



Ukraine: Current Issues and U.S. Policy

Steven Woehrel
Specialist in European Affairs

March 5, 2009

Congressional Research Service

7-5700

www.crs.gov

RL33460

Report Documentation Page

Form Approved
OMB No. 0704-0188

Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.

1. REPORT DATE 05 MAR 2009		2. REPORT TYPE		3. DATES COVERED 00-00-2009 to 00-00-2009	
4. TITLE AND SUBTITLE Ukraine: Current Issues and U.S. Policy				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Congressional Research Service ,Library of Congress,101 Independence Ave SE, Washington,DC,20540				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT	18. NUMBER OF PAGES	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

Summary

In January 2005, Viktor Yushchenko became Ukraine's new President after massive demonstrations helped to overturn the former regime's electoral fraud in what has been dubbed the "Orange Revolution," after Yushchenko's campaign color. Some hoped Ukraine might finally embark on a path of comprehensive reforms and Euro-Atlantic integration after nearly 15 years of half-measures and false starts. However, infighting within his governing coalition hampered economic reforms and led to disillusionment among Orange Revolution supporters. A long-running power struggle between Yushchenko and Prime Minister Yuliya Tymoshenko has paralyzed policy making, resulting in widespread public disgust with the Ukrainian political class as a whole.

The global economic crisis has hit Ukraine harder than perhaps any other eastern European country. Ukraine's currency, the hryvnya, has lost over 40% of its value and continues to face speculative pressure in international markets. Ukraine's banking sector is in crisis. In November 2008, the International Monetary Fund approved a \$16.4 billion standby loan for Ukraine to bolster its finances. The loan was conditioned on a commitment from Ukraine to allow its currency to depreciate in a controlled way, to recapitalize the banking sector, and to pursue more rigorous fiscal and monetary policies. However, it is unclear whether the fractious Ukrainian leadership will be willing or able to take the needed steps to receive all of the IMF loan and restore the confidence of international markets.

After taking office as President, Yushchenko said that Ukraine would seek integration into the global economy and Euro-Atlantic institutions. Ukraine joined the World Trade Organization (WTO) in May 2008. In the longer term, Yushchenko seeks Ukrainian membership in the European Union and NATO. Relations with Russia have been tense over such issues as Ukraine's NATO aspirations and energy supplies. The leftist opposition in the parliament opposes NATO membership and is more favorable to closer ties with Russia, especially in the economic sphere. Conflict between Ukraine's political forces has led its foreign policy to appear incoherent, as the contending forces pulled it in pro-Western or pro-Russia directions or simply neglected foreign policy as less important than domestic political combat.

U.S. officials supported the "Orange Revolution" in Ukraine, warning the former regime against trying to impose fraudulent election results, and hailing Yushchenko's ultimate victory. U.S. officials have remained upbeat about Ukraine's successes in some areas, such as securing WTO membership, as well as in holding free and fair elections and improving media freedoms, while acknowledging difficulties in others, such as fighting corruption, establishing the rule of law, and constitutional reforms. The Bush Administration strongly supported granting a Membership Action Plan to Ukraine at the NATO summit in Bucharest in April 2008, a key stepping-stone to NATO membership. However, opposition by Germany, France, and several other countries blocked the effort. On the other hand, the Allies surprised many observers by confirming that Ukraine will join NATO in the future, without specifying a timetable. The Bush Administration strongly reiterated its support for Ukraine in the wake of the Russia-Georgia conflict of August 2008, which has sparked fears that Russia could take steps to divide Ukraine. The Obama Administration has expressed the desire to "reset" relations with Russia, but has warned that it will not accept any country's assertion of a sphere of influence. It has also reaffirmed its support for NATO's "open door" to NATO aspirants such as Ukraine.

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Background

Ukraine, comparable in size and population to France, is a large, important, European state. The fact that it occupies the sensitive position between Russia and new NATO member states Poland, Slovakia, Hungary, and Romania, adds to its geostrategic significance. Many Russian politicians, as well as ordinary citizens, have never been fully reconciled to Ukraine's independence from the Soviet Union in 1991, and feel that the country should be in Russia's political and economic orbit. The U.S. and European view, especially in Central and Eastern Europe, is that a strong, independent Ukraine is an important source of regional stability.

From the mid 1990s until 2004, Ukraine's political scene was dominated by President Leonid Kuchma and the oligarchic "clans" (groups of powerful politicians and businessmen, mainly based in eastern and southern Ukraine) that supported him. Kuchma was elected President in 1994, and re-elected in 1999. He could not run for a third term under the Ukrainian constitution. His rule was characterized by fitful economic reform (albeit with solid economic growth in later years), widespread corruption, and a deteriorating human rights record.

Ukraine held presidential elections on October 31, November 21, and December 26, 2004. The oligarchs chose Prime Minister Viktor Yanukovich as their candidate to succeed Kuchma as President. The chief opposition candidate, former Prime Minister Viktor Yushchenko, was a pro-reform, pro-Western figure. International observers criticized the election campaign and the first and second rounds of the election as not free and fair, citing such factors as government-run media bias in favor of Yanukovich, abuse of absentee ballots, barring of opposition representatives from electoral commissions, and inaccurate voter lists. Nevertheless, Yushchenko topped the first round of the vote on October 31 by a razor-thin margin over Yanukovich. Other candidates finished far behind.

After the November 21 runoff between the two top candidates, Ukraine's Central Election Commission proclaimed Yanukovich the winner. Yushchenko's supporters charged that massive fraud had been committed. Hundreds of thousands of Ukrainians took to the streets, in what came to be known as the "Orange Revolution," after Yushchenko's chosen campaign color. They blockaded government offices in Kiev and appealed to the Ukrainian Supreme Court to invalidate the vote. The court invalidated the runoff election on December 3, and set a repeat runoff vote on December 26. Yushchenko won the December 26 re-vote, with 51.99% of the vote to Yanukovich's 44.19%. After court challenges by Yanukovich were rejected, Yushchenko was inaugurated as President of Ukraine on January 23, 2005. On February 4, 2005, the Ukrainian parliament approved President Yushchenko's appointment of Yuliya Tymoshenko as Prime Minister of Ukraine by a vote of 373-0. Tymoshenko is a charismatic, populist leader with a sometimes combative political style who campaigned effectively on Yushchenko's behalf. She is a controversial figure due in part to her alleged involvement in corrupt schemes as a businesswoman and a government minister during the Kuchma regime.

The "Orange Revolution" sparked a good deal of interest in Congress and elsewhere. Some hoped that Ukraine could finally embark on a path of comprehensive reforms and Euro-Atlantic integration after years of half-measures and false starts. However, subsequent events led to disillusionment among Orange Revolution supporters. Yushchenko dismissed Prime Minister Tymoshenko's government in September 2005. The atmosphere between the two leaders was poisoned by accusations of corruption lodged by supporters of each against the other side's partisans, including over the highly lucrative and non-transparent natural gas industry.

In order to secure support for a new government, Yushchenko then made a political non-aggression pact with his opponent from the presidential election, Viktor Yanukovich, and promised not to prosecute Yanukovich's key supporters for electoral fraud and other crimes. Some supporters of the Orange Revolution viewed the move as a betrayal of one of the key principles of their movement. Some began to question whether the new government was better than the old regime, given ongoing government corruption scandals and the perception that the Orange Revolution might be reduced to squabbling over the redistribution of property among the "old" oligarchs and would-be, new "Orange" ones.¹

On March 26, 2006, Ukraine held parliamentary elections. The largest vote-getter in the elections was the Party of Regions, headed by Yushchenko's former presidential election rival Viktor Yanukovich. After the failure of protracted attempts to reconstitute the Orange Revolution coalition, the Socialist Party, formerly part of it, changed sides and formed a coalition with the Party of Regions and the Communists, which put forward Yanukovich as its candidate for Prime Minister. Yushchenko reluctantly appointed Yanukovich as Prime Minister, and the Ukrainian parliament approved the new government on August 4, 2006. Yanukovich's government and the parliamentary majority, led by the Party of Regions, worked steadily to whittle away at Yushchenko's powers and political influence. The government and parliament removed ministers appointed by Yushchenko and rejected his proposed candidates to replace them. The government refused to implement Yushchenko's decrees.

Hoping to stem the threat to his power, President Yushchenko dissolved the Ukrainian parliament on April 2, 2007, claiming that the defection of individual members of the opposition to the majority (as opposed to a whole faction) made the ruling majority illegitimate. Prime Minister Yanukovich condemned Yushchenko's decree as unconstitutional and called on the government and parliament to ignore Yushchenko's decree and keep working. On May 27, after weeks of political and legal turmoil, Yushchenko, Yanukovich, and parliament chairman Oleksandr Moroz agreed that new parliamentary elections would be held on September 30, 2007, to end the crisis.

According to many observers, this political crisis underlined the fact that the country still needs to make substantial progress in developing a smoothly functioning democracy. The poorly defined separation of powers in Ukraine's constitution has invited conflict and needs to be clarified. Another key problem is the persistence of a post-Soviet political culture in which "winner-take-all" attitudes and unscrupulous tactics take precedence over a genuine respect for the rule of law.

¹ Jamestown Foundation, *Eurasia Daily Monitor*, September 9, 2005; RFE/RL *Belarus, Ukraine, Moldova Report*, September 16, 2005.

Current Political Situation

On September 30, 2007, Ukraine held early parliamentary elections. The Party of Regions remains the largest party in the new legislature. It won 34.37% of the vote and 175 seats in the 450-seat parliament. The Yuliya Tymoshenko Bloc, which won 30.71% and 156 seats, is the second largest. Our Ukraine-People's Defense came in a distant third, with 14.15% and 72 seats. The Communist party received 5.39% of the vote and 27 seats. The Lytvyn Bloc was the only other party to reach the 3% vote barrier for representation in the parliament. It won 3.96% of the vote, and secured 20 seats.

These results were not a dramatic departure from the results of the March 2006 election. The Party of Regions lost 11 seats, but its Communist allies gained six. The Our Ukraine bloc lost nine seats. However, its former Orange Revolution partner, the Yuliya Tymoshenko Bloc, gained 27 seats. The Socialists, perhaps punished by the electorate for betraying their former Orange allies, fell below the 3% and lost all of their parliamentary seats. The Lytvyn Bloc was not represented in the previous parliament, as it fallen below the 3% threshold.²

As has occurred in elections since Ukraine became an independent country in 1991, support for the parties was heavily regionalized. The Party of Regions was dominant in largely Russian-speaking eastern and southern Ukraine, but did poorly in western and central Ukraine, where Ukrainian nationalism is strong. Support for the Communists was also concentrated in the east and south. Our Ukraine-People's Self Defense did well in western Ukraine, but poorly in the east. The Yuliya Tymoshenko Bloc was strongest in western and central Ukraine, beating Our Ukraine-People's Self Defense in all districts of these regions but one. The Tymoshenko Bloc was much weaker in eastern and southern Ukraine, but made moderate inroads there as compared to the previous election, perhaps opening the way to a future as democratic Ukraine's first truly country-wide party.

After lengthy negotiations, President Yushchenko nominated Tymoshenko as his candidate for Prime Minister. The parliament approved Tymoshenko as Prime Minister on December 18, 2007

Ukraine's Main Political Groups

Party of Regions: The largest party in Ukraine's parliament. It draws its support from eastern Ukraine, where suspicion of Ukrainian nationalism is high and support for close ties with Russia is strong. It defends the economic interests of powerful oligarchic groups in eastern Ukraine.

Yuliya Tymoshenko Bloc: Mainly a vehicle for the ambitions of the charismatic Tymoshenko, it has little ideological cohesion. It is the second largest group in the Ukrainian parliament largely because many Ukrainians have seen Tymoshenko as the most stalwart defender of the populist, anti-corruption ideals of the Orange Revolution.

Our Ukraine-People's Self Defense bloc: This bloc is composed of a number of parties favoring free market economic reforms and a pro-Western foreign policy. It draws its support from western Ukraine, where Ukrainian nationalism is strong. It has been President Yushchenko's main base of support in parliament, although the group has faced internal divisions recently as Yushchenko's popularity has plummeted.

Communist Party: Overtaken by the Party of Regions in its eastern Ukraine strongholds and faced with an aging electorate. It strongly opposes market economics and favors strong ties to Russia.

Lytvyn Bloc: A centrist bloc headed by Volodymyr Lytvyn, former top official in the Kuchma regime. Lytvyn has changed sides several times in Ukraine's political struggles, backing the side with the upper hand at the moment.

² For the 2007 Ukrainian parliamentary elections results, see the Ukrainian Central Election Committee website, <http://www.cvk.gov.ua/vnd2007/w6p001e.html>.

by a vote of 226-0. The parliament then approved Tymoshenko's government. The Party of Regions, Communist Party and Lytvyn Bloc did not take part in the votes.

The extreme fragility of her majority has made Tymoshenko's task as Prime Minister difficult. However, perhaps the key problem has been escalating tension between Tymoshenko and President Yushchenko. The two have clashed over economic policy (including privatization and budgetary policy), foreign policy (especially relations with Russia), energy policy, and over the relative powers of the presidency, the government, and the parliament. In addition to intense personal enmity and distrust between the two leaders, the conflict is also likely due to jockeying for power in advance of presidential elections in January 2010 (in which Yushchenko and Tymoshenko could both be candidates). At present, Yushchenko appears to be in the weaker position as recent opinion polls have shown him to have approval ratings in the low single digits.

The Ukrainian government has lurched from crisis to crisis in recent months. On September 3, 2008, the Our Ukraine bloc announced that it was leaving the governing coalition unless Tymoshenko reversed herself on the passage of laws by the parliament reducing the president's powers. The Tymoshenko Bloc and the Party of Regions had provided the votes for the measures. Our Ukraine also demanded that Tymoshenko join Yushchenko in condemning Russia's military assault on Georgia in early August. Tymoshenko had avoided commenting on the issue.

In December 2008, Tymoshenko was able to save her government by expanding it to include the centrist Lytvyn Bloc, with Lytvyn becoming parliament speaker. Our Ukraine, which had been divided on whether to leave the government in the first place, reluctantly agreed to participate in the new government. In February 2009, Tymoshenko was able to defeat a no-confidence motion put forward by the Party of Regions. A new crisis emerged in March. The parliament, with the support of the leftist opposition and some Tymoshenko Bloc members, voted to dismiss Foreign Minister Volodymyr Ohryzko. Ohryzko, who was appointed by President Yushchenko, was accused of worsening relations with Russia and other shortcomings. Continuing government instability could cause the collapse of the government and early parliamentary elections, which would be the third in less than four years.

According to opinion polls, an overwhelming majority of Ukrainians are disgusted with the Ukrainian political class as a whole. This is due to the fact that Ukrainian leaders have continued to squabble despite the global economic crisis, which has inflicted severe blows on Ukraine's economy. Some analysts believe that the situation could result in public unrest if economic conditions continue to worsen.

Current Economic Situation

Until the global economic crisis, Ukraine was experiencing substantial economic growth, fueled mainly by consumption, including an import boom fueled by heavy domestic and foreign borrowing, which resulted in a widening trade deficit and current account deficit (7.2% of GDP in the first seven months of 2008). Ukraine's growth was also due to strong demand for products of the country's large steel and chemicals industries.³

³ Economist Intelligence Unit Country Report: Ukraine, June 2008; "Ukraine: Slowing Growth Suggests Stagflation Risk," Oxford Analytica, August 14, 2008.

Due to the unsustainable basis of its growth and the lack of confidence caused by its squabbling political leadership, Ukraine has been perhaps the eastern European country hardest hit by the global economic crisis. Ukraine's real Gross Domestic Product contracted by 14.4% in November 2008 and 9.9% in December. Ukraine's industrial output dropped by 34.1% in January 2009, year-on-year. Exports from Ukraine's key metals sector (which supplies about 40% of the country's foreign currency earnings) fell nearly 45% in January 2009, year-on-year. Ukraine's stock market has declined by 80% as compared to its level in February 2008.

Ukraine's currency, the hryvnya, has lost over 40% of its value and continues to face speculative pressure in international markets. The drop has been particularly devastating because 70% of consumer loans and half of corporate loans in Ukraine are denominated in foreign currency (mainly dollars), triggering the possibility of massive defaults by borrowers. As a result, Ukraine's banking sector is in crisis. Ukraine's banks borrowed heavily on international markets in recent years and their ability to repay those loans or receive new ones is questionable. They have also been negatively affected by the collapse of a real estate bubble in the country. Many banks have stopped making loans in Ukraine and have even stopped giving depositors their money back. Ukraine's central bank has already taken over eight failing banks.

Ukraine currently has more than enough reserves to service its sovereign debt of about \$18 billion. However, total foreign debt of Ukraine's corporations (mainly banks) is five times larger than the sovereign debt. The state does not have enough cash to take over the obligations of the banking sector, if it collapses. Some large European banks that have invested in the Ukrainian banking sector have stepped in to prop up their Ukrainian subsidiaries, although others could worsen the situation by withdrawing funds in order to bolster their own positions at home.

In November 2008, the International Monetary Fund approved a \$16.4 billion standby loan for Ukraine to bolster its finances. The loan was conditioned on a commitment from Ukraine to allow its currency to depreciate in a controlled way, to recapitalize the banking sector, and to pursue more rigorous fiscal and monetary policies. An initial tranche of \$4.5 billion has been disbursed, but subsequent tranches were placed in jeopardy by the Ukrainian parliament's passage of a budget which runs a deficit of 3% of GDP in order to pay government salaries and make social payments. Even this budget is based on overly optimistic assumptions, according to experts. The IMF had demanded a balanced budget. Tymoshenko has sought a \$5.5 billion loan from Russia, but rejected a Russian proposal that came with unacceptable conditions. Tymoshenko has also asked the United States, EU, Japan, and China for loans.

After weeks of backbiting, in March 2009, Yushchenko and Tymoshenko finally agreed to a reform package in order to get the IMF aid flowing again. The budget would be revised to reduce the deficit. Consumers would be required to pay more for natural gas, the remaining budget deficit would be financed from loans and higher taxes rather than loosening monetary policy, and pension reform would be enacted, stop relying on its foreign currency reserves on defending its currency, among other provisions. However, the Tymoshenko government may find it difficult to secure parliamentary approval for the package, given its small and uncertain majority.⁴ Moreover, the austerity measures called for in the plan may increase social tensions in Ukraine and cause

⁴ Ukraine: Finance Outlook, EIU Viewswire, February 18, 2009; EIU Country Report: Ukraine, February 2009; "East Europe Home Buyers Squeezed by Foreign Loans," Associated Press wire service, March 4, 2009; "Ukraine: Default Risk Lies in the Corporate Sector," Oxford Analytica, February 26, 2009.

unrest. Tymoshenko may also fear that they will damage her prospects in the 2010 presidential election.

Ukraine's Foreign Policy

Until Yushchenko's election in 2005, Ukrainian foreign policy was characterized by an effort to balance ties with Russia with those with the United States and Western countries. Previous leaders gave lip service to joining NATO and the European Union, but did little to meet the standards set by these organizations. Ukrainian leaders also promised closer ties with Russia in exchange for Russian energy at subsidized prices, but balked at implementing agreements with Russia that would seriously compromise Ukraine's sovereignty, such as ceding control over Ukraine's energy infrastructure to Moscow.

After taking office, President Yushchenko put integration into the global economy and Euro-Atlantic institutions at the center of Ukraine's foreign policy. One key foreign policy goal has been for Ukraine to join the World Trade Organization (WTO). Ukraine joined the WTO in May 2008. In addition to helping Ukrainian exporters, WTO membership may give Ukraine political leverage over Russia, given that the consent of Ukraine (and every other WTO member state) is necessary for Russia to join the organization. In the longer term, Yushchenko wants Ukraine to join the European Union and NATO. Ukraine has sought to retain good ties with Russia, but relations have been troubled since Yushchenko took power.

Conflict between Ukraine's political forces has led its foreign policy to appear incoherent, as the contending forces pulled it in pro-Western or pro-Russia directions or simply neglected foreign policy as less important than domestic political combat. Yanukovich and the Party of Regions are less eager to pursue rapid integration into Euro-Atlantic institutions and more favorable to closer ties with Russia, especially in the economic sphere. Prime Minister Tymoshenko has swung from backing Yushchenko's support for NATO membership for Ukraine in early 2008 to trying to mend fences with Moscow more recently. This may be due to her deteriorating relationship with Yushchenko. She may also be hoping to boost her chances in Russophile eastern Ukraine in presidential elections scheduled for early next year.

NATO

Ukraine currently has an "Intensified Dialogue" with NATO, but President Yushchenko has sought a Membership Action Plan (MAP), a key stepping-stone to joining the Alliance. The MAP gives detailed guidance on what a country needs to do to qualify for membership.

On January 15, 2008, Prime Minister Tymoshenko joined President Yushchenko and parliament speaker Arseniy Yatsenyuk in sending a letter to NATO Secretary General Jaap de Hoop Scheffer requesting a Membership Action Plan for Ukraine at the April 2-4 NATO summit in Bucharest, Romania. On March 17, Yushchenko and Tymoshenko sent letters to De Hoop Scheffer, German Federal Chancellor Angela Merkel, and French President Nicolas Sarkozy reiterating Ukraine's request for a MAP.

The Party of Regions and the Communists are strongly opposed to a MAP for Ukraine. They responded to the first letter by blocking the functioning of the parliament for several weeks. Yanukovich threatened to hold public demonstrations against the government's request for a

MAP. Public opinion polls have shown that less than one-third of the population supports NATO membership. Both President Yushchenko and Prime Minister Tymoshenko have launched a public information campaign to educate Ukrainians about NATO. They have also agreed that Ukraine's entry into NATO would have to be endorsed beforehand by a public referendum. Perhaps in an effort to defuse domestic and Russian criticism, President Yushchenko has said that Ukraine will not allow the establishment of NATO bases on Ukrainian soil. He has noted that the Ukrainian constitution does not permit the establishment of foreign military bases, with the temporary exception of Russia's current Black Sea naval base, the lease for which runs out in 2017.

NATO declined to offer Ukraine a MAP at the Bucharest summit, despite strong support from the United States and almost all central European NATO members. Germany and France played the leading role in blocking the effort. They raised questions about Ukraine's qualifications for a MAP and also expressed concerns that granting a MAP to Ukraine would hurt relations with Russia. However, the Allies agreed that Kiev could receive a MAP as early as the NATO Foreign Ministers' meeting in December 2008, if remaining questions over its application are resolved. In a move that surprised many observers, the summit communique also contained an unqualified statement that Ukraine (and Georgia) "will become members of NATO," without specifying when that might happen.

The ambiguous result of the summit caused varying reactions within Ukraine. President Yushchenko and the Ukrainian government hailed the summit as a key stepping-stone on Kiev's path toward NATO membership, pointing in particular to the commitment made to admit Ukraine into the Alliance. In contrast, Yanukovich and the opposition applauded the denial of a MAP at the summit, viewing it as a blow to Yushchenko's pro-NATO policy.

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

On December 2, 2008, NATO foreign ministers agreed to work with Ukraine on "annual national programs" within the framework of the existing NATO-Ukraine Commission, which assists Ukraine's defense reform efforts. This approach may provide a way for Ukraine to make progress toward its NATO aspirations without calling it a MAP. However, France and Germany have warned strongly against viewing the compromise as a shortcut to NATO membership for the countries, saying that a MAP would still be required for that.

Domestic political infighting in Ukraine has also hurt Ukraine's MAP prospects by convincing some NATO members that Ukraine lacks political maturity required for NATO membership. In addition, if President Yushchenko is not reelected in 2010, which appears likely given his current single-digit support levels in opinion polls, the new president may downplay or even renounce the current government's MAP aspirations.

European Union

Ukraine seeks to open talks on an Association Agreement with the European Union that would clearly state Ukraine's status as a candidate EU member. Many countries in the EU have been cool to Ukraine's possible membership, perhaps because of the huge burden a large, poor country like Ukraine could place on already-strained EU coffers. Indeed, EU officials have tried to dissuade Ukraine from even raising the issue. However, not all EU states are reluctant to consider

Ukraine's eventual membership. Poland and the Baltic states have advocated Ukraine's joining the EU, in part because they see a stable, secure Ukraine as a bulwark against Russia. Nevertheless, even supporters of Ukraine's EU membership acknowledge that it could be more than a decade before Kiev is ready to join, but believe that formal EU recognition of Ukraine's candidacy could speed the reform process in Ukraine.

Ukraine currently has a Partnership and Cooperation Agreement (PCA) with the EU, as well as a Ukraine-EU Action Plan within the context of the EU's European Neighborhood policy. The agreements are aimed at providing aid and advice to assist Ukraine's political and economic transition and to promote closer ties with the EU. At an EU-Ukraine summit in December 2005, the EU announced that it would grant Ukraine market economy status. The move makes it easier for Ukrainian firms to export to the EU without facing antidumping duties.

In March 2007, the EU and Ukraine announced the opening of negotiations on an Enhanced Agreement to replace the current PCA. Talks on an EU-Ukraine free trade area began in February 2008. The two sides have agreed to work toward visa-free travel between the EU and Ukraine, a key Ukrainian goal. The EU plans to spend 494 million Euro (\$658 million) from 2007-2010 to support reform in Ukraine, in such areas as energy cooperation, strengthening border controls, bolstering the judiciary and the rule of law, and addressing environmental concerns.⁵

In September 2008, the EU agreed to call the new Ukraine-EU accord currently under negotiation an "association agreement." However, unlike the association agreements signed by other European countries in the past, the new accord will not contain an explicit recognition of Ukraine's EU membership aspirations. In Spring 2009, the EU is expected to launch an Eastern Partnership program within the context of their European Neighborhood policy, which also includes non-European countries. It is not clear whether the new initiative will offer Ukraine significantly more than current efforts.

EU countries were angered by the January 2009 natural gas standoff between Russia and Ukraine, which led to a cut-off of natural gas supplies to EU countries for two weeks. However, the EU did not assign sole blame for the crisis to Ukraine, despite Moscow's diplomatic and public relations efforts aimed at doing so.

Russia

Ukraine's most difficult and complex relationship is with Russia. President Putin strongly backed Yanukovich's fraudulent "victory" during the 2004 presidential election campaign and reacted angrily at the success of the Orange Revolution. Russian observers with close ties to the Kremlin charged that the Orange Revolution was in fact a plot engineered by the United States and other Western countries. For his part, President Yushchenko offered an olive branch to Moscow, calling Russia a "permanent strategic partner" of Ukraine.⁶ Nevertheless, relations have been rocky. Russia has been irked by Yushchenko's efforts to support greater democratization in the region, impose tighter border controls on Transnistria, a pro-Moscow, separatist enclave within neighboring Moldova, and forge closer links with Georgia.

⁵ "Commissioner Ferrero-Waldner Announces Substantial Increase in Financial Assistance to Ukraine," EU press release, March 7, 2007.

⁶ Jamestown Foundation, *Eurasia Daily Monitor*, January 25, 2005.

Ethnic Russians make up 17.3% of Ukraine's population, according to the 2001 Ukrainian census. They are concentrated in the southern and eastern parts of the country. They form a majority in Crimea, where they make up 58.3% of the population. In the Crimean city of Sevastopol, the home base of the Russian Black Sea Fleet, 71.6% of the population are Russians. In addition, ethnic Ukrainians in the east and south also tend to be Russian-speaking, are suspicious of Ukrainian nationalism, and support close ties with Russia. Russian officials have tried to play on these regional and ethnic ties, not always successfully, as demonstrated by the 2004 Ukrainian presidential election. On the other hand, Ukrainian politicians are often tempted to curry favor with Moscow during presidential election campaigns, such as will take place in the run-up to the January 2010 presidential vote, in order to court pro-Russian voters in populous eastern and southern Ukraine.

The Russia-Georgia conflict in August 2008 has had a negative impact on Russian-Ukrainian relations. Since President Yushchenko took power, Ukraine and Georgia have had close ties. President Yushchenko strongly condemned Russia's military actions in Georgia. Ukraine's foreign ministry accused Russia of using Black Sea Fleet vessels based in Crimea to attack targets in Georgia without consulting Ukraine and said Ukraine reserved the right to exclude such vessels from Ukraine. Russian leaders charged that Ukraine had supplied Georgia with arms.

On August 13, 2008, Yushchenko issued a decree requiring Russia to provide advance permission for movement of Russian military ships, planes, and personnel on Ukraine's territory. Russia said the decree was anti-Russian and in contradiction to the 1997 treaty that gave Russia the right to base its fleet in Crimea. Prime Minister Tymoshenko also criticized the Yushchenko decree, saying she would not permit a conflict to occur between Russia and Ukraine over the Fleet. The Russian vessels that participated in the Georgia conflict later reportedly returned to their Crimean base. In September 2008, Ukraine's foreign minister charged that Moscow was providing Russian citizenship documents to inhabitants of Crimea. He expressed fears that Russia could use the presence of Russian citizens in Ukraine to justify military intervention in the future, as it did in Georgia.

Energy Issues

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

Russia's efforts to increase gas prices to market levels provoked crises in 2006 and 2009 that resulted in cutoff of Russian gas to western Europe. In 2005, the Russian government-controlled natural gas monopoly Gazprom insisted on a more than fourfold increase in the price that it charged Ukraine for natural gas. When Ukraine balked at the demand, Russia cut off natural gas supplies to Ukraine on December 31, leading also to cuts in gas supplies to Western Europe. The gas supplies were restored two days later after a new gas supply agreement was signed. In early 2007, with the pro-Russian Yanukovich government in power, Russia and Ukraine agreed to gradually increase the price of Russian natural gas to Ukraine over the next five years, at which time it will reach the world market price.

Another issue is the involvement of a shadowy company, RosUkrEnergo, as the nominal supplier of Russian natural gas to western Europe through Ukraine. Some analysts are concerned about possible involvement of an organized crime kingpin in the company, as well as corrupt links with Russian and Ukrainian officials. The U.S. Justice Department has reportedly investigated the firm.⁷ Tymoshenko has battled to eliminate the company as a middleman in Russian gas exports to Western Europe and in supplies to Ukraine's domestic consumers. Yushchenko has defended the company, triggering charges by Tymoshenko that his supporters are profiting by the company's existence, which Yushchenko denies.

The role of middlemen in the Ukrainian gas market may also be reduced by market forces. RosUkrEnergo's profits are based on selling cheap Central Asian gas at higher prices to Ukraine. As Central Asian countries demand that prices for their gas move closer to market rates, the intermediary's margins may be squeezed. Tymoshenko is also reportedly seeking a steep rise in gas transit fees from Gazprom. Russian President Dmitri Medvedev expressed support for removing RosUkrEnergo as an intermediary, but it still remains unclear whether Russia supports a genuinely transparent energy relationship with Ukraine.

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

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

According to the agreement, RosUkrEnergo was eliminated as a middleman in the gas trade. In the first quarter of 2009, Ukraine will have to pay more than double what it paid in 2008 for gas. Ukraine may be able to avoid this price increase if it can use gas it has in storage until the gas price declines later in the year, as the sharp drop in oil prices is reflected in natural gas prices. However, there is a dispute between RosUkrEnergo and Ukraine over who owns the stored gas. The price that Russia would pay for gas transit will remain at last year's level. The poor financial situation of Naftogaz and its customers could lead to further gas crises this year, as Gazprom has threatened to cut off supplies again if it is not paid the full amount it is owed.

Although Russia still hopes to achieve its long-standing goal of owning a controlling stake in Ukraine's natural gas pipelines and storage facilities, it is also trying to develop a new gas

⁷ Glenn R. Simpson, "U.S. Probes Possible Crime Links to Russian Natural-Gas Deals," *Wall Street Journal*, December 22, 2006, 1. For background on the gas crisis, see CRS Report RS22378, *Russia's Cutoff of Natural Gas to Ukraine: Context and Implications*, by Jim Nichol, Steven Woehrel, and Bernard A. Gelb.

pipeline under the Baltic Sea (called Nord Stream) and through the Balkans (called South Stream) to western Europe that could reduce sharply Russia's need for Ukraine's pipelines starting as early as 2012, in the case of Nord Stream. If successful, these efforts could reduce Ukraine's leverage over Russia on energy issues.

NATO Membership

Russian-Ukrainian relations have been strained by Kiev's desire to join NATO. Russian leaders were angered when the April 2008 NATO summit in Bucharest said that Ukraine will join NATO at some point in the future. According to Russian press accounts, President Putin reportedly told President Bush and NATO leaders that Ukraine was not a real state, given its regional heterogeneity, and that it would cease to exist if it joined NATO.

On April 8, 2008, Russian Foreign Minister Sergei Lavrov said Russia would do all that it could do to prevent NATO membership for Ukraine. On April 11, Chief of the Russian General Staff General Yuriy Baluyevsky warned that Russia would take military and "other measures" if Ukraine joined NATO.⁸ Non-military measures could include economic sanctions and efforts to encourage secessionist or other centrifugal forces in eastern and southern Ukraine, especially the Crimea. Russia could make territorial claims against the city of Sevastopol in Crimea (where Russia has a naval base) or the Crimean peninsula as a whole. Russia is upset that Ukraine has rejected Russian proposals to extend the Russian Black Sea Fleet's stay in Crimea beyond 2017. On the contrary, Ukraine wants to start talks on preparing for the withdrawal of the Fleet, so as to prepare a smooth transition in 2017.

In June 2008, the Russian Duma (lower house of the parliament) passed a resolution asking the government to consider suspending the 1997 friendship treaty between Russia and Ukraine, if Ukraine receives a MAP. Such a move could be perceived as withdrawing recognition of Ukraine's borders by Russia. Also in June, Deputy Russian Prime Minister Sergei Ivanov during a visit to Sevastopol warned that Ukrainian membership in NATO would lead to a severing of military ties, reduced trade and industrial cooperation, and the introduction of visas for Ukrainians traveling to Russia.

U.S. Policy

U.S. officials supported the "Orange Revolution" in Ukraine in late 2004 and early 2005, warning the former regime against trying to impose fraudulent election results, and hailing Yushchenko's ultimate victory. President Yushchenko visited the United States from April 4-7, 2005 and had meetings with President Bush and Secretary of State Rice. Yushchenko's address to a joint session of Congress on April 6 was interrupted by several standing ovations. U.S. officials have remained upbeat about Ukraine's successes in some areas, such as joining the WTO, holding largely free and fair elections, and improving media freedom, while acknowledging difficulties in others, such as fighting corruption, establishing the rule of law, and constitutional reform.

⁸ Jamestown Foundation Eurasia Daily Monitor, April 14, 2008, Radio Free Europe/Radio Liberty Daily Report, April 9, 2008, and Agence France Presse wire dispatch, April 11, 2008.

President Yushchenko withdrew Ukraine's troops from Iraq in December 2005, in fulfillment of a campaign pledge, but promised to continue participation in Iraqi troop training efforts. Ukraine has not contributed troops to Afghanistan, at least in part due to bad public memories of the Soviet occupation of Afghanistan in the 1980s, but has supported a provincial reconstruction team.

The United States has taken steps to upgrade its economic relations with Ukraine. On January 23, 2006, the United States reinstated tariff preferences for Ukraine under the Generalized System of Preferences (GSP). Ukraine lost GSP benefits in 2001 for failing to protect U.S. intellectual property, particularly CD and DVD piracy. U.S. officials hailed Ukraine's efforts to improve its record on this issue. On March 6, 2006, the United States and Ukraine signed a bilateral agreement on market access issues, a key step in Ukraine's effort to join the WTO. U.S. officials said that Ukraine committed itself to eventual duty-free entry of U.S. information technology and aircraft products, as well as very low or zero duty on chemical products. U.S. firms will also receive more open access in such areas as energy services, banking and insurance, telecommunications, and other areas. The bilateral agreement addressed other key concerns such as protection of undisclosed information for pharmaceuticals and agricultural chemicals, imports of information technology products with encryption, the operation of state owned firms based on commercial considerations, and reduction of export duties on non-ferrous and steel scrap.

The Administration was sharply critical of Russia's behavior during the January 2006 natural gas standoff between Russia and Ukraine. State Department spokesman Sean McCormack criticized Russia for using "energy for political purposes." He stressed that while the Administration supported a gradual increase in prices to market levels, it disagreed with a "precipitous" increase and cutoff. Secretary of State Condoleezza Rice likewise on January 5 stated that Russia had made "politically motivated efforts to constrain energy supply to Ukraine."⁹ In May 2006, Vice President Dick Cheney characterized Russia's energy policy toward vulnerable countries as "blackmail" and intimidation."¹⁰

On January 22, 2009, after the resolution of the second major Russia-Ukraine gas crisis, a State Department spokesman said the conflict "underscores the need for transparent, market-oriented arrangements for the sale and shipment of natural gas and the importance of diversifying energy supplies."¹¹

The United States has favored helping Ukraine and other countries reduce their dependence on Russian energy supplies. The United States has advocated extending an existing oil pipeline that currently runs from the oil terminal at Odesa in Ukraine to Brody, on the Polish border. This pipeline could then be extended to Gdansk in northern Poland. However, the project remains stalled due to a lack of financing.

U.S. officials called on Ukrainian leaders to resolve peacefully the political crisis caused by President Yushchenko's April 2, 2007 decree dissolving parliament and calling new elections. The State Department issued a statement welcoming the May 2007 agreement to hold early

⁹ The State Department. Statement, January 1, 2006; Daily Press Briefing, January 3, 2006; Secretary Condoleezza Rice, Remarks at the State Department Correspondents Association's Breakfast, January 5, 2006.

¹⁰ "Vice President's Remarks at the Vilnius Conference," May 4, 2006, from the White House website <http://www.whitehouse.gov>.

¹¹ "Statement on Agreement to Restore Gas Flows to Europe," January 22, 2009, <http://useu.usmission.gov>

parliamentary elections on September 30, 2007 as demonstrating the “resiliency of Ukrainian democracy,” but stressed that the country still needed to clearly define the roles of the executive, legislative, and judicial branches of government. U.S. officials said they agreed with OSCE assessments that the September 2007 parliamentary elections were conducted mostly in line with international standards.

President Bush visited Kiev on April 1, 2008. He offered “strong support” for Ukraine’s request to receive a Membership Action Plan from NATO at the Bucharest summit. He praised Ukraine for its contributions in Iraq, Afghanistan, and Kosovo, noting that Ukraine is the only non-NATO country supporting every NATO mission. He praised Ukraine’s commitment to democratic values and open markets, and offered continued U.S. support to fight corruption, support civil society groups and strengthen Ukraine’s institutions.

The two sides also signed a “roadmap” for strengthening bilateral ties in many areas, including trade and investment, energy security, defense cooperation, technology and space cooperation, among other issues. One document signed was a Trade and Investment Cooperation Agreement, which Ukraine would like to see as a stepping-stone to an eventual free trade agreement between the two countries. In order to boost U.S. investment in Ukraine, the United States has urged Ukraine to continue to make reforms in several areas, including reducing regulation, clarifying commercial laws, and introducing more transparency into the privatization process.¹² Ukraine is also seeking the return of the U.S. Overseas Private Investment Corporation (OPIC) to Ukraine. The two countries signed a memorandum of understanding on November 10, 2008, on the steps Ukraine needs to take in order for the United States to restore OPIC efforts to increase U.S. investment in Ukraine¹³

Although the United States was unsuccessful in persuading NATO to give Ukraine a MAP at the Bucharest summit, Administration officials hailed NATO’s commitment in the summit communique to grant Ukraine membership in the future. They were successful in the development of annual national plans within the context of the NATO-Ukraine Commission, although differences continued to exist between the United States and those countries (particularly France and Germany) on whether such plans could advance Ukraine’s NATO membership aspirations in the absence of a MAP.

The Bush Administration sharply criticized Russia’s military actions in Georgia in August 2008. On September 5, Vice President Cheney visited Ukraine, as part of a tour to bolster U.S. allies in the region. Other stops included Azerbaijan and Georgia. After a meeting with President Yushchenko, Cheney stressed the U.S.’s “deep and abiding interest” in Ukraine’s security. He said Ukraine should be free of “threat of tyranny, economic blackmail, or military invasion or intimidation” in the region. He said Ukraine’s “best hope to overcome these threats is to be united—united domestically first and foremost, and united with other democracies.”¹⁴

In an effort to signal support for Kiev after its failure to secure a MAP, the United States signed a “Charter on Strategic Partnership” with Ukraine on December 18, 2008. The charter discusses

¹² Transcript of Remarks by U.S. Secretary of Commerce Carlos M. Gutierrez to American Chamber of Commerce in Ukraine, June 5, 2008.

¹³ Transcript of Bush-Yushchenko press conference, April 1, 2008, from the White House website at <http://www.whitehouse.gov/news/releases/2008/04/20080401-1.html>.

¹⁴ “Remarks by Vice President Cheney and President Yushchenko of Ukraine After Meeting,” September 5, 2008 from the White House website, <http://www.whitehouse.gov/news/releases/2008/09/print/20080905-3.html>.

areas of current and future cooperation between the two countries, including “a program of enhanced security cooperation intended to increase Ukrainian capabilities and to strengthen Ukraine’s candidacy for NATO membership.”

During a speech to the Munich Conference on Security Policy in February 2009, Vice President Biden echoed President Obama’s call for U.S. relations with Russia to be “reset,” but warned that the United States would not accept any country’s asserting a “sphere of influence” and that states have the right to choose their own alliances. At a March 5 meeting of NATO foreign ministers, Secretary of State Hillary Clinton said “we should continue to open NATO’s door to European countries such as Georgia and Ukraine and help them meet NATO standards.”

Congressional Response

During the Ukrainian presidential election campaign and during the ensuing electoral crisis, the 108th Congress approved legislation calling for free and fair elections in Ukraine and urged the Administration to warn Ukraine of possible negative consequences for Ukraine’s leaders and for U.S.-Ukraine ties in the case of electoral fraud. The 109th Congress passed resolutions after President Yushchenko was inaugurated. On January 25, 2005, the House passed H.Con.Res. 16 and the Senate passed S.Con.Res. 7 on the 26th. The identical resolutions included clauses congratulating Ukraine for its commitment to democracy and its resolution of its political crisis in a peaceful manner; congratulating Yushchenko on his victory; applauding the candidates, the EU and other European organizations and the U.S. Government for helping to find that peaceful solution; and pledging U.S. help for Ukraine’s efforts to develop democracy, a free market economy, and integrate into the international community of democracies.

Congress has also dealt with the issue of U.S. aid to Ukraine. The FY2005 Iraq-Afghanistan supplemental appropriations bill (P.L. 109-13) provided \$60 million in aid to help the new government in the run-up to the March 2006 parliamentary election. Including funds appropriated in FY2005 foreign operations appropriations legislation, Ukraine received \$156 million in U.S. assistance in FY2005.

The FY2006 foreign operations appropriations legislation (P.L. 109-102) provided \$84 million in Freedom Support Act (FSA) funds to promote reforms in Ukraine. Five million of that amount was earmarked for nuclear safety initiatives and \$1 million for mine safety programs in Ukraine. Total FY2006 U.S. aid to Ukraine was \$100.1 million. In addition to Freedom Support Act funds (\$82.16 million were actually allocated in FY2006, according to the Administration), Ukraine received \$2.18 million in Child Safety and Health (CSH) funds; \$10.89 million in Foreign Military Financing (FMF); \$1.75 million in IMET military training funds; and \$3.1 million in NADR funding to fight terrorism and proliferation.

In FY2007, U.S. aid to Ukraine was \$96.5 million. Of this total, \$80 million was in FSA funding, \$9.5 million in FMF, \$2.17 million in Child Survival and Health funding, \$1.86 million in IMET, \$1.36 million in NADR, and \$1.63 million in Global HIV/AIDS Initiative funding. The Administration estimates FY2008 funding for Ukraine at \$83.4 million. Of this amount, \$72.4 million is in FSA, \$4.7 million in FMF, \$2.1 million in NADR, \$1.81 million in IMET, and \$1.9 million in CSH. For FY2009, the Bush Administration requested a total of \$86.48 million in aid for Ukraine. Of this amount, \$67.58 million is slated for FSA, \$8 million for FMF, \$5.4 million for CSH, \$1.8 million for NADR, and \$1.75 million for IMET.

U.S. aid to Ukraine is focused on anti-corruption and rule of law efforts, stopping trafficking in persons, media and civil society development, energy sector reform, and fighting HIV/AIDS. Aid will help Ukraine prepare for presidential elections in 2010 and improve local governance, particularly in eastern and southern Ukraine. The United States also seeks to increase exchange programs between the two countries. Other programs include efforts to help Ukraine implement WTO accession, encourage the growth of small business, strengthen export and border controls, assist defense reform and interoperability with U.S. and NATO forces. In 2005, the Millennium Challenge Corporation (MCC) selected Ukraine for Millennium Challenge Account (MCA) Threshold status. MCC funding in Ukraine is focused on fighting the country's severe corruption problem. In November 2006, Ukraine was made "compact-eligible" by the MCC board. The MCC will spend about \$45 million on anti-corruption efforts over the next two years.¹⁵

Congress dealt with a long-standing stumbling block in U.S.-Ukrainian relations by passing legislation to terminate the application of the Jackson-Vanik amendment to Ukraine, granting the country permanent Normal Trade Relations Status. On March 8, 2006, the House passed H.R. 1053 by a vote of 417-2. It was approved by the Senate by unanimous consent on March 9, and was signed by the President on March 23.¹⁶

On April 17, 2007, Representative Hastings introduced H.Con.Res. 116, which called on all sides in Ukraine's political crisis to solve the issue peacefully and in accordance with the rule of law. The resolution reaffirms U.S. support for Ukraine's transition to democracy and a free market economy, as well as for the country's independence, sovereignty, and territorial integrity. A Senate version of the resolution (S.Con.Res. 30) was introduced by Senator Dodd on May 2. On July 23, Mr. Hastings introduced H.Con.Res. 189, which called on Ukrainian leaders to abide by the May 27 agreement to hold new parliamentary elections, and to hold those elections in accordance with OSCE standards.

On September 21, 2007, the Senate passed S.Res. 320. The resolution expresses hope that Ukraine will hold its September 30 parliamentary vote in a way that is consistent with OSCE standards, urges Ukrainian leaders to work together to solve Ukraine's problems, and pledges continued U.S. friendship for and assistance to Ukraine. On October 4, Mr. Hastings introduced H.Res. 173, which congratulated Ukraine on conducting the September 30 elections in accordance with OSCE standards and pledging continued U.S. support for Ukraine's efforts to achieve a democratic political system, a free market economy, and full integration with the West.

Congress has expressed support for Ukraine's possible membership in NATO. The NATO Freedom Consolidation Act was passed by the Senate on March 15, 2007, and the House on March 26. The bill (S. 494) expresses support for further enlargement of NATO and authorizes U.S. aid to Ukraine to assist it in preparing for possible NATO membership. President Bush signed the bill into law on April 9 (P.L. 110-17). On February 14, 2008, the Senate passed S.Res. 439, which expresses the "strong support" of the Senate for a MAP for Ukraine and Georgia. On February 25, 2008, Representative Wexler introduced H.Res. 997, the House version of S.Res. 439. It was passed by the House on April 1, 2008.

¹⁵ FY2009 Congressional Budget Justification for Foreign Operations, from the State Department website, <http://www.state.gov>.

¹⁶ CRS Report RS22114, *Permanent Normal Trade Relations (PNTR) Status for Ukraine and U.S.-Ukrainian Economic Ties*, by William H. Cooper.

After the NATO summit, the Senate passed S.Res. 523 on April 28. The resolution expresses the “strong support” of the Senate for the statement of the Allies at the Bucharest summit that Ukraine and Georgia will become members of NATO. It also urges NATO to grant a MAP to Ukraine and Moldova at the NATO foreign ministers’ meeting in December 2008. On May 19, the Senate passed S.Res. 570, which reiterated the Senate’s strong support for Ukraine and Georgia’s NATO aspirations.

Author Contact Information

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