

Identifier	Created	Classification	Origin
06KIEV604	2006-02-15 13:36:00	SECRET	Embassy Kyiv

Cable title: **UKRAINE ON THE ROAD TO NATO: A STATUS REPORT**

Tags: [PREL](#) [NATO](#)

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S E C R E T SECTION 01 OF 05 KIEV 000604

SIPDIS

E.O. 12958: DECL. 02/14/2016

TAGS: PREL NATO

SUBJECT: UKRAINE ON THE ROAD TO NATO: A STATUS REPORT

REF: A. STATE 7173

B. KIEV 408

C. KIEV 520

D. 05 KIEV 4097

E. 05 KIEV 5174

Classified By: Ambassador, reason 1.4 (b,d)

1. (C) Summary: Ukraine's 2004 Orange Revolution revitalized Ukraine's aspirations to join Euro-Atlantic institutions such as NATO and the EU, but significant challenges in transforming the institutions, conditions, and mentalities inherited from the Soviet Union at independence in 1991 remain. The launching of the NATO-Ukraine Intensified Dialogue in 2005 highlighted three major challenges on the road to membership in NATO: low public support for membership; security sector reform; and intelligence reform. Ukraine's reform agenda touches on many other issues as well, including areas where much progress has been made, such as defense reform, and others where it will be a continual process, such as political and economic reforms. The planned high-level interagency road show team (ref A) should stress U.S. support for Ukraine's aspirations while emphasizing the need for Ukrainian leaders to deliver on implementation of their ambitious reform agenda and to become more actively involved in the public outreach and education campaign about NATO and why it is in Ukraine's national interests to join the Alliance. End summary.

Political transformation

2. (C) If the Orange Revolution and the election of Viktor Yushchenko as President in 2004 reopened Ukraine's stalled drive towards Europe, a successful free and fair election March 26 for the Verkhovna Rada (national parliament) and for regional and local councils is the mandatory next step forward for Ukrainian hopes to secure approval for a Membership Action Plan (MAP) in the spring-summer of 2006. Six weeks prior to the election, the pre-election environment



is completely different from 2004: unfettered freedom of speech and access to the media; no systematic use of administrative resources to favor pro-government parties (ref B). The fluid political dynamics and the possibility that as many as nine parties might make it over the three-percent threshold into the next Rada -- six appear to be shoo-ins -- precludes exact predictions about the form and policies of

the next government. Still, the overall direction of policies will likely remain the same, though the pace may depend on the configuration of the coalition formed (see ref C for more details).

3. (SBU) Perhaps Ukraine's greatest political challenge on the near-term horizon, after the elections and coalition government formation, is implementing judicial and law enforcement reform (for the latter, see para 14). Yushchenko announced judicial reform as one of the government's top five priorities for 2006 and hopes to lock in Euro-Atlantic directions in both sectors through concept papers to be adopted by Presidential decree prior to the March 26 elections. Yushchenko signed a wide-ranging Presidential decree January 20 with specific taskings to bring Ukrainian legislation, regulations, and institutions such as the General Prosecutor's Office (GPO) and the Security Service of Ukraine (SBU) in compliance with EU norms, based on recommendations from the Council of Europe, the Parliamentary Assembly of the Council of Europe (PACE), the EU, and the Venice Commission. Justice Minister Holovaty's Rule of Law and Democracy Commission will produce a Judicial Reform Concept Paper and redraft the Criminal Code. It remains unclear whether implementation will be overseen by the National Security and Defense Council (NSDC) or the Cabinet of Ministers; given turf battles in the aftermath of constitutional reform transferring certain powers of the President to the Cabinet/Rada, institutional rivalries could slow down implementation.

4. (SBU) Tackling corruption was one of the defining issues of Yushchenko's successful Presidential candidacy. While certain progress was made in 2005, as reflected by a better Transparency International rating, the expectations of Ukrainian citizens were not met. Ukraine failed to receive a sufficient score on corruption to qualify as a Millennium Challenge Account (MCA) country; its threshold country application for MCA assistance focuses on addressing institutional shortcomings hampering anti-corruption action. As with judicial reform, there are institutional rivalries and differences of opinion about likely post-election political realities between the NSDC, which has the support of law enforcement and security services, the Cabinet (Ministries of Interior and Justice), and the GPO on the best way to proceed on anti-corruption. There are also differing opinions on what mechanisms should be created to investigate and prosecute high-level corruption. Yushchenko set a February 15 deadline for the GOU National Anti-Corruption Concept Paper, though two parallel processes continue to work on the issue.

5. (C) Ukraine is one of the most tolerant societies in Europe, scoring as high as Germany on the Bogdarus scale (ref D). Nevertheless, Ukrainian leaders must remain vigilant about the potential for a spike in anti-Semitism. The Inter-Regional Academy of Personnel Management, a large, Mid-East-funded commuter university known by its Ukrainian acronym MAUP, is the leading purveyor of anti-Semitic material in Ukraine. President Yushchenko and FM Tarasyuk have both distanced themselves from any connection with MAUP and have strongly condemned MAUP's anti-Semitic views, most recently in December and January, respectively. Interior

Minister Lutsenko told EUR A/S Fried February 9 that he was working with the Education Ministry to deregister MAUP if the legal case could be made; although the GPO ultimately would be the organization to take action, Lutsenko remained optimistic the effort would prevail.

Economic Reforms: WTO, energy security, investment climate

6. (SBU) Ukraine is financially solid with low external indebtedness, large foreign exchange reserves (\$19 billion), and acceptable fiscal performance. The GOU achieved significant reforms in 2005; it 1) eliminated tax and tariff privileges for well-connected businessmen, thus reducing opportunities for corruption, raising tax revenues, and enhancing competition; 2) lowered tariffs; 3) liberalized restrictions on hard currency flows; 4) improved protection of intellectual property rights; and 5) began open and fair privatization and procurement tenders. The EU granted Ukraine Market Economy Status December 1; the U.S. Department of Commerce plans to announce its decision in mid-February. However, Yushchenko failed to achieve his stated top policy objective in 2005 -- accession to the WTO -- due to a combination of disorganization and infighting within the governing coalition and a recalcitrant parliament (Rada) focused on the personal business interests of its members and a desire to obstruct GOU goals.

7. (SBU) The recent standoff with Russia over gas has put energy source diversification, increased efficiency, and domestic exploration back at the top of the policy agenda; energy security is an issue Ukraine is eager to explore with NATO. The most energy-inefficient economy in Europe, Ukraine has a transition economy that has shown strong GDP growth in recent years, with a balanced mix of industry, agriculture, and services, low wages, a shrinking state sector, a relatively stable currency, and growing foreign investment. In the wake of the recent rise in the price of natural gas imports, most analysts predict economic growth of between 1.5-3.5 percent in 2006. Thereafter, if Ukraine manages its fiscal and monetary policies properly, the IMF believes it can sustain 3-to-5-percent annual growth over the medium term.

8. (SBU) Net foreign investment per capita remains low relative to other Central European countries and a limiting factor in growth and modernization prospects. The business climate suffers from gaps and contradictions in the legal base, inadequate capital markets, corruption, and unreliable courts, though the GOU is seeking improvements. Oligarchic groupings that gained control of the country's heavy industries and holdings in other sectors through suspect privatizations at cut-rate prices dominate Ukrainian business. Discord about the degree to which previous privatizations should be annulled discouraged additional investment in 2005, though the single successful reprivatization, of the Krivoryzhstal steel mill (sold to international steel conglomerate Mittal Steel), successfully doubled total foreign direct investment since independence.

Defense Reform: Much progress, challenges remain

9. (SBU) Defense reform, launched in earnest by former Defense Minister Marchuk in the Kuchma era, has been accelerated since February 2005 by President Yushchenko and Defense Minister Hrytsenko. The MoD will soon release a Defense White Book detailing the current state of the Armed Forces and future development plans, a landmark step forward in public transparency. Downsizing continues (currently at

245,000 troops, to be reduced by 20,000 annually through 2010); the conscription term has been cut to 12 months, with a target to transition to an all-contract professional force by 2010. The MOD overhauled Annual Target plans to reflect reform priorities and are now transitioning in form to a MAP-like action plan.

10. (SBU) While the 2006 defense budget was significantly larger than 2005 (up 30 percent to 8 billion hryvnias, or roughly \$1.6 billion, 2.0 percent of GDP), adequate funding remains the biggest barrier to quicker implementation of reform and to reaching desired standards of NATO compatibility and interoperability. Roughly 90 percent of the 2005 budget went to sustainment. The 2006 target is 70 percent for sustainment and 30 percent for modernization. A Joint Rapid Reaction Force based around PARP units, along with interoperability and deployability, are improving but are not yet up to NATO standards. The MoD is beginning to deploy intact units for peacekeeping operations rather than forming ad hoc units, a practice that in the past resulted in operational inefficiency and corruption. Ukraine has a strong desire to participate in and contribute to NATO operations -- currently providing personnel to NATO Training Teams in Iraq, airlift for Afghanistan, and operations in Kosovo and Africa.

11. (SBU) Despite considerable progress, Soviet legacy challenges continue to bedevil Ukraine, including: excess facilities and equipment; excess/expiring munitions stockpiles; housing shortages; the lack of an NCO corps and civilian capacity at MoD; hazing of conscripts; and corruption. Hrytsenko has been one of the most aggressive ministers in fighting corruption by firing/demoting officials, both civilian and military; he has vowed to separate the military from the 600-odd commercial enterprises currently associated with the military in order to reduce opportunities for graft and increase resources for operations. Progress has also been slow on headquarters staff restructuring (positions, roles, missions, operational planning procedures, joint interoperability).

Legal impediments to accession: referendum

12. (C) There are no known legal impediments to Ukraine's accession to NATO. However, some Ukrainians, not just NATO opponents, maintain that a popular referendum on accession should be held; President Yushchenko has on several occasions suggested that he supports holding a referendum. Opponents point to the July 1990 Declaration of Sovereignty by the (Soviet) Ukrainian Rada, which predated Ukraine's 1991 independence; the Declaration included a stated intent to become a neutral state that did not participate in military blocs. A referendum may be called by the President, the Rada, or through popular initiative involving 3 million signatures, including at least 100,000 from at least two-thirds of Ukraine's 25 provinces; several fringe political parties against NATO accession are attempting to collect enough signatures to force a referendum before the March 26 election. Such a referendum could alter accession dynamics (and might draw out more base supporters for pro-Russian parties), given the current state of popular support for accession (see below) and the prospect for heavy Russian intervention, through media coverage (Russian channels are prevalent throughout Ukraine and primary news sources in eastern and southern Ukraine) and covert activities (sponsorship of anti-NATO NGOs and provocations).

13. (C) Ukraine does not consider Russia's lease for Black Sea Fleet (BSF) facilities in Sevastopol and elsewhere in

Crimea and along the Black Sea Coast as a legal impediment to move forward on NATO accession; the current BSF lease runs through 2017. Ukraine under Yushchenko has adopted a more vigorous approach to clarifying the terms of the BSF presence in Ukraine and resolving a series of unauthorized activities and unfulfilled obligations. Ukraine also currently hosts two radar sites, in Sevastopol and Mukacheve, which are part of Russia's early warning radar net. With the transfer of control of the sites from the MoD to the National Space Agency of Ukraine (NSAU), recent public disclosure that Russia only covers 20 percent of the operating costs, and suggestions from Russian officials that it should establish new radar sites on Russian territory in the next three-five years, the fate of the radar sites has become a subject of public speculation. In early February, Ukrainian officials reached out to working-level U.S. counterparts, attempting to gauge potential NATO/U.S. interest in the sites.

Security/Intel Challenges: reform, oversight, sharing

14. (C) Reform of the wider security sector is one of the three greatest challenges identified in the Ukraine-NATO Intensified Dialogue. Security sector reform lags the progress made to date in defense reform and involves more politicized institutions. That said, the GOU has established an ambitious schedule for security sector reform, led by an NSDC Working Group, which hopes to produce a White Paper in November 2006, the culmination of a year-long review process involving detailed reviews agency-by-agency to determine roles, missions, resources, and interaction with other agencies and elimination of redundant responsibilities (ref E).

15. (S) Reform of the intelligence sector, particularly the Security Service of Ukraine (SBU), poses a special challenge. In his February 9 "State of the Republic" speech before the Rada, President Yushchenko emphasized that the guiding principle for the security services should be protection of citizens' rights, not the application of state power; he called for the establishment of a citizen's control board. While intelligence budgets are approved by the Rada, there is currently no effective Rada oversight of intelligence activities. There is also a need for stronger executive branch control, since the intelligence board authorized under the aegis of the NSDC is currently nonfunctional/nonstaffed; NSDC First Deputy Secretary Krutov is committed to reestablishing this body. Current SBU chief Dryzhchany appears genuinely committed to reform. A separate foreign intelligence service was established in 2004; Dryzhchany is committed to give up the SBU's current law enforcement powers in line with European norms. Still, lingering personal relationships with former KGB colleagues in the region make intel reform an issue of ongoing concern.

16. (C) The U.S. and Ukraine have signed a General Security of Defense Information Agreement (GSODIA), which addresses protection of classified material, and continue to craft a supporting implementing agreement. The Main Military Intelligence Directorate (HUVR) favors the reinvigoration of the intelligence board under the NSDC to coordinate intelligence activities and sharing between different services. Ukraine does not currently have effective interagency intelligence cooperation; setting up an implementing mechanism for Operation Active Endeavor-related intel-sharing requirements, with the Ukrainian Navy and the 6th fleet in Naples serving as the primary points of contact, could serve as a pilot project in this regard.

Public Support/Education: perhaps the biggest challenge?

17. (C) The low level of public support for NATO membership may well prove to be the Achilles' Heel of Ukraine's ambitions to be invited sooner (in 2008) rather than later to join NATO. There is an unusual chasm between the views of Ukraine's policy- and opinion-making elite, which overwhelmingly supports NATO membership, and the general population, which currently does not. While Ukrainian polls often suffer from imprecise questioning and dubious coefficient massaging, it would safe to say that 25-30 percent of Ukrainians are in favor of NATO membership, 30-35 strongly opposed, and the remainder uncertain. (Note: One of the most extensive polls on this subject, conducted by the independent Razumkov Center in November 2004 during the week of the falsified second round Presidential vote, indicated that 70 percent of government officials, military officers, journalists, and academics were in favor of eventual NATO membership, compared to just 30 percent of ordinary Ukrainians.)

18. (C) These numbers reflect the enduring legacy of both Soviet-era stereotypes and Kuchma-era cynical manipulation of media coverage of alleged "NATO" aggression in Serbia and Iraq. While an aggressive public education campaign about the "new NATO" and Ukrainian national security interests is clearly needed, pro-NATO Ukrainian officials to date have been tentative in their public outreach, given competing priorities in the run-up to the March elections and concerns that marginal political forces like Natalya Vitrenko's Progressive Socialists and Viktor Medvedchuk's SPDU(o) are manipulating a virulently anti-NATO stance as their best hope to make it over the three-percent threshold to be seated in the next Rada.

19. (C) The October 2005 visit and provincial public outreach activities of NATO PermReps helped initiate a public dialogue process on NATO and Ukraine's Euro-Atlantic aspirations that needs to be built upon by official visitors, unofficial NGO/academic experts, Ukrainian government activities, and support from other Ukrainian interest groups, whether from civil society or the business sector. While some new NATO members like Slovakia, Hungary, and Slovenia successfully overcame similarly low numbers of public support for NATO, and others like the Baltics shared the legacy of Soviet domination and strong Russian resistance to their NATO aspirations, no other previous aspirant country had Ukraine's centuries-long close cultural, religious, and identity affiliation with Russia, complicating the public education process. That said, Bulgaria has historically had friendly relations with Moscow, and that was no impediment to its public's embrace of NATO.

20. (C) Moreover, as Yushchenko Security Policy Adviser Horbulin (a former close associate of ex-President Kuchma) notes, several years ago there was much higher (approaching 50 percent) support in Ukraine for NATO membership. That changed when Kuchma's relations with the West became troublesome, and the Ukrainian media started to report negatively about NATO. If the March 26 elections vote in a government interested in NATO membership, there will likely be the necessary information campaign to build up public support. The situation would look different if the next government did not share that enthusiasm for NATO.

21. (U) Visit Embassy Kiev's classified website at:
www.state.sgov.gov/p/eur/kiev.
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