

# UKRAINE'S FOREIGN POLICY AUDIT

## T TRUMAN

### INDEX OF RELATIONS

OCTOBER-DECEMBER / 2016

№ 2







### ***To our colleagues, partners and friends!***

We are pleased to announce the publication of the second issue of “Index of Relations,” with in-depth analyses of Ukraine’s current relations in four key foreign policy areas: the EU, the US, the Russian Federation, and China.

To establish the index, every foreign policy event, whether a high-profile public statement, meeting, agreement or decision, is given a “plus” or a “minus,” depending on whether it had a positive or negative impact on bilateral relations. The total points for each of these events establish the index of relations in that area.

Over October-December 2016, Ukraine and its partners concluded the year on a relatively positive note, despite the high degree of uncertainty in terms of Russia’s actions towards Ukraine and in the US election, which unexpectedly ended in a victory for Donald Trump.

Processes in Ukraine-EU relations picked up pace: the European Union has rightly taken its place as Ukraine’s top partner. Despite Russia’s growing influence on the EU energy market, Ukraine continues to be in focus in EU energy policy. In 2017, comprehensive reforms in the power industry will be one of the key areas in which the EU and Ukraine will collaborate. During the previous quarter, the usual lull took place in the policy cycle due to the vacation period in Brussels and across Europe.

For this same reason, relations between Ukraine and the US also entered a kind of animated suspension, reinforced by a lame-duck presidency as the Obama Administration wound down. Since the election ended, Ukraine-US relations have ceased to exist in any classical sense, leaving only the same expectations of the incoming Trump Administration: that the US will help Ukraine defend itself.

Russia continued to be the negative leader in relations with Ukraine and even the actual number of points that events during this quarter received remains as low as it was during the previous quarter. What distinguished the fall-winter season was that Russia came up mostly in the context of domestic scandals in Ukraine, rather than foreign policy events.

In relations with China, the late months of 2016 saw a surge in economic ties. A major milestone was the acquisition of a 99.9% stake in the Ukrainian Bank for Reconstruction and Development by a Chinese company, which will be significant in China’s future operations in Ukraine and on EU markets. Cooperation in other areas also kept pace: nuclear energy, financial assistance, and culture and the arts.

Our special topic in this second issue of “Index of Relations” is a review of possible developments in the energy sector over the winter of 2016-17. The authors write that the ‘weaponization’ of energy by Russia is playing a major role in how Ukraine is perceived as a partner in Europe and elsewhere in the world. This makes it extremely important for Ukraine to put serious effort into offering solid arguments to its western partners to persuade them that (1) Ukraine is quite capable of undertaking successful reforms and remains a key partner in the gas sector and (2) this requires additional financial and political support for the country.

Overall, 2017 will require that Ukrainians take more initiative to effectively persuade their foreign partners that supporting Ukraine offers their countries considerable added value.

***Cordially,***  
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# RESEARCH METHODOLOGY

The publication “Ukraine’s Foreign Policy Audit. Index of Relations” is based on the monitoring and analysis of the events in the foreign policy of Ukraine by key areas: the EU, the US, the Russian Federation and the People’s Republic of China. The document is issued regularly, at least once every four months, to monitor the dynamics in the developments. In addition to the permanent areas, the expert group will provide an analysis of a special topic, i.e. the most important event, issue or trend for the reporting period. Besides by the experts’ observations, an important component of the research is exclusive interviews with Ukrainian officials responsible for certain areas in the foreign policy, Ukrainian and foreign diplomats. Furthermore, the document is based on numerous discussions with foreign opinion leaders and officials.

The report presents an analysis of foreign political events in Ukraine in each area, as well as that of the partner country’s (region’s) approaches to Ukraine within the period under research. The document discloses the context of the events and provides the assessment of factors that affect the country’s reputation. A forecast of the developments is made based on the facts presented.

Along with the qualitative analysis, the researchers have performed a quantitative analysis, assessing each area on a ten-grade scale.

## **Step criteria (0.5 points each):**

- Discussion
- Agreement
- Document signing
- Implementation commencement
- Finance allocation
- Political support
- Headline-making public statements
- Partial implementation of agreements
- New initiatives
- Full implementation of agreements.

A “minus” will be applied to the score if the criteria assessment is negative.

**Total score for the area** is the sum of points for the criteria, which characterize the area within the reporting period.

The expert group takes the BISS <sup>1</sup> methodology as the basis: they have developed a clear scale for foreign policy events assessment.

## **Event assessment scale:**

- Economic and political integration, entry of agreements for more intensive cooperation into force – **7-10 points**
- Signature/ratification of an important agreement (on cooperation, trade, tariffs etc., signature of agreements on integration), provision of loans or economic aid – **4-6 points**
- Official visits at the ministerial level (key ministers: Foreign Affairs, Interior, Defence, Economy and Finance), negotiations on the conclusion of agreements, Top level (President or Prime Minister) official visit by any of the parties – **1-3 points**
- Positive statements made by the key politicians of the state and by the Ministry of Foreign Affairs on the foreign policy direction, parliamentary resolutions – **1-2 points**
- Official visit at the vice minister (or non-key minister) level, a visit of a parliamentary delegation, exhibitions, business forums, national culture days, important diplomatic contacts and negotiations – **1 point**
- Negative statements made by the key politicians of the state and by the Ministry of Foreign Affairs on the foreign policy direction, parliamentary resolutions – **minus 1-2 points**
- Delays in agreement ratifications, denial of invitations to events, denial of support at the international level – **minus 2-4 points**
- Breach of an agreement or mutual obligations – **minus 3 points**
- Trade wars, antidumping investigations, boycott of goods, embargos, expulsion of diplomats, recall of ambassadors – **minus 4-6 points**
- Severing of diplomatic relations, provocations or hostilities – **minus 7-10 points.**

<sup>1</sup> BISS (Belarusian Institute for Strategic Studies). Source: <http://belinstitute.eu/ru/tags/индекс>

# UKRAINE – EUROPEAN UNION RELATIONS

October-December 2016

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Positive points: +75

Negative points: -10

Total Index: +65

## SUMMARY

*The last quarter of 2016 brought few significant changes in relations between Ukraine and the European Union. The main focus remained on deepening relations on existing bilateral issues. Visa liberalization was the central element in public discourse in relations between Kyiv and Brussels, and, despite earlier expectations, did not happen in 2016. However, there is a more-or-less clear calendar for the ongoing process. Also, the ratification of the Association Agreement saw some progress with the adoption of the EU Council's Conclusions after a joint agreement with Ukraine. The EU Council conclusions accommodated the fears and myths expressed by some Dutch voters to reassure them that the AA does not offer candidate status or security guarantees.*

*Where Ukraine has been anxious about the delay in visa liberalization and the ratification of the Association Agreement, the EU has been concerned with the ban on timber exports and a series of reforms that has been moving slower than initially anticipated. Among the main issues are restructuring Naftogaz and adopting laws related to the electricity market. Additional issues include ensuring the full independence and functionality of anti-corruption agencies, which means firstly granting the National Anti-Corruption Bureau of Ukraine the power to wiretap, and appointing a fifth member to the National Corruption Prevention Agency. Of special concern is amending legislation that permits the post-elections exclusion of elected candidates and ending the long delay in appointing 12 new members to the Central Election Commission.*

## TIMELINE

Cooperation between Ukraine and the EU has deepened on the main issues on the agenda. Despite the fact that progress has been recorded in all areas, Kyiv and Brussels have not delivered on any of them.

### Visa liberalization still delayed

The visa liberalization process remained at the top of the agenda, especially on the Ukrainian side. President Poroshenko and other officials at all levels voiced optimistic views on several occasions regarding the EU's final decision on visa liberalization for Ukraine, which they thought should have been delivered by the end of 2016. Despite support from EU leaders on the issue, the decision-making process involves a multi-layered institutional procedure with a co-decision mechanism and this delayed finalizing visa liberalization in 2016. On top of the institutional process, establishing a visa suspension mechanism has delayed the process even more.

At least this is the explanation of EU representatives. Meanwhile, Ukrainian officials and experts more often are raising concerns due to delay of EU visa regime for Ukraine, emphasizing the risk of losing Ukrainians' trust and support for the EU. Certain public figures and media outlets, citing their own sources, have noted that some EU members have been blocking or delaying their

decision on Ukraine because of domestic considerations, in particular France, which will go through a tough presidential election in the end of April. The issue has become an important factor in domestic politics, since with the abolition of visas all Ukrainians will feel real benefit from the European integration process. Indeed, EU officials, both in Brussels and in Kyiv, seem concerned by the Ukrainian narrative, that, from their perspective, it is counterproductive and damages the process more than it helps, especially that some EU bureaucrats point out that Ukraine did not fully deliver on all its commitments, such as on the automatic verification of data received from e-declarations. Still, the visa liberalization process picked up pace in the last months of 2016, what gives reason for cautious optimism. The current timeline on the EU side show that the visa liberalisation could be adopted after the French elections while the entry into force is foreseen for summer 2017. That timeline is confirmed by the EU plans to adopt the suspension mechanism in February-March 2017, which basically means that the visa dialogue on Ukraine will take place in March-April 2017.

Table 1 provides a closer look at the visa liberalization process taking place in the EU in conjunction with the negotiating position adopted by COREPER<sup>1</sup> on November 17, which basically spells out the relationship between the process and its sequences.

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<sup>1</sup> Anagram for Committee of Permanent Representatives of the Governments of Member States to the European Union, taken from the French version.

*The process of agreeing, adopting and enacting the EU visa suspension mechanism<sup>2</sup>  
in relation to visa liberalization for Ukraine*

## SUSPENSION MECHANISM

AGREED	ADOPTED	ENACTED
<p>The suspension mechanism was agreed on December 7, between the Council and the Parliament, which allowed the start of the procedure on Georgia and the procedure to adopt the suspension mechanism.</p>	<p>The process of adopting the suspension mechanism was launched the day after the mechanism was agreed by a vote in LIBE<sup>3</sup> on December 8, and passed first reading at the December 15 plenary session. In parallel, COREPER approved the mechanism on December 9. The Council has to vote its decision and the Parliament has to vote on the final reading no sooner than 20 days after the Council decision.</p>	
<p>Start of visa liberalization process for Georgia</p>		<p>Enactment of visa liberalization for Ukraine simultaneously with the suspension mechanism on condition that Ukraine procedure is completed in accordance with COREPER negotiating position adopted of November 17.</p>
<p>Triologue among European Commission, EU Council of and European Parliament on Georgia visa liberalization. European Parliament will approve first in LIBE, then in Plenary Session. EU Council will approve first in COREPER.</p>	<p>Start of visa liberalization process for Ukraine</p> <p>Triologue among the European Commission, EU Council and European Parliament on Ukraine visa liberalization. European Parliament will approve this first in LIBE then in Plenary Session. EU Council will approve first in COREPER.</p>	

Source: Author compilation based on interviews with EU officials

In Ukraine, many officials believe that the suspension mechanism was “invented” in order to delay visa liberalization. In fact, Ukraine could have had visa liberalization much earlier had it been a priority. To underline, the Visa Liberalization Action Plan (VLAP) was initiated in 2010 to Ukraine, yet real implementation began only in the fall of 2014. Had Ukraine delivered on VLAP sooner, the suspension mechanism would not have been an issue, as it only came up in 2013. So, despite the evident disappointment of some officials with the visa liberalization process, from an expert perspective the process has been positive and a real problem has been managing expectations.

The visa suspension mechanism was first instituted in 2013, mainly because of the high number of asylum-seekers from the Balkans to the EU, but also because of other negative phenomena, such as a decline in cooperation on readmission, a substantial increase in the refusal rate of readmission applications, including for third-country nationals in transit, and a substantial increase in the risk to public policy and the domestic security of the member states. The mechanism was

meant to ensure that visa-free travel did not lead to serious irregularities or abuse.

The new visa suspension mechanism blueprint agreed in 2016 provides for stricter control of visa-free travel to the EU. First of all, member states are now also able to trigger the suspension mechanism, apart from the European Commission. Secondly, the grounds for suspension have been extended. Finally, the new mechanism speeds up the suspension process and introduces a monitoring component to assess the extent to which the countries that are enjoying visa liberalization comply with the criteria that were the basis for granting a visa-free regime in the first place. In fact, it means that member states get greater and faster control over the process and countries that were granted visa liberalization but then have a negative track record can temporarily lose their visa-free regime.

The mechanism would also apply to Kyiv once Ukraine gains visa-free travel to the EU. This also means that the EU can keep pressure on Ukraine on related issues even after a visa-free regime is instituted.

<sup>2</sup> According to the European Council, the main objective of the revised regulation is to strengthen the suspension mechanism. It does this by making it easier for member states to notify about circumstances which might lead to a suspension, by enabling the Commission to trigger the mechanism on its own initiative, and by tasking the Commission with sending an annual report to the European Parliament and Council on the extent to which visa-exempt third countries continue to meet the necessary criteria. The possible grounds for suspension have been extended and the use of the mechanism will also be facilitated by shortening reference periods and deadlines in order to allow for a faster procedure.

<sup>3</sup> Committee of Civil Liberties, Justice and Home Affairs.

## Stalemate with the Association Agreement

One aspect that has shifted in relations between Ukraine and the EU more recently is that progress on key issues depends less on Ukraine, in many cases, than on the EU. Aside from visa liberalization, which is in the EU's hands at this point, and the long-delayed enactment of the Open Skies Agreement, the Association Agreement has been a source of major concern in Ukraine and the EU alike. The Dutch referendum opened a Pandora's box to challenge EU foreign policy and proved a litmus test for Brussels on how to overcome unexpected hurdles and rising populism. Even though the AA was actually a collateral victim of a populist anti-EU movement in the Netherlands, the EU has been working closely with The Hague to find a solution that would make it possible to finalize ratification of the Association Agreement with Ukraine.

The efforts of the Rutte Cabinet and those of the EU to diffuse the fears of Dutch citizens reached a peak on December 15, when the European Council adopted resolutions on Ukraine based on a joint approach by the EU and Ukraine to clarify what the Association Agreement actually stands for. Negotiations between President Poroshenko and PM Rutte were, in fact, quite tense. In private discussions some officials from Ukraine and the EU noted that some of their telephone conversations ended with Poroshenko hanging up in anger. The document adopted by the Council has intended as a "myth buster," clarifying that the AA did not offer Ukraine candidate status, does not require EU members to offer collective security guarantees or a certain level of financial support, and other issues that had been raised among Dutch voters.

The EU has been very supportive in finding a solution that would keep the Agreement and allow ratification to be concluded. However, despite the December 15 decision, EU insiders are not so confident that ratification in the Netherlands will be quick and successful. First of all, it involves a lengthy procedure that includes: the advice of the Council of State; a resolution in the House of Representatives that involves the Foreign Affairs Committee, then a Plenary session and a vote; then a resolution in the Senate's Foreign Affairs Committee, then a Plenary session and a vote; and finally, the signature of the monarch. Although Deputy Foreign Minister Lana Zerkal says that there are enough votes to ratify the Association Agreement in both chambers of the Dutch legislature, it's not certain that this will happen due to elections on March 15, 2017 that could change the makeup of the legislature. Much will depend on what stage the procedure is at prior to the election.

## EU concerns in Ukraine

The visa liberalization process and the ratification of the Association Agreement are of concern to Ukraine because of delays in EU and EU member states. However, the EU also has concerns regarding certain developments and reforms in Ukraine.

A major sticking point in relations with the EU right now is the recently-implemented ban on export of unprocessed

timber from Ukraine, which violates Ukraine's commitments under the DCFTA part of the Association Agreement, and WTO rules. Sources in the EU say that Brussels is likely to insist on dropping the moratorium altogether, or risk serious damage to relations with the EU. The EU does not seem very enthusiastic about a proposal by the Ukrainian side to withdraw the ban in several phases. Indeed, this issue could even affect the disbursement of next €600mn tranche of macrofinancial support.

Meanwhile, the sources in the Ministry of Economic Development and Trade has advised the need to work closely with Ukrainian MPs, otherwise there would be little chance of fixing the issue properly. The moratorium on unprocessed timber exports is also a difficult issue for the Government of Ukraine. Prime-minister Volodymyr Groisman has promised to take measures to stimulate domestic processing and stop timber smuggling in order to convince the Verkhovna Rada to lift the ban. Among others, the Government has already set up an interactive resource where visitors can see the real situation in forestry. Groisman also recommended that MPs set up a working group to come up with solutions to restore Ukraine's forests.

Economic disputes between Kyiv and the Brussels have not been beneficial to Ukraine, especially with the EU being the country's main trading partner. The latest data shows that foreign trade between Ukraine and EU countries in 10 months of 2016 was worth US \$4.898 billion, which is up 8.7% from the same period of 2015. The largest shares of foreign trade between Ukraine and the EU are with: Spain at 14.7%, Poland at 14.3%, the Netherlands at 13.9%, Italy at 12.8%, and Germany at 10.3%. Exports to the EU were worth US \$3.324bn, while imports from EU countries added up to US \$1.574bn. Notably, 78% of investments in the agricultural sector come from EU and some 277 Ukrainian companies have permission to export in the EU. Trade could increase even more if a recent proposal by the European Commission to include autonomous trade measures to top up certain concessions in the DCFTA were adopted. The proposal is currently under consideration by the European Parliament and the Council. In the meantime, €2.2mn have been disbursed to Ukraine out of €3.4mn committed in 2014.

## Energy above all

Following the format developed in recent years, trilateral Ukraine-EU-Russia energy negotiations took place on December 9. The agenda focused on two issues: gas supplies to Ukraine and gas transit to the EU. No agreement was reached at the meeting and the three sides decided to continue consultations. From the Ukrainian perspective, the lack of results was not crucial since Ukraine has enough gas and other energy sources to cover the heating season adequately. Still, disappointment was voiced by the EU Commissioner for Energy Union Maros Sefcovic, who told media that Russia had refused to sign a "winter package," because

“the Russians explained that they saw no need to sign something. We were unable to overcome this problem.”

Meanwhile, Ukraine, along with some EU countries and EU officials, is quite concerned at Russia’s expanding influence on the EU energy market. At the end of October, the European Commission authorized Gazprom greater use of the Opal pipeline, which joins the Nord Stream gas pipeline to the Central and Western European system. This would raise Russia’s delivery capacity considerably. The decision also affects Ukraine, since Russia would be able to divert even more gas transit away from Ukraine. Various EU officials and Presidents Poroshenko and Duda have called for the decision to be rolled back, pointing out the risks for the EU. In the end of December, however, following the lawsuit filed by Polish company PGNiG against the EU, the European Court of Justice suspended the decision that allowed Gazprom increased capacity to OPAL.

But the hubbub over energy is not limited to the winter package and Opal. The EU has been keeping a close eye on Naftogaz reforms. On July 1, 2016, the Ukrainian Government approved a plan to unbundle the state oil and gas company. The plan is meant to meet the requirements of the Third Energy Package and calls for a new Transmission System Operator and a Storage System Operator. This reform will be a key EU focus in Ukraine, together with other sector reforms involving energy efficiency and the electricity market. The interest of both parties was highlighted during the Ukraine-EU summit on November 24, and at the high level EU-Ukraine Strategic Energy Partnership conference on December 19. Discussions have been underpinned by the December 19 signing of a Memorandum of Understanding between the European Investment Bank and Ukraine to provide funding for energy sector projects.

## The reform agenda

The EU has been broadly satisfied with the reforms that have taken place in Ukraine, especially given the conditions in which Ukraine has found itself, with both Russian aggression and an economic crisis. Nevertheless, EU officials have voiced criticism on the lack of progress on several key issues during the last quarter—mainly anti-corruption reform. The EU is satisfied with the establishment of new anti-corruption agencies, but wants to see them fully operational and independent. Among key issues here are the lack of wiretapping powers at the National Anti-Corruption Bureau of Ukraine (NABU) and the lack of a vision for instituting special anti-corruption prosecution. Aside from these issues, the EU is also disappointed with the fact that the National Corruption Prevention Agency has still not appointed a fifth member to its board.

The EU officials acknowledge that the reform process is quite difficult because there are daily attempts to derail the process and the system keeps striking back against certain reforms. The EU also expects amendments

to a law passed in February 2016 that allows the post-election exclusion of candidates for the Rada who were elected on party lists. The Venice Commission has given the law negative assessment because it allows political parties to *ex post facto*<sup>4</sup> deny the electorate its choice through post-election exclusion. The trend has become even more alarming with the Rada’s consideration of a similar law for local elections, which is pending a vote on the final reading. Finally, new 12 members need to be appointed to the Central Election Commission, to replace mandates that expired back on June 1, 2014.

## Support for security

On December 19, the EU Council passed a resolution to extend sanctions against the Russian Federation until July 31, 2017. As before, the sanctions are restricting cooperation with Russia in the financial, energy, and defense industries, and trade in dual-purpose goods. This time, however, the extension was smoother than before and was not accompanied by media histrionics. The EU also increased its support for the OSCE Special Monitoring Mission (SMM) by allocating an additional €5mn.

Russia’s aggression in eastern Ukraine and its illegal occupation of Crimea faded somewhat from the headlines during the last months of 2016, with the exception of October 19, when the Normandy group met in Berlin and agreed to develop a Roadmap with a clear sequence for implementing the Minsk accords and guarantees that the agreed actions would be implemented. Although the meeting cannot be considered a breakthrough, it did contribute to solidifying commitments and keeping the ceasefire in place, however fragile it might be and however much it has been violated.

Ukraine has also been cooperating with the EU in the framework of its Common Foreign and Security Policy (CFSP) by aligning with EU declarations. In the first 10 months of 2016, Ukraine supported 19 CFSP declarations out of 26, comparable to 39 out of 45 in 2015.

## Expectations for Q1 2017

The first quarter of 2017 should be very busy in relations between Kyiv and Brussels. Positive decisions are anticipated on visa liberalization and the ratification of the Association Agreement. If these two components are delivered, then the two most important issues on the Ukraine-EU agenda will have been resolved and discourse towards Ukraine could change, forcing the country to devote more attention to reforms.

The reform agenda will remain focused on ensuring the independence and proper functionality of anti-corruption institutions, on fixing issues with law on *ex post facto* exclusions, on new appointments at the Central Electoral Commission, and on breaking up Naftogaz, the energy efficiency fund and the law on the electricity market.

<sup>4</sup> *Ex post facto* is a law or principle that retroactively changes the legal consequences or status of actions that were committed, or relationships that existed, before the enactment of the law.

**Events in Ukraine-EU relations  
(October-December 2016). Point-based evaluation**

Date	Event	Points
October 5	Ukraine becomes associate member of European Organization for Nuclear Research.	+2
October 13	President Poroshenko signs Law "On the ratification of the Agreement between Ukraine and the European Atomic Energy Community on scientific and technological cooperation and Ukraine's association with Euratom research and training program (2014-2018)."	+2
October 19	Normandy Format meeting on Minsk implementation takes place in Berlin	+2
	EU-Ukraine high-level political consultations take place in Brussels, with Ukrainian President Petro Poroshenko, European Council President Donald Tusk, European Commission President Jean-Claude Juncker, European Parliament President Martin Schulz, and members of European Commission.	+2
	Verkhovna Rada addresses EU Member States, European Parliament, Government and Parliament of Netherlands to complete process of ratifying Ukraine-EU Association Agreement.	-2
October 28	European Commission agrees to allow Gazprom to increase gas pumping capacity in OPAL pipeline, which connects Nord Stream with Central and Western European system.	-2
November 10	Ukraine signs European Social Security Code.	+2
November 11	Agreement is signed under which European Investment Bank will provide €200mn to improve public transport infrastructure in 20 cities of Ukraine.	+5
November 16	Verkhovna Rada adopts an appeal to governments of EU Member States, European Parliament and Council urging visa liberalization by end of 2016.	-2
November 17	Position on simultaneous entry into force of suspension mechanism with visa liberalization for Ukraine is adopted.	+2
November 24	EU-Ukraine Summit	+3
	Agreement on allocating €15mn from EU and €1mn from Government of Denmark to implement EU Anti-Corruption Initiative in Ukraine	+4
	Updated Memorandum of Understanding on energy partnership is signed between Ukraine and European Commission.	+3
November 25	EU increases support for the OSCE Special Monitoring Mission (SMM) by an additional €5mn.	+4
December 1	Ukrainian delegation visits Brussels to discuss cooperation between the European Defense Agency and Ukraine's Ministry of Defense.	+3
December 2	Joint Statement by Presidents of Ukraine and Poland on European Commission decision regarding OPAL pipeline	-2
December 5	EU Delegation in Ukraine issues statement on EU position on ban on unprocessed timber exports.	-2
December 7	Verkhovna Rada Committee on Fuel and Energy Complex, Nuclear Policy and Nuclear Safety supports setting up an energy efficiency fund.	+2
	European Parliament and Council agree on suspension mechanism, bringing Ukraine closer to EU visa liberalization.	+3
December 9	Trilateral EU-Ukraine-Russia energy consultations	+1
December 13	Association Implementation Report on Ukraine is published.	+2
December 15	European Council Decision on Ukraine Association Agreement	+3
December 16	Dutch Government passes bill required for the Ukraine-EU Association Agreement to be ratified by its Parliament.	+2
December 19	EU Council extends economic sanctions against certain sectors of the Russian economy until July 31, 2017.	+5
	Ukraine and European Commission sign agreement on financing joint cross-border cooperation programs for 2014-2020 under ENP framework, including "Ukraine-Romania," "Ukraine-Hungary-Slovakia-Romania," "Ukraine-Poland-Belarus" and "Black Sea." Total budget: €365mn	+4
	Memorandum of Understanding is signed between Government of Ukraine and European Investment Bank (EIB)	+4
	Agreement on EU funding for administrative reform in Ukraine is signed. Overall budget: €104mn	+4
	High-level conference on EU-Ukraine Strategic Energy Partnership	+3
	Ukraine and EU hold third meeting of Association Council in Brussels.	+3
December 27	European Court of Justice suspended the decision that granted Gazprom access to up to 80% capacity of Opal.	+1
	Ukraine received the second tranche of the EU financial aid amounting to €55mn in accordance with the agreement between Ukraine and European Commission signed in 2014.	+4

# UKRAINE-US RELATIONS

October-December 2016

Positive points: 28

Negative points: -6

Total Index: +22

## SUMMARY

*Ukrainian-American relations, in their classical sense, ceased to exist after the Nov. 9, 2016 Presidential election in the US. All there is right now is relations with the Obama Administration and relations between Ukraine and US president-elect Donald Trump. Different backgrounds, different approaches, different atmospheres... only Ukraine's expectations remain the same: if the United States cannot help defend Ukraine, then at least they will systematically help Ukraine defend itself.*

*Ukraine had finally managed to properly understand the logic of Obama's America and worked out a mechanism for partnering with it when the country found itself faced with a huge unknown in the form of Trump's America and its future approach to Ukraine. Significantly, world opinion about the possible consequences of a Trump presidency is much more dramatic than opinion in Ukraine itself. In Ukraine's government offices, Trump's election was a surprise but not a knockdown that might have forced them to leave the diplomatic ring temporarily and take up Ukraine's favorite holding position: "It'll work out somehow." Instead, the Poroshenko Administration clearly wants to establish contact with the incoming US Administration. It was obvious that even Kyiv was busy kicking around ideas about its American rather than completely delegating this to its embassy in Washington. However it might have criticized the Obama Administration, Ukraine is not ready to give up the level of relations that it had with the US over the last three years.*

*The biggest challenge facing Ukraine today in relations with the US is to persuade the Trump Administration and America as a whole that Ukraine is not a complete mess but an opportunity and a good place for American investment in the broadest sense of the word: politically, financially and security-wise.*

*Ukraine's success in relations with a Trump presidency will depend on how effectively Kyiv is able to formulate and persuade the new Administration of two key issues:*

- *What added value can Ukraine bring to the US?*
- *How much does supporting an independent Ukraine coincide with US interests?*

## TIMELINE

### **Obama's America: What legacy is being handed over to the 45th US president?**

Relations between Ukraine and the US went into transition mode even before the current election in the US. At some point, Kyiv's decision-makers understood that there were issues that the Obama Administration would simply not consider, such as a defense agreement between Ukraine and the US and the provision of lethal weapons. And so these issues were deliberately set aside for negotiations with the future US president, which Kyiv had thought would be Hillary Clinton.

Similarly, long before the election it also became clear that the Obama Administration was unlikely to make any major last-minute decisions in favor of Ukraine in the last days of his residence in the White House. Ukraine was not even in the running as a success story for Barack Obama personally and the White House was not prepared to seriously invest in either of its two priority policy tracks with regard to Ukraine: fostering domestic reforms and halting Russia's aggression. This was in marked contrast to, say, Joe Biden, who was pretty clear that he wanted to turn "Biden's pet project," as Ukraine was called in his circles, into a Biden success story as Vice President of the US.

What legacy did the Obama Administration, then, leave in each of the components of the US-Ukraine partnership, and which of them is it critically important to maintain under a Trump Administration?

First, there's restraining Russia's aggression. Despite the many critical assessments of the Obama Administration's policies in relation to Ukraine, the issue is where Obama's America has demonstrated really worthy leadership and consistency. There's the matter of sanctions against Russia and the ability to coordinate them at the international level, especially with the EU and the G7. Until his last month in the White House, Barack Obama clearly maintained his sanction-based approach both in terms of the strict tie between sanctions and the full implementation of the Minsk Accords and of a steady expansion of the sanction list. In the last quarter alone, the US three times expanded the sanction list against Russia, twice directly linked to Russia's aggression in Ukraine. Under a Trump presidency, maintaining sanctions against Russia for its aggression against Ukraine will likely become an open question. Most American experts and government officials agree that the new administration will be prepared to review the sanctions against Russia as it does not see any specific added value in terms of changing Vladimir Putin's behavior. Instead, the Trump team is actively promulgating the argument that sanctions

have only strengthened Putin's hand at home instead of changing his approach to Ukraine. In Trump circles, the preferred approach to lifting sanctions is not to tie them to the complete implementation of Minsk, but to phase them out gradually as a reward for each component that is implemented—an approach that is also favored among some EU members.

In Ukraine, fears that, in the last half-year of office, the Obama Administration would try to move towards a political solution to the Donbas situation in line with the Minsk Accords were needless. Ukraine's American partners reassured Kyiv that the US would not demand that Ukraine fulfill Minsk against its own interests and that it was not a matter of principle for the US to resolve the conflict by the end of President Obama's term, although these reassurances were somewhat skeptically received in the Ukrainian capital. The Poroshenko Administration still remembered the pressure put on Ukraine earlier by Assistant SecState Victoria Nuland and especially during talks between Poroshenko and Vice President Biden in New York last September.

In the last months of his presidency, Obama had US diplomats work on two objectives with regard to the Minsk Accords, neither of which involved pressuring Ukraine to carry out the political components. In fact, the point was to ensure that Ukraine was not accused of disrupting the Minsk process, in particular for violating the process of pulling back forces and provoking a humanitarian catastrophe in Donbas by, for instance, interfering in the water supply. American diplomats are convinced that Minsk will work in Ukraine's favor if the country manages to demonstrate on an ongoing basis that it is a pro-active, constructive participant in the negotiations. All told, the United States has made it clear on more than one occasion that its priority is to prevent new escalation in Donbas, rather than a permanent resolution of the conflict. It was already clear in 2015 that the US was mentally prepared for occupied Donbas to become a frozen conflict.

By the end of Barack Obama's second term, Ukraine and the US had established a very comfortable mechanism for cooperating on security issues. Ukraine's Defense Ministry and General Headquarters note that the level of intense cooperation with the Americans is greater than with any other country. The hopes that there would be real, hands-on cooperation with NATO ended up being realized on a bilateral basis with the US instead. Moreover, the US delegated as an advisor to the Ukrainian defense agency legendary General John P. Abizaid, US Army (ret.), who has been able to visit Kyiv several times already and about whom only positive feedback has been forthcoming. According to available information, the Defense Ministry initially wanted Gen. Philip Breedlove to be their advisor, but certain restrictions on taking on such a function immediately after ending his term as head of the US European Command and the 17th Supreme Allied Commander Europe of NATO, this option was discarded and Abizaid was proposed instead. Insiders say that Gen. Abizaid is still studying the situation, among others by visiting the ATO zone, and has not been offering specific

advice so far. Moreover, he warned from the start that Ukrainians themselves would have to eventually decide which of his advice was worth following and which was not.

The impression is that Kyiv only began to appreciate the consultative and advisory assistance provided by the US this last year: prior to that, the focus was only military aid. In addition to 350 instructors at the Yavoriv base who have been training the Ukrainian army, there have also been American advisors who helped in drafting doctrinal documents. Importantly, this is precisely about consultative assistance from the US, as positive feedback about NATO advisors has been the exception rather than the rule. A four-star general like Abizaid, about whom Clint Eastwood even made a film, could become an important voice in support of Ukraine—especially given that Donald Trump admires the legendary soldier enormously

For Ukraine, the critical point is that cooperation in security and defense must remain a priority for the new president. American insiders are generally predicting that security programs, including training and consultation, will remain in effect. Possibly such programs will be under greater scrutiny as to their results. Earlier, several members of the Trump team even mentioned the possibility that Ukraine would be sold some lethal weapons—but not given them.

But it's important for Kyiv that Ukraine continue to get military assistance. The Defense Ministry and General HQ are counting on more supplies of electronic weapons, communication systems, which are in tremendous need in order to establish a proper management system that is based on them, drones of different capacities, RLS for countering artillery attacks, and medical rehabilitation equipment. Ukraine could also use US assistance in building up its Navy fleet. Some steps in these various areas have already been taken at the Congressional and State Department levels.

For instance, Congressman Duncan Hunter (R), himself an ex-marine who visited the war zone in Ukraine in 2015, proposed that the foreign relations and armed forces committees in the House of Representatives consider a bill to provide Ukraine, among others, with equipment for electronic warfare to protect drones and monitoring sensors. The bill also provides assistance to Ukraine in establishing its own anti-tank manufacturing and setting up training centers for special forces. Eight electronic surveillance towers equipped with radar and cameras that make it possible to observe that is happening at a distance of 64 kilometers, deep into the occupied territories, will be constructed under a contract approved by the State Department with Worldwide Aeros, a California company owned by Igor Pasternak, who is himself originally from Ukraine.

Another piece of good news was the US's official passing of the 2017 defense budget in which US \$350mn is allocated for assistance to Ukraine—US \$50mn more than in the previous budget because of the additional provision of means and technical support to develop an integrated system for monitoring the state border and

assistance in training staff officers and senior military commanders in Ukraine's Armed Forces.

As to the second track of the Ukraine-US partnership, fostering reforms in Ukraine, especially the war on corruption, it's clear at this point that President Poroshenko was not able to come through with a pleasant surprise for the Obama Administration as a determined reformer. "In its current state, Ukraine needs a president who is capable of being a radical reformer, but Poroshenko, as we've seen, is not the man," a representative of the US government said about Petro Poroshenko in an off-the-record conversation. This pretty much reflects the dominant opinion in Washington.

Nor was Premier Volodymyr Groisman able to instill any special confidence in Washington: members of the American diplomatic corps and the Congress have shared what they have seen, in informal discussions: Groisman has clearly been given certain limits beyond which he can't take the reform process. At the same time, these officials say that they had hoped that he would not be so loyal to these limits and would be bolder in taking on reforms. "We understand that Groisman has a more difficult task in establishing himself as a reformer than did Yatseniuk because things have become tighter and the reforms that need to be undertaken now will be much more painful than those undertaken by Yatseniuk. It's not clear that Yatseniuk would have been any better as premier under the current circumstances, except that maybe his international PR would definitely have been better," some US government officials openly admitted in November 2016.

The replacement Prosecutor General, Yuriy Lutsenko, also failed to live up to the promise Americans were hoping for after giving him virtually complete *carte-blanche* in reforming the Prosecutor General's Office in summer 2016. In this case, the Americans painted themselves into a corner by personalizing the PGO with the notion "anybody but Shokin." It didn't work. They spent the lion's share of energy and time advocating powers for their pet project, the National Anti-Corruption Bureau of Ukraine (NABU), and getting the PGO to accept it. Even so, they haven't risked calling this a reform success story yet, given the unreasonable expectations of the scale of activity of this anti-corruption agency. It's not clear whether Biden meant it as a challenge or a plea, but at a business forum in 2015, he said, "Put people in jail," a call that completely matches the mood among ordinary Ukrainians, but failed to be heard by Ukraine's leadership in 2015 and 2016.

There are other issues, too, that gave rise to concerns on the American side. Some of them, the Ukrainian side was clearly not prepared for. For instance, the Presidential Administration was surprised at the concerns expressed at a meeting between Administration officials and the new US Ambassador, Marie Yovanovitch, where she noted that the recent quotas for Ukrainian music on the radio interfered with free speech.

Arsen Avakov has attracted considerable interest. As one American diplomat said privately, "We understand that Avakov is #2 in Ukraine today in terms of influence."

Still, Bill #5094, the STAND for Ukraine Act, did not reach its logical conclusion in these last months, that is, President Obama never did sign it into law so that the US president would not be allowed to recognize the annexation of Crimea and give Congress the go-ahead to lift sanctions. Bill #5094 in support of Ukraine now remains in committee in the US Senate. According to the latest information, Committee Chair Bob Corker (R), who was considered one of the candidates for the post of Secretary of State immediately after Donald Trump's victory, took the position that the bill was premature and succeeded in quashing it. This means that, for the Bill to be passed in 2017, it will have to go through the entire process in Congress again, meaning pass the Senate and House of Representatives. Some say that ExxonMobil, whose former CEO, Rex Tillerson, was nominated for SecState by Trump, was actively lobbying against the bill, but Tillerson has denied this.

In spite of all this, it's clear that the US Congress remains the strongest voice on Ukraine's behalf. Even if STAND for Ukraine is not pass, other bills are likely to be presented to the Congress that also offer support to Ukraine and for the maintenance/institution of sanctions against Russia. There is already one comprehensive bill on the floor that is intended to provide for additional sanctions against Russia that was sponsored by well-known Democrat Senator Ben Cardin.

One important recent political signal was an appeal by 27 senators to the President-elect of the United States calling for him to increase its political, financial and security assistance to Ukraine. Significantly, more Democrat senators signed the letter than Republican ones, diffusing the stereotype that Republican Party in the Congress is the more pro-Ukrainian one. Effectively a continuation of this appeal was a regional tour that included Ukraine, initiated by Republican Senators John McCain and Lindsay Graham to confirm US support.

In the last months of the Obama Presidency, however, there was investment breakthrough in relations between Ukraine and the United States. For the US, the test case was supposed to be the privatization of the Odesa Port Plant (OPP), which turned into yet another reputational fiasco for Ukraine. Americans, who have shown serious interest in this asset for several years now, finally walked away when they began to suspect that political games were going on around its sale and found out that OPP supposedly owed Dmytro Firtash something like US \$250mn. Nor should anyone be misled by an application from IBE Trade Corp of New York, whom some US businessmen call "not entirely American," given that its owner, Alex Rovt, is originally from Mukachiv.

Ukraine failed to improve its investment appeal for American investors even with the personal involvement of US Secretary of Commerce Penny Pritzker, who apparently personally called the executives of several US companies to invite them to the Ukraine-US Business

Forum. Even the most optimistic in American business circles say that Ukraine needs to concentrate on holding on to those investors who are already on its market and provide incentives for them to expand their investments, rather than worrying about attracting new ones. Given the country's current problems, it's a tall order to even get those investors who are already working on the Ukrainian market to get involved in new projects.

## **Trump's America:**

### **A choppy start to an unclear finish**

Although the international press included Ukraine among active supporters of a Clinton win in the presidential election, the Poroshenko Administration continues to insist that Poroshenko himself never made any gesture indicating that he favored Hillary Clinton. Requests to meet with the President of Ukraine in New York in September were sent to both candidates, although the official explanation on the Ukrainian side about "conflicting schedules" was not taken at face value in the US.

In the heat of the campaign in the US, President Poroshenko did receive one close advisor of Trump's, Newt Gingrich, and his wife. According to several Ukrainian diplomats, he also was very careful to maintain a balanced approach and to ignore provocative statements in the US press on this issue. His interview with Fareed Zakaria on CNN was a particularly good example of this.

Despite Ukrainian claims that Poroshenko distanced himself from the presidential race in the US, the biggest headline was the scandal involving the one-time Yanukovich and Trump consultant Paul Manafort who, according to some American sources, is convinced that the information implicating him in the Party of Region's black book was leaked into the US press on behalf of the Democratic Party. No surprisingly, the minute Trump was elected president, the director of the National Anti-Corruption Bureau of Ukraine announced that its investigation into Manafort was being suspended. The issue became even more complicated when, after a pause, Manafort began to once again be seen in Trump's circle. According to various American sources, he was even actively involved in discussions over various candidates in the incoming Administration. How much of a role he will play in forming Trump's Ukraine policies remains an open question. Obviously, Ukraine will have a difficult time establishing a trusting dialogue with the Trump Administration if Trump himself, under the influence of those he trusts most, has already been convinced and will consolidate the belief that Russia is the country that helped him become president, while Ukraine was the country that tried to get in his way.

Regardless of the Manafort factor and the absence of a meeting with Trump in New York, at the official level at least, Ukraine is not inclined to over-dramatize the situation and to see itself as the biggest loser in the world over the results of the US presidential election, as former Russian Ambassador Michael McFaul notably tweeted. There are a few reasons and explanations behind this.

First of all, the Poroshenko Administration was already disappointed with the Obama Administration's Ukraine policies. The very fact that Barack Obama was the first American President who never once found the time or need to visit Ukraine during his 8 years in office is probably said more than any number of declarations of support. This disillusionment with the outgoing Administration will undoubtedly be exploited by Ukrainian officials when they begin communicating with the incoming one. The belief that, had Obama reacted immediately to the attempt to annex Crimea, Russia's aggression would not have gone forward is something members of the Trump team have concurred with at meetings with their Ukrainian counterparts. According to some sources, even Vice President Biden hesitated about visiting Ukraine in the run-up to the inauguration of the new president. Apparently, he was concerned about complicating Ukraine's contacts with the new US Administration by demonstrating with his presence in Kyiv that Ukraine was the pet project of key members of the "old" one.

Secondly, both in Kyiv and partly in Washington there is a feeling that Donald Trump will, for a variety of reasons, not be especially active on the state of reforms and the progress of the battle with corruption in Ukraine as individual members of the outgoing Administration have been, and as a Clinton Administration would likely have been. This completely suits top officials in Kyiv, who would rather wrap their partnership with the US in a security blanket than anti-corruption armor. Still, it's not worth ignoring the fact that its inadequate approach to corruption could also become a convenient excuse for the Trump Administration to write Ukraine off its list of foreign policy priorities. It's also quite probable that the new US team will be more particular about any assistance provided to any country at taxpayer cost. This means that the Ukrainian Government should itself propose an audit of US aid in Ukraine, to show that the country is not prepared to waste a single cent of American assistance.

Thirdly, Kyiv seriously doubts that Donald Trump will, unlike his predecessor, be able to "reset" relations with Putin's Russia for long, although there is no question that in the early stages of his presidency Trump will likely try to do this and—equally likely—with out taking Ukraine's interests into account. Still, there is reason to believe that these restraining factors as bipartisan consensus in the Congress on support for Ukraine, varying positions within the Trump Administration, and the debate that has risen as a result of the intelligence community's investigations will prevent the new US President from achieving a grand bargain in the Russian sense, unless Ukraine itself proposes or approves of it.

Trump's victory was as unexpected for Ukraine as for anyone else, but it seems to have given a new lease on life to Ukrainian politics in relation to the US. A series of brainstorming sessions were held at the highest level to determine the most effective way to establish relations with the new American Administration and independent analysis of the US became very much in demand. A roundtable dedicated to the Trump win was held in the Verkhovna Rada, although, admittedly, very few deputies attended. Finally,

the beginnings of an action plan to get the US interested in Ukraine emerged: not to obligate, as it had been under President Obama, but to interest. Indeed, the desire to interest the new Administration is so strong that in places it's on the edge between "interesting" and "cajoling".

As posted on the US Department of Justice website, the Poroshenko Administration has even hired a lobbying firm in the US – BGR Group, founded by Haley Barbour, a governor of Mississippi and one-time chair of the Republican Party committee, at a monthly cost of US \$50,000 to, among others, strengthen ties between Ukraine and the US. Ukraine has long needed a serious lobbying firm in Washington to promote the country's interests as opposed to those of individual oligarchs. Recommendations to this effect were included in a study of Ukraine-US relations as part of a Foreign Policy Audit. It can only be hoped that the BGR Group will, in fact, promote state interests and not just those of President Poroshenko.

An action plan has been prepared at the highest level that outlines how relations with the new President and his team will be established and the proper signals transmitted. Official Kyiv's approach is pretty clear: a drop of water can hone a rock, so waiting, hands folded "until they surrender us" is not the answer. Ukraine's new foreign-policy pro-activeness towards the US can only be welcomed: it's simply a pity that it emerged only after the election of Donald Trump to the presidency.

In order to have any hope of influencing US policy towards Ukraine, all possible communication channels have been set in motion. One, for instance is between Vice Presidents Biden and Pence. During the transition period, Biden took advantage of the process of handing over his affairs to familiarize Pence with the situation in Ukraine and to somewhat emotionally inspire his successor regarding the Ukraine dossier. In diplomatic circles, rumors even went the rounds that Biden said something to the effect: "I won't visit Ukraine until I'm positive that my successor understands everything about Ukraine."

During the first six weeks after the election, key emissaries from Ukraine actually visited Trump Tower in New York and had an hour-and-a-half conversation with already-nominated Trump national security advisor, Gen. Michael Flynn. Reports were entirely positive: Flynn, who has been accused of very pro-Russian views after being photographed at an RT anniversary party at the same table as Vladimir Putin and his commentary on this propaganda channel, seemed very pleased with his interlocutor and left a better impression than is generally had of him in the US. One of Flynn's assistants at the meeting left an even more positive impression: she clearly was very well briefed and understood what was going on in Ukraine.

A conversation between Trump and Poroshenko also left a positive impression. Interestingly, Trump was prepared to talk with President Poroshenko the same day as he spoke with Vladimir Putin, Monday, November 14. But since Poroshenko was then in Sweden and wanted to be reassured that the call was really from Trump, after an earlier scandal with a call

from "the President of Kyrgyzstan" who turned out to be a well-known Russian prankster, because Trump was calling from an ordinary cell number. So the conversation was postponed to the 15th. Three elements were demonstrative in the eventual conversation. Firstly, without any diplomatic formalities, Trump asked Poroshenko to tell him about the aggression. The important point there was that Russia's aggression was actually called aggression. Secondly, Trump asked what Obama had done to stop the aggression. Thirdly, as far as anyone knows, Trump never once brought up the subject of reforms and fighting corruption, which were the top priorities on the Ukraine agenda under the Obama Administration.

Still, there are many issues on which neither Kyiv nor Washington have an answer yet, issues that represent both risks and opportunities for the partnership, including

- How critically important in any reset with Russia the positions of other key members of the Administration will matter to the new President? Indeed, it's not even clear what the role of the State Department will be, whether it will have virtual *carte-blanc* in this region or will turn into an appendage of the National Security Council in foreign policy terms, as it *de facto* was under Obama.
- How might a good story about Ukraine be formulated and delivered to Washington, based, as US Ambassador to Ukraine Marie Yovanovitch recommends, on facts? How might a narrative be presented about Ukraine as a country that is worth American investment in the broadest sense: political, security and commercial investment that would then be worth defending?
- To what degree will the US under President Trump feel the need to increase its role in the process of resolving the situation in the Donbas? Kyiv is looking at the idea of inviting the new President to join the Normandy format, with the approval of the German Chancellor and the French President. So far there is no reason to think that Trump will be excited about this given that he has consistently—unlike his usual wont—insisted the Germany should handle the Ukraine question. The fact is that neither Germany nor France will be particularly focused on the Normandy format in 2017 because of their own elections, so the US President-elect could actually take on a leadership role in this area.
- What will be the conditions for further assistance to Ukraine? All American representatives are of one thought on this: any new US aid to Ukraine will have even more conditions attached to it than under the previous Administration. Funding in return for firing Shokin was only the start of this new approach.

And so, Ukraine's success in relations with Trump's America will come down to how effectively the country will be able to formulate two main points and persuade the new Administration:

- What added value can Ukraine offer the United States?
- To what extent does supporting an independent Ukraine correspond to US interests?

If it succeeds, the Ukrainian droplet will far more effectively be able to smooth out the American stone.

### ***Events in Ukraine-US relations (October-December 2016). Point-based evaluation***

<b>Date</b>	<b>Event</b>	<b>Points</b>
October 6	US Ambassador to Ukraine Marie Yovanovitch notes that the US is monitoring attempts to restrict the independence of NABU in investigating corrupt activities and give the PGO the opportunity to determine the order in which criminal cases are handled.	-1
October 18	The US launches the Antares OA5 rocket, which is manufactured by a series of international companies under the direction of Orbital Science Corporation (US). The first stage of the launch vehicle was developed in Ukraine.	+3
October 25	President Poroshenko and Vice President Biden talk over the phone. Biden is updated on the progress of the Normandy talks in Berlin and the need to actively engage the American side in implementing the Minsk Accords is underscored. The American report on this conversation notes the importance of de-escalating and the need to continue to withdraw forces from the line of contact, as well as the need to support sanctions against the RF until the Minsk Accords are fully implemented.	+1
November 2	The US State Department gives high marks to the e-declaration campaign in Ukraine and calls for those who have used public office to enrich themselves to be brought to justice.	+1
November 9	Donald Trump wins the US presidential election. This raises concerns in Ukraine about Washington's further steps in bilateral relations and on issues related to the Russian-Ukrainian conflict because of Trump's contradictory statements during his campaign.	-3
	US Ambassador to Ukraine Marie Yovanovitch announces that the US will continue support Ukraine regardless of who is president and the US will remain a powerful partner. This is primarily confirmed in bipartisan Congressional consensus on the need to support Ukraine.	+1
November 14	The US Treasury institutes sanctions against 6 members of the State Duma of the Russian Federation from Crimea.	+2
November 15	President Poroshenko holds a telephone conversation with US President-elect Donald Trump. According to the Ukrainian side, the two agreed to continue their contact and, among others, hold bilateral meetings.	+3
November 16	President Poroshenko holds a telephone conversation with outgoing US Vice President Joseph Biden. They discuss regional security and bilateral relations after the presidential election in the US. The need to coordinate actions until Russia completely complies with the Minsk Accords and to maintain the sanctions policy until Ukraine's sovereignty and territorial integrity are completely restored.	+1
November 17	During a joint press conference, Barack Obama and Angela Merkel confirm that sanctions against Russia will remain in place until the RF complies fully with the Minsk Accords and that Ukraine has the right to freely determine its own destiny.	+1
December 3	The Trump team announces that he will nominate retired USMC Gen. James Mattis for Secretary of Defense. In May 2015, Mattis spoke at the Heritage Foundation about the need for the US to respond to the Russian Federation's actions in Ukraine.	+1
	Ukraine and US fully agree to plans for holding the Sea Breeze 2017 multinational military exercises.	+1
December 3, 8, 23	The US Congress, starting with the House of Representatives and then the Senate, approves a bill with the 2017 defense budget and President Obama signs it into law. Accordingly, Ukraine will get US \$350mn to increase its defense capabilities in 2017.	+4
December 9	27 US senators from both parties write an open letter to President-elect Donald Trump calling on him to strengthen America's political, economic and military support for Ukraine, including lethal defensive weapons, as well as to not acknowledge the illegal annexation of Crimea by Russia and to maintain sanctions against the RF until key provisions in the Minsk Accords have been fully implemented.	+2
December 13	Word comes that Donald Trump plans to nominate ExxonMobil CEO Rex Tillerson for Secretary of State. In 2014, Tillerson spoke against US sanctions against Russia.	-2
December 16	President Poroshenko held a telephone conversation with outgoing US Vice President Biden, who supported Poroshenko's humanitarian initiative to release 15 held individuals as a way of unblocking the prisoner exchange process.	+1
December 20	The US extends sanctions to an additional 7 individuals and 23 companies as being linked to Russia's aggression against Ukraine.	+3
December 31	A delegation of US senators visits Ukraine.	+3

# UKRAINE-RUSSIAN FEDERATION RELATIONS

October-December 2016

Positive points: +7

Negative points: -39

Total Index: -32

## SUMMARY

*This area of Ukraine's foreign relations picked up considerable pace over October-December 2016, although not always in relation to foreign policy. In fact, Russia began to make itself felt more and more in domestic scandals: rumors began to circulate that Moscow was preparing a special operation to destabilize Ukraine. Whether because the actual plans were revealed or possibly fabricated documents about such plans were, the operation collapsed before ever getting off the ground. The first phase was supposed to be mass protests but they failed to materialize.*

*This does not at all mean that Russia's role in domestic political matters remains marginal. Information sources both in Russia and Ukraine, especially in that segment associated with pro-Russian political forces, have been widely publishing articles primarily targeting President Petro Poroshenko. Vladimir Putin himself decided to hit his Ukrainian counterpart in his Achilles' heel. It seems that the informational tidbits tossed during the reporting period may have just been practice for more serious special ops.*

*The armed conflict in eastern Ukraine intensified at the end of 2016. Neither the Normandy talks nor the latest agreement about a ceasefire after December 24 has made any difference. Most likely this state of "neither peace, nor war" will continue in this year, given that Vladimir Putin seems to have gone into waiting mode. Initially, Moscow is likely to try to come to some arrangement with Washington, then with Paris. Russia is nurturing some expectations for a change in Germany's leadership as well.*

*Meanwhile, 2017 could be a kind of a 'Judgment year' in relations between Ukraine and Russia. In the first few months, the Stockholm court is expected to hand down its ruling in the gas dispute between the two countries. More verdicts and lawsuits follow that could potentially deal a blow to Russia's reputation and finances alike*

## TIMELINE

### Putinesque maneuvers

Putin's dreams began to come true towards the end of 2016. The electoral victory of Donald Trump, who is clearly inclined to engage with Russia, gave the Kremlin a boost after years of ineffective negotiations regarding Ukraine under the Obama Administration. Russia's leadership had not placed much hope on resolving its conflict with Ukraine through the mediation of Germany and France, either, so its enthusiasm for Trump was palpable. As the year drew to an end, Russia's efforts to drag out the negotiation process became more and more obvious: the Normandy summit on October 19, 2016, held in Berlin, looked like a kind of compulsory test that Vladimir Putin, due to Russian version, successfully passed and could next prepare for diplomatic breakthroughs with, as he may consider, more amenable partners.

In the last three months, relations between Ukraine and Russia have not progressed in any way. The two countries' leaders are no longer on speaking terms: the Russian president has remained true to his word and refuses any kind of bilateral contact with his Ukrainian counterpart since the so-called Crimean diversion last August.<sup>5</sup> The

one exception was the Normandy talks, where Putin was pretty well forced to attend. Among the reasons were the cancellation of his visit to France because of Russia's bombing in Syria, and announcements by EU leaders that they would add new sanctions against Russia over those same military events in the Middle East. And so the meeting, which was originally planned for September in China as part of the G20 Summit and was cancelled unilaterally by the Kremlin, took place after all.

In the end, Putin behaved entirely diplomatically during the Ukrainian part of the talks, agreeing to compromise even on those points that should not have been particularly pleasing to the Russian side, such as establishing an OSCE policing mission in Donbas. Still, it was obvious that Ukrainian issues were being treated as a secondary matter. The main topic of discussions for Germany, France and Russia was, nevertheless, Syria. What's more, there was little point to Putin offering any promises at these talks as they were not binding in any way: the roadmap needed to be further approved at the ministerial level a few weeks later—which made it easy for Moscow to renege on any point.

Neither Ukraine nor Russia was prepared to give way to the other, although each of them had to demonstrate a

<sup>5</sup> Russia accused Ukraine of sending operatives to sabotage installations in Crimea, a charge Kyiv rejected outright.

willingness to regulate the conflict through negotiations: Putin was worried that the EU might add further restrictions to existing sanctions, while official Kyiv was worried that the EU might not even extend the existing sanctions against Moscow. In the end, both Ukraine and Russia got what they wanted: the Syrian sanctions package was tabled, while sanctions connected to the Minsk process were extended for another six months—not that this brought the situation in Ukraine any closer to a resolution. Ukraine’s leaders offered the standard argument for regulating the conflict in Donbas: first resolve security issues and only then we can move to the political phase, including local elections.

Ukraine’s diplomats offered the usual explanations: with a war going on, constant violations of the public peace made it impossible to talk about an election campaign that meets international standards. There are other, not-so-public explanations: Russia has gamed Ukraine more than once just as soon as some agreement was reached. For instance, as a result of the first Minsk Accords, a decision was made to hold local elections on the occupied territories in line with Ukrainian law, which meant holding such elections on Dec. 7, 2014. In defiance of this, Russia’s proxies organized an election on Nov. 2. The second set of accords was signed in February 2015 and was also subject to serious violations on the part of the militants: for instance, Debaltseve, a key railway hub, was occupied days after the ceasefire had been signed. Kyiv is worried that any new agreements will end up being violated by Russian tricks. During these negotiations, Ukraine’s leaders have taken to justifying their demands because “Ukrainians won’t understand us” and “This could destabilize the situation.” And they are insisting that every single step be clearly defined in the resolution process.

The result was that the October Normandy talks led to a decision to prepare a roadmap to implement the Minsk Accords. The main disparity is in the approach to a resolution: where Russia insists on a parallel process, and Germany and France see no problem with that, Ukraine is adamant that each phase in the process be carried out consecutively. First there must be a ceasefire and the truce has to last at least 30 days without violations; only after this can Ukraine begin to approve the legislation required to hold local elections. Meanwhile, Russia keeps insisting that the legislation can be passed earlier, because among of the key priorities for Russia’s negotiators are special status for the occupied territories and a complete amnesty for its proxies.

This last Normandy meeting was accompanied by well-prepared public awareness campaigns both in Ukraine and in Russia. Russian media was filled with commentary about how the Normandy meeting would be dedicated to putting pressure on Ukraine. In Ukraine, meanwhile, there was no doubt that pressure would primarily be put on Putin. Details about the progress of the talks flowed from both the Ukrainian team and the Russian president. Among others, the Ukrainian press buzzed for several days about how President Poroshenko had supposedly

raised his voice at President Putin. The Russian press, on the contrary, said that pressure was being put on the Ukrainian leader: due to Russian version, he was supposedly frequently asked by Angela Merkel to leave the room “for five minutes,” after which he “agreed with everybody.” The objective of the representatives of the two sides came down to portraying their leader as the hero of the negotiations.

The truth was that the talks did not require any heroics from anyone, given that the two sides knew in advance that they weren’t prepared to agree to anything. The announcement that a road map would be prepared by the end of November was just pseudo-news. Everyone understood that the press needed to present at least some kind of result and so the formula was “to agree to agree.” This was particularly obvious in the Normandy talks involving the foreign ministers, which took place on November 29 in Minsk. Diplomats who were at the talks later reported that the Russian minister had “smoked endlessly, making it clear to all that these talks did not concern him.”

Over this period, the Russian president publicly criticized the Normandy format at least twice, claiming it was ineffective and stagnant. Such statements were designed to bring western partners around to an idea long promoted by the Kremlin: carrying out further talks in a bilateral format between Moscow and Washington. Russia is confident that Ukraine would be forced to carry out any decisions thus reached. Moscow also believes that the European Union will have little choice but to accept any agreements between Russia and the US.

Ukrainian diplomats are convinced that Russia is now in waiting mode. Initially, Moscow was counting on Donald Trump winning the US presidency, and then on a change of leadership in France. Further on, the Kremlin is hoping that the German Chancellor will lose position and become more conciliatory during that country’s next election campaign. With new negotiators lacking in-depth knowledge of all the nuances of prior discussions, Russia also hopes to be able to manipulate and distort things in its favor. Ukrainian FM Pavlo Klimkin has already expressed regret that Frank-Walter Steinmeier will no longer represent Germany at the talks, as he is expected to take on the post of FRG president in March 2017.

Among Ukraine’s leadership, Russia’s apparent choice of a wait-and-see approach suggests that there won’t be any major changes in its policy towards Ukraine, either. Most likely, the current low-intensity conflict will simply continue: for Russia, there’s no point in stopping it, but any move to large-scale aggressive actions is likely to damage already-established dialog with the new American and, later, French and German administrations, from the very start. (On the other hand, Russia may launch more intensive military actions to force negotiators to be more concessive).

Meanwhile, the OSCE SSM reported that the largest number of violations of the ceasefire was recorded in November 2016 since the beginning of the year.

Especially intense fighting on the Svitlodarsk Bulge on December 18-20 became a kind of climax in the Russian-Ukrainian stand-off of the last year, culminating in mutual accusations of provocations, multiple deaths and dozens of wounded on both sides. According to Ukraine's generals, Ukraine made 119 calls for a ceasefire over the three days of ever-increasing fire. Chancellor Angela Merkel and President Poroshenko met in an emergency session. Members of the Trilateral Contact Group agreed that a ceasefire would begin on December 24 due to the New Year's and Christmas holidays, but the Russian-sponsored militants violated the truce within 25 minutes.

Altogether, the Ukrainian army lost 211 combatants and 256 non-combatants over 2016. There were 300,000 violations of ceasefires, leading to the deaths of 83 local civilians, while another 305 were wounded. All told, 9,758 people died between mid-April 2014 and December 1, 2016.

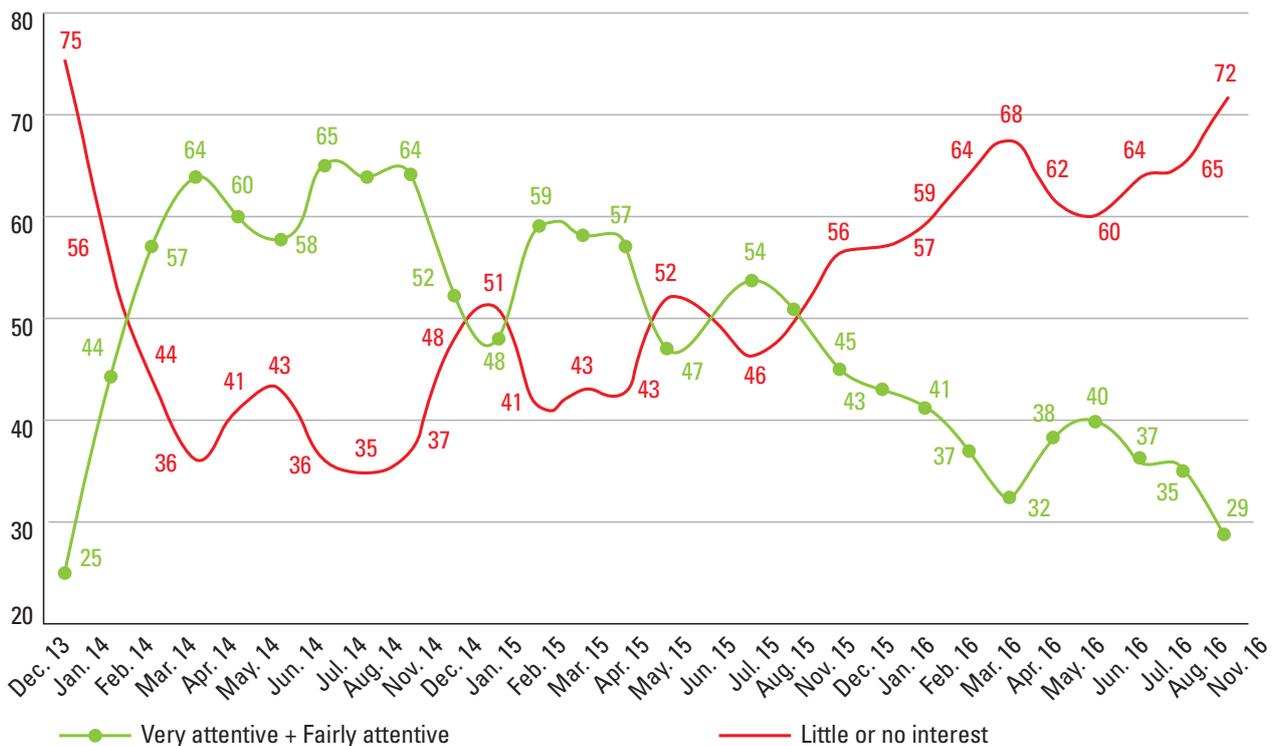
It's still not clear whether Russia will resort to a large-scale military campaign against Ukraine in order to mobilize voters during its 2017 presidential campaign. Opinion polls taken in Russia have shown a steady decline in interest in Ukrainian affairs among ordinary Russians: in November 2016, it was a record low of 72%. The last time it was similarly low, 75%, was in December

2013, at the very beginning of the Euromaidan. But this only suggests that, if necessary, public sentiment could be awakened very easily among Russian, given that the Euromaidan drew very strong interest within just a few weeks (see Figure 1). What's interesting is that actual attitudes among Russians towards Ukraine have not changed over the last two years: in September 2016, 56% felt negative towards Ukraine, compared to 49% in May 2014. In other words, the foundation is in place to stir up a new round of public hysteria and distract Russians from domestic problems.

From time to time, the informational environment in Russia is "enriched" with stories whose purpose is, in fact, to maintain a constant hostile attitude towards Ukraine. For instance, on October 16, the news came out that Arsen Pavlov, aka Motorola, a Russian militant-turned-hero by Russian talking heads, had been killed. The peak of public hysteria was reached in Russia when presenter Dmitri Kiseliov declared on the Rossiya channel: "This terrorist act was sanctioned by Poroshenko [sic]." Bilateral tensions grew as Russia made hostile comments over missile training in Ukraine at the end of November. During this entire period, Moscow continued to try to scare the world with claims that Ukraine was incapable of operating as a transit country for Russian fuels.

Figure 1

*Interest in events in Ukraine among Russians<sup>6</sup>.  
Trends in attention to events in Ukraine among Russians*



<sup>6</sup> This survey by Levada Center was carried out November 18-21, 2016, and involved a sampling of 1,600 urban and rural Russians over the age of 18 in 137 population centers in the 48 regions of Russia. The survey took place in the form of a personal interview in the homes of respondents. <http://www.levada.ru/2016/12/02/ukrainskie-sobytiya/респондентів методом особистого інтерв'ю>. <http://www.levada.ru/2016/12/02/ukrainskie-sobytiya/>

## Whose “connecting rods”?

Talk about a Russian fifth column has long been a component in Ukraine’s domestic political discourse. Until recently, scandals involving suspicions directed at one public person or another were not very common, but now they have reached epic proportions. President Poroshenko went so far as to say that, thanks to the Armed Forces, Russia was forced to focus its efforts on internal destabilization rather than a military offensive against Ukraine. In the last three months, a number of scandals broke that showed clear evidence of Russia’s fingerprints.

It began with a hack into an e-mail account belonging to Putin aide Vladislav Surkov, which revealed an alleged plan to destabilize the situation in Ukraine. The Security Bureau of Ukraine (SBU) issued a special statement that outlined the main phases of Russia’s interference in the country’s domestic affairs. The main objective of this supposed special op nicknamed “Shatun” or “connecting rod” was to have a snap election called. The Shatun plan was carefully scrutinized in Ukraine and what was most striking was that it contained many grammatical errors that are typical mainly of Ukrainian speakers, including the declension of male surnames ending in “o.” Nevertheless, the SBU maintains that the document is genuine. The special op was apparently supposed to go into motion on November 15, leading to massive protests by November 25. The SBU also announced that there were other documents that apparently had as a goal to destabilize the situation in 10-15 regions of Ukraine throughout November. The overall goal was to bring a pro-Russian leader to political force to power through a snap election. By the end of the year, nobody was talking openly about this special operation any more, except maybe for a laugh or as a joke.

This does not mean that Russia was not working to destabilize Ukraine and discredit its leadership, both at home and abroad. The interventions have been happening even in more savvy ways (such as statements of labourers from Ukrainian companies to resume economic cooperation with Russia). Ukrainian businessman Victor Pinchuk proposed its own peace plan on the pages of *The Wall Street Journal*. The representatives of Ukrainian authorities tend to consider the boom of voices ‘for peace at expense of national interests’ as an expression of hybrid warfare carried out by Russia.

The main object of its informational assault was President Petro Poroshenko himself. It’s also obvious that the Presidential Administration has long and specifically been preparing to fend off just such an attack against the Ukrainian leader’s business in Russia. Opposition media in Ukraine have often raised the argument, “Ukraine is fighting Russia but the president keeps trading with Russia.” It got to the point that even the Russian president brought this fact up at a meeting with international experts at the Valdai Club: “The [Poroshenko] factory works like clockwork, pays wages, earns profits, and has no restrictions related to how it uses those profits...” Putin was well aware of the consequences of his statement, said

in a very condescending tone. And it spread like wildfire in the Ukrainian press. The Ukrainian president’s inner circle took the Russian leader’s statement as a deliberate set-piece: it drew attention to the fact that Putin was responding to an “unexpected” question from a Russian expert known to be in the Kremlin’s pocket. The Roshen company also was clearly prepared for something like this, only perhaps not coming from the president’s mouth. Putin’s “assault” came on October 27, but the very next day, Roshen issued a statement that provided detailed information about the Lipetsk factory’s profits for the last two years, a total of \$72 million: they went to paying taxes in Ukraine and to carrying out charitable projects. Roshen Corporation President Viacheslav Moskalevskiy denied Putin’s statement: “We thought his [Putin] secret service was better than that: they should have informed him of the fact that the Lipetsk factory does not belong to Mr. Poroshenko. He signed an agreement to place it in a blind trust in January 2016.”

The Poroshenko Administration is certain that this is not the last informational attack that will be aimed at the president’s business. (It seems that for this reason Poroshenko decided to close Lipetsk factory). During the period covered in this paper, this issue was exploited on several occasions: on November 17, a telephone conversation between Poroshenko and allegedly the President of Kyrgyzstan. In fact, a well-known Russian prankster called Vladimir Kuznetsov, suspected of working with the FSB, was at the other end. The prankster suggested that the President of Ukraine have “his people” transfer the Lipetsk plant to “themselves,” to which Poroshenko supposedly replied, “Send the names, who they will be, have the ambassador or someone identify them, I’ll give the orders, and someone will take care of it. I’m very grateful to you for this!” If the point of this special op with a “president” of Kyrgyzstan was to cause a scandal in Ukraine, it failed. Although the conversation with prankster raises many questions about the work of the special services of Ukraine who have made such a special operation with the president possible.

Another scandal blew open in early December, also focusing on President Poroshenko. Once again, many observers noted Russia’s fingerprints. This time it was over fugitive MP Oleksandr Onyshchenko, who announced that he had in his possession an audio recording of a conversation with the President of Ukraine that compromised the Head of State, confirmed that MPs in the Verkhovna Rada were on the take, and more. The Russian press latched onto the Onyshchenko story and flogged it far more intensely.

However, no actual tapes of the conversation with the President were ever released during the period of this study. In the end, the impression was that the fugitive MP was engaged in a private political game using the favorite argument of several generations of Ukrainian politicians to ensure immunity: “I’ve got bagloads of compromising evidence, so if you go after me, everything’s going to come out about everybody.” Typically, such stories go into the dustbin of history, as in reality there are no bags full of

evidence. The SBU, however, accused Onyshchenko of treason, announcing that he had “agreed to cooperate with Russia to destabilize Ukraine in order to avoid criminal prosecution.” Meanwhile, the US Department of Justice, whom Onyshchenko claimed to have given the compromising tapes, declared that it had “no plans to hold any further meetings with Mr. Onyshchenko.”

Observers also saw the imprint of the FSB on the actions of MP Nadia Savchenko, the Ukrainian pilot held in a Russian prison for two years. On December 7, she met with ORDiLO leaders Ihor Plotnytskiy and Oleksandr Zakharchenko at talks that were also attended by Russian officials. The Ukrainian delegation decided to raise the issue with the OSCE regarding the inadmissibility of parallel negotiations involving Russian representatives—ostensibly a reference to an RF Ministry of Emergencies official called Andrei Shkryaba, whom the Ukrainians suspect of being an FSB agent. As a result of these talks, two hostages were released. In a joint statement by Plotnytskiy and Zakharchenko, Savchenko was called a “representative of the Ukrainian people.”

### Year of the courts for Ukraine and Russia

At the end of 2016, another major component took on scale in bilateral relations between the two countries: legal suits. Ukraine has been gradually emphasizing international law in its policies towards Russia, and its Government has been putting efforts into gaining justice through all possible international institutions. Because it’s so used to playing with rules rather than according to them, starting with the annexation of Crimea, one would expect Russia not to pay too much attention to Kyiv’s legal initiatives. However, during recent months, the Kremlin seems disinclined to ignore the risks attached to Ukraine’s actions.

The most obvious example was the November 14 report on a preliminary investigation of Russia’s actions in relation to Ukraine, prepared by the prosecutor at the International Criminal Court. Among others, the report treats the taking of Crimea as an “international conflict:” “For the purposes of the Rome Statutes, armed conflict can be considered international if one or more states partly or fully occupy the territory of another state without regard to whether the occupation is accompanied by armed resistance.” The prosecutor must continue investigating, but Russia did not bother to wait for further results. Within two days of the publication of the report, Vladimir Putin signed an order that withdrew Russia from the jurisdiction of the ICC.

It’s not clear for Ukraine what consequences the actual investigation will lead to. Obviously, Russia’s decision will allow it to declare an unfavorable ICC verdict biased in the future. By withdrawing from the ICC’s jurisdiction, Moscow can ignore any rulings by the court. But for Ukraine, the result can be a guide to launching other legal initiatives in the international arena. For instance, Art. 27 of the UN Statutes says: “...any party to a conflict should abstain from voting on related decisions.” So far, all the efforts of Ukraine’s diplomats to have this provision

apply have not succeeded as Russia does not consider itself a party to a conflict and has therefore been able to block the majority of resolutions in the UN Security Council. After the ICC ruling, it will be harder for Russia to do so. Still, Ukraine should consider other options for establishing Russia’s status as “party to a conflict” at the international level. Moreover, it might find support for an advisory ruling at the International Court of the UN by appealing to the General Assembly.

On December 19, the UN General Assembly passed a resolution called “Provision on the human rights situation in the Autonomous Republic of Crimea and the City of Sevastopol (Ukraine).” The preamble to this resolution condemns the “temporary occupation of a part of Ukrainian territory by the Russian Federation” and confirms that it “does not recognize the annexation.” The GA went on to call on Russia to “carry out all your obligations in line with the applicable norms of international law as an occupying state.” Unfortunately, the resolution was lost in the news: that same day, the Russian ambassador to Turkey was assassinated and a terrorist act took place in Berlin. In Russia, the resolution did not cause as much reaction as the ICC decision, although a slew of comments from Russian diplomats and politicians made it clear that the resolution was an unpleasant surprise for Moscow. A few news agencies in Russia reported that Crimea was preparing an appeal to the UN regarding “human rights violations in Ukraine.”

The Parliamentary Assemblies of the Council of Europe and of NATO also passed a series of resolutions during this same period. In addition to condemning Russia’s aggression, the PACE documents also note a significant number of points of principle, including some related to implementing the Minsk Accords. Art. 14 of the report presented by German politician Marieluise Beck, notes that “in the absence of security, accompanied by impunity and the lack of freedom of speech, it is impossible to hold free and fair elections” in the occupied territories.

But the resolution is only a small part of the legal efforts that the Ukrainian government undertook during the reporting period. In December, it became known that Ukraine is preparing a sixth lawsuit against Russia for the European Court of Human Rights, all of them related to events in Donbas and Crimea over 2015-16 that is expected to be submitted in early 2017. The hearing of the gas dispute between Ukraine and Russia is at the final stage in the Stockholm Arbitration Court. Meanwhile, a London court is hearing a case on the US \$3 billion Russian debt known as the Yanukovich loan. The first rulings of the ECHR are expected to be made public in 2017, as is a decision on the gas dispute. There is reason to believe that a ruling will also be handed down by the London court this year.

On December 22, 2016, a special tribunal was set up that will start to hear Ukraine’s lawsuit against Russia at the beginning of 2017. This one is about Russia’s violations of the UN Convention on marine law. A decision in this case is not expected until 2019. Ukraine is suing Russia on commercial matters as well, and will shortly submit a

third suit against Russia to the World Trade Organization, for restrictions on imports of Ukrainian food and industrial products. Oschadny Bank, the state-owned savings bank is getting ready to announce its own lawsuit for over US \$1bn in lost investment in occupied Crimea: the actual court hearing is scheduled for March 2017. New year 2017 began with the announcement made by the Ukrainian authorities of a lawsuit filed in the International Court of

Justice calling on Russia for acts of terrorism and illegal discrimination during its aggression against Ukraine.

So it is that 2017 will be the real year of lawsuits in relations between Ukraine and Russia. Should Ukraine win even one of these cases, it will be a major incentive for Kyiv to continue to fight, using every opportunity available in international law. Some decisions Russia will, of

course, be able to ignore, such as the ECHR rulings. But some could well prove a serious blow to both its reputation and its finances, especially the suits against Gazprom.

### ***Events in Ukraine-Russia relations (October-December 2016). Point-based evaluation***

<b>Date</b>	<b>Event</b>	<b>Points</b>
October 12	PACE passes two resolutions on Ukraine labeling Russia's actions in Ukraine as "aggression." The resolution includes a demand that Russia withdraw its forces from Donbas.	-1
October 16	Arsen "Motorola" Pavlov is killed.	-1
October 17	President Poroshenko signs a decree extending sanctions against Russia for another 12 months.	-4
October 19	A meeting of heads of state in the Normandy format takes place in Berlin. A decision is made to complete by the end of November a roadmap for implementing the Minsk Accords.	+2
October 26	Ukraine's Foreign Ministry issues a protest over the latest visit by Vladimir Putin to Crimea without Kyiv's agreement.	-1
October 27	Putin declares his support for Ukraine's initiative to set up an OSCE police mission in Donbas.	+1
November 8	Poroshenko blames Russia of using hybrid methods to steal history" when a monument to Volodymyr Velykiy (the Great) is installed on Red Square in Moscow.	-1
November 11	The SBU announces that Russia is planning to destabilize the internal situation in Ukraine through Operation Shatun.	-2
November 14	The prosecutor of the International Criminal Court compared the occupation of Crimea to an international conflict between Ukraine and Russia.	-2
November 16	Putin signed an order to withdraw Russia from the Statutes of Rome and the International Criminal Court.	-2
November 17	The OSCE SMM reported about a record number of exchanges of fire in Donbas since the beginning of 2016.	-7
November 29	A meeting of FM's in the Normandy format takes place in Minsk. No road map is approved.	-2
December 1	Military exercises near occupied Crimea cause a hostile reaction from Russia.	-2
December 7	Representatives of ORDiLO and Russia meet in Minsk with Ukrainian MP Nadia Savchenko regarding the release of hostages. Ukraine's official negotiators expressed anger at the parallel talks with Russia.	-1
December 14	NSC Secretary Oleksandr Turchynov reports about a massive Russian cyber attack against the internet resources of Ukrainian government agencies.	-1
December 15	Ukraine decides unilaterally to release 15 individuals who were arrested and sentenced in Ukraine in order to revive the prisoner exchange process.	+2
December 18	The battle of the Svitlodarsk Bulge begins.	-7
December 19	The UN passes a resolution on the human rights situation in Crimea with the support of 70 members.	-2
December 21	Members of the Trilateral Contact Group in Minsk approve a ceasefire starting on Dec. 24.	+1
December 23	President Poroshenko calls on Russia to uphold the ceasefire agreement that is supposed to start at 00:00 on Dec. 24. He also calls for the release of all Ukrainian hostages.	+1
December 24	Режим тиші було порушено бойовиками вже через 25 хвилин після опівночі. У цілому за цей день позиції Збройних сил України були обстріляні 28 разів	-3

# UKRAINE-PEOPLE'S REPUBLIC OF CHINA RELATIONS

October-December 2016

Positive points: +26

Negative points: -1

Total Index: +25

## SUMMARY

*Ukrainian-Chinese relations continued to develop in terms of bilateral economic ties during the final quarter of 2016. Nearly all the events during these three months were related to trade and investment, and suggest the directions in which cooperation between the two countries will continue, especially in energy.*

*One significant event in bilateral political relations was the participation of First Lady Maryna Poroshenko and top Ukrainian officials in the First Ukraine Silk Road Forum on November 7. Speeches by Ms. Poroshenko, Deputy Premier Ghennadiy Zubko and First Deputy Speaker of the Verkhovna Rada Iryna Herashchenko were important signals of how China is looming larger in Ukraine's foreign policy priorities. On the other hand, at lower levels of Ukrainian officialdom, China remains "distant and incomprehensible" and, therefore, uninteresting. The average Ukrainian official still has little interest in knowing about China and the state of Ukrainian-Chinese cooperation in any sphere, and this is the main obstacle to expanding bilateral cooperation.*

*A definite milestone in trade relations between Ukraine and China was the acquisition of a 99.9% stake in the Ukrainian Bank for Reconstruction and Development by a Chinese company called Bohai Commodity Exchange Co., Ltd. through a State Property Fund auction. This purchase is significant strategically for China to enter the European market and for potential projects in Ukraine in such key sectors as farming, machine-building and infrastructure. Moreover, a Ukrainian bank could be interesting for China both as an investment and as an instrument for servicing the operations of its own corporations in Ukraine.*

*Another area in which relations have been expanding has been in material assistance to Ukrainian agencies. Over the course of this quarter, the Chinese Ambassador in Ukraine, Du Wei, signed two agreements on behalf of the Government of China with the Government of Ukraine to provide the country with 50 free ambulances and special rescue equipment. This is not merely a gesture of friendship on the part of China, but also an indication of growing support for Ukraine in its struggle for sovereignty and territorial integrity. The rescue equipment China is providing goes to the Ministry of Internal Affairs, which is directly involved in running the ATO in eastern Ukraine, where provocations on the part of Russia continue in Donbas to this day.*

*Sino-Ukrainian cooperation in humanitarian areas has also picked up through charitable activities and the enthusiasm of artists in both countries, testifying to the perpetuation of traditionally friendly relations between the two nations.*

## TIMELINE

### Growing contacts and connections

Politically, over the last three months of 2016, relations between Ukraine and China grew more concrete, which suggests a positive trend, primarily in attitudes towards China among Ukraine's political elite and in its expert circles. For starters, on October 12, the Institute of World Policy presented an audit of Ukrainian-Chinese relations. A lively debate around topical issues in bilateral political relations and in trade and commercial cooperation were covered widely in the Ukrainian press and among experts. Equally significant was the participation of Chinese diplomats in the event, including the political attaché from the Embassy in Ukraine, and the absence of officials from Ukraine's Foreign Ministry.

The next important event was the first international Ukraine Silk Road Forum on November 7. In his speech to the forum, Vice Premier Ghennadiy Zubko noted that Ukraine sees the initiative for a New Silk Road as one of the priority opportunities for Ukraine to take advantage of its transit potential. He noted that Ukraine had already achieved a certain level of progress in carrying out this initiative, including the launch of a test run of a container train from the Black Sea port of Illichivsk to the border with China and the opening of a rail corridor from this port to the Baltics. This would allow for one million tonnes of cargo to be transported per year.

Deputy Minister of Economic Development and Trade Natalia Mykolska announced the possibility that an international transport corridor will be opened that would join Europe and Asia and greatly increase Ukraine's investment appeal. Ukraine is counting on attracting Chinese investors to manufacture products to sell on the

Chinese market, as well as other markets where Ukraine has free trade agreements, such as the European Union, CIS and Canada. "Ukraine could become a manufacturing hub for Chinese investors," said Mykolska. She noted that Ukraine was interested in expanding cooperation in such sectors as industry, agriculture, tourism and IT.

First Deputy Speaker of the Verkhovna Rada Iryna Herashchenko reported that Ukraine's legislature had established a "Friends of China" group that included more than half the deputies in the 450-seat Rada and has been involved in an active interparliamentary dialog on getting Ukraine to join China's Silk Road Economic Belt, also known as the One Belt, One Road initiative (OBOR). She noted that Ukraine was interested in joining this project as part of China's cooperation with Central and Eastern Europe in the 16+1 format. "We've been talking about getting the countries who are already official involved in this format to support the official addition of Ukraine," said Herashchenko.

Chinese Ambassador Du Wei stated that China was pleased with Ukraine's efforts to spur economic cooperation under the One Belt, One Road initiative. "We expect that Chinese companies will come to Ukraine with investments for the farm sector, science and technology, infrastructure, logistics, finance, e-commerce, and nuclear and renewable energy," said the Ambassador. He proposed setting up a Sino-Ukrainian free trade zone and noted that it was inconceivable that China's OBOR project would work without Ukraine.

This is the first time in recent years that there was a public exchange of ideas about ways to grow Ukrainian-Chinese relations among top officials and the Chinese Ambassador to Ukraine. The topic of Ukraine's participation in the strategic One Belt, One Road initiative launched by Chinese President Xi Jinping was subsequently reinforced by foreign policy and foreign economic discourse in Ukraine.

On November 17, a delegation from the Academy of Social Studies of China participated in a roundtable entitled "Ukrainian-Chinese Relations in the Framework of the One Belt, One Road (OBOR) Concept, its History, Reality and Prospects: An assessment by Chinese experts." The roundtable was notable for two events. Firstly, this was the first time Chinese academics publicized their own estimations of potential Chinese investment in Ukraine, placing it at up to US \$50 billion. Secondly, an official from the Foreign Ministry stood up and chastized the Chinese for not supporting a UN resolution in support of the rights of Crimean Tatars the day before. This speech, unfortunately, reflected the weakness of Ukraine's Foreign Ministry in understanding China's position and in its ability to find mutual understanding in ambiguous situations. China's negative vote needs to be seen the light of Beijing's generally negative attitude towards human rights issues. In China, human rights protections are seen as interfering in the internal affairs of another country, which does not imply support for Russia or antagonism towards Ukraine.

On another theme, there appeared to be a serious lack of media support for the activities of Ukraine's MPs, seen in the absence of meaningful coverage on the results of a working visit to China by a Rada delegation in October. All that was reported was that the president of the Ukrainian Football Federation, Andriy Pavelko, met with the vice president of the Chinese Football Association Zhang Jian. The two discussed promising areas of cooperation in football, including the exchange of trainers and the joint organization of matches for teams of young men and young women.

Meanwhile, the Chinese have been working hard to increase media support for the Sino-Ukrainian dialogue and cooperation in various sectors. On October 14, a delegation of Chinese media visited Ukrainski Novyny, a news agency, during which they discussed different approaches to developing news media using new technologies. The delegation included the national Xinhua News Agency and regional media like Guangming Daily, Jilin News and Liaoning Radio. The visit was organized by the Ukrainian National Union of Journalists. Growing cooperation in the news business is a current objective for both sides, but to a large extent, it relates mainly to Ukraine. At the end of 2016, a correspondent from the central Chinese paper, Renmin Ribao or the People's Daily, began to work in Kyiv, becoming the fourth full-time representative of Chinese media in Ukraine. Correspondents from Fazhi Ribao or the Legal Daily, the Xinhua News Agency and the main Chinese television channel are already working in Ukraine. Currently, there is no Ukrainian bureau in China, so the news items provided by UkrInform are translated by staff at Ukraine House in Beijing, which is essentially a private Chinese entity.

### **First serious commercial moves**

Economically, the last quarter of 2016 had a significant breakthrough event that clearly will have an impact on the further development of bilateral trade relations. On November 30, the State Property Fund of Ukraine sold a 99.9% stake in the Ukrainian Bank for Reconstruction and Development (UBRD) to a Chinese company called Bohai Commodity Exchange Co., Ltd. (BOCE) Since there was only one applicant for this tender, the bank was privatized at its starting price, UAH 82,827,000 or about US \$3,150,000. Founded in 2009 by several state corporations with the participation of private Chinese citizens and the municipality of Tianjin, BOCE is the biggest spot trading exchange in China, with annual turnover of around US \$1 trillion.

In April 2016, the privatization auction for UBRD was canceled for lack of takers. After that, the NBU announced plans to liquidate the bank altogether if it failed to be sold at the next auction. This time, the SPF exerted the maximum of effort to privatize this asset so that the bank would not be closed down altogether and so the State Budget could gain some revenues. Right now, the key condition for the investor is to capitalize the bank to UAH 120 million in order to comply with NBU norms. The SPF

expects the NBU to shortly grant the necessary permits for a Chinese investor to invest capital in the bank in order to develop operations in Ukraine

From the economic standpoint, this asset has been a very profitable acquisition by China, as the bank was sold at a premium of 35% over its equity value and the sale price was higher than the book value of its assets. The new owners paid for the bank assets and investment property, but effectively also gained a banking license without any of the problems that can sometimes be inherited from previous owners. UBRD interested Chinese investors because of the good reputation of its management team. Unlike many other Ukrainian banks, UBRD was not burdened by debts or by liabilities before its owners.

The acquisition of this bank is the beginning phase of Chinese investors setting up a vertically-integrated organization that will include the bank and an agricultural commodities exchange. In the longer term, the emergence of a bank with Chinese capital will make it possible to use its resources for lending purposes and the possible clients for such a bank might be agribusinesses. The money borrowed from a Chinese bank under contract with domestic processing companies can already be treated as income for Ukrainian growers, without the cost of intermediaries.

This is indubitably a good signal for Ukrainian business. The arrival of a new investor also indicates interest in both Ukraine's financial services market and its overall economy. Of course, at this time, it's more of a testing of the waters for the Chinese investors, a time to figure out the conditions and find the weak spots to minimize the risks to further collaboration with Ukraine. China is using this contract as a test, so the bank's low rating is not that important. The value of the contract is not that high, at about US \$3mn, so the risk is also not that high for the Chinese. BOCE now has a representative office without having had any competitors in the tender. The bank is trouble-free because it barely handled any operations. In effect, the Chinese side has no risks in terms of restructuring a credit portfolio, which tends to be an issue with most Ukrainian banks put up for sale.

Still, the acquisition of UBRD is not a major investment on the part of the Chinese, either. It's more about setting up a base from which to later service trade contracts on a platform that is reliable. In terms of implementing the New Silk Road project (OBOR), the Chinese investor will be in a position to offer financial, consultational and other services to Chinese companies interested in the Ukrainian economy. So far, Chinese investments haven't even reached 1% in terms of volumes of FDI in Ukraine today, but, given the political and economic instability in Ukraine today, the arrival of a high-profile company like BOCE serves as a kind of green light for other Chinese companies. The bank will possibly be used to support Chinese SMEs, which are currently entering the Ukrainian market without state support or guarantees.

Meanwhile, these steps are in line with the Chinese strategy of setting up trade in the currencies of other

countries without the mediation of the dollar, in order to internationalize the yuan. After all, in April 2013, the Bohai Exchange was the first non-financial entity on mainland China to be granted permission by the People's Bank of China to trade goods abroad in yuan. That year, BOCE began trading with Hong Kong as its debut outside the mainland. For this reason, BOCE is likely interested in establishing a platform for trading Ukrainian commodities in yuan. Meanwhile, this market in Ukraine is not without its own problems and it's not clear right now just how the Chinese hope to organize this.

After joining the European Bank for Reconstruction and Development (EBRD) in 2015 and acquiring a 0.1% stake, China gained new opportunities to expand its influence in Europe and to strengthen trade links between Europe and Asia. Membership in the EBRD provided the conditions for long-term Chinese investment in regions where the EBRD operates, as Chinese interest in Europe extends to major transport projects, the development of natural resources, industrial development, and financial cooperation.

Four conclusions can be drawn from these developments:

1. The purchase of UBRD was important for the Chinese side because it gained a financial entity with the name "Bank for Reconstruction and Development."
2. The acquisition of the bank made it possible to establish a platform to finance future investments in Ukraine and to organize a commodities exchange for agricultural and metal products, provided that the Chinese government makes the necessary political decisions.
3. BOCE is now in a position to investigate the Ukrainian market from a financial point-of-view and to find the weak spots for investing in the country.
4. Additional conditions are being set up to handle Ukraine-China settlements in yuan with the objective of strengthening the position of the Chinese currency in the world.

Another key direction for Sino-Ukrainian economic collaboration is the power sector. Over October 24-28, officials from the China National Nuclear Power Co., Ltd. visited the head office of NAEK Energoatom and the Khmelnytskyi AES. Among others, the Chinese delegation went on-site at the AES and saw the control room of the #1 Unit, the machine room, and the construction sites for the #3 and #4 Units. They also met with KAES management, which showed them how the station operates and the progress of the construction of the two new units. CNNPC officials presented the main areas of their company's operations, how the modernization process is going at the Tianwan Nuclear Power Plant in China. The first vice-president and technical director of Energoatom, Oleksandr Shavlakov, and the first deputy general manager of CNNP, Wu Suxian, discussed opportunities for continued collaboration and agreed to expand cooperation in all stages of the atomic energy cycle. Based in Beijing, CNNP is a subsidiary of the Chinese National Nuclear Corporation (CNNC) and is responsible for investing, building, operating and managing nuclear

power projects. Today, CNNP operates 12 nuclear power units with an installed capacity of 9,773 MWT.

On November 21, two Chinese firms announced that they were planning to build a solar energy station in the 30-kilometer exclusion zone of Chernobyl, with construction starting in 2017. GCL System Integration Technology and China National Complete Engineering will jointly carry out this project. Surveyors and specialists from both Chinese companies have already checked the planned site for the facility several times. The contaminated area will be cleaned using green and renewable power, which should bring considerable social and economic benefits. GCL SIT Director Shu Hua announced that building a 1-GWt capacity solar energy station in Ukraine was part of his company's international plans. According to Ukraine's Minister of Environment and Natural Resources, Ostap Semeryak, the Chinese are prepared to invest more than US \$1bn in the project.

On December 9, a Chinese delegation from the City of Yichang and Hubei Province met with the Ministry of Energy and Coal to discuss opportunities for Ukrainian-Chinese collaboration in the power industry. Deputy Minister and Chief-of-Staff Dmytro Labozhenko noted that Ukraine was taking steps to become energy independent, that it would welcome investor interest in the power industry and was prepared to discuss areas of potential cooperation with the Chinese side. The Chinese officials noted their interest in cooperation, especially in the area of renewable energy, the need to know what Ukrainian law requires of potential investors, and the terms and conditions for investing. They also emphasized the importance of working together, not just with large corporations but also with small private entrepreneurs. The two sides agreed to meet again together with interested industry specialists and investors, who would be able to discuss such collaboration in this sector at a deeper level.

On December 22, Minister of Energy and Coal Ihor Nasalyk announced the pending construction of a nuclear fuel plant during his annual review press conference. According to him, three companies are prepared to join a tender: Westinghouse, a Chinese company, and a French firm. The Minister did not mention the name of the Chinese firm, but the China Nuclear Energy Industry Corporation (CNEIC) earlier indicated its interest in the Novokostiantynivka uranium deposits in Kirovohrad Oblast.

This suggests that cooperation between Ukraine and China in the power generation sector has moved from mere talk about opportunities to declarations of intent. Given the general state of bilateral investment and economic interactions, this is good news indeed and testifies to the steady thaw of relations and a move to more pragmatic approaches on both sides.

Similar processes are underway in other areas of mutual interest.

Over November 1-6, the Antonov subsidiary presented its current projects at an international aerospace salon

called the China Air Show 2016 in the city of Zhuhai in China. The corporate stand showed models of AN-178 and AN-132, both promising cargo planes, and the AN-158, a passenger model. Antonov planes are the result of a combination of enormous experience on the part of the maker and the latest in aviation technologies that are well known in China: Antonov has been collaborating with Chinese enterprises for 60 years this year. In this time, Antonov has been involved in developing a series of aircraft in China, including the ARJ21 regional jet and the Y-8F600 transporter.

On November 16-18, a Verkhovna Rada delegation headed by the Petro Poroshenko Bloc faction leader MP Ihor Hryniv participated in the Third World Internet Conference (WIC) in Wuzhen in the province of Zhejiang. The objective of this visit was to accelerate cooperation between Ukraine and China, especially in the science and technology and in IT sectors.

Also on November 16-18, the National Association of Sugar Producers took part in one of the biggest food expositions in the Asia region, ANUFOOD China 2016. Today, Ukraine urgently needs to be looking for new markets because sugar production this season is expected to rise to nearly 2 million tonnes, while domestic demand is around 1.5mn t, plus a transitional surplus at the end of the marketing year that adds another 330,000 t. Right now, it's not easy to deliver Ukrainian sugar to Europe because the quota for duty-free deliveries has still not been raised from 20,000 t. This makes China a key priority. As part of ANUFOOD China 2016, the Ukrainian national stand presented dairy, meat, sugar and oil-fat products. The Ukrainian Food Export Board (UFEB) organized the mission with the support of the UN's Food and Agriculture Organization (FAO) and the European Bank for Reconstruction and Development (EBRD).

On November 22, China announced that it was ready to purchase sugar products from Ukraine, as well as pork and cooking oil. UFEB added that, by the end of the year, China would also begin to buy Ukrainian beef. Whereas Ukrainian oil used to be shipped directly to China already in the past, sugar and pork only went there via Hong Kong. The volumes involved are large and give reason to say that there has been a serious expansion in demand for Ukrainian products on the Chinese market.

On December 4, a working visit took place between the head of the State Consumer Service, Volodymyr Lapa, and the trade and economic counsellor at the Chinese Embassy in Kyiv, Liu Jun. The two discussed how to deepen cooperation, especially through bilateral trade. During the meeting, Lapa noted that China was one of Ukraine's main trading partners for foodstuffs, so Ukraine appreciated the high level of interaction between the two countries.

Altogether, collaboration in the farm sector and machine-building remains an important component of Sino-Ukrainian relations and is picking up pace.

Discussions of major infrastructure projects also returned to the Ukrainian-Chinese agenda in the last

three months of 2016. On November 1, Infrastructure Minister Volodymyr Omelyan announced on Channel 5 that European and Chinese investors were interested in a concession to build roadways in Ukraine. According to the Minister, the first concessions should begin to appear in Ukraine in 2017-2018.

On December 22, Kyiv Mayor Vitaliy Klitschko and the vice president of the China Road and Bridge Corporation (CRBC), Du Fei, signed a memorandum of cooperation that anticipates collaboration in a series of transport infrastructure construction and reconstruction projects. The document states that, in 2017, CRBC will invest its own capital and experts to carry out a feasibility study of three key projects involving transport infrastructure in the Ukrainian capital: completing the building of the Great Ring Road; reconstructing transportation interchanges where prospekt Peremohy crosses vul. Vadyma Hetmana; building the Right Bank access road from Nyvky-Vidradniy-Sovky-Telixhka to the Darnytsia Bridge crossing. CRBC is also prepared to participate in tenders involving transport infrastructure and to assist in getting access to credits from Chinese financial institutions. CRBC is already carrying out projects worth a total of US \$3bn in Serbia, Montenegro, Czechia, Poland, and other countries.

The final quarter of 2016 saw considerable activity between Ukraine and China in the humanitarian arena as well. Cultural and educational events that were, in and of themselves, important, were also tied to the top leadership of the country this time. In the absence of significant political events at the highest levels, the presence of Ukraine's second President, Leonid Kuchma, and First Lady Maryna Poroshenko during the Sino-Ukrainian cultural events gained great political significance.

On October 21, as part of their visit, a delegation of Chinese artists led by renowned artist Liu Jianjun met with ex-President Kuchma. During their conversation, Kuchma invited the Chinese to participate in cultural projects funded by the Presidential Ukraina Foundation. He emphasized that Ukraine and China were long friends united in a single desire to develop and flourish.

On November 1, the Ukraina Foundation held the presentation of a Ukraine-China cultural exchange program for young people, attended by Kuchma. Chinese musicians and artists came to Ukraine to familiarize themselves with Ukraine's cultural achievements and to show Ukrainians the beauty and greatness of traditional Chinese culture. The Chinese artists brought with them a gift consisting of two parts: paintings and music. Half a dozen paintings executed in traditional Chinese style were selected for the exposition.

On November 6, Ukraine's First Lady and President of the M. Poroshenko Charitable Foundation, Maryna Poroshenko, and Liu Jianjun, president of the Silk Road Chamber of International Commerce, sign a grant agreement worth US \$ 200,000 to develop an inclusive educational environment in the country. Grant funds from China will be aimed at developing scientific pedagogical pilot projects that the First Lady will undertake together with the Ministry of Education and Science in Zaporizhzhia Oblast over 2016-2019. The main objective of this project is to involve as many handicapped children as possible in active social relations by setting up an inclusive educational environment. The main outcome of this project is that, in three years, the results will be used to draw up a roadmap for instituting inclusive education all across Ukraine. Liu emphasized that this agreement is not a one-time deal but the beginning of serious Ukrainian-Chinese cooperation under the Shining Silk Road charitable project.

Another key event in late 2016 was the provision of material assistance by the Government of China to Ukrainian agencies.

On October 21, the Government of China donated 50 ambulances with medical equipment worth a total of over US \$3.7mn to Ukraine. The related agreement was signed by the First Deputy Premier and Minister for Economic Development and Trade Stepan Kubiv and Chinese Ambassador to Ukraine Du Wei. The ambulances were designated for the Ministry of Health of Ukraine and the vehicles were supposed to be delivered to Ukraine by the end of the year.

On December 16, the Government of China donated emergency rescue equipment and the related agreement was signed by Ambassador Du Wei and Interior Minister Arsen Avakov. The Ambassador underscored that the equipment was being provided for free as a mark of friendship between Ukraine and China. Chinese specialists are expected to come to Ukraine very soon to train Ukrainian rescue workers how to use the donated equipment. Among the items are 25 units of engineering and automotive equipment as well as 32 sets of emergency rescue equipment and spare parts, worth a total of over UAH 185mn or about US \$7mn.

China's willingness to support Ukraine's interior ministry, which is directly involved in confronting Russian aggression in eastern Ukraine, shows Beijing's balanced position regarding the situation in the country. As such, it is also a real manifestation of the strategic partnership between the two countries.

**Events in Ukraine-China relations  
(October-December 2016). Point-based evaluation**

Date	Event	Points
October 12	Institute of World Policy presents an audit of Ukraine-China relations.	+2
October 14	Management of Ukrainski Novyny, a news agency, meets with a delegation of Chinese media: Xinhua News Agency, Guangming Daily, Jilin News and Liaoning Radio.	+1
October 21	Chinese Government donates 50 ambulances with medical equipment to Ukraine.	+2
	Chinese arts delegation meets with Ukraine's second president, Leonid Kuchma.	+1
October 25	Andriy Pavelko, MP and president of the Ukrainian Football Federation, meets with Zhang Jian, vice president of the Chinese Football Association.	+0,5
October 24-28	Officials from the China National Nuclear Power Co. Ltd. visit the main office of NAEK Energoatom and the Khmelnytskyi AES.	+1
November 1	The Ukraina Foundation holds the presentation of a Ukrainian-Chinese cultural exchange program for youth with the participation of Leonid Kuchma, Ukraine's second president.	+1
	Infrastructure Minister Volodymyr Omelyan announces that Chinese investors are interested in a concession to build roadways in Ukraine.	+0,5
November 1-6	The Antonov company presents its current programs at the international aerospace salon China Air Show 2016 in Zhuhai.	+1
November 6	Ukraine's First Lady and President of the M. Poroshenko Charitable Foundation, Maryna Poroshenko, and Liu Jianjun, president of the Silk Road Chamber of International Commerce, sign a grant agreement to develop an inclusive educational environment in Ukraine.	+1
November 7	The first International 2016 Ukraine Silk Road Forum takes place.	+3
November 16-18	A Ukrainian delegation headed by Petro Poroshenko Bloc faction leader MP Ihor Hryniv participates in the Third World Internet Conference (WIC) in Wuzhen in the province of Zhejiang.	+1
	The National Association of Sugar Producers participates in one of the biggest food exhibitions in the Asia region, ANUFOOD China 2016.	+1
November 17	The Kyiv Institute of International Relations holds a roundtable called "Ukrainian-Chinese Relations in the Framework of the One Belt, One Road (OBOR) Concept, its History, Reality and Prospects: An assessment by Chinese experts."	+1
	An official from Ukraine's Foreign Ministry makes a hostile speech at a roundtable organized by the Kyiv Institute of International Relations and called "Ukrainian-Chinese Relations in the Framework of the One Belt, One Road (OBOR) Concept."	-1
November 21	GCL System Integration Technology and China National Complete Engineering, two Chinese companies, announce that they plan to construct a solar energy station in the 30-kilometer Chornobyl exclusion zone.	+0,5
November 22	China announces that it's prepared to buy sugar produces, pork and oil in Ukraine.	+0,5
November 30	The State Property Fund sells a 99.9% stake in the Ukrainian Bank for Reconstruction and Development to the China-based Bohai Commodity Exchange Co., Ltd.	+3
December 4	Volodymyr Lapa, director of the State Consumer Service of Ukraine, holds a working meeting with Liu Jun, trade and economic counsellor at the Chinese Embassy in Ukraine.	+1
December 9	Officials representing Hubei Province and the city of Yichang visit the Ministry of Energy of Coal.	+0,5
December 16	The Chinese Government transfers emergency rescue equipment to Ukraine.	+2
December 22	Minister of Energy and Coal Ihor Nasalyk announces that a Chinese company is participating in a tender to build a nuclear fuel plant in Ukraine.	+0,5
	Kyiv Mayor Vitaliy Klitschko and China Road & Bridge Corporation Vice President Du Fei sign a Memorandum of Cooperation.	+1

# INDEX OF RELATIONS

Points



# SPECIAL THEME

## WINTER 2016-17: THE ENERGY DIMENSION

*January 2006 and 2009 made headlines thanks to two gas wars between Russia and Ukraine. They were a signal that Russia's energy policy had begun to weaponize energy—and revealed Ukraine's vulnerability to the Russian Federation's using gas as a weapon. Today, this is seen as Russia's effective use of non-military instruments in new generation wars. The preparations for this went basically unnoticed by the outside world. Both gas wars were started and controlled by the Kremlin with the purpose of increasing Ukraine's energy dependence on the RF, thereby increasing its economic and political dependence as well. It also demonstrated to Europe the need to undertake its own projects because Ukraine was being made to look like an unreliable transit link.*

*Ukraine's GTS and UGS were and remain a key element in ensuring the uninterrupted delivery of natural gas to Europe. Despite the many years of systematic accusations by the Russian Federation that gas has been stolen or disappeared on Ukrainian territory, there has been no legal confirmation of such incidents, notwithstanding countless attempts by Gazprom to present these accusations as proven facts.*

*Every heating season in the last decade has been used as a means to discredit Ukraine through deliberate propaganda campaigns that underpin Gazprom's provocative technical manipulations and Russian media speculation in the European Union. This kind of propaganda has been one of the factors that fostered the building of Nord Stream 1 and continues to be used to promote its second branch and undermine Ukraine's efforts to reform its national gas market.*

*The most obvious proof of Ukraine's reliability as a transit link to the EU is that it has maintained uninterrupted delivery of gas despite an armed conflict with Russia and the unprecedented economic and political crises of 2014.*

*Ukraine can easily continue successful reforms and remain an important partner in the gas sector. However, this requires further financial and political support from the EU. And here the European Commission has done the opposite by granting Russia greater access to the OPAL pipeline—a move that has been properly assessed as a violation of bilateral commitments in the Association Agreement between Ukraine and the EU, specifically Art. 274.*

*Meanwhile, Russia continues to make use of all possible political, economic and informational instruments to cause Ukraine harm, specifically by: violating the technical conditions for the GTS to operate properly by reducing volumes and pressure on incoming gas; harming Ukraine economically by cutting into its income from transit; and damaging political dialog with the EU by continuing to foster negative actions or inaction in Brussels.*

### The energy component of hybrid warfare

In 2014, Russia counted to a large extent on Ukraine's energy vulnerability through a gas blockade and shortages of anthracite and power. In mid-June, as the Novorossiya project went into full swing, a gas blockade was launched against Ukraine. Gazprom completely stopped supplying the country with natural gas and when it resumed in December, under pressure from the European Commission, it still kept gas deliveries to the EU to an absolute minimum in Q1 of 2015 in order to reduce reverse deliveries to zero. Ukraine's main pipeline, Uhrengoi-Pomary-Uzhhorod also suffered from several attempts at sabotage. The idea was that all of this would first force Kyiv to capitulate on energy, and eventually lead to military and political capitulation.

A radical reduction in domestic gas consumption and the success of reverse deliveries as world prices for hydrocarbons went into a tailspin, coupled with imports of anthracite from non-Russian sources, and growing deliveries of nuclear fuel from alternate suppliers, all cut into Russia's ability to use the energy component in its hybrid war against Ukraine. Instead, the Unified Energy System of Ukraine came under attack. The first large-scale attempt by hackers to cause a blackout on the UES

took place on December 23, 2015. A year later, on Dec. 17, a second attempt was made. Fortunately, both attacks were unsuccessful, although they did cause damage.

Even after Ukraine has managed bring its imports of Russian gas down to zero, the Russian Federation keeps trying to use the energy factor in its hybrid war. At the end of summer 2016, it began to be evident that Russia was preparing for an artificial provocation to start a third gas war. As in the case of the previous two wars, the entire weight of Russian propaganda will be used to make Ukraine the designated guilty party. With weather forecasts predicting a colder war and Russia succeeding in promoting its interests in the OPAL pipeline, the Kremlin has made it clear it intends to return to using gas as a weapon in the 2016-2017 winter season. So far, it's been using the media to spread false rumors about Ukraine's underground gas storage system (UGS) supposedly not having enough reserves to comfortably make it through the heating season.

#### *A note on Ukraine's GTS and UGS*

*Ukraine's gas transport system (GTS) is a network of 38,550 km of medium- and hi-pressure pipes, 72 compressor stations, 1,435 distribution stations, and 13 underground storage systems (UGS) (see Fig. 1).*

Figure 1



Ukraine's GTS trunk lines are highly interconnected, which ensures the continuous supply of natural gas in case of accidents or other unforeseen events, and the UGS is an integrated part of the GTS. They are designed to supply additional gas to consumers in unforeseen and extreme situations, such as if part of the pipeline is shut down because of an accident or a natural disaster, extremely cold temperatures, or a spike in demand.

A number of aspects give Ukraine's UGS its important advantage. First is the placement of its infrastructure: all 12 underground storage facilities, with the exception of the Hlybivske UGS in Crimea, are near the main national gas corridors—Urengoi-Pomary-Uzhhorod, Soyuz and Proress—and are integrated into them. Secondly, with a maximum capacity of 30.95bn cu m of gas, Ukraine's system is the biggest in Europe. Thirdly, the UGS has a high aggregate capacity to take in and pump out gas: the maximum daily throughput during the peak season is to 290mn cu m.

### Surplus stored gas as factor

In the current season, the UGS was filled based on estimated consumption figures in Ukraine, transit volumes and capacity for importing gas. In February 2017, depending on how much of the main gas reserves in the UGS are depleted, the technical capacity to pump gas could

go down to about 60mn cu m per day. This means that, in addition to about 55mn cu m of daily domestic extraction and imported resources from European partners that add up to a combined 53mn cu m daily through all three reverse lines, even if temperatures are exceptionally cold, Ukraine should still be able to make it through the heating season—although the comfort level will be minimal towards the end.

To understand whether the status of the UGS reserves is sufficient or insufficient to make it through the winter season, the thing is to look retrospectively at what happened in previous years.

Для того щоб зрозуміти становище з достатністю чи недостатністю запасів газу в ПХГ для проходження зимового сезону, необхідно ретроспективно поглянути на те, як це виглядало у минулі роки.

Table 1 shows a 12-year history of key parameters for the GTS and its UGS reserves, making it possible to calculate the necessary coefficient to project demand. This coefficient is the correlation with the surplus of active gas, that is that gas that can be taken from storage without affecting their technical operating parameters at the start of the heating season and the aggregate volume of domestic consumption and the volume of transit gas. In fact, the gas in the UGS is there to supply domestic demand and transit to Europe.

Table 1

Year \ Items	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
Transit to Europe (TtE), bcm	121,5	113,8	112,1	116,9	92,8	95,4	101,1	81,2	83,7	59,4	67,1	78,3
Consumption of Ukraine (CoU), bcm	76,4	74,0	69,9	66,3	51,9	57,7	59,3	54,8	50,4	42,6	33,7	29,7
Total (TtE+ CoU), bcm	197,9	187,8	182,0	183,2	144,7	153,1	160,4	136,0	134,1	102,0	100,8	108,0
Active gas in UGS (PG), bcm	15,3	18,1	18,0	15,9	11,0	13,4	10,9	13,7	11,6	9,8	9,6	9,7
Coefficient of correlation PG/(TtE+ CoU), %	7,73	9,64	9,90	8,68	7,60	8,75	6,80	10,1	8,65	9,60	9,52	9,0

\*Projection on the base of 10 month

The media storm over Ukraine's supposed shortage of reserves in the UGS has been based on three main points:

- This year the heating season began somewhat earlier than in 2015-16 and could be more intense, given that the weather forecast is for a colder winter. In 2016, Ukraine stopped pumping gas into its UGS by October 16, and total reserves stand at 14.7bn cu m.
- In previous years, the volume of gas stored in the UGS was higher than in 2016: in 2015, gas stopped being pumped in only on October 31 and reserves stood at 17.05bn cu m, while in 2014, it stopped being pumped in on October 21 and aggregate reserves stood at 16.73bn cu m.
- NAK Naftogaz Ukrainy pumped only 6.4bn cu m in 2016, which appears to be an unprecedentedly low volume in absolute terms.

All of this is true, but overlooks the fact that Ukraine has unprecedentedly low levels of consumption and transit volumes are at only 55% of capacity. The other factor being ignored is that 3.3bn cu m of unused gas remained in the system after the 2015-16 heating season ended. Given all this, a correlation coefficient of 9.00%, as shown in Table 1, is completely acceptable, compared to previous years. In six of the last 12 years, from 2005 to 2016 inclusive, this indicator was lower than it is this year.

### Changes in the gas sector

In the last two years, Ukraine's gas sector saw significant changes that have been affecting the normal

passing of the heating season, as might be expected. These changes, whose dynamic is shown in retrospect in Table 2, include:

- a significant reduction in domestic consumption;
- increased domestic extraction;
- minimized dependence on a single supplier of natural gas;
- reforms in Ukraine's electricity market.

The reduction in domestic consumption has been primarily due, of course, to a major decline in industrial production because of Russia's war against Ukraine. With the Russian occupation of certain counties in Donetsk and Luhansk Oblasts (ORDiLO), a slew of major industrial gas customers stopped operations, such as the Stirol Concern, a chemicals processing company based in Horlivka.

Despite the occupation of ORDiLO and the difficult economic situation in the country, gas extraction was maintained without too much of a drop in output.

Over the last few years, Ukraine was also able to significantly diversify its sources of natural gas, which sharply reduced the risks of political and economic blackmail on the part of its one-time monopolist supplier, Russia. Today, Ukraine can get its gas from half a dozen traders through three countries: Slovakia, Poland and Hungary. As the consumption of gas has gone down, Ukraine's reverse deliveries from the EU can pretty well cover all of its needs for imported gas.

Table 2

Years \ Indicators	2011	2012	2013	2014	2015	2016
Consumption, bn cu m/y	59,3	54,8	50,358	42,5	33,727	30,3
Extraction, bn cu m/y	20,6	20,2	20,998	20,5	19,896	20,290
Imports, bn cu m/y	44,8	32,9	27.974: RF-25.842 EU-2.132	19.600: RF-14.450 EU-5.016	16.442: EU-10.302 RF-6.140	11,078: EU-11.078 RF-00.000

## Risks of Gazprom maneuvers during the winter

Despite having achieved gas stability, Ukraine is still vulnerable to machinations of one kind or another on the part of Gazprom to disrupt gas supplies to the EU during the course of this winter. Confirmation of such intentions has been evident in the way that the operating pressure of gas coming into Ukraine's trunk lines that move gas from Russia to the EU has been pulsating. Obviously, the Russians are counting on Ukrtransgaz will distribute the gas to European consumers at the EU-Ukraine border with similar pulsations. Needless to say, this would not please EU companies and, as a consequence, Gazprom's insistence that Nord Stream 2 was necessary because of "depreciation and proneness to accidents at the Ukrainian GTS" would have been justified and would have achieved its objective.

One other explanation is that Gazprom has practiced for "winter military action." By maximizing deliveries to the EU primarily by transiting through Ukraine in QIV of 2016, Gazprom can easily minimize it at some point in QI of 2017, the way it did in QI of 2015. The objective here is that should Ukrtransgaz take additional fuel gas from the transit stream to provide the necessary technical conditions to compensate for the pulsating working pressure of the pipelines, Gazprom will accuse Ukraine of "stealing transit gas" designated for consumers in the EU. Thus, the groundwork is laid for the next propaganda campaign: Ukraine steals gas because it did not reserve enough in its UGS and refused to buy additional volume from Gazprom, so Russia cannot continue to transit gas through Ukraine because Ukraine siphons off gas from the transit stream. And Gazprom stops all transit through Ukraine.

*This is how a third gas war might be provoked, with all the weight of Russia's propaganda presenting Ukraine as the guilty party while Gazprom becomes Europe's savior. And thus, the European Commission will have to quickly agree to Nord Stream 2 as, whether the EU wants it or not, the new pipeline will have to be built because Ukraine is "no use" as a transit link.*

Propaganda-style media claims prepared in the Russian Federation to provoke a gas crisis have been forthcoming both at the corporate level and at the diplomatic and political levels. "Gazprom is concerned at the level of Ukrainian gas being pumped into the UGS," said Gazprom's foreign economic activities department deputy director, Viktor Valov<sup>7</sup> on August 10, 2016. "If the winter is really cold, the country might not be able to ensure transit gas to Europe." The Russian side announced on October 24, "Russia's Permanent Representative to the EU, Vladimir Chyzhov, has stated that, because of insufficient supplies in its gas storage facilities, Ukraine will be forced to siphon off Russian gas from the transit pipes going to Europe even if the winter is not excessively cold, which threatens to bring on a new gas crisis."<sup>8</sup>

Then, on December 14, the Russian president joined the propaganda campaign. "Putin expressed concern that the Ukrainian side is not upholding the agreement regarding the purchase of gas in this winter season. It was pointed out that this creates the risk to the transit of gas to Europe,"<sup>9</sup> said a Kremlin press release after a telephone conversation with German Chancellor Angela Merkel. And that same day, Russia's Energy Minister Novak joined the fray. On December 19, Gazprom boss Alexei Miller himself stated openly: "Gazprom sees clear risks for transit gas going through Ukraine to Europe and should there be illegal siphoning of gas by Ukraine, we may have to disrupt gas deliveries to Europe."<sup>10</sup>

These examples of large-scale political and propaganda activity on the part of Russia demonstrate its preparations for a third gas war as soon as the European Commission makes its final decision about the OPAL pipeline. The European Commission has not responded to the Russian accusations so far, which suits Russia well. Most likely, should another "gas crisis" start, Russia will make use of its distant early warning system with the European Commission, hastily put together in November 2009 and meant to manipulate consumers on the part of the supplier while completely ignoring the transit country.

## Winter risks with the EU

In the circumstances where Gazprom will mostly no longer use the Ukrainian transit network, but will deliver gas via Nord Stream-OPAL, based on the October 28, 2016 decision of the European Commission, Ukraine's GTS could realistically end up functioning in an unstable manner, for technical reasons, that is, if Gazprom continues not to provide the necessary incoming pressure, the way it did this past summer. Ukrtransgaz was able to cover the low pressure from the Russian tubes with its own gas in order not to disturb the current technical conditions for transit gas and its distribution to European customers at the exit points. With these conditions and this decision on the part of the Commission, the Ukrainians need to reject liability for the situation and hold the Commission responsible, all the more so that Naftogaz is not a third party to bilateral contracts between Gazprom and its European customers.

In making its decision to increase Gazprom's use of OPAL, the European Commission essentially provided Gazprom with a legal basis for manipulating the directions and volumes of its deliveries of gas to Europe, which could lead to greater turbulence on the EU gas market. As we saw in 2009, the European Commission is incapable of quickly identifying the guilty party in hostile actions.

This inability or reluctance on the part of official Brussels to issue a verdict as to what happened in January 2009 did Ukraine disrupt transit deliveries or did Russia disrupt incoming supplies? encourages the Russians to repeat these kinds of "gas crises." And this kind of crisis is the very thing to force the Commission into agreeing to Nord

7 <http://tass.ru/ekonomika/3526566>

8 <http://www.vz.ru/news/2016/10/24/839915.html>

9 <http://kremlin.ru/events/president/news/53463>

10 <http://tass.ru/ekonomika/3886393>

Stream 2, because, so Gazprom insists, “Ukraine is an unreliable transit link.”

In addition, the Commission’s decision and the way the Germans have ignored the European Court’s December 23 decision about shutting down the project are disrupting reforms to the oil and gas sector in Ukraine, especially the unbundling of Naftogaz Ukrainy. The October 26 decision has obviously reduced transit through Ukraine’s GTS. In this context, if the European Commission decides to also wash its hands of the Nord Stream 2 issue, then it will be not so much Gazprom as the Europeans who will have left Ukraine’s system without transit gas. In other words, the GTS, which is run by a separate company within Naftogaz Ukrainy, will inevitably become unprofitable.

Under these circumstances, the Ukrainians need to consider the option of suspending not ending! the kind of unbundling that will predictably lead to further losses for Ukraine. They must immediately consult with the European Commission. In short, if the Commission agrees to compensate Ukraine for the losses due to its decision to allow Gazprom to maximize its throughput via OPAL, then it will be possible to talk about further steps to reorganize Naftogaz.

## Recommendations

Given all the conditions and circumstances outlined here, it is possible to draw a number of recommendations.

Given the loss of support in the EU in the confrontation of Russia’s bypass pipeline networks and the threat of serious reductions or even termination of transit through Ukraine’s territory, the country needs to:

- expand domestic extraction of natural gas to bring down the need for imported gas altogether to zero;
- promote as much as possible the building of a Ukraine-Poland gas interconnector to provide diversified options for importing gas;
- make financing and implementing energy-efficiency and energy-saving measures a top priority.

Ukraine also needs to improve and devote specific attention to cyber security on critical energy infrastructure: the UES, GTS and PTS and all the technical communication links.

Finally, Ukraine needs to become more active in foreign relations and the provision of information in order to reduce the risks of the GTS becoming unbalanced as gas transit volumes go down, and to ensure its further stable operation. This means:

- consolidating efforts with interested partners to maintain and use the transit lines available on Ukrainian territory;
- instituting the post of Government Ombudsman for Energy Security with the necessary authority to coordinate the efforts of various ministries and agencies;
- oppose, in concert with other stakeholders, the implementation of Nord Stream 2 and TurkStream;
- increase efforts to set up an Eastern European gas hub based on specific UGS in Ukraine;
- mobilize international pressure on Russia to ensure free access to the Russian GTS by independent gas extracting companies and transit gas from Central Asia to Europe.



### ***TRUMAN Agency***

The Truman Agency of Strategic Communications' activities are aimed at the resolution of sensitive communication issues in Ukraine and for Ukraine.

Our experts create and implement communication programmes that engage the political establishment and other target audiences in a constructive dialogue at local, regional, national and international levels. The result of this work will always be the growth of goodwill, increased trust and more opportunities for our clients.

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### ***Institute of World Policy (IWP)***

IWP represents a new generation of analysts committed to the European choice of Ukraine. The mission of the Institute is to develop analytical research and implement project activities in order to promote European standards and practices inside Ukraine, as well as to increase support of the foreign opinion leaders, EU and NATO officials for the European and Euro-Atlantic aspirations of Ukraine.

The IWP products include political analysis and recommendations, discussion platforms for all-round public discussions of core foreign policy issues and challenges, maintenance of regular dialogue with the world's leading scientists, thinkers and experts in international relations.

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