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U.S. interests in Ukraine are at stake as that country's political crisis deepens. On Thursday, April 26, the Ukrainian Parliament (Rada) voted the popular reformer, Prime Minister Victor Yushchenko, out of office.

The country is suffering from increasing political turmoil.

An unprecedented scandal, allegedly involving President Leonid Kuchma in the disappearance and gruesome decapitation of an opposition journalist, Georgyi (George) Gongadze, erupted, destabilizing Ukraine. Little is clear about this mysterious event, including who was behind the extensive taping which took place in Mr. Kuchma's office. The only clear element is outcome of the scandal itself. The Ukrainian presidency, the executive branch – and by extension, Ukrainian statehood -- suffered a serious blow to their legitimacy.

The West has distanced itself from Mr. Kuchma. As a result, Ukraine seems to be drifting into Russia's orbit. This trend could eventually imperil Ukraine's political independence and economic performance, which began to improve in 1999. Last year, Ukraine enjoyed its best macroeconomic results in 15 years, with GDP growth reaching 6.3 percent. It is imperative for Ukraine's survival that its current economic policy successes be preserved regardless of the identity of its future Prime Minister.

Increasing transparency, sustaining GDP growth, and promoting sound macroeconomic policies—the main achievements of the recent two years—have to be enhanced and built upon by the next Cabinet. Importantly, these goals cannot be achieved without attracting Western investors. Thus, the future Prime Minister has to be a symbol of further reforms, not an ally or protégé of one business “clan” or another.

Ukraine's next Premier must be acceptable to the investor community, including Western investors. The new executive should be a leader who symbolizes Ukraine's movement into the future -- an independent, Euro-Atlantic future, that of democracy, free market based on the rule of law, and individual rights. Whoever takes the helm should not steer the country back into the past.

Unfortunately, Ukraine's crisis is being aggravated by lack of trust in the government, political conflict, dissatisfaction with the country's standard of living, which remains low, and pervasive corruption among the ruling class. The situation is made worse by a foreign debt

crisis. This explosive combination of issues is driving the popular discontent with Kuchma, and may force Ukraine into Russia's bear hug.

Under pressure from Moscow, President Kuchma fired Ukraine's Western-oriented Foreign Minister, Borys Tarasiuk, in the fall of 2000. Since then, Ukraine has considerably slowed down its cooperation with the members of a new strategic group of countries nicknamed GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova). The first truly voluntary organization of states within the territory of the former USSR is now in dire straits. These developments could threaten U.S. security interests in Eastern Europe and increase the level of tension in U.S.-Russian relations.

Ukraine's geopolitical situation is key to Eastern Europe and thus is of great interest to the U.S. Russian empire-builders in the military and national security community openly state the necessity to establish hegemony in Ukraine in the context of the zero-sum nature of Russian-American confrontation.⁴ Ukraine prevents Russia, which is becoming more nationalist and authoritarian, from direct access to the borders of East-Central Europe, including NATO members Hungary and Poland, South Eastern Europe and the Balkans. Ukraine today also controls the strategic northern coast of the Black Sea, which is adjacent to NATO ally Turkey.

In the eighteenth, nineteenth and twentieth centuries, Ukraine and the Crimea were the base from which Russia threatened the Turkish Straits. From Ukraine, Russia launched the four partitions of Poland in the eighteenth and the twentieth centuries. Today, the re-absorption of Ukraine, with its 50 million citizens and territory bigger than France's, into a Russian super-state would effectively quash all hopes for a Western-oriented, democratic Eastern Slavic state in Europe. It would then be only a matter of time before such a Russian super-state would revert to its historic pattern of behavior, throwing its weight around the region.

The Place of Ukraine in U.S.-Russian Relations:

The future of Ukraine as an independent and democratic state is important to American interests in Europe. The survival of an independent and democratic Ukraine is also crucial to Russia's future as a democracy. The re-absorption of Ukraine into Russia's fold would bring about a new, quasi-imperial and undemocratic Great Russia. Such a development could destroy the post-Cold War status quo in Europe, revive a threat to NATO allies in Europe and worsen U.S.-Russian relations.

Since President Vladimir Putin's rise to power, Ukraine has become a vulnerable target of Russia's revamped foreign policy. While officially the two countries maintain cordial diplomatic relations,

5. Unofficially many among Russia's policy makers and elites have not come to terms with Ukrainian independence, and see Ukraine as a "younger brother," to be incorporated into the Russian state, or at least brought into Russia's orbit at an opportune time.

6. Recently, Russia's state controlled Channel One TV (ORT), launched an unprecedented and crass attack against Prime Minister Yushchenko. Before an audience of millions in Russia and Ukraine, ORT's commentator insinuated that Ms. Yushchenko, a Ukrainian-American, was a

sinister means of U.S. governmental control over the Prime Minister. This may indeed have been mirror-imaging taken too far, but more likely, it is what the Russians today call a “black PR” job – a character assassination ordered by the Government of Russia.

Moscow is taking advantage of Kuchma’s vulnerability to subjugate Ukrainian security policy making. In January 2001, Moscow and Kyiv reportedly signed a 52-clause classified military agreement giving Russia control over Ukrainian military planning; and plans to establish a joint Black Sea naval force are underway. These agreements may place Ukraine’s cooperation with NATO in the Partnership for Peace framework in doubt and jeopardize the joint naval exercises which Ukraine and NATO have held for the last three years. While the Ukrainian Embassy in Washington, D.C. denies that far-reaching changes have taken place, senior Ukrainian policy makers have confirmed to me that Ukraine has indeed signed some of the documents proposed by the Kremlin, and is under pressure to re-orient itself closer to Moscow.

7. Another agreement restored joint Russian-Ukrainian aerospace and military-industrial cooperation, including joint research and the development of weapons systems, manufacturing and coordination of weapons sales.⁸ Instead of competition, the two aerospace and military-industrial complexes will work together to capture foreign markets. Ukraine was the principal manufacturer of giant, ten-warhead intercontinental ballistic missile (ICBM) SS-18 (NATO designation Satan) during the Soviet times, and Mr. Kuchma was director of the Yuzhmash plant, which manufactured this missile. In case of Moscow’s “asymmetric response” to U.S. plans to deploy a ballistic missile defense, it is possible that ICBMS armed with multiple individually targeted re-entry vehicles (MIRV) for Russia will again be manufactured in Ukraine.

The Kuchma Tapes: A Political Chernobyl:

Is the ongoing “Kuchmagate” scandal an intricate ploy by Russia to subjugate Ukraine, or a coup engineered by Ukrainian oligarchs to emasculate the President and impose a successor they can control? Can it be both? Who could have ordered Major Mykola Mel’nychenko to install a sophisticated digital tape recorder in President Kuchma’s office, when it is supposed to be regularly swept against eavesdropping? Who might have known that Mel’nychenko bugged the office, but failed to take action? Who failed to apprehend Mel’nychenko when he crossed the border with his family to seek asylum abroad? There are more questions than answers, and the hypotheses are indeed mind-boggling.

A scandal, involving alleged digital audio taped evidence that President Kuchma may have been involved in directing his secret services to murder an opposition journalist, Gongadze, recently became a catalyst for mass demonstrations and calls for Kuchma to step down.⁹ Gongadze’s decapitated body showed up in a wood near Kyiv (Kiev). The tapes, released by opposition members of parliament such as former Speaker Oleksandr Moroz and former Justice Minister Sergei Holovaty, triggered a wave of popular indignation and demonstrations in Kyiv’s Independence Square (in front of the Presidential Palace) under the slogan “Ukraine Without Kuchma.”

The Ukrainian President, the Parliament, and powerful business groups, or “clans,” are engaged in a free-for-all battle for power. The most prominent victim in this power struggle is

the reformist and pro-Western ex-Prime Minister Victor Yushchenko, who seems to have very little to do with the tapes. In addition, President Kuchma was forced to fire some of his closest political allies who obviously violated the law in the Gongadze affair, while other supporters have abandoned him, sensing his vulnerability.

The Mel'nichenko Tapes and the Bane of Corruption:

The digital tapes recorded by Major Mel'nichenko, who recently received political asylum in the U.S., reportedly contain close to 1,000 hours of conversations in Kuchma's office. The question arises whether these tapes may contain important information, which goes beyond the Honhadze affair. Perhaps they contain evidence that might implicate prominent members of the Ukrainian political and business world in corrupt practices, money laundering or other criminal activities that could effectively terminate their prominent careers if brought to light. Do these tapes point to previously unknown external political and criminal connections of President Kuchma and his entourage? Are any of the figures featured in these tapes conducting illicit business in the United States, or orchestrating illegal dealing with U.S. entities? Thus far, former Prime Minister Pavlo Lazarenko is in custody in this country for alleged money laundering. What can we learn from these tapes about the criminal activities of other Ukrainian politicians?

Were vital U.S. interests involved, such as supplies of sensitive technologies and arms to countries on the U.S. Department of State terrorism list, such as Iran, Libya, Syria, or others?

Geopolitical tectonic shifts:

The Gongadze scandal resulted in the weakening the Ukrainian body politic and generated a political vacuum. Russian influence in Kyiv has increased. It has been one of a series of factors allowing Moscow to force Ukraine to re-orient its policy from carefully measured, Western-oriented neutrality, to being openly Moscow dominated. If the Russian pressure continues unabated, Kyiv may eventually join the Russian-Belorussian Union, or another Moscow-dominated neo-imperial entity.

The Gongadze scandal is not the only factor weakening Ukraine. The other causes contributing to Ukraine's decent into the Russian orbit, in particular, are its economic weakness and energy dependency on Russia. The Kremlin's relative strength and ambition also capitalize on the residual effects of Russia's 330 year occupation, such as the broad cadre of former Soviet bureaucrats and security officials, and the cultural and linguistic affinity of the population, especially in Eastern Ukraine.

Energy Dependence And Ukrainian Foreign Policy:

The connection of Ukraine's power grid to Russia's, agreed upon February 12th by Presidents Putin and Kuchma, symbolizes Ukraine's increasing dependency on Moscow. Reconnection of the power grids will increase Kyiv's dependency on Moscow, which will then literally have a finger on Ukraine's light switch. It demonstrates how Russia is using energy as a blunt tool of foreign policy in the "near abroad" – the former Soviet Republics. This pattern of behavior is indicative of the newfound assertiveness of the Putin Administration, which is utilizing Russia's position as a major energy exporter and its advantageous geopolitical location to re-establish its predominance along its periphery.

The Ukrainian state happens to be the first to stand in the way of the Russian energy steamroller. Kyiv is also on the verge of assuming a debt, which may lead to the transfer of its strategic energy related assets to Russian companies. Moscow is pressuring Kyiv to repay half of the \$1,2 billion debt within 10 years, while the other half would be assumed as a state debt. In a debt-equity swap, bonds issued as securities for that debt could be used by Russia to acquire Ukrainian enterprises, which Kyiv scheduled to privatize. Under this scenario Ukraine's oil and gas pipelines, electric grids, power generation facilities, and other lucrative businesses, would be purchased by Russian bond-holders.¹⁴ Russia's control over Ukraine's energy infrastructure would then further strengthen Russia's ability to influence Kyiv's policies.

Russia's willingness to bring Ukraine into the fold, and Ukraine's energy dependency on Russia, as well as its inability to repay over \$1.2 billion debt owed to Moscow for past natural gas supplies purchased from Russia are key factors in understanding the recent developments. Russia is leveraging its position as a major supplier of Ukrainian energy needs that controls all of Ukraine's incoming oil and gas pipelines. Through this leverage, Moscow will be able to influence Ukrainian domestic and foreign policy to a much greater extent than before. Itera, a controversial Russian-owned natural gas company headquartered in Florida imposed severe interruptions of natural gas and electricity supplies from Russia. Managers of Gazprom, Russia's gigantic state-dominated gas monopoly, (controlled by the Kremlin), reportedly control Itera. Russian companies interrupted Ukraine's electricity supplies less than a month after the two countries claimed that they had settled their outstanding natural gas debt issues.

The Price of Independence

According to senior Ukrainian Foreign Ministry officials I spoke with in November 2000, Russia used gas prices as a tool to exert political pressure. Moscow is forcing Ukraine to choose between world prices for natural gas or joining the Russia-Belarus Union or Russia-Belarus-Kazakhstan customs union. If Ukraine joins the Russia-Belarus Union, the price for 1,000 cubic meters of gas will be \$25; if it joins the Russia-Belarus-Kazakhstan customs union, the price will go up to \$40 per thousand cubic meters, whereas the world price is \$80-\$100 per 1,000 cubic meters.

Today, Russia is supplying 30 billion cubic meters of gas to Ukraine, close to 40 percent of its annual consumption of 78 billion cubic meters. All of this supply is to compensate Ukraine for the transit of natural gas through its territory to markets in Central and Western Europe, and represents a tariff payment. However, this revenue may also disappear in the future. Russia is understandably unhappy with Ukrainian companies' "unauthorized withdrawals" of natural gas, and is threatening to build a new pipeline from the Yamal Peninsula in the Arctic, which will go through Belarus and Poland, circumventing Ukraine. Under the new Kuchma-Putin agreement signed December 22, 2000, Ukraine will stop this "borrowing" of gas. However, Ukraine's oil and gas transit system must improve to attract future exports of Russia's energy to Europe.

The second supplier of natural gas to Ukraine is Turkmenistan (also 40 percent of demand), but Russia controls the pipelines which cross its territory, thus providing Gazprom (and the Kremlin) with additional leverage against Ukraine. Thus, Ukraine depends on Russia for 80

percent of its natural gas needs, as it produces only 20 percent of its demand. Russia's pressure tactics may begin to work. Throughout the year 2000, President Kuchma realigned his policies and got closer to Moscow. He fired Foreign Minister Boris Tarasiuk, who had a reputation for being a NATO and EU integration supporter; and he attempted to undermine reformist Prime Minister Viktor Yushchenko, the respected former Chairman of the Ukrainian Central Bank. Kuchma also reversed progress on freedom of press, as the Gongadze affair demonstrated, and achieved little in the implementation of legal reforms and the rule of law.

Buying up Ukraine

Russian energy companies are on a buying spree, acquiring Ukrainian businesses in the energy, heavy industry and telecommunications sectors (see table). In such acquisitions, often conducted to the disadvantage of Ukrainian and Western companies, Russian businesses are using their "competitive advantage" to bribe officials and muscle their way to a winning bid.

Russian Acquisitions of Ukrainian Companies, 2000-2001

Company Buyer (Russia) Industry \$ Dollar Ammount Percent Sold

JSC Zaporizhia Aluminum AvtoVAZ (Russia) Metallurgy 101.5 million 68.01
 Kyivinvestbank Alfa Bank (Alfa Group) Banking n/a 76
 LiNOS TNK (Alfa Group) Oil & Gas 70 million 67
 Mykolayiv Alumina Ukrainian Alumina/Siberian Aluminium Metallurgy 100 million 30
 Elmiz TechMashPribor Space & Communic. n/a 26
 JV with Oriana Lukoil Naftokhim Chemicals Investing over \$100M over 5yrs n/a
 Ukmafta Alfa Nafta (unofficial) Oil & Gas n/a n/a
 Odesa Oil Refinery Luk Sintez Oil (Lukoil) Oil & Gas n/a n/a
 Kherson Oil Refinery Kazakhoil (Alliance Group) Oil & Gas n/a 63
 Pobuzhya Ferronickel Plant Nikomed Metallurgy n/a n/a
 Kyiv Dairy 3 Wimm-Bill-Dann Food & Beverage n/a n/a
 Khersonoblenerho Investment Pool Energy n/a 26
 Kirovohradoblenerho Investment Pool Energy n/a 42

Future Tenders:

Company Buyer Bidder(s) \$ Dollar Ammount Percent Sold

Rovnoazot n/a n/a 50
 Vinnitsky Oil Extraction Plant n/a n/a 54.57
 Utel Ukrtelecom (51%) 80 million 49
 Kievoblenerho EDF n/a 75
 " " AES Silk Road n/a " "
 " " Union Fenosa n/a " "
 Sevastopoloblenerho UES n/a n/a
 Zaporizhye Aluminium Smelter *Kremenchug Automobile Factory AvtoVAZ 70 m. + 200 m. over 5yrs 68.01
 Ukrtelecom n/a 548 million (opening bid) 25
 Sources: Financial Times, February 6, 2001, p. 2, and The Heritage Foundation

Slow Economic Reforms as a Cause of Dependency:

The slow pace of economic reforms; lack of restructuring in the obsolete, energy-consuming smokestack industries; and widespread, high-level corruption and opaqueness of the Ukrainian industry since independence (1991), are among the main reasons for Ukraine's chronic energy-driven debt to Russia. Simply put, the Ukrainian economy does not generate a sufficient cash flow to pay for its prodigious energy habit. This is for three reasons: first, the Soviet era smokestack industrial base is obsolete and inefficient. Ukrainian enterprises produce too few goods that can compete in the global markets, wasting too much energy in process. Secondly, ownership in the Ukrainian energy sector is too murky and complex to attract Foreign Direct Investment (FDI). Finally, according to U.S. officials, some of President Kuchma's top business and political allies personally benefit from the current state of affairs. Widespread corruption in the energy sector has enriched top Ukrainian politicians and businessmen. Former Prime Minister Petro Lazarenko is in a California jail facing accusations of corruption and money laundering tens of millions of dollars. Lazarenko's associate, former Deputy Prime Minister Julia Timoshenko, until recently in control of the energy sector, was charged by Kuchma's Prosecutor General with three counts of corruption in January 2001, and arrested in February of this year.

The Geo-economics of Energy:

It is of no surprise that Russia wants to pull Ukraine in to a closer orbit. Ukraine is both an important transit state and a market, as far as the energy supply of the region is concerned. In the future, Ukraine may serve as an important transit state for the Caspian Sea oil, which increasingly flows from Kazakhstan and Azerbaijan. The proven reserves of the Caspian region are larger than those of the Northern Sea, and are comparable to the oil wealth of the United States. With the newly discovered fields of West Kashagan in the Kazakhstani sector of the Caspian Sea, and additional discoveries likely in the future, the narrow Bosphorus Straits will be incapable of handling all shipments to the Mediterranean. A new pipeline, such as the Odessa-Brody (that will connect to the European network), as well as the Ukrainian domestic markets, will become necessary to absorb the output.

U.S. Policy Towards the Current Crisis:

The case of Ukraine raises questions about how to bolster the sovereignty of the New Independent States (NIS), which have come under pressure from Moscow due to deliberate manipulation, as well as their energy dependency and economic weakness. In the future this Russian policy may be applied to other importers of Russian energy in the Commonwealth of Independent States. If successful, the policy of pressure utilizing energy resources may be applied among other importers of energy from Russia, such as Western Europe and Turkey. It is in U.S. interests to support Ukraine's independence, territorial integrity, democracy, economic reforms based on the rule of law, and sustainable pro-Western orientation. To achieve this, the new Bush Administration should:

Recognize the strategic importance of Ukraine, its continuous pro-Western orientation, as well as the threats to its independence. The Administration should utilize economic and political

tools to support Ukrainian sovereignty and prevent its falling into the Russian orbit. These tools include “traditional” democracy assistance through the National Endowment for Democracy, the International Republican Institute, the National Democratic Institute and International Foundation for Electoral Systems; international broadcasting such as Radio Liberty and Voice of America; technical assistance to speed up restructuring of the economy, and military-to-military training and contacts. However, this may not be enough. A search for new tools to uphold U.S. interests in strategic regions should begin.

In FY 1998-2001 requests for US AID assistance for Ukraine fluctuated between \$170 and \$225 million, with a tendency toward decline (see table).

FREEDOM Support Act (FSA) Funds (in Thousands of Dollars)

Government agencies implementing these assistance programs included the Environmental Protection Agency; the Nuclear Regulatory Commission; and the U.S. Departments of Energy, State, Justice, Commerce and Treasury.

Conduct emergency intelligence assessment of what is known and what needs to be known about Russia’s intentions and capabilities in Ukraine. Attempt to answer the question, who was behind the Gongadze case, and what was the purpose of it. Who encouraged Major Mel’nichenko to produce damning tapes in Kuchma’s office, and with what purpose? Reassess and reallocate resources in view of the current crisis. Such an emergency review could be coordinated by the National Security Council, and conducted by the Department of State, with the participation of the U.S. Embassy in Kiev and inputs from the government departments, such as Treasury and Defense, and the intelligence community. In conducting its crisis management, the U.S. must act bilaterally, through the Department of State, the Pentagon; the Department of Commerce, and other agencies, and multi-laterally, in consultation with America’s European allies with interest in Ukraine, primarily Britain, Germany and Poland.

Promote measures leading to energy independence and economic growth. A growing and efficient Ukrainian economy will generate a cash flow, which will allow to pay for energy, vastly reducing dependence on Russia. Such economic policies should be based on the protection of private property; transparency; the rule of law; deregulation; increased competitiveness; and the fight against organized crime and high level corruption. Encourage the Government of Ukraine to develop business models, legislation and regulations that encourage transparency and provide a level playing field to encourage Western investment. Such policy will allow Western companies to invest in energy and other heavy industry sectors of the Ukrainian economy, where Russian companies have a “cultural competitive advantage.” Ensure that the privatization and restructuring of the Ukrainian energy sector is speedy, equitable and transparent. It is vital that the Government of Ukraine stamps out high level government corruption. This will allow American private sector firms to compete on a level playing field. Ukrainian politicians, experts and businessmen recognize that significant American and Western equity in the Ukrainian energy sector is crucial to that

country's economic restructuring and future energy independence.

Conduct open, transparent and impartial privatization of large enterprises, including utilization of impartial privatization managers, such as the leading accounting firms and major Western management-consulting firms. Promote policies that eliminate subsidies to industrial enterprises through government-imposed cheap energy supplies, thus eliminating energy indebtedness to Russia. Only a globally competitive Ukrainian economy can boost the country's independence and curb economic hegemony from Russian energy and heavy industry conglomerates.

Ensure participation of reformist, pro-democracy, pro-independence political forces in the government. Thus far, Ukrainian governing coalitions have included many Soviet-era communist party, security, and economic leaders. Larger numbers of honest reform-oriented politicians and experts could help speed the needed changes, making the Ukrainian economy more competitive, well as attractive to FDI. Support the development of civil society through support of NGO activities with the assistance of the National Endowment for Democracy. Identify and cooperate with those parts of the Ukrainian military who fully support an independent Ukraine to enhance and preserve Ukrainian sovereignty and its pro-Western orientation. Expand the contacts of the Ukrainian military, its training and cooperation with NATO through the Partnership for Peace (PfP); boost bilateral cooperation with the U.S. military; learn to implement much needed reforms such as the enhancement of civilian control over the military and enforcement of personnel cuts, while simultaneously upgrading preparedness and capabilities.

Conclusion

The geopolitical future of Ukraine has emerged as one of the vital questions of the post-Cold War era in Europe and the Black Sea area. The country's fate hinges upon the further development of a robust and competitive market economy; capital markets; expansion of the rule of law and eradication of corruption; energy independence; efficient debt management; economic efficiency, and private sector transparency. The question of Ukraine will decide the future of Russia as a democratic nation state, as opposed to a neo-imperial super-state. A non-democratic Greater Russia, which will include Ukraine, may become an increasingly anti-status quo power willing to overturn the geopolitical status quo which coalesced in post-Cold War Europe. Ukraine's fate will determine whether the Russian sphere of influence expands in the 21st century to create regional hegemony over its neighbors. In addition, at stake is the security of U.S. NATO allies, such as Poland and Turkey. The political and economic independence of Ukraine and its political orientation are likely to define the security environment in Eastern and South-Eastern Europe for decades to come. The Ukrainian question is quickly becoming an early and complex foreign policy challenge facing the new Bush Administration.

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