



President to Uphold Gas Contract

On Friday, President Viktor Yushchenko again vowed that Ukraine would uphold the terms of the gas contract signed by Naftohaz Ukrainy and Gazprom. His pledge overturns a recent statement by Oleksandr Shlapak, the first deputy head of the presidential secretariat, who expressed a willingness to reopen the terms of the deal.



▲ President Yushchenko vows to honour the gas contract brokered by Prime Minister Tymoshenko.

Friday's statement by the president reaffirms his pledge last week to EU leaders in Brussels. Then Mr Yushchenko said, "The agreements signed are not easy ones, but Ukraine fully takes up the performance (of its commitments) and guarantees fully-fledged transit to European consumers."

A relieved European Commission President José Manuel Barroso described it as "an important step forward."

Whilst toeing the line in Brussels, the president is still unhappy with the terms of the contract. He recently told the *Financial Times*, "It's a bad deal" and argues that Ukraine is paying too high a price for gas at a time when its economy is being ravaged by the economic downturn. However, many analysts suggest that the real focus of his ire is Prime Minister Yulia Tymoshenko, who returned to Kyiv victorious after successfully brokering a 10-year deal.

Under the new contract, Ukraine gets a 20 percent discount for gas in 2009, which equates to \$360 per thousand cubic metres in the first quarter. However the country will pay far less in successive quarters as gas prices catch up with oil prices that have dropped from \$147 a barrel in July 2008, to around \$45.50 today. The average price for gas in 2009 is expected to work out at around \$228.80 per thousand cubic metres.

First Deputy Prime Minister Oleksandr Turchynov dismissed Mr Shlapak's claim that the president may seek to reopen the contract. "The government will not allow revision of the reached agreements. They reflect the state's interests and were formed within the limits of Ukraine's strategic and economic interests," he said.

Ms Tymoshenko insisted that the new gas deal was favourable to Ukraine, saying that it would pay a lower rate to Gazprom than any other European state. During a recent interview on the 1+1 TV channel she said, "I think Ukraine has never had such preferential terms."

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Ms Tymoshenko has since announced that Naftohaz has signed a contract with Gazprom to buy 11 billion cubic metres of gas for \$153.90 per thousand cubic metres. The head of government said, "We will pay in advance for this gas given its price is three times lower than the market price."

Triumph for Transparency



▲ Pleased with the outcome of the gas dispute. Hryhorii Nemyria, Deputy Prime Minister.

The gas deal brokered by Ms Tymoshenko has been applauded by the international community. The elimination of the murky intermediary RosUkrEnergo from the new supply contract was heralded as a major victory. Furthermore, the agreement by both countries to pay market prices for gas supply and transit by 2010, removes a huge source of friction between Russia and Ukraine and is a major step towards normalising relations.

Deputy Prime Minister, Hryhorii Nemyria, charged with leading Ukraine's integration into Europe, was pleased with the outcome. He also welcomed last week's agreement between the EU and Ukraine to seek closer ties in the energy sector. The EU has pledged to bring Ukraine closer to its European Energy Community and agreed to work to unite Ukraine's electricity grid to those of EU states.

Construction Stimulus Package Proposed

Prime Minister Yulia Tymoshenko has proposed the need for a stimulus package to help kick-start Ukraine's stalled construction sector.

According to the premier, the cost of unfinished construction projects amounts to approximately UAH 14 billion (\$1.8 billion), whilst the entire construction industry needs UAH 33 billion (\$4.3 billion) if it is to recover. She was speaking at a meeting of a newly formed anti-crisis council to address the issues facing the construction sector.



Ms Tymoshenko stressed that adequate recapitalisation of the private banking sector was needed to make the stimulus package work. Critical of the actions of the National Bank of Ukraine (NBU), she said: "Almost 80 percent of the money sent to refinance commercial banks, unfortunately, went to the currency markets."

Ms Tymoshenko noted that the NBU has sufficient reserves to allocate annual funding of UAH 40-70 billion (\$7-9 billion) to bank refinancing. She stated that another option for refinancing the construction market could be the provision of state guarantees to help commercial banks raise capital on the international markets.

Also, Ms Tymoshenko announced that money from the national budget's stabilisation fund will be allocated to infrastructure projects, including those for the UEFA EURO 2012 soccer tournament and the completion of two reactors at the Khmelnytsky Nuclear Power Plant. Furthermore, UAH 1 billion from the State Mortgage Institution is being set aside for the construction of subsidised housing.



In preparation for increased infrastructure spending, Ms Tymoshenko called for a detailed inventory of projects by the Regional Development and Construction Ministry, regional governors and mayors of cities.

The new anti-crisis council was formed specifically to address the problems facing the construction sector. It is co-headed by Ms Tymoshenko and Volodymyr Polyachenko, the honorary president of the Kyivmiskbud construction company. Also included on the council are Vitaliy Hayduk, head of the prime minister's advisors, Oleksiy Kucherenko, Minister for Housing-Communal Economy and Vassyl Kuybida, the Minister for Regional Policy and Building.



Ukraine is one of many countries earmarking funds for infrastructure projects as a means to stimulate the economy. On Friday the Finnish government approved an increased budget of €1.2 billion to be spent mainly on transport infrastructure and construction. Canada's Conservative government has unveiled a plan that will inject C\$12 billion into infrastructure projects such as roads, bridges and clean energy programmes. Meanwhile the bulk of US President Barak Obama's proposed \$820 billion stimulus package is allocated to a wide range of infrastructure projects, from roads, rail, airports, bridges and dams to housing and military construction, among others.

Ukraine On Course for Next IMF Payment

The National Bank of Ukraine (NBU) has confirmed that the country is on course to meet the conditions that underpin its \$16.4 billion loan from the International Monetary Fund (IMF). The IMF mission, currently visiting Kyiv, must agree that its conditions are being met before it can approve the second tranche of the stand-by loan. Ukraine received the first tranche of \$4.5 billion in November 2008.

Anatoly Shapovalov, First Deputy Chairman of the NBU, confirmed that all the major criteria were being met.

"The IMF has confirmed that all obligations which we undertook at the initial stages were fulfilled," said Mr Shapovalov. He explained that the two most important criteria had already been satisfied. These concern the monetary base, which must be no higher than \$190 billion, and foreign currency reserves, which must not have dipped below \$26.7 billion at the end of last year.

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Notwithstanding this news, pressure on the leadership of the NBU was maintained by lawmakers in the Verkhovna Rada who last week narrowly voted in favour of a resolution to dismiss Volodymyr Stelmakh, the NBU Chairman. This was the third attempt by parliament to dismiss the veteran economist. Mr Stelmakh's reputation has been tarnished by allegations of incompetence and corruption over the collapse of the hryvnia and bank refinancing.

However, President Viktor Yushchenko has staunchly defended Mr Stelmakh. The president's office insisted that only the president has the right to remove the NBU chairman. Presidential spokesperson, Larysa Mudrak dismissed parliament's vote of no confidence saying, "This decision is illegal and unconstitutional."



Meanwhile, the president has referred the issue, as to whether parliament can appoint or dismiss the NBU head without a submission to the president, to Ukraine's Constitutional Court. The first deputy head of the presidential secretariat, Oleksandr Shlapak, has already made up his mind on the issue. He said that passing such a resolution contradicts Ukraine's constitution.

The 70-year old Mr Stelmakh is currently off work sick and it is unclear whether he will return.

OU-PSD Faction Leader Advises President Against Seeking Second Term

The recently appointed leader of the Our Ukraine-People's Self-Defence (OU-PSD) Bloc, Mykola Martynenko, has advised President Viktor Yushchenko not to seek a second term in office.



Mr Martynenko, a former business ally of Mr Yushchenko, has become disillusioned with the president and the chief of staff of his secretariat, Viktor Baloha. In an interview in *Fokus* magazine (23 January), he urged Mr Yushchenko against running as a candidate in the 2009/2010 presidential election, given the president's disastrously low poll ratings.

"With current electoral tendencies Viktor Andriyovych has few chances. Whatever his immediate entourage may have promised him in the form of different formulae, ratings, even election in parliament, I see only one chance for Viktor Yushchenko: to not run in the election campaign," said Mr Martynenko.

Since the 2004 Orange Revolution, President Yushchenko's ratings have plummeted from more than 80 percent to low single digit figures. A January Democratic Initiatives Poll put public support for him at as little as 2.4 percent.

Mr Martynenko, who now leads the president's faction, has aligned OU-PSD behind the new democratic coalition which is supported by the Bloc of Yulia Tymoshenko (BYuT) and the Lytvyn Bloc.

Like many within OU-PSD, Mr Martynenko was opposed to the president's call in the autumn to seek a December pre-term parliamentary election.

"This would have plunged the country into even more uncertainty and deprived it of a government when it was needed most," said BYuT faction leader Ivan Kyrylenko, "it would have made coping with the recent gas crisis nearly impossible. We are glad common sense prevailed."

The OU-PSD faction leader suggested that Mr Yushchenko should consider his legacy, which would be preserved best by him not seeking a second term. "Then he will remain in history as an honoured president who has accomplished a lot for Ukrainian society, democracy and freedom of speech. I hope that he will adopt this decision," said Mr Martynenko.

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Playing the PR Game

The recent gas dispute saw Russia crank up its PR machine into overdrive. Making extensive use of western PR advisers and lobbyists, Gazprom embarked upon a sharply executed international media campaign. Its aim was to shift blame onto Ukraine's shoulders and ensure Russia was not vilified as it was during the 2006 gas shut-off.



Helping Russia's majority state-owned gas company was US-headquartered Omnicom's Gavin Anderson and Ketchum PR agencies, and its Brussels lobbying company, GPlus. Well versed in PR, this was not the first time Russia has turned to this source of western expertise to help win over international opinion. Ketchum received a contract in excess of \$1.2 million for 6 months work in August 2007, and billed \$2 million for work in support of the St Petersburg G8 summit in 2006. However, the high priority ascribed to communications during this most recent dispute and the tight-knit involvement of senior Gazprom and Russian government officials, perhaps marks a watershed in the strategic use of communications in the region.

In the same way that cyber attacks have become part of Russia's foreign policy toolkit, we must now expect lavish PR campaigns to become the norm as Russia flexes its muscles on the international stage.

The reason for PR help was clear. In 2006 the Kremlin was widely condemned by the international community for turning off gas to Ukraine. Not only was the credibility of Gazprom as a reliable gas supplier to Europe brought into question, but Russia's leaders found themselves in the dock of public opinion – charged with using their energy trump card to bludgeon states that dared to step out from under the shadow of the Russian bear.

Arguably there was even more at stake in 2009. Feeling the pinch from the global downturn, Gazprom was under pressure to raise gas prices to Ukraine. Yet it stands to lose billions of euro if European states seek to curb their over-reliance on Russian gas imports in pursuit of diversified energy strategies.

This begs the question why embark upon such a potentially costly dispute in the first place? Writing in *The Moscow Times*, Anders Åslund, a senior fellow of the Peterson Institute for International Economics, postulated that it could have been to “whip up Russian patriotism against Ukraine and enhance support for the government in a time of economic decline.” He also suggested that it could have been a ploy to “destabilize Ukraine by exploiting its domestic divisions and its severe financial crisis.” But if the latter was the case then it failed.

Send in the Spin Doctors

Whatever the reason, Russia saw the need to bring in the spin doctors. A degree of blame had to be pinned on Ukraine, which could be painted as an unstable country not worthy of European integration – two foreign policy levers pulled for the price of one.

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Besmirching Ukraine's reputation would also help garner support for alternative costly European-Russian pipeline projects designed to bypass Ukrainian territory.

Some may argue that cash strapped Naftohaz should have hired its own experts to turn the propaganda tide. But from the beginning this was never going to be an even contest.

The launch by Gazprom of an English-language website (gazpromukrainefacts.com), complete with regular one-sided updates, statements and FAQ, illustrates how desperate Gazprom was to win the media battle. One journalist told *Inform* "they are making spokespeople available nearly 24x7."



Press briefings in European capitals sought to win over media support as did the deployment of so-called "independent experts."

No stone was left unturned. Even the former German Chancellor Gerhard Schröder – now Chairman of Nord Stream, the Russo-German pipeline project – was enlisted by Gazprom to brief the media.

"What we are experiencing now is a propaganda war."

In the face of this PR onslaught, Hryhoriy Nemyria, Ukraine's Deputy Prime Minister, told the *Wall Street Journal*, "What we are experiencing now is a propaganda war."

Core to the Russian proposition was the allegation that Ukraine was stealing gas. This line was pushed relentlessly. Naftohaz's spokesperson, Valentyn Zemliansky, explained again and again the need to remove gas for technical reasons to maintain pipeline pressure. But some of the mud stuck.

Damage Limitation

In many ways Gazprom was engaged in a damage limitation exercise as, from the outset, the best it could really hope for was not to be vilified as it was in 2006. True, the outcome in the media of the 2009 dispute was far less one-sided. Despite the British-tabloid, *The Sun*, reportedly depicting Prime Minister Vladimir Putin as "Vlad the Horrible," many publications conceded that Ukraine might not have been altogether a blameless victim. However, the longer the dispute dragged on and the more mud thrown, the greater the degree of self-inflicted damage to Gazprom's reputation as a reliable energy supplier. After all, it was Gazprom that shut off the gas, not Naftohaz. And it is Gazprom that has the delivery contracts with individual states, not Naftohaz.



Turning the Tide

Although Gazprom's PR advisers attempted the media equivalent of a blitzkrieg, the offensive lost its impact during the latter half of the dispute. A major PR blunder occurred when cameras were invited to film Prime Minister Putin order Gazprom's CEO Alexei Miller to reduce gas supplies to Ukraine. "Good, I agree," said Mr Putin stabbing the table with a finger, "cut it today."

TV cameras were also invited to a meeting between Mr Putin and Mr Miller when the order was given to cut all gas to Ukraine. What was meant to be a simultaneous display of strength and transparency served only to highlight the linkage with politics.



"Putin's order to Miller told the world what we already knew, that Russian politics and energy are indivisible," said Dr Taras Kuzio, Editor of *Ukraine Analyst* and Adjunct Professor, Carleton University, Ottawa. "This strong leader image may have gone down well with a Russian audience, but in the west it showed us who controls the puppet strings."

The high profile involvement of Russia's political leaders in the dispute, including a direct attack on Ukraine's leadership, confirmed a political dimension to the dispute – something the Russian government had sought to avoid. In contrast, Ukraine's premier resisted the temptation to escalate the crisis through a war of words.

A French energy banker, using the name of Jerome a Paris, for the blog *European Tribune*, wrote: "Putin's recent involvement in the gas crisis, to announce a complete interruption of all gas deliveries to Europe is incomprehensible... By this action, Russia becomes the obvious target of Europe's ire, as the guilty party."

This was confirmed by the public dressing down Mr Putin got from German Chancellor Angela Merkel on 16 January. Germany's leader simply had the guts to voice the views of many of Europe's leaders.

When all is said and done, the speed at which Russia resorted to strong-arm tactics did not help Gazprom. In hindsight, the most sensible course of action would have been to continue to supply gas to Europe and negotiate a settlement. Instead, what Gazprom did was to confirm Europe's worst fears and no amount of spin doctors can change that.



▲ Vladimir Putin and Gazprom CEO Alexei Miller on *Russia Today*. What was meant to be an exercise in strength and transparency backfired.



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