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EAST EUROPE DAILY BRIEF©

EXECUTIVE SUMMARY

April 18, 2002

UKRAINE: The March 31 Rada and regional elections in Crimea have underlined the defeat of pro-separatist forces and those favouring Soviet reintegration. While this augurs well for political stability, the outlook is less favourable for an end to oligarchic government. **See EEDB today.**

INTERNATIONAL: The world steel trade is more unsettled than at any time in the last twenty years. Global surplus steel capacity is holding prices down and harming otherwise competitive manufacturers. However, today's OECD steel talks are unlikely to produce meaningful proposals to resolve the crisis. **See EEDB today.**

RUSSIA: In his state-of-the-nation speech today, President Vladimir Putin called for the government to accelerate reform of bankruptcy laws, the banking sector and the 'natural monopolies'. He also urged the country to capture a greater share of the world oil and steel markets to boost flagging growth, and announced the formal end of military operations in Chechnya – although the territory's pacification remains distant. Putin's implicit criticism of the government appears aimed at attempting to preserve his own standing in a slowly declining economic context. His speech offered few details on economic plans but confirmed the orientation to liberalisation despite slowing growth. **See EEDB, June 11, 2001, II.**

YUGOSLAVIA: The UN announced yesterday that representatives of Kosovo's Serb minority had agreed to end their boycott of the new provincial assembly. This agreement will enable Kosovo's self-governing institutions to function with the full participation of the Kosovar Albanian majority and the Serb population, now that the latter have withdrawn their insistence on the establishment of a ministry to deal with refugee returns. Special Representative of the UN Secretary General (SRSG) Michael Steiner stipulated refugee returns remained the responsibility of the international community but has created two new posts for Serbs to deal with the issue. **See EEDB, January 16, 2002, I.**

CZECH REPUBLIC: National Property Fund subsidiary Osinek will buy Vitkovice Steel for 3.31 billion koruny (97 million dollars) in May, Vitkovice CEO Vladimir Bail said yesterday. Vitkovice will use the proceeds, which have somewhat exceeded its target price, to reach a settlement with creditors. Bail added that Osinek plans to raise productivity and cut costs without shedding labour. These objectives are in line with the government's social/political interests with regard to the steel sector, and may influence Prague's negotiations with the multinational LNM Group over the potential sale of the country's leading steel firm, Nova Hut. **See EEDB, March 7, 2002, I.**

CROATIA: State-owned pipeline operator Jadranski Naftovod (Janaf), yesterday submitted new conditions for its participation in the Adria-Druzhba pipeline project, reportedly requesting guarantees from Russia on transportation and the agreed volumes of oil. The project would provide an oil transport corridor from Russia to the Adriatic Sea, increasing Russia's export capacity by 5 million tonnes a year after completion of the first phase. To make the project viable, all transport companies en route must not charge more than 0.64 dollars per tonne of crude oil per 100 kilometres; the Croatians are therefore not likely to gain any further concessions. **See EEDB, June 20, 2000, II.**



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I

UKRAINE: Post-Election Crimea

EVENT: Following the March 31 national and regional elections, a new majority has this week been formed in Crimea's Supreme Soviet.

SIGNIFICANCE: Crimean voting patterns differed in elections to the Rada and Supreme Soviet. The outcome marks a defeat for pro-separatist forces and also the Ukrainian Communist Party, whose influential leader Leonid Hrach now faces losing entirely his regional platform.

ANALYSIS: In addition to the local and parliamentary elections held throughout Ukraine on March 31, Crimea also held elections for its republican Supreme Soviet. Within the Crimean Supreme Soviet, the main contest was between the pro-presidential bloc led by former Prime Minister Serhiy Kunitsyn and the Crimean branch of the Communist Party of Ukraine (KPU).

Distinct peninsula. For much of the 1990s, Crimea rested uneasily within Ukraine as a consequence of its distinct historical, political and ethnic character. In the early 1990s, the peninsula was controlled by pro-separatist forces. While these had been ousted by the middle of the decade, Crimea's level of autonomy and relations with Kyiv remained open to dispute (see EEDB, February 19, 1997, I). However, from 1997-98, Crimea came under the control of the KPU, which favoured Ukraine's membership of a revived Soviet Union.

Since 1998-99, Crimea has been ruled by two political forces:

- The KPU has controlled the leadership of the Supreme Soviet, in which Crimean Communist leader Leonid Hrach served as chairman.
- The Crimean government was controlled by the People's Democratic Party (NDP), which is loyal to Ukrainian President Leonid Kuchma, with local leader Serhiy Kunitsyn acting as prime minister. The NDP is one of the five constituent parties in the pro-Kuchma For a United Ukraine (ZYU) election bloc to the Ukrainian parliament.

Open conflict between the Crimean legislature and government prior to the poll had led to a successful no-confidence vote in the government. Kunitsyn's dismissal set the stage for further personalised conflict with Hrach during the elections to the Crimean Supreme Soviet.

Electoral outcomes. Crimea held three elections on March 31 -- to the Ukrainian Rada (proportional and majoritarian voting), Crimean Supreme Soviet and local councils in the Crimea.

1. Rada vote. In the national vote, Crimea did not differ fundamentally from other eastern regions (which are traditionally leftist/pro-Russian in orientation). The KPU topped the poll in the proportional race, with 33.91% -- one of the highest levels recorded by the KPU nationally, alongside the two Donbas oblasts of Donetsk and Luhansk. The pro-presidential party, the United Social



Democratic Party of Ukraine (SDPUO), recorded one of its best performances in Crimea, attracting 12.47%. Pro-presidential Crimean businessmen and state officials may have defected to the SDPUO from the NDP.

The most surprising performance was that of pro-western former premier Viktor Yushchenko's Our Ukraine (NU), which came third with 9.77% of the vote. NU was boosted by support from the Crimean Tatars, who constitute 300,000 of Crimea's 2.5 million population (see EEDB, May 28, 1999, I). The two leaders of the Crimean Mejlis, Refat Chubarov and Mustafa Dzhemilev, were on the NU party list. Tatars were able to vote in larger numbers in these elections because 90% of them are now Ukrainian citizens, unlike in the 1998 elections when they were still mainly Uzbek citizens.

As elsewhere in Ukraine, parties supporting President Leonid Kuchma performed very strongly in majoritarian districts, partly through nominally independent candidates (see EEDB, April 4, 2002, II). In Crimea's ten majoritarian constituencies, ZYU won two seats and SDPUO won one. Seven seats were won by 'independents', most of whom are likely to join ZYU in the Rada.

2. Crimean Supreme Soviet. Elections to the Crimean Supreme Soviet were conducted under a different system, whereby all 100 deputies were elected by majority voting in separate constituencies. These results differed markedly from the Rada vote. The largest number of seats (39) went to the pro-presidential Kunitsyn bloc which won 39 seats while the Hrach's KPU list obtained 28 seats. This is the reverse of the Rada election, in which the KPU outperformed ZYU in the party list vote.

SDPUO, despite its strong performance in Crimea's vote to the Rada, obtained only two seats. The pro-presidential Democratic Union and the leftist Peasant Party each obtained one seat. The remaining seats in the Crimean Supreme Soviet are not affiliated to parties but, as 'independents', are more likely to cooperate with the Kunitsyn bloc than with the KPU. The Tatars have seven deputies.

Hrach undermined. On April 16, 67 deputies announced the Supreme Soviet had formed a stable majority, based around the Kunitsyn bloc. The KPU has lost control of the Crimean Supreme Soviet, and also fared poorly in its Sevastopol stronghold and lost all but one of the peninsula's mayoral races. Moreover, Hrach's position is under considerable threat, although he was elected to the Supreme Soviet in constituency 95. One month earlier, the local electoral commission deregistered him as a candidate because he had incorrectly filled out his income declaration. Suspicions of a political motive were raised by the fact that he was allowed to run in the Rada election. The Ukrainian Supreme Court will consider his appeal on April 19. If the charismatic Hrach is removed, there are two potential impacts:

- The KPU could suffer further setbacks in the peninsula. Without a leader of Hrach's stature the KPU in the Crimea could split and no longer resemble a united force.
- Nationally, Hrach's ability to challenge the uncharismatic KPU leader Petro Symonenko will be enhanced. If Hrach is no longer based in the Crimea, but in the KPU faction in the Rada, he will attempt to take over the KPU and give it a more moderate profile. Hrach has outlined his plans to run in the 2004 presidential elections.

Outlook. Crimea's separatist and pro-Soviet revivalist phases appear to be over. The strong showing in the Rada election of the KPU, which supports Ukrainian territorial integrity, was achieved at the cost of pro-Russian parties. These have now been marginalised. Moreover, the KPU's loss of influence in the Crimean Supreme Soviet reduces the influence of forces in favour of renewed integration in the Slavic former Soviet heartland.



This will bring greater stability to the Crimea -- the KPU is unlikely to stage street protests. The Kunitsyn bloc is moderately reformist but, like ZYU and other oligarch groups, prefers non-transparent reform and tolerates corruption.

CONCLUSION: Crimea is now controlled by a pro-presidential majority. This will have a positive impact on political stability but does not augur well for transparent reform and 'clean government'. If ousted from Crimean politics, Hrach may challenge for the national leadership of the KPU and could make it a more effective force ahead of 2004 national presidential election.

Keywords:EE, Ukraine, politics, election, ethnic, government, legislation, opposition, party, regional



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II

INTERNATIONAL: Steel Glut

EVENT: OECD members meet in Paris today and tomorrow in the fourth high-level forum on reducing global steel production capacity.

SIGNIFICANCE: The world steel trade is more unsettled than at any time in the last twenty years. Surplus capacity is holding prices down and harming otherwise competitive manufacturers.

ANALYSIS: In March, the United States imposed tariffs on most of its steel imports. The decision was widely criticised, as US steel imports had already dramatically fallen since their 1998 peak -- 2001 flat steel imports were about half of their 1998 levels. The US decision to impose severe safeguard protection in light of such trends appears to violate its WTO commitments, and the EU, Japan, Brazil, Korea and China have appealed the action to the WTO. While nearly all experts agree that the US decision will be struck down, the WTO dispute process is not expected to produce a decision before 24-30 months.

In the meantime, steel protection appears to be spreading. The EU has announced provisional safeguard measures on most of its steel imports. While the EU measures are not nearly as harsh as the US ones, they nonetheless indicate that the two major trading regions are willing to close their markets in order to appease important domestic constituencies. Mexico has also announced an extension of its 'provisional' steel tariffs. Other countries are reportedly designing their own US-style steel tariffs. By the end of the year, it is likely that several other Latin American countries will in effect close their markets to foreign steel. In this case, the US steel decision may have set back years of trade liberalisation progress.

Capacity talks. A December 2001 OECD steel meeting produced an agreement "in principle" to reduce steel-making capacity by 103.5-117.5 million tons, out of total current capacity of approximately 1.07 billion tons. In March, the OECD announced that restructuring in the steel industry is now expected to result in the closure of 124-128 million tons of steel-making facilities by the end of 2005.

While such pronouncements sound promising, there is little reason to believe that the OECD steel talks have had any impact:

1. **Non-binding.** The OECD announcements are not commitments. A country that announces that it will reduce 10 millions tons of steel capacity need not actually do so.

2. **Existing plans.** Most of the capacity reduction that the OECD refers to would occur without any multilateral meetings. Facilities in former Soviet-bloc countries in particular are obsolete and plans are already in the works to dismantle/upgrade these mills. The OECD steel group was simply announcing decisions that have already been made.



3. New mills. The OECD talks refer to gross rather than net capacity reductions. In other words, the OECD pronouncements do not take into account any of the new mills currently being built or planned around the world. The United States, for instance, has promised to reduce capacity by 10-15 million tons. Whether or not this is credible, the US remains silent on the millions of tons of new electric-arc-furnace capacity being built by industry leaders such as Nucor and Steel Dynamics. The resulting net reduction in steel-making capacity is open to question, but it will certainly be far less than 120 million tons, and it is possible that there will be a net increase in world-wide steel-making capacity over the next decade.

4. Conservative estimates. Most observers believe there is 250-300 million tons of excess steel-making capacity. Even if one were to ignore the caveats listed above, it is doubtful that steel prices will return to their historical levels unless a significant amount of additional capacity is dismantled.

Today's talks. There is little disagreement that world steel markets are in dire straits. Steel prices are about 40% lower now than in 1995. In real terms, they are 60% lower. Hence, facilitating the current and planned closure of inefficient capacity is essential. Even more important, the OECD talks must resolve the widespread, market-distorting, government interventions in steel.

In the wake of the US decision, US Trade Representative Robert Zoellick argued that the US market had been victimised by trading partners' subsidisation of steel capacity, and that the decision to close the US market would force those countries to confront the capacity problem. However, Washington has not hesitated to intervene in support of its steel industry, and its latest protection serves its weakest producers. That the protection appears to violate the WTO safeguard agreement, while supporting weak US producers, undermines Washington's credibility in asking trade partners to make hard decisions on reducing capacity; it is clear that the United States is unwilling to do the same. By all public estimates, countries such as Brazil and South Korea have substantial cost advantages relative to even the best US producers.

Statements emerging from the current meeting are likely to gloss over these differences. In the background, parties to the talks can be thought of as playing a game of 'chicken' -- someone else should close their capacity. In the simplest terms, as long as US decision-makers allow inefficient US producers to stay in the market while asking more efficient foreign producers to exit or compete unaided, there is little prospect that OECD steel talks will resolve the crisis.

CONCLUSION: Today's talks are unlikely to produce meaningful proposals to resolve the steel crisis. The most efficient steel producers in particular will suffer as the glut of steel-making capacity will mean they will struggle to earn reasonable rates of return.

Keywords: International, United States, EU, WTO, OECD, economy, industry, aid, foreign trade, policy, steel

