



Open Ukraine

Changing Course towards a European Future



TARAS KUZIO AND DANIEL HAMILTON, EDITORS

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Preface and Acknowledgements

Events in Ukraine are headline issues and there is considerable uncertainty about the direction of the country. With this in mind, the SAIS Center for Transatlantic Relations at Johns Hopkins University and Poland's Institute for Eastern Studies, the organizer of the annual Economic Forum in Krynica, Poland, asked the authors in this volume to address current issues related to Ukraine's domestic and international situation, and to recommend steps that could be taken to forge a more democratic, prosperous and secure Ukraine. Our intention is to evoke the political, economic and foreign policy possibilities of an open Ukraine in the heart of Europe.

This project succeeded because of the partnership between our two institutions. On behalf of the authors we would like to thank the many colleagues who participated in the deliberations and meetings that produced this book, including participants in the Ukraine Policy Forum, our Center's regular meeting series examining Ukraine's current challenges and future possibilities.

We would also like to thank our colleagues at the Center for Transatlantic Relations and the Institute for Eastern Studies for their help and good cheer throughout this project, and Peggy Irvine and Peter Lindeman for working with us on the many details related to the production of the book. We are grateful to the Austrian Marshall Plan Foundation, which supports our work on Central European issues.

Our authors express their own views, and do not necessarily reflect views of any institution or government.

Taras Kuzio

Daniel Hamilton

Towards an Open Ukraine: Policy Recommendations

Ukraine is one of the biggest, but also the second poorest country in Europe after Moldova. Given its territorial size, its geographic position, its almost 50 million population and its role as the main transit state for Russian oil and gas exports to central and western Europe, Ukraine has been a critical strategic factor for Euro-Atlantic and Eurasian security in the two decades of its independence. Today, it stands at a critical crossroads between developing a more open society increasingly integrated into the European space of democracy, prosperity and market-based economics grounded in respect for human rights and the rule of law, or an increasingly autocratic system, mired in the economic stagnation and political instability that is historically characteristic of Europe's borderlands. The choice is straightforward: Ukraine can either join the European mainstream or remain in a gray zone of insecurity between Europe and Russia.

The following recommendations outline how Ukraine could move away from immobility in the gray zone of domestic and international politics in which it finds itself, break its reform logjam and become an Open Ukraine—a democracy accountable to its people with a socially responsible market economy, governed by an administration that respects the rule of law, fights corruption and that can effectively implement needed reforms, and that is increasingly integrated into the European mainstream. These proposals are intended to expand the horizons of Ukrainian elites and opinion leaders and equip them with concrete reasons to move from short-term “momentocracy” to a more powerful vision that could guide their country. They also suggest ways Ukraine's neighbors can make the costs and benefits of Ukraine's choices clear.

Political Reforms and Democratization

Ukraine's fundamental problem has been government dysfunction with leaders changing the constitution and election laws to deny power

to the opposition or maximize power for themselves after elections. For Ukraine to have more effective governance, it must tackle seven interrelated challenges: switching from a presidential to a parliamentary political system, which is better suited for encouraging democratization; parliamentary and legislative reform; administrative reform; strengthening the rule of law; judicial reform; eradicating systemic corruption; and strengthening civil society and independent media.

- ***Switch to a Parliamentary System.*** The scholarly and policy debate has been extensive whether presidentialism or parliamentarism is best suited for countries in transition. Of the 27 post-communist states, those with successful democracies in Central-Eastern Europe have adopted parliamentary systems while authoritarian regimes in Eurasia are primarily built on presidential systems. Parliamentary systems have therefore been successful in promoting democracy and European integration than presidential systems. Ukraine has had a presidential system for a decade (1996-2005) and again since 2010 when the Constitutional Court ruled under pressure from the executive that constitutional reforms adopted in December 2004 and going into effect after the March 2006 elections were ‘unconstitutional’ (the same Court had refused to consider the same question under President Viktor Yushchenko). Presidentialism in Ukraine has stifled democratic developments, encouraged authoritarianism, promoted censorship of the media and became a nexus of corruption and illegality. Unelected regional governors, which duplicate elected local councils and mayors, have traditionally been at the center of election fraud, patronage and corruption. Abuses of presidentialism are clearly evident under President Viktor Yanukovich, who has sought to maximize power at the expense of parliament, the Cabinet, regions and local councils.
- ***Parliamentary and Legislative Reform.*** A strong and independent legislature is vital for jump-starting the reform process in Ukraine, yet the Ukrainian parliament turned into a rubber-stamp body with minimal political authority. Open Ukraine requires legislation, drafted in a transparent manner and be open to public deliberation, that would ensure a level

playing field for competing political parties and their fair representation in the parliament. The mixed system, adopted in November 2011 ignoring recommendations by the Council of Europe's Venice Commission, prevents this by skewing election results in favor of the Party of Regions. Provisions for full disclosure of candidates' funding sources and for challenging election results are essential for a democracy. The law should limit the ability of electoral commissions to interfere with the electoral process. The parliament's role in choosing candidates for Cabinet positions must be revived. It must also have strong oversight powers over the executive. Internal rules for coalition formation should prioritize party factions over individual deputies; the majority coalition should be formed based solely on parties elected to the parliament and not, as has been the tradition until now, of new parties and factions created after elections within the life of parliaments. There should also be a strict enforcement of the rules requiring deputies to vote individually (that is, a halt to the widespread practice of absentee voting) and disclose their personal incomes. The legislative process should be streamlined to improve the quality of legislation, possibly with the assistance of a Council of Foreign Advisers, as was the case in the first half of the 1990s.

- ***Administrative Reform.*** The executive needs to be streamlined and decentralized to allow for more effective and accurate application of law. Many government ministries and state committees have overlapping responsibilities, duplicating functions and wasting resources.
- ***Strengthen the Rule of Law.*** In Ukraine the law continues to be viewed as an instrument of partisan governmental power. That which is construed to be "illegal" is whatever the government in power finds to be politically expedient. Procedural safeguards that are at the heart of a rule of law legal system are absent or ignored. Ukraine should fundamentally and profoundly transform its legal system if it is to spread European values and the rule of law. This means coming to grips with the legal system's catastrophic Soviet past; reforming the legal academy; and reforming the laws, procedures and mechanisms

that remain in place as holdovers from Ukraine's totalitarian legacy. The Prosecutor's office needs to be overhauled or replaced. It has become highly compromised through corruption and under Yanukovich it has returned to its Soviet function as a state arm of repression.

- ***Judicial Reform.*** In a system that respects the rule of law, judges are professional, independent and impartial; they are not "accountable" to prosecutors. Prosecutors, in turn, do not act as the partisan political arm of the government. That is not the case in Ukraine today. The court system is endemically corrupt, incompetent and subject to commercial and political influence. Judges are routinely bribed to secure convictions or release of those charged or to alter title deeds in businesses in the widespread practice of corporate raiding. The President exerts political influence over the judiciary through the High Council of Justice, which is dominated by representatives of the ruling party and the Chairman of the Security Service, a direct conflict of interest. Ukraine's judicial system is in dire need of overhaul. The competence and jurisdiction of differing courts must be clarified. Training and selection of judges need to be made more transparent and meritocratic. Courts and judges require sufficient financing so as to discourage corruption. Concepts along these lines were approved five years ago, but have yet to be implemented. Court proceedings should be made more transparent, impartial, and effective. Procedures for mediation, independent arbitration, and enhanced use of notaries should be introduced. The power of the High Council of Justice to select or discipline judges should be transferred to a non-partisan body comprising of authoritative and experienced judges, such as the High Qualifications Commission. The President's and Parliament's role in appointing or removing judges should be limited to mere approval of the Commission's recommendations with few clearly specified exceptions.
- ***Eradicate Systemic Corruption.*** The presence or absence of rule of law in a society is closely related to the level of corruption. Corruption has become endemic in Ukraine and is

growing; it has degraded the country's governance, undermined its democracy, reduced public trust in state institutions, distorted the economy, discouraged foreign direct investment and been exported to Europe. To reduce corruption, Ukraine needs political leadership committed to and greater societal awareness that corruption impedes economic development, democratization and European integration. Organizations and individuals committed to combating corruption need to mobilize behind specific, concrete initiatives—such as draft laws regarding codes of criminal procedure, professional ethics, and financial declarations by public servants. There is a wealth of international experience on how to reduce corruption, particularly from other post-Soviet or post-socialist countries; Ukraine should take advantage of such experience.

- ***Strengthen Civil Society and Independent Media.*** Media censorship under Yanukovich has not yet reached the level characteristic of Kuchma's presidency and is different in nature. Nonetheless, even though major media outlets in Ukraine have not yet fallen fully under the government's control, their independence has eroded substantially due to the excessive interference of owners keen to remain on good terms with the executive in news coverage. Television news is dominated by good media coverage of the authorities and either paints the opposition in a negative light or ignores them. Only print and internet-based media still function as an instrument of accountability and a source of reliable news. Further international assistance to these media outlets is vital for supporting media pluralism.

Economic Growth and Modernization

During the last two decades Ukraine has moved from a command administrative system but has still to arrive at the final destination of a market economy, despite recognition by the U.S. and EU in 2005-2006 of a 'market economy' status. Ukraine's 'partial reform equilibrium' is stuck between the Soviet past and European future and only concerted reforms will move the economy towards a European-style

social market economy. Ukraine was hit hard by the global economic and financial crisis. The combination of weaker demand from Ukraine's trading partners, falling export prices, rising import prices and reduced access to international financial markets sliced GDP by 14.8% in 2009, and it will take until 2013 to recover that lost ground. Inflation is hovering above 9% and unemployment at 8%. The *hryvnia*, Ukraine's national currency, has lost almost half of its value against the U.S. dollar since July 2008. Pension expenditures increased from 9% of GDP in 2003 to 17.6% in 2010, one of the highest levels in the world—yet pension fund revenues cover only two-thirds of expenditures, the rest being covered by transfers from the budget. Demographic pressures will increase the burden on the working population even further. Ukraine's successful accession to the WTO in May 2008, after 15 years of negotiations, was an isolated foreign policy achievement of the Yushchenko presidency. President Yanukovich launched reforms in summer 2010, but implementation has been very slow due to a lack of political will, populist concessions ahead of parliamentary elections in 2012, and a deficit in government capacity to draft EU-compatible legislation. The refusal to implement further stages of the 2010 MF agreement, including raising household utility prices for a second time, has led to the suspension of IMF tranches. It is imperative that Ukraine return to the IMF agreement in order to introduce reforms and boost foreign investor confidence.

The following areas are urgent on the road to an Open Ukraine:

- ***Pension reform*** has been long delayed, yet is critically important for restoring Ukraine's financial sustainability. The IMF demand to raise the pension age from 55 to 60, as part of the July 2010 agreement for Ukraine, was adopted by parliament in 2011.
- ***Simplified taxation and licensing***, including simplified accounting of revenues, should be introduced for small and medium businesses. Previously introduced reform principles must be made operational, such as the "one-stop shop" for registering and licensing businesses. Any permits other than those directly stipulated by the law should be abolished. Remaining permits and activities subject to mandatory licensing should be compiled into a single piece of legislation.

- ***Corporate legislation reform.*** The Economic Code of Ukraine is a confused mix of Soviet command economy elements and market institutions. It should be abandoned. The Civil Code of Ukraine should comply with EU Directives on company law. The new law on joint stock companies must be amended to comply with EU Directives on company law, and internationally accepted principles of corporate law and corporate governance best practices, by replacing the profit-extracting legal model for such companies to one of investor protection. Modern legal structures are needed for small and medium enterprises and domestic and foreign investors via a separate limited liability company law that provides for an efficient system of governance, control bodies and reliable protection of minority participants. The law on re-establishing solvency of a debtor or declaring a debtor bankrupt must be amended to prevent abuses by related-party (conflict of interest) transactions and by enhancing the personal responsibility (liability) of company officers and the bankruptcy commissioner.
- ***Agricultural Reform.*** The moratorium on trading agricultural land should be ended and free access of citizens and agricultural producers to land resources ensured. Prices for agricultural land should be liberalized and work on establishing a land cadastre should be continued. Consideration should be given to allowing foreigners and foreign-owned companies to own some agricultural land deposits (e.g. up to 10% of land in each region [*oblast*]). Such reforms would attract more capital, help to import and disseminate modern agricultural technologies, and facilitate greater access to international channels of distribution of agricultural products. Moreover, Ukraine has a strong interest in the liberalization of global trade in foodstuffs. Administrative restrictions on exports should be abandoned and delays in VAT refunds to exporters urgently fixed. Targeted income support measures should be introduced for poor families to compensate for the rise in foodstuff prices. Social support and re-training programs for redundant agricultural workers need strengthening. Ukrainian law on state support of agriculture should be consolidated into one piece

of legislation. An information service for agricultural markets should be established to monitor and forecast global food markets and collect information on standards in other countries. Sanitary and safety standards should, as a matter of high priority, be aligned with international and EU norms. Establishing WTO-compatible free trade agreements with other non-EU trade partners is in Ukrainian interests.

Energy Efficiency and Independence

Ukraine's energy sector is plagued by aging infrastructure, widespread corruption, political manipulation of utility rates and statistics, and minimal foreign direct investment. Although Ukraine has oil, gas and coal reserves, it is one of the most energy inefficient economies in the world and only able to cover 47-49% of its energy demand. Gas imports account for 7-8% of Ukrainian GDP and are clearly unsustainable. Around half of Ukraine's total energy consumption comes from natural gas. Although Ukraine has large conventional and unconventional gas resources, it will be unable to boost domestic gas production without deeper and comprehensive reforms and significant foreign direct investment. While it has coal reserves for another 100 years, the productivity of coal extraction is very low and its production costs are high. Coal mining is highly dangerous and Ukraine has one of the highest rates of accidents in the world, close to Chinese levels. Without restructuring, modernization and liberalized market reforms, Ukraine will be unable to cope with its energy supply challenges, including decreasing its extremely high energy consumption.

Moreover, Ukraine is deeply dependent on Russia, which supplies 85-90% of Ukraine's oil imports and 75-80% of its natural gas imports. In addition, in 2010 Ukraine signed agreements with Russia to build two nuclear reactors and to deliver only Russian fuel to all Ukrainian reactors until they cease operation. These arrangements have stunted necessary domestic reforms and weakened Ukraine's bargaining position vis-à-vis Russia, particularly with regard to gas imports and transit. Moscow uses the gas issue to exert pressure on Kyiv over various bilateral issues. Kyiv signed a gas agreement with Moscow disadvantageous to Ukrainian interests, yet Moscow insists

that any review of that agreement would only be possible if the state gas company *Naftohaz Ukrainy* merged with *Gazprom*, ownership of the Ukrainian GTS was transferred to *Gazprom*, or if Ukraine joined Russia's Customs Union with Belarus and Kazakhstan. Yanukovich has publicly rejected such conditions as "humiliating," and Ukrainian law prevents the selling, renting or leasing of critical energy infrastructures to foreign countries and companies. Russia is pushing for a new gas consortium over the GTS acquiring majority control, leaving Ukraine just 20% of its shares. Such an arrangement would question Ukrainian sovereignty and independence, threaten efforts at deeper democratic and market reforms, and pose considerable challenges to EU energy security and foreign policy. Giving up sovereignty over the GTS is seen by the Nikolai Azarov government as a better option than implementing unpopular IMF reforms (such as raising household utility prices to reduce Naftohaz Ukrainy's contribution of 2% to the budget deficit) as Russia will provide gas at a subsidized price in a new contract.

An Open Ukraine requires Kyiv to boost domestic energy efficiency; eradicate endemic corruption in the energy sector; adopt all of the elements in the European Energy Community that it signed on to; and diversify its energy mix and strengthen its national security by reducing its dependence on Russia.

- ***Boosting Energy Efficiency.*** Ukraine's energy infrastructure is inefficient and wasteful. The country has invested little in energy efficiency, yet such efforts are critical to Ukraine's energy security. A major step forward would be for Kyiv to take the politically unpopular decision to raise gas prices for households and utilities, which are heavily subsidized (a first increase was undertaken in 2010 but the Cabinet balked at taking a second increase ahead of the 2012 elections). The domestic political fallout could be mitigated by compensatory measures for low income households. Artificially low gas prices in the past have dampened any incentive to boost domestic gas extraction or to improve efficiency and a new gas contract with a return to subsidized prices will again freeze Ukraine's inefficient and wasteful energy sector. These have fuelled high-price gas imports from Russia, compromising

Ukraine's national energy security and its overall economic competitiveness. Most Ukrainian energy producers have been unable to finance even their replacement investments because their revenues from domestic sales do not cover their costs. The only real beneficiary of the artificially increased demand for gas is the Russian state gas company Gazprom. In contrast, the Ukrainian state gas company Naftohaz Ukrainy needs budgetary support because of highly subsidized utility prices.

- ***Eliminate endemic corruption in the energy sector.*** The lack of strong market reforms is linked to systemic corruption and a nebulous legal and legislative framework, which have unnerved the markets and scared away foreign investment. If Ukraine is serious about its energy security, it will work to eradicate systemic corruption and establish clear legal ground rules for investments in its energy sector.
- ***Adopt European Standards.*** On February 1, 2011 Ukraine became a full member of the European Energy Community (EEC), which extends the EU's internal energy market to Ukraine. It is strongly in Kyiv's interest to live up to the obligations such membership entails, including full adherence to anti-corruption norms of European law and implementation of the EU's third energy package of unbundling energy production from its distribution in gas and electricity markets by January 2015. The implications of this third package are far-reaching and often not fully understood. EEC members are obliged not only to revise their laws and to adopt secondary legislation but also to promote fundamental changes in market structures by introducing market rules and legislation. Central European practice offers Ukraine a means to implement EU *acquis* in energy despite its dense interwoven ties with Russia, whereby long-term Russian contracts could enjoy temporary derogation from EU regulations.
- ***Diversify.*** Energy cooperation with the EU and other foreign partners could help Kyiv diversify its fossil-fuel imports and its overall energy mix and reduce its dependence on Russian gas and oil. Ukraine has excellent wind resources and possesses significant unconventional (shale) gas deposits.

Ukraine's Parliament has already passed more investor-friendly legislation to open its domestic natural gas market to foreign shale gas and coal-bed producers. Exploitation of these reserves could give buyers more leverage to renegotiate the high Russian oil-indexed gas price demands that are included in long-term contracts, and could drastically reduce Ukrainian dependence on Russian gas. Moreover, the confluence of EU energy market liberalization, stepped-up antitrust enforcement, and the emergence of unconventional gas supplies in European markets may prompt Russia to increase its own efforts at energy efficiency and to invest in its own unconventional gas resources, which may be much cheaper than investing in the extremely costly Yamal Peninsula and Shtokman projects, and perhaps lead to greater reciprocity and symmetry in both Ukrainian and EU energy relations with Russia. On the other hand, if Ukrainian and European gas policies remain hostage to long-term contracts, "take-and-pay" clauses and oil price linkages, prospects will be dim for new and sustainable integrated energy and climate policies, despite the fact that international gas markets have de-linked from oil price markets.

A Strategy for the West: Open Door, Straight Talk, Tough Love

Given Kyiv's turn to autocracy, it would be tempting for Western policymakers, besieged with other priorities, to turn their backs on Ukraine. This would be a strategic mistake. The United States and the EU have a strong stake in an Open Ukraine secure in its borders and politically stable. A more autocratic, isolated and divided Ukraine would be a source of continued instability in the heart of Europe. It would make it harder for Georgia and Moldova to pursue their pro-Western course. It would diminish prospects for reform in Belarus. It would perpetuate a gray zone of borderlands on a continent that has until now enjoyed an historically rare moment to transcend the tragedies of its past divisions. Western leaders should avoid falling into the same short-term mindset that currently befalls Ukrainian elites, and adopt a broader strategic perspective.

Ukraine is beset by regional and cultural divisions that will have a profound impact on the country's political evolution. As Ukrainians debate the norms that should guide their society, normative consistency by their Western partners can provide orientation and strength. This does not mean softening norms or conditions for effective engagement, but it does mean being clear about the benefits that could result from adherence to such norms. The West has a vested interest in ensuring that Ukrainian leaders understand the opportunities and consequences that could result from their decisions, and should be consistent in setting forth a coherent and coordinated framework of relations that can help shape those choices.

As Ukraine struggles to find its place in 21st century Europe, therefore, the door to that Europe should be kept open. There is no consensus at present within the EU about the possibility of ultimate Ukrainian membership. Yet if the door to Europe is closed, the Ukrainian government will have little incentive to advance political and economic reforms, and could either turn to alternative geopolitical frameworks or remain isolated in a geopolitical gray zone, generating instability and insecurity throughout its wider neighborhood. Clear EU support for the principle of the Open Door, on the other hand, can help Ukrainians build the courage and political will to implement tough reforms at home—not as a favor to others, but because they understand it is in their own interest to do so. have an effect on internal developments in Ukraine. And if Kyiv begins to implement reforms that promise to move Ukraine towards an open, democratic and market-based society, such actions can in turn affect what leaders in EU capitals are willing to offer Ukraine.

Based on the continued validity of the Open Door, Western strategy should advance along two tracks that work together. The first track should demonstrate the genuine interest of North America and Europe in close and cooperative ties with Ukraine, and should set forth in concrete terms the potential benefits of more productive relations. They should make it very clear that Europe and the U.S. stand as willing partners if Ukraine decides to invest in its people, forge effective democratic institutions, build a more sustainable economy grounded in the rule of law, tackle endemic corruption, diversify and reform its energy economy; and build better relations with its neigh-

bors. U.S. and European efforts should seek to strengthen democratic institutions; promote the growth of civil society, especially independent media; support economic reforms; provide technical assistance for energy reforms; and facilitate interaction between Ukrainian citizens and their neighbors, including visa liberalization, business and student exchanges. If Kyiv signals by its actions that it is interested in deepening its engagement with the West, North America and the EU should be equally ready to engage while pushing for more comprehensive economic and political reforms aimed at facilitating Ukraine's integration into Euro-Atlantic institutions.

At the same time the U.S. and Europe should make it clear that if Ukraine's leadership abuses the rule of law, facilitates corruption, fails to advance effective reforms, and resorts to intimidation tactics, as is currently the case regarding the Tymoshenko conviction, the prospects for an open, prosperous and secure European Ukraine will fade. International efforts to deter Ukraine's further backsliding should combine the threat of costly sanctions towards the ruling elite with calls for unencumbered engagement of citizens in political life, targeted assistance to key civil society actors and specific proposals for reforms that could pave the way toward a more open Ukraine. Outside pressure on Ukrainian authorities clearly has its limits, of course, and the main brunt of responsibility for the evolution of Ukraine's political regime lies with domestic actors. However, as the Orange Revolution demonstrated, Western influence can restrict the range of options available to authorities who choose to fight their own people, and can help to weaken the internal legitimacy of some of the government's anti-democratic policies.

In short, a proactive Western policy might be best characterized as Open Door, Straight Talk, and Tough Love. Such an approach requires persistence, patience, and consistent engagement on the following priorities:

- ***Support Civil Society.*** By monopolizing political space and marginalizing the opposition, Ukrainian authorities undermine the reform process and weaken public trust in government activities. Transformative reforms of the magnitude needed in Ukraine require support across the country and from political forces on both sides of the major political

divide. North American and European governments and international organizations should stress the critical importance of a free and fair parliamentary campaign in October 2012 ahead of the process and cast a spotlight on even minor violations of democratic procedures. They should weigh in against any signs of abuse of state-administrative resources or biased limitations on opposition activity or campaign financing, in order to prevent further emasculation of civic groups or further closure of the civic space for independent political action. They should encourage Kyiv to lower barriers to independent media and to ensure media access to the opposition. They should encourage active involvement of opposition parties and leading NGOs in the process of drafting reform strategies and ensuring government accountability at all levels. International organizations should provide technical assistance in training election observers and electoral commission members representing all political parties.

- ***Advocate Institutional Reform.*** Western governments and international organizations, particularly representatives of post-communist countries, should advocate targeted institutional reforms aimed at establishing a legally-grounded balance of authority among the executive, legislative and judicial branches; increasing the government's accountability to the parliament; and strengthening oversight agencies, such as an independent anticorruption bureau, accounting chamber, the office of the ombudsman and the financial regulatory body. They should offer concrete suggestions to depoliticize the judiciary and the civil service, which are still dominated by vested political and business interests.
- ***Support Ukrainian Efforts to Tackle Systemic Corruption.*** The West should develop consistent medium- to long-term strategies to help Ukraine fundamentally reform its legal system and to reduce systemic corruption.
- ***Offer Technical Support for Reforms.*** Ukraine's Cabinet lacks staff to develop draft legislation and government employees are not qualified enough to develop modern economic legislation. Provision of technical assistance will be crucial to

Ukrainian political, administrative, economic and energy reforms.

- ***Be Clear about the Consequences of Undemocratic Activities.*** North America and the EU demonstrated impressive unanimity in condemning the trial and conviction of Yulia Tymoshenko in October 2011 and issued strong demands for her release and resumption of her ability to participate in the political life of the country. They should link such condemnation with concrete measures that would raise the cost to Ukrainian authorities of further undemocratic steps. Such measures should include suspension of Ukraine's membership in the Council of Europe; introducing visa bans for those officials responsible for ordering the crackdown against protesters or persecution of the opposition; a freeze on negotiations for an Association Agreement (including the DCFTA); and limiting bilateral contacts with top Ukrainian officials and state visits to Kyiv. At the same time, the West must maintain its clear message that the door to Europe and Euro-Atlantic institutions remains open should Ukraine work to create the conditions by which it could in fact walk through that door.
- ***Make Better Use of the Eastern Partnership.*** In order to articulate a policy for neighbors for whom membership is a distant goal, the EU launched the Eastern Partnership in 2009 with Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. Yet instead of using the EaP to deepen engagement in Ukraine and other Partnership countries, EU officials dampen their own influence with rhetoric that distances themselves from the prospect of a space of stability, prosperity and democracy stretching as far across the European continent as possible. The EU should be far more proactive in its use of the Eastern Partnership.
- ***Combine Broad Visa Liberalization with Targeted Restrictions.*** Kyiv has a strong interest in visa liberalization with the EU; one in every ten Schengen visas goes to a Ukrainian. The EU should calibrate its approach by offering a generous broad-based approach to visa liberalization for Ukrainian citizens (particularly young people and students) and

facilitating special possibilities for study abroad and cultural, educational, business and local government exchanges, so that the average man and woman in the street, especially in the east and south of the country, can gain personal awareness of the benefits to be derived from closer relations. This strategy of maintaining an Open Europe for Ukrainian citizens should be combined with targeted visa bans and restrictions for Ukrainian officials engaged in undemocratic or illegal activities.

- *Engage Ukraine Actively via a Transcarpathian Macro-Regional Strategy.* New EU macro-regional strategies, for instance with the Danube states, offer a potential model for engagement with Carpathian states. This special area is surrounded by four EU member states, namely Poland, Slovakia, Hungary and Romania. All four are neighbors to Transcarpathia and to each other by cultural, historical and ethnic ties. The Transcarpathian Region could be developed into a strategic Ukrainian bridgehead for integration into Europe. It is already linked by broad-gauge railway to Hungary and Slovakia, and its special location and multi-ethnic traditions are convenient for offshore zones and assembling factories.
- *Support Ukraine's Democratic Development.* The proposed European Endowment for Democracy should disburse aid to Ukrainian civil society and encourage and defend Ukraine's democratic development to monitor Eastern Partnership policy toward Ukraine. The EU should ensure that its assistance is coordinated with U.S. and Canadian efforts to ensure they are complementary and not duplicative.
- *Use the Association Agreement and DCFTA to Advance the Broader Strategy.* With neither NATO nor EU membership on the horizon, the primary vehicle for keeping open the prospect for Ukraine's closer ties to the European mainstream is the Association Agreement and Deep Comprehensive Free Trade Agreement (DCFTA) currently being negotiated between Ukraine and the EU. However, the EU has frozen the final negotiations slated to lead to initialing of the agreement,

due to concerns in various EU member states about the political repression and serious violations of rule of law—particularly the arrest and trial of former prime minister Tymoshenko—that have occurred since President Yanukovich took office. The DCFTA offers the EU a mechanism by which it can calibrate a two-track approach to Ukraine. Initialing the agreement would signal that the EU is indeed ready to move forward with a much closer relationship with Ukraine, with concrete and substantial benefits for the Ukrainian government, Ukrainian elites, and Ukrainian citizens. But freezing the formal signing and ratification process would also signal that a fundamentally new partnership is only possible on the basis of respect for human rights and the rule of law.

The DCFTA is in fact a new generation economic agreement ranging far beyond a standard free trade agreement, not only liberalizing 95% of bilateral trade but aiming for deep and comprehensive harmonization of economic legislation. The opportunities for Ukraine are immense, given that the EU is the largest single market in the world, about 130 times larger than the Ukrainian domestic market and 15–20 times larger than the Russian, Belarus and Kazakhstan markets combined. The benefits to all sectors of Ukrainian society of joining the DCFTA far outweigh the small number of benefits from entering a free trade agreement with the CIS.

- ***Keep NATO's Open Door while Engaging Closely.*** Ukrainian membership in NATO has again been pushed off the international agenda for the immediate future. While the door to NATO membership remains open to Ukraine (and Georgia) in principle, in reality there is little support in Western capitals for further enlargement of the Alliance in the near term. Focusing on NATO membership now will only inflame the political atmosphere and make progress in other important areas more difficult. The main obstacle is not Russian opposition—though this is an important factor—but low public support for membership in Ukraine itself.¹ On the other

¹Popular support for NATO—22–25 percent and below 10 percent in the Russified areas of eastern Ukraine—is much lower in Ukraine in comparison to other states in Eastern Europe. See the chapter by F. Stephen Larrabee.

hand, Ukraine was the first CIS state to join the Partnership for Peace, has been one of the most active participants in its exercises, and the NATO-Ukraine Charter on a Distinctive Partnership gives Ukraine a unique status. Rapprochement with NATO increased Ukraine's freedom of maneuver and led to an improvement of ties with Moscow. Ukraine contributes to nearly all UN and NATO peacekeeping operations, in some cases more than some NATO members.

Nonetheless, as long as only about a quarter of the population favors membership, prospects for Ukraine being admitted to NATO remain remote. In the meantime, other steps in the security field could be taken to strengthen cooperation within the NATO-Ukraine Partnership in areas where there is mutual interest, while encouraging progress toward more open democratic institutions. Such activities include engaging the Ukrainian military in a dialogue on military reform; continuing to involve Ukraine in peacekeeping operations, both within NATO and bilaterally; enhancing cooperation on nuclear safety; further developing the crisis consultative mechanism; and further developing ties in such areas as civil-military relations, democratic control of the armed forces, armaments cooperation, and defense planning. Information campaigns should highlight how NATO provides practical help to Ukraine in emergency situations, cyber-security, security to the Euro-2012 soccer championship, orders for Ukrainian industry, and support for the training of Ukrainian officers. A critical area of concern, as Ukraine turns autocratic, is democratic control and reform of internal security forces (Security Service, Interior Ministry, border guards, customs officers, Prosecutor's office), which are far larger than the armed forces, and which are used in political repression and involved in corruption.

- ***Engage Ukraine on Its Own Merits, Not as a Subset of Russia Policy.*** A successful Euro-Atlantic policy of engagement toward Ukraine cannot be a subset of Western policy toward Russia; the West must consider its own substantial interests in an open Ukraine on their own merits. At the same time, the

United States, Canada and European allies should send a clear message to Moscow that they oppose any attempts to undermine the sovereignty of Russia's neighbors, including threats to their territorial integrity. Upon entering office Yanukovich acted quickly to remove key irritants with Moscow, such as the international campaign to recognize the *Holdomor* (1933 artificial famine) was genocide; shelving plans to join NATO; and ramming through an unconstitutional measure that prolongs the stationing of the Russian Black Sea Fleet in Crimea to 2042-2047. Russia has demanded more, however, including Ukrainian membership in its CIS Customs Union or Russian ownership of the Ukrainian GTS. It is clear that Russia finds it very hard to respect Ukrainian sovereignty and independence. Yanukovich has received little in return for his efforts at appeasing Moscow, and despite his interest in closer relations with Russia, he has also shown that he still prefers being the leader of a sovereign country to being the governor of a Russian province. Nonetheless, he faces strong and consistent Russian pressure on key issues; Western policy should make the implications of his choices clear. For instance, Ukraine faces a choice between entering the CIS Customs Union of Russia, Belarus and Kazakhstan, which is likely to block all fundamental domestic market reforms; or proceeding with the kinds of domestic reforms that would enable Ukraine to reap the benefits of the DCFTA with the EU and closer integration with the European mainstream, including visa liberalization, competitiveness, transparency and accountability in Ukraine's energy markets, greater investments in infrastructure and new technologies, and reduced energy dependency. The first choice demands far less than the second choice in terms of domestic reform, but the second choice promises substantially greater rewards. And joining the Eurasian Customs Union with countries that are not members of the WTO (Russia may soon join, but not Belarus and Kazakhstan) would require a renegotiation of Ukraine's membership in the WTO and end Ukraine's hopes for an Association Agreement and DCFTA.

We have no illusions about the difficulty of realizing the vision of an Open Ukraine. Yet the gains, both for Ukraine and for Europe, would be considerable. Ukraine's choices are its to make, but it is the West's responsibility to make the costs and benefits of those choices clear and credible to Ukraine's leaders and its citizens.

Introduction:

Why an Open Ukraine is the Best Path for its Citizens, its Elites, and its Neighbors

Taras Kuzio and Daniel Hamilton

In this volume a number of distinguished experts offer analysis and recommendations in politics, the economy, rule of law and corruption, national identity, energy, European integration and foreign policy. Together these contributions set forth a vision for an Open Ukraine, a democracy accountable to its people with a socially responsible market economy, governed by an administration that respects the rule of law, fights corruption and that can effectively implement needed reforms, and that is increasingly integrated into the European mainstream. This vision of Open Ukraine would fulfill the country's enormous potential, which has been beyond the grasp of every Ukrainian administration since independence.

Major strides forward in democratization following the 2004 Orange Revolution were combined with political instability and economic growth, until the 2008 global financial crisis. The Freedom House human rights think tank upgraded Ukraine to 'Free,' the only country in the CIS to receive this ranking. Progress in democratization in some areas, notably democratic elections and free media, however, were not matched by progress in the rule of law, fighting corruption and democratic control of law enforcement structures. Bohdan Vitvitsky and Stephen Larrabee discuss how the failure to combat these factors led to public disillusionment in the leaders of the Orange Revolution and made it relatively easy to quickly dismantle Ukraine's democratic gains following Viktor Yanukovich's narrow 3% election victory in February 2010.

Widespread U.S., Canadian and European hopes that President Yanukovich had accepted the democratic rules of the game and was therefore different from Prime Minister Yanukovich, who had been

accused of having orchestrated election fraud seven years earlier, have proven to be unfounded. Today, a concerted effort is under way to build an autocratic regime, with significant implications for Ukrainian society and Ukraine's integration into Europe, again preventing the country from fulfilling its potential as an Open Ukraine. In this regard, the conviction of former Prime Minister and opposition leader Yulia Tymoshenko in October 2011 to seven years imprisonment and three years ban from holding office is a watershed event, the most visible and emblematic manifestation of the country's turn away from Europe toward autocracy. The sentence has jeopardized Ukraine's chances of entering into an Association Agreement (including a Deep and Comprehensive Free Trade Agreement—DCFTA) with the EU that has been under negotiation since 2008, when the country joined the WTO. Integration into Europe, while not the full membership that a majority of Ukrainians support, would bring enormous benefits of access to the world's largest trading area, giving unlimited opportunities for the Ukrainian economy and its companies; institutional and legislative alignment that would strengthen the country's state-building processes; and visa-free access for citizens—all areas analyzed in great detail by Peter Balazs in his chapter in this volume. If Ukraine's leaders truly desire an Open Ukraine, then European integration is the country's best—and only—option.

Ukraine held four democratic elections between December 2004 and February 2010, but concern whether future elections would remain democratic became evident in widespread European and U.S. criticism of the conduct of October 2010 local elections, which failed to meet international standards. With Tymoshenko and other opposition leaders in jail it will be difficult for the OSCE and Council of Europe to recognize the 2012 elections as democratic. The conduct of parliamentary elections in October 2012 and strategic decisions about much-needed reforms will remain key benchmarks for Ukraine's likely direction over the coming decade. Other manifestations of democratic backsliding since 2010 include a decline in media freedom and the right to peaceful assembly, the erosion of parliamentary independence and monopolization of political power, and un-democratic practices against the opposition by the Interior Ministry, Prosecutor-General's office and Security Service (SBU).

While the crucial domestic and foreign policy decisions are for Ukrainians to take, signals sent from abroad could make a difference. The policy recommendations and expert opinions outlined in this volume present an alternative direction to that taking place in Ukraine, a path that is beneficial to all sectors of society and all regions of Ukraine, a path towards an Open Ukraine.

Despite the country's great potential, its political culture has been a "momentocracy," a Yushchenko reference to a collection of short-term policies that benefit a small group of elite insiders yet lack longer-term vision or strategies towards a better future for the country as a whole. A number of factors, most of which tend to feed on each other, have rendered Ukraine an immobile state¹ that exists not for its citizens but instead for the benefit of a small group of ruling elites, who remain concerned only with dividing up a rather small existing pie, rather than expanding that pie through reforms that could lift the lives of its people and integrate the country into a much larger space of prosperity, democracy and security. As Frank Umbach points out, the most brazen example of the prioritization of short term rents at the expense of reforms is the country's unreformed energy sector. With very few exceptions, Ukrainian politicians have succumbed to the temptation of seeing the energy sector as a cash cow for short term financial gain.²

The first factor inhibiting Ukraine from moving beyond an immobile state is the Soviet legacy of state control: deeply embedded traditions of markets distorted by monopolies, systemic corruption, manipulated elections, and a politically captive judiciary. When the Soviet Union disintegrated, Ukraine had to undertake a "quadruple transition." It needed to create the mechanisms and institutions of a sovereign state; build a nation from a quasi-republic in the Soviet empire; transform the command-administrative Soviet economy into a market economy; and establish an effective democracy out of a totalitarian

¹ This phrase is taken from Taras Kuzio, "Political Culture and Democracy: Ukraine as an Immobile State," *East European Politics and Society*, vol. 25, no. 1 (February 2011), pp. 88–113.

² This was pointed out in detail by Margarita Balmaceda in *Energy Dependency, Politics and Corruption in the Former Soviet Union: Russia's Power, Oligarch's Profits and Ukraine's Missing Energy Policy, 1995–2006* (London and New York: Routledge, 2008).

political system. Ukraine has been only partly successful, and since 2010 some critical gains have been reversed, as Serhiy Kudelia succinctly analyses in his chapter on the politics of the Yushchenko and Yanukovich presidencies.

A second factor important to Ukraine is national integration. Ukrainian society is divided along regional lines, and between Russian and Ukrainian language speakers, which makes it more difficult to consolidate Ukraine's elites around united goals of democratic and market economic reforms, improving the rule of law, reducing corruption and clear foreign policies, thus trapping the country in what have been described by Western experts as 'muddled' policies in a gray zone of uncertainty and instability.³

Ukraine's two decades of independence can be divided into two periods. Whereas national integration prevailed in the 1990s, regional divisions have grown since the 2000 "Kuchmagate" crisis. In Ukraine's first decade, reformist political forces on the center-right, popular in the western-central regions, cooperated with centrist forces popular in eastern-southern Ukraine, to advance Ukraine's "quadruple transition." In the last decade, however, growing regional divisions exploited by both sides of the political fence have divided reformers and, as Olexiy Haran analyzes in his chapter, distracted them from the pursuit of much-needed reforms and Euro-Atlantic integration. As a recent New York University policy paper points out, of the three potential scenarios facing Ukraine up to 2020 the only one leading to an Open Ukraine is that of a grand bargain between eastern and western Ukraine, a 'National Consensus Leading to Reform.'⁴ Unless Ukrainian elites overcome their regional divisions, it will be difficult to fashion an elite and public consensus for the reforms outlined in this volume that would facilitate both an Open Ukraine and the country's European integration. Selective use of justice against opposition

³ On Ukraine's "muddle way" see Alexander J. Motyl, "Making Sense of Ukraine," *Harriman Review*, vol. 10, no. 3 (September 1997), pp. 1–7; Dominique Arel, "The Muddle Way," *Current History*, vol. 97, no. 621 (October 1998), pp. 342–46; and Andrew Lushnycky and Mykola Riabchuk, eds., *Ukraine on Its Meandering Path between East and West* (Bern, Switzerland: Peter Lang, 2009).

⁴ Center for Global Affairs, New York University, *Ukraine 2020*. <http://www.scps.nyu.edu/export/sites/scps/pdf/global-affairs/ukraine-2020-scenarios.pdf>.

leaders who are popular in one half of the country, as is being practiced today in Ukraine, only deepens regional divisions and makes reforms and European integration far less likely.

A third factor, an unreformed, largely dysfunctional bureaucracy, stymies efforts at reform even in areas where there is general agreement within the ruling administration and opposition to move forward. Marcin Swiecicki's chapter analyzes the main areas of progress in Ukraine's transition to a market economy and the many areas where reforms remain to be implemented. Rent-seeking clans and oligarchs, most with close ties to the Party of Regions, extract what they can from the existing system without looking ahead to how the economic pie could be expanded for the benefit of themselves and Ukrainian citizens. Economic and social reforms in the last two decades have been piecemeal in response to IMF pressure (1994, 2008–2009, 2010–2011), and failed to meet all the conditions set forth by the IMF in its assistance programs.

Of Ukraine's fourteen governments since 1991, the most reformist was led by Viktor Yushchenko and Yulia Tymoshenko in 2000–2001, when their cooperation in introducing reforms showed signs of progress in moving towards an Open Ukraine. Unfortunately, their cooperation was not evident following the Orange Revolution, when fractious disagreement led to policy stagnation at home and frustration among Ukraine's U.S. and European partners.

A fourth factor, rule of law and corruption, is analyzed in great depth by Bohdan Vitvitsky. No Ukrainian president has seriously fought corruption, and policies in this field have remained virtual rather than real, especially in the energy sector.⁵ Transparency International only noted progress in reducing corruption in 2000 and in 2005 during the respective Yushchenko and Tymoshenko governments. Vitvitsky underscores the essential point that rule of law is the foundation of a democratic political system and market economy and therefore of an Open Ukraine. The ten or more criminal cases opened against Tymoshenko, in addition to the charge she was sentenced for, are understood by European and U.S. governments and international

⁵ T. Kuzio, 'Virtual Reform in a Virtual State,' *Kyiv Post*, May 8, 2003. http://www.kyivpost.com/news/opinion/op_ed/detail/15621/.

organizations as selective use of justice that does not meet democratic rule of law standards

These four factors, together with others, have conspired to prevent the emergence of the type of transformational leadership seen elsewhere in the countries that emerged from the post-communist world over the past two decades. The Orange Revolution inspired hopes both in Ukraine and in the U.S., Canada and Europe that the country had turned an important corner politically that could end the country's immobility and lead to an Open Ukraine and European integration. Kudelia explains how these hopes were dashed, however, as "Orange" authorities maintained symbiotic relationships with the oligarchs, preserved the rent-seeking traditions of their predecessors, used administrative levers to influence the courts and failed to make any substantial progress in integrating Ukraine more deeply into the European mainstream (the one exception being membership of the WTO in May 2008). The "Orange" administration did little to strengthen government accountability and the rule of law, or to place law enforcement structures under democratic control, which has made President Yanukovich's democratic rollback easier.

The fierce competition for power and rents between former allies destroyed the "Orange" coalition and paralyzed policymaking, leading to widespread Ukraine fatigue in Washington, Ottawa and in European capitals. Systemic corruption, which most reports show is growing, has devastated public trust in all branches of government and in the country's leadership making Ukrainians less eager to defend their democracy against attacks upon it by the current leadership. Following Yushchenko's successful visit to Washington in April 2005, the U.S. and NATO sent a strong signal to Ukraine that the country could enter a Membership Action Plan (MAP) towards NATO membership at the November 2006 Riga summit, but the opportunity was missed. Similarly, a second signal by the EU to Ukraine of signing an Association Agreement and Deep and Comprehensive Free Trade Agreement may be frozen again because of domestic political developments. In both cases, NATO and EU integration has been de-railed by divisive policies, disunity, weak political will and lack of strategic vision among Ukrainian elites.

In retrospect, the Yushchenko presidency took the form of what Kudelia describes as “feckless pluralism,” a lost opportunity to forge an Open Ukraine that instead paved the way for the country’s authoritarian retrenchment under Yanukovich. Democracy as a model of governance has been tarnished in the public eye due to poor governance and the inability of “Orange” leaders to prove they were better and less corrupt than their political opponents. As a consequence, government institutions have been severely weakened; elites are extremely polarized and democratic forces are fractured; and public cynicism about the role of government is pervasive. Ukrainian politicians of all stripes face incredibly high levels of public distrust.⁶

The lack of unity among top government officials in Ukraine and their inability to move beyond an immobile state and implement long-promised reforms has led to Ukraine fatigue among European, Canadian and U.S. leaders. Brussels, Ottawa and Washington are unable to comprehend how the current Ukrainian authorities could chose to prioritize the imprisonment of an opposition leader over the benefits that would accrue to the population at large and country of European integration. Poland, which held the presidency of the European Council in the second half of 2011, is especially disconcerted that its staunch support for Ukraine’s European integration has been spurned. As the European Union grapples with the euro-zone crisis, Yanukovich’s democratic backsliding offers those Europeans who always were skeptical about EU engagement with Kyiv, and who feared that the Association Agreement was merely the thin edge of a wedge that would lead to membership, a handy excuse to oppose it.

Yanukovich’s policies have left Ukraine more isolated internationally, thus creating the conditions for Kyiv’s potential drift back into the Russian economic and political orbit. In late April 2010, the coalition headed by Yanukovich railroaded through parliament a 25-year extension of the existing 1997 temporary basing agreement, allowing Russia to base the Black Sea Fleet in Sevastopol until 2042 with the possibility of a five year extension to 2047. As Stephen Larrabee points out, the agreement was ratified without proper parliamentary oversight and in violation of a constitutional provision forbidding for-

⁶ See numerous surveys by the International Foundations for Electoral Systems: <http://www.ifes.org/countries/Ukraine.aspx>.

ign bases on Ukrainian territory. In return for extending the base agreement, Russia agreed to lower the price of imported gas by 30 percent from the price determined by the January 2009 contract signed by then Prime Minister Tymoshenko that ended a 17-day European gas crisis. However, due to the falling demand for gas, Russia had already begun renegotiating contracts in Europe and giving customers discounts. Thus, as Frank Umbach writes, the 30% discount simply brought the price negotiated with Yanukovich down to current European average prices. The 2010 gas agreement, and the new agreement signed in late 2011 which lowered the price further, reduces the country's incentive to reform its inefficient and corrupt energy sector, and commits it to buy more gas in future than it may need. At the same time, it increases Ukraine's economic and energy dependence on Russia.

Yanukovich has also reversed the strategy of Ukraine's first three presidents and overturned parliamentary legislation geared toward seeking NATO membership. While distancing himself from NATO, Yanukovich has often expressed his goal of EU membership, and Ukrainian negotiators even demanded that Ukraine's membership goal be fixed in the text of the Association Agreement. EU leaders have failed to offer a membership perspective for Ukraine or any CIS country, however, and relations have focused on negotiation of a DCFTA as part of an Association Agreement, which had been slated for completion by December 2011. Initialing of the Association Agreement was to have been undertaken at the December 19, 2011 EU-Ukraine summit in Kyiv followed by the European Council signing of the agreement in 2012 and recommendation for its ratification by the European Parliament and 27 EU member state parliaments.

While initialing may go ahead, it is unlikely that signing and especially ratification will follow. The trial and conviction of Tymoshenko is the major obstacle to the agreement entering into force.

As the 2012 parliamentary and 2015 presidential elections loom, Yanukovich faces a dilemma. He will either have to accept the possibility of opposition parties gaining substantial representation in the new parliament and being defeated by opposition leaders, or he will have to undertake election fraud of a scale that would surpass that conducted in 2004. The stakes are high. Having established the prece-

dent of criminal persecution of his predecessors, Yanukovych and his allies face the possibility that they could become the target of similar policies if opposition forces record significant gains in 2012 and an opposition candidate wins the presidential election in 2015. Unless Yanukovych is prepared to change course and embark on reforms that could lead to a more open, prosperous and secure Ukraine, through a grand bargain between eastern and western Ukrainian elites, the temptation to falsify the elections could be irresistibly high, leading to further international isolation.

In short, Ukraine again stands at a critical juncture. The country can continue its slide into autocracy and watch as its chances of integrating into the European mainstream fade. Alternatively, as we argue, the country can move towards an Open Ukraine—an effective democracy governed by the rule of law, free of systemic corruption, with a functioning market economy integrated into a far larger European space of prosperity and stability. Actions taken at home and abroad can focus this choice and make the consequences clear to Ukraine's leaders.

