

CARNEGIE EUROPE

CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

WASHINGTON DC • MOSCOW • BEIJING • BEIRUT • BRUSSELS

EVENT TRANSCRIPT

The Carnegie Russia-Europe Forum – “The Next Decade: What Kind of Partner Can Russia Be?”

Wednesday, May 26, 2010

SAM GREENE: There has been a lot of discussion about the difficulties that arise from time to time in the reality of Russian/European relations. I think what we want to try to do today in a relatively brief and concise conversation is to marry these two aspects and to really explore what kind of partnership we can develop by starting with a clear evaluation of the constraints - what is it that Russia can bring to the table, what is that Europe can bring to the table and what is it that they can't bring to the table and see if we can, by almost a method of elimination, begin to have a clearer agenda for what can be achieved in the near to mid-term in Russian and European relations. It is often said, and I think generally correctly, that the fundamental essence in the foundation for Russian/European relations is economic and that that, on a more granular level, is fundamentally related to energy, and so that's where we're going to start today.

The title of this first panel is Beyond Energy and that doesn't mean that we're not going to talk about energy. We're going to start from energy and we're going to move out from there. We have an excellent panel of speakers to get us started off and we're going to go in a little bit of a different order than is presented in your programmes. We're going to start with my colleague to the left. Adnan Vatkansever, who joined the Carnegie Endowment Energy & Climates program in Washington about a month ago, after a distinguished career in the World Bank and Cambridge Energy Research, is an analyst with broad experience in Russian/European and Caspian region relations and the political economy of energy.

From there, we'll move to a broader discussion of what we've learned in recent times in terms of what the structure and the possibilities of the Russian economy are in presentation from Sergei Aleksashenko, scholar resident in the Economic program at the Carnegie Moscow Centre and an associate of Carnegie's Global Economic program. Sergei is probably known to most of you. His CV would take up most of the time that we have today if I were to read it out, but just to name

the highlights. In addition to his work at Carnegie, he is Head of Macroeconomic Research at the Harvard School of Economics in Moscow, former Deputy Governor of the Russian Central Bank, former Chief Economist at Merrill Lynch in Moscow, and the list goes on.

Then we're going to turn to the European side and hear from Iana Dreyer, trade policy analyst at ECIPE and a long time observer and analyst of European trade policy vis-à-vis emerging markets in Eurasia, Asia more broadly, but more specifically Russia. So, without further ado, I will pass the floor to Adnan, thank you.

ADNAN VATANSEVER: I'd like to focus on one major question from which I'd like to form the discussion. The question is whether the possibility for cooperation on energy issues between Russia and the European Union has increased or is likely to increase in the near future. We know what the major difficulties were and at least about a year and a half ago, due to climate, due to gas or the crisis, but currently I would like to draw attention to three areas which I believe make it much more likely that we might see greater incentives for cooperation, at least from the perspective of Russia.

The three areas that I'd like to focus on are the following. The first one is, one needs to look at the big picture and see what is happening to the Russian economic model and basically to the political economy of oil and gas price [?] in Russia. My main conclusion is that the existing model is very much strained and it creates incentives for Russia to adopt a much more cooperative stance, particularly in issues such as attracting foreign investments.

Now, whether this is going to happen or not is another issue that we can talk about, the constraints, but my sense is that the incentives are the right incentives, to some extent, there now.

The second area has to do with gas, which has been the main source of contention between the two sides, and I see certain trends that make cooperation again much more likely than before, and the third area is an area which is emerging increasingly important, from Moscow's perspective, and this is energy efficiency. It is really starting to focus on energy efficiency; it is basically an area that is much less controversial than anything that has been there so far in bilateral or Russian energy relations with the West, and this could be an area where opportunities start.

So let's start with the first topic. Basically the political economy of rent distribution or oil and gas rent distribution in Russia. Just to summarise how it looks so far, I would like to give a very simplistic model. A huge amount of rents have been generated and they are mainly distributed between the companies, as profits, another part goes for reinvestment in order to sustain a particular production level, and the third part of the rents has been going to the government.

Now, looking at the past decades, the period before the crisis when oil prices collapsed, Russia witnessed two major trends, especially in the first part of the decade. This was a huge growth of oil production and, at the same time, a massive increase in the price of oil and, by association, the price of gas. This resulted in a considerable increase in the total amount of rents which was able to satisfy an existing model of rent allocation. In this case, companies were getting more... they did have quite strong bonds [?] to invest in their fields and government was increasing its revenues substantially, actually a colossal increase in government revenues within a span of a decade, until the global recession hit.

Now, this model has become increasingly constrained currently and this is not just because of oil prices. The future of oil prices will be key about where this model will evolve, but if we assume that the current prices are pretty much what we might see on average for the next few years, or even for a decade - and I'm basing my assumptions on the fact that this last recession has shown that there is a certain limit about where prices could go without damaging the global economy. So even if we see higher prices, it will be cyclical again, to some extent.

Therefore, on the one hand, we assume at current prices Russia's economic model is going to be increasing in strength, very much because of geopolitical reasons.

Now, most industry insiders would know that for Russia basically there are two big problems. On the one side, the problem is on the old and mature fields where costs are increasing rapidly and production, for instance, in oil has been declining since 2007 in West Siberia. In the meantime costs have been growing rapidly and it has actually accelerated last year based on the various data.

Now, the gas sector doesn't look too different in terms of its mature fields stock. What is happening is that in each case, as the costs are increasing, there is much less money left for reinvestment or for the government as well. The other trend is that there has been a gradual shift towards new fields, but new fields naturally require much larger investment and much bigger amounts and much bigger commitment by companies.

Therefore, we would expect that the amount for reinvestment, even to maintain current production levels, has to increase and if we assume similar external conditions in terms of pricing, this is actually going to constrain very much the current economic model that has developed there. There will be less for the government and the government basically will fuel incentive that something needs to be done in this area for reinvestment.

Now, this is an area where the problem could be tackled by a better tax regime or also by promoting independent gas producers or small companies, but each of them could lead to some favourable circumstances for foreign investors as well. In general, my sense is that there is much stronger incentive, from Russia's perspective, to elaborate its stance towards potential foreign investors in its oil and gas fields.

Certainly there are some major constraints that we can talk about and that actually leads to uncertainty as to whether Russia will still act on these incentives or just prefer to postpone acting on them, and I guess one of the major constraints is the foreign investment law from 2008 which describes a huge range of areas, and strategic oil and gas is among them.

There are certain signs that Russia is actually rethinking its strategy in that area and there have been hundreds of projects that have been submitted for approval for the Commission that approves foreign investments, which is set [?] by Prime Minister Putin. There has been a huge backlog and there is a realisation this system is not working anymore. Even Prime Minister Putin has been actually making statements that the country needs to revise its stance on this and several months ago he invited some of the major executives of oil and gas companies, foreign oil and gas companies to [unclear] and making statements which sounded much more positive than what we had seen since at least the [unclear], I would say.

Now, certainly there would be other constraints as well, which is Russia has some big players that will have interest in maintaining the current system, such as Gazprom and Rosneft have been assigned to develop the big fields, or whatever is discovered as a big field. Will the Russian

government change its stance on this topic? It has the incentive to do so in order to recreate this potential for investment, but we are not sure how soon the Russian government will act on that.

The second area that I'd like to talk about is specifically about the gas sector. Now, I'm looking from the perspective of Gazprom and how Gazprom is likely to see what is happening in the gas sector. Now, there is a global, at least for now, glut in the gas market. There is a reason to think that there is an oversupply and it will last from at least until the European recovery of demand picks up some speed. Even though this might be happening, there is still some gap compared to the period before the crisis.

The other thing has to do with some strategic mistakes on the part of Gazprom in the past decade. For instance, Gazprom was very late in entering into the game for LNG exports. It was as late as 2003 when they decided to move in that area and they should have done it much earlier in order to sign to work in several countries or contracts in that area. Now it becomes increasingly harder to do so, partly because of the unconventional gas revolution in the US. It has shifted a lot of LNG tankers to the other side of the Atlantic basin and in the Pacific basin the competition is heating up because of Australia and LNG, for instance. This is an area where Gazprom is witnessing major difficulties.

The other problem is that it had a major failure in establishing its gas relationship with China as a potential big importer of its own gas. After talking for over a decade, simply nothing has been achieved there. There have been serious disagreements about price and, in the meantime, China was able to establish a link with Central Asian Gas, with Turkmenistan mainly, and it has signed contracts for energy, so its need for Russian gas, compared to a decade ago, is much more questionable and there are indications that China may not need Russian gas for at least a decade.

In this case for Gazprom the European markets appear as the main market where it would be concentrating its efforts and, to some extent, it's a negotiating position because it has to sell the gas that it is producing and Europe appears as the most cost-effective market to do so. That is, to some extent, something that Gazprom might be willing to adopt a much more cooperative stance.

There are certain constraints that need to be recognised, of course, where things might be headed. The first thing is – and these are much longer-term features – the first thing is that if we think about gas, it used to be a bridge for cooperation between Russia and the European Union for several decades until very recently.

Now it has become a source of conflict and discontent on both parts much more recently. This is partly to do with the fact that gas has become an increasingly important source of energy for the European Union, unlike two or three decades ago, and the European Union naturally has to think about gas in a much more strategic way. It has a much more important role in its own energy security calculations, so this is just one of the longer-term constraints that I would mention.

The other thing is that in the meantime Gazprom has increased its appetite for taking over other companies abroad or taking over various assets abroad and this has run into a major problem, simply because of lack of legal correspondence between Europe and between Gazprom. There is no indication that Russia is soon going to shift towards adopting or agreeing to the third directive of the European Union, so there are issues which the European Union is expecting from Russia and Russia is probably not likely to deliver them in the very near future, and this is a major constraint.

Another area is one thing that gives some hope probably is Russia's recent approach to the Ukraine, but again one needs to think about some larger structural constraints there. As long as Ukraine does not improve its energy efficiency, as long as Ukraine does not increase its gas prices, it is based on repeated problems; Naftogaz will not have an easy time in paying its gas bills and, if it does not increase its domestic gas prices, it will not be surprising if it faces another series of difficulties in the future in its relations with Gazprom.

Therefore, there are certain constraints that remain there, but at least, to some extent, a major strain in gas relations between EU and Russia is probably less likely to be caused by Ukraine, at least for some time, given the current situation.

Finally, regarding gas, I'd like to note that I assume that in the upcoming months the competition between Caspian gas and Russian gas will only heat up; it's not going to disappear. The competition between South Stream and Nabucco, some important decisions need to be made in the forthcoming months or year and it means this will create the sense of an ongoing competition rather than a sense of cooperation.

The last area that I'd like to talk about is energy efficiency and this is very different from other things that I have mentioned so far in the sense that it is much less controversial. I was in Moscow last week having over two dozen meetings on energy efficiency issues and my sense was that Russia has started to take this very seriously.

They have the necessary legislation, to a large extent, in place, to promote this energy efficiency and there is also an improved capacity to deal with this because they have identified the institutions to deal with them. Certainly, we can't be sure what would be the success in terms of coordinating this within the Russian government, but this is an area where both Europe and Russia could benefit.

From Russia's perspective it could reduce, to some extent, the strain that is created by its geological constraints; basically it needs to make huge investments in order to sustain existing levels of production in order to increase production, and to some extent by removing part of the domestic demand, by reducing it through energy efficiency it could be very helpful from their perspective. From your perspective, obviously it improves the sense of energy security as well, as that will allow a huge chunk of gas to be available for the European market.

Finally, I'd like to mention that Russia's focus on areas such as innovation, for instance, which appears as a big priority in rhetoric, this is an area which could easily be linked to energy efficiency because energy efficiency is something that requires a major transfer of technologies, especially from the West, and this brings certain opportunities where both sides could cooperate. Thank you.

SAM GREENE: Thank you, Adnan. Sergei.

SERGEI ALEKSASHENKO: Thank you for the presentation and I understand that I have a very unpleasant job because I have to explain to you why the future relations between Russia and Europe in the sense of oil and gas... beyond oil and gas. But really I have a funny story about this. Let me start with the Russian crisis where Russia probably was seen as the most [unclear] countries. Russian GDP fell by roughly 8% in 2009 and up till now there is no significant indication of an economic recovery.

In the second half of the last year there was a certain increment role [?] [unclear] in sectors in the Russian economy because oil prices have increased and gas consumption in Europe has increased, level of prices has increased and that led to growth of financial sectors while domestic industries are producing goods and services for domestic consumption and they continue to shrink.

As Adnan said, apparently in Russia there are only two centres. One is export and, as usual – this is not new – one is export oriented and it is growing not very fast and the other is domestic oriented. On the export sector, according to our estimates, it seems that the Russian economy has reached its pre-crisis maximum on export capacities that was fixed in 2007, and further on, certain goals may take place, but they will be very, very slow.

On the domestic sector, as I mentioned, there is no significant improvement. Why? Why did that happen? There is a widespread view that the Russian economy is dependent on oil; yes, that's true. But the growth we saw in the second half of the previous decade or the current decade was what linked to the fall in prices. Really from 2003 to 2004 oil prices were lower than \$30 per barrel. After 2008 [?] when oil spiralled to \$140, seems the Russian condition heat [?] enormously. But that's not true because from 85% to 90% of the increase in the oil price was admitted by the Russian budget and it was not spent towards the economy; it was accommodated into the reserve funds.

That means that despite oil prices increasing from 2003 to 2008, the Russian economy received only a small portion of those amounts. The growth in the economy in 2005 to 2008 was linked mainly to the increasing foreign borrowings. Russian companies and Russian events, intensified foreign borrowings and the corporate [?] foreign debt increased five times from the beginning of 2005 to mid 2008.

As the financial crisis occurred, the financial markets were closed and Russian companies were not able to borrow new ones, to repay old debts; moreover they had to pay the debts received in the previous year. This is why this financial inflow and this financial [unclear] has collapsed and definitely many Russian industries and local Russian firms, they faced the problem that they lost the financial resources.

Another problem that will delay the Russian recovery is the Russian budgeting policy and that is caused by the structural changes in the Russian budget in 2008, 2009 and 2010. According to the government, the decision on pensions and some social benefits have increased significantly and the share of direct payments to households like wages, pensions and different types of allowances increased from 47% to 58% in the consolidation budget.

Literally the whole deficit from this year, the whole deficit from the federal budget, is from the transfer to the pension fund to finance debt and pensions and paid to Russian people. Trying to keep the budget deficit down and trying to reduce the budget deficit in this year, next year, Russian government decided to cut investment and decided to cut current expenditures in some areas.

Of course, pensions are very important, but from a macroeconomic point of view, investment in public expenditure is much more favourable and useful for the economic growth rather than pensions. That's why in the real sense, the non-wage expenditure is not related to the household and they reduced by 8% in real terms. This year it seems they will be cut, next year as well.

That is the situation where roughly the economy is and of course the withdrawal from the Russian economy was so strong that Russian authorities had to react, and in mid 2009 when oil prices had recovered it seemed as if the crisis was over, the Russian authorities started to analyse what was going on and, as there is a different distinction on labour between Prime Minister Putin and President Medvedev, President Medvedev started to explore new ideas.

He started to criticise the current economic system, he started to speak about modernisation and finally in September he published his well-known article called Russian Forum [?], saying that Russia needs modernisation. As this article was published on the internet, in the website, the President invited a wide range of people just to discuss, and that created his career in the Russian society, who said, okay, finally he had changes and we need change like President Obama said.

But very soon President Medvedev has clarified this and said modernisation is not a comprehensive modernisation, it's not what we are looking for, it's not a modernisation of the country or of the political system or every sale in our society. Modernisation is only a technological process; we need to modernise not the economy, but several sectors in the economy, like space, like nuclear, like energy, like pharmaceuticals and computer science, so that's what modernisation means currently.

Moreover, there were very wide debates in Russia in autumn last year, at the beginning of the winter about organisation, and a lot of experts have agreed that in order to modernise Russia and make it contemporary, to make our country model, there is a need to start with the political organisation, the modernisation of the political system.

It seems that this idea, this conclusion, created a certain fear in the Kremlin, in the Russian White House, and the word modernisation has been replaced by greatly another word: that is innovation. If you hear the speeches of the Prime Minister or the President, you will see that they mention much often innovation rather than modernisation.

Is it serious? Is it serious even technological modernisation? To one extent, yes, because the President has established a special commission that is meeting every month, that is travelling all over the country meeting different companies, discussing different ideas and proving different projects. On the other hand, the Prime Minister has established a commission, his personal commission on innovation as well, but on the other hand it should be, at least as President, in indicates it should be a government-led innovation process of the technological modernisation. On the other hand, the Russian Government has decided to spend on all technological projects, on all innovative ideas, and only \$4 billion dollars will be coming in three years, while the Russian annual budget is annually €240 billion.

So you have seen that the government is ready to spend the money and is not ready to change the economic system. It is not ready to change the rules of the game. That makes me think that Russian authorities do not recognise very well what they want to achieve.

The most interesting development in the recent time was several speeches of Prime Minister Putin who said Russia needs foreign investment, and it seems to me that in the last Russian/Euro summit in Stockholm President Medvedev made a very good advertisement of Russian modernisation and the European Commission was ready to support, wants to support - but Europe doesn't know what to do. Russia apparently said, okay, let foreign investors go to Russia. Do you really believe the European Commission can change some of this aspect? The European Commission own some huge European companies may step up their presence in Russia? Definitely not. It is the decision of the companies.

Why Prime Minister Putin has changed, he was in the recent years of his rule he was a strong opponent of foreign investment. For many years the regulation of foreign investors was more and more restrictive. Initially it was on a case by case basis and personally in my business career I faced two very significant plans that failed because at that time President Putin's position. One was in [unclear], an enterprise in Russia where [unclear], an American company, had a stake of 25% and wanted to increase it up to 50%; that happened in 2003, 2004.

In fact all issues, financial issues, all technological issues have been resolved and the [unclear] was ready to improve Russian [unclear] [coughing] but still this transaction was prohibited by President Putin.

Another example was washing power machines, energy equipment company that is placed in St. Petersburg. It was established by Siemens before the revolution and Siemens was ready to acquire a foreign stake in this company just to build a European platform for its operations. Once again, commercial [unclear] have been reached and finally President Putin prohibited this transaction.

Moreover, in later years, 2004, 2005, afterwards there were several decisions of Putin who prohibited foreign penetration to oil and gas sector and, as a result, the lower foreign investment in strategic industries was adopted in 2008 where 42 sectors in the Russian economy were listed and there was a general condition that foreigners cannot buy more than 50% in companies in those industries, while oil and gas is limited to 10%. All foreign investment above those limits should be approved by a special commission that is headed by the Prime Minister, Mr. Putin.

That was a significant break and several attempts were done by foreign companies to get around this and all of them were prohibited, and certain things started to change with this meeting and the amount [?] that are concerned about where Prime Minister Putin advertised for foreign investment in the gas sector, that was very, very strange because normally that sector is closed for foreign investment. But if you look attentively, if you read what the Prime Minister suggested to foreign companies, it was not a lot. You may get no more than a 25% stake but you need to invest more [unclear] [coughing], you need to provide technology, you need to provide financial capabilities, you need to provide LNG and so on, but you do not get more than 25% of stakes. Normally in gas engine price [?] all projects will be managed by Gazprom.

It seems to me that the one significant purpose, one significant case, occurred last year that showed the position of Prime Minister Putin was AvtoVAZ. AvtoVAZ is the biggest Russian car producing company that was launched in 1970 and it's [unclear] build by tenants [?] and they started producing Fiat one, two, three, four. Since that time it [unclear] gradually and it was a problem, according to Russian authorities, it required subsidies, support and so on and high [unclear] tariffs. In 2007 the company was acquired by a company called Rostekhnologii, a state corporation, and the government in fact, the state corporation, started to manage, to take management of the company.

In 2008 AvtoVAZ virtually had collapsed financially. By that year AvtoVAZ has produced a record number of cars in its history, but every car sold produced \$1,000 of losses for the company and that was done under the government, in fact under the state management. And the Rostekhnologii knew that the stakeholder in AvtoVAZ is headed by a personal friend of Mr. Putin, [unclear], who has a personal respect and trust in Putin, and he was not able to do anything. He was not able to improve the situation in the company; moreover, AvtoVAZ is located in the seat of [unclear] and the bulk of the citizens of this city, they work on AvtoVAZ.

Finally, that created enormous social tensions in 2009 and by that time the re-launch [?], has acquired 25% stake in AvtoVAZ in the end of 2008. Suddenly Renault started to support the [unclear], Renault supported the independent new CEO of the company and started to support renovation of AvtoVAZ in technological development.

It seems that that change that Mr Putin had, and finally he said, okay, we need foreign investment. Moreover, President Medvedev featured on a narration and said, okay, we need to attract foreign specialists, we need great foreign technologists, we need to fill [?] a technological gap.

The problem in Russia – and that is very strange for me and not only outsiders who recognise it – that there is a huge gap between the words of Russian political leaders and their actions. When they say we need foreign investment, it doesn't mean they want to improve the situation, improve conditions, environment for foreign investors. It's not a huge secret that there are three principle obstacles for foreign investment in Russia, rule of law: corruption and intellectual property rights.

The Russian Government is doing nothing to solve these problems. Maybe the Russian Government will solve this problem in [unclear words] whose service is in square kilometres because it will be special zone, but the Russian Government is not ready to change the rules of the game, to change the economic environment over the country.

That prohibits foreign companies, European companies, to go to Russia because it's very difficult to run business in this culture. Can you do something in this area? In my mind, not. Definitely the European Commission may say, yes, we need the business climate to improve and we need the environment to improve, but unless this is done your solution even may not apply seriously to Russia because Russia is not attractive to foreign investment.

That's my view of where we are today and it seems to me that Europe does not need a lot from Russia. There is another story though, okay, but at least we know what Russia needs, or at least what Russia may require. Russia will require technology, Russia will seek for some industrial cooperation in aviation and in space, but does Europe really need something from Russia except for oil and gas? What else? Up to now it seems to me not. That's it.

SAM GREENE: Thank you, Sergei. It's time to talk about European police perspectives, Iana?

IANA DREYER: Thank you very much. I will actually pick up right there. Sam asked me to comment on, I quote, the scope for EU policymaking to shape a new institutionalised economic relationship with Russia. The short question is: is there scope for a workable framework for commerce between the EU and Russia?

Well, the core message of my speech is that there is hardly any scope for this, but I will focus on the EU and I will say that it is especially the case as long as the EU's energy markets are not reformed and unified.

What does the EU want to achieve of Russia on the commercial front? Better market access for exports through lower tariffs. Russia is one of the most important export destinations, pre-crisis, for EU's manufacturing goods. Investment in Russian services, the energy sector and manufacturing, generally a predictable, non-discriminatory treatment based on international norms for EU exporters and investors and of course energy security.

We all agree on this panel that Russia would benefit from this. Protection isn't an economic nationalism and in recent years does not serve Russia well and the EU has loads to offer.

The traditional approach to post-Soviet Russia is based on the idea that it can somehow transform Russia and have it adopt much of its own norms.

The main tool the EU uses to enable that are rules-intensive, bilateral agreements. This is what the Partnership & Cooperation Agreement of 94 was about, the PCA. But when one has a look at the document itself, one realises the simple diplomatic document had no legal rights at all; it was predictably quite ineffective. It expired in 2007. Moves to replace it with a strategic partnership agreement based on four common spaces, including an economic and trade space, have not materialised so far; this is for obvious political reasons.

Another reason on the economic front is that the EU does not want to conclude a trade agreement with Russia if Russia does not join the WTO first. It also wants Russia to respect basic energy charter treaty rules that regulate energy markets on market-based principles. The EU hopes of course that the current modernisation program of the government and recent overtures to foreign investors will translate into concrete engagement with Europe, but I share Sergei's scepticism here.

One must be aware that the recent economic crisis has not altered the political economy in Russia, contrary to what many people hoped. On the contrary, it has revealed the resilience of the system established under Vladimir Putin's rule. The system involves greater state monopolisation of the economy, control of the energy sector, a move towards more protectionism and the use of energy as a foreign policy tool.

The Reserve Fund established by the authorities to capture revenue from oil and gas has been a useful macroeconomic tool to have stabilised the economy, but it also has been a good political tool to keep the government afloat and to bail out the oligarchs that support it, along with the not so competitive corporations in banking, automotive, transport, to name a few, that belong to Russia.

The fundamentals of the regime remain intact. Gazprom, for example, has seen no reform at all; it still pursues policies that meet old-fashioned rent seeking with political goals. One such example is the project to which Ukraine's [unclear] has.

I have brought some slides with me. I will have to do without it. Russia, on the trade front, has average tariffs that are higher than comparable emerging economies. The trade's weighted average tariffs of Russia is 11.4%, according to government sources; this is higher than Brazil, which is 8.6%, or China which is 4.5%. World Bank scores on the business environment also shows that Russia scores quite badly compared to other very complicated emerging markets, such as China, Brazil, India, etc. It's score of trading across borders is quite an appalling 162nd, along with many African economies. This is because of the entire customs bureaucracy there.

There are also OECD indexes on the restrictiveness to FDI for services. The OECD has recently compared Russia with India, Asia and China on these indexes and everything points to Russia being among the most restrictive in all these sectors, some countries are even worse, but generally Russia is on the very restrictive end of the spectrum.

WTO accession and ideally Energy Charter Treaty ratification would discipline Russia's use of trade in energy also as a geopolitical tool. To name a few examples, there was a trade embargo on Georgia in 2006. After the Georgia War Russia used trade also to signal its discontent with responses from neighbours, Ukraine, so trade preferences withdrawn. Even the US had to suffer a ban on its poultry exports, so an interesting time.

All this would go, it would help them bring down political tensions, of course, if Russia had ceded to these disciplines.

Russia's attempts to revive its customs union recently in Belarus are, in my view, a diversion from the issue of Russia's WTO accession. The project is not necessarily an economically sound one. A lot of studies, including one we had done on Kazakhstan a few years ago, shows that CIS members actually trade already too much with each other; they still have this old legacy of trade among some uncompetitive firms, they should plug into the rest of the world, not into each other's uncompetitive markets.

Others say that the customs union is also a sweet deal for Russia's car industry, derry producers, metal producers. It's also a political tool to continue to exert influence in the neighbourhood and the United States has quite rightly questioned whether the customs union is consistent with the existing WTO's regional agreements.

Russia pulled out of the Energy Charter Treaty of 2009. The reason is that there was a court ruling that was brought by former Yukos shareholders; the tribunal ruled that even if Russia had not yet ratified the Energy Charter Treaty, had signed it but not ratified, it still was bound by its provisions. There were provision application paragraphs in the text that indeed would have forced Russia to abide by ECT rules, so Russia pulled out.

WTO rules, ECT rules, serious EU free-trade agreements, as they are being designed in the last years, all demand a substantial bend to national sovereignty in the field of trade, of course. So the reasons for Russia to accept the rules of the game must really be compelling; basically there must be a real change at home that favours the economic reform.

Let me compare Russia very quickly with China here. China, like Russia, is not exactly keen on letting its policies be dictated by multilateral institutions. However, it has accepted to abide by at least most WTO rules. The reason is that China's regime survival depends on strong economic growth and in China economic growth depends a lot on exporting cheap labour-intensive manufacturing. China needs the WTO to maximise its exports.

In Russia the calculus is different. Russia faces no barriers to speak of to its main exports and it exerts quite a lot of power in the way it organises its gas and oil exports. Why bother with WTO or ECT?

WTO induced economic reforms, when one looks at what Russia has signed up to on paper with its partners, it's quite ambitious actually. These reforms could just disturb the countries current internal power balance and if the Energy Charter rules applied in Russia, Gazprom's pre-eminence and the Yukos nationalisation could be questioned. This is a bit too regime threatening for the moment.

All this does, indeed, not bode well for the EU's ambitions with Russia, so what can it do? Unless there is a substantial shift in policy in Russia, the EU under current conditions will not be able to start talking to it seriously unless it achieves one thing, a single market in gas.

Russia has been holding sway over Europe with threats of and actually energy supply cuts; this is not so much because of an EU-wide overdependence on Russian hydrocarbons – it only accounts for about one-third of the overall EU imports. The problem is of fragmentation along national lines of the EU’s gas markets. There are different levels among different countries of dependency of imports of gas from Russia. There are also different levels of collaboration with Gazprom of these different gas companies, of the different countries.

This leads to strong divisions within the EU and the inability to formulate a coherent approach to Russia, so only a single market based on competitive market rules will bring an end to this self-defeating dynamic in the EU.

Adnan has mentioned the 2009 Energy Package. We published a paper earlier this year that has looked at it quite in detail where the EU Commission has tried to achieve a single market but the package does not achieve its goal. Brussels has failed to make Member States fully dismantle their gas monopolies and what is one of the most scary things is that the countries that need gas market reform most are in central Eastern Europe and that’s where most exemptions to any sort of unbelievable [?] competition rules are. Latvia and Estonia are completely exempted. It’s interesting because Gazprom has almost 30% shares in the local gas monopolies, so that says a lot on what is going on in these countries.

Now, as long as these features remain in the EU, there will be no single voice and no credibility when the EU discusses with Russia.

To conclude, given that there’s a summit very soon and the still stated ambition for a strategic partnership, let me look a bit into the substance if both parties ever get there. I would say that the EU would need to insist on strong investment protection, strong dispute settlement provisions for trade, of course, and investment, including probably investor state arbitration.

The EU, before the Lisbon Treaty, was not able to propose in this agreement, but the Lisbon Treaty now gave new powers to the EU Commission to do so, so there is more scope for this. It would take some time for the EU to clarify legal hurdles to achieve this, but it’s on its way, so that should be the precondition to start discussing deeper economic relationships.

This is not only to protect only European interests; it’s also good for Russia. It would improve the investment climate at home; it would improve the credibility of modernisation in other programs if they are really serious and also it would help improve conditions for investment for Russian companies themselves who often complain also of protectionism, so having tribunals instead of politics sorting this out would dramatically improve bilateral economic relations.

That’s all I have to say.

SAM GREENE: Thank you. I think we’ve had from all three speakers a very good overview of the...incentives and the imperatives that are driving economic decision making cross-border policymaking in Europe, and in Russia a lot of constraints in how far policymakers can really take that. I’d like to open the floor up to questions and I think, in the interests of time, what we’ll do is we’ll collect three or four questions and present those to the panel. Then, if we have time, we’ll go again. Please identify yourselves when you ask a question.

CLAUS HECKING: Claus Hecking from Financial Times, Deutschland. One question to Mr. Aleksashenko, you mentioned the AvtoVAZ deal. I didn't get what the investor... Could you just go a little bit more into detail about the new investor change and just explain it a little bit more, thanks.

ANDRE GERRITS: André Gerrits. I'm with the University of Amsterdam in the Netherlands at the School of International Relations. I have a question for Sergei. You referred to this gap between works and deeds; we're all familiar with that, I guess, but I was wondering why would there be this gap in the case of foreign direct investment. In other words, why would a Russian government be interested in pretending to be open to increasing the opportunities for that foreign direct investment while in reality they are not? Why this gap in this specific field?

SAM GREENE: Any other questions? All right, we'll start with those, both to Sergei on the AvtoVAZ deal and the gap between works and deeds.

SERGEI ALEKSASHENKO: I think that the gap exists not only in this area, but everywhere and in many areas of governmental and governmental policy. In foreign direct investment it seems to me that Russian authorities have recognised that it is not possible to reduce technological gap between Russia and Europe, Russia and the United States; it's not possible to increase the quality of Russian goods produced in Russia.

It's not possible to increase export potential of Russian companies without bringing FDI. It seems that the Russian authorities have recognised that FDI is not money. Russia has a lot of money; it's not an issue of money. FDI is technology, it's knowledge, it's management. In order to bring this, you have to accept that the day will come and that's why both Prime Minister and the President say we need FDI. That's true: Russia needs FDI, but in order that FDI comes to Russia, the words that Russia says is not enough; you need actions and that's it.

SAM GREENE: But why are there no actions?

SERGEI ALEKSASHENKO: You see, as soon as you start to solve problems of rule of law and corruption and intellectual property rights, you need to comprehensively change the political and economic system. That's what the Russian authorities don't want to happen. Their primary goal is to keep the political system as it is and the economic system as it is. They are not ready to fight corruption, they are not ready to implement rule of law, but they recognise that those issues are key issues in Russian society and, yes, there are problems.

And we, As President Medvedev said, yes, we will start to fight corruption, we'll have several laws, maybe we shall win in 15 years. Okay, I think that's your policy, either you start immediately and you want to fight it right now, maybe two years will be 15 years if you get to fight. Words are not enough; you need actions. Because any actions would change the system.

AvtoVAZ, the minority stakeholders, not minority, the 25% stakeholders in AvtoVAZ is Renault, a French company, and Renault had a stake in the beginning of 2008; they paid more than €1 billion for this stake and in an anti crisis plan Renault has agreed to provide a platform for the car production in AvtoVAZ, Renault has agreed to provide equipment and to use AvtoVAZ's facilities to produce cars on the Renault and Nissan grounds.

The idea is to transform AvtoVAZ's capacities and say that in three years the company that will produce the single [?] cars are the three brands, Renault, Nissan and AvtoVAZ. That means the

future will be single cars, very single cars on the same platform we see [unclear], about three brands. That is [unclear].

CLAUS HECKING: Was it the company that in old USSR times produced Moskvich?

SERGEI ALEKSASHENKO: No, it produced Ziguli, Lada, not Moskvich but Lada.

CLAUS HECKING: Who is the CEO now?

SERGEI ALEKSASHENKO: Igor Komarov from AvtoVAZ.

ADNAN VATANSEVER: I just wanted to add, regarding your question of why there is such a gap between words and deeds, I guess the main reason for the gap, I see two reasons. First of all, it's really a difficult to put words in a lot of areas, as my colleague mentioned. It will require a major change in how the Russian economy works and the political game as well.

The other thing is that the Russian leadership actually benefits from lack of clarity. Instead of having the comprehensive reform related to foreign investors by establishing clear independent judiciary, for instance, clear rules for property rights, from their perspective it is quite often much more beneficial to leave some uncertainty so that they can go on a personal basis with the investors, for instance. It always gives them more power to deal with them and that is one of the explanations why this gap will remain for a while. [unclear]

SAM GREENE: Thank you, more questions?

ANDRE GERRITS: Sorry, I have another one. In a few days we are going to have this EU/Russia summit. Do you think the FDI will be the main issue or what is going to be the main issue of that summit?

IANA DREYER: I'm not sure. It is too early to talk seriously about FDI liberalization and FDI rules with Russia. Many people in Human Rights expect that it's going to be rather an empty summit, good climate, trying to bring in a more positive climate between both sides. Both sides are keen on doing it, but I don't expect much substance. It seems talks right now are focused on issues like facilitation, visa and are easy things to do. Hard talks, serious talks on FDI, I'd say it's too early.

SPEAKER 1: [?] at the European Commission. I wanted to ask the panel whether they thought that developing not so recent Russia/Venezuela relationships is actually going to be taken any further and the effect it could have on relations with the EU.

ADNAN VATANSEVER: Well, I guess that's very hard to answer, what will be the future of that relationship. I'm just thinking that the two countries are not really able to complement each other and they are facing the same problems. Russia is a very high cost producer for oil and gas and Venezuela is a hard producer and actually produces a much lower quality of oil. They both need foreign investment and they have serious problems about being able to trade foreign investment.

By two countries who really cannot help each other much, that's a point in question, it could be that from a Russian company's perspective an opportunity for them to diversify somewhat and to expand some of their upstream operations maybe in Venezuela. There have been some attempts already, but I don't see that this is going to turn into a huge partnership in anyway.

Besides that, Venezuela is part of OPEC and Russia is not part of OPEC, so I'm sure there will be serious disagreements, even if they want to act jointly in certain areas.

SERGEI ALEKSASHENKO: I think that Russia/Venezuela relations started several years ago as a poison peel for the United States and definitely I'll leave that question for the second panel. As relationships between Russia and the US started to change and at least Russia seems to avoid certain new conflicts or tensions with the United States, there was a need to move from political cooperation with Venezuela to something else.

In this instance, in this area, Russia is to supply weapons and armaments to Venezuela and of course Russian companies would like to get access to Venezuelan oil because there are not a lot of places in the world where you can get access to a long developed resource. That's why Russian companies are in Iraq and Venezuela. But on political issues, you should ask the second session.

ADNAN VATANSEVER: [unclear] News Agency of Ukraine. During the last few months we observed quite intense development in relations between Ukraine and Russia and obviously it is not only about the merger of Naftogaz and Gazprom, but about a much wider spectrum of cooperation, including atomic cooperation, space, ship-building, aviation and so on. Maybe if you did not use that assets, it does not mean it's [unclear] now. I can approximately imagine what does it mean for Ukraine from Ukraine's side, but let us look to forces from the Russian side, from their side. What does it mean for the ability of Russia for internal reforms? How will that stimulate economical integration with their close neighbours in the wider sense, not only with Ukraine, to stimulate the internal development, political, economical and all kinds as well in Russia? Thanks.

ADNAN VATANSEVER: Could you specify by what you mean by internal developments? Who is affected by whom? It wasn't clear.

SPEAKER 2: Okay, we are speaking now about the potential for reforms inside Russia. Recreation of so-called post-Soviet space war economical and in political terms. How will that stimulate internal development in Russia? Will it stimulate it or not is rather the question.

SERGEI ALEKSASHENKO: In my mind it will not affect the domestic situation because definitely the Russian Government is seeking cooperation in aviation and in nuclear, but on both sides, on the Russian side there are state-controlled companies. So I do not see significant improvement in the domestic climate. Moreover, Russia is looking for investment in Ukraine to get access to Ukrainian companies because in that, I think this cooperation makes sense for both sides.

It's a question of Russian investment in Ukraine, not Ukrainian investment in Russia, so we are not treating Ukraine as an investment of Russia... so Russian sources they're not treating investment climate in Russia... so in my mind, from a political point of view, it's definitely Putin and Medvedev would like to have close relations with Ukraine, economical and political, because that helps them to keep the image that they are able to re-establish, if not the Soviet Union part, the Soviet space.

From a historical point of view, it seems to me it's counterproductive. It's counterproductive because the country is looking backwards not forwards. But from their political point of view, it's the right thing because a lot of their supporters, they support this idea.

ADNAN VATANSEVER: I guess there will be certain things for Russia in this greater cooperation. I'm just thinking about the gas sector, for instance. I think Putin tried to overplay Russia's hand in that case; he was acting too fast with too many proposals in a very short period of time and he could have spread this over a certain amount of time. He created a very large backlash and some of his proposals could have come in a very phased manner.

I'm not sure why that was not calculated on their part, but it has already led to some reaction and other restraint there is the biggest users of Russian gas are some industries such as chemicals and steel. The owners of these are very powerful people politically and they have interests in a strong cooperation with Russia, but in the meantime they don't have interest in paying European prices to Russia, so that by itself could be a source of conflict in the future and also could strain to some extent, their relations.

Regarding repercussions on Russia itself, Russia is a very different country from Ukraine, to a large extent. You don't have the same level of political competition in Russia, so as long as Russia itself doesn't change for various internal reasons, I don't think the relationship with Ukraine would really matter too much.

SPEAKER 3: I have a question for Adnan and Sergei concerning the change of limiting the gas political landscape in Russia. Do you see any role for an independent gas producer to be played, especially talking about Novatek Gas and recent events and the future, for instance, in getting the capital flow [?] back and now more independent gas producers use oil companies [unclear]. Do you see any future for it and what would be their role in the next decade?

SERGEI ALEKSASHENKO: That's a good question and I have no clear answer because definitely it is a fight between Gazprom – that means to Russia more than General Motors for the United States – and Gazprom is monitored, supervised and managed by Mr. Putin personally. On the other hand, Novatek is a company where Gazprom has 20% stake but, on the other hand, Mr. [unclear], a close friend of Mr. Putin, has 22% stake in this company and Mr. Sechin, the Deputy Prime Minister, is in charge of industry and in particular in oil and gas sector is Chairman of the Board of Directors in Rosneft which is a competing oil company and is involved in the row [?] over gas consumption, gas consuming power of this company.

It is very interesting to see this critical fight within Gazprom and Mr. Sechin in different angles. One the one hand, there is a government resolution around free access; that is describing how independent producers can get access through Gazprom to pipelines is prepared and agreed by everyone and is on the table of Mr Putin for more than six months. Mr. Sechin personally is lobbying this decision to decide because he's defending interests of oil companies of course Rosneft is a state-controlled company in particular and he has no success.

On the other hand, Mr. Sechin being the chairman of Ingerall, has insisted his company to break the contract with Gazprom on gas purchases and sign a contract with Novatek. That's why there is a certain space in the domestic market.

The crucial question in answering your question, yes, it seems that consolidated power of independent oil producers should grow and they should press the Russian Government more if Gazprom will not be able to keep production at the current levels in the future. On the other hand, it is evident that in the coming years the domestic market for Gazprom will be much more lucrative rather than the European market because competition in the European market with LNG is growing. If Shell oil and gas will emerge in Poland or in Germany or in France it will be even better competition and if Gazprom was at lower prices in three to five years, Gazprom will

have lower prices in Europe rather than Russia where it has all competitors and where it's a [unclear] position.

Currently in the realms of Gazprom today, Gazprom extends [?] the export market, but if there are people who have a strategic view in Gazprom, they should recognise that maybe it is better to allow independent producers to go to the export markets and to keep the domestic market. But today the domestic market is less profitable.

It seems that in the long run independent producers will get a bigger share in the gas market, but it will be a very interesting fight and not all of them will benefit. For example, three or four months ago you will recall that the Alexander's [?] oil company has decided that it's not expanding its Russian operations. It's tried to move their investment outside of Russia because they do not see opportunities to increase production in the domestic country. The outcome is unpredictable.

ADNAN VATANSEVER: That was a very comprehensive answer so there is little left to add to that, but just maybe two points. It is the rise of independent gas producers in Russia. One probably needs to look at the best part of the [unclear] of this competition. Now, you mentioned Timoshenko and obviously we are talking about competing elites within Russia and part of this newly arising elite image with like Timoshenko, who is basically from the last decade, rather than the 90s, they will have a strong interest to legitimise the wealth that they have gathered in the past decade and one way to do that is the gas business, to get increasingly involved in the gas business. That could be an indication there will be strong pressures for powerful players to get involved in that, as Timoshenko.

Now, for a comprehensive solution, you need to make a legislative change and this hasn't been happening for so many years. I have doubts that this can happen very soon because the domestic market pays less, for instance, than the foreign market but it's still a critical [?] market and I'm not sure that Gazprom would like to give up with that.

SAM GREENE: Thank you. We have run over time already and have taken time from the coffee break and thus from the next session. We will, of course, be revisiting a lot of these issues as we talk about security and international relations in the next panel, so I'd like to thank all of our panellists for their contributions, all of you for your questions, and we will return to the table at 10.45. Thank you.

FABRICE POTHIER: Thank you, ladies and gentleman. We are ready to resume this seminar on Europe and Russia. My name is Fabrice Pothier. I am the Director of Carnegie Europe, the Pan-European policy forum of the Carnegie Endowment for International Peace. It is a real pleasure to have you here today and to welcome our speakers for the second session, which will deal with: From Vladivostok to Vancouver, a Common Euro-Atlantic Space?

And yesterday I was asked by someone if we had done it on purpose to do an almost exclusively French panel. And my response was no, we didn't do exclusively Russian speaking panels because we have the great privilege to have all our speakers who are true Russian speakers, Russian experts; so I think this is going to be very interesting indeed.

Let me briefly introduce our three speakers today. On my right I have Professor Marie Mendras, who is the Director of the Policy Planning Staff at the French Ministry of Foreign and European Affairs in France. Before that Professor Mendras was at the Sciences Po and the LSE in London, and is, as you may know, regarded as one of the most accomplished Russia experts. I had the pleasure to attend Professor Mendras’ roundtables in Paris at Sciences Po, where she was really bringing the true Russian voices and Russian thinkers to try to read Russia right. So, it is a real pleasure to welcome Professor Mendras on this panel today.

On my left I have Ambassador Pierre Morel, who is the former French Ambassador to Moscow, and is currently the EU Special Envoy to Central Asia and for the crisis in Georgia; so a quite full plate indeed. Ambassador Morel has in fact kept Central Asia on top of the European Union agenda: made it a real place where Europe has to think harder about its strategic engagement, and also has been key more recently in bringing to the forefront of the UN Security Council the question of how to control better the chemical precursors that are reaching Afghanistan and are the key to produce illegal heroin. Ambassador Pierre Morel has been really at the frontline of those big policy questions, and is a true Russia connoisseur.

Then I have the pleasure to have my colleague, Doctor Dmitri Trenin, who is the Director of the Carnegie Moscow Centre, who has been with Carnegie Moscow since the inception of the centre in 1995, who has been the driving force, the driving intellect behind the centre’s real serious work on Russian efforts, but also on Russian foreign policy and Russian engagement with the world. Before that Doctor Trenin was an army officer in the Soviet, and then the Russian forces.

Today the panel is talking about this Euro-Atlantic security space. In fact what we have seen over the past 12 or 18 months are some kind of green shoots of improvements in the way the West and Russia work together. Even NATO has a better working relationship with Russia than it had a year ago. Russia and Poland are now talking to each other and on the path to hopefully what we can call reconciliation. The Obama administration’s Reset strategy has delivered its first deliverables, like the START treaty.

The real question that we face and that I will put before our speakers is whether we are seeing now the high of what are many ups and downs in the West and Russian relationship; or whether there can be a true transformational relationship between the West and Russia, and in fact fulfil what has been a long-term hope of a Europe whole and free. I think this is the real test on whether we can now go to a more strategic level of cooperation. The real test will be probably played in what we call the lands in-between: Ukraine, Caucasus, and to a lesser extent Central Asia; and whether Europe and Russia can both shift the approach: Europe to shift its accession paradigm inherited from the 90s, and Russia to shift from its power and sphere of influence of paradigm; and whether they can work together to stabilise those lines that ultimately aim to be integrated, both economically and politically, in the Euro-Asian continental mass.

I think this is the big strategic question I would like to put before our speakers today. I will first turn to Professor Mendras. Each speaker will be given ten minutes, and then we will turn to what I hope will be a lively question and answer session. Thank you.

MARIE MENDRAS: Thank you very much Mr. Chairman. I must say that I’m most happy to be speaking to you today with Pierre Morel and Dmitri Trenin, because both of them are old time companions of my Russian investigations. I remember staying with Pierre and Olga Morel in the French Residence just after the tragic October ‘93 events, and it was like being at home; and since then we’ve had a constant conversation about Russia.

I have to pay tribute to the Carnegie Centre in Moscow, without which I would never have achieved a great part of what I could have achieved in the last almost 20 years. When was the Carnegie Centre created?

FABRICE POTHIER: 15 years ago.

MARIE MENDRAS: So, 15 years. Ten minutes is short, so I would like really to probably start from what we've heard earlier this morning; which I find very good, very precise exposition of the internal situation in Russia, and the question of modernisation, what does it mean? Yes, indeed, Russian forces do speak of modernisation, which they didn't about a year ago; but they don't speak of reforms. Yes, indeed, Russian official voices have discarded the rather old style rhetoric that they had been adopting about Europe, about the West, about Poland – and I hope we can discuss this rapprochement between Russia and Poland, because I do think it has a significance, and I'm sure Dmitri has his opinion – so yes, this is happening; there is a change of tone. There is certainly a will on the part of the Russian leadership to get something; otherwise why change the rhetoric, why make propositions. So we have here to assess those trends, the new discourse, and see how much is really happening in practice that can help us give it its full significance to the Russian domestic and foreign policy in recent months.

We've seen that the question of modernisation, the economists spoke this morning; it is not very convincing yet. What struck me in Sergei's presentation was how often he said “Putin did”, “Medvedev said”; but we know that the problem of changing, reforming, modernising an economy, together with a society, it cannot be only top down. There was nothing about other actors - a little bit about Gazprom and Yushchenko - but other actors in the economic and social process. I think as long as we will have serious economists presenting the situation in Russia still quoting the leaders' speeches, there is not very much to expect.

It seems to me that the inter-relation between domestic politics in Russia and Russian policies outside is even more significant and essential today than it was in recent years. How can a more productive relationship with Europe happen if nothing really changes in the way Russia is ruled? I think it will be difficult, even if the European Union makes a great effort. And vice versa: can economic social political reform that Russia does need, can those reforms take place if relations with Europe remain as un-ambitious and strained as they still are today, even if there is some progress in recent months.

I think this is absolutely key in our discussion: to understand that one doesn't go with the other. There is absolutely no way that domestic politics in Russia can change if it continues to be a protected, almost protectionist policy. If Europe wants to have more productive relations with Russia it still has to pay attention to the way the country is ruled: rule of law, if there is true competition between enterprises.

Maybe it's like Fraser Cameron has been writing: should not we think about forms of conditionality; is it obsolete to think of... we are still very much in Europe concerned about the link between the various Helsinki baskets of 1975. I think it is still very recent; and in particular because of the very, very serious question of the in-between state, that I will mention in a few minutes: those countries that are not in a community or an alliance with Russia, but are not members of the European Union, are not members of NATO and will not be in the near future. That is the former Soviet republics, Moldova, Georgia, Ukraine, Belarus, Armenia, and Azerbaijan.

I think about the domestic situation much has been said earlier. We don't see a long-term strategy of the Putin government when it comes to the development of Russia. I'm always struck at the gap between long and tedious documents about Russia in 2020, which are fully impractical, and the immediate grasp of political, social, economic questions by Russian officials, or even by Russian academics. The gap that I think really needs to be filled.

If one compares the EU-Russia relationship with the Russia-US relationship, I think it is important to stress the difference. It is much easier for the United States to think of a Reset strategy with very specific aims, most of them being strategic. When it comes to the EU-Russia relationship you all know here very well that it is a much more complex relationship that cannot be made of easy strategic trade-offs. It is much more complex, much more day to day relationship, with much more proximity, and many, many different states. Again, the in-between states are our eastern partnership or eastern neighbours, as much as they are Russian neighbours.

If you sit in Washington or even in Vancouver, or at the ranch in California, it is far; it is far from this part of Europe that is still today, and will be in ten years to come, a sort of border region, a part of the continent that doesn't have its own identity; where countries, in my view, have grown weaker, have a weaker sovereignty today than they had ten years ago: take Ukraine, take Georgia, those countries have fewer prospects for developing independent sovereign policies in the economic field as much as in military security than a number of years ago, because simply they don't see where their future is. Some years ago there was still very much a possibility of joining the European Union, of joining NATO, and that gave some form of momentum or impetus at home in those countries; not all of them, but if you take Ukraine and Georgia it would.

Now that the situation has changed, and one of the keys even be the war in Georgia in 2008, this momentum is lost; and I hope we can go into the discussion of the nature of the relationship between Moscow and here; between Moscow and Belize; between Moscow and Moldova, which is the country that is trying to move ahead today but is still a very vulnerable country.

I think the European Union role and position is to address all those issues that relate to Russia, to especially economic cooperation, which means not only economic cooperation with Russia, but also with Ukraine, for example; and not continue to think, or speak at least, as if Ukraine is sort of taboo when you talk to the Russians, Russia is a taboo when you talk to the Ukrainians; so we feel stuck and we don't know how to move on. Which probably explains why there is some interest in our western countries, and the French president has been talking about this idea of a very large and open space on the continent, from France all the way to Vladivostok; which I think is first, simply admitting that things are not moving anywhere and not going anywhere. What can we do, what can we offer the Russians, or should we take seriously the Russian proposition of the new security architecture in Europe; is that the way to tackle the issues, to sort of override the in-between states, or the states that do not belong to Russia and do not belong to Europe and NATO, by envisaging a new, very large and probably very institutionalised kind of community.

I am not quite sure what can be put in this project that would help Russian development, that would help the development of Ukraine, Georgia, Moldova, and Belarus. It seems to me - and I would be very happy to have the opinions of the other speakers and everybody in the room – is the EU well placed to be dealing with security aspects when it comes to Russia and the Ukraine. If it does not and gives up on those issues, and if individual countries like France, Germany and others tend to discuss security issues, military issues, directly with Moscow in a sort of very, very wide and undefined forum, I'm not sure it's a solution. There is, indeed, a void, a vacuum, there

are issues that cannot be discussed, and we absolutely have to think differently, to invent new ways of discussing those issues.

But as long as Moscow’s policies, in Georgia in particular, is not changing, it is difficult, I think, for us, in Brussels, in Paris, in anywhere in Europe, to think that something really serious can be achieved, because we can’t accept the status quo as a long-term and stable situation. I think we have lived with the so-called frozen conflicts for too long, and now what we have, I think, is more a situation of frozen states. This is not a good basis for relations between the European Union and Russia. We do have to engage into more talks with Moscow about those countries. I think it is absolutely essential.

My conclusion would be about what I see as the missing factor in the discussion that we are having with Moscow on all those issues of economic development; a partnership for modernisation; even in bilateral relations, if we take them between France and Russia; or even if we think of this new foreign policy document, we don’t quite know if the document really exists, what is really in it; but that shows a change and a softening of Moscow’s position towards the West.

What about China? I feel - and I think Pierre will agree with me, he was our ambassador in Beijing after being our ambassador in Moscow – again, if you work in Moscow or in [unclear] or in Vladivostok or in Omsk [?], then you suddenly have a very different perspective, and you can’t just look west towards Europe and think what is this new continental space that we are going to organise with the Europeans independently of the relationship and the type of cooperation that Moscow seems to have with China. I say mostly China because of the proximity, of course; because of the demographic gap; because of what was said this morning, China’s success in trade that Russia has not achieved and will not achieve, because it is still very much a rent [?] economy, as I think Iana and Sergei stressed this morning. So, I would advise us to, in our discussion of the EU-Russia relationship, to keep in mind this other factor: China. Try to understand better, I hope Dmitri can give us a few clues about Russian policies towards China, and of course Asia more globally; but I think in our thinking in Europe about Russian policies and Russian security, not only today but in five years, ten years, 20 years, we absolutely have to take into consideration Chinese policies, and of course Russia’s policies towards China.

Thank you.

FABRICE POTHIER: Thank you very much Professor Mendras. Before I turn to our next speaker, you gave a very sharp and very interesting exposé. I think your starting point was to say we can’t envisage a good cooperation between Russia and Europe until Russia takes some domestic steps and changes inside Russia inside Russia before we expect Russia to change outside.

I wanted to turn this on its head and ask the same question about Europe; because we have seen over the last year Europe coming more together, vis-à-vis Russia. I think the Russia-Poland rapprochement has helped; but in your view what could be the two or three important steps that Europe, as a political culture should take, to be also a more effective partner with Russia?

MARIE MENDRAS: The EU, as you all know, is a complex animal because we don’t know how many heads it has: it is a collection of 27 member states. As you all very well know, the relationship with Russia is basically organised along bilateral relations. I now work in the Ministry of Foreign and European Affairs – I keep stressing the European Affairs part of the ministry – and I can be critical of the way our bilateral relationship with Moscow. Of course I don’t

represent the French government here: it's off the record. So, it is natural to criticise this emphasis on bilateral relations. I would make the same criticism of the German policy. It is natural to criticise it, and at the same time it is very difficult to see how to convince national governments to act differently.

There we come to the number one subject, which is energy, because it has been very much in the way of building consensual EU policy towards Russia. It is interesting that the financial crisis, the reduction in oil prices and gas prices and all raw materials, has made things a bit different: the EU, as an institution, has started thinking that maybe there were ways of negotiating with the Russians on energy. National governments have been a little more open about talking of a multi-lateral strategy, because they feel a little less hostage of Russian energy policies.

I would say that the EU policies in the partnership with Russia depend, to a large extent, on the national policies towards Russia. Not only is it big countries like France, Germany, Britain; but also small countries. If you take Hungary, the energy policy, Spain; each country tends to have its own policy towards Russia. It continues to be, very tricky, it seems to me, in Brussels to come to some common positions.

What I find also very interesting is the role of the European Parliament. The European Parliament has always been more active and more vocal about Russia, for some obvious reasons - parliamentary diplomacy is always more open - but it seems to be now a more important actor in the way the EU policies can be devised. I would be very happy to have your opinion; especially those of you who live and work in Brussels and are in daily contact with the EU institutions.

A lot has to do with perceptions: what we do, whether we work in a government or in an EU institution or in a think-tank or in a university, I think is work on perceptions; the perceptions of others and how, by making perceptions understandable to the neighbour, to the other, things can move on. I believe this is absolutely key, and not simply institutional change, or whether Russia abides by a treaty or the Energy Charter; this is one side of the story. The other side of the story is very much perceptions of what can be done with Russia. I personally am absolutely convinced there is a lot to be done in the dialogue with Russia in understanding Russian perceptions, work on those perceptions, and have also our Russian interlocutors understand better what the problems are in Europe, how the problems are discussed in Europe. I think there is still a gap in perceptions, in vocabulary and of course consequently in interests, and the nature of the interests of Russia, the interests of the European Union, the interests of each European country.

FABRICE POTHIER: Thank you very much. Let me now turn to Ambassador Pierre Morel.

PIERRE MOREL: Thank you very much. I first have to apologise because I couldn't attend the first part of the meeting. I understand that it was a very useful one. Maybe because I did not understand it I will bring you another angle or another approach; I hope it is not conflicting too much. I will at least try to progress on these key questions you have raised.

Thanks again to Carnegie for another meeting, where the great quality of closeness of rapprochement which is always allowing some movement in and out. Thanks again for your hospitality.

I will just start from the most recent event. The choice of date is a very good one, because on the 1st of June you will have the European-Russian Summit in Moscow. I think it must have been the first time for such summit in Moscow; a very interesting city. On [unclear]; but the rest of it is

another story. Let's just remind ourselves: it's the 25th Russian summit, so let's try to really take stock and see where we are. This will be the purpose of my words this morning.

The last one was quite good. There have been let's say some difficult summits in the past years, but the last one was Stockholm, which led to this idea of consolidation of partnership for modernisation. All this is one framework; a very simple one. For years, decades, we have made this choice of this strategy partnership between the European Union and Russia. Indeed, it is quite difficult to substantiate it, as some examples have been reminded by Marie; but I think at the same time we have now a real opportunity, also combined with the fact that you have the Lisbon Treaty, which means the European Union is now being turned outside.

If one asked me what is the sense of this Lisbon Treaty, and you will hear all you want about inefficiency, lack of substantiation and so on; well, let's just wait a few months, and I think the European External Action Service will not be a little thing. It has already begun to start; there has been a lot of criticism in the last few weeks and months, when nobody says anything, when it needs six months to have a new American solution in place. I remember being in Geneva in July last year, we went to [unclear] normal event, two months of difficult beginnings of something which has no precedent at all, to shape a common united service among the 27 member states and European institutions, and everyone said it's a failure, it's going nowhere, and so on. Well, let's be a bit more balanced in appreciations. It needs months. In the end I think we will realise that this goes rather fast, and it will be quite demanding for everybody. At least what is a very good sign is that the European Union is now getting excellent candidates from 27 countries, first rate people, which will make a very good unit on the ground in the 150 missions of the European Union on the ground, as well as in the headquarters this year.

So, let's be a bit patient and not prejudge too easily. I think that basically, in one word again, the Lisbon Treaty means for the European Union looking outside more than inside for the years to come. I think this is very important, and as Marie Mendras stressed, key out of the initial mission of shipping this European External Action Service, there will be the need to invest in great partnerships. Of course, Russia is key in that respect.

Let's also take into account the fact that since this difficult summit period, in Russia quite key events are taking place in the last months. The economy crisis expanded, including problems with the European Union, but which are of a much wider nature; all the lessons of Copenhagen, the impact of climate change; the new steps taken by China; all these things are matters to reflect; and the follow up of protracted crises, including the Georgia crisis. I will come back to that.

Coming to your point: there are opportunities; there are limitations. Where is the key problem? In my view the problem is in the mindset on both sides. I think that this is really the place we have to reflect. I will take some examples through the shared space dimension you quoted. To give it in a nutshell I quote Dmitri from recent statements from what I understand of his points. The European Union should be more equal with Russia: should not just engage Russia, but should engage with. Yes, but at the same time when we read either in Russian commentaries coming from this multi-powered vision, or just mentioned by the marginalisation of the European Union and so on, or on the impact of crises, taking away relevance from the European Union and so on, well where are we? Should we engage? Should we be more co-equal when you in fact have this grand, global vision in a multi-coloured world where many other partners are as important, and so on? So, that is where I think we are at crossroads.

I'm not here to advocate any special line; I think more important to stress, in certain circles especially, is that we should be very careful in not taking the wrong way. I'll try to give some

examples in other countries. I'll take the three shared space you quote: Ukraine, Caucasus – a frozen conflict, if I may say – and Central Asia.

Ukraine, I will be very short because both it's brand new, it's not the field in which I'm that responsible, and therefore I will be careful. One can argue there has been a reversal. Yes, indeed you can argue that; and of course the big announcements on Sebastopol and the price of gas and so on are clear signals; but it's not just a question of signals. The first visit of President Yanukovich to Brussels was an interesting step, and we consider it as more than protocol. Let's see. We were told you should take into account Russian interest in the Ukraine. It could be perfectly reversed: Russia should take into account European interest in Ukraine. The point is not tit-for-tat or whatever it may be; or I hope it's not, because otherwise we are on the wrong way. The question is after having these ups and downs we have a moment of opportunity where we can re-engage in what such a strategic partnership could mean for such an important country as Ukraine. We can have it wrong or we can have it right.

Let's take the example of gas. Well, we have seen very specific policies of bypassing Ukraine, [unclear] becoming real, soft stream, still a question mark with lots of announcements, 30bcm, 60bcm, who wants more or less. The question is not there. Where are these policies going? Is there still a strategic purpose to bypass Ukraine or not? Or just consider what Ukraine is, a key country for gas transfer, gas operating activities and so on, which have been quite shadowy in the past, we know, which have been very complicated. We can do it the right way, working in strategic partnership; we can do it further in the wrong way. I think this is a typical example where we all will be tested.

Consequently I would say we are all in a kind of plateau phase after all these ups and downs of internal Ukrainian politics, as well as external games. Now we are in some kind of plateau. I don't want to judge on that more for the time being. If we call for judgement on both sides, it will be, quite clearly, a test. Taking into account the changing energy landscape, which is not just Russia, Ukraine, the European Union, which is a wider change from shared gas to the Chinese government pipeline and so on. This is how we can be clever or we can be stupid.

I'll quickly take one example. This is a question for everybody; I don't want to make judgement upon this. I think it is quite a challenge, an interesting challenge, an interesting test in terms of EU-Russia partnership.

The second example, of course, Caucasus. I would like to put together Caucasus and frozen conflicts, because in the end it is more or less the same. What is at stake, we know, is special interest, neighbourhood and closed neighbourhood and so on. We have had all the gamut of vocabulary in that respect; but in the end what do we do with this kind of conflict when we have seen in the past years first there is a war, where shared responsibilities are obvious. Even the very careful [unclear] report in its key sentences says that the attack of 907 has been the culmination of a series of provocation. I don't want to expand more on that, but the reading of the [unclear] report is also a reading of the instruments of manipulation of special interests and specific actions which I understand. The question is this has been possible now in this place and in these conditions: why should a [unclear] not be a possibility.

Therefore I would say now there is a hole in the sink; I call the sink the Helsinki final act, 75 rule: war is out of question in Europe. We have rules which we all share, integrity, sovereignty and so on. We have renewed that in the past charter. We have confirmed that in instrument document 99. Is it an open question; then we are in real pressure. Is it a special case; but then where has it been shown that it is a special case and so on and so on. That is where the question

whether protracted conflicts, which should be solved as early as possible, are staying like some kind of instrument [coughing - unclear] with a certain [unclear] policy or not, I think is a key question about the rules of [unclear] in Europe. In other words if we should address an all-encompassing separate treaty throughout the continent and leaving aside the protracted conflicts we are working with a task which is intractable.

I think it is the same question as Ukraine with how to deal with a gas deficit and interaction in that respect. Of course Karabakh is bit complicated, but in the end if there is an opportunity in South Ossetia [?] and we don't seize the opportunity, if we keep on this rather complicated treatment of the sequence of the follow up the war in Georgia I think we can have all along the same pursuits of ambivalence, ambiguity which will not be stalemates or frozen handling of security, but in fact, once again, will entail a risk of aggression, in the interest of nobody in the end. Therefore the EU line is very clear: if we have to work, indeed we have to, on European security on the enforcement of existing institutions through the Corfu Process, which has been a rather successful re-enlivening of the OSCE – and by the way, I never understood this kind of quasi rejection of OSCE by Russia, who has been the co-founder with other co-founders, but the prevailing co-founder of OSCE before the last 30 years, that is something that cannot be fully understood – so here again we are at crossroads.

I think that the lesson of the Georgian war should lead to a more creative approach. It is very clear that the European Union is not ready, and will not be the kind of co-manager of a de facto situation, which is called New Realities by Russia. This remains an international crisis where, as part of an involved international community, we are looking for solutions, which will be complicated, which were difficult; but this is not a kind of co-management of a status quo forever. Because you will not have EU troops continuing to take risks, coming from 26 European countries; you will not. This is leading to something that which will be, I think, rather a failure.

Finally Central Asia. Yes, I would put this into shared space, as you say, even if it seems to be behind. Not because there is any pretence from Europe and Central Asia. We are just starting from the fact these countries are opening to the rest of the world, and there is a lot of goodwill to do for everybody in Central Asia, without denying in any way historical key interests of Russia which are part of reality. I think we can look at emerging opportunities. We have had good contacts and conversation in front of Kurdistan. I think for energy clearly too there has never been a kind of polarization from the European Union. We start from the idea that diversification is an economic necessity, no more, no less, for these countries which have their own opportunity in energy for a good part of that.

So, to finish. I think in front of the environment for Russia, including the Chinese factor, I must agree with what Marie said. I think that in order to exploit opportunities and overcome limitations there should be some kind of re-assessment from Russia by its neighbourhood, which has been handled in a very short and in an obsessive way, in my view, where we could do better. I think there would be a danger in Russia looking at itself as a kind of free player in a multi-player world. I don't believe Russia is a BRIC; let's not blur Russia into BRICs. Russia is Russia, as such, and doesn't need this kind of qualification. Russia has for Europeans one characteristic you don't find in any of the other of the BRICs: we are continuous, we are in the same continent, we are neighbours for centuries, we have learnt to [coughing] together; so the problem is not a question of figures and things like that; it is much more complex than that. Therefore are we a model for Russia: we don't pretend. Are we competitors: I don't think it is the purpose of our policy; because we should be partners. Let's hope to find a way to not disengage into some

kind of multi-partner game, but to rather [unclear] approach. That is what I’m advocating, because we are looking for common opportunities as we are partners.

Thank you.

FABRICE POTHIER: Thank you very much, Ambassador Morel, for this very comprehensive view on the neighbourhood and on the Europe-Russia relationship.

Before I turn to Dmitri I just wanted to ask you one specific question. In your final points you explained that we should work with EU institutions that already exist, and you particularly mentioned the OSCE; so I would like to connect that with those frozen conflicts that you mentioned. Do we have the right toolbox to address those conflicts, to stall them and to prevent new ones? Because you were explaining that in the part of the Caucasus we could actually address this conflict. But are the institutions that we currently not part of the problem sometimes?

PIERRE MOREL: Let’s be very short with this one. In handling the conflicts we have a forum and we have a toolbox which is called the OSCE, where everybody is there on an equal level. It is consensus based, which makes it difficult, and at the same time very useful, because it is common to everybody. Let’s say that with good coordination with the United Nations and with EU, among others, I think that together we have done good work in the past month in Kurdistan. No big fuss, no big action, but the danger was enormous, a split of the country and so on; and from good coordination but resting also on good work done by OSCE, among others, we can see the value of institutions rather than inventing new structures. Yes, you have different patterns for Karabakh or for Transnistria or with the Geneva discussions for Georgia; but this flexibility is not of the game. What is important is that we have a set of common rules. Either these rules hold, or in the name of new realities we are opening Pandora’s Box; to be simple.

FABRICE POTHIER: Thank you. Dmitri I turn to you for the final presentation.

DMITRI TRENIN: Thank you Fabrice. It is an honour to be an attendant to this French panel. And thank you for speaking English, by the way.

FABRICE POTHIER: Only for you. We know how it costs for French people to do that!

DMITRI TRENIN: Of course; going through the pain. I’m also thankful for being the last speaker because having heard so much, and having been enriched as a result, I would confine myself to a few comments on the brilliant presentations that we’ve heard, and actually very brilliant summaries and introductions that Fabrice has offered.

On regional security, if the Georgian war is a point of departure, then European regional security has greatly improved over the past almost two years; but we need to realise that we bounced back from the lower depths last seen in the early 1980s. I think we should be under no illusion how dangerous the crisis in August 08 was: it was not to be limited to Georgia or the Caucasus or the Black Sea area. The message that it sends to me is that European security is fragile. We’re going through a good patch, but the relationship has not been transformed and is not being transformed.

Of course, as Fabrice mentioned, there are many good things that work for us, all of us in Europe. I would say that the most important of all these things was the Reset of the entire

waterfront of US foreign policy cleared out by Barack Obama. That was what improved the situation enormously. Essentially Barack Obama re-prioritised US foreign policy. He also took a different view of relations with both some of the major players around the world, and the procedures, the methods relating to foreign policies. He deserves every credit for that.

In particular what has improved the relationship was de facto pause in NATO's enlargement to the east. The other thing that helped, and the United States is not pushing it, is what let me call it the cold shoulder that Washington has given to President Saakashvili, which decoupled Russia's relations with Georgia from Russia's relations with the United States.

Thirdly, Barack Obama reconfigured US ballistic missile defences in Europe, thus making far less of a provocation to Moscow.

A few other things that this administration has practiced. It basically sent a message to Moscow that we have our own views of your domestic situation; but essentially it is up to the Russian people to transform their country. They've heard enough from us and many others; it's yours, all yours. Basically a departure from the previous administration's de facto policy of let's say checking Russian, call it Russian expansionism, call it Russian net laying, call it whatever you like, in the former Soviet Union. The administration in Washington is no longer allergic to Russia's projection of its interests, or defence of its interests, or protection of its interests in the neighbourhood. In that sense the reaction, or lack of reaction, to the most recent agreement between Moscow and Kiev, either from Washington or from Brussels NATO, is a very telling indicator of where Obama stands in all these things. This improved the relationship. The credit goes to President Obama.

A second thing – a minor thing, and yet important – was the Russian cautious opening to the Poles. There was a realisation at some point that unless Russia showed goodwill to Poland, unless Russia behaved towards Poland the way Russia wants to be treated by the United States of America, unless the Russians showed some respect, unless the Russians talked to the Poles as a serious country, there wouldn't be a chance of a better relationship with the European Union as a whole. There was no chance of ganging up on the Poles using good friendships with Berlin, Paris and Rome and a couple of other places.

Putin's kneeling at the coffin was an important symbolic step, but it was a calculated symbol; there was no emotion. But the Russian leadership showed in a crisis situation, showed that it actually meant to improve the relationship with Warsaw when the tragedy happened with the Polish President Lech Kaczynski. The reaction was anything but the standard reaction from Moscow in similar cases. That was, I think, stunning, quite frankly; in a positive way.

My third source of improvement is what I would call self rebalancing in Ukraine. What is happening in Ukraine is not Ukraine tilted toward Russia; what is happening in Ukraine is Ukraine becoming more of a country of the regions - excuse this pun – but it is no longer led by Western Ukraine politically or ideologically. It is a more complex combination of factors and interests. That, I think, serves Ukraine well. That, I think, will contribute to the emergence of Ukraine as a strong nation in Europe.

The agreement on Sebastopol defuses the issue for the time being. Clearly, no one seriously believes that Russia will be staying in Sebastopol until 2042; who knows what will happen between now and 2042, or between now and 2017, or between the time when President Yanukovich's time is over, and the time when the original lease was to expire. There is no illusion on that. But for the time being the issue is behind us, or the issue has been put to one

side. I don't have to remind you that the Crimean issue could be as explosive as anyone can imagine.

Those are the elements that have contributed to the current climate. I agree with both Marie and Pierre that there are issues still that can threaten European security. I will start with Georgia. I will add, in all fairness, that we need to watch the situation; but all the watch should not be focused on the Russian side. A lot can be said about watching President Saakashvili. I fully agree, and actually I said it a couple of years before the conflict, that what was happening between Russia and Georgia was a game of reciprocal provocation. The Russians were provoking the Georgians in order to impress upon you people, mostly in Europe, that Georgia was not fit to join any serious club. The Georgians were provoking the Russians to basically send the message to you people, but mostly to Washington, that Russia was an imperialist bully, and Georgia was in need of protection so it had to join the club. That was the game that people were playing; and other people were dying.

I think Saakashvili really deserves a lot of attention. I think Washington is giving it more attention now than it was giving it before the Georgia war. Will Russia policy change on Georgia? It will, once Saakashvili is no longer in power. I see no chance of improvement before 2013, if they don't change the constitution or if Saakashvili does not remain in some other position in the government of Georgia.

Is the status quo unsustainable? Well, it depends on how long you want to see. You look at Nagorno Karabakh or you look at Cyprus, Cyprus has been there for a long time, Cyprus is an issue that has been dealt with in the European Union in a way, and Cyprus is still there. I'm not suggesting that it is a similar situation; I'm just saying that something which is unpleasant can unfortunately go on for much longer than we wish.

On Abkhazia actually the Russian leadership realises, I think, that for any improvement of relations with Georgia they will have to pay some price: and they know full well what the price is that the Georgians are quoting. Every time that Buzenazah [?] comes to Moscow to sit down with Putin, or Nogadeli or whoever, the question that the Georgians are putting at the top of their agenda is Abkhazia and South Ossetia. The Russians have realised full well that the present situation, the present status quo is not there forever.

What kind of solution is there I cannot see. What I cannot see either is the reversion to the I wouldn't say previous status quo anti, because if you think an independent Georgian state, much like the independent Moldavian state, much like the independent Azerian state, never included those territories; those territories were as much a product of the collapse of the Soviet Union as the independence of Azerbaijan, Moldova and Georgia. I'm not saying that these territories are lost forever; I'm just saying that it is a very difficult issue, and not easy to resolve. Between Abkhazia and South Ossetia we are dealing with two very different issues. I find it difficult to imagine Abkhazia being part of Georgia, quite frankly; but I couldn't imagine that even before the war. There is a certain level of violence, like in Kosovo or in Karabakh, that basically prevents people from coming back and living together in the same state. So, I don't know. South Ossetia is even more of a problem. In my wildest idealistic moments I think of South Ossetia as an Andorra in the Caucasus.

In the one minute that remains I think we need to add the Russian North Caucasus to the table. It is maybe not for an international discussion; but for intellectual thinking it is very much in the Caucasus situation.

On Central Asia I think that in the next ten years we will be witnessing very interesting developments. Kurdistan is fine; but that is a side show. The leaders of Uzbekistan, Kazakhstan will depart; what will happen when they depart is of extremely big interest.

FABRICE POTHIER: Thank you very much Dmitri. We have now 15 minutes left, and I'm sure there will be many questions. I will take questions by groups of three and four. If you can kindly introduce yourselves, and possibly keep your questions as brief as possible so we can have the chance to take as many.

MICHAEL EMERSON: Michael Emerson, CEPS. I would like to put two questions to the panel. One concerns the degree to which Russian foreign policy, with respect to Europe in particular, has changed recently. The second one concerns the Ukraine. Dmitri, you referred to the warming of relations with Poland and why; but how deep and important has the change been? I read a newspaper here, Communist newspaper: Russian foreign policy has changed, and the change goes beyond the rhetoric. And they refer to the settlement of the Barents Sea demarcation dispute that Norway, in addition to the Polish, are a player. Then they go on and refer to: Russia's new pragmatism is set out in a leaked foreign military paper - which we've all read about in the press – and this document is not an argument for liberalism and openness, but it argues that Russia must form modernisation alliances with leading countries and attract western technology etc. Can members of the panel enlighten us as to the status and importance of this leaked document?

It links, of course, to this morning's debate about modernisation. What I hear from different Russian colleagues is that the domestic modernisation debate has become a quite narrow affair, rather than a big economic and political concept, as some people might have preferred. That limits maybe the action between this foreign policy move and the domestic modernisation debate; but still I would be very interested to hear your assessment of how important has been the change.

The second question is in terms of Ukraine and pipeline. After Sebastopol and the gas price discount affair Yanukovych said niet [unclear] to the proposition of a gas from a natural [?] gas merger, and looks to the tripartite consortium idea. He has mentioned it, but there has been no response from the European Union side. My question to the panel, all of them, would be: would it not be a good idea now for the European Union, particularly the Commission of Energy, to say yes, I put up my hand, let us look at together the idea of a tripartite investment consortium for a lease on that pipeline.

FABRICE POTHIER: Thank you, Michael.

ALAIN DELETROZ: Alain Déléroz from the International Crisis Group. I think one of the issues that has not been underlined, for the moment at least, by the panel is how cacophonous and bad the European responses have been to Putin's new foreign policies. You just state six or seven big member states. You think Germany, how Germany reacts, how it pushes its interests; in France, Britain; Britain has a lot of troubles; Spain and Italy. And as the panel is very French, when the Russian Federation produces in January this year a security doctrine in which it states and lists NATO as its first enemy, and France is dealing with a country like this, selling or about to sell Mistral warships, without even asking what President Putin [?] meant, this is what I find amazing.

FABRICE POTHIER: Your question then, Alain?

ALAIN DELETROZ: My question is can we expect to have a foreign policy in Europe that serves this, our interests – I don’t think this serves our interest – that is doing exactly what the Russians do: being tough and telling them what we want them to do. We cannot reproach Mr. Putin not to have ever announced in advance what he was about to do.

You stated, Dmitri, that the status of the [unclear] in Georgia could be changed one day in Moscow; if you could elaborate on that? I would expect Russian Federation not to move back anyway on the recognition of the two independent states.

CLAUS HECKING: Claus Hecking, Financial Times Deutschland. A question to Mr. Trenin on the relationship between Russia and NATO. Why is Russia hesitating all the time when it comes to the missile shield? What do you think about strategic nukes in Europe? And what role does Ambassador Morel play in the game?

FRASER CAMERON: Fraser Cameron, Director of the EU Russian Centre. Let’s engage in a flight of fantasy, and all the panellists are the national security advisor for Russia: what are your top three security threats facing Russia?

FABRICE POTHIER: Thank you. Let me summarise very quickly. We had a question about the Lavrov leaked memo, what that meant. I think this is particularly a question for Dmitri.

We had a question about the possible tripartite gas deal in Ukraine between the EU, Russia and the Ukraine.

We had a question about the cacophony of the European response, and whether there can be hard interest in the European foreign policy.

A question about the status of the enclave in Georgia.

Then from the Financial Times Deutschland a question about the relationship between Russia and NATO.

Finally, from Fraser, what are the three top priorities if you were national security advisor?

MARIE MENDRAS: Can I add two very short questions to Dmitri? Dmitri, I was a bit surprised when you said that there was a de facto pause in NATO enlargement east, that was linked to Obama’s Reset. That happened before Obama came to power, it seems to me. I just wanted to make sure what you meant.

You also said that Ukraine is not now tilting towards Russia, but it is no longer led by Western Ukraine. Was Ukraine led by Western Ukraine in recent years, with Tymochenko and Iouchtchenko, and Yanukovich was Prime Minister of Iouchtchenko in 2006. I just wasn’t understanding Ukrainian policies in recent years as led by Western Ukraine.

The very last point, I think it is one of the questions about Abkhazia, South Ossetia, Moldova and Transnistria, to say that Armenia, Georgia, Moldova never existed as independent states, with those territories, I think it is really debatable. It depends how you...

FABRICE POTHIER: I will give Dmitri a chance to answer. We will start with Ambassador Morel.

PIERRE MOREL: I will first of all react to the points that Marie made about your statement, Dmitri. When you speak about the borders and so on, maybe look at history and so on. I'm sorry, but in 91 the whole international community recognised borders as they are, and if we play with that and if we recognise [coughing - unclear] we can have all kinds of recognition and all kinds of conflicts everywhere. This is very, very, very touchy. I think we must realise that, otherwise, once again, there is a hole in the sink forever in the whole of the European continent; let's be absolutely clear on that. That is why if this recognition has a new reality for Russia, and a question mark for North Caucasus, okay, but then the non recognition by the international community is another reality. I think we have to live with that.

That is why it is so sensitive, and that is why it is not a Cyprus, it is not Karabakh, because we can live with Cyprus for [unclear] or with Karabakh in a way that lasts; but this is connected with Russia and with key rules for the European continent. So, it's different and that is why it is so sensitive.

The leaked news document: fine, that is a document, there is a debate, that is a good sign; rather than, quote unquote, multi-polar ideology, which I think can be very misleading: the idea that you are a big independent planet in the international constellation. I think it's highly misleading, because this will lead to disengagement of any Pole towards any Pole, a kind of give and take every morning, and total uncertainty and unpredictability., where I think we can give certainty and predictability on the European continent with a real and strong partnership, after a difficult phase, between the European Union and Russia.

That is where I think thinking twice and revisiting easy slogans about BRIC and multi-polar, sorry to be insistent on that, but I think you have read very misleading tools which are easy to use in some kind of statement, but I don't think go very far when you look further.

Well, about cacophony, I would reverse the point. If you have had a reduction of EU relations to Russia it is because of the Georgian war. That is where you have seen – and please read the document of the special European Council of 1st September – everything is said clearly: not anti-Russian, not pro-Russian, but trying to put together the problem that has been formulated in a very short delay. We have sent, in two weeks, 350 people unarmed in the middle of this military turmoil, and this has been our line of conduct, and we have not changed. Believe me, the countries from 26 countries out of 27, send their guys over there. We are not thinking they will be there after two years. Further along no UN anymore, no [unclear] anymore. There were 600, they are away, we are only 300. So, I don't call that a cacophony; on the contrary it is taking full responsibility, together with a political exercise is going to solve the crisis because we don't send troops without political exercise. That is where the quality of the exercise in Geneva should have been, for the future, better.

Finally a question of Fraser Cameron, the threats to Russia. I'll give you my list: drugs, fundamentalism, and that is where Central Asia, I think, can be made forward, demography, lack of investment in Siberia, and first and foremost under investment into Russian wells of gas and oil in the last ten years. This will be my answer.

FABRICE POTHIER: Thank you very much, Ambassador Morel. It is a good thing to have French and Russian speakers: there is a lot of passion.

Let me turn now to Dmitri, who will answer some of the points; and then we will conclude with Professor Mendras.

DMITRI TRENIN: I think the European Union – and I’ll be very frank, and even blunt – The European Union lost a golden opportunity to strengthen the principle that you spoke so passionately about: and that was Kosovo. Quite frankly the European Union could have... I have no illusion that Kosovo cannot live within Serbia; there is no question about that. The question is how you go about that. The way that the European Union handled it was self-defeating, quite frankly. When I talk to senior European officials, very much involved in the negotiations, they said very frankly that they buckled under pressure from the Bush administration. The Bush administration wanted to close the dossier, and the European Union could not do anything about that: that was bad, I think, for Europe.

Now, I have no defence for Russian actions. I do not represent the Russian government. I criticise the Russian government on a daily basis. But that is what I would respond to you.

PIERRE MOREL: In one sentence, because it is a very important point. I have not been advocating for Kosovo; I just say that the Kosovo policy has been the outcome of nine years of negotiation with the ultimate attempt of Wolfgang Ischinger, with his Russian partner, which led nowhere, which is a great pity; and then I’m not advocating further on that. I just argue that where we are, if we take Kosovo, which is very different, whatever one can say, from what has been the Georgian crisis, then we have a tit-for-tat forever. Let’s turn the page and look for sensible policies for the future.

FABRICE POTHIER: It is not a panel about Kosovo, so let’s move to the other questions. Thank you very much Ambassador Morel. Dmitri, we have a question about the leaked Lavrov memo; what does it say from your endpoint.

DMITRI TRENIN: Pierre – it’s not tit-for-tat – I was just going to say I was not going to use Kosovo against that. I take your points, those are very important points. I think it is important that everything that is done within Europe is done according to the norms of the European countries that agreed to. I fully agree with that. Goodbye, and see you again soon.

FABRICE POTHIER: Going back to a kind of level of we know: on the level of the memo, what does it tell us?

DMITRI TRENIN: First of all it tells us that it is the real McCoy; that is the real paper. One of the interesting things that this paper tells you is that Russia has been using Armenia for a long time to get technology from the West, that otherwise it was not able to do. You do not normally fabricate a document saying these things.

There are many other things in that document which are very interesting: Russia’s attitude towards China. It’s a very interesting document. I think it is real. I don’t think it is part of a... Moscow is not Washington; they don’t use leaks.

MARIE MENDRAS: How much have you seen of the document?

DMITRI TRENIN: I’ve seen the whole of it. Strangely, the document missed a couple of pages. For example, there was nothing on Britain in that document, which I found very strange; nothing on Poland; maybe a couple of pages were missing. Otherwise the document struck me as very, very authentic. It said why don’t we use the relative lack of appetite in the European Union for investing in the Baltic States and buy them up, for example. You do not fabricate things saying the truth.

MARIE MENDRAS: What does it say about China?

DMITRI TRENIN: Well, it says that we need to be very watchful, that we need to monitor Chinese actions very closely because they touch upon our interests. There was nothing about partnership with China, nothing of this. It was also important in the document that the Russians wanted to pin the Chinese as much to their positions in the various international forum as possible. There was nothing about BRIC. BRIC is not... come on. Multi-polarity; that is last year's snow in Moscow.

FABRICE POTHIER: On the question about Russia and NATO.

DMITRI TRENIN: I have all the questions here. The MOD paper, Alain, is junk; unlike the foreign ministry paper. The MOD paper has nothing to do with what is happening within the military establishment. You give your people a sock you allow them to say the things they always wanted to say. Basically they did not identify NATO as a threat; they said that NATO enlargement is a threat; which is something that people have been saying for years. The MOD paper is a piece of literature.

Status of Abkhazia and South Ossetia. Abkhazia, in principle, could become a state, but there is not way that South Ossetia can become one. At least the status of South Ossetia will have to be somehow redesigned, redefined. There is no ignoring the fact that when there is a new government in place they will deal with Abkhazia and South Ossetia. For example, there is no need for Abkhazia to include a fairly large portion of ethnic Georgians. Why should the Abkhas want it? I asked one of Abkhazia's officials at some point a couple of years ago, do you really need it; he said we don't really. Why do you insist on that; well, there is an electric power station out there. I said if you were compensated for that; he said well, we can think about it. That was many years ago, but still this is...

There are many ways of dealing with these things. The Abkhas would be interested in creating a national Abkhazia state; they don't need Georgians inside that state.

FABRICE POTHIER: Dmitri, we have to wrap up. If you want to deal with the last few questions and then we will turn to professor Mendras.

DMITRI TRENIN: I will say one more question. Missile shield reluctance: in principle it is a transformative question, but what it means is that people would have to change their mindsets; it is very difficult on both sides.

On tactical nukes, I think we need to address it, absolutely. The Europeans want to address it. The Russians do not feel threatened by the presence of American nukes here, so they are more or less relaxed about that; but I think they will have to address it at some point. [?] is a politician; this guy is an ambassador.

The top three security threats: corruption, healthcare, demographics, North Caucasus.

The de facto pause in NATO enlargement came with Obama. There were two ways you could have responded to the Georgia war: one was to back off, in terms of NATO enlargement; the other one was to move forward and basically to treat Russia as a rising, revanchist power. Had a McCain administration taken over in Washington I'm not sure what the answer would have been.

Ukraine no longer led by Western Ukraine: I meant Yushchenko. Yushchenko, although he comes from the east, he has a Western Ukrainian mentality, and he thought that Ukraine belonged in the west, that Ukraine was no different from Poland. That, I think, is not something that is widely shared in other parts of Ukraine.

That it is. Thank you.

FABRICE POTHIER: Thank you Dmitri. Professor Mendras, we were wondering before the panel if you should give some wrap-up, concluding remarks. I think there is plenty of material for doing that, so I turn to you. If you can try to bring all those points, and bring your own insights in the next few minutes. Thank you.

MARIE MENDRAS: Thank you very much. I don't think I can do that because we don't have any time left; so maybe just two or three comments.

The first is clearly there is a disagreement with Dmitri Trenin on the question of Georgia. I think it is because Dmitri seems to assume that there will be a new president in Georgia, a new administration, that if, let's say, a successor to Saakashvili and to his administration, then something new can happen. But why? Why should it? I just cannot buy this idea that Saakashvili is the only problem between Russia and Georgia. Saakashvili gone, maybe Moscow will have a say in who replaces him, we don't quite know; but I don't see why the many deep problems that are in the way, and that led also to the conflict in August – the conflict was not only Saakashvili's hair-brained policies or Putin's obsession - there were very serious problems all along, since 1991 and even before.

As Pierre Morel said, if you don't accept the recognition of Soviet republics in their borders, the Russian position now would be completely different, then what about the legitimacy of the war in Chechnya. There is such a basic contradiction. You, Dmitri, yourself say that the North Caucasus is probably one of the major threats to Russia. Alain also phrased the question. I think this is a problem because the North Caucasian republics are in Russia and outside Russia. You talk to an average Russia, he doesn't believe that Chechen and [unclear] are in Russia; no, they are different, they are foreign. So, where is the border? This is a problem of identity. If a country like Russia, that has gone through major traumas in the 20th century, major transformation in the last 20, 25 years, and if some of those basic principles, concepts are always in question, how do you define the nation, how do you define the state, what do you do with empty Siberia, the east of Siberia and had Far East?

In particular, again, I was sorry there was not much discussion of the China factor, which I think will be for your next conference, because the Russians do not like to talk about it much; I would be very interested to see how it was phrased in that document. It must be in the heads, in the minds; it must be there, but probably it is difficult to tackle this Asian and more specifically the China factor.

Now just to conclude on the European position. It seems to me that we are at a crucial point where we more or less know what is in the toolbox – I don't think there is a major change – it is just the Lisbon Treaty may make things easier in a number of issues, but probably more complicated in other issues. Basically we know what is in the toolbox; we know what are the limitations of the Russian change in approach; we know there is some change of rhetoric, some change of approach, but probably not a major overhaul of Russian foreign policy. So, all the factors are there, I would say.

The question now is really how do we, in the European Union as it is, 27 member states, that will not much expand in the next five or ten years, how do we define our interests. I think finally we are faced with that really crucial question; which has always been difficult for the EU because the EU is not a nation state and doesn't really think in terms of national or trans-national interests; but we do, and it is probably the only way we can decide how to address Russian offers when it comes to security in Europe, when it comes to energy. It is very much a problem to be solved in Europe. As you said, most of Russian domestic problems will be solved by Russians in Russia. We can choose to have some forms of conditionality in partnerships and in cooperation, but that doesn't mean that we Europeans believe there is much we can do to influence Russian development.

This is different; I would like to make it very clear. I think the EU's position is not a position of interfering; it is a position of being clearer about its interests, about its principles, its objectives in two years, in five years and ten years, and try to come to some agreement with Russia where there are common interests, and work with the Russians in the longer-term perspective, try to really manage to have longer-term perspectives with the Russian interlocutors.

Finally, we are still facing the same problem of a lack of interlocutors in Russia, not clearly identified. We still lack this response from various parts of the administration, of society. We can't really name people. A few advisors around Putin, around Medvedev, a few figures; but we lack all the rest that is absolutely crucial in trying to keep a partnership going that would be a little less politicised, a little less personalised.

Thank you.

FABRICE POTHIER: Thank you very much, Professor Mendras. I apologise for being late, over time, but I think the discussion was very interesting. We had three great speakers, so if you could join me in thanking them, Ambassador Morel in absentia, for this great discussion. Thank you very much.