

Event Transcript

Ukraine's Future: The Challenges and Impact of Governance in Ukraine

Impact on the Economy and Foreign Policy

Moderator: Steven Pifer, Brookings Institution

Participants:

Andriy Fialko, Foreign Policy Advisor to the President of Ukraine

James Sherr, Royal Institute for International Affairs

Olga Shumylo-Tapiola, Carnegie Endowment for International Peace

Damon Wilson, Atlantic Council

Jorge Zukoski, American Chamber of Commerce in Ukraine

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This transcript is unedited.

Anders Aslund: Please come to your seats. Ladies and Gentlemen, please take your seats. Let us start again. Ladies and Gentlemen, let us start again.

Steven Pifer: Okay, we're going to get on with our second panel now. We just heard, I think, a very interesting, a somewhat depressing, but also somewhat nuanced discussion of governance in Ukraine.

I'm reminded of the Deputy Foreign Minister's comments. He said that he used to tell incoming ambassadors in Kiev that Ukraine is never boring. And it reminded me of a time several years ago when I was back visiting Kiev, when I was staying with one of my successors, and I said "It's a really interesting time here." And he sighed and said, "Yes, it's a real interesting time. Sometimes I wish it was not quite so exciting and interesting."

Governance matters for democracy in Ukraine, and it matters for civil society. But it also matters for other issues as well. It has an impact on the economy, and it has the impact on business, including decisions by foreign investors who look for countries where there's good governance, rule of law, and where they can have confidence that the law is fairly applied. And, if they don't find those locations, they tend to go elsewhere.

So we'd like to explore in this panel what does some of the issues of governancing hurt? How does that impact on Ukraine's economy? The other thing that governance impacts is how Ukraine is seen overseas. What

does it mean for Ukraine's engagement with Europe and the United States?

I think we heard very clearly from the Deputy Foreign Minister something I heard when I was in Kiev about a month ago, that the strategic priority for Ukraine now is the European Union, to draw closer into Europe; and I think from the perspective of many of us here, the right direction for Ukraine is to tighten its relationship with the European Union.

But issues of governance have an impact on how Ukraine is seen in Europe, and how Ukraine is seen in the United States. The narrative now, I think, is at best a difficult one, and it complicates Ukraine's ability to draw closer to the West when the discussion about democracy in Ukraine is going in a way that suggests that there's a broad perception that it's moving in the wrong direction - that Ukraine is backsliding.

So, with the panel we now have, we're going to explore the impacts. What does governance in Ukraine mean for the economy? What does it mean for Ukraine's ability to conduct foreign relations?

Let me introduce all five panelists at the beginning, very briefly, because we want to save time for the conversation. We're going to begin with Olga Shumylo-Tapiola, who is a well-known scholar on Ukraine. She's written a lot about Ukrainian developments. She's currently a visiting scholar at the Carnegie Center in Brussels, and she's going to talk about the impact of governance on economic issues in Ukraine.

Our second speaker is Jorge Zukoski. He's been in Ukraine now for what—at least twelve years, I think. We were there at the same time. He is the President of the American Chamber of Commerce in Kiev, which is the largest business organization in Ukraine, and represents about 80 to 85% of the foreign direct investment in Ukraine. He's going to talk about the impact of governance on the perceptions and the business decisions made by foreign business and foreign investors in Ukraine.

Our third speaker is Andre Fioko, a long time foreign policy expert in Ukraine, who has served in a number of senior positions, and currently Foreign Policy Advisor to the President. And he's going to give us a perspective from the point of view on the Ukrainian government on governance impact on Kiev's ability to conduct its foreign relations.

Our fourth speaker is James Sherr, who is a well-known analyst of developments in Russia, Ukraine, and the post-Soviet Space. He's currently head of the Russia and Eurasia Program at the Institute of International Affairs, Chatham House, and he's going to talk about the

impact of governance within Ukraine on Ukraine's relations with Europe, including the European Union and NATO, and also with Russia.

And then, our fifth speaker is Damon Wilson, a former Foreign Service officer, former senior director at the National Security Council, and now Executive Vice-President at the Atlantic Council, and he will talk about the impact of governance on American views of Ukraine and US engagement with Kiev.

So without any further introduction, I would only ask the speakers to be mindful of the clock, because I will. And Olga, you have the floor.

Olga Shumylo-Tapiola: Thank you, Steve, very good to be here. Hello everyone. The first session which I was listening to made me think that the picture is very much black or white in Ukraine. I disagree with such thinking, and I think that I will try to offer you a framework which will put the situation in Ukraine into a bit of a different perspective.

Because, if we take the black assumption, we will think that President Yanukovich and his people are devil people who want to either destroy Ukraine or take away independence. If you take the good side, you will see that the reforms are on the way, that we just have to wait, and the good outcome will be there.

Obviously, there was a discussion about economy versus values during the first panel, and I must say that the economy is not doing better than politics in Ukraine. I will very briefly talk about the numbers.

Of course, the economic situation is much better now in Ukraine. Ukraine was among the worst hit economies by the economic crisis a few years ago, and what is happening now that the IMF is back, that some conditions are being met, and that the money are coming—it's all there. And of course, this is probably the biggest success of the current leadership.

I will not give you much numbers, because you can read in the reports of the World Bank, of the Ukrainian economists. Basically the economy is going up, and we can see that industry pick up, that retail picks up slowly. Inflation is still there; there are problems with budget deficit. But still we see that the recovery is there.

The main question is, of course, is how sustainable is this growth? And, I would say that it both grows about economy, but about business in Ukraine, that sometimes economy grows despite what government is doing, and business is surviving and developing, despite what government is doing.

So, I see two pictures. There is one picture of the West, the picture of Ukraine that you want to see: Ukraine being closer to Europe, willing to integrate, willing to reform. And there is another picture in Ukraine. And here comes my framework: that if you don't take this black and white picture, and you ask yourself why these people are doing what they are doing, what is their motivation?

And the motivation is very simple. There is a need to create a system in Ukraine that will help a very small group of people to benefit from what's happening in the country, to benefit from the economy. And the system should not have any competition from the inside—which means no political opposition, no protest in the society, the system which is comfortable for the leadership and a small group of people.

There is also—there should also be very little intervention from the West, both from the outside—both from Russia, but also from the West. And we joke in Ukraine that “hass might rub with the hassi” [ph 00:08:56] which means “Texas should be robbed by only people from Texas.” And this is what basically the underlying idea of what is happening now.

Ukrainian economy is still very highly dependent on exports, exports of very low value added products. And we saw that when the crisis hit Ukraine, the strategy was not really sustainable, and many from the international community from inside Ukraine were saying that basically reforms are needed to make the growth sustainable.

So we have stability now—economic stability, political stability—but as we also say that, be careful of what you are wishing because you may get it. And yes, there were a big number of reforms started in Ukraine, and I will probably not go much into detail on IMF imposed or conditioned reforms, such as pension, tariffs for communal services, tax reform, reform of Naftogaz. But again, if we ask why this reform was implemented in Ukraine, it's basically to get loans and to keep the economy afloat.

We had a big discussion on the political reforms, and again, I will just mention constitutional change, electoral law, judicial administrative, access to public information. All these processes were started, but when you ask yourself why they were started, it's basically to support the system that the leadership wants to build, and not to move Ukraine to the market economy.

Now moving on to economic reforms: we discussed a lot about corruption, so I am not going to dwell on that. Obviously, the legislation was cancelled and new was adopted, but the question in Ukraine is obviously not about the legislation in place, or even institutions in place, but about

its implementation, the possibility to challenge the non-implementation in the courts.

And here comes a big problem with judiciary. Investment climate, obviously, I will not dwell much on that. We have other panelists to talk about. Privatization, which was also mentioned. When we have still a number of factors that are in state hands, and when we see that organization is again happening to increase the capitals of those who are in power or close to power.

Land reform. Yes, the loan cadastre was adopted by the Parliament today, but again we know that the land reform is not going to happen before a small number of people in Ukraine will be able to control all the land, and it will not be beneficial for the economy or for the people.

So basically my conclusion on the political reforms which will come to the economic part as well is that yes, we have a very strong vertical, which is very good for Ukraine. We have one person for the first time in Ukrainian history being responsible for what is happening. But at the same time, what this person is doing with this authority, and with those responsibilities, and is it possible to keep him accountable for that?

Conclusion on economic reforms: I would say that yes, as I said, we have growth, but it still looks like fixing problems in order to either get money from the IMF, or keep the voters more or less happy. And surprisingly, we see that the disillusionment and the disappointment of the public in Ukraine comes now from the East, from the part where Yanukovich and his colleagues come from.

And, obviously there is very little competition in the economy. We have about ten people controlling all the economy. I'll just give you numbers, which Ukrainian journalists use to feed the most speech in Ukraine provided, is basically: we have heavy industry controlled by just five people close to the authorities; we have the aviation sector controlled by three people; we have the sector of chemicals controlled by one person.

And again, we have to say that maybe it's not bad that people are trying to build stronger companies, and they want to be global players, but at the same time we see that they're not building their companies or their business empires on innovation, or on bringing investment and modernizing, but they're basically relying on either cheaper gas from Russia, which is go to be not very cheap very soon, or basically the lack of competition.

And I will just give you, to conclude, I'll give you a few numbers. Unfortunately, Ukraine didn't move to better numbers in terms of

international economic ratings, and IFC is still saying that Ukraine is on the 145th place out of 183 in terms of how you can do business in Ukraine. It's not improving.

Obviously, as today was mentioned, Ukraine was named the fifth worst economy of the world, and it doesn't help us, obviously, to attract investors or to encourage new business and innovation in Ukraine. And the Wall Street Journal's rating, which put Ukraine on 164th in terms of economic freedoms.

Again, I have to say that it's not about the current administration, president, government, who made these bad conditions or bad ratings happen. It's something that stems from the Soviet legacy that was not really transformed. It stems from non-doing of reforms by the previous administrations. But, we are here where we are.

And to conclude, I will just talk a little bit about the willingness, capacity, and constraints of the current leadership and the people around the leadership, that basically the willingness for reform is there if this helps create or maintain the system that Yanukovich and his people are trying to build.

And we also hear people in the administration saying we are now following our national interests. But again, if you ask what kind of national interests those are, those are basically corporate interests, and not about the country that much.

Capacity. It's very good to have vertical if vertical works, but again, I feel very big pity for the President and his team, that he may have certain will for certain changes, but the Administration, and the capacity of the Administration to introduce changes even if the good will is there, the capacity is very low, and there is very little done to enhance this capacity.

Deputy Minister Klimkin was mentioned about the cuts in the Administration by 20%, but again the cuts are not enough to strengthen the capacity. You have to do training, you have to connect people with Western institutions, and this is something that is not happening.

And, on constraints, there are too many constraints for the current administration, which is very good. On the one hand, we have the IMF, we have the EU, the US; but on the other hand, we have voters. But if you look at the voters' moods, first time probably in Ukrainian history after the Orange Revolution, it's clear that people who not really care much about democracies and freedoms anymore. What they will care about is bread and butter. And this is very bad news for Ukraine and Ukraine's economy. Thank you.

Jorge Zukoski:

Thank you, Steve. You know, our business community sees Ukraine as an incredible land of opportunities, where it has incredible comparative and competitive advantages on the border of the new, larger Europe.

We heard a little bit about a discussion today about the upcoming DCFTA with the European Union. Our members are looking at using Ukraine as an export platform, both into the European Union as well as into the traditional trading partners of the former Soviet Union.

A population of 46 million people that is growing, and also growing in their capacity to consume as incomes are growing, as the economy is starting to recover, and as the consumers are becoming much more sophisticated in their purchasing patterns and habits.

So, the way that we look at it as a business community is that, Ukraine continues to be a success story, but it's unfortunately a success story that's waiting to happen. And I think that's the key message for today. It's a success story waiting to happen, and it's all going to revolve around moving the reform agenda forward, and taking the decisions that are going to be necessary to address some of these systemic and endemic issues, such as the corruption problem.

Steve asked me to talk about how governance affects the perception and business decisions of foreign companies in Ukraine, so I'm going to talk about that a little bit here within my limited time, and I'm looking forward to taking questions from the larger audience.

At the end of the day what do businesses need? Businesses need - foreign investors need - predictability and stability. Governance and public policy is a key to delivering an investment environment that makes sense for foreign investors that will attract and retain major foreign direct investment into the country. Investors, as I mentioned, understand the environment that is in Ukraine. We are not blind - we understand corruption is pervasive. It's everywhere.

There's rule of law issues, there's problems with contract sanctity, and often there's a problem with moving the goal post and changing the rules of the game midway through the game being played. Now that being said, this is something that we've experienced since independence, and as Steve mentioned, I've been lucky enough to have spent quite a few years in Ukraine, and I'm starting to figure out how the place works.

And that being said, at the end of the day, there's this new administration. We're starting to see something a little bit different, and we're starting to see something a little bit different in regards that's good for the business community, and that in regards to dialogue and engagement with senior

policy makers, which is impressive, and the best level of dialogue that I've seen since my time in Ukraine and its independence.

So I just want to touch on a couple of key issues that we've seen that have, we believe, moved the agenda forward. We had an adoption of a new tax code at the end of 2010. Is it a perfect tax code? Absolutely not. Is it a tax code that is something that's workable with business? Sure it is. Can we navigate and manage it? Absolutely. Is there commitment by the current administration to allow the business community to engage in the process of reforming and amending the tax code as necessary? Sure. Absolutely.

And today the Verkhovna Rada passed a Law 8217, which is extensive amendments to the tax code, a piece of legislation the business community has worked very diligently on.

There were some problems within this piece of legislation, and one of those was Amendment 474, which was going to provide, initially—as the way it was initially drafted—was going to provide state agents in the agricultural sphere with the right to receive the AT refunds, un-leveling the playing field, and not allowing grain trading companies to receive the AT refunds.

Well, the version of the law that was passed today has changed that, so 474 is still in the legislation, but now it's allowing the AT refunds across the board for all grain traders, keeping and maintaining a level playing field. So that's just one example of how the business community has been able to engage and move an agenda forward that's very important.

We see agriculture as one of the key competitive industries for Ukraine. We believe that Ukraine can increase its production, and double its production, within the next ten years, but it's going to require extensive international investment, and new technologies, and capital. And this is just one of the key things that is going to help move that process forward.

Is the battle over? Absolutely not. Will there be more issues within the agricultural sector over the next several years? Sure. But there is a sense within the agricultural industry now that there is a good level of engagement, and this is leading to reform agenda and concrete deliverables.

Also, within the last two weeks, we had a new amendments to a production sharing agreement law was passed by the Verkhovna Rada, in the second reading, which included a stabilization clause, something that the business community was very interested in putting into this piece of legislation, which would allow large scale investments within the fuel and energy sector to move forward in the future.

This was a big issue. It is now on the President's desk, and we expect the President will hopefully sign this piece of legislation today. The deadline is today for this piece of legislation. We're assured that it's going to be signed, so the proof will be in the pudding. Whether this is signed or not, if this PSA Legislation is signed by the president today, then we anticipate two large PSA tenders will be announced by the end of the year, as well as one licensing tender, which will allow and create a paradigm shift in Ukraine, moving Ukraine from a small and medium size investment destination, to a potentially large scale investment destination, because these will be multibillion dollar projects.

So, also, one other quick example of this high level engagement is the President recently called his first plenary session of the Domestic and Foreign Investment Advisory Council at the end of June. It brings together a group of both domestic and foreign investors at a very senior level to engage in a high level policy dialogue. The outcomes of this meeting are now being finalized with various presidential decrees to help to move also the reform agenda forward.

The president also agreed to establish eight working groups that will be working under the Domestic and Foreign Investment Advisory Council, and these working groups will actually be tasked with creating some concrete deliverables in conjunction with relevant ministers.

So, at the end of the day, my key message is the business agenda is moving forward. We'd like it, of course, to move farther and faster, but we remain cautiously optimistic about what the future holds, and it's all about structured engagement and a willingness to move the entire agenda forward. Thank you.

Steven Pifer: Thank you. Andre.

Andre Fioko: Thank you, Steve. Two things first. The first session seems to me to be a little bit too gloomy, and since I like theater, I would like to introduce in my very short presentation three characters to support my case: two female and one male. Mine, obviously, has to be a French hopeful presidential candidate.

And the second thing is that if I start to borrow from James quotations—"Red Ink", "watery porridge"—shut up me immediately. So the first thing is that, a year ago we were having an alarm [ph 00:24:48] Ukraine's foreign policy a year ago: there were a lot of pundits who were criticizing, hounding you, and analyzing. But through the year, I should say, we managed quite successfully. And strategic orientations remain as they were proclaimed: that is, European integration, strategic partnership with

the United States, and strategic engagement with Russia. So how does it translate into financial institutional capacities?

Also I just want to answer the question of the adequacy, let's put it, how adequate is the leadership? Does it understand what these goals, what exact actions do these goals necessitate? And I would also like to speak on some other areas.

So, my basic point is that there's no basic difference between the optimist and the pessimist. Both are wrong, but just an optimist is a bit happier. This is where my first character, Christine Lagarde; she said it. And this is the bottom line of, actually, my presentation.

I think that institutionally, Ukraine has far stronger capacity to deliver on foreign policy. Without being disrespectful to any country or to any government, the previous five years were careless, and the good intentions were not possible to implement into good policy guidelines.

So institutionally, there is a political will on the one hand and the possibility to adopt laws, to pass legislation, to follow up on the commitments. And Ukraine has obviously, ambitions: ambitions to be a regional leader; ambitions, as we said, to join the first twenty richest countries, and most developed. And, unfortunately, financially this is not the case so far. And so, I think that the leadership is pretty realistic about its foreign policy agenda.

But again, here enters my second character, the French presidential hopeful, Nicolas Sarkozy, when he was hoping for the first term in his book, *Testimony*. He said, "Unless you 'I don't take no for answer;'" "I don't take things for granted;" "Unless you set ambitious goals, you can't move a lot." And in that respect I think what the president was saying makes good sense.

Then foreign policy is not just about declarations, toasting, visits, nice words, or not so nice words. It's not about mutually reinforcing, congratulating, et cetera, et cetera. It's about hardcore national interests.

In this respect, where do we see our hardcore national interest? Energy independence, attracting foreign investment, and consolidating the Ukrainian position with the number of key countries like China, Brick [Block 00:28:21] countries, and developing relations with the countries in the Gulf.

Here I would like to emphasize one important point: that on energy independence. Five years ago, Ukraine was able to get a tradeoff

complete, to be on a safe footing, and to get trade off completely of dependence on Russian gas.

I would like to remind you that five years ago, the gas balance of Ukraine was import of gas from Turkmenistan, 30% or so, payment of Russian gas on a very good tariff as a payment for transit, and extraction of our own gas. This was done by the administration which is now in office, and it wants to reestablish its independence from Russia on energy supplies. It pursues vigorously the possibilities to reestablish good relations with Turkmenistan and the Central Asian countries, to win back the positions we so shamefully lost.

As far as the energy independence, obviously the relations with the United States and Europe become pivotal, in the sense that technologies, advice, expertise, and participation of American and European companies, both in upgrading Ukrainian gas transportation possibilities and exploring new deposits of oil and gas. I think in this respect we can be also cautiously optimistic.

New contracts are being explored and we hope to be able to welcome big American companies as major investments in Ukraine oil and gas exploration. Let me put it this way: Ukraine cannot succeed in a decisive way unless there is a major Western investment in Ukraine. And the major Western investment in Ukraine cannot happen without a dramatic change in Ukraine investment climate.

Dramatic change in Ukraine investment climate cannot happen overnight by itself; it can only happen if there is a sustained work on behalf of the government, of the President, of the legislation, and I would agree—I think everyone one would agree in this room—that problem number one for Ukraine is corruption. It's been described as such by the President in his annual address to Parliament, and if Ukraine manages to overcome this problem, it will I think manage to turn decisive picture in its history, and to put another quotation, just what Jorge Yoda (how you were saying?), what Jorge was saying, it can finally become a success story.

On many occasions, Ukraine turned to a historic point and failed to turn. This time, I hope we be able to turn. And, that brings us to the final aspect of my speech: whether there's a political will and determinance of the government to make difficult decisions and sacrifices which reform inevitably entail. And my answer is yes.

I think it was demonstrated already by the way the slowness of the process demonstrates that, shall we say, allegations or interpretations of the abnormal concentration of power in Ukraine are a little bit exaggerated. Because definitely, the reform agenda is not going as fast as the president

would like, and as Ukraine should have gone, but it takes into account the specific internal situation, and the correlation of forces.

And, finally here I would like to enter my third character, my most favorite character, Lady Thatcher. When she was pressed for change, because her reforms were causing adverse effect on the voters and in her own party, she said to the Wets in Conservative Party, “You turn if you want to, the Lady’s not for turning.”

So, with this, I would like to say that this is a chance for Ukraine; it will be a shame if this chance is missed; and I think the government, and the President, are determined to use it to the full.

The progress may be disappointing so far, but there’s a progress, and I’m happy to say it was confirmed during this panel. The government and the president realize that European integration is not just joining the free trade area; it’s about values, and there has to be deliveries in this particular area.

But I believe, with David’s eye, and the help of our friends from America and from Europe, we will move within this path—or otherwise, Ukraine doesn’t have a future. Thank you.

James Sherr:

Thank you. First of all, I would also like to add my thanks to these three strategically placed institutes in Washington that had the wisdom to organize this conference, and the temerity to invite me here.

Governance in Ukraine is not the center of attention inside NATO or the EU, even when they think about Ukraine. But both of these entities understand that governance is very important by implication. And, in the EU particularly, there is a very strong view, that if other hurdles which, now are the center of attention, can be cleared successfully, that the problem of governance will start to resolve itself.

Let me first try to articulate the usually unarticulated premise that lies behind this way of thinking. Even before the leadership of Viktor Yushchenko and Yulia Tymoshenko disillusioned anybody in the West or in Ukraine itself, it became strikingly clear within months of them coming to power that they represented half the country, and that even if their policies were wise, proactive, and exemplary, they would have a Herculean task bringing the other half of the country with them.

And the result of this was a body of thinking which emerged—which I associate myself—that concluded: until the representatives of the other half of the country come to power; until they discover, for Russia, there’s no such thing as partnership, only subservience; that integration with the Customs Union is only a recipe for backwardness; that the path to Europe

is inescapable—there is none other--only then will we be able to talk about a sustainable course for Ukraine as a whole.

And this is a view that persists, and this strategic imperative takes—for good or ill—takes precedence over the awareness, and often blots out and moves to the margins, the awareness of neotastaki [ph 00:36:47], the awareness of all the abuses, all the shortcomings, everything that we have been speaking about today.

Along with this—and it's a codicil of this—there is correctly a firm belief that if the provisions of the deep and comprehensive free trade area are implemented, the results in Ukraine will be profound. And the people, who understand this best, also understand that this is not presently understood very well by those who understand Ukraine.

Those who in Ukraine very much want the DCFTA do not really understand the implications of it, and therefore, if we push this through, we're going to start to have something we could really work with. I do not mean to defend this point of view; my purpose is to explain that it is there, and why it is there, but also to say there is evidence that corroborates it, and provides encouragement to people who think this way.

If you look at that debate in the Verkhovna Rada, on the nineteenth of May, the striking thing is the absence of anyone who stood up and praised the Customs Union and said, what about this alternative. Even the Communist Party, which did not support the resolution on the E U, simply did not vote. So, there was an overwhelming preponderance there of understanding that Europe is the only path.

It is also the case, and it is a process which is now being written about so, it's not indiscreet for me to mention it, there's also been quietly a process of reviving cooperation, sometimes in a very concrete way, with NATO. So this is happening as well. There is a change of mood inside the Ukrainian elite about Russia, and what Russia is doing, and what it represents.

What is not being thought about adequately is this: that the whole calculation and much of the premise can be faulty. The first reason it could be faulty was articulated very well by Olga. If the highest objective of those who run Ukraine is really not Ukraine's place in Europe, or Ukraine's place anywhere, but simply the long term dominance of the political and economic system by a handful of individuals and groups of influence, then these provisions of the DCFTA are not going to be implemented.

The proposition, then, has to be weighted differently. Instead of saying, “Oh, they don’t understand what this means, and therefore it’s going to have an effect;” no, when they understand what it means, even after the agreement is concluded, something very different is going to happen there from what we expect.

And the second point, which relates to it, is that even, if the people in charge do want to implement this—because after all, I do think myself—many people that we are talking about around Ukraine do have a conception of Ukraine’s national interests, they do believe in it. The problem is not that they have no conception of it; the problem is that the personal and corporate interests always trumps the national interest...and has consistently done so up to this point.

But the second problem is that, even if they do want to implement it, they might not know how. I mean, Yanukovich himself is a man who seems to be absolutely impervious to understand his own inability to comprehend what European integration is about. And this doesn’t seem to deter him.

Now, you know, it’s like saying there has been a certain amount of optimism in the first panel, which I want to take exception to. The view has been put forward quite correctly, that on particular points, where they have crossed red lines, and you either mobilize people on the street, or there’ve been sharp warnings from the West they’ve drawn back. Absolutely.

But you can persuade them by these means to do that, but that is very different from persuading people to change their style of governance. And what I’m suggesting is that they might not know how to change their style of governance. The same way you can persuade a bear it’s not in its interest to come into your kitchen, but you’re not going to persuade him to adopt different eating habits.

And this is a very deep problem that we have to be very realistic about. And the third, and my penultimate point, Chairman, is the Russian dimension. And the Russian factor-- the worrying factor about Russia is not that it’s going to look at this and say “Aha! Now is the time to come in, and strike, and pressure Ukraine.” It’s more complicated, messy, and worse than that.

Just as inexplicably to me, Yanukovich’s circle did not realize, that by offering Russia these zacooski, the harkif, that the pressure would not diminish, it would increase. Russia, for reasons we don’t have time to talk about, and most of us understand, naturally has not been expecting that, at this point, Ukraine would start resisting them on all fronts, and very, very

effectively. That's not in their plot; that's not in their script and mental understanding of what Ukraine is.

And the result of discovering that, and accepting all this aman [ph 00:42:15] as we draw towards Winter, and as Ukraine, again, cannot pay again it's energy bills, are very serious, and not enough people I would suggest, in the West, are thinking about that.

So my final point, Chairman, is: the big question is not whether the association agreement with the EU is signed, or whether the DCFTA is signed and concluded, the time scale is going to slip. But I think we can assume these agreements are going to be concluded. The question is then what?

Who in the West is thinking about what kind of backlash there will be inside Ukraine when these provisions are implemented in a very harsh, very unjust, and brutally selective manor? What kind of backlash will there be inside the EU when the conditionalities are not being observed.

And in the midst of this, if we have to have another energy crisis at the end of this year, and Ukraine starts to come under brutal pressure from Starshiy Brat [ph 00:43:12], we are going to find ourselves confronting the old challenge: support us as we are for the sake of European security, or watch us go down. And if we don't think that through now, that, I predict, is where we're going to end up. Thank you.

Steven Pifer: Thank you. Damon?

Damon Wilson: Thank you, Steve. Steve asked me to address this part of this as the American perspective in response to this discussion. How does governance affect US views of an engagement with Ukraine? And I think the answer is, it's quite significant. I want to walk through some of the rationale for this.

First of all, if you think about it, we're having a conference today on Governance in Ukraine, not Ukraine's integration with Europe. So whether you like it or not, the agenda, the discussion, is not in the right center of gravity from a Ukrainian perspective, because of a set of issues of governance. So that affects the perceptions, the engagement of everyone here in this room, of the perspective from Washington.

But second, let me offer an anecdote on how governance, I think, is also relevant to engagement from the West perspective. I used to work for NATO Secretary General Lord Robertson at NATO Headquarters. And we were preparing for a NATO summit during the years of President Kuchma. This was in the wake of lots of angst in the relationship, not just

from the issue of Chuguev and potential arms sales to Saddam Hussein, but also of Kungadza [ph 00:44:43], and increasing concerns of issues of governance and freedoms within Ukraine.

And it led to real concerns, expressions of concerns from Washington, and London as well, that when we were convening these leaders around a summit table for the Euro Atlantic Partnership Council, sitting there in alphabetic order is Ukraine, United Kingdom, United States—President Kuchma, Prime Minister Blair, President Bush.

That was not sitting well with Washington or London at the time, because of the nature of what was happening, and concerns both on governance and decisions that President Kuchma had taken. Lord Robinson came up with the idea then to turn to the French alphabet, the other official language of NATO, putting the United States under E - “États-Unis,” and the United Kingdom under R - “Regne Unit,” separating President Kuchma from President Bush and Prime Minister Blair.

I only offer that because, I think that it illustrates how the perception, particularly in Washington, of the decisions that President Yanukovich is taking, can have a significant impact on our engagement.

I think it hits at the core of the issue, and I think as Deputy Foreign Minister Klimkin acknowledged this morning, there’s a direct link between internal reforms and foreign policy objectives. And so, my thesis on all of this is that governance has a significant, a huge impact, on US policy, US engagement.

If you put it in perspective of - think about the Orange Team. Obviously, at the time, it was a team that presided over an opening in terms of democratic space in Ukraine. But I was in government at the time, working heavily the Ukraine account.

And many senior American officials, while not giving up, came close to giving up, of incredible frustration, because of issues of governance, because of the infighting between President Rechenko and Prime Minister Tymoshenko.

Because of the lack of effective governance, we actually felt like we did not have partners with whom we could engage. And so, while there was strong support for the Ukraine’s move to the West, the vision that was articulated, it’s the issues of governance sapped the energy that existed, the momentum that was really there at the beginning of the days of the Orange governments, undermining the potential of a US/Ukrainian partnership at the time.

If you think about where we are now, I think it actually cuts both ways. In many respects, if you're a US Government interlocutor, if you're a US businessman, you finally have a fairly effective, a fairly coherent, partner with which you can get things done.

Cases upon which many in the audience have seen here, cases on which many of those in the audience have worked for years that were stuck in Ukraine, have actually moved in the past couple of years under this administration. Some particular investment cases, some particular energy cases that had been thorns in the side of the US-Ukraine bilateral relationship have moved.

We've seen this government make far more credible progress in working with the European Union than previous ones had. We've talked about administration reform, consolidation of agencies, the healthcare/pension/education. There's a whole set of issues related to governance that have opened up some opportunities in the bilateral relationship.

But at the same time, the tenor of the discussion that we are having today, I think it underscores how much of that can be Undermined by the concerns that folks have about Ukraine's democratic trajectory. It almost leaves you with the appearance of the Ukrainian government pursuing contradictory goals: moving to Europe while emasculating a political opposition. And at a certain point, those two goals are contradictory, and they're not viable options.

The governance issue I think can't be separated. If you think about issues from a foreign policy perspective, well, Ukraine's been trying to pursue a fairly stable relationship with Russia. And that's something that Washington actually would support and want to see. Ukraine's been serious about its negotiations with the European Union—again, something that Washington would support.

On discreet foreign policy issues, Ukraine's often been in a good spot, whether playing a useful behind-the-scenes role relating to political prisoners in Belarus, or even stepping up the plate in some unexpected ways on issues like Libya. If you were to divorce internal issues, divorce governance, the foreign policy roster isn't so bad and lends its support for a strong relationship, not to mention the cooperation on highly enriched uranium, which I'll mention in a moment.

But it's not taken in isolation. That set of issues doesn't exist in isolation. The way I like to think about it is, as a former US Policy maker, is that there's the potential for a narrow and a broad relationship with Ukraine. It's almost the minimalist and maximalist options that exist.

The minimalist approach is going to be based on real strategic issues, an interest-based relationship, based on strategic issues, where we can do deals of common interest. And this administration has demonstrated that it's good at doing deals. The deal on highly enriched uranium is a very significant deal on the part of Ukraine, of strategic importance to us. It has driven the relationship between President Obama and President Yanukovich to this stage. Some of the deals that we have seen are resolving some of these investment cases. This is where Yanukovich can be a partner, and frankly has been a better partner than what we had in Ukraine over recent years.

But the maximalist side of this is one that captures the idea of relationship that's not just premised on doing deals and the interest behind it, but is really premised on the values underpinning the relationship, that the United States becomes far more invested in Ukraine's success, far more invested in Ukraine's aspirations. And this hits at the heart of backing its European integration.

And this is where I think governance hits at the core. Without those issues of internal reforms, democracy, governance this is where the US buy-in to vision of Ukraine becomes shaky. I think we all want to share a vision of an independent, sovereign Ukraine, with a strong democratic institutions and free markets imbedded in Europe, and as a partner of both the United States and Russia. This requires certain decisions on the part of Ukrainian authorities, and I think getting the United States to not just buy into the vision rhetorically, but energetically, hits at the heart of our perception of governance issues. As Ukraine consolidates a democratic path, I think it increases the possibility for partnership with the United States.

Likewise, if Ukraine backslides, if we see a Ukraine in a few years becoming more of a post-Soviet kleptocracy altocracy, it really will place limitations on how far the partnership-- how far Washington's willing to go-- on the partnership.

The good thing is, is that in what this means, in some respects, is the Ukraine can shape the foreign policy environment, or can help shape US foreign policy. That said, I think we all need to be realistic, and Ukraine is not, and never will be, on the top of the foreign policy agenda. Furthermore, this idea of "completing Europe," Europe whole and free, of finishing the Unfinished business of Europe's East is not exactly on the front burner in Washington, either. But it becomes easier to downgrade these priorities if Ukraine is perceived as "messy, corrupt, difficult, nondemocratic".

But the Administration, I think, has demonstrated it wants to give this play. I think Vice President Biden, in particular, has been particularly

engaged. So if you shift to US foreign policy, I think the premise-- Ukraine can help determine its own future. I think that's something I've said, before but the West does have a role to play, and Washington as well.

First of all, I think there is a perception in Ukraine that the West has lost its interest, and I think events like this conference today, but also this is where I think we need to change that perception, and help not just the Ukrainian government officials, but civil society, media, others understand and that we have not disengaged, we haven't lost interest.

Second, I think this means that democracy does need to be high on our bilateral agenda. Cooperation on strategic issues, cooperation on economic issues, should continue, but it shouldn't imply that Ukraine will win a free pass on issues of democracy. That's not how we do business, and I think that needs to be clear.

Third, I think this does speak to the importance of engaging Ukraine: that the Administration should be supporting Ukrainian efforts, and Ukrainian reforms, where it makes sense; should be sticking through and engaging their counterparts, the President, Prime Minister, various ministers. Just because there are things we disagree with on issues democratic and of governance doesn't mean we stop talking. They need to hear from US senior officials on a regular and ongoing basis to be able to help provide a counterweight and a perspective.

Elections need to be at the top of that agenda. This needs to be the Upcoming litmus test, the Venice Commission, approval of the electoral code, and meeting standards of the Council of Europe and OSCE. Critically important.

Next, I think sustaining US assistance. This is a tough fiscal budgetary climate here today. US assistance, particularly to countries like Ukraine will come under pressure, but I would argue that even as per capita GDP increases in a country like Ukraine, the role for US support for NGO issues, NGO sectors, is increasingly important and needs to be protected.

Expanding exchange programs: this hits at the visa issue. This is important with Europe, but the United States has a role to play as well, opening our borders to Ukrainians for exposure to academics and students, businessmen.

And finally, I think perhaps the most important thing for US policy is for us to continue to press and work with European Union to move forward in its negotiations with Europe. The European Union is the game changer in

the Ukraine, not necessarily the United States. I think this is where the United States has an important supporting role to play.

So to conclude, why does this matter? I think it matters a lot, because of what's at stake. I do think that, in many respects, Ukraine is at an inflection point, and the decisions and actions that are taken today by the Ukrainian government, but also by Ukraine's civil society, by its political opposition, and by the West, they will determine whether the country gradually evolves into a European democracy, or whether it slips back into a corrupt post-Soviet authoritarian state. Unfortunately, both of these futures are possible; only one's preferable, and I hope that US policy can be a part of helping to move forward with that first vision. Thank you.

Steven Pifer:

Thank you, Damon. Let me thank all the panelists, and let me pose a couple of questions then I'll take two questions from the audience. My first question, I guess, would be to James and Damon.

When I was in government about eight or nine years ago, I remember at one point, when we were having a rocky period in our relationship with Kiev, we received, or we heard some version of "You need to support us as we are or we may go back towards the East."

And our reaction was roughly "If your commitment to going to the West in Europe is so shallow that you would even pose that question, you know, we may have a fundamental issue here." So the question that I ask James and Damon to think about is: if we get some variant of that, say in a crisis—an energy crisis—a year from now or six months from now, how do you think the West would respond to it?

My second question goes to Andre, which is: I think we heard, well, to paraphrase what I took from a couple interventions was the idea "Can Ukraine move towards Europe while appearing to move away from European values?" So Andre, my question to you is, there is a perception in the West—and we can argue for, you know, another seven or eight panels about the reality, but there is the perception, I think in Europe and the United States, that democracy is moving in the wrong direction in the Ukraine. Is that understood, and is it also understood that makes achieving what the President said is his strategic goal—drawing closer to Europe—harder to achieve?

Now let me open it and take two questions from the audience, and then I'll give a [inaudible 00:57:55].

Audience:

My name is Sublasfa [ph 00:57:55], and I'm with the Muldoff Foundation here in Washington, and my question is for Andre Fioko, and perhaps James Sherr if he wants to comment.

I am glad that Ukraine has its own priority agenda to integrate into the European Union, but there are three outstanding questions besides the internal reforms that were mentioned today, which is: one—NATO; second—Romania; and third-- Transnistrian conflict.

So NATO is, there is little chance for Ukraine, and for any other countries, to get into the European Union without NATO. So what is your relations with NATO?

Second, on Romania. There's no precedent that a candidate would join European Union without having good relations with member countries of the European Union. And your relations with Romania is not so good for a variety of reasons: exchange of territories of 1940 that includes Transnistria.

Which brings me to the third question: the Transnistrian conflict. What is the Ukrainian position, the current government position, on getting involved and cooperate with other partners when solving this conflict? Thank you.

Audience 2: Thank you. I would like to take this opportunity to ask Andre about the new stand on the Customs Union. President Yanukovich has stood very firmly against the Customs Union, and now there is a discussion about the possibility of three plus one, three being Belarus, Kazakhstan and Russia, and the one being Ukraine. Should we take this serious, or is this just a negotiation tactic? Thank you.

Andre Fioko: Thank you. Steve, the perception matter, I agree, there was a perception that Ukraine sold kachugas to Iraq, and Kuchma was publically whipped for that at the Prague Summit. I don't think it was the best example, frankly Damon, because Ukraine, no one found kachugas in Iraq, and I'm sorry to say, no one found the weapons of mass destruction there, either.

So on the energies, I would like to say this, that I think President Yanukovich and his government prides itself on the fact that it promises safe, uninterrupted deliveries of Russian gas to Europe, and it keeps its promise. It happens in 1997; it happened before; and I don't see why it shouldn't happen now. This is the Ukrainian responsibility, however difficult it may be. Nobody's going to kneel down or ask for any special favors. It's our responsibility to sort it out with our Russian friends.

And in this respect, I would like to say that "Zakusky in the harky," [ph 01:01:16] As much as I admire your style, this time I dislike the substance, I should say. This time, because frankly, it was not a question of Zakusky for cheap gas, which wasn't cheap in the first place, which is still very expensive; it was a question of breathing space and survival.

So in the legacy, as I already said, in 2004, in the energy sector, the outgoing government left an agreement for five years that made Ukraine completely independent from Russia for gas deliveries. And what this government inherited administration was a—how you call the “pitla” a noose on the neck. And on the seventh of each month, the government had to pay a bill for the Russian gas, which was contracted an exceeding amount, whether it consumed it or not.

Then I was given an example that for example, March last year, Ukraine had to pay \$600 million US dollars for the gas it consumed, and \$800 million US dollars for the gas it hasn't consumed. So the country would have been broke within two or three months. And our Russian friends were saying, “Why should we change the rules of the game? We are very happy with the agreement. It's a legal one, and we're not in a hurry.”

But we were in a hurry because we were needing to pass a budget. The country, in March and April, didn't have a budget. And we had to conclude a deal with the IMF. So this is, as far as your question, Steve, I should say that the Ukrainian Government and the president fully realize the challenges, let's put it this way: “It just sees them differently.”

And I would also like to forcefully disagree with James, although I liked immensely his style and manner. I think that this downgrading interpretation of the intellectual skills and intentions of the Ukrainian leadership is not entirely appropriate; and in a sense, I would like to challenge this in a very simple way.

If the Ukrainian leadership would be a creepy, cynical bunch of “don't-cares,” who would only care about their own profit, in the first place, they would agree: why should they pursue a European integration path and strategic partnership with the United States, and face tough questions about democracy, freedom of press and assembly, if they would gain much more financially and politically by concluding a deal with certain other countries?

And then, by spending millions, millions US dollars, on hiring the most expensive US consultancies, like McKenzie, to try and make the economy transparent and establish new rules of the game, I think that everyone realizes this, and if you would like to exclude the totally—how you call this?—unbiased stand on their side, you could think of the more commercial side, that the people who are rich enough would like to have established rules of the game, and to consolidate their riches and see their assets grow.

And this happens only in the growing economy, integrated in their world economy, and developing within the rules that are established worldwide.

As far as the questions of the friend from Moldova, Ukraine appreciates its relations with Moldova very much indeed.

And NATO, I think this government is more on the delivery side, and anyone who deals with NATO can confirm this, that while the rhetoric is essentially different, the practical deeds are more impressive. James, would you challenge me on that?

And Ukraine does not-- Ukraine took off the agenda the issue of membership, but it's pursuing an active cooperation course with NATO. Yes, it is possible to join EU without in NATO. I asked that question publicly, then the High Commissioner, Salana [ph 01:06:04] of the European Union, and he gave the same answer.

It's not amusing, but it was a question I had to answer it. On Romania, I didn't realize that our relations with Romania were so bad it prevented us from entering the European Union. As far as the territorial disputes, you alleged a concern. Romania, in the first place, had to settle them with Ukraine in order to be eligible to go for the European Union, so we believe the whole thing is completely closed.

On Transnistria, Ukraine does not have a theological interest, but a practical interest that the whole issue is resolved, and I think our European partners, United States and Moldova, appreciate our balanced and proactive approach on the issue.

James Chere:

First, Andre, I must say, I did not raise the issue of intellect; I assume, as a matter of course—well, with good reason-- that the intellect of Messaroft, Novachkin or Horachovsky [ph 01:07:14] or any number of other people I could mention is equal to that of any one in this room. The question I raised is one of understanding, and that is very different.

Steve, in answer to your question, if that point is put to us again, I would propose the West answer it in exactly the same way. The concern I have, though, is that if today's worst case were to occur, a different question is going to be asked.

It's not "Do you want us to go to Russia?" but "Forgive Us, we are under brutal pressure that we cannot resist economically, and we may have no choice, but to make certain concessions that violate certain previously agreed red lines when it comes to energy and some other matters ..."

And we'd better be thinking about that possibility now, because I would hope—I would like the West then to be in a position to say "There are certain practical things we can do to help you, but there are certain conditions we expect you to meet in order for us to be able to get the EU

and the relevant parties in the West to act in this way, and make sure that in two to three years' time you will not be in this position again." So, that would be my answer.

The questions raised from the floor are very serious ones, and I will be as brief as I can with them. One thing, which I'm surprised Andre didn't say, is that if you look at the last round of negotiations on Pridnestrovie, guess what has happened? Ukraine has broken ranks, effectively, with the Russian position, and took once again very constructive, effective stance in these latest discussions, and that is another indication of the point I'm making about reorientation and re-exploring cooperation.

Fully agree with Andre, particularly in this case. If Ukraine were seriously interested in joining NATO, and geopolitical circumstances were right, in any case about the EU, Ukraine would break this precedent that exists in our mind that NATO membership is necessary for joining the EU. No it is not.

And that is understood in the EU, and today, also, it is understood that, although for various political reasons we're not going to use the "M" word – membership, that the European neighborhood policy, as we understood it, is over. There is no practical limit on the degree to which Ukraine can integrate with the E U and what kind of relationship it would have. And that is understood inside the Commission.

Romania. Romania's a diplomatic policy. The policy pursued by its foreign ministry is impeccable. The problem today is that Romania has a president who continues to score the worst type of un-goals against Romanian interests, both in dealing with Ukraine and, most recently, in dealing with Russia, if you've seen the latest comments.

And so I think I've covered them all now. Thank you.

Andre Fioko: Steven, who was asking, who was making this silly declarations, that "if you don't take us as we are, we go to Russia?" Could you please name the heroes?

Steven Pifer: No, I would actually prefer not to name it-- this actually came up in the context of the kachuga case in 2002, when I was there, we heard that from several—

Andre Fioko: Could you please call the names?

Steven Pifer: I—I—

Andre Fioko: I suspect they have very strong democratic credentials.

Steven Pifer: Actually, it came from a variety of sources, and it covered the political spectrum in the Ukraine.

Andre Fioko: I never said such silliest thing in my life.

Steven Pifer: I didn't say you—

Unidentified Speaker: Because they know you wouldn't be fooled. They think we can be. That's why they say these things.

Thank you, Garth Trinkle, Economist with Department of Commerce.

I actually wanted to follow up on a comment that Olga Shumylo-Tapiola made about Ukrainian response to the financial crisis and coming out of it, which has given Ukraine the macro-economic outlook of growing by 5% for the next several years. Also, since Doctor Aslund is in the room, I thought this would be the time, rather than perhaps after lunch, to ask if he could talk a little bit about how governance helped the EU Eastern Ten through the financial crisis. You wrote a volume on that.

If you were to extend that analysis of governance, and the financial crisis to Ukraine, what would you say about the sixteen months of the new administration? Is there some assumption that—I'm not trying to say that--

I'm not trying to call the current administration of Ukraine a center rightist, which is the phrase you used and praised for the EU Eastern Tens response to the financial crisis. But I wanted to follow up on the earlier comment, and your Peterson Research on Eastern Europe, to get some sense of economic governance and the financial crisis, and the macro-economic sustainability going forward. Thank you.

James Sherr: Okay. I respond. I was a bit unprepared. It's a big question, of course. I would put it like this: that when you can do big reforms, as we have seen in the Baltic countries in particular, it's in the midst of a crisis. Julio Manchenko effectively could only get through against Yushchenko the most necessary laws through Parliament. So there was no legislative capacity whatsoever. It was a very different situation from what we have seen in Eastern Europe, and you can say that all the time in the EU countries, they have Parliamentary systems, and I think that this was a very strong argument for a parliamentary system. Because the government couldn't do anything, because of the President Yushchenko was vetoing it. Of course, the opposition – Yanukovych, etc. - were voting against it, but that is and should be the role of opposition. I don't complain about that.

When Yanukovych came in, he did present big reform program on the third of June last year. And it did push ahead with the standby agreement.

And then, what I would argue is that they have lost momentum totally with the adoption of a tax code from November, which was very much for the big enterprises and against the small enterprises.

So, I think that Jorge represents it correctly for his members; but his members are not small Ukrainian enterprises, and they were the ones who were suffering from the new tax code. And after that, the momentum has been lost.

It's a big question right now this week, today and tomorrow, if the pension code will be adopted. As Adrian has said, the land cadastre has been adopted. Ukraine has now got a massive legislative capacity. Laws are adopted, one after the other, but hardly any laws, apart from the most needed ones, were adopted for five Orange years because Yushchenko, essentially, vetoed whatever he could veto, especially towards the end.

But the problem is, that has been brought out, is very much that it is dominated by the interests of a few top businessmen. So therefore it comes back to democracy, and of course all the Ten Eastern EU members are very good democrats. And they are parliamentary systems. So they are differences that I should elaborate on more, but I can't quite do it here.

Audience: I apologize. I didn't mean to catch you off guard. I just thought that governance and the financial crisis—

James Chere: It's a big question simply, so I would have needed to elaborate more on it. But thank you.

Andre Fioko: Honestly, I do apologize. The question of Customs Union with Russia is off the agenda. On the other hand, the question of economic relations with Russia and with the countries of the Customs Union is on the agenda. And there are some real issues which will follow if Ukraine joins, if Ukraine signs DFTA with the European Union. So Ukraine wants to find [Inaudible 1:17:01.8] depoliticized as possible with the countries of the Customs Union without sacrificing its WTO obligations and its European inspirations [aspirations 01:17:13].

Olga Shumylo-Tapiola: I'll have a very short comment on what Andre was saying. Basically I think that the first problem before the crisis was that many people, including Yushchenko, denied the crisis coming. And nobody really had any plan how the governance issues will be linked, or basically how Ukraine would be dealing with crisis.

And also we have to remember at that time the [Inaudible 1:17:40.4] regions and President Yushchenko did come up with a law which made IMF leave Ukraine, and that was again-- that shows that it wasn't about

fighting crisis and coming to more market economy. But again I have to remind you that Ukraine was probably the most hit economy in the 90's, at the beginning of the 1990s after the calls with the Soviet Union, so people are used to surviving, and I think that the expectation of the population side is not really to reform, but how to survive during the crisis.

But that brings us to the question of IMF and how the US and the EU can be helping. And this is the question that we are discussing in Brussels. And my feeling is that there is very little that's this reactors can do, because what Ukraine needs now is very big money without strings attached. And IMF comes with conditionality, which is very vague and doesn't really encourage much of good governance—well it encourages, but it doesn't manage to deliver. And obviously US and EU assistance comes at too little and was too high strings. And even Russia at the moment doesn't provide for Ukraine as a necessary resources.

So I guess that it's again coming back to foreign policy choices, and Customs Union again goes into what I was saying at the beginning, that if you make your choices based on the national or corporate interests, obviously Customs Union is not something that will attract the leadership. And still, after [Inaudible 1:19:17.5] agreement we have one more integration, which is gas transit system, which can go first before Ukraine will try to join the Customs Union if this decision will be made.

Steven Pifer: Okay, we have time for one more question. Andy?

Audience: Andy Bion [ph 01:19:40], now from the Washington Group, but also formerly from the Commerce Department, so it will be two commerce questions. One: I would like to know what Andre had just hinted at, right now. What can be expected in terms of some of the bigger moves that may occur on the part of Russia, if in fact the FTA from the EU is accepted by Ukraine. Are we going to be talking here, or expecting, something along the lines of what occurred—or at least surfaced—last week, such as the [gas sprazo crahine 01:20:18]? Some sort of merger and similar gas and oil transit problems—or others. For example, gas through the Euria producers, the chemical industry producers, whether they're going to be problems with that.

Secondly, I'd like to ask the question, at least to Olga at this point. Where you had hinted, certainly mentioned the possibility of—well, the export trade of Ukraine is primarily within the product sectors that have been traditionally the old product sectors, with very little innovation. Whether anything can be expected out of this government, or any future governments, in modifying that, getting more into products that are plentiful in Ukraine, but have yet to see a break of some sort in export expansion to a great degree.

And third, to Jorge. Jorge you had mentioned the newly formed Domestic and Foreign Investment Advisory Council. We have seen variations of that in the past, I think over the last fifteen years or so. What will make this one a little different? Because you seem to certainly give us an indication that there may be hope for it, particularly with the formation of the eight compartments underneath that. What would make it work? We really would want to see that work, including issues that deal with corruption, and certainly entirety of the investment climate. Okay, that will be it.

Jorge Zukoski:

Well, I think, in Russia, nobody can answer any better than James, and I wouldn't dare, obviously, in his presence to speak on the subject. As far as the gas talks between Ukraine and Russia are concerned, I'm not a specialist in these, and I wouldn't like to speculate.

It just, without dodging these, I would like to say that, indeed one has to judge, not in an abstract terms, but in very specific terms, and this is the very difficult economic situation resulting, in many respects from high energy prices-- much higher energy prices, even with the rebate. Ukraine has to pay for the Russian gas. And the agreement is for ten years, so there's no easy solution. And again, our Russian friends say, that we're not in a hurry to change it. Give us something big that we could think of this.

And the something big was first Customs Union, and second is the merger of Naftogaz and Gazprom. Well, if the merger would have occurred with a fifty-fifty division, I think it may have been contemplated. But obviously, it's a swallowing basically, it is not a merger, it's more of a swallowing, and in that respect Ukraine-- but we'll see, the negotiations are going, it's very difficult, and I think counterproductive to comment on what they may achieve. I believe that the position of pragmatic defense of national interests exclude any unprofitable deals which would put Ukraine in a damaging position.

Steven Pifer:

Olga?

Olga Shumylo-Tapiola:

Um, if I may still speak when James is here on Russia, a trade war is already started for certain products between Russia and Ukraine from Russia's side, and we expect more, especially targeting the companies that are owned by oligarchs close to President Yanukovich. Gas prices will go up, definitely, unless there is our pipe, which is kind of on the table.

Visas for Ukrainians. That is something was articulated that will be very difficult to sell at home domestically by the Russians. So it is, but that's something I don't know if James will agree is another possibility.

In terms of innovation, I would say, if you expect from the government very little; because if you look, for me the heart of the agreement is not about even losing independence or giving the [black defeat state 01:24:45]. It's about cheaper gas. It's innovation, modernization, investments from Europe vs. cheaper gas and normalization. So it's a very clear indication that the government is not interested in modernizing that much, but building still or driving on the cheaper gas.

Yes, if DCFTA is implemented—again, James said today that there will be a big question if the DCFTA will be implemented. But if we have regulations, if we have possibilities for other businesses to develop, if we have more competition, I guess that there is hope, but this is five, ten years from now.

Jorge Zukoski:

Thank you, Steve. And thank you Andy for the question. If I could just talk a little bit about the knowledge based economy or the export-based economy; currently, right now, Ukraine is posting between 4 to 5% GDP growth. A lot of this is based on the fact that Ukraine is a commodity-based export economy, and commodity prices are high. So, all boats float when commodity prices are high.

So, we believe strongly that we will see, or Ukraine has the ability to post, much larger GDP growth, once comprehensive economic reforms are implemented. So I think that's something very important to keep in mind. There's nothing great about 4% GDP growth at this point, because of the global commodity prices, but if they leverage up the opportunities that are out there, I think we could see a lot more growth.

Also, there's another thing that's been interesting under the current Administration that is very different than previous administrations in regards to the commodity based exports-- the economy, based on commodity-based exports-- and this is the first time we're hearing the concept of "augmenting". They're commodity based exports, with more knowledge economy-based exports, looking at high technology, trying to stimulate research and development in the country, and also doing more value-added, so not just exporting agricultural commodities, but also trying to stimulate investment into food processing, which would be an interesting opportunity for Ukraine, especially with the DCFTA, once the DCFTA is in place.

So, I think that's something to keep in mind, to answer your question about the export-based economy and GDP growth. In regards to the Domestic and Foreign Investment Advisory Council, I've had the opportunity to serve on the investment council under President Kuchma and President Yushchenko. Both of those had varying degrees of success. What I think is interesting about this current structure, is in the past there

were foreign advisory councils, and now President Yanukovich has put into place a Domestic and Foreign Investment Advisory Council, bringing both large strategic domestic and foreign investors to the table, to engage in a high level policy dialogue.

Our feeling is that, where and when of foreign and domestic investors' agendas coincide, it will be much more-- well, it will be easier politically to be able to move that agenda forward and actually create concrete results that will come out of it.

Also, the working groups that have been set up a very specific, and they're very specific and they're geared around strategic industry sectors for Ukraine, with the idea to stimulate additional both domestic and foreign investment into these sectors by addressing issues that need to be addressed to be able to get than done. They include hi tech, agriculture, fuel and energy, heavy industry, intellectual property rights, which is important for hi tech to move forward, and research and development, infrastructure.

But also an interesting working group, as well, on e-Governance, because the concept that the President has now is that e-Governance is a concrete and tangible platform to be able to reduce the interaction between bureaucrats and the private sector, as well as citizens, to increase the level of deliverance of services to the population, but at the same time reducing the opportunities for corruption. I think there's some interesting options that will happen there. It's very well structured. There's plenary meetings that happen on an annual basis with the President, there's quarterly meetings that happen with the secretariat to bring forward ideas that are decree-able into life. So there's an interesting platform that's being put into place, so we'll see. The proof, again, is going to be in six months to a year from now to see what kind of forward movement we have on it. But we're committed to it, and the companies that are involved in the Investors Council are excited and very committed to the process. So thanks.

Unidentified Speaker: The recent changes in energy prices, unfortunately, have restored Russia's confidence, that was rightly questioned inside Russia in 2008 to 2009. Wrong, in my view, but it has taken place. Secondly, it's not difficult to produce a wish list of what Russians would want in Ukraine.

And, of course, top of it, and I would put it the following way, is I would say this: membership of the Customs Union for Russia is less important than Ukraine not joining the DCFTA. And somebody might, if they had time, might be thinking about how enough acquisitions of what is wanted in the Ukrainian economy can derail the DCFTA by other means.

But my final point is I don't know who in Russia is thinking about that. Because Russia has a lot on its own plate, at the moment. It has now made some major commitments in Bella Rous that I don't think it knows how to manage. I personally don't believe Russia knows how to manage Ukraine.

Ukraine, under conditions of adversity, has perfected the technique, which I would call consent and evade—you know, agree to all sorts of things, then don't carry them out. Russians know this very well.

So, I think that there is, therefore, a risk of tensions boiling over, and supplies of energy being cut off again; and that's the worry I have, coupled with a mess. And the mess is a worry. We shouldn't think, "It's just a mess; we don't have to worry." A mess is a worry. Thank you.

Steven Pifer:

I am not going to try to pull together the consensus view from this panel. But let me just offer a couple of observations on the economic side and the foreign policy side. I mean, I guess I come away from here saying that the economic picture is mixed, but perhaps brighter than what we heard from the first panel with regards to the political scene within Ukraine. The economy is growing. The question is "Is that sustainable?" And, at least from the perspective foreign business, there's huge potential seen. The question is "Can that potential be realized?"

But, I guess I would come back yet to the question of governance where it comes in here is the question. At the end of the day, do the powers that be in Ukraine place the national interest ahead of personal and corporate interest. Those are the "take-aways" on the business and economic side.

On the foreign policy side, I think we have heard clearly that-- for Ukraine, for Kiev-- Europe remains the strategic priority. The question there is, though, can Ukraine get there without fully embracing the democratic values of Europe? And to the extent that Ukraine is seen as not moving in the right direction on issues such as democracy and governance, that is going to make it more difficult for Ukraine to accomplish what President Yanukovich says he would like to do in terms of relationship with Europe.

But I will close-- I remember a year ago, when we had Andre here at another conference, and he basically—and I think a year later has shown correctly—refuted the concern at the time, which was that Ukraine, four months after the Yanukovich election, was going to turn back to Russia. And I think you made a fairly eloquent case that that was not going to be the course, that Ukraine would pursue a policy that was balanced between engagement with the West and engagement with Russia.

And, a year later, I think, your argument is correct. I hope a year from now what you said about governance in Ukraine proves to be equally correct. But I guess I have to say at this point I'm not as convinced that you'll be proven right a year from now as you've been proven right a year ago.

Andre Fioko: I didn't say a year.

Steven Pifer: Well, okay. We'll leave the time frame open then, but it's a...I'm still not quite as confident in the position as I was in what you were saying a year ago. Andrew, do you want to handle the logistics?

Andrew: Yes, thank you. We have lunch set up outside, and I can trust you, it's warm enough to keep the food warm outside—

