

# UKRAINE'S FOREIGN POLICY AUDIT

## T TRUMAN

### INDEX OF RELATIONS

JANUARY – MARCH / 2017

№ 3





***Dear colleagues, partners and friends,***

TRUMAN Agency and IWP are happy to present our third issue of the “Index of Relations”. This publication offers in-depth analysis of the current situation in Ukraine’s foreign policy with several key partners: the EU, the US, China and Russia.

The way we calculate our index is that each foreign policy event – key public statement, meeting, agreement, decision – is given positive or negative points, depending on whether the event had a positive or negative impact on bilateral relations. The sum of points for events related to each partner form the Index of Relations with that country.

Over January-March 2017, Ukraine continued to develop its key bilateral relationships in a generally positive way, despite a high level of uncertainty associated with both Russian actions against Ukraine and the transition period of the new American administration.

In Ukraine–EU relations, the first three months of 2017 were broadly mutually beneficial for both Ukraine and the European Union. Dialogue between Brussels and Kyiv was fairly predictable and was less politicized than in the past. While the main issues on the bilateral agenda remain combating corruption and reforming Ukraine’s judiciary, Ukraine–EU relations also managed to reach a breakthrough on visa liberalization.

Much like Trump’s campaign slogan, Ukraine’s relations with the United States were guided by the principle, “America First”, with the main rationale being to establish and manage a relationship with the incoming administration that would keep the US as an active partner in deterring Russian aggression, if not as an ally of Ukraine. To that end, Ukrainian officials initiated a striking series of contacts in the Trump Administration.

As to relations with China, the beginning of the 2017 saw a surge in cooperation. Overall, the relationship with China has shown a steady trend towards improvement and has finally taken its place in the spotlight for Ukraine’s leadership, alongside the country’s other key bilateral partners, the US and the EU.

Russia keeps setting the negative record in relations with Ukraine: the overall points obtained by events during this quarter were twice as bad as in the previous Index. In the first trimester of 2017, Russia mostly made itself felt in covert operations, a major escalation in Avdiivka, and its position on trials pending in a number of international courts.

The special topic in this third issue of the Index of Relations is an analysis of Ukraine’s defense industry. While Russian aggression has been the main driver of developments in the country’s military-industrial-complex in the last three years, a number of serious obstacles facing the MIC can be overcome by expanding infrastructure and drawing international support.

We will be happy to share more details on these topics during our presentation of the third issue of the Index of Relations.

Thank you for your interest in Ukraine in the international context.

***Cordially,***  
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# RESEARCH METHODOLOGY

The publication “Ukraine’s Foreign Policy Audit. Index of Relations” is based on the monitoring and analysis of the events in the foreign policy of Ukraine by key areas: the EU, the US, China and Russia. The document is issued regularly, at least once every four months, to monitor the dynamics in the developments. In addition to the permanent areas, the expert group will provide an analysis of a special topic, i.e. the most important event, issue or trend for the reporting period. Besides by the experts’ observations, an important component of the research is exclusive interviews with Ukrainian officials responsible for certain areas in the foreign policy, Ukrainian and foreign diplomats. Furthermore, the document is based on numerous discussions with foreign opinion leaders and officials.

The report presents an analysis of foreign political events in Ukraine in each area, as well as that of the partner country’s (region’s) approaches to Ukraine within the period under research. The document discloses the context of the events and provides the assessment of factors that affect the country’s reputation. A forecast of the developments is made based on the facts presented.

Along with the qualitative analysis, the researchers have performed a quantitative analysis, assessing each area on a ten-grade scale.

## **Step criteria (0.5 points each):**

- Discussion
- Agreement
- Document signing
- Implementation commencement
- Finance allocation
- Political support
- Headline-making public statements
- Partial implementation of agreements
- New initiatives
- Full implementation of agreements.

A “minus” will be applied to the score if the criteria assessment is negative.

**Total score for the area** is the sum of points for the criteria, which characterize the area within the reporting period.

The expert group takes the BISS <sup>1</sup> methodology as the basis: they have developed a clear scale for foreign policy events assessment.

## **Event assessment scale:**

- Economic and political integration, entry of agreements for more intensive cooperation into force – **7-10 points**
- Signature/ratification of an important agreement (on cooperation, trade, tariffs etc., signature of agreements on integration), provision of loans or economic aid – **4-6 points**
- Official visits at the ministerial level (key ministers: Foreign Affairs, Interior, Defence, Economy and Finance), negotiations on the conclusion of agreements, Top level (President or Prime Minister) official visit by any of the parties – **1-3 points**
- Positive statements made by the key politicians of the state and by the Ministry of Foreign Affairs on the foreign policy direction, parliamentary resolutions – **1-2 points**
- Official visit at the vice minister (or non-key minister) level, a visit of a parliamentary delegation, exhibitions, business forums, national culture days, important diplomatic contacts and negotiations – **1 point**
- Negative statements made by the key politicians of the state and by the Ministry of Foreign Affairs on the foreign policy direction, parliamentary resolutions – **minus 1-2 points**
- Delays in agreement ratifications, denial of invitations to events, denial of support at the international level – **minus 2-4 points**
- Breach of an agreement or mutual obligations – **minus 3 points**
- Trade wars, antidumping investigations, boycott of goods, embargos, expulsion of diplomats, recall of ambassadors – **minus 4-6 points**
- Severing of diplomatic relations, provocations or hostilities – **minus 7-10 points.**

<sup>1</sup> BISS (Belarusian Institute for Strategic Studies). Source: <http://belinstitute.eu/ru/tags/индекс>

# UKRAINE – EU RELATIONS

January – March 2017

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*Positive: +59*

*Negative: -6*

*Overall: +53*

## SUMMARY

Broadly speaking, the first three months of 2017 have been mutually beneficial for Ukraine and the EU. The dialog between Brussels and Kyiv was fairly predictable in nature and less politicized this quarter, moving cooperation more in a technical direction.

On the positive side, Ukraine-EU relations saw a breakthrough in the visa liberalization process, which is now pending the approval of the Council and entry into force by mid-June. The ratification of the Association Agreement by the Dutch Parliament and the result of recent parliamentary elections gave cause for optimism regarding full ratification of the AA. Finally, despite outstanding issues on the EU-Ukraine agenda, especially the moratorium on the export of unprocessed timber, the EU approved and disbursed a second tranche, worth €600 million, of macro-financial assistance to Ukraine.

The top issues on the bilateral agenda are the fight against corruption and the reform of Ukraine's judiciary. Two issues that caused serious damage to Ukraine-EU relations were inconsistencies in selecting an auditor for NABU and amendments to the law on e-declarations. Both prompted a negative response from the EU at various levels, as they were interpreted as backtracking on the fight against corruption.

### **Events in Ukraine-EU relations (January-March 2017). Point-based evaluation**

Date	Event	Points
January 17	State Aviation Service signs an agreement to converge certification during a meeting with the European Commission	+3
	Twining project is launched with State Border Service.	+1
January 31	EU Spokesperson issues a statement on the human rights situation in Crimea.	+2
February 1	The EU in cooperation with Denmark launches the Anticorruption Initiative in Ukraine with a €16 million budget.	+1
February 8	Ukraine ratifies the Agreement on Cooperation between Ukraine and the European Organization for Justice.	+3
	The Government passes a Decree "Approving the Action Plan in preparation for introducing a Common Aviation Area between Ukraine and European Union and its Member States."	+2
February 10	The European Investment Bank (EIB) launches a new program to support the private sector in Ukraine.	+3
February 13	The European Parliament approves the suspension mechanism for its UA visa-free regime.	+3
February 20	The EU allocates €18 million of humanitarian aid to victims of the conflict in eastern Ukraine.	+4
February 22	Ukraine ratifies an Agreement between Ukraine and the EU on Ukraine's participation in the EU Competitiveness of Small and Medium Enterprises program (COSME).	+2
February 23	Dutch Lower House of Parliament ratifies the EU-Ukraine Association Agreement.	+4
February 28	MEPs and Council negotiators agree to waive EU visa requirement for Ukrainians	+2
March 1-2	Ukraine and the EU start a high-level Ukraine-EU dialog on horizontal issues and individual industrial sectors and a number of working groups meet: <ul style="list-style-type: none"> <li>• on eliminating technical barriers to trade;</li> <li>• on SMEs;</li> <li>• on cooperation in the space sector;</li> <li>• on public procurements;</li> <li>• on industrial issues (automotive).</li> </ul>	+2
March 2	The Committee of Permanent Representatives of EU member states (COREPER) approves the decision on visa liberalization for Ukraine.	+3
March 3	The EU Council extends the decision to freeze the accounts of 15 persons suspected of embezzling state property of Ukraine or abuse of power that led to budgetary losses for Ukraine—until March 6, 2018.	+4
March 7	The European Union issues a statement in support of NABU and SAPO and notes the need to establish anti-corruption courts.	-2
March 9	The European Parliament Committee on Civil Liberties, Justice and Home Affairs (LIBE) passes final reading of a resolution to add Ukraine to the list of third countries for whose nationals visa requirements are waived.	+3
	The US Embassy and the EU Delegation in Ukraine issue a statement on the NABU audit.	-2
March 13	The Council extends the validity of restrictive measures imposed against actions that limit or threaten the territorial integrity, sovereignty and independence of Ukraine—until September 15, 2017.	+3
March 15	An International Conference of EU Member States and Eastern Partnership countries on integrated management and a common border takes place in Ukraine.	+1
March 16	The European Commission approves the disbursement of a second tranche of macro-financial assistance to Ukraine worth €600 million.	+4
	The European Parliament urges Russia to free Ukrainian prisoners.	
	The EU-Ukraine Parliamentary Association Committee meets.	+2
March 17	On the third anniversary of the illegal annexation of Crimea and Sevastopol, the EU commits itself to continued non-recognition.	+3
March 24	New funding of €3 million under the Instrument Contributing to Stability and Peace is approved to provide timely and focused assistance to the OSCE, with satellite imagery.	+4
	EU Commissioner Johannes Hahn issues a statement on changes in Ukraine's e-declaration law.	-2

# UKRAINE-US RELATIONS

January – March 2017

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*Positive: +34*

*Negative: -6*

*Overall: +28*

## SUMMARY

“America First” is not merely a slogan that helped Donald Trump win the White House. It’s also the principle that has guided Ukraine’s foreign policy in recent months, as every effort was made to build bridges to the new US Administration. The main purpose of Ukraine’s “America First” approach was to maintain the United States, if not as an ally, then at least as an active partner in restraining Russia’s aggression.

So far, American officials see Ukraine’s efforts to establish ties with the new and still understaffed Administration in terms of Ukraine as having mixed results.

On one hand, at the point when Trump was elected president, Ukraine had a network of contacts that even some of the US’s closest allies might have envied, let alone the average Washington partner. On the other, all American sources, without exception, confirm that the problem for Ukraine is who and how represents it in Washington. And so it’s hard to understand what the state of Ukraine’s key message is and what is the meaning of the story about itself that the state of Ukraine wants to get across to the new US president and his inner circle. American diplomats also suggest that Ukraine avoid a situation where the process of building bridges with Washington leaves Ukraine’s potential supporters in Berlin and Paris dangling.

“The position of the newly-elected president and his team regarding Ukraine was one thing in December–January, and it has become something else in February–March,” says one highly placed official in the Ukrainian Government. Thanks to a slew of fact and factors unrelated to it, Ukraine has managed to slowly eliminate its title as “biggest international loser from the Trump victory.” Beyond this, there are a number of indicators that Ukraine’s strategy towards the US effectively lay in not only preserving what it had gained during the Obama years, but to try to get even more under Trump.

But in raising an ambitious bar of expectations, two things must not be confused: a more skeptical policy towards Russia on the part of the new Administration will not automatically make this White House pro-Ukrainian. Anti-Russian and pro-Ukrainian positions may typically go hand-in-hand in the political circles of many countries around the world, but they aren’t the same thing.

Job One for Ukraine’s foreign policy is to make Ukraine attractive to the new Administration, regardless of the dynamics of US relations with Russia. Since this is not an easy task, what remains is to take maximum advantage of the point when disenchantment with Russia opens the door to greater interest in Ukraine.

### **Events in Ukraine-US relations (January-March 2017). Point-based evaluation**

Date	Event	Points
January 12	The US Senate considers a bill by Senator Cardin to challenge the RF's hostile acts. The second part of the bill makes the effect of the sanctions instituted by President Obama for Russia's actions in Ukraine binding.	+1
	In the US House of Representatives, Bill 463, the Crimean Annexation Non-Recognition Act is brought to the floor again. This bill establishes US policy of not recognizing, de jure or de facto, RF sovereignty over Crimea, its airspace or its territorial waters.	+1
January 16	US Vice President Joe Biden arrives in Ukraine for a farewell tour during which he talks to the President and Premier of Ukraine.	+1
January 19	In an interview with the Wall Street Journal as part of the WEF in Davos, President Poroshenko says that he expects to meet with the new US president, Donald Trump, in February 2017.	-1
January 31	The US State Department issues a statement calling for a ceasefire as the conflict escalates around Avdiivka and reaffirms US support of complete compliance with the Minsk accords.	+1
February 2	The STAND for Ukraine Act (H.R.830) is brought out for second reading in the US House of Representatives. At this time, 33 representatives of both parties support the bill.	+1
	In her maiden speech at the UN Security Council, US Ambassador to the UN Nikki Haley focuses on Russia's aggression against Ukraine, condemning the aggression in Donbas and demanding that the Russian Federation stop the escalation. Ms. Haley also confirms that US sanctions over Crimea will be maintained until the peninsula is returned to Ukraine's control.	+1
	In a letter to the President of the United States, Senator John McCain, chair of the Senate Armed Forces Committee, called on Donald Trump to provide Ukraine with lethal weapons.	+1
February 5	In a telephone conversation, the presidents of Ukraine and the United States confirm that they will work together to restore peace on the borders of Ukraine and discuss the options for a future meeting.	+2
February 8	A group of Senators brings a bill to the upper house of the Congress called the Russia Sanctions Review Act, whose main purpose is to ensure that the final decision about sanctions against Russia will lie with the Congress.	+1
	Ukraine and the US sign the Foreign Account Tax Compliance Act or FACTA, an intergovernmental agreement, to improve transparency on tax issues between the two countries. Signing FACTA will allow Ukrainian banks to provide information to the IRS regarding the bank accounts of American citizens.	+1
February 14	Michael Flynn resigns as National Security advisor to President Trump. Flynn favored normalizing relations with Russia in order to counter Islamic State.	+2
	White House spokesman Sean Spicer announces that the US President has made it clear that he expects the conflict in eastern Ukraine to be de-escalated and Crimea to be returned to Ukraine.	+2
February 15	The House of Representatives considers a bill to review sanctions against Russia and to ensure that the final word on this issue will be with the Congress.	+1
February 16	Ukraine's FM Pavlo Klimkin travels to the US on a working visit, where he meets with the Deputy Secretary of Defense Robert Work. During their talk, Work reconfirms US support for reforms in Ukraine's security sector.	+0,5
	The US Embassy issues a statement expressing concern over the blockade of coal deliveries from ORDiLO to the rest of Ukraine and calls on all sides to resolve the confrontation before the situation deteriorates further. The statement also calls on the Government of Ukraine to speed up modernization in the electricity sector.	-1
February 17	President Poroshenko and US Secretary of State Rex Tillerson speak over the phone about ways of countering Russia's aggression and restoring Ukraine's sovereignty.	+1
February 18	President Poroshenko and US Vice President Mike Pence talk during the Munich Security Conference, after which Poroshenko states that Pence is well-informed about the situation in Ukraine and that the country is an important foreign policy priority for the US.	+3
February 19	The New York Times reports that Ukrainian MP Andriy Artemenko (RPL) has been trying to present a plan to resolve the conflict between Ukraine and the Russian Federation to members of the Trump team that involves withdrawing Russian troops from eastern Ukraine and organizing a referendum to lease Crimea to Russia for 50-100 years.	-1
February 20	The State Department issues a statement on the third anniversary of the tragic events on the Euromaidan and calls on Ukraine's political leadership to speed up reforms to honor the memory of those who died.	+1
	President Trump appoints Herbert McMaster National Security Advisor. Shortly afterwards, McMaster calls Russia one of the main threats to the existing world order.	+1



### **Events in Ukraine-US relations (January-March 2017). Point-based evaluation**

Date	Event	Points
February 28	The US ambassador to the UN issues a statement at a Security Council meeting that Russia must carry out its obligations under the Minsk accords, including a proper and complete ceasefire, and the withdrawal of all heavy weapons, and providing access to OSCE monitors.	+1
March 7-8	Ukrainian FM Klimkin visits the US again and talks with SecState Tillerson and NS Advisor McMaster. Klimkin says that Tillerson reassures him that the Ukrainian issue will be a separate priority in US foreign policy and Ukraine will not become a bargaining chip. Klimkin reports that he has also participated in a hearing in the US Senate.	+2
March 7	During a State Department briefing, Mark Toner notes that sanctions against Russia will not be eased until it fulfills its obligations in eastern Ukraine and Crimea.	+1
	A joint statement by the US Embassy and the EU delegation praises the actions of SAP, the special anti-corruption prosecutor, and NABU in arresting SFS boss Nasirov, noting that this case made it clear that a special anti-corruption court needs to be set up.	+1
March 8	The House of Representatives passes the defense budget for 2017, which allocates US \$150mn to improve Ukraine's defense capabilities and carry out joint military exercises.	+2
March 15	Ukraine and the US sign an intergovernmental agreement on financing US \$54mn through USAID to continue combating corruption and carrying out reforms.	+1
March 16	State Dept. Deputy Spokesman Mark Toner notes that Ukraine's blockade of ORDiLO could have dangerous consequences and that the US would like to see the situation resolved.	-1
	The State Department reaffirms non-recognition of Russia's annexation of Crimea and continuing sanctions until Russia returns the peninsula to Ukraine.	+1
March 21	The US supports Ukraine's claims against the RF in the WTO regarding Russia's attempts to restrict Ukrainian transit through Ukraine's own territory.	+0,5
March 22	The Verkhovna Rada passes Resolution №6111 in which it appeals to the US Congress and the Presidential Administration to grant Ukraine status as "Major non-NATO ally" and to sign a bilateral defense agreement.	+0,5
March 23	The US Embassy in Ukraine refers to amendments to the law on e-declarations that add a requirement for representatives of CSOs working on corruption issues to declare their incomes as "a step backward."	-2
March 28	US Ambassador Marie Yovanovitch attends the launch of the "New Face of the Border" project, which is intended to improve services to travelers and prevent corruption at border crossings. The project involves the law enforcement department of the US Embassy in Ukraine.	+0,5
March 31	SecState Tillerson affirms at a meeting of the Ukraine-NATO Commission that the US will not drop sanctions against the RF as long as Russia refuses to stop the actions that led to sanctions in the first place. For the first time a US government official admits that, unless the security situation in eastern Ukraine improves, there can be no progress in the political components of the Minsk accords.	+1

# UKRAINE-CHINA RELATIONS

January – March 2017

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*Positive: +27*

*Negative: 0*

*Overall: +27*

## SUMMARY

The main event in Ukrainian-Chinese relations during the first quarter of 2017 was a meeting between President Poroshenko and PRC President Xi Jinping at the World Economic Forum in Davos on January 17. During their meeting, Xi Jinping noted that China supported the territorial integrity and sovereignty of Ukraine and the choice of the Ukrainian people. Poroshenko expressed the hope that China would support a peaceful resolution to the situation in Donbas and a stop to Russia's aggression against Ukraine, and the restoration of Ukraine's territorial integrity, including Crimea.

This meeting not only managed to end the risks that had arisen during a period of uncertainty in bilateral relations but also ensured the further development of Ukrainian-Chinese relations in two key ways: an official state visit at the highest level and the Third Session of the Commission on Cooperation between Ukraine and the PRC, both of which are supposed to take place this year.

The main item on the agenda for this Third Session of the Intergovernmental Commission is a discussion of the status quo and prospects of major investment projects that were included on the agenda in the Program for a Strategic Partnership between Ukraine and China approved back in December 2013. Although the "Air Express" project is pretty much dead, there are two large Chinese lines of credit still available: a grain credit worth US \$3 billion and an electricity credit worth US \$3.6bn. At the end of Q1'17, the grain credit appears to be secured. The electricity credit unfortunately expires in December 2017, so the options there remain complicated by unresolved issues.

However, this quarter has shown that interest in wide-ranging cooperation in Ukraine's farm sector and food production continues to grow in China.

China has also been paying attention to Ukraine's need to upgrade infrastructure, evidenced by its inclusion of Ukraine in the development of the New Silk Road that is supposed to link Europe and China. This is clearly demonstrated in the fact that Chinese corporations are involved in building new bridges across the Dnipro River. Links between Ukraine and China in IT have also become more active since late 2016, as have been humanitarian links and regional cooperation.

Altogether, it's clear that Ukrainian-Chinese relations have moved to a new level and show a steady tendency towards improvement. China is once again a component in Ukraine's foreign policy and is moving to center focus in the Ukrainian government.

### **Events in Ukraine-China relations (January-March 2017). Point-based evaluation**

Date	Event	Points
January 4	President Poroshenko congratulates Chinese President Xi on the 25th anniversary of diplomatic relations between the two countries.	+1
	Chinese President Xi congratulates Ukraine and its people on the 25th anniversary of diplomatic relations between the two countries.	+1
January 13	China presents the Ukrainian MFA with telecommunications equipment worth nearly US \$100,000.	+1
January 17	During the World Economic Forum in Davos, Presidents Poroshenko and Xi meet to talk.	+5
	During an official reception on the 25th anniversary of diplomatic relations between Ukraine and China, Chinese Ambassador Du Wei notes the growing cooperation in 2017, especially in trade.	+1
	A delegation from Vinnytsia Oblast led by First Deputy Governor A. Hyzhyk arrives in China on a working visit.	+0,5
January 19	Deputy MEDT Titarchuk and officials from MEDT's Department of Tourism and Resorts, the MFA, and Ukraine International Airlines (UIA) meet with officials from the Chinese Embassy in Kyiv.	+1
January 20	A Chinese inspection group holds a working meeting with specialists from the State Food Safety and Consumer Protection Service of Ukraine.	+0,5
	A celebratory event takes place at Boryspil International Airport in honor of the Chinese New Year and 25 years of diplomatic relations between Ukraine and PRC.	+0,5
January 25	Kyiv City Council issues a press release announcing that the China Road and Bridge Corporation (CRBC) will be developing the Greater Ring Road, the Nyvky-Brovary highway and an interchange at the Shulavska Metro station.	+0,5
	Smart Mentor, a Chinese investor, buys the Sumy professional FC.	+0,5
January 28-30	Lviv celebrates the Chinese New Year.	+0,5
February 2	During a session of the UN SC regarding the intensified conflict around Avdiivka, the Chinese representative notes that China is paying close attention to the situation in Ukraine and is concerned about the latest escalation, which has led to civilian deaths.	+2
February 7	The National Academy of Fine Arts and Architecture opens a show called "New Silk Road: Renowned Chinese painters and their pupils" in Kyiv, in honor of the 25th anniversary of diplomatic ties between Ukraine and PRC.	+0,5
February 8	National Broadcasting Corporation President O. Nalyvaiko and Deputy Director of the Main Administration of the Press, Printed Press, Broadcasting, Cinematography, and Television Xian Kin sign a memorandum of cooperation between the NBC and its Chinese counterpart.	+1
February 12	The Cabinet of Ministers holds a working meeting to discuss investment projects related to Ukraine-China cooperation, chaired by First Deputy PM and Minister of Economic Development and Trade S. Kubiv.	+1
February 13	Odesa Governor M. Stepanov meets with Chinese Consul in Odesa Madame Cao Xianjun.	+0,5
	Kirovohrad Governor S. Kuzmenko meets with members of the Academy of Agricultural Sciences of the city of Xuzhou in Jiangsu Province, China.	+0,5
February 14	National Guard Commander Lt.-General Yuriy Allerov agrees with the Chinese Military Attaché Sr. Col. Xiao Siaojian to expand cooperation between the Guard and the People's Armed Militia in China.	+2
February 16	President Poroshenko announces that he has agreed with Polish and Chinese partners to modernize Ukraine's power-generating companies.	+1
February 28	The Chinese Association of Friendship Abroad organizes a celebratory evening in Beijing in honor of 25 years of diplomatic relations between Ukraine and China.	+0,5
	The Ukrsadprom Association and China Haisum Engineering Co., Ltd. sign a Memorandum of Mutual Understanding.	+1
March 10	Lviv Governor O. Syniutka meets with Trade Counsellor Liu Jun of the Chinese Embassy in Kyiv.	+0,5
March 15	State Food and Grain Corporation (DPZKU) President O. Hryhorovych announces that CCEC, a Chinese company, is prepared to invest in the reconstructing the port elevator in Mykolayiv.	+0,5
March 16	UkrZaliznytsia President Wojciech Balczun starts a working visit to China.	+0,5
March 22	China agrees to reduce the interest rate on its line of credit to the State Grain Corporation of Ukraine.	+0,5
March 27	At the Summit of GUAM members in Kyiv, PM Groyzman announces deeper cooperation in the Black Sea-Caspian basin as a component of developing China's "One Belt, One Road" strategy.	+2

# UKRAINE-RUSSIA RELATIONS

January – March 2017

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*Positive: +1*

*Negative: -62*

*Overall: -61*

## SUMMARY

The start of this year looked very promising for Russia, based on political developments around the world. The Kremlin was counting on fruitful results from an upcoming electoral season in key European capitals. Based on the mood during his election campaign, warmer relations were due between Washington and Moscow with the coming of Donald Trump to power in the US. The Kremlin also expected a crisis in relations between Kyiv and Brussels, over the collapse of visa-free talks, over a failure to get the Association Agreement ratified across the EU board, or over the failure to implement the Minsk accords. But US relations have not warmed up, Ukraine's visa-free regime with the EU has gone into the home stretch, and the US and EU continue to support Ukraine. Nor are things looking especially pink for Russia's bets in the French and German elections at the end of the first quarter.

Moscow's much-expected victorious political and diplomatic blitzkrieg against Ukraine has been postponed—if not actually squelched. One severe test in the last three months was the military standoff outside Avdiivka at the end of January–early February. It proved to be a very clear demonstration of Russia's real purpose: to restore dialogue with key world players and to discredit Ukraine as much as possible.

In the meantime, a kind of competition emerged between Ukraine and Russia as to who would be first leader, Poroshenko or Putin, to meet with their American counterpart. On the home front, it came out that there had been at least two telephone conversations between the presidents of Ukraine and Russia in the last three months. Last August, after much-ballyhooed supposed sabotage in Crimea planned by Ukrainians, Vladimir Putin had refused any and all contact with the Ukrainian president. This time, it's likely that one of the topics discussed was the blockade of occupied Donbas.

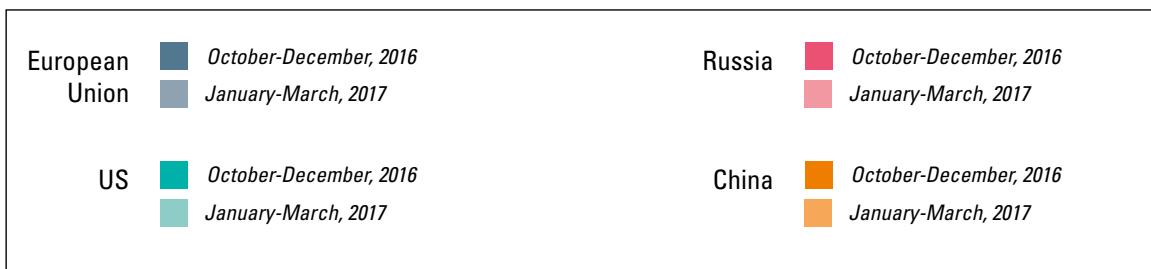
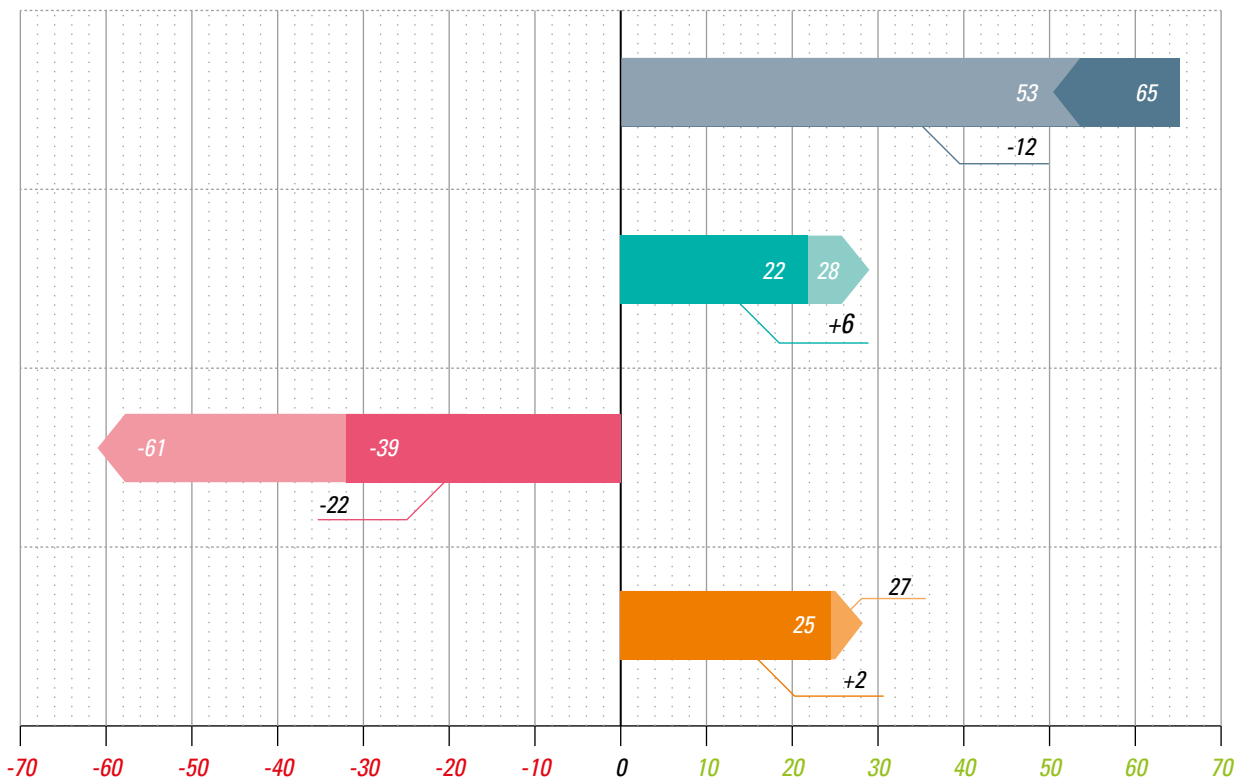
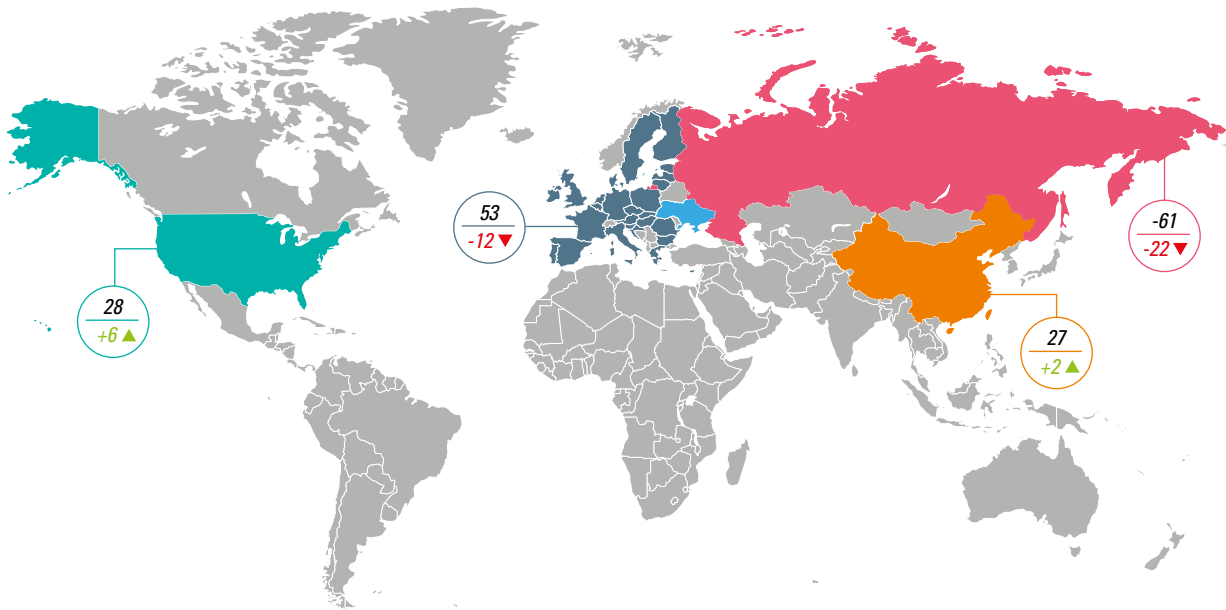
The last three months, like the last three years, saw any number of special ops taking place. It seems that these now constitute the essence of Ukrainian-Russian relations: special ops instead of co-ops. As economic, political and other kinds of cooperation decline between the two countries, the number of special operations being announced has grown. The blockade of the occupied territories, Russia's recognition of documents issued to Ukrainians by the illegal statelets, the murder of a former Russian MP—all of these Ukraine considers special operations organized by Moscow.

Meanwhile, Ukraine has placed a good part of its bets on international law in the hopes of standing up for its position and finding justice against Russia's aggression. The case before the International Court of Justice in the Hague is probably the key suit among all the claims submitted by Ukraine to various world courts, ranging from the case of the "Yanukovich loan" of US \$3 billion that is being heard in London and the arbitration of a natural gas dispute between Kyiv and Moscow being heard in Stockholm, to claims before the European Court of Human Rights in Strasbourg.

**Events in Ukraine-Russia relations (January-March 2017). Point-based evaluation**

<b>Date</b>	<b>Event</b>	<b>Points</b>
January 16	Ukraine submits claim against Russia to the International Court in the Hague.	-7
January 23	NSC Secretary announces that Russia has moved into a new phase in its hybrid war against Ukraine, political terrorism—killing political and community activists.	-2
January 25	A number of MPs announce the launch of a permanent blockade of ORDiLO. Rail movement is blocked in Luhansk Oblast.	-5
January 29	The conflict outside Avdiivka intensifies. By February 10, President Poroshenko reports that 15 soldiers and 1 rescuer have been killed in battle.	-9
February 2	The UN Security Council holds an emergency session in which most participants condemned Russia's aggression outside Avdiivka.	-2
February 8	A field commander of the Russian proxies, Mikhail "Givi" Tolstikh, is killed. Putin's spokesman calls the assassination "an attempt to destabilize the situation in the Donbas," suggesting that Ukraine was involved.	-1
February 18	A field commander of the Russian proxies, Mikhail "Givi" Tolstikh, is killed. Putin's spokesman calls the assassination "an attempt to destabilize the situation in the Donbas," suggesting that Ukraine was involved.	+1
	Russia recognizes documents issued by LNR and DNR.	-7
March 1	The "nationalization" of enterprises operating legally in Ukraine begins in the occupied territories of Donbas.	-7
March 6-9	Hearings begin in the International Court of Justice over Ukraine's lawsuit against Russia.	-7
March 9	Russia's Prosecutor General denies claims that Viktor Yanukovich had appealed to the RF to interfere militarily in Ukraine in 2014.	-2
March 15	The NSC passes a resolution halting all freight movement across the line of contact.	-6
March 19	The agencies that will be engaged in "integrating Donbas in the RF" are announced in Crimea.	-3
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# SPECIAL TOPIC

## REBUILDING UKRAINE'S MIC: A JOINT EFFORT

Russia's aggression revealed a slew of problems that have long existed in Ukraine's security and defense sector. For the third year running, the government has been trying to resolve these issues with the help of international donors and its own resources, with mixed results. The key element in this process is, without doubt, developing the domestic defense industry, which is the main factor in rearming the military and attracting western investors. To date, however, it's too soon to say that all the necessary conditions for defense manufacturers to work effectively as a state system or that the evident industrial potential is being realized.

Russia's occupation of Crimea and its further military aggression in Donbas became the catalysts for domestic development and manufacturing of military equipment and arms to sharply pick up pace, in both the private and the public sectors. Still, the defense industry was oriented towards exporting and ties with Russian enterprises for decades, and it proved unable to quickly supply its own army. Moreover, historically, the arms being produced in Ukraine could not completely cover the needs of the Armed Forces in a broad range of weapons and military equipment.

For instance, Ukraine has never manufactured combat aircraft, or anti-aircraft defense system, aircraft carriers, naval weapons, attack, strategic or tactical UAVs (drones), combat helicopters, many guided air weapons, most ammunition, small arms, and much more. Undoubtedly, two components have to play a major role in this situation: international assistance and maximum mobilization of the country's own resources. Still, this has not been as straightforward as one might have hoped.

### International assistance

With the constant threat of armed escalation in the Donbas region, Ukraine's leadership has more than once turned to the international community with requests for military support, including helping organize military technical cooperation between domestic and foreign companies. Finally, at the NATO summit in September 2014, the members of the alliance agreed to provide more support to Ukraine. Six trust funds were set up that were intended to improve things such as logistics, cyber security, management, communications and so on. In short, foreign assistance amounted to the supply of non-lethal materiel and services. As of March 2017, NATO had provided assistance to Ukraine worth nearly €35 million. Field exercises were held for more than 2,000 Ukrainian service personnel and civilians.

Beyond NATO, major countries also helped improve Ukraine's defense capabilities. Altogether, according to the Defense Ministry, as of H2 2016, the Ukrainian Armed Forces received material, technical and humanitarian assistance from various countries worth nearly UAH 3 billion or €100mn between 2014 and 2016.

**Note:** As part of technical assistance from the US, Ukraine received: material, medical and technical goods worth around UA \$111mn, including expensive medical equipment, first aid kits, armored HMMWV-type vehicles and spare parts, multi-channel Harris radios, night vision equipment, a chemical lab for rapid analysis of chemical substances, demining equipment, AN/TPQ-36 firefinder radars, tactical gear, summer and winter camouflage uniforms, body armor, kevlar helmets, scarves, sleeping mats, and microfleece caps. As part of its humanitarian assistance, the US gave the UAF a mobile field hospital, food kits, generators, and indoor heaters, and gave the Air Force diving gear and

*other equipment. In addition, they bought Ukraine a slew of weapons and military equipment, including RQ-11B Raven Mini-UAVs or drones.*

*At the beginning of the year, the US is planning further assistance. On December 8, 2016, the US Senate approved the US Budget for 2017, which includes US \$350mn in assistance to Ukraine in the defense sector. Former US President Barack Obama signed it into law.*

*Canada has shipped ballistic masks aka facial armor to the Ukrainian Armed forces, as well as night vision equipment, body armor, kevlar helmets, sleeping bags, and a huge quantity of winter clothing. Poland sent up bedding, long-lasting rye bread, dried rations, and other goods worth nearly US \$10mn. Australia sent winter clothing worth over US \$4.5mn. Great Britain sent goods and medical supplies, tactical gear, winterized diesel fuel, night vision gear and GPS navigators. China sent equipment for an ophthalmological clinic. Slovakia sent power generators, lighting kits, plastic dishes, sleeping bags, other goods and a broad range of medical equipment. Turkey sent basic goods. France sent body armor and medical supplies worth around US \$600,000. The Netherlands sent power generators and winter supplies worth US \$500,000. Spain sent body armor and kevlar helmets, Czechia and Albania sent equipment and clothing, Norway, Latvia, Denmark and Japan sent a variety of equipment.*

*The UAF have decided that their priority for 2017 is to expand the marines and navy. The US has already been providing Ukraine's fleet with advice in a number of areas: expanding anti-mine capacities, training marine units and naval officers, setting up a maritime situational system, and developing a system of administration and personnel management for the Navy. Over the past two*

years, the Ukrainian Navy received high-speed boats, diving gear and communication equipment from the US.

Ukraine's Navy has received assistance from the UK in the form of training marine sergeants, while Italy has helped train service personnel in amphibious operations, and Turkey has trained seagoing crews. Sweden, Norway, Bulgaria, Romania and other countries have helped Ukraine develop the Navy command and administration system.

In addition to this, the US, UK, Italy, France, Poland, Bulgaria, and Romania have been assisting the UAF in training future naval officers through courses and practica on warships for cadets from the Naval Institute.

Over the next few years, the US is also expected to provide assistance in developing marine situational systems, increasing the capacity of the naval fleet, the marines and select units of the Navy, and expanding coastal infrastructure.

One of the key areas in which Ukraine's defense industry has been getting support is in instituting NATO standards. In summer 2016, the management of UkrOboronProm, the state munitions corporation, announced that it was starting to put together system for testing developments, upgrades, the manufacture and repair of weapons and military technology to NATO standards under real conditions. This project is being sponsored by the NATO Communications Office in Ukraine. Technical standards that govern the application of AQAP 2000 series management systems and quality control will be applied at all stages of the life-cycle of weapons

This, however, is actually not enough. For Ukraine to receive lethal weapons that would ensure effective defense against Russian aggression would be a much more important factor in improving the country's defense capabilities. Over 2014-2016, aid to Ukraine's defense sector was very limited. In its attempts to purchase munitions on the open market, Ukraine was not given any breaks. On the contrary, some European countries refused to sign contracts for the delivery of military equipment and munitions. And foreign companies found it impossible to operate successfully in Ukraine, too.

All told, a slew of different factors affected the development of military cooperation with other countries in terms of receiving weaponry. These can be grouped into external and domestic factors:

*External factors include such aspects as:*

- the international political and economic situation around the world. This had a serious impact and continues to influence the organization of military technical cooperation, both in terms of buying and selling of arms, and in the links between manufacturers of munitions. (For a long time now, the question of delivering arms to Ukraine has depended on who is president in the United States, how harmoniously relations between Ukraine and other countries are evolving under the current historical circumstances,

what foreign policy orientation the leadership of potential partner countries has, and so on);

- export regulations in individual countries that forbid selling weapons and military equipment to countries that are in a conflict situation. This is the case with Norway and a slew of other European countries;
- the ripple effect of the sanctions instituted by western countries against the Russian Federation. These have indirectly affected Ukraine as well. Domestic firms are regularly refused when they try to buy software, equipment and spare parts or ready-made weapons abroad because of the risk of high-tech military products or dual-purpose goods finding their way to Crimea or occupied Donbas and thence to Russia;
- reluctance among the military and political leadership of individual countries to get into a conflict of interests with the RF. This is particularly true of countries with close economic ties with Russia, where Russian influence is quite significant, such as Hungary and Italy;
- previous experience of collaborating with Ukraine among foreign manufacturers, prior to the occupation of Crimea and the start of the war in Donbas. For instance, a number of international defense projects being carried out on behalf of Ukraine's Armed Forces stopped looking promising some time ago. One example is developing a corvette for Ukraine's navy in cooperation with a number of leading international companies and upgrading the Mi-24 helicopter with France's Sagem. Too often the implementation of these projects is given to foreign partners as an example of how difficult it is to cooperate with the Ukrainian side.

*Domestic factors include:*

- the poor quality of domestic legislation and the absence of structural changes in the way Ukraine's defense industry is run. In the last three years, a slew of important basic laws on security and defense have been passed, but the proper conditions for international manufacturers to want to invest developing the country's MIC are still not in place. Nor is there an effective algorithm for interacting with foreign manufacturers in the defense sector. Ukraine's main state-owned defense enterprise, UkrOboronProm, still hasn't been corporatized, despite plenty of talk on the subject. SOEs still don't have the right to set up JVs with foreign partners to manufacture munitions, with the exception of Antonov, the aviation giant. And so on. All this leads, among others, to a slew of promising projects with foreign partners being on hold to this day. For instance, there was a major announcement about a joint enterprise with Lubawa, a Polish manufacturer of body armor, and a few other such projects are facing enormous organizational, financial and bureaucratic hurdles on the Ukrainian side. Western defense companies are not happy to consider propositions for projects in which 51% is supposed to belong to the state and that



no one in Ukraine is prepared to paying royalties to the developers of military technology;

- overly dilatory access key documents that allow potential partners to see the prospects of industrial development and actual domestic demand. One example is the adoption of the Concept for a State Targeted Program to Reform and Develop the Military-Industrial-Complex through 2020. Moreover, only after three years of constant war, on March 22, 2017, did the President of Ukraine bring into effect the State Program to Develop the Ukrainian Armed Forces through 2020;
- a high risk of corruption that has not, unfortunately, improved significantly since the war began. So far, the newly-established anti-corruption agencies have not demonstrated their full capacity.

If the situation does not improve radically in the next three to five years, any strengthening of the country's defense capabilities and its military will effectively have to be based entirely on the government's own possibilities, which are not exactly all-encompassing.

## The domestic market

Nevertheless despite all these problems, Ukraine's defense sector has managed to display some considerable achievements.

1. Feeling that it was needed, the defense industry has come to life again and begun to work to supply domestic demand to the extent that it was capable, and even more. A slew of new players showed up while the old ones began to expand their product lines. The private sector side of the MIC grew substantially and soon began to catch up to the state side. Lately, it has taken over the initiative in terms of volume and services offered. For instance, while in 2015 state defense procurements from companies that form UkrOboronProm amounted to 67% and the remaining 33% went to variously owned companies, including private ones, in 2016 things shifted dramatically, with the state giant getting only 38.9% of the orders while 61.1% went to others. For one thing, new ideas come to life several times more dynamically in the private sector than in the state sector.

**Note:** According to the Ministry of Economic Development and Trade (MEDT), Ukraine currently has 166 state-owned companies and 92 private ones, with 133 of the defense companies being part of the UkrOboronProm conglomerate. Of these, 6 exporters of high-precision weapons and ammunition, and around a dozen plants and R&D bureaus are effectively on territory occupied by Russia. A significant portion of defense companies, 25, are part of the State Space Agency of Ukraine (SSA) and the Defense Ministry runs an additional 8 specialized plants, mostly enterprises that restore weapons and military equipment. Some companies belong to other ministries: MEDT operates four, MIA operates two, and so on.

In the private sector, companies like Praktyka, MotorSich, Tekhimpex, Ukrspetstechnika, Adron, Leninska Kuznia—

which has been renamed Kuznia na Rybalskomy—, Stiletto Ukraina, Temp-3000, Atlon Avia, UkrSpecSystems, Telekar-Prylad, UA.RPA, an advanced research project agency, and many more are operating successfully today.

Still, private companies are not yet financially strong enough to take on large projects. It's one matter when they have to develop a small drone, but another matter altogether when what's needed is an air defense system or an aircraft worth many times more. This is where the state must come into play.

What needs to happen now is for a series of enterprises to be divested from UkrOboronProm, including, but not only, the Luch R&D Bureau, the Kyiv, Lviv, Zhytomyr and Mykolayiv tank factories, the Malyshev tank factory in Kharkiv, the Morozov Machine-Building R&D Bureau in Kharkiv, and the Mayak Plant. In addition to producing new equipment, they are busy repairing and upgrading the existing arsenal of weapons on behalf of the Ukrainian Armed Forces and National Guard, which are at the forefront of raising Ukraine's defense capabilities.

Just since the beginning of 2017, the UAF have received somewhat more than 3,000 units of weaponry and military equipment, and almost 60,000 of ammo from state enterprises. However, these are not especially impressive numbers, given that the UAF have restored nearly 50,000 of its 54,000 pieces of military equipment using its own labor and material resources.

2. UkrOboronProm, like other state-owned and private companies, has pretty much completely stopped buying Russian parts and components. According to the corporation, only about 55% of components for military equipment and weapons were being manufactured in Ukraine at the beginning of the war: 10% were being imported from western suppliers and 35% came from the Russian Federation. Now, 70% are being manufactured in Ukraine while 30% come from the West. In 2016, 400 private and public companies across the country that together manufacture more than 1,700 substitute components, assemblies and spare parts were included in the import substitution program. For instance, the armored tank manufacturing branch already produces 87% of the parts needed in Ukraine and only 13% is currently being bought from western partners.

3. In the last three years, a slew of new models of weapons and military equipment have appeared on the market. Some of them are already being supplied to the army, including in the war zone. These include a line of various 4x4 vehicles: Kozak-2 from Praktyka, BARS-8 from Bohdan Motors, the Cougar and Spartan from AvtoKrAZ, and the Triton from the Kuznia na Rybalskomu plant. Some of them are already being used in the field. For instance, 64 Kozak-2s have come off the assembly lines and are being used by the State Border Service and the National Guard. At least 120 armored KRAZ Spartans and Cougars have gone to a series of enforcement agencies, and a few Tritons are being used by border patrols as well.

Fury A1-C drones by Atlon Avia are already operating successfully, as are PD-1s from the Narodniy Proyekt

All-Ukrainian Volunteer Center and UkrSpecSystems, as is the multipurpose Leleka-100 from the DeViRo innovative manufacturing company, Carboline's Mara-2M, and Army SOS's Valkyrie. Not many assemblies have been shipped so far, but the main point is that the situation with munitions for the army has begun to change.

Privately-owned Motor Sich has been developing its new versions of helicopter models Mi-2MCB-V and Mi-8MCB-V on its own, but so far none have been handed over to the military. Meanwhile, UA.RPA has been developing a tactical reconnaissance and strike system, a laser-based sniper detection system, ballistic helmets, and a portable VHF modem for transmitting data in pseudo-random tuning of frequencies.

In addition to this, the Mayak Plant, part of the UkrOboronProm conglomerate, has developed a Molot 120-mm mortar that is being used in the war zone. Incidentally, UOP subsidiaries produced the first Ukrainian attack robot, Phantom, while Luch has been collaborating with State Space Agency enterprises to produce Vilkha rockets based on the Smerch MLRS.

On the other hand, the military is already using munitions developed since Ukraine became independent: anti-tank rocket assemblies like the Stuhna-P from the Luch Design Bureau, armored personnel carriers like the BTR-4 8x8 made by the Morozov Machine-Building Plant in Kharkiv and the BTR-3 from the Kyiv Tank Plant, the Dozor-B 4x4 from the Lviv Tank Plant, and a variety of navigation systems and much more. Since 2014, the National Guard has received at least 50 APCs of the BTR-4 type. Since that time, Kharkiv's Morozov Plant has been supplying orders from the Defense and Interior Ministries for nearly 200 BTR-4s. A bit more than 100 BTR-3 ACVs have been distributed among various forces agencies and the first 10 Dozor-Bs were transferred to the Armed Forces in summer 2016.

Nevertheless, all these achievements on the domestic market are overshadowed by a slew of problems. Right now, a clear state monopoly has been established and private defense companies are finding it very hard, even when they have competitive models of weapons and equipment, to be able to supply them in the interests of the country's military. At the same time, there is a definite pro-Administration lobby on behalf of certain private companies that either belong to members of the government or are under their control in some way and are clearly favored in the defense procurement process.

### ***The eternal question: How to respond and what do to?***

Over the three years of ongoing war, opinion in Ukraine has already come to the conclusion that increasing the country's defense capabilities under the current military and political circumstances depends entirely on Ukrainians themselves. The international aid being provided by partner countries is an important factor in raising capacity but it's merely a form of external support and cannot resolve all the problems facing Ukraine. The lion's share of vital challenges need to be dealt with independently.

The question of supplying the army with modern munitions depends completely on how smoothly and properly the state mechanism works in establishing internal conditions for available resources and capacities to be effectively used. To this end, the minimum that is needed is for an appropriate defense industry agency to be established to ensure that military logistics policy in building the defense industry is formulated as suitably, and that there is a healthy competitive environment and the same transparent rules apply to every company, public or private, in state procurements and foreign trade alike. The conditions for organizing investment in the industry also need to be liberalized and the legal conditions for setting up joint ventures between state companies and foreign partners ensured. The case of the Antonov aviation enterprise should not be an exception to the rule.

At the same time, the potential for working with foreign partners should be used to the maximum of efficiency, as that kind of cooperation will be the only way to overcome the limitations of the domestic defense industry. This also means Ukraine needs some success stories with foreign partners in terms of jointly coming up with new models of military equipment and systems. Here it makes sense to take advantage of cooperation with countries that are prepared to engage in really deep cooperation, such as Poland. Successful projects with Polish partners could help convince foreign partners that it is possible to cooperate in this sphere with Ukraine. So far, however, grand announcements about joint projects with Poland have not, in reality, led to anything so far.

Aside from that, it's important to establish common ground in the defense sector with the United States and European countries and to eliminate as many political, organizational, bureaucratic and other hurdles as possible.

But most importantly, Ukraine needs to understand, once and for all, that, under the current circumstances, all energy must be focused on resolving a single issue: to make its defense capabilities strong enough to withstand Russian aggression and keep it from expanding.







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