



Ukraine and Russia Normalise Gas Relations Ukraine Pumps Gas into Storage for Smooth Flow this Winter

Prime Minister Yulia Tymoshenko has taken a huge step in resetting gas relations with Russia. It comes at a time when measures are being taken to strengthen the finances of Naftohaz Ukrainy – Ukraine's state run gas company – and reduce natural gas imports.



▲ Prime Minister Yulia Tymoshenko and Russian Prime Minister Vladimir Putin ironed out remaining issues on gas, meeting in Sopot, Poland, on 1 September.

The premier declared that Ukraine expects to cut its gas imports in 2010 by 25 billion cubic metres. Speaking at a cabinet meeting she said, "We agreed that 27-33 billion cubic metres will be (imported) next year, depending on how the fight against the crisis unfolds and how the crisis ends."

Naftohaz has confirmed that it is likely to reduce imports of gas in 2009 from 40 billion cubic metres to 33 billion cubic metres. This is due to lower demand for gas as a result of reduced industrial consumption due to the global economic downturn.

According to estimates, in the first half of 2009, gas imports were around 8.5 billion cubic metres. Under

the terms of the January gas deal cemented by Prime Minister Tymoshenko and her Russian counterpart Vladimir Putin, Gazprom has the right to impose penalties on Naftohaz for importing less than the volume contracted. However, relations between Gazprom and Naftohaz have improved and assurances have been made by Russia that it will not invoke penalties.

Meeting with Ms Tymoshenko last week in the Polish town of Sopot, Mr Putin agreed to waive any penalties, saying that the two leaders "agreed that the current global financial crisis... must be taken into account in our bills and supplies."

Mr Putin continued, "We'll give the order to the companies to respect the circumstances. We understand that the Ukrainian economy uses only that which it needs today."

Some commentators have suggested that for penalties to be waived, Ms Tymoshenko will give concessions on the fee Gazprom pays for transporting Russian gas across Naftohaz's pipeline network to Europe. But Naftohaz quashed these allegations, indicating a hike of more than 57 percent in the transit fee in 2010, by which time Ukraine will pay European market prices for Russian gas.



▲ Remembering the victims of World War II. Prime Minister Tymoshenko joined European leaders in Poland to commemorate the 70th anniversary of the outbreak of the war.



Clearly pleased with her meeting with Mr Putin and the normalisation of gas relations with Russia, Ms Tymoshenko said, "We feel that all the crisis-inducing occurrences in this sphere have gone."

Sufficient Gas in Store for the Winter

Meanwhile, Gazprom has reported that Ukraine is pumping gas into storage at sufficient rates to guarantee the smooth uninterrupted transit of Russian gas to Europe during the winter months. About 80 percent of Russia's gas exports to Europe flow through Ukraine's massive gas transportation system, which is the second largest in Europe.

"Gazprom estimates Ukraine has pumped 25 billion cubic metres into storage, while 28 billion cubic metres is enough for uninterrupted supplies to Europe. Ukraine plans to pump a total of 32 billion cubic metres," said Valery Golubev, Gazprom's deputy chief executive.

August Gas Bill Paid

Despite the severity of the economic downturn, Naftohaz has met all its monthly payments to Gazprom. This month will be no different. On Friday, Naftohaz confirmed that it had paid Gazprom for gas consumed in August, ahead of the 7 September deadline. The August gas bill amounted to \$667 million; an increase on July which reflects higher levels of gas pumped into storage.



Deputy Prime Minister Hryhoriy Nemyria said, "We have entered a new phase in our gas relationship. The contract brokered in January removed unnecessary middlemen and has provided the basis for long-term stability – ushering in transparent contractual relations that are on a par with most Western European states."

Cleaning Up Nadra Ukrainy

Boosting prospects for Naftohaz, the Cabinet of Ministers, on 20 August, took the decision to transfer licences from Nadra Ukrainy to Naftohaz. Nadra Ukrainy, which is run by the Environmental Protection Ministry, is responsible for the exploration of mineral resources and investment projects to exploit the country's geological sector. However, the agency has been plagued by allegations of corruption, particularly during the period of its operation under the Yanukovich government.

"All the licenses which were unlawfully issued to Viktor Yanukovich's people – these are deposits with a billion cubic metres of gas and wells with a million tonnes of oil – will be transferred to Naftohaz," said Prime Minister Tymoshenko.

The government's efforts to clean up Nadra Ukrainy also extend to the company's offices and the 140 hectare Mizhgiria residence, which will be returned to the state.

"We've decided on methods and ways to return Yanukovich's private residence to state ownership," said Ms Tymoshenko.

Naftohaz Restructuring: Will They Won't They?

Last week Naftohaz announced that it had appointed Credit Suisse to restructure its \$1.6 billion debt, including its \$500 million Eurobond, which matures at the end of this month.

A statement from the company said that it "considers that in the light of tough market conditions and structural difficulties in the domestic and international gas market, the extension



of the maturity of the Eurobond is one of a number of measures the company is considering to best manage its financial situation."



It went on to say that the "appointment of Credit Suisse further demonstrates that the company is striving to restructure its debt in a transparent way that is both appropriate and fair to the company and its creditors."

The move to restructure the Eurobond is not a popular one. The perceived wisdom of many analysts and bondholders is that the government should not seek to restructure the debt if it has the means to pay it.

The belief is that a restructuring of what is essentially quasi-sovereign debt against the will of the bondholders would be tantamount to a technical default situation. This would have negative consequences by increasing the cost of borrowing on international markets for the state and Ukrainian companies. "It's quite late in the day, and I don't sense they want to do an aggressive restructuring," Tim Ash, Head of Research for CEEMA, at the Royal Bank of Scotland told *The Moscow Times*.

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Resistance to restructuring is coming from a number of quarters. Russian investors, including the former head of a Gazprom affiliate, plan to mount a challenge. Corblow, a Belize-registered holding company looking after the Russian interests, said it is forming a bondholders' group to veto any offer by Naftohaz to restructure its bond. The group, which holds 20 percent of the Eurobond, is seeking the support of additional bondholders in order to carry a successful veto.

With the bond maturing on 30 September, it is open to question whether the debt can be restructured in time. It is unlikely the government will allow an actual default situation. In the past, Ms Tymoshenko personally stepped in to give the equivalent of a sovereign guarantee to protect investors' interests.

Libya and Ukraine to Ink Aviation Deal

Ukraine and Libya are formalising a major deal for military and industrial cooperation. The announcement came after Prime Minister Yulia Tymoshenko's second visit to Tripoli in five months. The first fruit of the deal will be an agreement for Libya to distribute Antonov military transport aircraft in Africa.

The Antonov An-12 and An-26 are popular in Africa due to the aircrafts' rugged design which is well suited to the rigours of the African continent.

Talking about her meeting with Libyan leader Muammar Gaddafi – who last week celebrated 40 years of being in power – Ms Tymoshenko said, "This meeting was dedicated to the discussion of the contracts ... and I'm sure they will be signed soon."



A delegation from Ukraine has stayed on in Tripoli after the premier's two-day trip to iron out the details and prepare contracts for signature by the aircraft manufacturer and exporters.



▲ The Antonov An-26 turboprop transport aircraft which is ideally suited to operations in Africa.

Ms Tymoshenko said that the signing of the contracts would lead to "significant additional orders" that will create new jobs and secure regular work.

On 27 August, Ms Tymoshenko visited the Kyiv-based Antonov design bureau, where she announced government investment of UAH 3.5 billion (more than \$400 million) to modernise design and manufacturing facilities. A new range of Antonov aircraft has been designed but orders need to be placed to secure

mass production and generate sales. The government investment is directed at achieving production and kick-starting orders. The first foreign sales of the new aircraft are expected to be made to Russia and Libya.

Mending Fences With Russia

In Sopot, Poland, Prime Minister Yulia Tymoshenko and her Russian counterpart Vladimir Putin ironed out lingering issues on energy and discussed cooperation in the aviation sector. This friendly and businesslike meeting came a little over a week after Mr Putin sent a message to Ms Tymoshenko, congratulating Ukraine on its Independence Day celebrations – itself an indicator that the Ukrainian premier's pragmatic approach to Ukraine-Russia relations is paying dividends.



▲ Forging relations with Russia. President Viktor Yushchenko and Prime Minister Yulia Tymoshenko have taken different approaches. Only one is working.

On 24 August – the 18th anniversary of Ukraine's independence – Ms Tymoshenko delivered a rousing speech, reiterating the need to stand up for Ukrainian sovereignty and independence. She congratulated the Ukrainian people and promised to guide Ukraine through its financial problems. "I am asking you to trust in Ukraine, love it, respect your state, even if you are having hard times," she said.

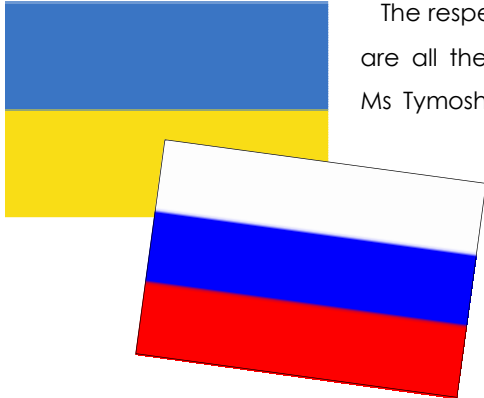
In contrast, President Viktor Yushchenko, speaking in Independence Square, took the opportunity to hit back at Russia, criticising the Kremlin's foreign policy and emphasising the need for Ukraine to push for NATO membership.

Different Approaches

The different approaches from the two leaders have not gone unnoticed by the Kremlin and indeed by European leaders. In stark contrast to the



public rebuke delivered to Mr Yushchenko early last month by Russian President Dmitry Medvedev, Mr Putin publicly congratulated Ms Tymoshenko and the Ukrainian people on Ukraine's Independence. Mr Putin's letter of congratulations read, "I hope that close joint work between our governments will help resolve the practical tasks of our bilateral cooperation and create a favourable atmosphere for the development of all relations between Russia and Ukraine."



The respective differences in the approaches of Ukraine's leaders are all the more remarkable because both Mr Yushchenko and Ms Tymoshenko are fiercely pro-Ukrainian, and little divides them on issues of sovereignty and territorial integrity. Yet throughout his presidency, Mr Yushchenko appears to have adopted a more confrontational stance towards Russia. Last month, relations between the two reached an all time low when Mr Medvedev accused Ukraine's leaders of pursuing anti-Russian policies. Mr Medvedev even indicated that he had

given up on any improvement in relations as long as Mr Yushchenko remained in power.

The severity of the attack on Mr Yushchenko was interpreted widely as evidence of Russia seeking to interfere in Ukraine's upcoming presidential elections. If this was the case, the plan backfired as Mr Yushchenko received an uptick of support following the exchange. Notwithstanding this, political commentators agree that due to Mr Yushchenko's low opinion poll ratings, his presidential bid is doomed before it starts.

Finger in the Eye Approach to Diplomacy

Sadly, bi-lateral relations between Russia and Ukraine have been the casualty of this "finger in the eye approach" to diplomacy. The head of state's rhetoric on NATO membership, hawkish criticism of Russia's military intervention in Georgia, slating of the January gas contract, and insistence that Russia's Black Sea Fleet withdraws from Ukraine's Crimea peninsula by 2017, have damaged relations. While Ms Tymoshenko has herself called for a removal of all foreign bases on Ukrainian soil by 2017, her tone towards Ukraine's neighbour is more measured and diplomatic. It takes into account the fact that Ukraine – for historical, cultural and business reasons – would be foolish to turn its back on Russia and therefore must seek to build a relationship founded upon mutual interest and respect.

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This approach in no way negates Ukraine's European aspirations. On the contrary, European leaders view good relations with Russia as a sign of Ukraine's maturity – another box to be ticked on the long road to membership.

Fundamentally, Mr Yushchenko and Ms Tymoshenko have different approaches to Ukraine-Russia relations. The latter takes a more moderate approach to dealing with the Kremlin and recognises the strategic and economic importance of a healthy relationship between the two nations. This approach is rooted in Ms Tymoshenko's belief in doing what is right for Ukraine, because first and foremost she is not pro-Russian, nor even pro-Western, she is pro-Ukrainian.



The Battleground of Western Ukraine

The battleground in the upcoming January 2010 presidential elections is expected to be Western Ukraine. This region – the heartland of the Orange Revolution – will be fiercely contested by a large number of candidates from the former “orange” camp, of whom Yulia Tymoshenko is the most popular. Viktor Yanukovich’s domination of Eastern Ukraine and Prime Minister Tymoshenko’s strong position in Central Ukraine are unlikely to be seriously challenged.



▲ Speaking in Lviv at the World Congress of Ukrainians. Prime Minister Yulia Tymoshenko with Deputy Prime Minister Hryhoriy Nemyryia on her right.

Traditionally the swing region of Central Ukraine decided the outcome of Ukraine’s presidential elections. This was seen in 1994 when it voted for Leonid Kuchma and a decade later when it voted for Viktor Yushchenko, the victors on both occasions winning with 52 percent of the vote.

It was therefore important for Ms Tymoshenko to attend and speak at the World Congress of Ukrainians (WCU) annual congress in Lviv on 21-22 August. There, according to those who attended the congress, “The meetings were very warm.” Besides the official

part of the congress, Ms Tymoshenko had a three hour evening meeting with the WCU.

Bearing Her Soul

The head of the WCU, Ukrainian-Canadian Yevhen Choliy, said that the prime minister had “opened up her soul to them.” They sang “Многая літа (May You Have a Long Life)” after her speech to the WCU, a speech that pitched an ideological manifesto for Prime Minister Tymoshenko ahead of the presidential elections.

The premier’s speech was full of patriotism without being overly nationalistic, accomplishing an important balancing act in a regionally diverse country where a third of the population are Russian speakers. Ms Tymoshenko talked about the number one priority of steering Ukraine through the economic recession. Yet perhaps more importantly for this audience, she outlined a programme for upholding “our native Ukrainian language,” which is taught to 81 percent of pupils in Ukrainian schools as the only state language in Ukraine. “And I want to say that while our team is in power, while real patriots and Ukrainians are in power, and I think that this will not change, we will not permit in Ukraine the raising of the question, in any form, of a second state language.”

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Ms Tymoshenko also stressed the importance of reviving a national memory and continuing to document and raise the issue of the 1933 Holodomor artificial famine as a genocide against the Ukrainian people. She stressed the importance of reviving an “honest Ukrainian history” and thanked the Ukrainian diaspora for its tireless work in this area. Ms Tymoshenko, without



mentioning President Dmitry Medvedev by name, replied to his appeal to President Yushchenko earlier this month by stating categorically that Ukrainians have a right to their own history. She added that her team and government would continue to view the famine as genocide despite this not being accepted by Moscow in such a manner.

Question of National Identity and Energy



Language and national memory are two traditional areas of interest to the Ukrainian diaspora but a third issue, energy independence, is usually ignored and yet is perhaps more important to Ukraine's sovereignty. The Party of Regions and President Yushchenko have both supported the shady gas intermediary RosUkrEnerg and its corrupting influence on Ukrainian politics. In parliament, only the Bloc of Yulia Tymoshenko (BYUT) supported the removal of gas intermediaries from Ukraine's gas relationship with Moscow.

A second important area that Ms Tymoshenko stressed to the WCU was the need for Ukraine to move towards a gas relationship with Russia without gas subsidies. Removing gas intermediaries and moving to market gas prices will enhance Ukraine's independence and reduce pressure from external influences. In addition, the premier stressed that the presidential elections in Ukraine were different to those held in other countries: "for Ukraine every election is not simply an election. Every election is an election on the strategic course of Ukraine."

Europe: Charting the Strategic Course



In Ukraine who wins the elections decides the outcome of this strategic course. "That is why elections in Ukraine must ensure the ideological continuation of the strategic development of Ukraine: a pro-European state with European values built on the civilized base of the development of a European community. No steps backward," said Ms Tymoshenko. The premier then called on candidates from the "national-

patriotic camp" to unite around their strongest candidate in the presidential elections, as they did in the 2004 elections and to end their quarrelling. This would be a logical step given that President Yushchenko and the former Minister for Foreign Affairs Anatoliy Hrytsenko both have less than 5 percent support, insufficient to see them past the first round.

Arseny Yatseniuk's support stopped growing in May and the 10-12 percent that he is normally credited as having in opinion polls is "soft support." It draws on public disillusionment with quarrelling politicians and represents a protest at inter-elite quarrelling in Ukrainian politics. It is most doubtful that this "soft support" will stand up in the heat of a tough election campaign.

Disastrous Campaign

Mr Yatseniuk launched his election campaign in July with billboards that have met with ridicule even from his own supporters. And sprouting up all over Kyiv are military-style tents – bases for



handing out Yatseniuk flyers. Mr Yatseniuk's militaristic to "save the country" campaign has fallen flat; its authoritarian overtone turning off older voters and failing to engage the young. In contrast the "she's working" billboards attributed to Ms Tymoshenko have been acclaimed widely.

Of the candidates from the former "national-patriotic camp" only Prime Minister Tymoshenko has the charisma, popularity and support in the key region of Central Ukraine to defeat Mr Yanukovich. In 2004 only then opposition leader Mr Yushchenko from the democratic camp had the ability to defeat Leonid Kuchma's intended successor, then Prime Minister Yanukovich.

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As in 2004 the democratic camp is again faced by Mr Yanukovich who seeks revenge for his defeat at the hands of the orange electorate. Today he is busy telling people that he is in pole position for victory, and if elected president will introduce Russian as a second state language and strengthen ties with Russia. But what he underestimates is the strength of a second round orange vote; for if united the democratic forces will defeat him.

Today, it is still early days and campaigners will no doubt come back again and again to the battleground that is Western Ukraine. As for now, Ms Tymoshenko's speech to the WCU in Lviv represents a far more auspicious start to the presidential election campaign, striking a strong ideological chord ahead of the upcoming elections.

Questions or comments? E-mail us at nlysova@beauty.net.ua