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Table of Contents

| | |
|--|----|
| NEWS OF THE MONTH | 3 |
| TOPIC OF THE MONTH: RUSSIA'S AGENDA ON UKRAINE | 7 |
| A ROARING START | 7 |
| WELCOMING THE PRODIGAL SON | 8 |
| SECTOR-SPECIFIC INITIATIVES: BACK TO THE USSR | 11 |
| CHALLENGES TO RUSSIA'S AGENDA ON UKRAINE | 14 |
| LOOKING AHEAD | 15 |

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News of the Month

New Budget, More Problems, No IMF

State budget fast-tracked through parliament

On April 27, the Verkhovna Rada adopted a deeply flawed state budget for 2010. Its main value lies in the fact that it was adopted quickly. But this speed came at the expense of parliamentary procedure, and of the Constitution.

The adoption of the budget was an essential step toward renewing Ukraine's cooperation with the IMF and receiving further tranches of its emergency loan (or even securing an expanded USD 19 bn aid package). However, the Fund has already expressed doubts that its projected 5.3% deficit is realistic, and has yet to send a mission to Kyiv. This is widely seen as further evidence that the budget does not meet its conditions.

Budget has four good qualities...

The budget has four qualities. First, it exists. The previous government had proven unable to adopt a budget, thus leaving local communities unable to adopt theirs and bringing their activities to a halt. Second, it triples the amount of investment by the state, with major outlays planned for EURO-2012 infrastructure, energy efficiency projects, and road construction. Third, while it provides for a significant increase in social spending, the hike is lesser than the unreasonable promises made during the electoral campaign. And fourth, it is based on a realistic reading of macroeconomic indicators.

...but contains serious flaws

Unfortunately, however, the budget's faults outweigh its qualities. Expenditures are not capped: several articles leave room for the Cabinet of Ministers to adjust spending, which would of course affect the deficit. In addition, the budget's deficit forecast does not include (major) subsidies to Naftogaz or spending on bank recapitalization. Independent experts estimate the true 2010 deficit at between 12% and 16% of GDP, depending on the government's ability to collect revenues.

On the revenue side, the budget is overly optimistic. It forecasts a 36% increase over 2009, an unrealistic figure for a recovering Ukraine even if the government continues to avoid paying VAT refunds in cash, replacing them instead with treasury bonds. This estimate banks on increased taxes. The government has already increased excise taxes on cigarettes, alcohol and gasoline, and a number of technical innovations are expected to improve the state's ability to collect, but this is unlikely to boost revenues 36%.

Like its content, the budget's adoption procedure reflects the government's penchant for discretion. Normal parliamentary procedure was flouted, as the document was fast-tracked through parliament without hearings. What's more, the Law on the 2010 Budget allows the Cabinet of Ministers to change it without prior parliamentary approval, which is unconstitutional.

Finally, and most importantly, the budget is completely void of measures for reform. The state will continue to hemorrhage money to sustain the unsustainable pension system, energy tariffs, and local budgets.

Opposition Still Coming to its Senses

May saw Ukraine's fractured opposition attempt to unite under the banner of the "People's Committee for the Defense of Ukraine." The Committee comprises representatives of eight political parties (including BYuT, parts of NUNS, and non-parliamentary parties such as Svoboda), but important players have remained outside this new tent. Foremost among these are Viktor Yushchenko and Arseniy Yatseniuk, who have opted instead to go it alone.

Opposition leaders are still failing to win over the population

Big tent or no tent, opposition leaders are failing to win over the population. A recent poll organized by the Committee gave President Yanukovych an approval rating of 41%, with only 21% dissatisfied. The corresponding figures for his premier, Mykola Azarov, are not as strong — 36% against 24% — but still much better than those of Ms. Tymoshenko (18% against 54%), Arseniy Yatseniuk (19% against 40%), and Viktor Yushchenko (3% against 66%).¹

The opposition's problems have less to do with party alliances than with the vacuity of its discourse. Opposition leaders rarely make more sophisticated arguments than calling President Yanukovych and his team "liars" and "traitors." Unsurprisingly, these messages have failed to resonate with a population that elected Mr. Yanukovych less than six months ago, and they have generally stifled, rather than stimulated, debate.

May was a tumultuous month for Yulia Tymoshenko. On the 12th the Prosecutor General's office reopened a bribery case dating back to the Kuchma era (and closed during her first premiership). Her questioning, initially scheduled for May 17, was later postponed to an unspecified date. The move was clearly designed to intimidate the former premier, and drew ire from many European quarters. Wilfried Mertens, leader of the European People's Party, condemned it as a manipulation of Ukraine's justice system.

All for One

Ukraine's journalists unite against censorship

May also brought heightened fears of a return to media censorship. On May 6, journalists from the leading 1 + 1 television station issued an open letter warning that "the news items [they] prepare that contain criticism of the current government are being taken off the air for political reasons. The final decision whether something gets aired isn't made by the editor [...] but by the general director of 1 + 1." On May 7, journalists at STB published their own open letter supporting their 1 + 1 colleagues and accusing their own channel of "systematic censorship" of its flagship news program, Vikna.

¹ <http://www.nkzu.org/article.php?articleID=286>

The allegations prompted hearings at the Verkhovna Rada's Committee on Freedom of Speech and Information, which called on the Prosecutor General's office to investigate them. This elicited a strong reaction from 1 + 1 management, which in turn denounced the Committee's actions as government interference in its editorial policy.

In late May, various groups began to coalesce into a coherent movement. On the 22nd, several prominent journalists gathered for a public discussion on censorship. They concluded that the *temniki* (overt instructions to the media) of the Kuchma era had been replaced by a more systemic and insidious form of censorship, with news broadcasts designed to crowd out analysis and media owners anxious to avoid any form of conflict with the government.

Dmitry Medvedev Visits Kyiv

After years of tense relations and rare high-level contacts, top officials have been meeting on an almost bi-weekly basis since Viktor Yanukovich's election in February. At a recent joint presidential press conference in Kyiv, President Yanukovich even complained that negotiations on new agreements were moving too fast — to which his Russian counterpart replied that a fast pace was necessary to make up for the time lost during the Yushchenko presidency.²

Dmitry Medvedev's first official visit proved just how far Russia wants to go

The Kharkiv gas-for-fleet deal paved the way for Dmitry Medvedev's first official visit to Kyiv since taking office in 2008. The trip's key outcome was the signing of a border demarcation agreement, an important development that removed a major stumbling block on Ukraine's road to visa-free travel to the EU. However, the agreement does not apply to the sea border between the two countries, which remains under dispute.

As important as the border demarcation agreement was, the Medvedev visit was mainly notable for its ambition in a variety of sectors.

Aerospace: The heads of the two countries' space agencies signed an agreement on cooperation in the development of the Russian GLONASS satellite navigation system. Ukraine will gain access to the system, in addition to owning and managing the support infrastructure based on its territory.

Banking: The heads of state banks VTB (Russia) and Ukreximbank (Ukraine) signed a cooperation agreement. Commenting on the agreement, Andrei Kostin, VTB board chairman, expressed his firm's interest in cooperating with Ukrainian banks in the areas of treasury operations, investment services, and ruble payments, adding that "the use of the ruble in trade contracts reinforces its role as the main reference currency in CIS markets."³

² <http://unian.net/rus/news/news-377281.html>

³ http://www.vtb.ru/about/releases/56200/?phrase_id=958862

Education: The two countries' ministries of science and education signed an agreement on "immediate measures to promote scientific and educational co-operation for 2010-2012."⁴ In one of the agreement's few specific prescriptions, the two sides agreed to maintain their support to the Ukrainian-Russian Joint Commission of Historians. Other commitments include the promotion of student and scholar exchanges, and the development of "additional measures" to support the teaching of each other's language and literature at home.

Culture: The two countries' ministries of culture signed a "Program on Cooperation for 2012-2014." Among other things, the parties committed to enhancing cultural exchanges and to meeting the "cultural needs" of each other's Russian/Ukrainian minority.⁵

In addition to formal agreements, Medvedev's visit led to a number of important joint presidential statements.

On European security: The Presidents agreed to jointly advance key initiatives, such as Yanukovich's proposal "on the creation of a European system of collective action against threats and challenges to global security in the twenty-first century," and Medvedev's draft European Security Treaty. President Medvedev also expressed his support for Ukraine's bid to chair the OSCE in 2013.⁶

On Transnistria: The Presidents reaffirmed their commitment to a peaceful settlement of the Transnistrian dispute based on respect for the territorial integrity of Moldova, constitutional neutrality and the creation of a single legal, economic, and military space. They also expressed the hope that the 5+2 negotiating format⁷ would yield results.⁸

On security in the Black Sea region: The Presidents committed to fostering security in the Black Sea region, namely by working together in the Organization of the Black Sea Economic Co-operation and deepening cooperation between Russia's Black Sea Fleet and the Ukrainian navy.⁹

⁴ http://www.mon.gov.ua/newstmp/2010/20_05/ugoda.doc

⁵ <http://mincult.kmu.gov.ua/mincult/doccatalog/document?id=207030>

⁶ <http://www.mfa.gov.ua/mfa/ua/news/detail/39596.htm>

⁷ Формат переговорів «5 + 2» складається з представників Молдови, Придністров'я, України, Росії та ОБСЄ за участі спостерігачів з ЄС і США.

⁸ <http://www.mfa.gov.ua/mfa/ua/news/detail/39563.htm>

⁹ <http://www.mfa.gov.ua/mfa/ua/news/detail/39593.htm>

Topic of the Month

Russia's Agenda on Ukraine

This issue of Inside Ukraine examines Russian plans for Ukraine. Be sure to read the next issue, where we assess Kyiv's ability to deal with them.

A Roaring Start

Russia sees an opportunity to pull Ukraine back into its orbit, and it is intent on seizing it

For Russia, 2010 has started very well. Never in recent years have conditions been better for Moscow to push its agenda in Kyiv: the ruling party has a strong pro-Russian constituency and the public largely favors better relations with Russia, as does Europe — which in any case is too busy trying to save the Euro to deal with Ukraine. With the Obama administration still pursuing a reset with Moscow, Ukraine has very little alternative but to work closely with its larger neighbor. This window of opportunity is likely to remain open to Moscow until the next parliamentary elections in 2012.

This, of course, is in stark contrast to the early "Orange" years, where Russia feared that color revolutions in its near abroad would create attractive new political models in the region, and even perhaps spread to Moscow.

No more. Russia's strategic goal today is not defensive, but offensive. It aims to cement its influence in Ukraine. Sizeable segments of both the Russian elite and the public at large see the political and economic domination of Ukraine as desirable, if not natural. The Ukrainians, after all, belong to the "Slavic Orthodox brotherhood," along with the Belarusians and Russians. For them, the only question is how to draw Ukraine back into the Russian sphere of influence.

While publicly available official documents do not lay down a clear "Ukraine strategy," Moscow's agenda has come through in unofficial speeches and publications.

Key Goals

With NATO membership off the table, Moscow's top objective is to gain control of Ukraine's gas transit system

Moscow's priority tactical objectives have been preventing Ukraine from joining NATO, and gaining control over its gas transit system (GTS) through Gazprom. With Ukrainian Foreign Minister Konstantin Gryshchenko officially taking NATO accession off the agenda on May 27, the first has been achieved. Russia is now free to focus on the second.

Also central to the Russian strategy is attracting Ukraine back into economic orbit — whether through enhanced economic cooperation or the acquisition, direct or indirect, of assets and enterprises seen as either politically or economically useful. As many of Russia's most important industries have been nationalized, the merging or sale of Ukrainian businesses to Russian giants more often

than not means ceding control to Moscow. In other words, Russia is attempting to reconstitute the otrasli (Moscow-controlled industrial sectors) central to the old Soviet economy. The logical next step would be to pull Ukraine into the Russia-led customs union, even at the expense of its WTO membership. While this is still hypothetical, it would allow Russia to 'unhook' Ukraine from the West still further.

Over the last 10 weeks Russia has made major progress toward reaching its tactical objectives, with the main breakthrough coming in the form of the Kharkiv gas-for-fleet deal. Kyiv and Moscow are now working on the establishment of a consortium (which may or may not include the EU) to manage Ukraine's pipeline system, as well as on myriad other inter-form and inter-agency agreements.

In this section, we look at Russia's objectives, its probable next steps, recent developments in Ukraine-Russia relations, and potential pitfalls in Moscow's strategy. We also have a first glance at what this means for Ukraine, which will be the subject of our next issue.

Welcoming the Prodigal Son

Russia's Objectives and Priorities: Three Views

After years of discord, Russia is asking Ukraine to move back in – on its terms

The first key summary of Russian strategy is the country's latest **Foreign Policy Concept**,¹⁰ which laments that relations with Ukraine are not as close as they should be and argues for "de-politicized relations based on the national interests of both countries." However, the Concept's priority in relations with Ukraine – the "protection of Russian-speakers and ethnic Russians" – is eminently political, implying as it does incursions into its neighbor's domestic affairs. Other, broader priorities include the preservation of a common cultural space and preventing NATO expansion.

The second is Russian foreign minister **Sergey Lavrov's** "Program on the Use of Foreign Policy to Support the Development of the Russian Federation,"¹¹ leaked to *Russian Newsweek*, which sets out more concrete measures, namely:

1. increase economic cooperation with Ukraine, namely in the aviation, transport, and energy sectors;
2. integrate Russia's "United aircraft building corporation" with Ukraine's own aeronautics enterprises in the production of many aircraft and engines;
3. seek to establish an international consortium to manage Ukraine's GTS;
4. support Russian oil companies seeking to reverse the flow of the Odessa-Brody pipeline, thus limiting Ukraine's access to Caspian oil;

¹⁰ <http://www.niros.ru/news/17730.html>

¹¹ <http://www.runewsweek.ru/country/34184/>

5. expand cooperation in the field of nuclear energy, namely by signing a long-term contract to supply nuclear fuel to Ukraine;
6. increase Russian investment in Ukraine, and seek to have Russian investors acquire major Ukrainian enterprises.

*Russia wants
"special relations"
with Ukraine*

The third overview of Russia's strategy is a speech delivered on April 27, 2009, by **Konstantin Zatulin**, a hawkish Russian Duma member, Director of the Institute for the Study of CIS Countries and former *persona non grata* in Ukraine.¹² The speech is the most candid description of the Russian elite's views on the matter. It argues that Russia's top priority should be the establishment of "special relations" with Ukraine, similar to the relationship between the United States and the United Kingdom in the 1950s.

This, Mr. Zatulin argued, was the only way to insulate the relationship from political turbulence, and depended on four key conditions – all of them internal to Ukraine.

1. the official proclamation and legislative confirmation of a neutral, non-aligned status for Ukraine;
2. the adoption of a federal constitution;
3. the elevation of Russian to the status of state language, along with Ukrainian;
4. to unify Russian and Ukrainian orthodoxy under the Moscow Patriarchate.

Several of the other objectives laid out in the speech have already been achieved. Political forces representing the Russian-speaking East and South of Ukraine are consolidated and in power, and "anti-Russian" politicians have been forced out of the scene, at least for the time being. The "orange" take on the history of Ukrainian-Russian relations has lost salience. NATO accession has been taken off the agenda.

*Russian objectives
include changes to
Ukraine's political
and administrative
structure*

Goals still to be achieved include turning Ukraine into a federation, devolving special powers to Crimea and allowing Sevastopol residents to directly elect their mayor. At the military level, the speech argues for enhanced cooperation between Ukrainian and Russian arms producers, and for Kyiv to refrain from implementing NATO standards. Co-operation is also foreseen in the area of law enforcement, including joint training programs, and in the creation of a joint disaster-management mechanism.

On the economic level, Moscow seeks to merge Russian and Ukrainian enterprises, and to bring Ukraine into its Single Economic Space. This is to be followed by the approximation of legal standards and the adoption of a single currency, the ruble, for trade. Other priorities include the protection of Russian property and investment, the expansion of Russian banks, the creation of cross-border economic zones and, as always, the stability of Ukraine's gas transit system.

¹² <http://www.from-ua.com/politics/925733c7469fb.html>

In addition to these "hard" areas, Russia also aims to reconstitute a common information space, to pursue educational convergence, to ensure freedom of movement between the two countries, and to create a single labor market.

These measures are examined in the next section.

Two Schools

The Orange Revolution was a cold shower for Russia's foreign policy establishment, which now sees relations with Ukraine as risky and unpredictable. Today, it is divided on prospects for cooperation and on the means to achieve Russia's strategic objectives.

The pessimistic school, represented by Mr. Zatulin, envisions highly conflictual relations ultimately resulting in a loss of sovereignty for Ukraine, or even the secession of some regions. The optimists, on the other hand, foresee Kyiv agreeing to a "special relationship" with Moscow in exchange for a commitment to respect Ukraine's sovereignty and refrain from supporting any form of irredentism.

The Public Opinion on Ukraine-Russia Relations

Ukraine-Russia relations through the eyes of Ukrainians (poll by the Russian firm FOM-Ukraine in April 2010)¹³:

72% are have a positive opinion of Russia, 20% are neutral, and 6% have a negative opinion. The proportion of Ukrainians with a favorable opinion of Russia has remained stable since 2006.

47% of Ukrainians trust Russian president Dmitry Medvedev, while 23% do not.

58% want Ukraine to pursue rapprochement with both Russia and the West, while 25% favor a strong pro-Russian stance.

63% support joining a Union with Russia and Belarus, while 27% oppose the idea. At the same time, 53% support EU accession, while 26% oppose it.

Ukraine-Russia relations through the eyes of Ukrainians and Russians (poll by the Levada Center (Russia) and KMIS (Ukraine) in January 2010)¹⁴:

52% of Russians have a positive opinion of Ukraine, while 36% have a negative opinion. 93% of Ukrainians have a positive opinion of Russia, with only 4% expressing a negative opinion.

Majorities in both Ukraine (66%) and Russia (55%) support the idea that Ukraine and Russia should be independent of each other but maintain close relations by opening the border and abolishing visas and customs barriers.

Interestingly, a greater proportion of Ukrainians (22%) than Russians (14%) support the idea of a single state.

55% of Russians believe that Ukraine should remain independent and maintain good relations with Russia, while 33% think that it should be under the political and economic control of Russia.

¹³ Poll conducted by the Russian sociological service FOM-Ukraine between April 10 and 19, 2010. 1,000 respondents. Margin of error: 3.2%. http://bd.fom.ru/report/map/ukrain/ukrain_eo/du100430

¹⁴ <http://www.levada.ru/press/2010022605.html>

Sector-Specific Initiatives: Back to the USSR

The Gas Sector: Dispensing with Niceties

Gazprom seeks to control Ukraine's gas sector

Russia is seeking control of Ukraine's gas transit system, its gas storage facilities and, according to some analysts, its Black Sea shelf gas fields, as well as other hydrocarbon resources. Gazprom is also after the right to deal more directly with Ukrainian consumers, potentially through ownership of gas distribution companies.

On April 30, Russian premier Putin suggested the merging of Naftogaz and Gazprom. Were this to happen, Gazprom would essentially absorb Ukraine's GTS and thus reduce the risks associated with pumping gas through foreign territory. Gazprom head Alexei Miller has promised that under such an arrangement his company would make the investments necessary to modernize Ukraine's decrepit transit infrastructure.¹⁵ But a Naftogaz-Gazprom merger is just one of the many avenues that could lead to Russian control Ukraine's GTS. Other options include the creation of an international consortium (with Russian participation) to manage it and finance its modernization.

Russia could gain control of Ukraine's GTS through a bilateral consortium

Today the alienation in any form of the Ukrainian GTS is prohibited by a 2007 law proposed by Yulia Tymoshenko, but some have already begun preparing the ground for a consortium. On May 17, Rada member Vasyl Kiselev proposed a draft law to eliminate these restrictions.¹⁶ Were it to be adopted, the Cabinet of Ministers would be free to decouple the GTS or gas storage facilities from Naftogaz and transfer management or ownership rights to other entities. This is ideal for Russia, which could then gain control of key assets without lading itself with Naftogas' crippling debts.¹⁷

Moscow has also set its sights on Ukraine's Black Sea shelf gas deposits. The drilling and extraction rights once belonged to a daughter company of an American firm, Vanco Energy Company, but in 2007 were sold to Vanco Prikercheska, which is partially owned by Rinat Akhmetov and Russian businessman Vadim Novitskiy. The transaction had initially been blocked by the Tymoshenko government, but on May 12 the Cabinet of Ministers announced its intention to seek an amicable agreement with Vanco Prikerchenska.¹⁸ Many experts believe that the company lacks the necessary technology and resources to exploit the rights, and thus may sell them to Gazprom.

The Kharkiv deal proved that Russia is willing to offer Ukraine gas discounts but not to renegotiate the formula by which the price is determined, as had been requested by premier Azarov. Instead, the new agreement reduced the export duty on Ukraine-bound gas. While the duty is currently 0, it will increase if the

¹⁵ <http://www.interfax.com.ua/rus/eco/39010/>

¹⁶ http://gska2.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=37674

¹⁷ Due largely to artificially low gas prices, Naftogaz's losses for January-March 2010 alone were UAH 2.05 bn (~US\$ 260 mn).

¹⁸ <http://www.interfax.com.ua/rus/eco/38559/>

price rises above USD 333.33 per thousand cubic metres (tcm), so as to ensure that the total discount does not exceed USD 100 per tcm. This system will remain in place until 2019, until which date it will count as rent for Russia's Sevastopol naval base.

Russia is currently Ukraine's only supplier of natural gas, and diversification (namely through imports from Central Asia) is unlikely. Indeed, Central Asian gas must transit through Russian pipelines to reach Ukraine - and President Medvedev recently made clear that any such arrangement would have to be in line with his country's own gas strategy, which states that Gazprom alone can export gas from Russia.¹⁹

The Broader Energy Sector: Investing in the Relationship

Moscow is also after a bigger share of Ukraine's larger energy pie. Russian Bank Sberbank Rossii and the Russian state company Rosatom are considering a joint venture to complete the construction of two nuclear reactors for the Khmel-nitskiy nuclear power plant. The project is still in the development stage, and details have yet to be released. But Sberbank head German Gref has indicated that a consortium may be created to carry out the project, with the bank providing most of the financing.²⁰

The completion of new nuclear facilities is to be coupled with the construction of hydroelectric power stations. There are plans to finish the Dniester, Kanev and Kakhovka plants, and for the electricity they generate to be managed and marketed by a joint Russian-Ukrainian firm. The total cost of the project is estimated at USD 1.9 bn.

Russia is interested in both natural resources and energy infrastructure projects

Russia is also interested in Ukraine's metals. It has suggested a joint venture to extract uranium ore and zirconium, with the uranium then being enriched into nuclear fuel by Russian plants. Rosatom head Sergei Kirienko has suggested that investment in the Novokostiantynivske field could total USD 500 mn. The field's uranium ore reserves are estimated at 100 thousand tons.

Finally, Russia aims to become a long-term supplier of nuclear fuel to Ukraine. A 15- to 25-year supply contract allowing it to begin shipments as early as 2011 is expected to be signed on June 1st. As an incentive for a long-term agreement, Russia is willing to pin its discount to the length of the contract.²¹

Shipbuilding

United Shipbuilding Corporation (USC), a Russian state enterprise, has expressed interest in acquiring approximately 10 of its Ukrainian suppliers. Russia's Ministry of Energy and Trade has stated that USC is mainly interested in the controlling shares currently owned by the Ukrainian state, and that the company may later consider acquiring enterprises with noncontrolling state ownership.

¹⁹ http://www.embrus.org.ua/news/news/index.php?ELEMENT_ID=734

²⁰ <http://www.interfax.com.ua/rus/eco/39066/>

²¹ <http://www.interfax.com.ua/rus/eco/38904/>

Russian shipbuilders and aircraft manufacturers seek to acquire Ukrainian state assets

During a meeting with Vladimir Putin in early May, acting USC president Roman Trotsenko indicated that his company was considering the acquisition of two Ukrainian state companies, "Zarya-Mashproekt" and "Feodosiyska kompaniya 'Morie,'" arguing that their integration into USC would allow them to increase their output. Ukraine is USC's largest foreign supplier, and produces several essential components.

Aircraft manufacturing

The ideal scenario for Russia would be a merger of the Russian United Aircraft Corporation with Ukraine's Antonov, known for its large freight liners. Cooperation could begin with the joint production of the AN-148 passenger plane, and be deepened through the assembling of the AN-124-100 and AN-124-200 freight carriers in Russia. Cooperation in the manufacturing of the AN-70 military freight carrier is also an option.²²

Culture and education: Speaking the Same Language

Russia wants the "foreign" label removed from its language

Russia is seeking to restore a common cultural space. Concretely, this means removing the "foreign" label from the Russian language in Ukraine and, ideally, making it the second state language. A first step in this direction could be exempting Russian language and literature from measures and policies aimed at foreign languages. This could include having schools and universities offer separate courses on them (rather than merely having a Russian section in foreign literature courses), and exempting Russian broadcasts from the requirement to display Ukrainian subtitles.

Recreating a common cultural space would also involve the uniformization of textbooks, and ultimately of education policy. For Russia, the priority is the study of the two nations' common statehood from the seventeenth to the twentieth century.²³ It sees the post-WWII efforts of France and Germany to forge a common understanding of their shared history as a model for this policy.

Another of Moscow's top cultural objectives for Ukraine is to allow its universities to teach in Russian. Today, the only language of instruction is Ukrainian, which all but precludes the attraction of students from Russia and the CIS.

Finally, Russia wants restrictions on Russian television channels broadcasting in Ukraine lifted. In exchange, Moscow has offered to broadcast a major Ukrainian television channel in Russia via satellite.²⁴

Other projects

In addition to these sector-specific initiatives, Russia is pushing for several joint infrastructure projects. These include a toll highway linking Moscow, Kharkiv and Simferopol, the building of a transport corridor across the Kerch strait, and

²² <http://www.interfax.com.ua/rus/eco/37874/>

²³ <http://www.geopoliticalmonitor.com/russia-ukraine-summit-a-strategic-partnership-1/>

²⁴ <http://www.interfax.com.ua/rus/eco/39006/>

creating the infrastructure necessary for Russia to export its electricity to the EU via Ukraine.

Major joint infrastructure projects are also in the offing

In the oil sector, Moscow may push for Kyiv to re-impose an import duty on gasoline and other oil-based products in order to protect its Ukraine-based producers from foreign competition. It may also propose a new oil transit agreement to ensure the stability of its Europe-bound exports through Ukraine.

Finally, Russia is looking to expand cooperation in the aerospace sector, namely in the Sea Launch project and the construction of the Taurus-II launch vehicle designed to carry supplies to the International Space Station.

Challenges to Russia's Agenda on Ukraine

Easier Said than Done

In Ukraine, even the most ironclad agreement can fall into the bureaucratic abyss, and even the best-connected oligarch has to personally shepherd his interests through the administrative maze. Russia may learn this the hard way if it puts too much stock in political promises.

A stubborn bureaucracy, corruption, incompetence, and political tone-deafness may combine to turn Russia's hard-nosed agenda into wishful thinking

Indeed, Ukraine's broken state machinery makes the implementation of any decision a major challenge. This is less true for Russia, where a better-controlled bureaucracy can be counted on to obey orders. In Ukraine, decisions by ministers, the premier, or even the President can be killed by bureaucrats with vested interests in the status quo. This is *a fortiori* true when said decisions involve the sale or transfer of state assets to external actors, as is often the case in Ukraine-Russia agreements.

Those at the top of many state companies have been successfully fighting off privatization efforts and political decisions for many years. The state's hold over these firms has traditionally been weak, with financial flows mainly controlled by management. For these groups the sale, privatization, or transfer of the company to Russian or other interests means huge losses in rents. As a result, such efforts are often sabotaged.

The expensive infrastructure projects envisioned by the political leaderships are also risky, as they are likely to be seen by bureaucrats in both countries as mere cash-cows to be milked. It is not in Russia's interest to see these projects fail, but it may find itself unable to use them as tools in building its new "special relationship" with Ukraine.

Yet another risk to Russia's Ukraine agenda is the potential incompatibility of the two countries' political economies. In Russia, politics controls business, and is supported by gas and oil revenues. This is not the case in Ukraine, where politicians depend on the financial support of their business backers, and where big business generally pays as much in taxes as it wants to. If these oligarchs

perceive the Russian rapprochement as going against their interests, they will be able to apply major pressure on the government to change its course.

Politically Incorrect?

The Russian agenda may be politically impossible to achieve in Ukraine

There are also major political risks to the Russian agenda in Ukraine. The strongly Eastern direction of Ukrainian foreign policy today is less a long-term choice than overcompensation for the strongly pro-Western (seen by many as anti-Russian) policies pursued by Viktor Yushchenko. As President Yushchenko himself found out, polarizing society by moving hastily in either direction is very risky and can lead to punishment in the ballot box. With local elections likely in March 2011 and a parliamentary ballot due in November 2012, the failure of the Russian vector to bring obvious dividends to the people may well prompt President Yanukovich to revise his foreign policy strategy. In other words, it may turn out that the "multi-vector" approach of Leonid Kuchma best meets Ukraine's needs — or at least those of its ruling elite —, in which case the Kyiv-Moscow rapprochement will inevitably slow.

At the same time, Yanukovich and his team may decide to stay the course on foreign policy and attempt to win the upcoming elections by using the state's "administrative resources" and curtailing press freedom. But that poses its own political risks: freedom of speech is deeply ingrained in the Ukrainian media, and recent events have shown that any move toward censorship will be met with revolt. This course could therefore be self-defeating.

The Weakest Link

Finally, Ukraine lacks both a good negotiating strategy and competent negotiators. It is clearly the junior partner in relations with Russia and is in a perpetually reactive, rather than proactive, stance. Its negotiators are underprepared and treated as interchangeable (the negotiating team on the Ukraine-Russia Intergovernmental Commission changed three times in as many meetings). They lack a clear understanding of Ukraine's strategic interests and accept one-sided — and therefore unsustainable — deals that will necessarily have to be reopened. Bad deals have bad effects, and with bad effects come political repercussions. This reality is perfectly encapsulated in the Kharkiv deal: the gas discounts will not obviate the medium-term need for an increase in the price charged to households. As a result, the agreement does not spare the Ukrainian government from the need to impose unpopular measures, while at the same time associating Russia with these measures. That is neither Kyiv's nor Moscow's interest.

Looking Ahead

While his government works on the implementation of Russia's agenda on Ukraine, President Yanukovich will be very active in Western capitals. He will make public overtures to Brussels and Washington, while his team privately prepares low-key but high-impact deals with Moscow.

If successful in Ukraine, Russia's "strong-arm" policy will spill over westwards

If Russia succeeds in imposing its agenda — that is, if the opposition fails to challenge it, and if oligarchs deem it in their interest — , Ukraine will happily let itself be merged with its neighbor.

Many in the EU have fallen prey to the illusion that Russian expansionism will stop 'naturally' at Ukraine's western border. But if its "strong-arm" policy is successful in Ukraine it will spill over westwards, affecting Orthodox countries first.

In the next issue of Inside Ukraine, we look at Ukraine's ability to deal with Russia's agenda.