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UKRAINE-NATO INTERPARLIAMENTARY COUNCIL
AND THE ECONOMICS AND SECURITY COMMITTEE

VISIT TO KYIV, UKRAINE

SECRETARIAT REPORT

15-16 MARCH 2007

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1. From 15-16 March 2007 members of the Ukraine-NATO Interparliamentary Council (UNIC), the Sub-Committee on East-West Co-operation and Convergence and the Political Sub-Committee on NATO Partnerships met at the Rada in Kyiv, Ukraine, for discussions on the political, economic and security developments in Ukraine.

I. FOREIGN POLICY PRIORITIES OF UKRAINE

2. Yuriy Kostenko, the Deputy Minister of Foreign Affairs, opened the conference by suggesting that the vivid debate unfolding in Ukrainian society is largely focused on domestic matters and that the foreign policy ambitions of the Ukrainian state remain relatively constant. A change in government may introduce subtle shifts in foreign policy but is unlikely to upset longer-term policies. In Mr. Kostenko's view, Ukraine's national interests are too fundamental for this to happen. In this sense, Euro-Atlantic integration will very likely remain a Ukrainian priority. He suggested that this view is shared by both the president and the parliament and is enshrined in the legislation passed in 2003.

3. At the same time, however, strengthening relations with the West should not imply an unravelling of the close relationship between Russia and Ukraine. Ukraine seeks to remain active in its own neighbourhood and will continue to work with other states in the region, including Russia, on matters of mutual concern including energy security.

4. Ukraine is particularly focused on its relations with both the European Union and NATO and is seeking to implement action plans developed in partnership with both institutions. This requires both intensified dialogue and a serious commitment to reform. Ukraine hopes to conclude eventually a new treaty with the EU to deepen relations and establish a clearer path for eventual Ukrainian membership. This would lay out a path for progress in political development, energy security, human and cultural development, and would also include the eventual establishment of a free trade zone with the EU and a common market permitting the free movement of goods, capital and people. Ukraine's leaders feel that the EU's current neighbourhood policy does not provide the kind of market access, nor the long-term integration prospects that Ukraine needs to galvanize and sustain its reform process. In this respect the proposals that the European Commission have tabled for a revamped relationship are not seen as satisfactory in Kyiv. Ukraine wants the EU to acknowledge that, as a European state, it has the right to apply for EU membership. Ukraine's European vocation and its right to accede when it succeeds in meeting the criteria for membership should be recognized in the new agreement. Talks with the EU are ongoing, and the next round of talks is scheduled to get underway in April 2007.

5. By contrast, the internal discussion about Ukraine's relations with NATO is more heated. The question has been excessively politicised but it needs to be understood, not in narrow political terms, but as a strategic choice for the country. Advocates of NATO accession are pushing for a deepening of Ukraine's relationship with NATO, but are frustrated by some in the majority in the governing parties who are seeking to slow this process down.

6. Ukrainian officials link regional prosperity to regional stability and this is the cornerstone of its "relations with the neighbourhood". Deepening relations with Russia is also a priority and Ukrainian officials do not see this as a contradiction with their Western vocation. Ukraine also enjoys strategic partnerships with Poland, Slovakia, Romania and Bulgaria and is seeking to deepen these relationships as well. Moldova, Belarus and the South Caucasus are not on the verge of acceding to the European Union, but Ukraine hopes to help these regions move closer to the European family of nations, while developing closer economic relations with them. It is working to contribute to the resolution of frozen conflicts in Transnistria, Georgia, Armenia and Azerbaijan.

Because of geography, it is particularly concerned about the Transnistrian conflict, and President Yuschenko recently advanced a plan to encourage negotiations, which are now taking place. Ukraine, like Turkey, also wants to intensify cooperation in the Black Sea region and work to build prosperity there. It sees GUAM (Georgia, Ukraine, Azerbaijan and Moldova) as a vital tool to pursue both aims.

7. Former Foreign Minister Borys Tarasyuk also noted that while NATO has been quite open to the notion of eventual Ukrainian accession, the EU has not. He suggested that this contradicts the founding document of the EU. He did note that on 5 March, negotiations were launched to put the EU-Ukrainian relationship on a new foundation. These talks are likely to be completed by next April when the current agreement will have expired. But there are fundamental differences to be ironed out, mainly relating to the fact that Ukraine wants its EU aspirations taken seriously and the EU is not willing to acknowledge them, in Mr. Tarasyuk's estimation. He argued that Ukraine is too frequently associated with Russia in the Western mind and suggested that this is a consequential mistake.

8. Today, Ukraine is the EU's largest trading partner. 31.1% of its trade is with the EU, while Russia holds second place. Ukraine is also closely cooperating with the EU on regional issues and a range of foreign policy matters. Ukraine's foreign policy vision is very similar to that of the EU, particularly on the importance of human rights matters. It is also participating in the EU police mission in the Balkans. President Yuschenko, with the support of Russia, the EU and the United States, has also been working to resolve the Transnistrian problem.

9. Ukraine brings important defence capabilities to the table as well. It has the world's third largest airlift capability and hopes to deepen cooperation with both the EU and NATO in this area, although it is not happy with the current level of cooperation. It has also proposed deeper airspace cooperation and has concluded several international agreements to develop new rocket launch systems. The EU and NATO have both been working to support the destruction of obsolete munitions in Ukraine.

10. In response to a question Mr. Tarasyuk outlined elements of the constitutional disagreement that has characterized recent Ukrainian politics. He noted that the constitution accords the president exclusive rights in the conduct of foreign policy, while the parliament has the right to approve the fundamentals of foreign policy. But until recently there had been no law governing those fundamentals. The president also has the exclusive right to nominate the foreign and defence ministers, while parliament is charged with approving their nomination.

11. He suggested that, because of a decision by the Socialist Party to leave the Orange coalition, the governing coalition does not reflect the will of the voters. This has sparked a genuine internal crisis that has implications for Ukraine's external position. Mr. Tarasyuk noted, for example, that the crisis has forced a pause in Ukraine's deepening relationship with NATO.

12. Mr. Tarasyuk also discussed emigration as a problem for his country. He noted that there are between five and seven million Ukrainians who have left the country in search of employment, a development that has hampered economic development. Moreover, many of these Ukrainians working in Europe do not enjoy legal protection. The government has established assistance centres in Poland, Italy, Spain and Portugal, and has urged EU countries to grant more Ukrainians legal status. Ukrainians have been particularly vulnerable to criminal exploitation because of this lack of protection. To date, 13 agreements have been signed to provide a degree of social protection to Ukrainians living in EU countries. Ukraine and the EU have also initiated an agreement to simplify visa and readmission procedures and government officials hope eventually to forge a visa free regime with the EU.

II. UKRAINE'S DEFENCE PRIORITIES

13. Ukraine's defence sector has undergone important changes over the past year. There are far more civilians working at the Ministry of Defence today than several years ago, although some of these are former military officers. This is, indeed, a transition period, which should result in a fully civilian controlled military establishment.

14. At the end of 2005 the government and the president approved a national programme of armed forces development. This is a comprehensive defence programme the country has conducted to rectify security objectives and resources through an interagency process. This breadth and thoroughness of the review process has improved the capacity of the MoD to defend the budget. This was the first time that Ukraine had conducted a major defence planning exercise employing NATO standards and thus represented a major advance for the country and for its transition. In 2003 and 2004 the government embarked upon a thorough defence review that made the national development programme possible. According to Ukrainian officials, this has bolstered the country's capacity to operate with NATO and Western forces and established new markers for higher and more relevant training standards. It is now employing a similar methodology to embark on a broader security sector review. Ukraine is working with NATO, the EU and the UN on this review. One Ukrainian parliamentarian noted, however, that the security sector initiative is strictly presidential and has not been discussed in parliament, although it was based on the Ukrainian law on national security.

15. NATO and NATO member governments have been very active in supporting these efforts, while Ukraine has an inter-agency commission working under the Ministry of Foreign Affairs to focus efforts on deepening cooperation with the Alliance. Ukraine takes the PARP (Planning and Review Process) process very seriously and sees it as way to advance force modernization whilst bolstering interoperability with NATO forces. NATO technical assistance programmes have provided important support to Ukraine's revamped planning process. NATO has also provided important assistance to Ukraine's munitions destruction programme.

16. NATO has also reached out to civil society as well as political leaders. Kyiv hosts a NATO Information Centre, which has an important outreach function. Roughly 10% of Rada members, for example, have travelled to Brussels for discussions with NATO officials. Many of these politicians harbour strong reservations about NATO, but the dialogue is designed to clear up misunderstandings on both sides. Cultural elites, religious leaders and young people are also engaged in a number of activities organised by NATO. Despite these efforts, there is a sense that more can be done to engage the population in a well-informed dialogue about the role and function of the Alliance.

17. A growing number of NGOs are adopting an explicitly Euro-Atlantic agenda. But as the head of the Ukrainian Atlantic Council noted, there is a sense among those in civil society supporting this agenda that the government is very reluctant to adopt it, nor does it respond when NATO is attacked by strongly anti-NATO forces like the Communist Party. This suggests that a new internal impetus is needed to generate a greater understanding of the potential benefits of a closer relationship with NATO. The Atlantic Council of Ukraine has been particularly active in this regard with young people and university students. Indeed, there is a sense that the younger generation is far more open to Western integration than the older generation. The problem is both generational and geographical with eastern and southern Ukraine registering far more objections to deepening ties to NATO than western Ukraine. The problem ultimately lies in the lack of good public information on the Alliance and on security issues in general. Some of those supporting Ukraine's dialogue with NATO feel that the environment is growing more difficult because of Russia's openly expressed hostility to this relationship and its active public campaign against it. The government's

own public relations campaign, from the perspective of these critics, has not been adequate to the task.

18. Ukraine has offered airlift capabilities for the KFOR operations, and negotiations on this offer are underway. Ukrainian police units are also deployed in Kosovo, as well as forces in the Ukrainian, Polish, Lithuanian battalion. At one point, Ukraine also had 1,500 troops in Iraq, but that number has fallen to 40 working on border, police and training matters. In Liberia, Ukraine has sent a helicopter squad to provide fire support and transport.

19. Ukraine confronts an array of non-traditional threats: the proliferation of WMD, terrorism, mafia groups, mass migration, energy security and the aftermath of Chernobyl. The recent decision to deploy elements of an American ABM (anti-ballistic missile) system in Poland and the Czech republic has generated a great deal of controversy in Ukraine in recent months. Ukrainian officials want to examine the issue very closely before making a decision on how to approach the matter. Ukraine also wants to participate in the international discussion about this system and the general threat it aims to thwart. There are clearly concerns about the proliferation of missiles and missile technology and this, in the minds of some of the Ukrainian participants, certainly should inspire a discussion about the possible role of ABM. If this can be dealt as a technical challenge, it can be handled in a more rational fashion and, thus, common ground is more likely to be found. But the dialogue must be intensified and Ukraine's demands are, at least, in part, a direct consequence of its now enhanced capacity to assess threats and to formulate national strategies for coping with these.

20. For its part, the EU has also embarked on a number of security sector programmes with the Ukrainian government, and Ukraine is seeking ways to work more closely with the EU in the security field. NATO and the EU have shared notes and are making an effort not to duplicate their efforts.

III. ECONOMIC OUTLOOK

21. The Ukrainian economy has been growing at roughly 7.5% over the past year, and its public finances have significantly improved. It has made great progress in poverty reduction, although significant levels of poverty persist, particularly in the countryside. A moratorium on sales of land has made it more difficult to generate wealth in the countryside.

22. Ukraine's economic management has been generally good and the country has benefited recently from favourable terms of trade and increased exports. Because of significant installed capacity, rising demand has not proven inflationary.

23. The business and investment environment, however, must be changed. The economy is harmed by the state's low level of administrative efficiency. This is recognized in the Council of Minister's Action Plan for 2007-2008. Tax reform, and reduced fiscal and administrative burdens are essential. Currently 35% of the economy is operating in the grey and black markets, in part, because state inspections and licensing requirements remain burdensome and liable to abuse and corrupt practices. The government hopes to establish more simplified and lower cost systems to create a better business environment. The barriers to business in Ukraine remain formidable, and confusing regulatory requirements create an environment very conducive to corruption and discretionary decision-making. In 2005 an important reform was introduced in this regard and 9,475 regulatory acts were revised or cancelled. This significantly reduced pressures on businesses operating in Ukraine. This has helped reduce the size of the shadow economy. The longer-term challenge will be to galvanize the high-tech sector of the national economy to ensure a

higher degree of added value production. Ukraine has an important scientific tradition but it has yet to develop systems to transform this to commercial advantages.

24. Public investments must also be improved. The problem is that social spending has crowded out fiscal space, and if a new balance between investment and consumption is not struck, Ukraine could confront bottlenecks to growth over the longer term. There is ample room to improve the social welfare sector in order to render it more cost effective and efficient. Ukraine's pension system is the most expensive in the world in terms of its size relative to GDP. Roughly 25% of the population is paid pensions, and this number simply has to be reduced. Many of these entitlements are received by people who do not need them and should not qualify. The system has also placed high costs on businesses and the tax system is increasingly underwriting consumption rather than investment. Change in the retirement age is an essential but politically daunting initiative that will eventually have to be undertaken.

25. The government has made growth, poverty reduction, further international links and a closer relationship with the EU top economic priorities. The EU has been accelerating support to the country in recent years and the World Bank group has been the biggest supporter. The Bank has focused on Ukrainian infrastructure and energy efficiency projects. There are major new investments designed to spur energy efficiency, and this has helped the country adjust to the introduction of market gas prices. The Bank also wants to support quality improvements in public institutions and particularly those that govern markets. Here, there is much work to be done. US support through the Millennium Development Project could play an important role here.

26. One of the greatest economic challenges Ukraine has faced has been a lack of consistency in the application of its economic transition strategies. The country has had more than ten different transition programmes since its independence. Myriad reforms have been adopted but never implemented. The government is now focusing on the basic reforms needed to galvanize the economy to a higher level of technological development and greater economic efficiency. High technology accounts for only 5% of Ukraine's exports, and the trends have been negative in recent years, despite increased spending on research. The government recognizes that it must reverse this course by improving the country's capacity to commercialise its basic research. The government is introducing a series of education reforms and is working with Hungarian officials to develop methodologies for developing its technological potential. But the problem is not simply technical, it also has important legal dimension.

27. Attracting more foreign direct investment represents another government ambition. The re-nationalizations of 2006 deterred investors, and the level of investment inflow has yet to return to that of 2005. Greater stability, as well as an improved regulatory environment, is needed to encourage foreign investment flows, which are needed to generate jobs and access to advanced technology.

IV. THE ENERGY SECTOR

28. Ukraine confronts a range of energy challenges that have important implications for the national economy and for national security. Western Europe tends to see Ukraine as a critical energy transport region. 45 millions tons of oil passed through the country last year as well as 128.5 billion cubic meters of natural gas. Natural gas pricing has posed painful problems for Ukraine and has been a source of enormous tension with Russia. Although an agreement has been signed on pricing, it is not on as favourable terms as some had hoped. Romania, for example, is paying significantly less for its gas supplies. Moreover, prices rise significantly once gas passes into the country and this is proving a burden to Ukraine's chemical and steel industries. Debt for previously consumed gas is a significant problem for a number of Ukrainian

communities, where only half of consumers pay for their gas. Limits have now been placed on communities that fail to make their payments and this has adverse social effects.

29. Ukraine needs to address domestic market inefficiencies as part of its energy security strategy. There has been an absence of vision for the sector's future and no attempt to inform the public of its own responsibilities in this regard. The market itself is poorly structured and fails to encourage energy savings. Ukraine also needs to diversify its own energy sources in order to reduce its energy dependence on a country that routinely uses its own gas and oil endowments for political purposes. That said, Russia's own capacity to fix global gas prices through the creation of an OPEC-like cartel is very limited. With the exception of Liquefied Natural Gas, gas exports depend on pipelines and it is therefore not a globally "fungible" commodity.
