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Summary: Ukrainian President Viktor Yanukovich's government is widely seen as "pro-Russian" and is much less democratic than its predecessor. Yet it is engaged in negotiations with the European Union on the Deep and Comprehensive Free Trade Area (DCFTA) accord, whose provisions go far beyond the elimination of tariffs. Russia is pressing Ukraine to join the Russia-Belarus-Kazakhstan Customs Union (CU) instead, but Ukraine seems set on DCFTA. Moreover, Ukrainian officials now lament the 2010 Kharkiv Accord with Russia, which ended up giving Ukraine higher gas prices than those paid by EU members. Based on Russia's demonstrated determination to retain its predominance in its "sphere of privileged interest," its evident opposition to the DCFTA, and its efforts to persuade Ukraine to choose the CU instead, one should not overlook the possibility of a crisis in Ukrainian-Russian relations this year.

The views expressed here are the views of the author's alone and do not necessarily reflect the stance of the German Marshall Fund of the United States.

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The Two Ukraines

by Rajan Menon

Synopsis: A Looming Crisis?

Ukrainian President Viktor Yanukovich's government is commonly depicted in Western analyses as "pro-Russian" and much less democratic than the government of Viktor Yushchenko and Yulia Tymoshenko that followed the 2004-2005 Orange Revolution. The former characterization is not totally false, but an oversimplification, for reasons I will elaborate later. The latter assessment is on the mark: there has unquestionably been regress on the democratic front. This is apparent whether one considers the fairness of elections (which were held for mayors and regional councils in October 2010) or the freedoms accorded to the press and civil society, and Ukrainian journalist and civic leaders are not shy about making this point, even in Donetsk, a stronghold of Yanukovich's Party of the Regions (POR).

As for the government's "pro-Russian" reputation, there's certainly something to it. Consider, for example, the April 2010 Kharkiv Accord under which, in exchange for a supposedly advantageous gas prices for nine years (more on that below), Ukraine provided Russia's Black Sea Fleet a 25-year lease on its base in Sevastopol, with an additional five years as a option, or the revisions underway in school textbooks that are designed to cast the history of Russian-Ukrainian relations in a positive light and to paint an unflattering picture of the Orange Revolution. In addition, the Yanukovich cabinet contains individuals who openly call for alignment with Russia and are leery of the West; Dymtro Tabachnyk, Minister for Education, Science, Youth, and Sports, and an avowed foe of those advocating the development of a separate Ukrainian national identity, is Exhibit A in this regard.

On the other hand, Ukrainian officials now lament that the Kharkiv Accord, signed two months after Yanukovich took office, ended up giving Ukraine higher prices than those paid by members of the EU. They are also determined to sign the Deep and Comprehensive Free Trade Area (DCFTA) accord with the EU despite Moscow's evident displeasure and multifaceted pressure and its insistence that Ukraine join the Customs Union (CU) forged by Russia, Belarus, and Kazakhstan instead. During a recent visit, Ukrainian offi-

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cials insisted that the decision to join the DCFTA had been made and that, despite Russian pressure and unhappiness (which they acknowledged freely), Ukraine would not join the CU.

Moreover, the representatives of the Yanukovich government have not (as witness educational policy, official business cards, documents, street signs, and hotel brochures) abandoned the increasing use of the Ukrainian language. The leaders of the Ukrainian Orthodox Church linked to the Moscow Patriarchate spoke to us solely in Ukrainian and took pains to stress that Ukraine's distinctive national identity had evolved over 1,000 years and that Ukraine is part of the West. Yanukovich himself has worked to improve his Ukrainian and reportedly even gave a speech in that language in Russophone Donetsk. (At the same time, Yanukovich's regional allies in such places as Odessa, Luhansk, Donetsk, and Mykolaiv have downplayed the role of Ukrainian as the state language.)

The main take-away point from convergent opinions on hot-button issues (such as the DCFTA) among diverse Ukrainian leaders is that Russia is worried that Ukraine's decision to join the DCFTA — which, as I explain later, is far more than a free trade accord — represents a signal strategic choice, one that will likely diminish Russia's political influence in the country and weaken its capacity to achieve its longstanding aim of increasing its stake in major Ukrainian economic assets, notably Naftohaz Ukrainy, the state energy and pipeline company. Less concretely, since Ukraine has a special place in Russian strategic thinking by virtue of its location, history, and culture — which have tied it tightly to Russia for hundreds of years — there is bound to be a profound sense of loss as Moscow watches what it believes is Ukraine's decision to cast its lot with Europe at Russia's expense.

Based on Russia's demonstrated determination to retain its predominance in its "sphere of privileged interest," its evident opposition to the DCFTA, and its efforts to persuade Ukraine to choose the CU instead, one should not overlook the possibility of a crisis in Ukrainian-Russian relations this year. This could emerge from a last-ditch effort by Moscow to derail, or delay, the DCFTA accord between Ukraine and the EU by pressuring Ukraine to alter its course. This outcome is hardly inevitable — nothing in politics is — but with the EU already politically divided and now consumed by the continent's economic crisis, the United States heading into a presidential elections, and Americans preoccupied with their own economic woes, prudence demands that the possible modalities of a Russia-Ukraine crisis, and the appropriate responses, be considered carefully. The EU and Ukraine believe that the DCFTA will be concluded by the end of 2011. If they are right, the endgame is underway — and the stakes are high.

Domestic Politics: Backsliding on Democracy

There is little room for good cheer when one surveys Ukraine's internal politics. To begin with, there is a political vacuum in the country. To be sure, the Yanukovich government holds the reins, and on the basis of a fair election held in 2010, but given the rising prices of energy and food, high unemployment (8.4 percent in the last quarter of 2011), and deep and pervasive corruption, it is not now held in high regard by the citizenry. Over the past six months or so, Yanukovich's approval rating in opinion polls has plummeted from 60 percent to 14 percent — quite a feat, if one can call it that. His government is widely seen as incompetent, dishonest, and undemocratic.

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This should be good news for opposition leaders, but that's hardly the case. The public's view of them is scarcely more favorable given the persistent dogfights between Yushchenko and Timoshenko, the absence of a strong and charismatic leader (Timoshenko is busy fending off a corruption investigation launched by Yanukovich), and the deep divisions and demoralization in the "Orange camp" following its electoral defeat. The typical Ukrainian's attitude toward the political class seems to be "A pox on both your houses." The citizenry believes that those who hold power are out to enrich themselves and are disengaged from the economic problems facing ordinary men and women, whose sentiments they worry about solely when elections loom, if then.

The euphoria generated by the Orange Revolution has dissipated, and there is not a little public apathy. That suits the government just fine, though, should the already severe economic situation deteriorate, mega-corruption scandals surface, and the regime seek to rig the next parliamentary elections (set for October 2012). There is abundant discontent that could be mobilized in sudden and unexpected ways, not least because of the power of the "social media" and youth, which demonstrated their capacities recently during the so-called Arab Spring. Tellingly, despite the public's malaise, polls reveal that some 45 percent of Ukrainians still say they are willing to take part in street demonstrations. So Yanukovich and company are certainly not sitting pretty, and remain vulnerable to a perfect storm.

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Though Ukraine is a far cry from Russia in this respect, independent journalists and civic leaders and organizations are on the defensive under Yanukovich. This is so in part because of government restrictions. Outspoken investigative journalists are called in for "talks" on occasion. NGOs sometimes face audits and sundry inspections and, in any event, are dependent on Western money and find that local businessmen have little interest, or even sympathy, for their concerns, particularly when these relate to probing the ubiquitous corruption and cronyism. Journalists and civic organizations are also handicapped by inadequate professionalism in what is still a young country with a heavy Soviet legacy. Civic groups worry that, following the heady days of the Orange Revolution, Western governments and NGOs have lost their enthusiasm for fostering democracy and good governance in Ukraine, and that the West itself may be resigned to the authoritarian drift in Ukraine's politics. On the bright side, although it is fragmented, civil society remains vibrant, and there is a plethora of organizations devoted to a various causes. Fear of the government is notably absent, and a post-Soviet generation that will play an increasingly important role in politics and society is approaching adulthood.

Then there is corruption, which is omnipresent. It is not just an impediment to the development of a clean government and an independent judicial system; it is a source of widespread public animosity and cynicism as well, and neither sentiment provides fertile ground for the growth of the civic values that underpin democracy. The Yanukovich government has a bad reputation when it comes to corruption, and a senior Western diplomat's quip that Yanukovich is chiefly interested in "getting as rich as possible, as quickly as possible" reflects the public's perception.

That one of Yanukovich's sons, Oleksandr, is widely seen as the beneficiary of ill-gotten gains hardly helps the president's image. A journalist in Donetsk (a place friendly to the POR) said that the Druzhba Hotel in Donetsk and its land and adjoining areas were acquired for a song, and with no transparent tenders, and the hotel demolished by a firm linked to Yanukovich fils. The spontaneous protest at the site and irate complaints posted on the website of the mayor (a former Soviet apparatchik and current POR man named Alexander Lukyanchenko) were ignored by the local authorities. Said the journalist of Yanukovich's son, "How could a person in his thirties, a dentist with no business experience, amass a $130 million fortune? For this we need an explanation." That he related this story in a meeting attended by another journalist working for a paper linked to the mayor's office (and muttering her disapproval) points to both the depth of anger about corruption but also to the reality that, despite the backsliding in democracy, Ukraine's press and civic organizations remain outspoken

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and have not been muzzled or cowed. What is more, the government is sensitive about — if not to — the problem of corruption and insists that it is moving forcefully to eradicate what is a resilient pathology. When asked about this, members of the Yanukovich government responded that some 300 corruption investigations against officials — "100 of them high-ranking" — are underway, although it is unclear how many of these probes involve senior members of the current government.

A Westerner with extensive experience in Ukraine and deep knowledge about the country's investment climate estimates that Western companies spend 60 percent of their time battling corruption, negotiating the bureaucratic labyrinth and regulations (both of which feed corruption), and fending off local "corporate raiders," which was vastly more time than companies in the West devoted to familiarizing themselves with regulations in Western markets. Apart from the public's ire about corruption, the IMF (which disburses its $15 billion loan in installments, and only after its stipulated benchmarks on governance and reform are met) and the EU, as part of the DCFTA negotiations and the accompanying compliance standards, are watching the government's record in this domain. The question is whether corruption is part and parcel of Ukrainian politics, especially under Yanukovich, and an essential element in the dispensation of patronage to political allies, clans, and oligarchs — and the offspring of the elite. If so, asking Ukraine's rulers to eradicate dishonesty may be akin to asking them to commit suicide. Furthermore, under the best of circumstances, in countries drenched in corruption, the fight can take decades, moves in fits and starts, and often fails.

Corruption also works to the advantage of the government in other ways. It allows it to investigate and jail political opponents in the guise of fighting financial malfeasance. This gambit is evident in the charges filed against Yulia Timoshenko, though in her case, given her prominence, and even more importantly the watchful eyes of the EU as the DCFTA negotiations proceed, what is likely is a suspended sentence that contains a ban on political activity for some length of time. Jailing Timoshenko (herself hardly a paragon of rectitude) on the strength of what are generally seen as politically motivated and dubious accusations would generate bad publicity at a time when the Ukrainian government is seeking to meet the DCFTA's standards for democracy and good governance and, more generally, to polish its image.

Based on discussions in Ukraine, there is ample evidence that Russia has been active in trying to shape Ukraine's future course now that the DCFTA process is in high gear. (This is hardly surprising; great powers, the United States included, have routinely pressed their weaker neighbors so as to preserve their longstanding spheres of influence, and Russia is conforming to a well-established historical pattern). A frequent Russian visitor to Ukraine these days is Metropolitan Kirill, head of the Russian Orthodox Church. Kirill, who has been open about his support of Yanukovich's government, has been active in articulating the importance of an extended Slavic-Orthodox community with Russia at its helm and is viewed not just as a man of the cloth but as a shaper and implementer of the Russian government's policies in Ukraine and other neighboring countries. Kirill seeks to bring the Ukrainian Orthodox Church (Kyiv Patriarchate) — the two other Orthodox orders are the Ukrainian Orthodox Church, aligned to the Russian Orthodox Church, and the Ukrainian Autocephalous Orthodox Church — back into the Russian church's fold and to open a number of churches and monasteries linked to the Moscow Patriarchate in Ukraine, and he has criticized what he considers the West's secular and materialistic culture. (However, it is far from clear that the leaders of the Ukrainian Orthodox Church connected to Russia are simply tools of their Moscow superiors.)

Ukraine's politics has its own dynamics and it would be a mistake to attribute everything that the Yanukovich government is doing that appears to favor Russia to Moscow's machinations. Cases in point are the revisions of the Ukrainian school textbooks, the revisionist accounts of the Orange Revolution in official school textbooks, the disappearance of anti-Russian motifs from Kyiv's official discourse, and the widespread belief among independent journalists that the new Ukrainian election law (drafted with little public consultation) is designed to favor the

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POR, which they fear will attempt to win the 2012 parliamentary elections through fraud. These steps are best explained by the reality that the POR has an authoritarian bent, stands for a more friendly policy toward Russia, and draws its principal support from Ukraine's Russophone east and south. The POR leadership came to power determined to end what it believed was Yushchenko's gratuitous and counterproductive anti-Russian animus. And it has moved to do so both out of genuine conviction and because of the nature of its electoral base, the worldview of many of its top officials, and the pragmatic belief that Ukraine only stands to lose if it antagonizes Russia, a large and powerful neighbor. Little wonder, then, that Moscow hailed the POR's electoral victory — Patriarch Kirill attended Yanukovich's inauguration in February 2010 and bestowed his blessings — and was glad to see the backs of those who led the previous government, which symbolized the aspirations of the Orange Revolution (though only to dash them).

Economics: Short Term Pain vs. Long-Term Gain

As noted earlier, public anger about high unemployment and prices (especially for energy and food) runs deep in Ukraine. These problems, not the DCFTA (which, in any event, is little understood by most Ukrainians, who do not see any palpable connection between this complex accord and their quotidian problems) or relations with Russia, will decide the next elections, whether parliamentary or presidential. Hence the Yanukovich government is under pressure to deliver. But it has some tough problems to deal with and some hard choices to make. What's worse, while the long-term gains generated by reforms may be evident, the short-term pain (economic for citizens, political for the government) is even more so.

One nettlesome issue is the price of energy. Ukraine produces 20 billion cubic meters (bcm) of gas and imports some 40 bcm, just about all of it from Russia. When it comes to energy, there is no free-market price: Russia is a price-maker, Ukraine a price-taker. The economic prospects of Ukraine, to say nothing about the nature of Ukrainian-Russian relations, will be shaped by the energy question so long as this state of affairs continues; and Russia has shown itself all too ready to use energy as a weapon against uppity neighbors.

The Kharkiv base-for-gas deal has, for Ukraine, hardly been a great deal: the price of gas it buys from Russia is pegged to global oil price, less $100 per thousand cubic meters

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(tcm). Even with this discount (which applies to 80 percent of annual purchases, not beyond), Ukraine has faced a surge in gas prices given the recent skyrocketing oil prices, and it could soon be facing a bill of $300 per tcm, or more. Already, it is shelling out more than the average price paid to Russia by the EU. This, as a senior Ukrainian official in charge of energy issues conceded, is a bad deal for Ukraine and, as he put it wryly, "the best agreement that Gazprom [Russia's state-controlled energy giant] has ever signed." He added that the price differential was especially incongruous because "we buy more gas from Russia than any single European country does, it runs through our own pipeline system, and we are nearer to Russia than Europe is."

There are various explanations for why the POR government signed this deal (which also provided for the demarcation of Ukraine's land border with Russia and a $2 billion credit line to help Ukraine handle its budget deficit): the desire to take a big, and early, step on the Black Sea Fleet base issue to show Moscow that the Yanukovich government was opening a new and cordial chapter in its relations with Russia, inexperience on energy matters relative to Russian negotiators, political naïveté and misplaced trust in Russian gratitude, and — of course — corruption. Whatever the reasons, Ukraine's economy and, in particular, Ukrainians living below the poverty line, have been shortchanged.

What makes energy price reform urgent is that Ukrainian companies and consumers receive gas at a lower price than Ukraine buys it for — thanks to huge state subsidies. The IMF is determined to end this arrangement on the grounds that it is regressive (rich and poor consumers pay the same price, even though the former hardly need help), contributes to the sizeable budget deficit, and encourages waste (Ukraine uses four times the amount of energy per unit of economic output than Europe does). And the

IMF has leverage: the multi-billion dollar loan, which it extends in installments (so far it has disbursed $1.4 billion of the total $15 billion) and can use to gain the Ukrainian government's compliance. But with ordinary Ukrainians already bitter about the high cost of living, energy price reform is a dicey political proposition for the government, not least because Ukrainians have an average income that is 10 percent of the EU average. Even with the informal sector of Ukraine's economy included (which according to some experts constitutes as much as 40 percent of GDP), it increases to 20 percent, at most, of the EU's average per capita income according to a knowledgeable, experienced individual we met. As a senior Ukrainian official well versed in energy issues asked, "Which democratic government that heads a country in which the per capita income is $300 would plunge heedlessly into raising energy prices steeply?" He has a point. But given a large budget deficit and a watchful IMF, which has set a ceiling of 6.5 percent of GDP for the deficit, Kyiv has little choice.

One bit of promising news on the energy front is that Ukraine has its own resources — both offshore and on land in the form of methane and shale gas — and is moving to invite Western companies to invest and crafting the necessary Production-Sharing Agreements (PSAs), a la Azerbaijan and Kazakhstan. One Western source with considerable experience in this area noted that these steps amounted to a "paradigm shift" and boded well for reducing Ukraine's dependence on Russian energy and for attracting foreign investment more generally. What remains to be seen is how rapidly these domestic supplies become available and how economical they are to extract.

A second economic problem is the steeply rising obligations facing the state treasury on account of pensions. Ukraine is among the world's most rapidly aging societies, which means that its governments must reckon with a shrinking income tax base and increasing expenditures for pensions. The imbalance is exacerbated by a generous retirement age: 55 for men, 60 for women. While average life expectancy in Ukraine is lower than in Europe, once a Ukrainian lives up to the applicable retirement age, his or her lifespan is not that much shorter than that of Europeans. Not surprisingly, growing pension costs aggravate the budget deficit — the Pension Fund's unfunded obligations account for about 1.5 percent of GDP — and amount to what economists call a structural problem. So, seen in economic terms, pension reform is imperative (a draft bill was sent to the parliament in June, which among other provisions proposes to raise the retirement age), but in political terms it could stir up public anger against an already unpopular government.

A third economic problem is the dismal state of the banking sector. Its problems were increased by the 2009 global economic crisis, which spurred capital flight from Ukraine on a grand scale and made foreign banks, already skittish about lending in risky markets like Ukraine's, even more so. In six months, Ukrainian banks lost some 40 percent of their "deposit base," one top-level Western official told us, adding that some 30 percent of all existing loans are now "nonperforming." This insolvency needs to be addressed through some mix of sacrifice by lenders and by the government, which is already strapped for cash. Otherwise, banks will not regain the confidence to provide the loans needed for Ukrainian firms to make the investments that increase jobs and exports.

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There is additional work to be done on the financial front if foreign investment is to increase. Laws governing creditors rights and collateral are either nonexistent (cars and houses cannot be repossessed when borrowers default) or weak, and in the latter instance are not enforced. Once again, corruption is a prime reason for the gap between principle and practice.

In short, there's plenty of tough work required to set Ukraine on a better financial footing and to make it a place that wins investors' confidence. But it's scarcely an impossible task. Ukraine has the advantage of possessing abun-

dant resources, a well-educated population, and a large internal market. These attributes explain why, despite the staggering corruption and reams of red tape, Western firms operating there say they have decent profit margins and voice optimism about the future. But the reforms, especially when it comes to energy and pensions, will inflict pain on an already hard-pressed population. The government is jittery about the political backlash that could result when people are asked to swallow bitter medicine now in exchange for the promise of better health sometime in the future. Moreover, the reforms would erode the murky patronage system that has served as the path to wealth and power for the economic and political elite, which, incidentally, are often indistinguishable.

The DCFTA and Moscow's Anxieties

First, some words of clarification about the DCFTA. While it does involve the phased reduction of tariffs between the EU and Ukraine, the DCFTA is not merely an agreement on removing trade duties. There are also extensive provisions dealing with regulatory convergence (including in the sphere of energy), environmental safeguards, intellectual property rights (a major irritant for Western companies, who complain about the violation of patents by Ukrainian firms), and the like. The DCFTA also involves benchmarks on good governance, civil liberties, and democratic procedures. EU officials are emphatic about the capacious nature of the DCFTA and underscore the provisions pertaining to democracy. They add that the EU monitors the progress Ukraine is making in meeting the mandated standards, communicates its concerns to Ukrainian officials regularly (the EU has diplomatic representation in Kyiv), and publishes periodic evaluations. This explains why the EU has come up with the ungainly term "deep and comprehensive" to describe the agreement and why its officials stress that the DCFTA is embedded within a larger Association Agreement. The two combined represent the most ambitious agreement that the EU has signed with another country, aside from the accession agreements that paved the way to EU full membership for the countries in East-Central Europe.

This is not to make light of the challenges posed by the elimination of tariffs. The EU's agriculture sector is protected by generous subsidies and high tariffs, and Ukraine is a major exporter of agricultural products. Not surprisingly, Ukraine wants the EU's barriers to its farm exports eliminated and the EU is resisting. Ukraine, for its part, wants to protect its nascent automobile industry and has been unsuccessful in luring European car and truck makers to set up shop in Ukraine. They apparently prefer to retain Russia as a major manufacturing venue and to export automobiles to Ukraine, a model that would threaten the Ukrainian automobile sector while also depriving Ukraine of the opportunity to benefit from technology transfer and acquire world-class management skills.

The Deep and Comprehensive Free Trade Area (DCFTA) accord represents the most ambitious agreement that the EU has signed with another country.

A case has been made that the Yanukovich government will sign the necessary DCFTA documents and then maneuver to avoid implementing their provisions. This is a fair point, though it makes the situation facing Yanukovich easier than it in fact is. For the moment, Ukraine's leaders are under the microscope of the EU (and the IMF). To enter into negotiations on a far-reaching accord with the EU despite Russia's opposition and to then to have it implode because of a failure to meet the standards for entry would leave Ukraine isolated and even more exposed to Moscow's ire and influence. The EU monitors Ukraine's progress in compliance with the DCFTA's provisions and egregious noncompliance could lead to disputes that curtail, or even deny, the benefits the agreement is expected to bring to the Ukrainian economy, and Yanukovich needs to deliver on the economic front. Moreover, Ukraine looks to the IMF for loans, and the EU has influence on IMF decisions.

Furthermore, there are aspects of the DCFTA that hold a particular appeal for Ukrainians, notably the prospect of visa-free travel within the EU. Ukrainian officials and their EU counterparts seem confident that the DCFTA will be signed, as scheduled, by the end of the year. The former also claim that the deal will include the visa-free provision, though it seems doubtful that the EU will do away with visa requirements for Ukrainians in so short a time, not least because of the economic crisis in Europe and the

controversies surrounding illegal immigration. Nevertheless, the DCFTA is something that Kyiv wants. As for Ukraine's oligarchs, they are a mixed lot and it would be wrong to see them as united in opposition to the DCFTA. Some have extensive business dealings with Russia and may prefer the CU; others fear that joining the CU would mean a future in which Russia's richer and more muscular tycoons gobble up their assets and tighten their grip on Ukraine's economy. The latter variety of oligarch prefers the DCFTA and believes that the real economic opportunities and benefits in the decades ahead lie westward.

Beyond the tangible benefits, the DCFTA confers status, something that we were told by Western diplomats is particularly important for Yanukovich, a poor-boy-made-good who enjoys being received with respect in Europe's corridors of power. The legacy of being the president who took Ukraine into Europe (not that the DCFTA offers assurances about EU membership) also holds allure for Yanukovich, and it is significant that his first official trip abroad as president was to Brussels, not Moscow. By contrast, given Russia's dominant role in the CU, should Ukraine join it, Yanukovich would, as one Western diplomat put it, be reduced to the status of "the governor of a Russian province," a prospect he does not relish, particularly given his apparent animus toward Vladimir Putin, whom he regards as the epitome of Russian high-handedness and a master of the art of pocketing concessions and then seeking more. Yanukovich is said to now feel disrespected by Russia, the more so because he has sought to change the anti-Russian course of Yushchenko and made early and substantial gestures of goodwill toward Moscow such as giving Russia's Black Sea Fleet a long-term lease on Sevastopol.

The legacy of being the president who took Ukraine into Europe holds allure for Yanukovich.

This is not to say that the DCFTA is a sure thing for Ukraine; it isn't. The Yanukovich government must meet an array of benchmarks, some of which will threaten the cronyism, corruption, and patronage that are endemic and essential to the political order over which he presides. Then there is the corruption case underway against Yulia Timoshenko. If she is found guilty and jailed and the EU concludes that she has been the victim of a kangaroo court and politically motivated charges, it will be hard-pressed to certify that Ukraine has met the necessary democratic standards. What remains unclear is whether Yanukovich realizes how seriously the handling of the Tymoshenko case could hamper an agreement on the DCFTA and whether it may be more important for him to have Tymoshenko out of the way given that she is the most likely figure who could mobilize public discontent in the next election. He may try and finesse things by arranging for her to receive a suspended sentence that is accompanied by a ban on political activity by her for certain number of years or by pardoning her after the court hands down a jail sentence.

For its part, Russia could treat the DCFTA negotiations as an opportunity and not a threat, viewing the prospect of a democratic and prosperous Ukraine as net plus for itself on several counts. That, however, is not the way Moscow seems to see it. Russian officials have made it clear to their Ukrainian counterparts that they do not want Ukraine to join the DCFTA and that they want it to become a member of the CU, which now consists of Russia, Belarus, and Kazakhstan. Yanukovich announced at an early stage in his presidency that Ukraine would not join NATO and would, instead be a "non-bloc" country. True, Ukrainians are deeply divided about NATO, but he could have made this concession at a later time for a decent quid pro quo. But his decision not to seek NATO membership has not made Russia feel any less apprehensive about the DCFTA, particularly because, despite Yanukovich's "non-bloc" declaration, Ukraine continues to participate in NATO exercises, to allow NATO ships into the Black Sea, and to play an active part in NATO peacekeeping operations.

DCFTA continues to worry Russia, and Ukrainian leaders we met with alluded to pressure from Moscow. One of them commented that the EU should support Ukraine more firmly by insisting to Russia that the DCFTA was a bilateral matter between the EU and Ukraine and that Russia should not interfere. The subtext seems to be a degree of anxiety on Ukraine's part that it may lack steadfast friends should Russia start ratcheting up the pressure as the DCFTA process advances, or squeeze Ukraine even after the deal is sealed. In the latter scenario, Ukraine would be in the vulnerable position of having signed a major accord with Europe that Moscow opposed but having no security guarantees if Russia decides to turn up the heat.

Already, Russia has suggested that Ukraine's entry into the DCFTA could affect the price at which it receives gas in the future and that Ukraine may be called upon to settle its energy debt with Russia, quickly and in full. Some Ukrainian officials — including Yanukovich as recently as July 2011 — have floated the idea of a 3+1 agreement under which Ukraine signs the DCFTA but also joins the CU, presumably with a special status, as a way to ease Russian concerns. The Russians, however, have rejected this out of hand and have told Kyiv that it must chose between the EU and the CU. Moreover, Ukrainian's officials were unable to explain how exactly the 3+1 arrangement would mesh with the DCFTA. More to the point, Ukraine seems to have made its choice: to join the DCFTA, not the CU. It appears determined to finalize the agreement by year's end.

Ukraine's size and location as well as its deep and centuries old cultural connections with Russia (represented, for instance, by its 8 million or so ethnic Russians, who reside mainly in the Donbass) make it hard for Moscow to look upon DCFTA with equanimity. In the eyes of Russian officials, given the multifaceted provisions of the agreement, Ukraine is making a decisive choice about its future. No matter Kyiv's reassurances, Moscow believes that the DCFTA will pull Ukraine closer toward Europe and push it further from Russia — a point stressed by Ukrainians who champion the accord. A senior Ukrainian official pointed out that once Ukraine adopts the third "energy package" of the EU's *acqui communautaire*, Russia will be unable to acquire Ukraine gas and pipeline system because all 27 members of the Union would have to approve stakeholding by outside parties. Ukraine already conducts a third of its total trade with the EU, the same proportion as it does with Russia, but Moscow doubtless fears that its share will decline as Ukraine's integration with the EU advances on all fronts. These concerns are hardly groundless and are indeed understandable, even though, from a legal standpoint, it is Ukraine's sovereign right to choose the DCFTA. But it's a mistake to assume that Moscow sees the DCFTA as chiefly involving law and trade and investment; the accord has far greater strategic valence for Russia's leadership, and indeed to Russians more generally.

Since 1992, Russia has demonstrated, and indeed declared, that it regards the space once occupied by the Soviet Union as an area vital for its prosperity and security. Accordingly, it has sought to maintain its paramount position — in what is the only place in which it can still claim predominance — and to parry threats to its interests, using carrots and sticks, singly or in combination. Thus it is hardly likely that Moscow will stand passive as Ukraine proceeds with the DCFTA negotiations.

Moscow can respond to the threat (as it sees it) of DCFTA in several ways, some more subtle than others. It might appeal to EU states, such as Germany, France, and Italy — which have been more sensitive to Russian foreign policy concerns relative to other EU members — in an effort to delay, or even scuttle, the DCFTA. A less benign response could include assorted political machinations and sundry forms of economic pressure. A Georgian scenario, i.e., one involving the use of force by Russia, can be safely ruled out — Ukraine is too big to digest — but a crisis between Ukraine and Russia within the next six months should not be ruled out. It is an eventuality that the United States and its allies must think about and plan for, even as they hope that it does not materialize.

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About GMF

The German Marshall Fund of the United States (GMF) is a nonpartisan American public policy and grantmaking institution dedicated to promoting better understanding and cooperation between North America and Europe on transatlantic and global issues.

GMF does this by supporting individuals and institutions working in the transatlantic sphere, by convening leaders and members of the policy and business communities, by contributing research and analysis on transatlantic topics, and by providing exchange opportunities to foster renewed commitment to the transatlantic relationship. In addition, GMF supports a number of initiatives to strengthen democracies.

Founded in 1972 through a gift from Germany as a permanent memorial to Marshall Plan assistance, GMF maintains a strong presence on both sides of the Atlantic. In addition to its headquarters in Washington, DC, GMF has six offices in Europe: Berlin, Paris, Brussels, Belgrade, Ankara, and Bucharest. GMF also has smaller representations in Bratislava, Turin, and Stockholm.