukraine was made "compact-eligible" by the MCC board. The MCC will spend about \$45 million on anti-corruption efforts over the next two years.<sup>12</sup>

Congress dealt with a long-standing stumbling block in U.S.-Ukrainian relations by passing legislation to terminate the application of the Jackson-Vanik amendment to Ukraine, granting the country permanent Normal Trade Relations Status. On March 8, 2006, the House passed H.R. 1053 by a vote of 417-2. It was approved by

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<sup>12</sup> FY2009 Congressional Budget Justification for Foreign Operations, from the State Department website, [<http://www.state.gov>].

the Senate by unanimous consent on March 9, and was signed by the President on March 23.<sup>13</sup>

On April 17, 2007, Representative Hastings introduced H.Con.Res. 116, which called on all sides in Ukraine's political crisis to solve the issue peacefully and in accordance with the rule of law. The resolution reaffirms U.S. support for Ukraine's transition to democracy and a free market economy, as well as for the country's independence, sovereignty, and territorial integrity. A Senate version of the resolution (S.Con.Res. 30) was introduced by Senator Dodd on May 2. On July 23, Mr. Hastings introduced H.Con.Res. 189, which called on Ukrainian leaders to abide by the May 27 agreement to hold new parliamentary elections, and to hold those elections in accordance with OSCE standards.

On September 21, 2007, the Senate passed S.Res. 320. The resolution expresses hope that Ukraine will hold its September 30 parliamentary vote in a way that is consistent with OSCE standards, urges Ukrainian leaders to work together to solve Ukraine's problems, and pledges continued U.S. friendship for and assistance to Ukraine. On October 4, Mr. Hastings introduced H.Res. 173, which congratulated Ukraine on conducting the September 30 elections in accordance with OSCE standards and pledging continued U.S. support for Ukraine's efforts to achieve a democratic political system, a free market economy, and full integration with the West.

Congress has expressed support for Ukraine's possible membership in NATO. The NATO Freedom Consolidation Act was passed by the Senate on March 15, 2007, and the House on March 26. The bill (S. 494) expresses support for further enlargement of NATO and authorizes U.S. aid to Ukraine to assist it in preparing for possible NATO membership. President Bush signed the bill into law on April 9 (P.L. 110-17). On February 14, 2008, the Senate passed S.Res. 439, which expresses the "strong support" of the Senate for a MAP for Ukraine and Georgia. On February 25, 2008, Representative Wexler introduced H.Res. 997, the House version of S.Res. 439. It was passed by the House on April 1, 2008. After the NATO summit, the Senate passed S.Res. 523 on April 28. The resolution expresses the "strong support" of the Senate for the statement of the Allies at the Bucharest summit that Ukraine and Georgia will become members of NATO. It also urges NATO to grant a MAP to Ukraine and Moldova at the NATO foreign ministers' meeting in December 2008.

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<sup>13</sup> CRS Report RS22114, *Permanent Normal Trade Relations (PNTR) Status for Ukraine and U.S.-Ukrainian Economic Ties*, by William H. Cooper.