

**CARNEGIE ENDOWMENT  
FOR INTERNATIONAL PEACE**

**RUSSIA-UKRAINE GAS DISPUTE: EXPERT BRIEFING**

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JAMES COLLINS: Well, why don't we get started. First, let me just say I'm Jim Collins here at Carnegie, I run the Russia/Eurasia program and I have with me this morning Anders Åslund, who's probably well-known to most of you – is presently at the Peterson Institute and formerly was at Carnegie and is one of the real authorities on economic development and the economies of Russia, Ukraine and East Europe. And on my left is Martha Olcott, who is senior associate here in Washington with the Carnegie Endowment and does specifically major work on Central Asian affairs and, in that connection, in part on Russia as well and gas and oil in particular. And in Moscow, for those of us here, Dima, let me let you introduce yourself. (Laughter.)

DMITRI TRENIN: I'm Dmitri Trenin, I do foreign and security policy here at the Carnegie Moscow Center. Since about a week ago I've taken over as the director of the center.

AMB. COLLINS: I don't know – I guess it might be useful if we did let people quickly just introduce yourself and say where you're from so Dmitri has an idea. Why don't I start here.

BRUCE JACKSON: Bruce Jackson, Project on Transitional Democracies

IRINA KRASOVSKAYA: Irina Krasovskaya, We Remember Foundation, Belarus.

VIKTOR NIKITIUK: Viktor Nikitiuk, Embassy of Ukraine.

ANDREI BUKVYCH: Andrii Bukvych, Embassy of Ukraine.

YULIYA MELNYK: Yuliya Melnyk, *Kyiv Post*.

STEPHANIE SQUIRES: Stephanie Squires, CRDF.

CAROLINE MCGREGOR: Caroline McGregor, the U.S. Department of Energy.

ANNE WOLLACE: Anne Wollace, First International Resources.

TOM DETERS: Tom Deters, also First International Resources.

AMB. COLLINS: Okay, let me kick this off, Dmitri, simply by saying from the news reports we have here this morning there is still no bargain struck on next year's gas arrangements between Russia – Gazprom and Ukraine – Naftogaz Ukrainy. This seems to be a rather regular New Year's event, but I think in this particular case there are some very significant differences in the way it's being developed and how it has developed from what we saw a couple of years ago where it sort of sprung up on everybody and caused great concerns and problems, not only in Russia, Ukraine, but also across Europe and here.

And what seems to be the case here is certainly there's been a great deal more publicity about what has been going on in terms of negotiations for some time, so there are no surprises this time that there is a negotiation, that there is a deadline, that there are disagreements still and that there's a hard-slogging negotiation going on. The question really is, how does it look to the people who are the experts, I think, and then I'd like to engage our audience here in the discussion as well. But let me – Dima, if I could turn to you first to get a sense for how this has been unfolding from the standpoint of the people there in Moscow and as you see it, then I'd like to turn to Anders, perhaps who is more familiar with the Ukraine side, to get us a sense of how do people see this at the moment and where it – first of all - how people think it will come out, but let me start with you.

MR. TRENIN: Well, Jim, thank you very much for this invitation and for this event. Again, as you said, I will try to cover the Russian end of that and I will defer on Ukraine and on energy to others and Martha. I'm happy of course to take any questions, but let me say that seen from Moscow, it does look very familiar. The end of the year is approaching and Ukraine has not paid up and this is a scandal again and Russia has every right to demand every penny; Ukraine is balking and the negotiation is coming closer and closer to the deadline and the Russian government and Gazprom – because there's precious little daylight that people see between the government and Gazprom – so Russia as it were is standing firm.

Russia has no reason to give Ukraine a break; after all, the Ukrainian government or rather the Ukrainian president has been trying to pull the country into NATO and in the recent war in Georgia Ukraine had been supplying – or prior to the war Ukraine had been supplying Georgia with military material – that was a statement by a senior Russian general that Ukrainian military people had been responsible for shooting down a Russian strategic bomber and they were manning the air defenses or some of the air defenses of Ukraine, so there's a feeling in this country that Russia has nothing to – owes Ukraine nothing and has every right to pursue this really tough policy.

On the other hand, you see that just by looking at how the president, the prime minister, the foreign minister – presenting that to the public, you can get the feeling that they're not enjoying it very much. They see that they are walking straight into a situation that will not do Russia any good. They will have to exercise that press, they think, otherwise they will be showing Russia's weakness. But once Russia cuts Ukraine off, the onus is very likely to be on Russia. There was a statement by the foreign minister – rather an interview with the foreign minister broadcast this morning, in which he was asked this question: What do you think the reaction of the Western public will be to the cutoff, should it come to that? And he said well, we're not fully responsible for the reaction of the Western public, which basically means that Russia will suffer as the result of – in exercising what it cannot fail to exercise.

So that's how it looks from here. I don't think I will go much longer than that. I'll be happy to join you later.

AMB. COLLINS: Anders, maybe I could ask you if you'd give us a sense from what you know on the – particularly on the Ukraine side – how they're looking at this.

ANDERS ÅSLUND: Yeah, let me take you through the whole of the story. The first question if you have a dispute over the payment is, who are the parties? And the parties in this case are RosUkrEnergo, which has not been paid by UkrGazEnergo. This is the issue. So RosUkrEnergo is a private company; it's owned by essentially two parties. One is Gazprombank, which is essentially privatized by its managers although it's still attached to Gazprom. Gazprom of the state don't own anything of UkrEnergo. And on the other side it's two Ukrainian businessmen, essentially Dmytro Firtash.

So I don't understand how this can be a Ukrainian-Russian conflict; this is a conflict between very shady businessmen. And the strange thing is that the Russian state and Gazprom argue that they are party to it – they are not. And who has not paid? Well, it is UkrGazEnergo, which is half-owned by RusUkrEnergo and controlled by RusUkrEnergo, which has not paid, RusUkrEnergo. Admittedly, NaftoGaz Ukrainy, which is actually state-owned, owns a half of UkrGazEnergo. That is, the previous management of NaftoGaz Ukrainy before the current Ukrainian government worked for RusUkrEnergo as private individuals. NaftoGaz Ukrainy has seemed to have been used – to be exploited and therefore the Ukrainian state has been losing a lot of money. NaftoGaz Ukrainy has received no dividends from UkrGazEnergo as it should have. So this is the shady deal and there's no reason for any state to accept this.

And where does the gas come from? Turkmenistan. So Gazprom has not produced the gas, it hasn't sold the gas; it has only transported the gas. And this has been done through a contract with RusUkrEnergo, which is a well-known management company. So in order to understand this we have to understand that Gazprom is effectively an economic crime syndicate and the money's not due to Gazprom; then you wonder why does Gazprom and indeed Prime Minister Putin insist that Ukraine, in a very vague sense, should pay. And then we have to go back to the Russian government objectives and let me start with the overall one. The fundamental thing is to take money from Gazprom, which is selling things at low prices to an intermediary. First we have a tariff and Ural Trans Gas and then RusUkrEnergo – all of them have been inspired and controlled by people in the Kremlin.

And the second objective is to squeeze as much money as possible out of Ukrainian state – that is NaftoGaz Ukrainy – for private gain. And this is primarily done through mobilization of UkrGazEnergo for industrial sales. And the third objective is to buy top Ukrainian politicians with slush funds partly for political purposes, partly in order to make sure that this kangaroo – and here we have the top region politicians, in particular former minister of energy Yuri Boyko as the top person who's very much the one who controls it, but it's also a few others. And also members of the presidential secretariat have been involved and there are persistent rumors of payoffs to other people that we can't really control.

And of course, the main objective here is to destabilize Ukrainian politics, to show how bad democracy is in this part of the world so that it shouldn't be tried in Russia. And I think particularly the timing now is that the Kremlin is very worried about social unrest in Russia after the New Year holidays. And then they want to whip up some patriotism. So in short, the Kremlin's gain is corruption and political destabilization of Ukraine and there's no state

economic objective in this – there’s not even a Gazprom objective. I just received a report on Gazprom today, which said wonderful profits but no cash flow - this is how Gazprom functions.

So what should be done? Take out RusUkrEnergo from the domestic Ukrainian gas trade that has been agreed between NaftoGaz Ukrainy and Gazprom and I think that’s an additional objective, that Gazprom officials now want to block that agreement that has already been reached; and secondly, take RusUkrEnergo out of – it should not be involved in the Ukrainian domestic gas trade, which Yulia Tymoshenko more or less has accomplished; and then, third, provide transparent accounts of gas deliveries to Ukraine, which has not been done. This is all controlled by Gazprom and RusUkrEnergo people and I think that Gazprom’s bluff should be called.

And the amazing thing here is that the EU countries do nothing to secure their energy supplies. Here they allow themselves to be vulnerable because of some shady organized-crime deals and of course this is an amazing tolerance of such activity. So I think that the timing – so I guess that Putin thinks that it’s good to whip up some patriotism against Ukraine. It has worked before, so why not try it again? Thank you.

AMB. COLLINS: Martha, do you want to say a word or two about the general energy picture?

MARTHA OLCOTT: Okay. Thanks very much. I’d actually like to go back to some of Anders’ shaping of the crisis and take a hand at reshaping it a bit and then go on to the general energy picture and sort of the mixed messages about Gazprom itself. I mean, I agree with – obviously I agree with everything Anders said; I’m not sure, however, if that’s – I’m trying to think how to put it – I’m not sure if that is what’s holding up reaching agreement at this point in time. I mean, all of those factors are on the table. I think, one – and it’s interesting to me is that there have been rumors of settlement each day and it keeps falling apart, in my sense, I mean, so I don’t – I have a sense that this has gone beyond the level of theater on the Russian-side that Dima captured for us and on the Ukrainian side Yushchenko and his people as well as Tymoshenko’s people’s desire to change the shape of the gas purchase agreement with Russia.

But I think where people are stalled now is between how to get – I think that both sides have their positions staked out in terms of the debt. I mean, both sides recognize the existence of this debt, for all their disagreements on what the shape of Ukrainian gas trade should be and who should be the partners in it. This debt is on the table and that is what is stopping the agreement from moving forward, at least formally. And it seems to me there is still space between the minimally acceptable payment that Russia will take and the maximally acceptable payment that Ukraine will give and the pieces that Anders described are sort of the chess pieces that they’re all using to close that gap, because what they will agree to at the very end – the formal agreement – will only be part of the story.

That’s going to be – there will be a statement about what Ukraine is going to pay for gas in the end and how much of the debt is going to be paid up front and how much is going to be deferred, but the really important parts will be all the pieces that Anders alluded to that will still be hidden under the table. I suspect that at this point in time the commercial factors are

impeding or shaping the negotiations more than the picture given in the Russian press. Gazprom does need this purchase agreement, they do need to keep gas flowing to Europe; they are locked in to high pricing in Central Asia for both Uzbek and Turkmen gas for the first half of 2009 and if there is any disruption on the flow of gas to Europe and any grounds for Europeans renegotiating their agreements with Russia or ill-will on the part of the Europeans, that's going to damage the shape of Gazprom's trade for the year even worse than would have been the case in 2006.

I do think, though, that the European position is different than it was in 2006. The Europeans have also warned the Ukrainians this time. There was a pretty strongly worded statement that came out a week or so ago saying that Ukraine had no right to disrupt – that they had to meet their obligations as well to allow gas to flow. I think, unlike 2006, the Europeans have tried unsuccessfully to spur these negotiations on and, again unlike 2006, they've really stored a great deal of gas – they are prepared for this crisis. So in a sense the theater doesn't have to end on January 1<sup>st</sup>; it can continue for another week or two without their being serious disruption to European supply, unlike 2006.

So I know – I'll just stop here.

AMB. COLLINS: Okay. Well, if I could just make an observation: It seems to me there's a fair difference between in some sense the emphasis given to the political and the emphasis given to the economic. It strikes me that from Anders' point of view here, really what we're dealing with is a rather large squabble among various stakeholders in the gas business however you wanted to categorize this and who's involved, but that the Russian state at the same time is using this squabble to achieve political ends. Dmitri, you're suggesting that in fact this is not a particularly positive approach to a problem or a problem that necessarily gives great benefits to the leadership in Moscow as it goes on. I wonder if you could elaborate a little bit on that.

And Martha's saying, you know, well, there is a problem, I mean, there is an absence of some money – known as debt – that needs to get sorted out somewhere. Now, I would like to know whether everybody agrees there's a debt. And what the Gazprom people are saying publicly is that they're prepared to settle it by sort of advance payment on transit fees or something of that kind – get it off the books and then go on to the next year. So I'd just like one more round of this if I could. Dmitri, could you kind of give a sense for this, because if in fact you don't see the leadership – see it as a very positive situation, how does that square, do you think, with Anders' picture?

MR. TRENIN: Well, I think that it's very unfortunate that the contracts have to be renewed on the first of the year. If you ever think about the worst time – (laughter) – for a deadline, that should be New Year's Eve. And whatever happens after that, people will remember that on New Year's Eve they were cut off from gas supplies from the neighboring country. Would have made more sense for Russia to shift it to say, March 1 or whatever – October 1, that the financial year in the Soviet Union and today's Russia and in Ukraine, I think, starts on January 1. Russia does look brutal when it demands every penny on the barrel; it also

looks mean and ruthless and I think that they are a little bit wary of looking again that way, especially to the Europeans but more broadly to the Western public.

I do not spy any jingoism this time related to this event in Moscow. This is not – it's given prominence, but this is not something that comes at the top of the news agenda. It's treated more as a money issue: They owe us money and in this time of crisis – we're in an unfolding crisis, we're in need of money. Gazprom has just concluded an agreement with Belarus in which it had to make concessions – price concessions to Minsk in return for Minsk probably seeing some political concessions to Moscow. So you know, this is not something that you would want to happen when precious little else is happening in the world, the Middle East being an exception. So that's not how I would see it and how I would interpret the situation in Russia.

The Russian leadership is totally – and I agree with what Anders said – is totally immersed in this economic crisis, which is getting a social dimension, with a political dimension not far behind. It's a very, very uncertain situation in Russia. It's a situation in which people have pretty bad expectations as far as the New Year is concerned. And Gazprom is strapped for cash; they want every dollar they can lay their hands on and that gives the situation an aura of urgency, which, again, after having fought in the Caucasus Russia does not need to have more showdowns in its neighborhood. I think that the message that the Russian leadership wants to send is slightly different these days; they're toning down considerably on a number of issues, so this is not a crisis that they're looking forward to.

AMB. COLLINS: Anders?

MR. ÅSLUND: Yeah, three issues. First, on the debt: The debts are not cleared and the debt issue came up immediately to then Yuri Boyko's was ousted as minister of energy. Previously it was presumed that there were no debts and then all of the sudden there were massive debts and the new government couldn't get a handle on it because it was Boyko together with the head of RosUkrEnergo, who's working together with Gazprom who controls it all together with a few people. So really the Ukrainian government does not have historical records of it; the Ukrainian gas sector is extremely murky for this reason. When Boyko was head of NaftoGaz Ukrainy at the end of 1990s, no audited accounts were provided whatsoever. Sorry, it was Bakai who was head of it then. So this is hardly managing the business.

So this is considerable corruption in alliance with Gazprom. And Boyko has been there 2002 to 2004 and again 2006, 2007, so he has been there much of the time and made sure that there are no proper historic accounts. And then the whole time there has been an argument who owes what and RosUkrEnergo demands – Gazprom demands money from NaftoGaz Ukrainy although there are two parties in between and this is not clarified and it was very good, as Dima said, they owe us money. And if you look up on Gazprom's statement now they are not clarifying it any way exactly when who was owing what and if you're not more serious about it you can't be taken seriously. So the debt issue is not clear, the Ukrainian – now president of NaftoGaz Ukrainy, Oleg Dubina, who is a former deputy prime minister for energy and is on Tymoshenko's side. He made a big interview in *Zerkalo Nedeli* this summer where he said that

we don't control the accounts on what is delivered and what is held in our reservoirs in Ukraine. So the accounts are not there.

Second – on is this commercial? Hardly. And I'll give you the summaries as why I don't think that it's commercial. This of course means that Gazprom sales will fall. Gazprom's production fell by 10.6 percent in November over November last year and the reason is that in particular the Central Europeans don't want to buy Gazprom gas at all if they want to – if they can avoid it. An additional reason here is that – Dmitri mentioned here that Russia has now lowered the price – and in that case it's actually Gazprom – to Belarus. And at the same time and if I remember right they lowered from \$200 dollars to something less.

MS. KRASOVSKAYA: They didn't know the price and I think they decided today.

MR. ÅSLUND: Yeah, okay so it's not –

MS. KRASOVSKAYA: It should be near 200, yeah.

MR. ÅSLUND: And here Gazprom wants now to increase from 179.50 to \$418 and this is Gazprom that wants to undertake this price increase. Clearly this is not serious. At a time of falling prices, you don't push it through with these massive price increases. So this price is then what they relate to as European price; the European prices have never been applied in trade between Russia and Ukraine. Why should they when the – for a short period, for a quarter or so, will be very high and then they will fall sharply since the European prices are based on a formula which is connected to the oil prices with a certain lag of about a half a year. So this is just a way of saying we don't want an agreement – that's what we are really interested in.

And then the most evident thing is that yesterday Gazprom set up a Web site on Ukraine, facts about Ukraine. And there isn't much on it as yet. I just printed out –

MS. OLCOTT: They keep putting more. (Chuckles.)

MR. ÅSLUND: – printed it out this morning and there isn't much information, but if you open a Web site, against, one of your main customers, you cannot be perceived as a commercial organization. And you're not providing relevant information but just accusations, so clearly Gazprom wants to break the deliveries. And, Dmitri, it's interesting what you said about that there hasn't been much noise as yet. I guess, but we will get – if you really want to get a big media noise about it you should wait until we can get Dmitri Medvedev as we had on the 1<sup>st</sup> of January, 2006, turning off the gas on prime-time television to Ukraine. Well, perhaps this time around we will see Prime Minister Putin himself doing it. So I think that we can't move – it's an interesting observation you had but we can't do it as yet.

And then finally, with regard to foreign policy I think that Russia's policy to Ukraine now is to destabilize. Since 2005 Russia has not taken any positive initiative towards Ukraine at all; it has been a beating up of NATO, beating up of the Crimea, Sevastopol, gas and various trade sanctions reducing Ukrainian imports to Russia and there's been nothing positive whatsoever regardless of which government that has been in power in Ukraine, I mean, including

Yanukovych and then all this corrupt business in the gas trade, which is clearly a major part of Russian policy towards Ukraine. And my interpretation of this is that Russia's interest is to destabilize Ukraine, to make Ukraine look bad – not to attack Ukraine, but to make sure that democracy in Ukraine looks like a failure for domestic purposes, as I already said. Thank you.

AMB. COLLINS: Martha?

MS. OLCOTT: I want to try to take this discussion and categorize – (chuckles) – it in four ways. I mean, I think what Anders has been talking about is this question of what is just and what is fair. Then I think there's a separate issue, which is what I was trying to address and I'll maybe take another step in coming back to it, is trying to imagine what is now going on behind closed doors in the course of the actual negotiations themselves. Then there's the question of how it is framed to the Russian public, which you both have been addressing, and how it relates to Russia's foreign policy goals. And then what's Europe's reaction.

I want to look just for a minute about the how it relates to Russia's foreign policy goals and I think that's very clearly tied to the question of Europe's reaction. I agree with everything that Anders says; I do believe that the Russian government – (chuckles) – is eager to find any way possible to destabilize the Yushchenko presidency in Ukraine. They are playing in this playground and this is clearly one of their goals. The question for me is – I suspect where we differ is that I'm not sure that they will use this drama to the end to do this, that I think that this question of Russia's other foreign policy goals really becomes important at a certain point.

The question is: Does it click in tomorrow, does it click in on – (chuckles) – January 3<sup>rd</sup>, does it click in on January 5<sup>th</sup>? I think Russia is very concerned with European reaction, in addition to going on Gazprom's site, which if I recall is only in English – (chuckles) – it's not in any other language, which I also thought was an interesting feature of the site – this special site on the Ukrainian crisis. Russia is very concerned about that European reaction. I also have been trying to monitor European reaction to what is going on. This has really not been a big item in the European press; it's a very striking difference between 2006 – 2005, 2006 and today that right now the Europeans have, either because they have so many other issues that they're focused on or because they are trying to keep a low profile to this issue for as long as possible, have not been writing extensively about it.

So I don't think that this will immediately become a huge crisis for Russia in Europe. I think that the visions within the European Union on energy are very clear. The long-term – the different perceptions of Russia are very clear and that the question of this year's supply – that there's a sense that the Europeans don't want to drag – to take the question of this year's supply and make it the focus of the disagreements over energy and the role of Russia. I think that the Europeans feel, I mean, by comparison the question of keeping Russia behaving along the terms of the negotiated ceasefire – I don't know what to call it – between Georgia and Russia in South Ossetia – that become more important. That there are problems that Europe wants to engage with Russia in the short-term that priority over this gas delivery issues, which is why I think they've tried to facilitate – and not succeeded in facilitating – some resolution of the problem.

One last thing before I give back the floor: What's going on between closed doors? Again, it's a question – (chuckles) – of the debt – whether it's just or not – to me, when I think about this as a chess player and how they're possibly playing with each other is less important than that it's on the table. Ukraine's paid part of the debt in – if I recall correctly, October – \$800 million of the debt has been discharged. So, in a sense, whether the debt can be substantiated or not, it's already out there as a tool on that table. And there are all sorts of ways that it can be discharged other than by paying 14 – other than by handing out cash for \$418 a thousand cubic meters. There are ways that ledger prices can be set much higher against debt. So to me these fantastic prices that are being thrown out and leaked to the press, which that 419 in today's context is, pretty fantastic – is partially, in my mind, a negotiating tool to be used against that.

And so, again – and this what I'll close with – I still don't have a sense of what the maximum Ukraine is willing to pay – what they're willing to give up to get this settled and what is the minimum that Russia is willing to take to have it settled. But I do believe that both sides have gained through the publicity up to the non-settlement, but there will be a point in time in which – and it comes around the gong of midnight and shortly thereafter, where both sides will lose from the failure to find resolution. And that to me is different from 2006, where one side lost much worse than the other, in that case Russia.

AMB. COLLINS: Well, as someone who has participated over a few years in the past in Ukraine-Russian negotiations, I can tell you – (laughter) – this is first and foremost a negotiation. So I think it's probably fair to say that statements from both sides have to be taken with a grain of salt; they're largely meant to put out one side's case against the other, whether it's right or wrong – and it usually has very little to do with the facts, because this is a negotiation and the point of it is to come to some kind of an agreement. In my experience, it will probably not come until the very last minute if it's going to get resolved, because that's the way this works.

Now, what is unclear to me is exactly who's negotiating at this point. It is not the governments, then presumably it is people with the gas community on both sides who are working for lord knows how many different bosses. But at the same time you have political stakes behind them in each case and it seems to me what I hear here is that there's not a lot to be gained politically by either side letting this go to a rupture. I think we're going to be engaged in a game of chicken right to the end and whether or not they will let it go forward will be a calculus politically if the political wind is dominant as to who will gain most by having the rupture happen. And I don't know the answer to that.

I think what Martha is suggesting is this is not 2005, 2006 when frankly the Russian side suffered, if you will, sort of a political disaster from the way it turned out. They've taken certain preemptive actions this time to prevent that; Ukraine has a more difficult role this time to present its case. But who knows? But what still troubles me is the sense that we don't have a good handle at all – it seems to me, and therefore my own instinct is to sort of withhold judgment about exactly what's going on – as to who the real beneficiaries are when all this gets sorted out.

Anders is suggesting it's always Gazprom, but frankly there's got to be some Ukrainian side in this that is either benefiting or losing, otherwise we wouldn't be in a negotiation. So I

would like to understand if I could what's going on on the Ukraine's side. I mean, this isn't all just the Russians negotiating with each other, I don't think, and therefore, even if destabilization and other things are there, there are Ukrainian parties too – I don't understand the dynamics. And so anyone who can help me out on this would be – (chuckles) – most useful.

MR. ÅSLUND: First, your first question – who is negotiating? It's Alexei Miller and Oleg Dubina – the two top cats, company officials who are sitting in Moscow and negotiating. So that's perfectly clear.

AMB. COLLINS: Dubina represents whom?

MR. ÅSLUND: Dubina represents Tymoshenko.

AMB. COLLINS: Yes, but what company?

MR. ÅSLUND: He represents NaftoGaz Ukrainy. And the party that is driving Mrs. Tymoshenko in the Ukraine and she has the three obvious demands: first, that UkrGazEnergo should be taken out of Ukrainian domestic trade, which is part-owned by RosUkrEnergo; second, that RosUkrEnergo should be taken out and that was agreed between NaftoGaz Ukrainy and Gazprom in October and I think that the Gazprom officials are now trying to revoke at least the second issue because they want to have – (inaudible) – so that they can steal as much money as possible from Gazprom. That's their objective, as we knew from many years if we're at all realistic about what this is.

And then the third objective is of course to get a reasonable financial agreement, both with regard to payments actually made. And if you notice here, what Gazprom demands is a prepayment of deliveries in December, which has never been done before. So this is a very radical and new demand that Gazprom proposes and they referred to that agreement between Tymoshenko and Putin on the 2<sup>nd</sup> of October, which has not been published. And we can't check if this is an accurate understanding, if Tymoshenko has made such a mistake or what it is. I'm not saying that this is in the interest of Gazprom; I'm saying that Gazprom is a company that has been – is losing a lot of resources to its managers and not trying to distribute who exactly is stealing what.

We know that Gazprom is a major operational test. We have this excellent booklet by Vladimir Milov and Boris Nemtsov, where they show how Putin and friends took out assets worth \$80 billion in the spring of this year from Gazprom during Putin's second term. So even if one of the other seven major transactions happens to be slightly incorrect, we know that this is a pattern. It's not in the interest of the Russian state, it's not in the interest of Gazprom; it's in the interest of a limited number of top Kremlin officials who are in the habit of stealing from the Russian state and this is really what is going on. So since Tymoshenko is here for a long time and produce a very clear sense about strategy, I think that now Gazprom is trying to do something very different and of course we can't know what it will be. And the essential thing is for them to make sure that the stealing can go on.

AMB. COLLINS: Well, why don't I – Dima, did you want to make any comment or should I open it up to questions?

MR. TRENIN: Maybe it's better if you open it up.

AMB. COLLINS: Okay.

MR. TRENIN: For discussion.

AMB. COLLINS: Bruce?

MR. JACKSON: I just wanted to comment on Martha's formulation, which I thought was very good. I mean, this is the same crisis that we've been seeing for the last three or four years – (inaudible) – supply from the east to Europe's west, but there's a little bit of a shift in where the questions are. It seems to me that there are many more questions about Ukraine today than there were in the first crisis.

AMB. COLLINS: Can you speak up a little bit, too? I have to make sure Dima can hear you.

MR. JACKSON: I mean, the questions would be – you don't know, as Anders was saying, you don't where the receipts are. I mean, presumably he paid somebody for the oil, you know, the gas – you must have kept a record. Nobody would believe us if we said the Bush administration borrowed from China; we can't possibly know what they borrowed so we're not liable for it. That's not going to work.

Ukraine has never made an argument for why they didn't pay. It's never – and it's been in the European press for months that it was 2 billion to 5 billion and going up. Somebody, if that wasn't true, somebody would have said something by now. And, again, this year, it's RUE and I think Anders is the expert on this, all of these same companies – these are the same companies who were identified last year and the year before and everybody has said we're going to correct it.

They weren't corrected and both Russia and Ukraine, all of the political people in Ukraine, allow that to continue. That's a little strange. And, at the end of the day, particularly Ukraine is making the case for being the transit country, I mean, the transit country to Europe. Is it politically stable enough? And, on the other hand, there is a new question for Russia. This is the first year that they basically just talk about the shooting down of strategic bombers as being conflated directly with this relationship with Ukraine. That was never mentioned before. There was, essentially, a military component; it was the actions of Yushchenko during the Georgian war that is somehow – well, certainly disturbed Putin in a way. And it's referred to in all of the Russian media. That is certainly a new element on the Russian side.

Anyways, it seems to me that there have sort of been new kinds of questions and a different emphasis this year than there was in years before. That's sort of the question here.

AMB. COLLINS: Dima, do you –

MR. TRENIN: Well, I think that the big difference between this situation and the situation in 2005 and six was that the hopes with regard to Ukraine were flying very high four years ago – three years ago. And when Russia was doing what it was doing towards Ukraine, it was seen at the – certainly seen in the West as Russia stifling – or the Kremlin, whatever – stifling the Orange Revolution.

Now, the glamour of the revolution has worn off and Anders is saying that it's the Kremlin's policy to destabilize Ukraine and Martha is talking about destabilizing the Yushchenko presidency and the Kremlin wants to see the back of Yushchenko at the end of next year. But, Ukraine – let's face it, Ukraine has been stabilized, most of all by the failure, its political leadership, to get their act together. I would also say that by raising prices to the whatever, European international level, however you want to define it, Russia was de-facto cutting Ukraine off as a former republic, as a country subsidized by Russia, as an ex-Soviet territory.

Basically the message that Russia was sending in 2005 and six was that you're as foreign to us anyone else and, basically, you pay up. And that, I think, was a golden opportunity for Ukraine. When I was in Kiev last, I heard a very good definition of what independence is. My Ukrainian friends told me that independence starts when people stop paying for you. And that I think is a very true statement.

Ukraine did have an opportunity. I think there is still an opportunity to have another look at its industrial policy, at its industrial enterprises, at the energy intensiveness of the Ukrainian industry and the fact that you only owe Russia money, but nothing else: no loyalty, no sentiments, no nothing. It's just about money. That, to me, looked like a perfect setting for a serious nation-building effort in Ukraine.

Again, unfortunately, I am saying that with a lot of sadness. We haven't seen much positive happening on the Ukrainian political scene in terms of using the achievements of the Orange Revolution, if you like, the real moralists that exist in Ukraine to come up with a clear policy. Ukrainian leaders are spending most of their time attacking one another. This is not made in Russia and, unfortunately, this is, as Anders said and I agree, this is the message that the Kremlin, the picture rather, that the Kremlin is using for its own purposes and that is not serving Ukraine's case very well in Russia nor does it sell Ukraine's case very well elsewhere.

AMB. COLLINS: Anders?

MS. ÅSLUND: Yeah, I didn't respond fully to your point here about the Ukrainian interest. And that, of course, comes into Bruce's question. Not really major point is the Region's Party where one has 175 deputies out of 450 has two main sources of financing. One is Akhmetov and one is RosUkrEnerg. And RosUkrEnerg finances for Yanukovich; part of that might be harmful. So therefore of course nothing can be done against RosUkrEnerg as long as Yanukovich is involved in it. And RosUkrEnerg has also persistently been rumored to be paying, have sort of – (inaudible) – the presidential secretariat on the payroll.

I'm not sufficiently clear about it so I dare not say who, but it can be no despair to President Yushchenko, at one of his statements to Tymoshenko simply to pay up, took actions and complained that she didn't manage payments properly, which one shouldn't take too seriously because Yushchenko is making lots of statements of this – in nature to anything Tymoshenko does is wrong. The fundamental point of it is that the Ukrainian politics don't hang together. It's almost impossible to adopt laws in the Ukrainian parliament and, therefore, to undertake major decisions like exclusion of RosUkrEnergo which might be paying as much as half of Ukrainian politics, would be almost impossible. I wouldn't say so much, but perhaps a third of Ukrainian politics is being financed by RosUkrEnergo.

And this is probably not only to the presidential secretariat and to the Regions Party, but also to the individuals in other parties. And this means that RosUkrEnergo is a major part of the inability of Ukraine to decide that. You can also look up on it in the general term, would you get decision through the U.S. Congress that go against ExxonMobil? Hardly. And RosUkrEnergo is far stronger. So by any stretch of imagination, it will be very difficult to get RosUkrEnergo out of this mess. And I think that Prime Minister Tymoshenko's behavior is quite naturally, she focuses on this as the main issue that she wants to solve and all of the other things are far less important because RosUkrEnergo today is, to a considerable extent, owns Ukrainian politics. And RosUkrEnergo – (inaudible) – to a considerable extent the Kremlin all to work together because there are also a lot of other parts linked to – (inaudible).

MS. OLCOTT: I'd like to go back to what Bruce said and also add another important difference from the 2005, 2006 crisis. I think that one of the things that Europe is asking itself now, as Bruce said, is what kind of partner Ukraine will be for them. And another big difference from 2005, 2006 is that Europe has spent this intervening period examining what other pipelines routes they have, what other ways can they move energy to Europe. And some of these routes are – some of these new routes seem like they're going to go ahead.

I mean, Nord Stream does seem like it's going to go ahead. It's very controversial within Europe and that does bypass Ukraine. At the same time, Europe's efforts to invigorate Nabuko have not gotten very far. So this other alternative, which would cut Russia out, has not solved their problems. So I think, you know, they will watch this crisis, the European energy people will watch this crisis really clearly, really closely, and ask themselves what routes – if this doesn't work out quickly, what other routes are they willing to take, even routes having continuing their dependency on Russia but bypassing Ukraine in the process?

So I think there's a lot of risk for Ukraine in terms of their future role in Europe and I do think, I mean, to the point about Georgia being thrown on the table, in a sense, whether the weapons – whether the fighter planes were dug up at a convenient time or not, Yushchenko did race down to Georgia and appear with the Baltic presidents and the president of Poland in Georgia's defense. (Chuckles.) And that is a change of balance much along the way that Dima was talking about for 2000 brought 2006.

It really is a change of status quo for him to take the same position as these NATO countries that do have a strong agenda vis-à-vis Russia.

AMB. COLLINS: Others? I want to make a couple of other comments and then ask a question. First, you're never going to cut Russia out of the gas grid or Ukraine. I mean, they're going to be there. What you can do is induce competition, lessen dependence on any one particular group. But you're never going to cut them out. So, I mean, it's a matter of some limit.

But the other element that's not been discussed here is the fact that the economic picture for everybody right now is a good deal different from what it certainly was in 2005, 2006, and, for that matter, what it was in the beginning of last year. Now, I do have a factual question because I don't know the answer, but what I recall is that in the process of negotiating the previous agreements on gas, there was agreed a formula by which gas prices for Ukraine would be set. I don't remember what the base for setting it at any given moment was, but it was presumably what it had been some time ago as opposed to what it is now.

Well, it may not make sense at \$35-a-barrel oil to be setting it as though it's 140. On the other hand, six months ago, it was considerably more. And so the base for setting it is contracts are contracts, some will argue. And so I'm just curious as to whether, you know, there is a legitimate case for the price being way out of kilter with today's simply by virtue of that formula.

But I also really would like somebody to say a word or two about how this is all playing out in the current economic and financial time. I mean, clearly, Ukraine itself is in much worse economic shape than it was six months or a year ago. So is Russia. You have whole problems of credit everywhere, et cetera. So I'd certainly like to have a sense for these issues.

MS. ÅSLUND: Yeah, there are no price formulas. There have never been any price formulas. It was \$50 per year for a very long time until –

AMB. COLLINS: So I understand.

MS. ÅSLUND: And then it has been raised each year or each half year and it has been an open negotiation until the last minute each time. So there's never been any price formula. At the meeting on 2<sup>nd</sup> of October Tymoshenko said that there would be a gradual transition to the European price formula in the course of three years. But that was only a statement, not a document, as far as we know.

And they did not agree on a price and Tymoshenko then expected the price to be 250 to \$300 for 1000 cubic meters for next year and that was, of course, when prices were still very high. Ukraine obviously has had a very substantial financial interest in having an agreement as late as possible since the price is falling by the day. So in that way Ukraine has not only acted as it habitually does, but also rationally.

And what will happen now is that Russia is losing leverage. As I mentioned, in November, Gazprom's production fell by 10.6 percent, just because of lack in demand. So when the Central Europeans are now counting energy consumption, they are first counting on Gazprom's deliveries partly because they are too expensive because of this European price

formula, partly because Gazprom is, for very obvious reasons, perceived as very unreliable as a supplier.

So what is happening here is that Gazprom is very swiftly losing leverage and I think that Gazprom will have serious financial problems because it can't sell its output at the prices it demands. So, basically, since 80 percent of gas to Europe flows through the Ukraine and will so for several years Ukraine has an enormously strong negotiation position. And the transit fee now through Ukraine is only 1.7 – whatever unit, when it should be several times that. And this was set in the agreement in 2006, the 4<sup>th</sup> of January 2006 agreement. And clearly Ukraine would like to change that also.

So Gazprom is simply overplaying its hand. It should be trying to get a long-term agreement so that it can stay afloat and have customers and instead Gazprom is scaring its customers away when it should be begging to keep them.

AMB. COLLINS: Bruce?

MR. JACKSON: On the indexing, since we have economists here, is it not the case that gas is indexed to oil because there's an efficient market for oil at spot – price fluctuations occur faster because gas is negotiated on a multi-year or a year basis, it will tend to lag the price going up and lag the price again when oil is coming down. And so one of the incentives I guess you were saying is Russia wants to negotiate now when the lower prices are not reflected into the year completely. But if they negotiated a little further, you get very compressed prices for gas, in theory.

MS. OLCOTT: Could I say something about that? I mean, that's true. And it's even more complicated because it's an – no one knows, every gas purchase agreement is secret, you know, but we have some sense of shape. And it's an averaging of a three- or six-month period of the gas, of the oil prices going back. So it's quite slow. It will take six – and in the case of the Europeans, it's a quarterly adjusted price. But Russia's purchase price for Central Asian gas, they trapped themselves by their own cleverness and they seem to have adopted a six-month average, a six-month price with the Central Asians rather than a three-month price, as they do with the Europeans.

So they thought this would give them the advantage of holding back price increases from the Central Asian purchase price. But what this means for 2009 is that they're paying inflated prices to Central Asians for the first six months, not simply for the first quarter. And that's a big reason why they need to get the gas to Europe.

But, at the same point, because of that, they're not going to take a new pricing formula from the Ukrainians where they're basing it on today's spot price of oil. I mean, they're going to – Gazprom is going to have to try to hold them to the same structure of formulating pricing in this and the Ukrainians have always fallen into this CIS corridor which Russia has now been telling them they're going to get pushed out of the CIS pricing structure. But those are the two constraints they have. So, yeah, Russia isn't going to be in the same commanding position that they have been previously.

About the paying forward, though, that's something that's new to Gazprom in their dealings with the Central Asians this year. And it is in their agreement for this year's purchase because of the things they're doing – and they can do this with Ukraine too, both with debt and also with maintenance costs for the pipeline system across Ukraine. But the Central Asians have – what Gazprom has done with the Central Asians is get them to agree to co-finance improvements and expansion of the existing pipeline system through Central Asia, through the forward sale of gas credit.

And this is something that they haven't done previously. So if it's turned up in the Tymashenko-Putin talks, you know, this is something that Gazprom has begun playing with this year that they hadn't previously done. And it's a way that they're trying to handle debt financing, other people's debt to them, rather than – and do it, effectively, a barter arrangement, which they were so good at historically, but a barter arrangement for selling customers or suppliers' debt to Gazprom.

So they are tract in very, very complicated formulas of their own making, which is limiting real profit that they can actually achieve, real cash that they can actually realize.

AMB. COLLINS: Dima, anything from your side on this?

MR. TRENIN: Well, I don't think I have much to contribute, quite frankly, on that issue. So why don't we have more questions if there are any questions.

AMB. COLLINS: Questions, further questions. Well, maybe I'll – do you want to have any summing up? Dima, I think maybe if we've kind of exhausted people's capacity to listen to this. (Laughter.)

MR. TRENIN: I think, Jim, I agree with you. This is a negotiation. This is a very hard-fought battle for the best price that either country wants to get out of that. I agree with Martha that if they fail to clinch a deal, they know that both will lose. The Russians know they will lose because that's – they've been through that, they know how hard it can be, how difficult it will be for them this time. But the Ukrainians also realize that the situation is different today from what it was three years ago, that they will not be given the kind of lenient treatment that they were in the wake of the Orange Revolution.

And I believe it's a great stimulus for both countries to come to closure. I think what is really troubling for someone sitting in Moscow is that in all of these years since the collapse of the Soviet Union, Russia has not been able to develop a serious, long-term policy towards Ukraine. And recently when Russia has embarked on a policy of high gas prices, more exacting policy across the board, there has been too much steel in Russia's approach to its neighbors and not nearly enough attractiveness that Russia should be seeking to restructure the relationships with its former borderlands.

It's never easy to start anew with countries that used to be your provinces or parts of your territory, as a lot of Russians still regard Ukraine, but it's really striking that, apart from this gas

situation and a few geopolitical things like no NATO in Ukraine, no U.S. bases in Ukraine, that kind of thing, Russia has not developed a positive approach to what arguably the most important country on its immediate periphery. And this, I think, is a major flaw in Russia's foreign policy overall.

Hopefully this is not the last word, but it's very clear that the pattern of Russia's foreign policy set recently calls for hard instruments, much more than for soft power influence. And that's – as I said, that's sad and that will not bring Russia much success or much happiness.

MR. ÅSLUND: Well, just briefly, if it is political, as I think it primarily is, we should expect the cat out at midnight on New Year's Eve. If it is commercial, we should expect an agreement at midnight on New Year's Eve, of course not a minute before, just exactly at midnight. So I think that this will be an interesting test, hypothesis to see what predominates.

I wanted to take the opportunity to thank you for the invitation and very good to see you, Dima, always good to see you.

MR. TRENIN: Very good to see you at all.

AMB. COLLINS: Martha?

MS. OLCOTT: I want to thank you all too for doing this, especially so close to New Year's Eve. I suppose I think that this is both commercial and political, that there will be a cutoff, but it will be quickly solved afterwards.

AMB. COLLINS: Well, first of all, I want to thank everybody for doing this. We're, I think, going to try to make this a more regular practice to try to discuss topics in this way. I think what I would comment is that – I think it's important that this is all taking place in the context of a global economic meltdown and great uncertainty on everyone's part about just what the implications of this are for the future.

For the Russian side, it certainly has budget implications. It has any number of rather nasty possibilities emerging as I think – as Anders has said. Gazprom, for instance, which may have been riding high as the price kept going up, is suddenly faced with serious problems for its own development. These are not kinds of development programs that are done on a month-to-month basis. These are decade-long decisions that you have to make to make it work. And that makes it much more complicated today for Gazprom to determine its development structure, its investment policy and particularly at a point when my assumption is, they don't have any more credit than anybody else. So they're internally financing whatever they have to do, which puts ever greater pressure on trying to extract and get whatever you can as a certain flow of funds into your system.

In short, this context, it seems to me, does complicate matters for both sides. Ukraine also is in serious economic trouble. Any money that it agrees to pay out over the coming year, you know, in addition to what it thinks it might have got away with, is going to be politically

controversial; it's going to be painful. So if they're paying \$10 more, 1000 cubic meters, by the time you get done, it means something.

So I think, this is a context in which the political economics of the situation are complicated by today's overall environment. And you have, in addition to all of the factors that have been discussed today, which are more continuity than anything else. I'm not sure it will be quite so obvious that it's either political or economic depending on whether the deal gets struck. I have watched these two parties manage to shoot themselves in the foot collectively on several occasions so that it's not at all clear to me that this will tell us much one way or another.

I do think it's also true that you will end up with an agreement sometime in the relatively near future, whether it's by midnight on New Year's Eve or a few days later, it won't matter much in terms of the actual economics of things. But it will certainly generate a lot of hoopla. If there is a cutoff, we will probably see a revival and a re-spike in all of the discussion about who's the unreliable supplier.

My guess is Russia will lose on that no matter how this really plays out. I think they know it and therefore I would agree with you, Dima, that this is not something they're looking for, particularly in the present context of a new American administration coming in, all of these things that they don't need the complication. On the other hand, there's a limit to how far they're willing to go to save that and I think, on the Ukraine side, a cutoff also, frankly, is going to raise other issues about whether Ukraine is a reliable transit country, because I don't think probably either side is going to win on this. My sense is the Europeans, from what little I've read of the commentary, is sort of a pox on both of your houses. You know, this is something you ought to get settled. This is not something that we should all be held hostage to.

And it will not do Ukraine or Russia much good to have this particular dispute result in a disruption of supply or raising that question. And it may well be true that then, in Martha's world of alternate pipelines and so forth, maybe people will in fact in Europe take a look much more concertedly at alternatives to the singular dependence on the current system that has been very controversial.

So we'll wait and see. Maybe we'll reconvene in a month or so, see where we think this all came out. But I appreciate everybody coming. It's been a good morning discussion. Thank you very much.

MR. TRENIN: Thank you so much and happy new year to you all.

(END)