

# AICGS WORKING PAPER

AICGS WORKING PAPER SERIES

**The US-German-Russian  
Triangle: German-Russian  
Relations and the Impact on  
the Transatlantic Agenda**

**AMERICAN INSTITUTE  
FOR CONTEMPORARY  
GERMAN STUDIES**

THE JOHNS HOPKINS UNIVERSITY

©2007 by the American Institute for  
Contemporary German Studies

**AICGS WOULD LIKE TO THANK:**

The German Marshall Fund of the United States for  
funding this AICGS publication.

**ADDITIONAL COPIES:**

AICGS Working Paper Series are available  
at \$3.50 each to cover postage and processing  
from the American Institute for Contemporary  
German Studies, 1755 Massachusetts Ave. NW,  
Suite 700, Washington, D.C. 20036. Telephone  
202/332-9312, Fax 202/265-9531, E-mail:  
info@aicgs.org Please consult our web-site for a  
list of on-line publications:  
<http://www.aicgs.org>

The views expressed in this publication are those  
of the author(s) alone. They do not necessarily  
reflect the views of the American Institute for  
Contemporary German Studies.

**TABLE OF CONTENTS**

About the Authors	2
Putin's Security Policies and U.S. Missile Defense in Europe: Is An Arms Race "Inevitable"?	3
Debates Over Missile Defense in Europe: Sound, Fury, and Signifying?	6
Energy Relations of Europe, Germany, and Russia in the Transatlantic Context	13
Energy Interdependence and Security: Russia and Europe	20
European Energy Security and German-Russian Relations	24
Russia's Influence on German-American Relations	27

## ABOUT THE AUTHORS

---

Hannes Adomeit is Senior Research Associate at the Stiftung Wissenschaft und Politik in Berlin and Director for Eastern Studies at the College of Europe, Natolin (Warsaw).

Clifford Gaddy, an economist specializing in Russia, currently holds a joint appointment as senior fellow in Brookings' Global Economy and Development and Foreign Policy Studies programs.

Jörg Himmelreich is Senior Transatlantic Fellow at The German Marshall Fund of the United States in Berlin.

Catherine McArdle Kelleher is a College Park Professor, University of Maryland at College Park and also holds both a research appointment as Senior Fellow at the Watson Institute, Brown University, Providence, Rhode Island and the honorary title of Research Professor Emeritus, U.S. Naval War College, and Newport, Rhode Island.

Irina Kobrinskaya is the Executive Director of the Foundation for Prospective Studies and Initiatives (a Russian think-tank) and a leading research fellow at the IMEMO of the Russian Academy of Science.

Vladimir Milov is President of the Moscow-based independent Institute of Energy Policy and former Deputy Energy Minister of the Russian Federation.



# PUTIN'S SECURITY POLICIES AND U.S. MISSILE DEFENSE IN EUROPE: IS AN ARMS RACE "INEVITABLE"?

HANNES ADOMEIT

American plans to install a radar station in the Czech Republic and missile interceptors in Poland have met with harsh criticism in Russia. The argument is being made that such deployments would not be directed against Iran, North Korea, or any other problem states (according to U.S. definitions of terrorist organizations) but against Russia. Correspondingly, at the Munich International Security Conference in early February 2007, President Putin warned that the realization of these plans would "inevitably trigger an arms race."

The chief of the Russian general staff, General Yuri Baluyevsky, and the commander of the Russian strategic missile forces, General Nikolai Solovtsov, accordingly have warned that Russia may withdraw from the INF treaty on the complete disarmament of intermediate-range nuclear missiles and consider the antimissile positions in Poland, the Czech Republic, "and other countries ... targets of the Russian strategic missile forces." Moreover, Putin has linked NATO's eastward enlargement to NATO's refusal to ratify the 1990 Treaty on Conventional Armed Forces in Europe (CFE) and its 1999 adaptations. Indeed, in a presidential decree of mid-July 2007, Putin stipulated that if NATO countries failed to ratify the modified treaty by the end of 2007, Russia would no longer feel committed to it.

Along with the threat posture, Putin has made some offers. At the G8 summit in Heiligendamm, on 8 June 2007, he suggested to U.S. president George W. Bush the joint use of the radar station Gabala in Azerbaijan run by Russia on lease. Acceptance of the proposal "would allow [the United States] to refrain from the deployment of offensive complexes [also] in space in the context of the ABM program," he declared. During his meeting with President Bush in

Kennebunkport, on 3 July, he extended his offer, proposing the joint operation of a radar station at Armavir in the Krasnodar district of southern Russia, a facility still under construction. In addition, former defense minister and now first deputy Prime Minister Sergei Ivanov stated a few days later that the Armavir radar station become part of a global antiballistic missile defense system open also to neutral states such as Austria, Finland, and Sweden.

The Russian reactions raise some important questions:

■ Does Russia really feel threatened by components of American missile defense in Europe and, consequently, do the Kremlin's threats of counter-measures and a new arms race have to be taken seriously? Or is Moscow, contrary to its official position, responding to medium-term threats coming from Iran and other states of the South—e.g., Pakistan after an Islamist coup—and therefore wants to install a global antimissile defense system jointly with the USA?

■ What is behind the harsh attacks on the U.S. military policy, opposition to NATO enlargement, and the threats to renounce the CFE and INF treaties? Is Moscow striving for a comprehensive new architecture of European security? Or is it simply returning to the traditional Soviet diplomacy of "using contradictions between and within imperialist power centers"—which in the present circumstances means utilization of differences in perception and policy between the United States and Europe, and between the "old" and the "new" Europe?

■ Even before the harsh reaction to the U.S. antimissile plans, Moscow had embarked upon the modernization of its nuclear strategic potential. The

question needs to be asked, therefore, whether the Russian campaign is really to be considered a reaction to perceived threats or meant to legitimize a new round of Russian armament.

■ Finally, to what extent are domestic factors involved? Possibly the sabre-rattling is designed to help stage a smooth change of power in Moscow after the parliamentary elections in December 2007 and the presidential elections in March 2008.

What follows is an attempt to answer these questions.

### Pretended Russian Threat Perceptions

"Iran is not threatening Europe," Putin stated categorically in Munich. Just like at the end of the Yeltsin era and the beginning of Putin's first term, when the USA renounced the 1972 anti-ballistic missile (ABM) treaty, high-ranking Russian politicians and military officers today have asserted that U.S. missile defense in Europe is not directed against "rogue states," but against Russia. This is just what General Solovtsov had in mind when he stated in mid-February 2007 that the American missile defense program will "without any doubt affect the strategic balance." Russia would be "forced to take retaliatory steps."

However, less than a month later, he revised this judgement by declaring that "The deployment of elements of the American missile defense system [in Poland and the Czech Republic] will have no substantial impact on our strategic components." These elements "will not be able to intercept our intercontinental ballistic missiles." The commander-in-chief of the Russian air force, General Vladimir Mikhailov, too, has described the potential American systems in Europe as "harmless" for Russia, because they are "stationary" and "no offensive weapons."

Indeed, ten interceptors deployed in Poland would hardly be able to affect Russia's global offensive potential. But in addition to what Generals Solovtsov and Mikhailov have said about the U.S. missile defense components in Europe, former defense minister Ivanov has stated with regard to the global

nuclear rivalry that "Our intercontinental systems are able to break through any defense system any time, now or in future."

But what about the dangers that may arise not in the strategic relationship between Russia and the U.S. but from developments in the South?

### INF To Cope with Threats from the South

Such dangers have, in fact, been recognized in Moscow, and they have been linked to the INF issue. Thus, Putin declared in Munich that "Today many other countries have [short and intermediate range] missiles, including the Democratic Republic of Korea, the Republic of Korea, India, Iran, Pakistan, and Israel. Many countries are working on these systems and plan to incorporate them as part of their weapons arsenals. But only the United States and Russia bear the responsibility not to create such weapons systems. It is obvious that in these conditions we must think about ensuring our own security." Similarly, former defense minister Ivanov has justified the testing of a new version of the Iskander-M short range missile in May 2007 by declaring that the "acquisition of the newest high-precision weapons" was necessary because "our neighbors in the South and East are equipping themselves with short and intermediate range missiles. This is a real threat for us."

It is safe to conclude, therefore, that the on-going modernization of short-range missiles and INF research and development programs are not direct reactions to the planned deployment of American defensive systems in East-Central Europe but the realization of plans that have been under discussion in Russia and with the United States for quite some time in connection with threats from the South. Similar considerations apply to the modernization of the Russian nuclear strategic arsenal.

### Nuclear Strategic Modernization for Political Reasons

The modernization of nuclear weapons is part of Russia's long-term endeavor to convey the impression that it continues to maintain strategic parity with

the U.S. and that the country politically, too, is an equal partner of the USA. The main focus of modernization is on offensive weapons and the development of multiple, independently targetable reentry vehicles (MIRV), including maneuverable vehicles (MARV), which would be able to overwhelm an extensive American missile defense (e.g., in Alaska and California). A shift within the triad of strategic weaponry is taking place so that by 2015 sea-based systems (SLBM) will carry twice as many warheads as ground-based missiles. To reach this goal, the Bulava, a sea-based version of the ground-based Topol-M, is now being developed, also to be equipped with maneuverable warheads and to be deployed on newly-developed nuclear submarines of the Borey class. There is, to repeat, no relevant connection between these plans for the offensive strategic potential and the U.S. anti-missile plans in Europe.

### Domestic Determinants Not Decisive

The campaign for the December 2007 parliamentary elections as a prelude to the March 2008 elections for a post-Putin president is already in full swing. To convey the notion that Russia, on the one hand, is again surrounded by enemies but, on the other, that the leadership under Putin is firmly in control and cannot be pushed around, would fit well into a strategy to secure a maximum vote for the Kremlin party "United Russia" and a smooth change of power in spring of 2008. However, the argument that the Kremlin's saber-rattling is for domestic reasons is overdrawn. The election processes in Putin's "managed" and "sovereign" democracy can sufficiently be structured, controlled, and manipulated to reach just about any result the leadership wants.

### Enhancement of Alliance Differences: Instrument, Not Strategic Goal

Similarly, the utilization and, as the case may be, the ignition of differences between the United States and Europe and between, in former U.S. secretary of defense Donald Rumsfeld's definition, "old" and "new" Europeans should not be considered a principled aim of Russian foreign policy but as an instru-

ment to shape the course of transatlantic debates and their outcomes.

### East-Central Europe and the Post-Soviet Geopolitical Space: A Russian Sphere of Influence

As shown above, even the Russian military acknowledge that the envisaged deployment of components of an American missile umbrella in East-Central Europe cannot be considered to be a threat. In the Kremlin's perception, the real challenge of the U.S. plans lies in the build-up of any military infrastructure and military presence of the USA and NATO in former Warsaw Pact member states (e.g., Poland, Czech Republic, Bulgaria, and Romania) or in former Soviet republics (e.g., the Baltic States) and to prevent a further eastward extension of NATO (e.g., to Georgia and Ukraine). This, it would seem, is the main determinant of the Russian reaction to the American anti-missile defense plans.

### Limited Prospects of Success for U.S.-Russian Cooperation in Missile Defense

Russian and American views as to Putin's offer of joint usage of the Gabala and Amavir radar stations are fundamentally different: Whereas Moscow considers these offers as an alternative to the U.S. anti-missile plans in Europe, Washington—at best—considers them to be auxiliary. Furthermore, it is unclear whether Russia is really ready to share the Armavir station with the USA or whether it is only willing to concede to U.S. experts access to a station that will remain under Russian control. There are good reasons to assume the latter. Fifteen years of Russian-American co-operation in anti-missile defense, including joint staff training to test the interoperability of the early warning systems of the two countries, have shown that neither the American nor the Russian military is willing to give up its own early warning systems with data gained in real time and direct communication with their own command and control systems for interceptors to be located preferably close to the radar stations.





# DEBATES OVER MISSILE DEFENSE IN EUROPE: SOUND, FURY, AND SIGNIFYING?

CATHERINE MCARDLE KELLEHER

---

## Introduction

The debate in Europe in 2007 over American plans to base a missile defense (MD) system in Europe has been loud and constant and often phrased in technical terms.<sup>1</sup> Questions raised throughout Europe range from those about the declared threat the system is to meet (e.g., the credibility of an Iranian missile threat in the foreseeable future) to the placements in central Europe and to the efficacy of the not-yet tested GMD 2 stage missile the U.S. proposes to deploy. The debate in the United States has been more muted and far overshadowed by the issues of what to do regarding Iraq and Iran. But experts have been extremely critical of the technical value of present plans, and the House of Representatives has so far again resisted Bush administration budget proposals for European site preparation. Deadlines are purported to have slipped from a timeframe of 2010-2012 to perhaps 2012-2014 or later.

By far the most dramatic debates have focused on political, not technical, issues: Is the real target of the American MD system in Europe, as President Putin and some of the Russian military leadership have charged Russian offensive capability?<sup>2</sup> The initial system proposed is small but could easily and relatively rapidly be expanded to include enough capability to threaten the missiles stationed in European Russia. If this is the case, why should Russia continue to cooperate with the West under the Conventional Forces in Europe (CFE) treaty or the Intermediate Nuclear Forces (INF) treaty of the 1980s? While analysts murmur about the onset of a new Cold War stoked by Russian nationalism and burgeoning oil revenues, Putin has appealed to stability-minded Europeans directly. Will this program not have desta-

bilizing military and political effects? Does this deployment not violated the spirit, if not the letter, of the informal US-Russian agreements about the conditions for German unification and perhaps NATO expansion as well? Does it not constitute a plan for permanent NATO forces deployed in states “of concern” to Russia, in the former WTO allies and within “Russian space” around its borders? Have the NATO allies beyond the host countries, the Czech Republic and Poland, really been consulted or just informed about American actions? And who will decide, or consult about future actions?

Somewhat surprisingly, mixed into the heated exchanges and impassioned rhetoric seem to be options for significant Russian-American cooperation as well. President Putin has suggested the inclusion/substitution of MD radar sites in Azerbaijan (Garbala) and in southeastern Russia (Armavir) and the establishment of joint data exchange centers in Moscow and Brussels.<sup>3</sup> In their October 2007 Moscow visit, Secretaries Rice and Gates raised the prospect of the participation of Russian liaison officers and officials at all the MD nodes, with full transparency and communication opportunities. As has been true at several points since 1991, American and Russian experts have also suggested areas of complementarity in present Russian and American technical expertise if there were to be agreement on developing future joint system.

In the heightened sensitivities that always accompany election seasons, there is yet to be significant movement forward toward agreement. The MD in Europe remains a good, if not always a convincingly real, reason for Russian and American tension and political disagreement at several levels. Despite growing popular opposition in Europe, the Bush administration

remains committed to seeking formal MD basing agreements with the Czechs and with the new Polish government that will be elected later this fall. The Russian military elite continue to fulminate and Russia will probably allow its adherence to CFE to expire by non-renewal in December. Nonetheless, Russian and American MD talks and visits continue at several levels, and the flow of offers and counteroffers has increased.

How this will end or even what are plausible scenarios for the next stages is far from clear at this point. To understand the dynamics, it is important in this essay first to sort out the political and technical background of the American and Russian positions over the past decade and how these have been affected by the broader Bush and Putin strategies. A second concern will be the stakes and strategies of the European players and how these will be affected by the new European leaders elected in the past two years. Finally, the focus will turn to an analysis of possible outcomes and the possible effects of the upcoming Russian and American leadership changes in 2008.

### The Political and Technical Framework of MD in Europe

Contrary to public belief in both Europe and the U.S., the present MD plans have a lineage reaching back before the Bush administration itself. A joint program, or at least technical cooperation in MD between Russia and the United States, has been discussed intermittently since the mid-1990s. It was one of the first issues on the Russian discussion agenda when they took up formal representation in Brussels in 1995 and it has long been a subject of expert speculation and occasional governmental interest. Russia still has the only seemingly operational MD system (Galosh), operating around Moscow as sanctioned by the ABM treaty. Insider interest in MD renewed after Bush's reversal of the Clinton decision to drop National Missile Defense (NMD) and Bush's withdrawal from the ABM treaty in 2002. Bush's shift drew strength from the fears raised by 9/11 and the renewed interest in offense-defense tradeoffs in doctrine and planning against rogue states with small nuclear forces (e.g., as in the North Korean tests in

1998 and again in 2006 that alarmed Japan).

The precise point of decision on an American MD in Europe seems somewhat shrouded in the public record but the program appeared to gain attention early in the Bush administration, as plans went forward toward fulfilling the Bush 2000 campaign pledge to get "serious" about MD. A number of analysts point to a core memo by Secretary of Defense Rumsfeld to the Missile Defense Agency (MDA) in January 2002, reinforced by the National Security Presidential Directive 23 (NSPD-23), signed by President George W. Bush on 6 December 2002. In plans that unfolded in 2003 and 2004, the base MD architecture is of a multilayered, ground-sea-air-space based system with individual components both capable of operating separately but integrated in a rapid information-sharing, centrally controlled framework that was to be deployed quickly. Missile defense in Europe has always been described as a mid-course theater coverage system against the threat of longer-range small rogue missile attacks against the United States and Europe, constructed to be in parallel to the 21-plus interceptor deployments in Alaska and in California aimed against rogue actions in the Pacific.

Involved will be ten GMD interceptor missile silos in Poland and a highly capable X-band radar transported from Johnson Island in the Pacific to the Czech Republic, but also linked into existing American early warning radar networks in Europe, originally designed for ABM deployment and now to be upgraded, at two sites in Britain (Fylingdales and Menwith) and one in Greenland.(Tule).<sup>4</sup>

The missiles to be deployed will be a two-stage variant of the three-stage interceptor that is presently deployed in Alaska and California. It will first be available for testing in 2010 if present schedules are kept. In addition to removing the third-stage of the missile, the Missile Defense Agency also has proposed a number of changes to the missile's avionics package, such as nuclear hardening.

Discussions with the eastern Europeans seem to have begun as early as 2002, in parallel with renego-

tiation of usage agreements for the existing British and Danish-Greenland radar sites. But in public reports, all these plans seemed to gain momentum in 2005 and 2006, as Washington stepped up its opposition to Iran, and particularly to its nuclear enrichment program. Russian critique has been low-level but continuous throughout, taking on new drama first in President Putin's confrontational address in February 2007 at the *Wehrkunde* gathering in Munich and then throughout the spring of 2007.

Criticisms particularly in Europe about the lack of transparency and consultations in these decisions are questionable in light of the regular, if limited, coverage all these conversations and site visits have had in the transatlantic press. Skepticism also grows in the realization of a contemporaneous, relatively well-publicized set of discussions on a broader, somewhat contradictory concept of MD cooperation that featured in the direct US-Russia-NATO discussions about broader theater MD issues that took place in the framework of the NATO-Russia Council in 2003 and 2004. Involved were a series of formal and informal expert discussions and exercises as well as a Russian-American command post exercise in 2004. According to several participants, topics explored included the possible inclusions of Russian radars (including those subsequently proposed by President Putin), Russian personnel at MD sites outside of Russia, and the establishment of information clearinghouses in and outside Russia.

The NATO Council itself recognized the significance of this on-going dialogue at the Prague Summit in 2002, when it decided to commission a study on the feasibility of a full-spectrum multilateral MD architecture to protect Alliance territory, forces, and population centers against the full range of missile threats, a study completed in 2006.<sup>5</sup> At the Istanbul Summit in 2004 it called for joint NATO-Russia cooperation in MD in crisis response situations as well as generally in the development of short and mid-range MD in Europe. Although they have moved glacially in recent years towards any operational steps, NATO efforts are always described, at least by the U.S., as "complementary" to the goals of the longer-range U.S.-only proposal.

## The Crucial Debates in Detail

### U.S.-RUSSIA

The debate in 2007 has taken a number of surprising turns, most dramatically in terms of Putin's decision to revive earlier options for cooperation despite his increasingly hostile rhetoric. The offer at the G-8 summit to make the Garbala radar available (purportedly without prior notification to the Azeri government) was a surprise. Most of the hard-core MD supporters in the Pentagon and in central and eastern Europe dismissed the offer as "theater"<sup>6</sup> or claimed that it wouldn't and shouldn't substitute for the CEE sites or fit in with "our system." But Putin soon followed with a second offer at the Kennebunkport meeting in July not only for site visits and expert discussions, but also to make data from Armavir, a more attractive radar in southeast Russia, available that would provide an unprecedented view from Russian territory into Iranian airspace and elsewhere. He continued to insist that these sites would substitute for the CEE sites and that the U.S. should cease negotiations with the CEE states and take active cooperative steps to ensure that the MD in Europe would not be the basis for active defensive shield against all Russian forces.

Putin's bombast is seemingly a function both of his increasing reliance on the nationalist "Russia as victim of the West" theme that has come to characterize many areas of Russian foreign policy over the past two years. The *Wehrkunde* speech was as much about Russia declaring "we're back and you had better pay attention to us" as it was about specific policies or charges. It reflected actions in other areas, as in oil and gas resource ownership, or the clawing back of much of the political control the Yeltsin regime had dissipated to the regions and the oligarchs in the 1990s. Putin has increasingly characterized any external constraint on Russian actions in its own interest as illegitimate and as part of the regime of "snares" the West established around a weak Russia in the 1990s. The MD in Europe issue also provides yet another justification for fulfilling long-neglected promises for military modernization and a restoration of technological military investment—items long

sought by a military that has never believed NATO expansion should have been accepted or the INF treaty agreed to.

Russian threats about targeting the MD sites and about withdrawing from key arms control agreements in retaliation (INF, CFE, and even the broader OSCE) were and still are generally dismissed by Bush administration insiders but taken more seriously by experts outside, both Russian specialists and those committed to arms control. In part, too, positions are colored by a related, larger area of concern, the expiration of the START I regime in 2009, and the announced intention of the Bush administration, despite relatively recent Russian requests for a formal, legal successor regime, to do nothing to extend it. The Bush position formally is that such “treaties among adversaries” are no longer needed between the U.S. and Russia who are now declared as “strategic partners.”

Russia itself, however, has received far less positive attention in the second Bush administration than Mr. Putin alone received in the first term. Part of this results from the absorption of the top levels in Iraq and now Iran contingencies. Part is also a certain level of what might be called “Russia fatigue” throughout the bureaucracy.<sup>7</sup> And there is also the general inattention paid to Europe since 2001 (“where else do they have to go”). One striking example is particularly relevant: Bush officials have generally been somewhat dismissive of southeastern Europe fears (the Balkans, Greece, and Turkey) that they will not be protected by the American MD in Europe system and have simply assigned that problem to alternate, old technology systems—THAAD, Pac-3, and Aegis based interceptors.<sup>8</sup>

Bush critics on both the left and the right see this as major disaster, given that the expiration will require almost immediate action by any new president in 2009. Congress has become increasingly active on this, as had the intelligence community. Expiration will, they argue, lead to a significant loss in the U.S. intelligence and open a major gap in the American political-military tool box. They assert START I is the basis of the set of verification regimes, especially as

the support for the current SORT regime, regulating the number of strategic warheads on each side and has been crucial to the building of U.S.-Russian strategic trust and to the development of strategic intelligence over the past two decades.

A number of prominent critics outside the government have also stressed the technical arguments.<sup>9</sup> Richard Garwin, for example, has repeatedly argued that the Russians may indeed have some technical support for their argument that the proposed system could be used to counter Russian offensive capability.<sup>10</sup> He also raised questions about the untested performance of the proposed interceptors, and argues that other alternatives, such as Aegis-based interceptors, would be equally effective and less provocative. Others have joined his general argument: what is the point, they argue, of pushing into Russia’s near neighborhood to secure agreement for the deployment of an ineffective system against an Iranian missile threat that many do not believe will exist much before another decade? Or does this just prove Russia’s allegation that it is one more Western “snare” imposed while Russia is still thought to be “weak.”

The fall of 2007 has recorded a number of significant turns in this debate. There has been an official site visit to Garbala in September 2007; there has been a meeting of the designated Missile Defense Cooperation working group. Secretaries Rice and Gates have traveled to Moscow to meet with their counterparts and with Putin, bearing responses to Putin’s earlier offer and bringing several proposals for discussion, including the inclusion of Russian liaison at every MD in Europe site. Another meeting at the secretarial level is promised in six months, with more expert meetings, if not agreement, scheduled for the intervening period.

One clear message from the Congress, however, is worth noting. The House has refused to authorize MD funds for a “third” MD site unless and until there are formal agreements signed with both the Czech Republic and Poland governing U.S. use of their territory. Appropriations bills or the House-Senate conference may lead to a different outcome but it is

by no means certain in light of substantial opposition within the Democratic ranks. Given elite approval but significant popular disapproval of the MD plans in both European countries, formal bilateral agreements may take considerably more time. A Polish response will also have to await the formation of a new political coalition, unless the upcoming election in fall 2007 grants one party a clear majority.

#### THE RUSSIA-EUROPE DEBATE

Russia's debates with Europeans on this issue take a very different tone. Critics assert that this is just a familiar Russian tactic, to divide the NATO allies from the United States and from one another to maximize its influence and opportunities. Russia has followed similar tactics in marketing its oil and gas on which Europe is so dependent. Good friends and sympathetic ears are given priority. Those who opposed Russia's wishes are at least leaned upon heavily; Russia has wielded its new economic role repeatedly towards its former allies and made access and trade as well as oil and gas supplies far more difficult for them. The lack of NATO and European solidarity with the targets, the critics say, just makes it more likely that a Russia that pursues an increasingly assertive brand of nationalism will try again.

There are clear differences in the discourse Russia has pursued with what Donald Rumsfeld once called "Old" versus "New" Europe. The initial softer Russian approach was targeted at Germany, stressing the failure of the U.S. to consult, and the breaking of the informal understanding surrounding Russian agreement to German unification. It fell on receptive ears within the Schroeder government and within the Social Democratic Party, and Green party in general.

In contrast to Chancellor Schroeder, Chancellor Angela Merkel has been somewhat less impressed by Russian claims of threat, although she and her foreign minister, Frank-Walter Steinmeier, have both chided the U.S. for being less than forthcoming with them as well as with Russia. She has pushed hard for a multilateral solution, arguing in March 2007 and again at the May G-8 meeting in Germany that it should be a NATO matter, an issue left to NATO decision. She

does face popular opposition to MD in Europe of well over 50 percent, as well as expert fears within her security bureaucracies about the viability, given U.S.-Russian tensions, of the entire arms control and European stability regimes.<sup>11</sup> Several of those interviewed expressed a real fear of a new arms race and a return to the frozen past of the Cold War.

Russia has had far less success with Nicolas Sarkozy than with Jacques Chirac. Sarkozy's first visit to Moscow gave far more approval to the general concept of missile defense and the position of the United States. Popular sentiment is divided although there is surprising sympathy for a multilateral European solution.

The generally negative turn in British-Russian relations over the last three years has meant little elite discomfort with the MD proposal and indeed some enthusiasm for participation in production at the cutting edge of technology that British MD systems contributions seem to promise. Popular opinion is mixed, with a majority seemingly more concerned by increasing Russian authoritarianism and rampant nationalism than the details of the MD in Europe program.

The clearest contrast to the more sympathetic German, Italian, and Spanish reactions to Russian complaints has been the strong approval of the MD in Europe plans in the Polish and Czech governments. Strong majorities (more than 60 percent) in their populations oppose the deployments or express fear that the Russians will make good their threats and re-target Polish and Czech cities in retaliation. Both governments, however, can count on some domestic political bonuses for their positions and an affirmation of the strong anti-Russian sentiments that still run deep. German calls for negotiation are also seen as just one more German unwillingness to treat Poland as a full member of Europe, able and determined to defend its own national interest, and unwilling to follow any German aspirations to superiority. Both governments also have appealed to popular revulsion at Russian economic heavy-handedness. The Polish case has reached significant proportions with the long-lasting Russian prohibitions on Polish meat

exports to Russia and the claims of Polish attempts to undermine existing Russian legal rights. The Czechs, on the other hand, were responsive to Russian requests in August 2007 that they delay their decision to allow for further consultations.

Perhaps the more fundamental issue is Polish and Czech resentment of Russian efforts to define their territory as subject to a Russian "droit de regard." Neither state accepts the designation that it is or should be part of "Russia's near abroad." That ended, they argue, with their entry into both NATO and the EU as full members. Their choices regarding MD in Europe are their sovereign right, not part of some informal understanding about "NATO expansion." Wasn't this the kind of protection for which they had wanted to join NATO, and enter close partnership with the United States, up to and including sending contingents to Iraq?

### The Next Phases?

Some of the critics interviewed fear that MD in Europe will be just one more area in which the Bush administration will try to create "facts on the ground," that is, commitments that an incoming administration will find it almost impossible to deny or overturn. This might happen through the sealing of bilateral agreements before January 2009 that will require considerable effort to revise or considerable debate within domestic contingencies, including the ethnic lobbies associated with CEE, about the wisdom of doing so.

Others see a very different, though no more pleasing outcome. The Bush administration with so many things to do and with Iraq ever more important, will simply "run out the clock," and leave this particular project to the mercies of the next president. Meetings will continue, offers and counteroffers will be tendered, the public bluster and hostile exchanges will continue. But there will be little or no real movement and even less willingness to trade away any of the Bush legacy to secure MD in Europe.

Both scenarios discount two factors that may prove decisive. The first is the persistent efforts of the MD partisans, largely at the working level but with signif-

icant support from those around the Vice President, and elsewhere. This is the parallel of the Alaska and California deployments, and as such, has a crucial role to play in stashing global reach for MD. The existing monies are sufficient if re-oriented and the rewards to be gained, substantial. If another rogue state were to launch a missile, or to acquire significant nuclear success, then the full support would be there and the demand for completion, irresistible. Another attack on the United States would only up the ante.

The second is the growing disaffection in substantial sectors of the American body politic with Vladimir Putin. Putin may no longer be interested in the perspectives of the West or on the "rules" of international institutions dominated by the West but his disdain is matched by his counterparts in Washington and London, at least seemingly on all but energy-related matters or Iran issues. Few in these debates are willing to treat Russia as "an ordinary country." Few, however much they style themselves as realists, are willing to acquiesce to Putin's growing authoritarian style or what seems the regular instances of non-democratic behavior within the Russian bureaucracies and especially the legal system. Most are disappointed with Russia's assertion on non-support for Iraq or foot-dragging on critical issues in the Security Council. The Bush administration in the fall of 2007 is pushing Russia hard to help the American policy on Iran's nuclear program, and while Russia has shifted to a far more U.S.-friendly position, more is desired. MD in Europe may then have appeal as a way to raise the stakes, to stoke the fires, or simply to look as if the Administration is becoming "tougher" on Russia.

All of this seems from the perspective of this analysis to miss the point: missile defense in Europe is not yet established but can creep forward bureaucratically unless a decision is reached. The more fundamental questions this issue raises have yet to be addressed and the time seems ripe to do so. What kind of role does the United States wish Russia to play in the European security system? How truly equal will it allow any strategic partnership to be and how significant? How willing is the U.S. to establish a joint project or joint development plan with the Russians,



one that might focus on a blending of strengths rather than the hostilities of the past? What should be the steps to be used to constrain not only nuclear but also nuclear capabilities among rogue states? And under what international, rather than national chapeau are efforts to avoid the threat of rogue launches to be constrained and if necessary challenged.

All of these questions will take their places in the crowded waiting rooms that will not be addressed until electoral outcomes are known in both Russia and the United States, and the new teams of actors and experts assembled. It could be a longish wait.

## NOTES

1 This essay has benefited from several expert interviews in Berlin and in Washington in fall 2007, and from the research assistance of Andrew Kostrzewa ('08) at the Watson Institute, Brown University.

2 Putin's most forceful statement came in his *Wehrkunde* speech in February 2007. See this and further statements in *Arms Control Today* throughout 2007, and the authoritative reporting by Wade Boese on the MD in Europe issue beginning in September, 2004.

3 George Lewis and Ted Postol in their article in *Arms Control Today* in October 2007 report that Putin also said Russia would have no objections to U.S. missile defense interceptors being stationed in Iraq or Turkey or other appropriate southern European locations or to the United States using Aegis ship-based interceptors as part of a missile defense for Europe. See their "European Missile Defense: The Technological Basis of Russian Concerns."

4 Fylingdales is a long-range radar station, which forms part of the Ballistic Missile Early Warning System (BMEWS) and Space Surveillance Network (SSN). Fylingdales was the third and last of the BMEWS stations to be built. The other two are Tule, Greenland and Clear, Alaska.

5 The study was done by a transatlantic consortium led by SAIC.

6 See former Ambassador Bob Joseph's comment on this as a "trick" made at the Army conference. "Celebrating 50 Years of Space and Missile Defense," August 13-17, 2007 quoted by Jack Mendelsohn in his article "European Missile Defense: Strategic Imperative or Business as Usual" in *Arms Control Today*, October 2007.

7 Some of those interviewed for this essay suggested that the specific announcement of the CEE sites (presumably the announcements in early 2007), while generally approved earlier at the highest levels, seemed to come as somewhat of a surprise since the discussions had not been closely monitored above the working level.

8 Interestingly enough, Congresswoman Ellen Tauscher (D-CA) writing in her "A Congressional Perspective" in *Arms Control Today* in October 2007 makes this total NATO coverage and the compatibility or "bolt-on" capability of the Bush MD in Europe system with a future NATO system two of her prescriptions for fulfillment before Congressional approval of additional funds. She is the current chair of the House's Armed Services Committee's Strategic Forces subcommittee.

9 See the Lewis and Postol effort, for example, cited above.

10 Richard Garwin, Paper presented at the Erice Conference, Summer 2007, private communication to the author. See also the related arguments of the late Wolfgang Panofsky of Stanford University, "Missile No Defense" in the *San Francisco Chronicle* on September 26, 2007, who wrote "The technical performance of the American ABM system is dubious. None of the few tests has been realistic operational exercises. Moreover, a very substantial fraction of these tests have resulted in failures, not because of fundamental design flaws but because of insufficient quality control needed by complex systems. The items which failed in these tests had functioned previously. The test missile trajectories were known beforehand, and the target missiles did not employ any decoys or other means of deceptive tactics to defeat the ABM system. Technically such decoys are considerably easier to produce than the missile itself; therefore, any nation capable of ballistic missile delivery against the United States could also employ countermeasures adequate to render the United States ABM system useless."

11 See, for example, the debate featured on the Deutsche Gesellschaft fuer Auswaertige Politik webpage. Among the participants, Admiral Ulrich Weisser (former head of the Defense Planning Staff) and Ambassador Frank Ebele (formerly Foreign Office and unification negotiator), <[www.dgap.org/...bfz/veranstaltungen/](http://www.dgap.org/...bfz/veranstaltungen/)>





# ENERGY RELATIONS OF EUROPE, GERMANY, AND RUSSIA IN THE TRANSATLANTIC CONTEXT

VLADIMIR MILOV

---

This paper briefly analyzes the current strategic background of European-Russian energy relations and German-Russian energy relations in a broader European context, as well as their impact on the transatlantic agenda.

Europe is currently entering a period of difficult challenges and choices in relations with Russia, its main energy supplier. As European dependence on energy imports grows due to decline in indigenous energy production and increasing demand, Europe is facing new challenges related to the risks of growing energy dependence on Russia, primarily the dependence on Russian gas supplies. When it comes to oil supplies, Europe's dependence on Russia matters much less: Although Europe imports about 7 million barrels of oil per day from Russia (about 45 percent of EU-27 oil consumption), it should be said that the oil market is quite globalized, there are multiple other oil supply sources available, and, after the Arab oil embargo of the 1970s, the OECD countries have established and maintain oil stocks sufficient to protect the oil importers from the risks of supply interruptions—at least for several months.

However, Europe is much more vulnerable when it comes down to gas supplies. These supplies feature much less mobility, particularly with pipeline gas supplies. By 2015, if Gazprom will manage to increase gas imports to EU-27 countries to the level of 180-200 bcm per year, its share in the EU-27 gas consumption will make up to 36-40 percent.<sup>1</sup>

The risks of increasing gas imports from Russia appear to be severe. Systemic underinvestment in upstream gas production and risks of emergence of severe deficit of gas supplies to meet the Russian and international gas demand, complicated energy rela-

tions between Russia and key gas transit countries (Ukraine, Belarus, Poland) and assertive use of energy as a tool of political pressure on these countries (mixed with economic motifs in a complicated way), underinvestment in refurbishment of the rapidly ageing trunk gas pipeline transportation infrastructure, continuing nationalization and monopolization of the Russian energy sector, and the risk of expansion of these monopolization trends to the European energy markets—these are just the most important risks associated with increasing role of Russian energy supplies to Europe. The background for these risks is only a limited number of real alternatives, some of which, in fact, appear hardly more reliable, and possibly less economically competitive, than the additional Russian supplies.

Are the potential future trends of increasing European dependence on energy, and, particularly, gas supplies from Russia, dangerous? What is the reasonable policy approach to address them from the European and transatlantic points of view?

## The Overall Landscape of Russian-European Energy Relations

Some analysts tend to compare the recent new wave of Russian expansion to the European markets to the story of construction of the gas pipelines from the Soviet Union to western Europe in 1980s, which is viewed mostly as a positive example—despite political concerns (the idea of linking western Europe with the USSR by gas pipelines was strongly opposed by the United States), in reality strengthening energy relations with Europe's eastern communist neighbor did not turn out to be dangerous for Europeans twenty years ago.

However, it is important to distinguish the differences between the energy relations of Europe with modern Russia and those with the former Soviet Union. The Soviet Union viewed the construction of the large scale gas pipeline infrastructure to western Europe primarily not as a source of achieving political domination in Europe (which was simply not achievable due to a limited scale of these supplies), but rather as the source of monetization of its newly discovered and developed gas reserves. In this respect, despite open political confrontation between the Soviet Union and the West, the USSR was economically interested in as smooth relationships in energy supply area as possible. The Soviet Union had other forms of demonstrating its political influence, and it considered energy mostly as a source of a very much needed hard currency income, not as a tool to threaten the West.

Besides, the majority of the European countries that are strongly dependent on Russian gas are eastern European nations, which, during the 1980s, were members of the Communist bloc. Western Europe was not, and, in fact, is still not very dependent on Russian gas, therefore, establishment of some extent of gas imports from the USSR was not a threat from the energy security point of view. Insofar as the share of Russian gas imports not in the gas consumption, but in the overall primary energy consumption is concerned, the share of Russian gas in the national energy mix is not large for the western European countries, and it was even smaller in the 1980s.

So, if the construction of the Soviet gas pipelines to western Europe in the 1980s should be considered as a relatively small-scale market entry, today's plans of construction of the new gas pipeline infrastructure from Russia may rather be viewed as the expansion of already significant market share. Indeed, an important change was the transformation of the large number of former Communist bloc countries into EU members: since the largest volumes of Russian gas had been traditionally supplied to eastern Europe, this had dramatically changed the landscape of the dependence of the European Union on the Russian gas supplies. Whereas in 2006 the share of Russian gas imports in the primary energy consumption of the

EU-15 countries made up just 5.8 percent (not really a large dependence), in the six eastern European countries that have joined the EU in recent years (Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia), the share of Russian gas imports in the primary energy consumption makes up as much as 14.7 percent (in Hungary and Slovakia—more than 30 percent).

#### THE EU ENLARGEMENT HAD INCREASED EU DEPENDENCE ON RUSSIAN GAS SUPPLIES.

So, in fact, the present landscape of energy relations between Russia and Europe is totally different from that of the 1980s. As opposed to the 1980s, Russia already has mature, established positions in the European gas market, and the interests of the Russian authorities are mainly focusing on expansion of its already strong presence.

Where might that expansion lead? Here is where the main area of concern lies. There is a large possibility that the stronger Russian presence on the European gas market may assist its transformation into some form of oligopoly or a market domination by Gazprom, similar to the one currently experienced either in the Russian domestic gas industry or in energy relations between Russia and the Central Asian countries (where Russia maintains a firm monopoly grip over Central Asian energy exports, taking advantage of the historical logistics of the Soviet-built pipeline infrastructure).

If this significant market share of Russian gas in the European Union's gas consumption is to be supported by more downstream gas asset acquisitions by Gazprom in Europe, then Europe may also feel the monopolistic effects on its gas market caused by Gazprom's vertically integrated monopoly throughout the gas production and supply chain.

How these effects may look in practice is hard to tell at present. At this point, Gazprom is largely trying to obey the European rules and regulations while entering the European market. The word "largely" is used here because of the record of strong opposition by Gazprom to certain rules and ideas imposed by

European regulators—gas market liberalization, unbundling of vertically integrated gas monopolies, adjustment of the conditions of Gazprom’s long term gas supply contracts, third party pipeline access rules. Although this opposition did not lead to conflicts of significant scale yet, Gazprom and its officials have traditionally been using certain strong language and even demonstrating disrespect towards EU competition rules, as well as plans of the gas market restructuring.<sup>2</sup>

It is hard to tell whether this attitude will further evolve into a stronger political and legal opposition to the European regulators, once Gazprom strengthens its positions at the European downstream market, backed by the vertical monopoly in the gas supply chain. A possibility of severe conflicts with European regulators certainly should not be excluded, particularly taking into account the present strong language used by Gazprom’s top managers to characterize the actions and plans of EU regulators.

Additionally, the experience of gas markets in Russia and the post-Soviet countries, where the domination of Gazprom is far stronger, does not provide a case for optimism with respect to Gazprom’s potential future behavior on the European gas market. The potential forms and consequences of the monopolization of the European gas market by Gazprom, or the establishment of an oligopoly by Gazprom and its allied European energy companies (as have been experienced before in the course of conclusion of the long-term gas supply contracts and their specific conditions, e.g., “destination clauses”) should be studied in more detail.

It is also important to say that gas will continue to play an important and increasing role in the European energy mix, and the dependence on Russian gas supplies will increase. According to the IEA projections, in 2015 gas will make up only 26.4 percent of the total primary energy supply in the European Union countries. Currently, gas imports from Russia by EU-27 countries make up about 7 percent of the total EU-27 primary energy consumption. In 2015, in accordance with the International Energy Agency forecasts for growth of primary energy consumption

in the European Union,<sup>3</sup> and taking the assumption that both the Nord Stream and South Stream pipelines will be commenced and supplying gas in full capacity, the share of Russian gas imports by EU-27 nations in their primary energy consumption will increase to 9.3 percent.

Despite the fact that there are clear advantages associated with the expansion of European-Russian commercial ties in energy—particularly the economic, environmental, and climate change benefits arising from broader use of the Russian natural gas—it still makes practical sense for Europe to strengthen energy relations with Russia. A wise strategy will be not to overlook the fundamental risks associated with expanding cooperation with the current Russian administration, as well as its potential successors, who are most likely to inherit the basic policy principles from Vladimir Putin’s administration.

There are all the reasons to worry with regard to the physical reliability of supplies (because of potential shortages of gas supply due to systemic underinvestment in gas production upstream by Gazprom), monopolization or oligopolization of the European gas market, and the potential future cases of politically motivated use of energy supplies, like those experienced recently with the post-Communist states. These risks are neither unavoidable nor unmanageable. Europe should take a closer look at the potential measures targeted to protect its gas market from future monopolization, particularly when it comes to increasing vertical integration of the downstream gas distribution and supply assets in Europe with Russian production monopoly. Europe should continue to encourage market reforms in the Russian energy sector, working with subsequent Russian administrations, in order to eliminate the foundations for monopoly risks. Europe should develop an internal mechanism of coordination of its energy relations with Europe to avoid conflicts between European countries in developing the European position on the new energy infrastructure projects linking Europe and Russia. The diversification of the sources of energy imports and wider use of renewable sources of energy will definitely remain on the European energy policy agenda.

## BUT, DESPITE ALL THE RISKS, THE NATURAL BENEFITS OF DEVELOPING ENERGY RELATIONS WITH RUSSIA SHOULD NOT BE IGNORED

It is very important to stress that Europeans should pay more attention not only to the politicization of energy relations in itself, but to the risks of monopolization of the European energy market by the Kremlin. Monopoly increases the ability of successfully using energy as a political tool; the competitive environment and absence of a monopoly significantly reduces these risks. Protecting European energy markets from vertical monopolization in this respect turns out to be key to building successful energy relations with Russia.<sup>4</sup>

Also, it is the monopoly environment and the absence of competition that eliminates stimulus for energy suppliers to satisfy the needs of customers in terms of prices and the quality of services, thus reducing the reliability of energy supply. This can be well observed in the case of modern Russia, where customers face gas supply shortages together with a sharp rise of gas prices, and without any prospect of improvement of the situation. Monopolization of the European gas market by Gazprom creates the threat of transplantation of Gazprom's monopolistic behavior model towards the European market, reducing the reliability of gas supplies for European consumers. The current status of the Russian gas market, plagued by gas deficit and gas supply cutoffs to consumers, is probably the best proof of the idea that the possession of gas reserves is not necessarily the best guarantee for reliable gas delivery.

If such a responsible government will not come to power, then Russia will continue to present a severe risk for its international partners. This risk, however, is neither fatal nor unmanageable—Europeans just need to find the right way to manage it.

### German-Russian Energy Relations in a Broader Context

Germany is the main European energy partner of Russia, and it is widely perceived that Russia and Germany have a “special” energy relationship of a

much better quality than those between Russia and the European Union. The “special” bilateral nature of relations between Gazprom and certain German energy companies and German politicians present a challenge to the unified European approach to the energy relations with Russia. However, it should be said that, in reality, German energy partners of Gazprom are largely not treated very differently than others, which basically raises the question about the sustainability and the very existence of a “special” relationship.

First, although Russia supplies large amounts of gas to Germany in absolute volumes, the overall dependence of Germany on Russian supplies is not critical as compared to some eastern European countries. Yes, Germany is by far the largest consumer of Russian gas among European nations in absolute terms (just little less than 35 bcm in 2006). However, Russian gas imports make up less than 10 percent of Germany's total primary energy consumption, which, considering the size of the German economy and the fact that, in Germany, coal still plays the dominant role in the power generation mix as opposed to gas, is not a very large dependence on Russian gas supplies as compared to countries like Hungary and Slovakia, where the share of Russian gas in the primary energy mix far exceeds 30 percent.

Second, several years ago, after Russia had started to formally and informally limit the foreign access to development of its oil and gas resources, it was widely believed that German energy companies enjoy the status of an “exception” from the general investment barrier rule, as German companies Wintershall and E.ON-Ruhrgas were promised to be granted access to the upstream western Siberian gas production assets as a part of the widely praised “asset swap” scheme, in accordance with which European energy companies are supposed to swap equity shares in the downstream energy assets in Europe in return for access to upstream energy production assets in Russia.

Subsequent developments with the implementation of the “asset swap” scheme in relations between Gazprom and its German partner companies,

Wintershall and E.ON-Ruhrgas, however, revealed the limitations of this scheme, demonstrating the particular non-transparency of this process and inequalities in Gazprom's treatment of its European partners. Whereas Gazprom has been seeking full-graded access to downstream energy assets in Europe as a part of the "swap" scheme (and, in fact, Gazprom's joint venture with Wintershall, WINGAS, is already successfully operating in Europe), it has been agreeing to provide symbolic, rather insignificant "access" to its own downstream assets. Wintershall had achieved a 50 percent share in the Achimgaz joint venture in western Siberia, a greenfield gas project with peak gas production to reach just over 8 bcm per year; also, Wintershall had been promised a 25 percent minus one share in the operator company of the South Russkoye gas field in western Siberia with expected peak gas production 25 bcm per year. The negotiations on E.ON-Ruhrgas "access" to the western Siberian upstream gas production assets have yet not delivered any success and are proving extremely difficult.

All the gas that is to be produced at the fields where German companies had already acquired or are still supposed to acquire an equity share is supposed to be immediately sold to Gazprom on the wellhead basis at the prices unilaterally set by Gazprom. Neither direct marketing nor exports of gas by the joint ventures at market prices are allowed, which is the standard Russian practice in the environment of Gazprom's total and unchallenged monopoly over the trunk gas pipeline infrastructure. In fact, this practice was strengthened last year due to the adoption of the "Gas exports" law in Russia in July 2007, which was legally banned the possibility of gas exports by any company except Gazprom.

In such an environment, German counterparts have virtually no rights for the marketing of gas produced, no ability to sell this gas at the international markets, and are forced to sell it to Gazprom under the prices that cannot be negotiated under fair conditions. In fact, the role of German companies in the upstream development of the western Siberian gas fields remains quite limited.

At the same time, Gazprom demands full access to the downstream assets owned by its German partners; for instance, its share in the WINGAS gas distribution joint venture with Wintershall, operating on the European market, is supposed to increase in the coming period from 35 percent to 50 percent.

Such a situation demonstrates an unequal nature of the positions of Gazprom and its German counterparts in their energy relations, and the selective and non-transparent nature of the current regime of "access" to Russian upstream energy assets.

Another problematic issue of Russian-German energy relations is the Nord Stream gas pipeline project. Despite the fact that the project itself is highly controversial in environmental terms and in terms of serious conflict potential in relations with certain Baltic littoral states (Poland, the Baltic States), it should be said that the project also contains a strong potential for conflict between its Russian and German participant companies from the economic standpoint. The full cost of the construction of the sub-sea section of the Nord Stream pipeline that is to be built and owned by the Nord Stream AG pipeline operator company (co-owned by Gazprom, Wintershall, and E.ON-Ruhrgas), is still not disclosed and would most likely turn out to be much more expensive than initially expected, with construction costs potentially reaching \$10 billion. The approval of increased costs is yet to be made by German shareholders of Nord Stream AG, which appears to be a source of potential conflict, as German companies would most likely not be interested in participating in a loss-making project. Another potential area of conflict is the relations regarding further transit of gas via Nord Stream through Germany to other countries. Up to 40 percent of the already contracted volumes of gas supplies through Nord Stream are to be supplied to countries other than Germany (Denmark, France, UK), and, if/when the pipeline will start operating at the maximum planned capacity (55 bcm per year), it is quite realistic to expect that more than 50 percent of the supplies will go to countries other than Germany (mainly the UK, where the indigenous gas production in the North Sea continues to decline).

Therefore, in the Nord Stream, the role of Germany appears to be quite similar to that of the other countries currently playing key roles in the transit of Russian gas—Ukraine, Belarus, Poland. Although these countries also consume a fair amount of Russian gas themselves, they also play a key role in the transit of the Russian gas to other European markets; Germany, after the expected commencement of the Nord Stream, would become another important transit country for the Russian gas. However, the sustainable framework for transit relations with Germany is yet not settled and presents another area of potential conflict.

It also should be said that, taking into account the recent rejection by the Estonian government to allow the construction of the part of sub-sea section of the Nord Stream in its exclusive economic zone, that Gazprom has been approaching the Nord Stream project, and the issue of supplies of gas through Nord Stream to consumers from Germany and other countries, in quite an adventurous format, already commercially contracting certain supplies of gas via Nord Stream, at the same time not really taking care in advance of the fundamental risks of potential delays or rejection of the project implementation, associated with problems in Gazprom's relations with Baltic littoral states in connection with the pipeline construction.

In the end, it is important to note that the engagement of German companies in a "special" relationship with Gazprom virtually does not provide these companies with any kind of special advantages and exposes them to all the same risks that other European energy partners of the Russian state-affiliated energy monopolies are facing. The advantages of the "special relationship," so far, seem to be questionable, whereas the risks of dealing with Gazprom in the current format of relationships appear to be serious.

The German companies, thus, apparently continue to maintain and expand relations with Gazprom in this unequal format simply due to the fact that they are increasingly dependent on gas imports from Russia due to declining gas production from the North Sea. However, the current format of relations with

Gazprom does not protect these companies neither from the risks imposed by Gazprom's monopoly status and traditional monopolistic business practices, nor from the risk of subsequent acquisition by Gazprom. This basically questions the sustainability of the whole concept of maintaining stronger bilateral energy relations with the Kremlin and Gazprom, pursued by certain German energy companies and backed by certain German politicians, as opposed to contributing to the development of the unified European energy policy, which may serve both as an effective instrument of managing the risk of Europe's dependence on Russian energy supplies (particularly gas supplies), as well as an instrument of encouraging market reforms in the Russian energy sector, primarily the Russian gas industry.

### European-Russian and German-Russian Energy Relations: Impact on the Transatlantic Agenda

As to the transatlantic implications of the described landscape of the European-Russian and German-Russian energy relations, it should be said that the optimum strategy for the United States would be not to block the expansion of the European-Russian relations in the area of energy supplies, taking into account that Europe has very few other sources of energy, and, particularly, gas supply. These relations still make practical sense and Russia, despite all the problems, may not be the worst and least reliable source of energy for Europe in the future.

However, taking into account the increasing monopoly risks arising from growing European energy dependence on Russia, the assistance to Europe in terms of protection from monopoly risks, development of alternative energy supply infrastructure solutions, competitive energy markets, and energy supply risk mitigation measures may prove most helpful.

Unnecessary transatlantic politization of the energy issue may only further irritate Russian political leaders and provoke them to take potentially inadequate political steps. Encouraging successful liberalization of the European energy markets, together with the



necessary steps taken in order to protect the European energy infrastructure being acquired by energy monopolies from countries that maintain protectionist energy investment barriers for the European countries, may greatly pay back through establishing effective and competitive energy markets in Europe with high liquidity and strong incentives for investment and competition. The successful establishment of the single and competitive European energy market may also encourage further market reforms in the energy supplying countries, including Russia, which are currently experiencing multiple troubles (underinvestment, poor performance of the energy companies) due to monopolism and protectionism.

It is also important to demonstrate to the politicians of certain European countries, which prefer to maintain specific bilateral energy relations with Russia in order to secure their own interests, that such bilateral relations do not provide these countries with good

protection against the monopoly risk of the Russian supplies (like in the described case of Germany), but, however, such relations may prove harmful for development of a unified European energy policy in order to address the challenges imposed by increasing dependence of Europe on the Russian energy monopoly.

Until the current administration, or its successor, remains in power in Russia, such an approach may continue to be relevant. If it is not pursued, Europe, and Germany in particular, will be exposed to a greater risk of monopolization of its energy market (including the energy downstream) by state-affiliated companies from the energy producing countries, including Russia. This situation may only change if a more responsible, reform-oriented government will take over control in Moscow, which hardly appears a possibility, at least within the coming decade.

## NOTES

1 Source: International Energy Agency, World Energy Outlook 2006

2 See, for instance, an interview by Gazprom's deputy CEO Alexandr Medvedev, "Gazprom non é l'orso cattivo", 4 February 2007, *L'Espresso*, <<http://espresso.repubblica.it>>

3 Source: International Energy Agency, World Energy Outlook 2006

4 This subject is considered in more detail in the article: Vladimir Milov, "The EU-Russia Energy Dialogue: Competition Versus Monopolies" *Russie.Nei.Visions* electronic collection published by Institut Francais des Relations Internationales (IFRI), #13, September 2006.





# ENERGY INTERDEPENDENCE AND SECURITY: RUSSIA AND EUROPE\*

CLIFFORD G. GADDY AND BARRY W. ICKES

---

## Energy Cooperation or Conflict?

Are Russia and Europe forever destined to clash over issues of energy supply and energy security? Is there really a possibility for tenable producer-consumer cooperation in the long run? Energy producers and consumers have opposing interests. Producers want ample supply—defined by their own needs—at low prices. Producers want maximum revenues.

It is thus the issue of price that calls into question any possibility of a compromise solution. For what would the compromise look like? Would one try to choose a long run average price? Would that be the median price, or the mean price? Over what period? The hallmark of the oil market is extreme price volatility. Over the period of 1947 to the present, for instance, the mean price is \$24 a barrel and the median is \$19 a barrel. What producer would today accept such a “compromise”? In fact, the gap between almost any notion of a historically “normal” price and the current price is simply too great to be bridged.

The conflict hinges on producers’ and consumers’ differing notions of an acceptable price. From the economist’s point of view, there is a proper price of energy. Like that of any other commodity, it is the price determined in a competitive global market. However, note what that would entail. First, global demand and supply would have to be in equilibrium based on the individual activities of uncoordinated buyers and sellers. Second, there would be no borders constraining production, sale, or investment.<sup>1</sup>

For the economist, the outcome determined in a competitive global market would be fair, given initial endowments. Unfortunately, the assumptions required for a competitive market—secure property

rights, free entry into production and distribution, no transaction costs, and so on—do not hold in the real world. As a consequence, countries have developed notions of energy security, and these differ according to specific situations. As a result, they are led to behave in ways that distort or constrain the market to their advantage. In addition, borders do matter for production and investment. Endowments are not equal. (Some countries have energy deposits, others don’t. Some countries are wealthier than others.)

Energy producers distort the market, hugely. The Saudis and other Middle East producers have successfully constrained development of their resources to the point that they “prevent abundance” globally. This, after all, is the point of a cartel. And this appears to be something that the consumer nations have accepted.<sup>2</sup>

In an unconstrained market, production would be driven by demand at prices equal to marginal cost (including a fair rate of return on capital). If there are deposits that could be developed at the prevailing long run marginal cost, they would be. The lowest cost deposits would be developed first. To jump directly to high cost deposits would be inefficient. With prices far above marginal costs, however, even producers with high cost deposits can earn rents. And this is exactly what happens in the case of Russia. In the world as a whole, energy development is hugely inefficient in this sense. There has been great improvement in the efficiency of trading the oil that is produced. But this is little compared to the inefficiency with regard to production of oil, and especially with respect to investment in producing oil. And the major beneficiary of this inefficiency is Russia.

The fact that an agreement on price is unworkable

does not mean that there are no grounds for cooperation, however. To understand that we first turn to Russia's problem.

### Russia's Problem No. 1: Managing the Oil in the Ground

It is a common perception that Russia's energy abundance gives it great leverage over consumers. This is certainly what many Europeans seem to believe. In fact, however, Russia has vulnerabilities that arise precisely because it is such a large supplier of oil to Europe and the rest of the world market.

Russia is a high cost producer of oil. Indeed, among major producers, it is the highest cost producer. This is a natural feature of Russia's climate and geography. Only thanks to current high oil prices is Russian oil profitable enough to develop. Russia thus does not merely benefit additionally from high oil prices in the sense that they add marginally more to Russia's earnings. It is vitally dependent on the high oil prices to make its oil profitable at all.

Prices are high because the low cost producers—mainly the Persian Gulf countries—have elected to constrain production in their fields. Because the Saudis value having a slower depletion rate—keeping more oil in the ground—than an efficient global market would dictate, they generate huge rents for all producers. Those rents are paid for by consumers. They are, in effect, a tax on users of oil. Consumers pay \$80 a barrel for oil instead of, say, \$15 because all the Saudi low cost reserves are kept in the ground.

This means that Russia is intrinsically at odds with the West regarding the oil price. Lower oil prices would be very costly to Russia.<sup>3</sup> Moreover, its investments in future supplies are contingent on high prices. High prices, however, are not a certainty. The price of a barrel of oil, measured in 2006 dollars, has fluctuated between \$10 and \$20 since 1867, aside from wartime. The record high oil prices that we currently observe were unexpected, as evidenced by futures prices. Thus, a rational decision-maker must consider the likelihood that oil prices may drop significantly. Therefore, Russia needs foreigners to share the price

risk of future development. In other words, it needs to diversify investments in new deposits. Although it is not always acknowledged by the Russians themselves, this is an objective necessity for Russia.

The need for Russia to diversify the risk of a fall in prices means that Russia needs to open up opportunities for Western oil firms to invest in new deposits in Russia. If Russia allows only domestic firms to invest in new deposits, it bears the entire risk of a fall in oil prices and the losses this would entail. A closed Russian environment would thus necessarily lead to lower levels of investment. An open Russian environment would attract greater levels of investment in new deposits because Western oil firms lack good opportunities elsewhere. Hence, this is a win-win proposition for Russia and the West. This is the first part of Russia's problem of management of its oil and gas wealth.

### Russia's Problem No. 2: Managing the Financial Wealth

The second dimension of Russia's challenge in managing its resource wealth is what to do with the financial wealth it earns from the sale of oil. What are Russia's choices? It could keep the wealth internally, to either consume it or invest it. Certainly, consuming too much today is bad (although, note that this is exactly what has happened), since it leads to a bad future, no provision for a rainy day, and so on. On the other hand, investing internally is also problematic. Russia suffers from an extremely high relative price of investment.<sup>4</sup> This is due to inefficiencies in the sector and a history of corruption. Suffice it to say that Russia has a very bad history of misinvestment. This means that the return on domestic investment in Russia is low, especially on investments outside the energy sector itself. Hence, Russia simply cannot absorb the volumes available.

It is therefore laudable that Russia three years ago took the steps it did to set up a stabilization fund. But here there are choices as well. Russia has so far pursued an extraordinarily cautious approach and used the money to pay down its foreign debt. From a strictly economic point of view, it has arguably gone

too far in this direction. Putin has clearly decided that having virtually no state foreign debt is important in reducing Russia's political vulnerability to lenders.

With the foreign debt now repaid, the huge surpluses from oil sales flow into and accumulate in the stabilization fund. The stabilization fund until now has been filled with foreign government securities. These securities (debt) offer very low returns. If Russia continues to invest exclusively in foreign government securities, it loses very substantial potential returns.

Using the stabilization fund assets to purchase equity in the West, on the other hand, offers high returns. It is true that equity investments carry a higher risk, and that not all the funds should be placed in corporate equity. But risks can be diversified. Russia needs a portfolio approach, obviously. At the moment, it has nothing in equity. There should be some shift. The precise proportions of debt and equity in Russia's portfolio can be debated. The decision should be made on the basis of weighing risk versus return. But the general conclusion is that for its best economic self-interest, Russia should put a substantial part of its reserves and stabilization fund into shares of Western companies.

### Europe's Interest

Russia's exclusive holding of government securities also represents a risk for the West. It leads to a "balance of financial terror," to use the words of former U.S. Treasury Secretary Larry Summers in referring to a similar issue with Chinese investment in Western securities. Although debt is not a practical weapon, since it would damage the lender as well, it is a useable one. And it is too easy to make mistakes. It is like nuclear missiles on "hair trigger" alert as opposed to de-alerted missiles. There are easier ways to cause trouble than misusing one's own assets.

Therefore, the current investment policy of the Russian government gives the Russians great leverage over Europe and a bad return for them. An exclusively debt-based approach offers no diversification, and leads only to a balance of financial terror. An equity approach, in contrast, gives high returns to

the Russians and ties Russia's interests more to the West than other approaches. It gives Russia a stake in the direct success of Western economies. It leads to commonality of interest.

The problem is that the potential recipient countries are nervous about accepting Russian money into corporate equity. People worry that the sovereign wealth funds will not play by the accepted rules of the market. Rather, it is said, they will be used by governments for political control of companies, and so on. There may be grounds for these concerns. But the fact is: the alternative is worse. Russia has this surplus in the first place because Europe bought Russia's oil and gas. Europe has no choice in this regard. It must continue to buy Russian oil and gas. So the only question for Europe is, are you better off being in debt to Russia or being a partner, a co-owner? It is definitely better to be a partner.

Notice that the partner solution is not contingent on one's generally being in favor of cooperation with Russia. It does not require a benign view of Russia or optimism about Russia's political future. In fact, if you have a negative outlook for Russia, you should logically be even more in favor of the equity approach. Consider two views/scenarios for Russia: a pessimist's view and an optimist's. In the pessimistic view, Russia intends to dominate. But if this is true, then being in debt is worse than being a partner. A Russia that is willing to pay a price to harm Europe will readily dump debt at a moment's notice and cut off deliveries. In the optimistic view, Russia is not a monolith. There are people inside the Russian elite who prefer economics over politics. If this is true, the equity approach bolsters those forces.

### The Bottom Line

The bottom line is that Europe's dependence on Russia's energy is a fact. The issue is how should Europe formulate this dependence? Is it better to be a debtor or an equity partner? The message of these remarks is that the answer is clear. Debt in the hands of your enemy is bad. It leads to a balance of financial terror.

An even stronger argument is that equity can modify behavior and promote cooperation. It gives Russia a stake in Europe's prosperity. Despite the risk of politics, then, to encourage Russia to use its financial wealth to take an ownership stake in Europe's economy is the best policy for Europe as well as for Russia. It is best no matter what one thinks of Russia's intentions. It is not conditional on reciprocity.

What is presented here is not a magic bullet. Although economic self-interest is a powerful force, it often cannot overcome political interests. The issue

is admittedly controversial. Yet it would be very bad if Russian ownership were discriminated against. The big Russian surpluses now and for years to come offer a unique chance for better East-West relations and for Russia's future. The West can find common ground with Russia if it recognizes that Russia has a fundamental problem of what to do with its wealth. Energy flows from east to west. Money flows west to east. The key problem for both sides is how the wealth is deployed. This is where a cooperative solution may be found.

## NOTES

\* This is an expanded version of remarks delivered by Clifford Gaddy on panel no. 2, "The Implication of Energy," at the workshop on "German-Russian Relations and the Impact on the Transatlantic Agenda," sponsored by the American Institute for Contemporary German Studies (AICGS) in Berlin, Germany, on September 17, 2007. The remarks are the product of joint work between Gaddy and Barry Ickes. Ickes first presented the ideas at a Konrad Adenauer Stiftung workshop in Eltville, Germany, on September 8, 2007. Gaddy presented them in Kazan, Russia, for the Valdai Discussion Club on September 10, 2007.

1 And for the price to be efficient there would be a third requirement: namely, that that decisions on depletion rates and investment in new sources would also be determined by the principle of highest value use.

2 The consumer nations, led by the US, do so for pragmatic reasons of preserving political and social stability in the Mideast. The level of production and investment in Saudi et al. oil fields—and therefore the world oil price—is the result of a compromise judgment of what is permissible for political stability in the Mideast and in the United States.

3 The vital dependence of all of Russian society on continued rents—therefore, continued high prices—is a main message of the forthcoming book by Gaddy and Ickes, *Russia's Addiction: The Political Economy of Resource Dependence*.

4 See Clifford G. Gaddy and Barry W. Ickes, "Investment and Transition in Russia." Unpublished manuscript. Pennsylvania State University Department of Economics, February 2005.

# EUROPEAN ENERGY SECURITY AND GERMAN-RUSSIAN RELATIONS

JÖRG HIMMELREICH

---

Russia is, by far, the main energy supplier for the EU and Germany and it will remain so for decades to come—even if all of the EU Council’s ambitious goals (approved in March 2007) of energy efficiency, reduction of fossil energy use, and increase of renewables should materialize by 2020. Today the EU imports 57 percent of its gas and, according to the EU Commission, will even have to increase its imports to 84 percent in 2030; the dependency on oil imports will, under business-as-usual scenarios, grow from today’s 82 percent to 93 percent in 2030. Russia has the world largest gas reserves and fourth largest oil resources. Although the EU Commission already referred to Europe’s growing energy import dependency as a source of a potential risk for European energy security in 2000, only since January 2006 when the Russians briefly cut-off of gas deliveries to Ukraine—which effected the EU as well—was a broader debate in major EU countries about Europe’s gas import dependency from Russia and its implications for European gas security kicked-off.

The dependency on Russian gas supplies varies considerably among EU member states. For example, the United Kingdom has been a gas net importer only since 2004, whereas Finland receives all of its gas from Russia, but gas has only an 11 percent share of the national energy mix. Germany, however, is particularly exposed, as gas has a share of 24 percent in the national German energy mix, 83.4 percent of which Germany has to import. In Germany’s gas import dependency, Russia has the largest share with a significant 46 percent of German gas imports (before Norway). With an ever-increasing share of gas, Germany’s future energy mix will probably still grow, especially with gas being a “cleaner” fossil fuel with fewer carbon emissions than oil.

This is one predominant explanation for German sensitivities in its relations with Russia. Energy is the fuel for every economy. Although German-Russian relations do not consist exclusively of energy relations, they do lie at the heart of it. Due to European directives since the end of 1990s, German governments have begun to privatize the energy market, nonetheless the German energy sector continues to be defined as an oligopolistic market structure with few companies that own production and the transport pipeline network.

Russian energy supply interruptions to Ukraine in January 2006, to Georgia since summer 2006, to Belarus in January 2007, and the open offer for better tariffs to Ukraine’s pro-Moscow Yakunovich government than to a pro-Western Timoshenko government clearly indicate to what extent Russia uses the energy dependencies of its “near abroad” customers for political objectives as well. Gazprom, Russia’s state-owned gas monopoly, serves as the main gas producer and exclusive exporter, is an agent of Russia’s energy policy, and is the 100 percent owner of the gas pipeline network (in particular in south-eastern Europe in Bulgaria, Hungary, and Greece, but as well in Italy and Germany) and it wants to buy additional pipeline networks in order to get access to the end customer. The Belarusian and Ukrainian experiences prove that whoever can decide on the quantity of production and whoever owns the transport pipeline at the same time decides the price and may exert political influence to its end customer. Gazprom offered new pipelines to Bulgaria, Hungary, and Greece in order to counter the “Nabuccho” pipeline project (planned to bring Central Asian gas to Austria, Slovakia, and southern Germany via the Baku-Tbilisi Ceyhan pipeline and south-eastern Europe, essentially bypassing Gazprom and the

Russian territory) in an effort to avoid these countries becoming more independent of Russian gas supplies.

As state-owned Gazprom (for gas deliveries) and 100 percent state-owned Transneft (for oil) are today the exclusive agents of Russia's foreign policy, Russia cannot accept foreign investors in its oil and gas pipeline networks. That is why Putin refuses to ratify the Energy Charter Treaty which provides for transparency in the energy companies and the mutuality of investment opportunities. It seems to be difficult even to save softer versions of these principles in a new Partnership and Cooperation Agreement between the EU with Russia.

At the same time, Russia carefully markets the idea of a Gas-OPEC, which Putin called "an interesting idea" during his visit in Qatar in February 2007. The Gas Exporting Countries' Forum, the organisation of major gas exporting countries like Russia, Iran, Qatar, Venezuela, Algeria, Turkmenistan, and others, agreed at their meeting on 9 April in Doha to plan to reach strategic understandings on export volumes, schedules of deliveries, and the construction of new pipelines and to discuss a segmenting of consumer markets. This would mean, for example, that Russia would not touch Algeria's gas supply position in Spain and Algeria would refrain from encroaching on Russia's position on the German gas supply market. In spite of contesting Russian voices these developments indicate all characteristics of a cartel in the making, from which Russia and Iran with their large gas resources will profit most, which is the main reason for Russia's hesitancy to harden the UN sanctions on Iran.

Russia's new energy policy of using economic energy dependency for the pursuit of Russian political interests requires an urgent European response. The challenge is that the EU is itself in the midst of a privatization and liberalization process in the energy sector, and, at the same time, confronted with Russia's energy policy. As energy policy competence still lies mainly within the national responsibilities of every EU member state, the EU Commission can only gain legislative competencies in the energy sector by extending its responsibilities in the area of trade and

competition. In fact, the EU still has twenty-seven rather different energy policies. Both trade and competition policy almost invite Russia to play private European energy companies against each other, as with single EU member states. Adding to the diversity of national European energy policies, the variety of views on Russia among the various EU countries (and in Germany even across party lines) gives an indication of the challenges the EU faces in formulating an easily-suggested common European energy policy and calling for the diversification of energy supply routes and national energy mixes.

Nevertheless, there are two recognizable political trends for building up defensive mechanisms against this energy policy of Russia—one from the EU Commission, the other from individual EU member states. On 19 September, European Commission President Barroso presented a new Energy Package of the EU Commission with alternatives to unbundle the pipeline network from private European energy companies in the gas and electricity sectors and to liberalize the EU energy market by offering easier access to the pipeline network for new competitors. In this context, the EU Commission proposes that the eventual sale of an European energy company's pipeline to a third non-EU party requires the permission of the EU if an agreement between the EU and the third party regulating mutual investment conditions does not exist. This is a European "Lex Gazprom" that is clearly aimed to counter Russia's energy policy. Certainly this EU Commission directive has to be approved by the European Council and the European Parliament to become valid. On the other hand, a high level task force of the German government prepared a draft for the protection of key strategic industry areas—energy being certainly one of them. The final details are not yet agreed upon, but an investment of state funds like those in China and Russia in more of 25 percent of a German company will require that information be given to the German government with the ultimate governmental right of prohibiting this investment. Comparable rules already exist in France. With Germany being a major hub for Russian gas supplies to Europe; such a law would contribute to European energy security, too. In addition to it, during the German presidency in the first half

of this year, the EU approved a Central Asia strategy and an improved European neighborhood policy that support the diversification of the European energy policy and the integration and regional cooperation of the central and eastern European energy markets among each other and with the EU.

Liquid natural gas (LNG) is becoming more and more a worldwide commodity; by 2010, LNG's share of the world's total gas consumption will double. This could lead to a closer global interdependence of energy consumers and producers and among consumers if Russia's and Iran's Gas-OPEC project fails. To counter the risks of a Gas-OPEC for the global energy market, the EU's close cooperation with the U.S., China, and India—as main consumers—seems of utmost importance. By 2011, at the latest, Russia will have serious problems in meeting its gas delivery obligations as it is already far behind its exploration targets. This will equally affect the Russian and the foreign economies. For years, Gazprom has invested in the acquisition of new pipelines in its neighborhood rather than in the renovation of its infrastructure and the exploration of new gas fields. In consequence, Russia's growing need for Western capital and exploration techniques might create the potential for future energy cooperation between the EU, the U.S., and Russia. Before that, stronger energy cooperation within the EU should strengthen the EU's leverage such that the EU could be the key customer for Russia's energy supplies. A position of strength is the best key for cooperation with Russia.





# RUSSIA'S INFLUENCE ON GERMAN-AMERICAN RELATIONS

IRINA KOBRINSKAYA

The very title of the panel would have given President Putin a deep sense of satisfaction. His Munich speech worked! The chosen political technique was correct. Russia is back again on the stage of key world politics. Still, during an informal meeting with the "Valday group" in Sochi this year, Putin reportedly said, "It is no good for Russia to pose itself as a great power and kick against the pricks."<sup>1</sup>

Why this humble and straightforward self-containment in Sochi? Is it a "one step forward, two steps back" policy or the renaissance of real politics? Can Russia really influence the relations of the "greats"?

In my view it can. However, the Russian factor still remains secondary in solving the problems that the Euro-Atlantic community in general, and especially within German-American relations faces nowadays. Nevertheless, Russia may become influential in two cases. In the first scenario, the West consolidates in the face of a strengthening and assertive Russia and makes not two, but four steps back—to the pre-Gorbachev era; i.e., the West turns back to the containment of Russia. The second scenario is the opposite; the West involves Russia in closer cooperation on global matters (rapprochement through engagement—*Annäherung durch Verflechtung*). For now, the likelihood of these two scenarios happening is more or less equal. At least in the analytical circles in the West there is an understanding that in such acute and politically dividing issues as anti-missile defense (AMD), the main question is not AMD or security, but what role Russia will play in European security.

Still, nowadays the main problems standing before not only the United States, Germany, and Russia, but the whole world, are different. This includes the tran-

sition from the mono-polar system to a new situation—multi-polarity—in Haass' words, "the end of the American era."<sup>2</sup>

In this situation Sergey Lavrov, the Foreign Minister of Russia, suggested a new formula: "A broad non-prejudiced approach is needed on both sides. Such an approach could be based on the perception of Russia and the United States as two branches of European civilization, each of which gives it an 'added value.' A practical formula of preserving the Euro-Atlantic space intact in global politics could be a triple interaction in international affairs—between the U.S., Russia, and the European Union."<sup>3</sup>

On the one hand, this formula is an attempt to preserve the manageability of world affairs on the basis of the existing post-World War II or Cold War institutions (the UN, NATO and the European Union), despite their weaknesses or crises and the degradation of international law, including in the sphere of arms control and disarmament.

On the other hand, this is an attempt to find new grounds for unity—or even an ideology to replace "Western democratic values" (which were compromised by the United States in Iraq and in too many cases by Europe). It is an attempt to find an ideology which may substitute Francis Fukuyama's "the end of history" idea (who has admitted his mistake) and Samuel Huntington's "clash of civilizations" theory.

The proposed formula is definitely good news in one very important aspect: Russia, as Lavrov sees it (as well as Putin) would follow along the European, Western way. It is the road of Peter the Great, not Ivan the Terrible. At least for now and in the foreseeable future it means a definite victory of the "Westerners"

over “Eurasianists” in Russia on the official policy level. Public opinion polls in Russia show that foreign policy is regarded as a main achievement of Putin’s presidency—a situation where Russia is back on stage is welcomed by the former super-power citizens.

Yet, limiting relations to a “tripartite union” of the U.S., EU, and Russia is an attempt to repeat the past. This formula lacks a global dimension and cannot work if it is not enlarged and enhanced by the new emerging great powers. But then will it be a working format at all? This resembles the G8 “enlargement” dilemma. This is why if Russia is to overcome the numerous civilization barriers and solve the acute global issues Lavrov repeatedly suggests, that it will also need a “network diplomacy” in the coming years.

The question is: how does this networking correspond to the “tripartite union”? How does Russia make its activities in non-Western institutions (including in the post-Soviet space, the Shanghai Treaty Organization, the northern Asia-Asian Pacific region, or its relations with the anti-U.S. South American leftist regimes) compatible with the “tripartite union”. The other side of the same coin is how will Russia re-formulate its reaction to European and American activities in the post-Soviet space?

#### After George W. Bush

The key problem for the future of U.S.-German relations, U.S.-EU relations, Euro-Atlantic relations in general, and U.S.-Russian relations is not Russia, but the uncertainty connected with the policy of the next U.S. administration.

Among post-Bush scenarios, as discussed in Russia, included is a possibility that America will go through a post-Iraq syndrome, including the increase of isolationist moods. Isolationism in the United States—as far as it is at all possible in a globalized world—is a scenario which hardly suits Europe or Russia. This is due to the simple reason, which is openly articulated by Russian politicians, that the U.S. remains number one in the world and, in the foreseeable future, there is no other to substitute America in this position. It will

take a long time—no less than a decade—to establish a new post-mono-polar world balance.

The key global issues cannot be solved without active U.S. participation, if not leadership. These are: non-proliferation, North Korea, Iran, the Middle East, and the Asian-Pacific puzzle. This is also impacted by the discussions on European security, as there are no signs of willingness on the part of Europeans to pay more for defense or to participate broadly in peace-making missions. In the long run Europe will be unable to take on a leadership burden in the security sphere if it does not radically change its posture towards Russia and integrate it into the European security architecture. This scenario of a pan-European security structure is hardly realistic, taking other factors into account, including the central and eastern European countries’ posture. But even if this is realized, the main condition for European security in the long run remains an active U.S. role. Thus, to keep itself secure, Europe needs the United States “in.”

Though it may sound paradoxical, Russia shares this interest. In spite of anti-Western, anti-American, and anti-NATO rhetoric in the media, the official documents and expert assessments<sup>4</sup> argue that Russia welcomes close cooperation with NATO in the security sphere and sees no alternative to the alliance—an alliance whose effectiveness remains only with the United States’ active and interested leadership.

#### Russian-American Relations: A Narrow Window of Opportunity

Russian-American relations have not improved but have stabilized. This is not a difficult task, taking into account that the common agenda is very narrow and mainly concerns the military-security sphere. What has appeared after U.S. Secretary of State Condoleezza Rice’s visit to Moscow in May 2007, the G8 meeting, the informal Bush-Putin summit in July 2007, and a short meeting of the presidents in Australia in September 2007 is *Realpolitik*, a rather unusual policy for neo-cons in Washington. Washington has definitely lowered the tone of its criticism of autocracy and democracy problems in Russia and turned instead to a dialogue.

The most evident example is the case of WTO membership. For Moscow, in particular for Putin, it is very important that Russia becomes a WTO member by 2008. In my view<sup>5</sup>, WTO membership remains the key instrument in “civilizing” Russia from the outside for Putin, to insert those rules which can otherwise not be agreed upon inside the country. And Bush has blessed its membership. In exchange, Russia—at least under Putin, which means until April 2008 plus a year more (according to the current elections scenarios)—may give many concession, whether economic or political, in exchange for WTO membership.

First, in spite of his harsh tone, Putin in fact did not say anything new in Munich. What was new was the manner, not substance. He spoke about the U.S. as a “wolf,” about an asymmetrical response to weapons creation, and about neutralizing the U.S. AMD at least as early as May 2006 (in his Address to the Federal Assembly). But in Munich, Putin joined the Western side on the Iranian nuclear problem. And that was heard in Washington.

Second, Russia is no longer looking at the CIS as it had in 2004 during the Orange Revolution. During his lecture in Moscow Institute of International Relations (MGIMO) in September 2007, Lavrov did not mention Ukraine or Georgia membership in NATO as “red lines” as before. He stressed only two red lines: Kosovo and the anti-missile defense in Europe. In regard to the first issue there is no secure long-lasting and legitimate solution. In the opinion of many experts (including Americans), the Russian stance on Kosovo is not that much about Kosovo, or even Abkhazia and South Ossetia, but about preserving the legitimacy of the UN Security Council—or, in other words, keeping the manageability of world affairs during the long transition period.

Third, in regard to anti-missile defense in central Europe, post-Putin Russia may strongly react to this initiative. The first steps are done—a moratorium on the CFE, a questioning of the INF treaty, and the testing of new weapons. But these are not yet irreversible. Putin has simultaneously not put forward any less far-reaching compromises. And Russia—at least

for now, in the short-term—may be able to find a consensus, a cooperation formula. Putin is careful that Russia does not “kick against the pricks” and keeps the freedom to maneuver in order to “take two steps back.”

The situation, as described above, is real for now and in the short-term because Putin is a “Teflon President.” He can combine a harsh tone with concessions and not lose his high ratings domestically. His Munich harshness is explained by many commentators as a result of the coming elections. Undoubtedly this and other speeches enhanced the anti-Western moods in Russia. But simultaneously, only the Teflon President Putin could afford to suggest the joint use of Gabala and Armavir installations (not speaking about Central Asian bases after 9/11, or leaving the bases in Cuba and Vietnam) for a missile defense system and not be accused of treason.

Taking into account the time or election factor, Russian realists, including the General Chief of Staff Baluevsky, suggest putting aside the anti-missile defense issue for at least six months to one year. There are many reasons for it. First, doubts remain regarding the anti-missile defense system itself. Second, the chances are low (but still exist) that the new U.S. administration will keep the issue low profile and be realistic on the matter (as it happened with SDI). Third, it is true that the population in Poland and, in particular, in the Czech Republic is against missile defense. While the Czech leadership is very careful, the Polish political landscape may also change after the October elections and become more realistic, less ideological, less anti-Russian, and less anti-German.

The other option—which Chancellor Angela Merkel suggests—is to transfer the missile defense problem to NATO and the Russia-NATO Council, or to institutionalize the problem in order to free it from national (be it Polish, American, German or Russian) prejudices.

Another important characteristic of Putin’s foreign policy could be explained by his “Europeanness.”

Russia has already refused to export oil to China on the previous conditions. In Central Asia, Russia is struggling to win the competition against the EU and the United States and, even more, to gain the upper hand in the competition over the region with China itself.

### The Time Factor

The elections in Russia will play a certain role in German-Russian relations. According to the latest public opinion polls regarding the next Duma elections, the most popular parties are the United Russia Party and the Communists. This does not mean a repetition of the 1996 presidential election's dramatic alternative, in particular taking into account the subordinate role of the Parliament in the Russian polity.

Still, public opinion is anti-Western, the Communists are still popular (the Kremlin is afraid of the previous parliamentary elections' experiment with Rogozin's *Rodina* party, which received 14 percent and went out of control; now there is no successful left social-democratic alternative to the Communists. Mironov's *Spravedlivaya Rossiya* has very low support) and the next president won't be "Teflon."

In the event that twelve to twenty months after the elections there is a crisis or semi-crisis (economic, social, ethnic) in Russia, the ruling politicians may need an outward enemy. Even now some analysts in Russia see Russia's mission as containment of the United States. If today some in the West—and even Ukraine—suggest containing Russia, in a year or two there may be the same demand for containment of the West in Russia.

Of course, Putin will retain his influence on Russian foreign policy for some time. In this way he gives some time advantage to his partners in the West in coming up with a more coherent partnership policy agenda.

It is difficult to predict how the political situation in Russia will develop after Putin, but the opinion of a few thoughtful observers in Russia that Putin has started decentralization of the system seems to be correct. While he managed to keep both the vertical

and centralized power under control, the next president may not be able to do so. Thus, his idea may be creating a sort of balance between several centers or groups of power. This new situation, taking into account Russian semi-transparency, would hardly be easier to deal with for the West—either for Europe or for the United States.

### Russian-German Relations

Russia is satisfied with its relations with Germany, though less so than during Gerhard Schröder's chancellorship.<sup>6</sup> Russia and Germany have a difficult past, but they do not have a mutual phobia. These relations, unlike U.S.-Russian relations, are based on broad economic cooperation and interdependence, which make them long-lasting, transparent, and less dependent on domestic political changes.

Russian-German relations are not equal or similar to Russian-EU relations, which are in a crisis nowadays, mostly due to the problems in the EU. The popular idea in the West—a suspicious approach to Moscow's policy towards the EU as "divide and rule"—seems to be a simplification. In the 1990s Russia was too weak, it was on the margin of the world affairs, had weak institutional relations with the EU, and had a very poor understanding of the EU functions (it has improved tremendously during the last five to seven years). It is no surprise, then, that Yeltsin (and then Putin) took advantage of informal relations with some European leaders (so-called "sauna" or "without ties" diplomacy). This opportunity has practically disappeared in the most natural way—with the change of the leaders. Later, when it had added some muscle, Moscow concentrated on the G8 as an institutional priority in its relations with the West and Europe. The G8 also provides a unique possibility of informal contacts with the top eight world leaders, and, at the same time, serves as an argument to Russia's revival and its being one of the leading nations in the world. Still, Russia is interested in institutionalizing its relations with the EU (being its top trade-economic partner) and creating a new strategic partnership treaty instead of the obsolete Partnership and Cooperation Agreement (PCA). High expectations in regard to the progress on this matter were

connected with the German presidency of the EU (though for well-known reasons— such as the Polish veto—that did not happen).

In the new transition period Russia would be interested in the transformation of the EU into not only an economic, but also a strong political player. However, realistically assessing the current problems of the EU (including the tendency towards re-nationalization as a complex reaction to integration and enlargement processes), the chances for it are very low.

A strategic partnership with Germany is extremely important for Russia, but there are no reasons why the equidistance policy of Berlin and its strategic partnership relations with Washington should be a problem for Moscow. Moscow can only gain from Germany's mediation with Washington on several issues. But Russia is definitely against the "U.S. in, Germany down, Russia out" situation, which obviously does not suit Germany, either.

Policy towards Russia would hardly turn into a serious barrier in German-American relations. The problems remain the same: these are anti-missile defense, post-Soviet space, energy, and democracy.

We are likely to enter into a "Realpolitik" period in a new globalizing world, where the competition will strengthen. There is a new situation in the post-Soviet space, where Russia may be ready for competition. The competition in Central Asia, in which the U.S., EU, and Russia took part, is finished for now with the outcome recorded as 0:0. Still, in their competition over resources, it is necessary to remember that this region neighbors with Iran, Afghanistan, and China.

In this new situation Russia, as well as its western partners, need allies. What role Russia will play depends mainly on where its allies and partners are—in the mainstream or in the margins. Today's and tomorrow's Russia is still open to be institutionalized and co-opted into the West.

## NOTES

1 As quoted by Kommersant daily, Sept. 15, 2007)

2 Richard N. Haass, "The New Middle East," *Foreign Affairs* 6 (2006): 5.

3 Sergey Lavrov, "Containment of Russia: Back to the future?" *Russia in Global Affairs*, No. 4, July-August 2007.

4 Like the MoFA "Review of Russian Foreign Policy" (Spring 2007) or "Russia in the World: 2017" by Council on Foreign and Defense Policy

5 See my articles in *Russia in Global Affairs*.

6 The Sept. 15, 2007 issue of *Moscow news* article about G. Schroeder starts with the words: "The German Social-Democrat is historically beloved personage in Russia."