



# Ukraine: Current Issues and U.S. Policy

**Steven Woehrel**

Specialist in European Affairs

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## Summary

On February 7, 2010, Viktor Yanukovich defeated Prime Minister Yuliya Tymoshenko to win Ukraine's presidency. International monitors praised the conduct of the election, although Tymoshenko charged that the election had been fraudulent. Yanukovich was able to quickly to form a new parliamentary majority in the current parliament by inducing dozens of supporters of the previous government to change sides. Government opponents charged that bribery and threats to the business interests of members were used to effect the change.

The global economic crisis hit Ukraine hard. Ukraine's real Gross Domestic Product (GDP) fell by an estimated 15% in 2009. The economy began to recover in 2010, with GDP increasing by 4.2%, due in part to a surge in demand for Ukrainian steel exports. However, living standards for many Ukrainians remain low, leading to a rapid drop in Yanukovich's popularity when compared to the period soon after his inauguration.

President Yanukovich has pursued closer ties with Russia, especially in the economic sphere. A major focus of his policy has been to seek reduced prices for natural gas supplies from Moscow. In April 2010, he agreed to extend the lease of the Russian Black Sea Fleet in Ukraine for 25 years in exchange for a reduction in gas prices. However, the impact of the deal on gas prices has been less than anticipated, as oil prices (on which Ukraine's gas price is calculated) have soared due to unrest in the Middle East. As a result, Yanukovich has sought additional gas price cuts from Moscow, so far without success.

Yanukovich has said that EU integration is a key priority for Ukraine, but his administration appears to be wavering between a free trade agreement with the EU currently under negotiation and an incompatible customs union with Russia, Belarus, and Kazakhstan. Russian officials have said Ukraine's natural gas costs would decrease if it joined the customs union.

At the NATO summit in Bucharest in April 2008, the Bush Administration strongly supported granting Ukraine a Membership Action Plan, a key stepping-stone to NATO membership. However, opposition by Germany, France, and several other countries blocked the effort. The issue became moot after Viktor Yanukovich became president in February 2010 and announced that Ukraine would no longer seek NATO membership. However, Ukraine has maintained its cooperation with NATO, including the holding of joint military exercises.

The Obama Administration has worked to "reset" relations with Russia, but has warned that it will not accept any country's assertion of a sphere of influence, a reminder of U.S. support for Ukraine's sovereignty. The Administration has not publicly expressed concern about what some observers view as the increasing pro-Russian tilt of Ukraine's foreign policy under Yanukovich.

The Administration has focused on helping Ukraine rid itself of its supplies of highly enriched uranium, assisting Ukraine with the clean-up of the Chornobyl nuclear site, and diversifying Ukraine's sources of energy, including advice on developing Ukraine's shale gas reserves. Administration officials have expressed concerns about regression in Ukraine's democratic development since Yanukovich took power, including in such areas as media freedoms, election laws and the conduct of elections, and selective prosecution of the government's political opponents.

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## 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 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 belongs in Russia's political and economic orbit. The U.S. and European view (particularly 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's 2004 presidential elections were characterized by electoral fraud and massive street protests. 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. After the November 21 runoff vote, 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 Kyiv and appealed to the Ukrainian Supreme Court to invalidate the vote. The court invalidated the runoff election and set a repeat runoff vote. Yushchenko won the December 26 re-vote, with 51.99% of the vote to Yanukovich's 44.19%.

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 disillusionment among Orange Revolution supporters, both in Ukraine and abroad. President Yushchenko soon fell into squabbling with Yuliya Tymoshenko, his main backer during the Orange Revolution and his first Prime Minister, over policy and over mutual allegations of corruption, slowing progress on reforms.

In 2006, Yushchenko reluctantly reappointed his former 2004 presidential election opponent Viktor Yanukovich as Prime Minister, after Yanukovich's Party of Regions won the most seats in parliamentary elections that year. Yanukovich's government then worked steadily to whittle away at Yushchenko's powers and political influence. In response, President Yushchenko dissolved the Ukrainian parliament. Yanukovich charged that the move was unconstitutional. The contending sides eventually worked out a compromise and on September 30, 2007, Ukraine held early parliamentary elections. The Party of Regions remained the largest party in the legislature. However, the Yuliya Tymoshenko Bloc and Yushchenko's Our Ukraine-People's Defense group won enough seats to form a new government. After lengthy negotiations, President Yushchenko nominated Tymoshenko as his candidate for Prime Minister. The parliament approved Tymoshenko as Prime Minister on December 18, 2007, with 226 votes, the barest of majorities in the 450-seat assembly.

Over the next two years, Ukraine's government lurched from one political crisis to another. Perhaps the key problem was the familiar one of tensions between Tymoshenko and President Yushchenko. In addition to policy differences and intense personal enmity and distrust between the two leaders, the conflict was also due to jockeying for power in advance of upcoming presidential elections, in which both were to be candidates. As Ukrainian leaders engaged in this three-sided political battle, an overwhelming majority of Ukrainians grew disgusted with the Ukrainian political class, according to opinion polls. Observers say that this is in part due to the fact that Ukrainian leaders continued to squabble despite the global economic crisis, which inflicted severe blows on Ukraine's economy.

Ukraine held new presidential elections on January 17, 2010. As expected, Viktor Yanukovich came in first, winning 35.32% of the vote. Yuliya Tymoshenko, doing somewhat better than some pre-election polls indicated, won 25.05%. Serhei Tihipko, a former Prime Minister whose support was strongest in pro-Russian eastern Ukraine, won 13.05%. Former parliament speaker Arseniy Yatsenyuk won 6.96%. Incumbent President Yushchenko did poorly, winning a mere 5.45%. Other candidates split the rest of the vote. Voter turnout was 67%. The results set up a second round runoff vote between Yanukovich and Tymoshenko on February 7. Yanukovich won 48.98% of the vote, beating Tymoshenko, who won 45.47%. As in previous Ukrainian elections, the results showed a sharp regional split, with Yanukovich winning in Russian-speaking eastern and southern Ukraine, while Tymoshenko prevailed in central and western Ukraine, where Ukrainian nationalism is stronger. However, Yanukovich's overwhelming margins in the east (particularly in his home base, the Donetsk and Luhansk regions) more than offset Tymoshenko's modest victories in some western areas.

International monitors praised the conduct of the election. Joao Soares of Portugal, head of the observer team from the Organization for Security and Cooperation in Europe, said the February 7 vote was an "impressive display of democratic elections." In a possible hint to Tymoshenko, he added that it was "now time for the country's political leaders to listen to the people's verdict and make sure that the transition of power is peaceful and constructive."<sup>1</sup> Exit polls by independent groups did not show a significant departure from the announced results. Tymoshenko charged that Yanukovich's supporters had engaged in massive fraud, but that she would not call her supporters out into the streets to challenge the result. Analysts suggested that this was because a disillusioned public would not turn out for mass demonstrations as they had in 2004.

On March 11, 2011, the Ukrainian parliament approved Yanukovich's choice for the post of Prime Minister, Mykola Azarov. Azarov has been a loyal associate of Yanukovich for many years. He served as First Deputy Prime Minister and Finance Minister during Yanukovich's two terms as Prime Minister. The government is supported by the Party of Regions, the Communist Party, and the Lytvyn Bloc. However, in order to secure a majority, additional support from deputies of the former ruling coalition was required. As has happened after previous presidential elections, the new leader was able to gain that support. Opposition leaders charged that those who switched did so because they were bribed or threatened with government retaliation against their businesses if they did not comply. The opposition also said that such defections from a party faction was unconstitutional. However, the Ukrainian Constitutional Court later ruled that the method of the government's formation was legal.

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<sup>1</sup> The reports of the International Election Observation Mission can be found at <http://www.osce.org/odihr/>.

## Current Political Situation

The current government has been less politically turbulent than the previous one, due to the highly disciplined nature of the Party of Regions and President Yanukovich's undisputed control of Ukraine's executive branch. President Yanukovich's formal powers were further boosted in October 2010, when the Constitutional Court invalidated constitutional amendments adopted during the Orange Revolution that had ceded some of the president's power over the government to the parliament.

President Yanukovich and his supporters have portrayed themselves as a team of professionals engaged in the practical work of governing, as opposed to the unproductive squabbling of the Yushchenko period. The opposition, led by Tymoshenko, charges that the government has not achieved significant results while in office, except for engaging in massive corruption and favoring the business interests of its oligarchic backers. After a brief "honeymoon" period after the presidential election, the Yanukovich administration has dropped sharply in public opinion polls (as its predecessors have done), due in part to the lingering effects of the international economic crisis on Ukrainian living standards.

The new leadership has been criticized over its human rights record. Ukrainian journalists and international groups such as Reporters without Borders have charged that the government pressures the media to engage in self-censorship. Private media owners have reportedly been threatened with harm to their businesses if their outlets did not moderate their criticism of the government. In what appears to be a serious conflict of interest, Valery Khoroshkovsky, the head of the SBU, Ukraine's security service, also controls Inter, Ukraine's largest media empire. Critics charge he has used his position to harass journalists and influence the government and courts to attack his rivals.

President Yanukovich has vowed to fight corruption. However, U.S. and EU officials have expressed concern that opposition leaders have been targeted for selective prosecution on corruption and other crimes. For example, Tymoshenko has been charged with illegally diverting

### Main Groups in Ukraine's Parliament

**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. It has 187 members in the 450-seat parliament.

**Yuliya Tymoshenko Bloc-Fatherland:** Mainly a vehicle for the ambitions of the charismatic, sometimes combative Tymoshenko, it has little ideological cohesion. It became the second-largest group in the Ukrainian parliament largely because many Ukrainians saw Tymoshenko as the most stalwart defender of the populist, anti-corruption ideals of the Orange Revolution. However, since Tymoshenko's defeat in the 2010 presidential elections, dozens of members of the bloc have defected to parliamentary factions that support Yanukovich. It currently has 105 members in the parliament.

**Our Ukraine-People's Self Defense bloc:** This bloc is composed of a number of parties favoring free market economic reforms and a pro-Western foreign policy. It draws its support from western Ukraine, where Ukrainian nationalism is strong. It was former President Yushchenko's main base of support. It lost cohesion as Yushchenko's popularity waned. After Yushchenko lost the presidential election, some of its members left the bloc to join factions supporting Yanukovich. It currently has 68 members in the parliament.

**Communist Party:** The Communist Party has been overtaken by the Party of Regions in its eastern Ukraine strongholds and has a largely elderly electorate. It opposes market economics and favors strong ties to Russia. It has 25 members in the parliament.

**Lytvyn Bloc (People's Party):** A centrist bloc headed by Volodymyr Lytvyn, the current parliament chairman. Lytvyn has changed sides several times in Ukraine's political struggles, backing the side with the upper hand at the moment. It renamed itself the People's Party in 2010. It has 20 members.

**Reforms for the Future:** Formed in February 2011, this group supports the government. It was formed from defectors from opposition factions. It has 20 members.

public funds and abuse of power in signing a natural gas supply agreement with Russia. On the other hand, high-ranking members of the current government have not faced charges as yet.

Another concern is about the government's commitment to holding free and fair elections. The State Department criticized Ukraine's October 2010 local elections as being less free and fair than the presidential election earlier in the year. It noted that local non-partisan election observers had criticized numerous procedural violations on election day, as well as flaws in the electoral law. The European Union and the United States have urged the Ukrainian government to ensure that new electoral legislation to be adopted before October 2012 parliamentary elections will be in line with international standards and be the product of an inclusive process.

## **Current Economic Situation**

Until the global economic crisis, Ukraine was experiencing substantial economic growth, with GDP increasing by an average of 7.5% between 2000 and 2007. The growth was fueled mainly by consumption, including an import boom fed by heavy domestic and foreign borrowing. This was reflected in a widening trade deficit and current account deficit. Ukraine's growth was also due to strong demand for products of the country's large steel and chemicals industries.<sup>2</sup> Despite this growth, Ukraine remains much poorer than other European countries. Its GDP per capita in purchasing power parity terms is only 22% of that of the EU and only 40% of Russia's. Likewise, in 2010 its foreign direct investment (FDI) per capita was \$979, less than half of that in Russia and about a quarter of Poland's FDI per capita. Foreign companies often cite such issues as pervasive corruption and shortcomings in the rule of law (particularly a weak judiciary) as key stumbling blocks to investment.

Due to the unsustainable basis of its growth and the lack of confidence caused by its squabbling political leadership, Ukraine was hit very hard by the global economic crisis. Ukraine's real Gross Domestic Product fell by 15.1% in 2009. The economy has rebounded, however. Real GDP rose by an estimated 4.2% in 2010, according to the Economist Intelligence Unit, and is expected to achieve similar growth this year. Ukraine's recovery has been assisted by a sharp increase in demand for steel, which has spurred exports.

The decrease in domestic demand during the crisis reduced Ukraine's serious problem with inflation, which reached as high as 31% in May 2008, on an annualized basis. Nevertheless, annual average inflation remained quite high at 9.5% in the last quarter of 2010, on a year-on-year basis. Ukraine's currency, the hryvnia, dropped from 5.05 to the US dollar at the end of 2007 to 7.96 at the end of 2010. This development was devastating for Ukrainian banks as well as for many Ukrainian savers, as many deposits and loans were denominated in foreign currencies before the financial crisis.

There have been concerns about the transparency of the privatization process under the Yanukovich administration. In January 2011, Ukrtelecom, the state-owned telecommunications firm, was sold to Epic, an Austrian financial firm reputed to have close ties with Ukrainian officials and businessmen. It was the only bidder. Critics charged that the criteria for eligibility for the sale were rigged to exclude other bidders.

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<sup>2</sup> Economist Intelligence Unit Country Report: Ukraine, June 2008; "Ukraine: Slowing Growth Suggests Stagflation Risk," Oxford Analytica, August 14, 2008.

In July 2010, the International Monetary Fund approved a \$15.15 billion standby loan for Ukraine to support its reform efforts. The objectives of the loan include cutting the general government deficit to 3.5 percent of GDP in 2011 and 2.5 percent in 2012; improving the financial health of Naftohaz, the state-run natural gas firm, by increasing prices for natural gas to consumers; and finishing the effort to recapitalize the Ukrainian banking system, which was gravely weakened by the financial crisis; and increasing the independence of the National Bank of Ukraine with a focus on domestic price stability under a flexible exchange rate regime. Two tranches of the loan have been disbursed so far. President Yanukovich is negotiating with the IMF to secure additional tranches. Progress has been slow, as IMF demands for an increase in energy prices for domestic consumers and a reform of the pension system are highly unpopular with the Ukrainian public.<sup>3</sup>

## Ukraine's Foreign Policy

Since achieving independence in 1991, 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. Before the election of Yushchenko as President in 2005, 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.

In contrast, President Yushchenko put integration into the global economy and Euro-Atlantic institutions at the center of Ukraine's foreign policy. Ukraine achieved one key foreign policy goal in May 2008, when it joined the World Trade Organization (WTO). In the longer term, Yushchenko wanted Ukraine to move toward eventual membership in the European Union and NATO. He had limited success in this area, however. Relations with Russia were troubled throughout Yushchenko's presidency.

So far, President Yanukovich's foreign policy appears to resemble that of the Kuchma period, but with a stronger pro-Russia tilt. He continues to express support for EU integration for Ukraine, but the extent to which he is committed to undertaking the steps needed to reach this goal is unclear. He has taken steps to improve ties with Russia, but has so far tried to tactfully evade Russia's most ambitious demands for economic and military integration. He has departed from previous Ukrainian presidents by clearly rejecting NATO membership for Ukraine.

## NATO

Ukraine currently has an "Intensified Dialogue" with NATO. President Yushchenko 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. NATO declined to offer Ukraine a MAP at the April 2008 NATO summit in Bucharest, 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

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<sup>3</sup> Economist Intelligence Unit Country Report: Ukraine, April 2011.



MAP and also expressed concerns that granting a MAP to Ukraine would hurt relations with Russia. 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 conflict between Russia and Georgia in August 2008 may have had an important impact on Ukraine’s hopes of receiving a MAP. European NATO countries that have opposed a MAP for Ukraine may be even more reluctant to agreed to one, fearing a sharp deterioration in relations with Moscow and perhaps even being embroiled in a military conflict with Russia in the future.

On December 2, 2008, NATO foreign ministers agreed to work with Ukraine on “annual national programs” within the framework of the existing NATO-Ukraine Commission, which assists Ukraine’s defense reform efforts. The Bush Administration, the main supporter of a MAP for Ukraine, may have seen this approach as a way for Ukraine to make progress toward NATO membership without calling it a MAP. However, France and Germany, unwilling to provoke Moscow, warned strongly against viewing the compromise as a shortcut to NATO accession, saying that a MAP would still be required. In addition to concerns among some European countries about Russia’s response, critics point out that opinion polls have repeatedly shown that a large majority of Ukrainians oppose NATO membership.

President Yanukovich has dropped former President Yushchenko’s MAP aspirations, a move that has pleased Russia. He has said that Ukraine will continue cooperating with NATO in defense reform and other areas, but without seeking membership in the alliance.

Ukraine has not contributed substantial numbers of 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. According to the website of the NATO-led ISAF peacekeeping force, Ukraine currently has 20 soldiers in Afghanistan. As of November 2010, Ukraine has deployed 127 troops as part of KFOR, the NATO-led peacekeeping force in Kosovo.

## **European Union**

Ukraine seeks to be recognized as a potential EU member candidate. Most EU countries 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, Poland and the Baltic states have advocated Ukraine’s eventual membership in the EU, in part because they see a stable, secure Ukraine as a bulwark against Russia. Nevertheless, even the most optimistic supporters of Ukraine’s EU membership acknowledge that it could be many years before Kyiv is ready to join, but believe that formal EU recognition of Ukraine’s eligibility 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 a New Enhanced Agreement to replace the PCA. Talks on an EU-Ukraine free trade area began in February 2008. Ukraine is seeking visa-free travel between the EU and Ukraine, although the EU is offering only visa liberalization as a goal. The EU budgeted €494 million (\$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. The amount budgeted by the EU for aid for reforms in Ukraine for 2011-2013 is €470 million (\$682 million).<sup>4</sup>

In September 2008, the EU agreed to call the new Ukraine-EU accord currently under negotiation an “Association Agreement.” However, unlike the association agreements signed by other European countries in the past, the new accord will not contain an explicit recognition of Ukraine’s EU membership aspirations. In May 2009, the EU launched the Eastern Partnership program within the context of their European Neighborhood policy, which also includes non-European countries. Although the EU insists that the regional approach taken by the Partnership (which includes Belarus, Moldova, Georgia, Armenia, and Azerbaijan) will improve EU cooperation with these countries, it is not clear that the initiative offers Ukraine significantly more than previous efforts.

EU countries were angered by the January 2009 natural gas standoff between Russia and Ukraine, which led to a cut-off of natural gas supplies to EU countries for two weeks. However, the EU did not assign sole blame for the crisis to Ukraine, despite Moscow’s diplomatic and public relations efforts aimed at doing so. After the stand-off, the EU took steps to try to work with Ukraine to prevent another gas cutoff. In March 2009, the EU agreed to provide EU assistance to help modernize Ukraine’s gas pipeline system in exchange for greater transparency by Ukraine in how the system is run. However, the project has been stymied by Ukraine’s inability or unwillingness to meet the EU’s terms for the loan. Perhaps most importantly, Russia, the pipeline’s chief gas supplier, objected strongly to the plan.

President Yanukovich has said that he favors the completion of the Association Agreement, visa-free travel to the EU for Ukrainians, and eventual EU membership for Ukraine. However, while integration into Euro-Atlantic institutions was the ideological centerpiece of Yushchenko’s foreign policy, Yanukovich has taken a more pragmatic approach. Progress on a free trade agreement and other issues will likely depend in part on whether Yanukovich’s oligarchic supporters find such agreements favorable to their business interests. Ukraine is also facing pressure from Russia to join a customs union with Belarus and Kazakhstan, a move that the EU warns is incompatible with an EU-Ukraine free trade agreement.

## **Russia**

Ukraine’s closest, yet 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 to 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. Relations during the Yushchenko presidency were

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<sup>4</sup> “Commissioner Stefan Fuele Signed Today A Memorandum of Understanding on the National Indicative Program for Ukraine,” EU press release, March 2, 2011 at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/250&format=HTML&aged=0&language=EN&guiLanguage=en>

rocky. Russia was irked by Yushchenko's efforts to support greater democratization in the region, impose tighter border controls on Transnistria, a pro-Moscow, separatist enclave within neighboring Moldova, and forge closer links with Georgia.

Ethnic Russians make up 17.3% of Ukraine's population, according to the 2001 Ukrainian census. They are concentrated in the southern and eastern parts of the country. They form a majority in the Crimea (a peninsula in the Black Sea in southern Ukraine), where they make up 58.3% of the population. In the Crimean city of Sevastopol, the home base of the Russian Black Sea Fleet, 71.6% of the population are Russians. In addition, ethnic Ukrainians in the east and south also 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. Perhaps learning a lesson, Russia did not intervene so openly in the 2010 Ukrainian presidential vote. While Yanukovich was favored by Moscow, Prime Minister Putin made it clear that Russia could work with Tymoshenko as well. President Medvedev and other Russian leaders expressed open scorn for Yushchenko, who observers believed was destined to lose anyway.

One of President Yanukovich's top foreign policy priorities has been to improve relations with Russia. In April 2010, Russia and Ukraine agreed to extend the stay of the Russian Black Sea Fleet in Crimea until 2042, from the original withdrawal date of 2017. In exchange, Russia will provide Ukraine with discounted prices for natural gas supplies for 10 years, a benefit that the two sides estimated as worth \$40 billion. Russian companies, with Russian government support, have also stepped up efforts to buy key industrial assets in Ukraine since Yanukovich has come to power. While they have achieved some successes, they have also faced opposition from Ukrainian oligarchs who desire to maintain control of major companies.

However, some of Russia's boldest proposals for improving ties with Ukraine appear to have gone further than Kyiv can support. Yanukovich continues to stress Ukraine's neutral, "non-bloc" status. He has said Ukraine will not join Moscow's counterpart to NATO, the Collective Security Treaty Organization. Russia is pressing Ukraine to join its customs union with Belarus and Kazakhstan. Ukraine has not rejected these overtures outright, fearing the impact on economic ties with Russia, which is Ukraine's leading trade partner. Instead, Ukrainian leaders appear to be trying to maneuver for the best deal, saying that they still favor an agreement with the EU while ensuring maximum cooperation with the customs union. Joining the customs union would also require renegotiating the agreements Ukraine signed with other countries before it joined the World Trade Organization.

## **Energy Issues**

The most severe crises in Russian-Ukrainian relations have occurred over energy. Ukraine is heavily dependent on Russia for its energy supplies. About 80% of its oil and natural gas consumption comes from Russia. However, Ukraine's vulnerability to Russian pressure has been mitigated by the fact that the main oil and natural gas pipelines to Central and Western Europe transit its territory. Over two-thirds of Russia's gas exports pass through Ukraine. Until the Yushchenko presidency, Russian firms supplied energy to Ukraine at prices far below market rates. Energy sales have been conducted by non-transparent intermediary institutions, offering the elites of both countries opportunities to profit.

Russia's efforts to increase gas prices to market levels provoked a crisis in 2006 that resulted in cutoff of Russian gas to Western Europe. After Yushchenko came to power in 2005, the Russian

government-controlled natural gas monopoly Gazprom insisted on a more than fourfold increase in the price that it charged 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.

A second gas crisis occurred in January 2009. The state-controlled Russian natural gas firm Gazprom stopped gas supplies to Ukraine on January 1 after the two sides failed to reach agreement on several issues, including a debt allegedly owed by Ukraine to Gazprom and the price that Ukraine would pay for gas supplies for 2009. The cut-off was supposed to affect only supplies for Ukraine; Russia continued to send gas through Ukraine destined for other European customers. However, within a few days, Russia accused Ukraine of diverting these supplies for its own use, and by January 6 cut off all deliveries through Ukraine to the rest of Europe. The EU sharply criticized the cutoff, calling for a rapid resumption of supplies, but refused to take sides in what it termed a “commercial dispute.”

Many large European countries (and Ukraine itself) did not suffer greatly from the 2009 cutoff, despite frigid temperatures, due in part to substantial amounts of gas in underground storage facilities. However, some countries, particularly in the Balkans, were hit hard. Negotiations between Russia and Ukraine repeatedly broke down, with each side accusing the other of bad faith and trying to enlist European support for its views. An increasingly angry EU threatened to re-evaluate its relationship with both countries unless the impasse was resolved. Finally, on January 18, Russia and Ukraine reached an agreement, and gas supplies to Europe resumed on the 20<sup>th</sup>.

Since the collapse of the Soviet Union in 1991, Russia has sought control of Ukraine’s natural gas pipelines and storage facilities. However, its efforts have been unsuccessful so far, due to Ukrainian objections that Kyiv could not cede control of one of its key economic assets. As a result, Russia has worked to develop options to cut Ukraine out of gas supply to Western Europe, at least in part. Gazprom is developing gas pipelines under the Baltic Sea (called Nord Stream) and through the Balkans (called South Stream) to Western Europe. Both would bypass Ukraine. Nord Stream is expected to make its first deliveries of gas late this year, while South Stream would not be available until at least 2015. If successful, these efforts could sharply reduce Ukraine’s leverage over Russia on energy supplies. Moreover, Russia could then feel it would have a freer hand to put greater pressure on Ukraine on other issues. Key Western European countries could feel they have less of a stake in Ukraine’s future, if they, like Russia, were no longer dependent on Ukrainian gas transport infrastructure.

Yanukovich, who is supported by oligarchs who own energy-hungry steel and chemicals industries, has stressed the need to secure lower natural gas prices from Russia. He has criticized the gas agreement between Russia and Ukraine signed by Tymoshenko in 2009, saying that the gas was too expensive for Ukraine. The April 2010 Black Sea Fleet agreement was one step Yanukovich has taken to try to secure cheaper gas supplies. However, the impact of the deal on gas prices has been less than anticipated, as oil prices (on which Ukraine’s gas price is calculated) have soared due to unrest in the Middle East.

Russia continues to pressure Ukraine to make further concessions if it wants further gas price cuts. It has called for Ukraine to pay for gas in Russian rubles. Moscow has tried to persuade Ukraine to join a customs union with Russia, Belarus, and Kazakhstan by offering it cheaper gas if it does so, so far without success. Russia has also advocated the merger of Gazprom with

Ukraine's state-controlled gas firm Naftohaz, which would amount to a Russian takeover of the Ukrainian company, due to the former's much larger size. Yanukovich has rejected this project, but has offered Russia part-ownership of Ukraine's gas pipeline system in exchange for guaranteed gas volumes for Ukrainian gas pipelines and access to Russian gas and oil deposits.

## **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. During Yushchenko's presidency, U.S. officials were upbeat about Ukraine's successes in some areas, such as joining 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.

The United States took steps to upgrade its economic relations with Ukraine. In January 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.

The Bush Administration was sharply critical of Russia's behavior during the January 2006 natural gas standoff between Russia and Ukraine. Secretary of State Condoleezza Rice stated that Russia had made "politically motivated efforts to constrain energy supply to Ukraine."<sup>5</sup> On January 22, 2009, after the resolution of the second major Russia-Ukraine gas crisis, a State Department spokesman said the conflict "underscores the need for transparent, market-oriented arrangements for the sale and shipment of natural gas and the importance of diversifying energy supplies."<sup>6</sup>

President Bush visited Kyiv on April 1, 2008. He offered "strong support" for Ukraine's request to receive a Membership Action Plan from NATO at the Bucharest summit. Although the United States was unsuccessful in persuading NATO to give Ukraine a MAP at the summit, Administration officials hailed NATO's commitment in the summit communique to grant Ukraine membership in the future. They scored another success in getting NATO to agree to the development of annual national plans within the context of the NATO-Ukraine Commission, although differences continued to exist between the United States and those countries (particularly France and Germany) on whether such plans could advance Ukraine's NATO membership aspirations in the absence of a MAP.

In an effort to signal support for Kyiv after its failure to secure a MAP, the United States signed a "Charter on Strategic Partnership" with Ukraine on December 18, 2008. The charter discusses areas of current and future cooperation between the two countries. Through February 2011, the

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<sup>5</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>6</sup> "Statement on Agreement to Restore Gas Flows to Europe," January 22, 2009, <http://useu.usmission.gov>

Partnership Commission has met three times, and has established working groups dealing with a wide range of issues, including energy security, science and technology, and political dialogue and rule of law.

In 2009, some Ukrainian analysts expressed concern that the Obama Administration's "reset" in U.S.-Russian relations could lead to a downgrading of U.S.-Ukrainian ties, or even the making of concessions to Russia at Ukraine's expense. Perhaps in order to calm these fears, Vice President Biden visited Ukraine on July 20, 2009, in the wake of President Obama's visit to Moscow earlier that month. Biden expressed strong U.S. support for Ukraine's aspirations to join NATO and rejected the idea of a Russian sphere of influence in the region. He said that the "reset" in ties with Russia would not come at Ukraine's expense. He added that, on the contrary, it could help Ukraine by defusing "zero-sum" thinking in Moscow about U.S. relations with Russia's neighbors. Vice President Biden warned Ukraine's leaders that their country's economic freedom depended more on its energy freedom than any other factor. Biden said that Ukraine needs to move to market pricing for domestic energy supplies, improve energy efficiency, and diversify its energy supplies.

In December 2009, the United States Overseas Private Investment Corporation (OPIC) reopened its programs to Ukraine. OPIC provides financing and political risk insurance for U.S. investors in foreign countries. OPIC funding had been suspended after a commercial dispute between U.S. investors and their Ukrainian partners in 1999 led to OPIC payment of an insurance claim to the U.S. investor. The resolution of the issue in 2009 led to the resumption of OPIC funding to Ukraine.

On February 11, 2010, after Yanukovich's victory, President Obama called Yanukovich to congratulate him on his victory. Obama praised the Ukrainian people's conduct of the election and said the vote marked another step in the consolidation of Ukraine's democracy. He noted the "strategic partnership between the United States and Ukraine is based on shared interests and values. These include expanding democracy and prosperity, protecting security and territorial integrity, strengthening the rule of law, promoting non-proliferation, and supporting reform in Ukraine's economic and energy sectors."<sup>7</sup>

Yanukovich's rejection of NATO membership and his move toward closer ties with Russia (as shown for example in the 2010 agreement to extend the stay of the Russian Black Sea Fleet in Crimea) has not provoked public expressions of concern from the Obama Administration. The Administration has focused on enhancing cooperation in areas of particular U.S. concern.

One such area is nuclear non-proliferation. After a meeting on the eve of the Nuclear Security Summit in Washington in April 2010, President Obama and President Yanukovich agreed that Ukraine would rid itself of the entire stock of highly enriched uranium (HEU) from its soil by the time of the next Nuclear Security Summit in 2012. The United States agreed to help Ukraine to develop its nuclear research capabilities and diversify its sources of fuel supply for its nuclear reactors. The United States also pledged to continue to cooperate with Ukraine on nuclear safety issues, including the cleanup of the Chornobyl nuclear reactor site. In total, the United States has

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<sup>7</sup> Press release from the White House website at <http://www.whitehouse.gov/the-press-office/readout-presidents-call-with-president-elect-yanukovich-ukraine>.

contributed almost \$240 million to Chornobyl cleanup effort. At an international pledging conference for Chornobyl in April 2011, the United States pledged another \$123 million.<sup>8</sup>

The two countries are cooperating on other energy issues as well. In February 2011, the United States and Ukraine signed a memorandum of understanding on a U.S. Geological Survey effort to help Ukraine explore and develop its reserves of unconventional natural gas. Other U.S. aid programs are aimed at helping Ukraine improve its energy efficiency.

One area in which the Administration has expressed concern is in Ukraine's democratic development. After the October 2010 local elections, the U.S. Embassy in Kyiv released a statement noting statements by non-partisan election monitors that the local elections did not meet standards for openness and fairness set by the presidential vote earlier in the year. In March 2011, Vice President Biden telephoned President Yanukovich. In addition to discussing the HEU issue and the need to avoid laws or actions that would undermine foreign investment, Biden stressed the importance of avoiding selective prosecutions of political opponents and the need for a electoral law reform process that is fully inclusive.

## **Congressional Response**

### **U.S. Aid to Ukraine**

Congress has dealt with the issue of U.S. aid to Ukraine. According to the USAID "Greenbook" website, the United States has obligated \$3.1 billion in aid to Ukraine from FY 1990 to FY 2009. The FY 2012 Congressional Budget Justification says that Ukraine was allocated \$117.932 million in aid in FY 2010. Ukraine is likely to receive a similar amount in FY 2011. The Obama Administration has requested \$126.378 million for FY 2012. The FY 2012 request includes \$79.1 million for political and economic reforms in the Aid for Europe, Eurasia, and Central Asia account (AEECA); \$9 million in Foreign Military Financing; \$33.878 million in the Global Health and Child Survival account; \$1.9 million in International Military Education and Training funds; and \$2.5 million in the Nonproliferation, Antiterrorism, Demining, and Other account.

A significant portion of U.S. aid to Ukraine under the AEECA account for FY 2012 is dedicated to improving the safety of the Chornobyl nuclear facility, including finishing the construction of the containment structure over the damaged reactor and securing and storing spent nuclear fuel. Other AEECA programs are aimed at improving border controls, bolstering law enforcement, fighting cybercrime, and combating trafficking in persons. Global Health and Child Survival funding will help Ukraine fight its HIV/AIDS crisis, which is the most severe in the region. Security assistance for Ukraine is aimed at helping Ukraine's defense reform efforts, improving operability with U.S. and NATO forces, as well as taking steps to boost Ukraine's military capabilities. U.S. assistance has also helped Ukraine destroy its stock of SCUD short-range missiles and make progress toward the elimination of its stock for propellant for SS-24 ICBMs.

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<sup>8</sup> U.S. Participation in the Kyiv Summit and the Chornobyl Pledging Conference: Fact Sheet, April 19, 2011, from the State Department website at <http://www.state.gov/r/pa/prs/ps/2011/04/161228.htm>

## Other Legislation

During the 2004-2005 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, congratulating him on his victory and Ukraine on its commitment to democracy.

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

Congress 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 Membership Action Plan 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 Bucharest summit, the Senate passed S.Res. 523 on April 28, 2008. The resolution expressed 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. On May 19, the Senate passed S.Res. 570, which reiterated the Senate's strong support for Ukraine and Georgia's NATO aspirations.

Both the House and Senate passed resolutions calling on Ukraine to hold free and fair elections during the 2006 and 2007 parliamentary elections. On January 13, 2010, just before the first round of the Ukrainian presidential election, the House agreed to H.Res. 981 by voice vote. The resolution, sponsored by Representative Howard Berman, hailed the "strong relationship" between the United States and Ukraine and urged Ukraine to hold free and fair elections. After the election, on February 25, the Senate passed S.Res. 422, introduced by Senator Lugar and Senator Kerry. The resolution recognized the progress that Ukraine had made in establishing democratic institutions, as demonstrated by the presidential vote.

On January 26, 2011, Representative Kaptur introduced H.Res. 66, which supports the establishment of a staff exchange program between the House of Representatives and the Verkhovna Rada, Ukraine's parliament. On April 14, 2011, Senator Lugar and Senator Kerry introduced S.Res. 153, which recognizes the 25<sup>th</sup> anniversary of the Chornobyl nuclear accident.

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<sup>9</sup> CRS Report RS22114, *Permanent Normal Trade Relations (PNTR) Status for Ukraine and U.S.-Ukrainian Economic Ties*, by William H. Cooper.



## **Author Contact Information**

Steven Woehrel  
Specialist in European Affairs  
swoehrel@crs.loc.gov, 7-2291