

# Russia and the Caspian States in the Global Energy Balance



## Emerging U.S. Policy Toward Russia

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JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY  
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**ABOUT THE STUDY:  
RUSSIA AND THE CASPIAN STATES IN  
THE GLOBAL ENERGY BALANCE**

Russia's position as a major energy supplier has great significance not only for its foreign policy but for its relationships with major energy-consuming countries. The nature of Russia's future geopolitical role in world energy markets has become a major concern of international energy security with important implications for Europe, Japan, and the United States. Given a range of economic and geopolitical uncertainties, the fate of Russian and Caspian natural gas exports remains a major risk factor in global energy supply. For this study, researchers examined several scenarios for Russian and Caspian oil and natural gas production, possible export routes, and the geopolitics involved.

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### Abstract

Russia's invasion of Georgia in August 2008 brought the subject of U.S.–Russian relations to the forefront of political discourse, albeit for a short while. Since then, the United States' main foreign policy concerns have shifted back to the major problems it faces in the near future: the global economic crisis, the process of leaving Iraq, and the resurgence of the Taliban in Afghanistan. Still, relations between the United States and Russia are at their lowest point since the collapse of the Soviet Union in 1991, and the United States may have to contend with Russia in the coming months or years. Much of the tension between the two nations has to do with the problem of spheres of influence, as most of Eastern Europe has come to favor friendlier relations with the United States in recent years. It is in these regions along the Russian border that the tensions are at their highest, as exemplified by the recent clash between Russia and Georgia. Additionally, Russia's control over a large share of the natural gas supplies to Western Europe presents the possibility of a potential conflict. Yet, the United States maintains a carefully measured stance in regard to its policy toward Russia, with the Obama administration adopting a cautious and moderate tone in its statements on the subject. In the coming years, the Obama administration's challenge will be to increase cooperation with Russia on areas of mutual interest while limiting potential fallout on contentious issues.

### I. Introduction<sup>1</sup>

Barack Obama has become president at a time when U.S.–Russian relations are at their lowest point since the collapse of the Soviet Union in 1991. While Washington's sharp reaction to the Russo-Georgian war of August 2008 is perhaps the most dramatic instance of this deterioration, Moscow's policy toward Tbilisi is only one of a number of issues over which the United States and Russia find themselves increasingly at odds. Washington has long been concerned with what it perceives as Moscow's meddling in what Russia calls its “Near Abroad”—those now independent countries of the Caucasus and Central Asia that were once part of the Soviet Union. Moscow's energy policy—notably its willingness to cut off natural gas supplies to Ukraine and

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<sup>1</sup> This paper draws heavily on Joe Barnes' December 2008 paper, “U.S.–Russia Relations,” available at <http://www.bakerinstitute.org/publications/DIPL-pub-ObamaTransitionBarnes-121908.pdf>. Barnes is grateful for the research assistance provided by Graham Johnson, a Baker Institute intern.

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the implicit threat this poses to Western Europe—has raised hackles in Washington. So has Russian opposition to more stringent United Nations (UN) sanctions aimed at compelling Iran to desist from its nuclear program.

Yet Russia hardly ranks first on the new Obama administration's foreign policy agenda. Addressing the international financial crisis, limiting a severe global economic downturn, extricating the United States from Iraq, and checking a resurgent Taliban in Afghanistan are all clearly first-order foreign policy challenges. Other important priorities include addressing deteriorating security in Pakistan, crafting a multilateral response to Iranian and North Korean nuclear programs, and jump-starting moribund Arab–Israeli peace talks.

These, it must be stressed, are merely the most *immediate* of the major foreign policy challenges confronting the Obama administration. Others include sustaining multilateral efforts to combat terrorism, rebuilding frayed ties to traditional U.S. allies, engaging an ever more assertive China on a range of bilateral and regional issues, reviving international negotiations on trade and investment, and, not least, coordinating a global response to climate change at a time when most countries will be focused on short-term economic recovery rather than the long-term effects of rising atmospheric temperatures.

The last thing the Obama administration will want to do is expend financial resources and precious political capital in dealing with Russia. But it may have no choice.

### II. A Little History

The deterioration in Russo–U.S. relations—and, indeed, relations between Russia and the West more generally—was brought home with a vengeance by the Russo–Georgian war of August 2008.<sup>2</sup>

Both Georgia and Russia defend their decisions and actions regarding the Russo–Georgian war. For Georgia, conflict between South Ossetia and Georgia had been ongoing,<sup>3</sup> and President Mikheil Saakashvili, reacting with force to insurgency within Georgian borders, thought to quell things once and for all. Georgia claimed that Russia was interfering in Georgian territory via arming and training the South Ossetian separatists. Regarding Russian military movements into Georgia, Saakashvili stated, “If the whole world does not stop Russia today, then Russian tanks will be able to reach any other European capital.”<sup>4</sup> Russia, unsurprisingly, rejected the Georgian narrative. Moscow claimed it intervened to protect Russian citizens in South Ossetia following an unprovoked Georgian attack.<sup>5</sup>

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<sup>2</sup> Accelerated skirmishes between armed South Ossetian rebels and Georgian loyalists resulted in reported deaths and injuries on both sides as well as the destruction of a Georgian armored military personnel carrier. This led to Georgian President Mikheil Saakashvili declaring a unilateral ceasefire on August 7. But, it was not to last. Claiming that South Ossetians ignored the ceasefire by attacking loyalist villages in the self-proclaimed republic, on August 8, Georgia conducted ground and air military strikes into South Ossetia, including heavy bombardment of Tskhinvali, the capital of this separatist region. Russia intervened quickly on August 8 with military, tank, and artillery support in Tskhinvali to support Russian peacekeepers—as they had previously warned they would in order to protect Russian citizens in South Ossetia—with a naval blockade and landings along Georgia’s coast, and later via a full-out assault toward the Georgian capital of Tbilisi. The Russian offensive was called off on August 12. (Michael Schwartz, Anne Barnard, and C.J. Chivers, “Russia and Georgia clash over breakaway region,” *The New York Times*, August 9, 2008. Adrian Blomfield, “Caucasus in crisis: Georgia invades rebel region,” *The Telegraph*, August 8, 2008, <http://www.telegraph.co.uk>.)

<sup>3</sup> South Ossetia’s calls for independence have been ongoing since 1990 (when the Soviet Union fell and Georgia became independent). It is located in the north of Georgia and borders the Russian region of North Ossetia. Separatists in South Ossetia call for the autonomy of the region so that it may join its ethnic kin in North Ossetia. South Ossetia has attempted to secede by force from Georgia, resulting in over 1,000 deaths (Tony Halpin, “Battle for independence,” *The Times (London)*, August 9, 2009.).

<sup>4</sup> Chris Wattie, “Georgia, Russia Plunged into war; Russian tanks invade province of former Soviet republic,” *National Post*, August 9, 2008.

<sup>5</sup> Russia has granted nearly 70,000 Russian passports to South Ossetians and has peacekeepers in the region (Halpin, “Battle”). According to Russian Ambassador Vitaly Churkin at an emergency session of the U.N. Security Council held on August 7, Georgia had been purposely targeting Russian peacekeeping forces as well as conducting what he referred to as “ethnic cleansing” operations in South Ossetia. (Svitlana Korenovska, “Russia sends tanks into Georgia; fighting erupts over a separatist enclave,” *The Washington Times*, August 9, 2008.) Moscow further emphasized that the Georgian attacks inflicted great destruction on civilian targets in and around Tskhinvali.

During the conflict, the West, particularly the United States, urged Saakashvili to exercise restraint in his actions and condemned Russia's interference in the affairs of a sovereign nation.<sup>6</sup> The United States and the European Union (EU) called for cease-fire and direct negotiations between Georgia and Russia.<sup>7</sup>

The Russo–Georgian war prompted strong disagreement among U.S. foreign policy experts. The majority position was represented by Michael McFaul, who is now President Obama's national security adviser on Russia. McFaul believed that Moscow's actions were an excuse to act with “hard power” in order to maintain Russia's sphere of influence in the region and reestablish its hegemony.<sup>8</sup> McFaul called Georgia's actions in South Ossetia an “inappropriate use of military force,” and emphasized that Russia still violated Georgia's territorial integrity as a sovereign nation—an inviolable status firmly upheld in the opinion of the European Union.<sup>9</sup>

But other analysts disagreed with McFaul's hard power interpretation. These included Dimitri Simes, president of the Washington, D.C.-based Nixon Center and publisher of the *National Interest*. Simes has argued that there is no evidence to support fears or theories that Russia will make it a habit to invade other countries on its borders and notes that the United States supported Kosovo's independence—which by analogy might be viewed as a precedent for separatism.<sup>10</sup>

Though the Russo–Georgia war was of short duration (five days) and modest geographic scope—fighting was largely limited to the breakaway Georgian region of South Ossetia and areas contiguous to it—the international impact of the conflict was dramatic.

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<sup>6</sup> Blomfield, “Caucuses in Crisis.”

<sup>7</sup> Wattie, “Georgia.”

<sup>8</sup> Michael McFaul has been the Peter and Helen Bing Senior Fellow at the Hoover Institution, the Director of the Center on Democracy, Development, and the Rule of Law at the Freeman Spogli Institute (FSI) for International Studies, and a professor of political science at Stanford University. McFaul has also been a nonresident senior associate at the Carnegie Endowment for International Peace.

<sup>9</sup> In an interview with Glenn Beck during the conflict, McFaul opined that there should have been UN international peacekeepers in the region before the conflict escalated, and not Russian peacekeepers. In terms of peaceful negotiations, McFaul suggested a political solution with an internationally appointed mediator, a result that was forthcoming when President Nicolas Sarkozy of France helped negotiate a cease-fire between Russian President Dmitry Medvedev and Saakashvili. (“Russia–Georgia Conflict: The Real Story,” *Glenn Beck*. August 11, 2008, <http://www.glennbeck.com>.)

<sup>10</sup> Dimitri K. Simes, “Russian Roulette,” *The National Interest*, November/December 2008, 4–7.

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Russo–U.S. relations have come far since June 2001 when U.S. President George W. Bush famously looked into Russian President Vladimir Putin’s soul and saw a statesman with whom he could work. In 2002, Washington and Moscow signed the Strategic Offensive Reductions Treaty, which dramatically cut the number of strategic weapons deployed by each nation. In 2002–2003, Russia, unlike traditional U.S. allies France and Germany, remained largely immune from Bush administration criticism for its opposition to the U.S. invasion of Iraq.

In recent years, the United States has let its relationship with Russia deteriorate, which in turn has contributed to a decline in U.S. leverage with Moscow—as evidenced in the Russo–Georgia crisis.<sup>11</sup> Washington’s failure, since the end of the Cold War, to treat Russia as a full partner rather than a defeated enemy is seen by some analysts as a root cause of sinking U.S.–Russian relations.<sup>12</sup> Indeed, the Russo–Georgian dispute is only one of a long list of differences between Washington and Moscow. Many center on U.S. policy in former Warsaw Pact countries and the newly independent states of the Caucasus and Central Asia. President Dmitry Medvedev stated that “relations soured because of the previous U.S. administration’s plans.”<sup>13</sup> Specifically, Moscow objects to U.S. support for NATO expansion eastward to countries like Ukraine and Georgia. It is no less vociferous in its opposition to U.S. plans to deploy a missile defense system in the Czech Republic and Poland. The U.S. invasion of Iraq without unambiguous UN authority also irked Russian leaders and the Russian public.

There is no question that the Kremlin is unhappy about U.S. efforts to expand its, and other Western, influence in Russia’s “Near Abroad.” And it remains concerned by U.S. support for oil and gas pipeline routes in the region that compete with and bypass Russia. (Washington extended extensive diplomatic and financial support to the Baku–Tbilisi–Ceyhan [BTC] petroleum pipeline that went into operation in 2005.)

Moscow has also been unsurprisingly dismissive of Washington’s criticism of its human rights policies. The Russian government was blunt in pointing out what it calls the hypocrisy of the

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<sup>11</sup> Nathalie Gorman, “Chaos in the Caucasus.” *Salon*, August 13, 2008, <http://www.salon.com>.

<sup>12</sup> Dimitri K. Simes, “Losing Russia,” *Foreign Affairs*, November/December 2007, <http://www.foreignaffairs.org>.

<sup>13</sup> Dmitry A. Medvedev, “Building Russian–U.S. Bonds,” *The Washington Post*, March 31, 2009, <http://www.washingtonpost.com>.

Bush administration—with the U.S. record of rendition, torture, and detention without charge in Guantanamo and Iraqi and Afghanistan civilian casualties in the U.S.-led “War on Terror”—in presuming to lecture anyone on human rights. In the broader international arena, Moscow has played a largely obstructionist role in U.S.-led efforts, at the United Nations and elsewhere, to compel Iran’s cessation of its nuclear weapons program. Anti-American rhetoric is increasingly a staple of Russian government pronouncements.<sup>14</sup> The financial crisis has only added rhetorical fuel to the fire, with Prime Minister Vladimir Putin, in a January 2009 speech at Davos, assailing the United States for its role in igniting the crisis sweeping world markets, including Russia’s.

*Why the change? On one level, the answer is easy: energy prices*

Russia may not be the superpower that the Soviet Union once was, but in one area—energy—it remains an international force to be reckoned with. It leads the world in natural gas exports, most of them to Europe. And it is the world’s second-largest oil exporter after Saudi Arabia. Russia’s proven petroleum reserves represent roughly 5 percent of the world total. It possesses roughly a quarter of global natural gas reserves. Russia’s energy exports make it an important player in international markets. Its reserves—particularly of natural gas—ensure that it will be an important player for decades to come. And market conditions have been, to put it very mildly, highly favorable in recent years.

Both petroleum and natural gas prices rose five-fold between early 2002 and their 2008 peaks. This led to a giant financial windfall for Russia, which depends heavily upon energy exports for both economic growth and government revenue. High hydrocarbon prices have permitted President (and later Prime Minister) Putin to consolidate his personal political position at home, strengthen the authority of Russia’s central government, and bolster Russia’s status abroad.

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<sup>14</sup> McFaul noted that the Kremlin has promoted anti-American sentiment as a tool to enhance internal power. He notes the Kremlin’s “new need for an enemy” to distract and unite its public as it reconsolidates autocratic power has resulted in the Kremlin demonizing the United States—with stories of U.S. seizures of Russian natural resources and U.S. establishment of military bases surrounding Russia on state-controlled television. He further noted Russia’s deployment of permanently airborne “missile-carrying strategic bombers... to protect Russian territory”; according to him, the only country with similar capabilities is the United States. McFaul failed, however, to ask why the United States needed such capabilities while Russia did not. Such asymmetry is typical of those criticizing Russia. (Michael McFaul, “New Russia, New Threat,” *Los Angeles Times*, September 2, 2007, <http://www.latimes.com>.)

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There are particular concerns, in Washington and some European capitals, about Russian gas exports to Europe. European Union (EU) member states are heavily dependent on natural gas for electricity production and, in turn, heavily dependent on Russian natural gas as a share of total gas consumption. Imports from Russia represented 38 percent of German gas consumption in 2004; 26 percent for Italy; and 25 percent for France. Dependency is even higher among the former Council for Mutual Economic Assistance (COMECON) states of Eastern Europe. This dependency is all the more acute because of very limited practical options for fully replacing Russian gas should it be cut off. Neither Norwegian nor North African gas could fill the breach. Brief cut-offs of gas supplies to Ukraine in 2006 and early 2009 raised concerns in European capitals and Washington that Moscow stood prepared to use energy as a blunt instrument of its foreign policy.<sup>15</sup>

Russia's policy toward proposed gas pipelines has also raised concern abroad. Moscow has consistently discouraged proposed pipelines that bypass Russia (such as Nabucco, which would bring gas from Azerbaijan and Turkmenistan to European markets via Turkey), while promoting others—notably Nord Stream, a Baltic pipeline directly connecting Russia and Germany—that bypass traditional transit countries in Eastern Europe, including Ukraine.

The huge state-controlled monopoly, Gazprom—the third-largest company in the world in terms of market capitalization in 2007—is the world's largest producer of natural gas and manages the world's largest pipeline network. It is in many ways the flagship of Putin's revived Russia—a source of government revenue, generator of economic growth, and an instrument of foreign policy.

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<sup>15</sup> Russia claims that the 2006 gas cutoffs to Ukraine were due to “price disputes” between two state-owned natural gas monopolies, Russia's Gazprom and Ukraine's Naftogaz. The Gazprom cutoff deprived the Ukraine of a reported one-third of its total supply. Western Europe was particularly concerned because Russian supplies to the West came via pipelines transiting through Ukraine; though, Russia assured the West that their supplies would not be interrupted by the price dispute with Ukraine. (Alex Rodriguez, “Russia stops natural gas to Ukraine—Pipeline to EU nations could be in jeopardy,” *Chicago Tribune*, January 2, 2006.)

Last, Russia is at least considering the possibility of setting up an OPEC-like<sup>16</sup> natural gas cartel with countries like Qatar and Iran. Together, Russia, Qatar, and Iran account for more than 50 percent of proven global natural gas reserves.

### *Deteriorating U.S.–Russo Relations: Geopolitics and Russia’s Near Abroad*

But more than rising energy prices has played into deteriorating U.S.–Russo relations. The seeds of the current situation date back to the end of the Cold War and collapse of the Soviet Union. Washington welcomed Moscow’s new democratic government, offering both (fulsome) diplomatic and (modest) economic support for President Boris Yeltsin. But Washington also moved, beginning under President George H.W. Bush and continuing under Presidents Bill Clinton and George W. Bush, to expand NATO into Eastern Europe. At the same time, Washington increased its diplomatic, economic and, in some cases, military presence in the Caucasus and Central Asia. We did so for several reasons: to hedge against the possible return of Russian expansionism; to consolidate the political and economic transformation of former Warsaw Pact countries like the Czech Republic and Poland; to bolster the sovereignty of fledgling states in Russia’s “Near Abroad”; and, at least in part, to appease domestic constituencies, notably Americans of Eastern European descent.

Whatever Washington’s motives—and they assuredly have been mixed and at times contradictory—the fact remains that the United States has pushed its sphere of influence right up the borders of Russia. It is hard to imagine any Russian regime, whether democratic or authoritarian, gracefully acceding to this state of affairs. Russia’s position toward the breakaway Georgian regions of South Ossetia and Abkhazia dates from the Yeltsin era. There is nothing new about Moscow’s opposition to NATO expansion, nor its unease about U.S. involvement in the countries of the “Near Abroad.” But Russia—plunged into economic crisis and political chaos for much of the 1990s—was simply too weak to do much more than complain. With the ascendance of Vladimir Putin in 1999 and the rise in energy prices, that changed.

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<sup>16</sup> Organization of the Petroleum Exporting Countries.

### III. A New Cold War?

The deterioration in Russo–U.S. relations has given rise to talk of a “New Cold War” between Washington and Moscow. In the weeks following the Russo–Georgian war of August 2008, press references to the concept increased more than tenfold.<sup>17</sup> There was more than a little talk among U.S. foreign policy experts—and especially among neoconservatives—comparing Georgia in 2009 with Czechoslovakia in 1938. The comparison implicitly makes Russia today’s Nazi Germany and Vladimir Putin a contemporary Adolf Hitler. While support for Georgia almost always stopped short of proposing U.S. military intervention, a number of observers suggested that the United States take even more strenuous efforts to bring Georgia—and Ukraine—swiftly into NATO. There was also talk of punitive measures, notably a veto of Russia’s membership in the World Trade Organization (WTO) and expulsion from the G-8.

The arguments for a “New Cold War” with Russia are summed up nicely in a much-reviewed book of the same name by Edward Lucas. With today’s Russia, Lucas writes, “Repression at home is matched by aggression abroad.”<sup>18</sup> Elsewhere he strikes a truly alarmist note:

“If Russia gets what it wants in the Caucasus or the Baltics, the Balkans and Central Europe will be next. And what then? The Arctic? Western Europe? Slice by slice, the Kremlin is adding to its sphere of influence.”<sup>19</sup>

It is almost too easy to parody such statements: Today, Abkhazia and South Ossetia, tomorrow Western Europe! These—and similar—arguments suggesting that we face a “New Cold War” with Russia are much overdrawn. Our current differences with Moscow—however sharp they may be—are simply not comparable with the worldwide military, economic, and ideological struggle that constituted the Cold War. Russia may be an “energy superpower.” It may be capable of bullying its smaller neighbors. Its nuclear arsenal, though much diminished in

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<sup>17</sup> Christian Caryl, “The Russians Are Coming?” review of *The New Cold War: Putin's Russia and the Threat to the West*, by Edward Lucas, *The New York Review of Books*, February 12, 2009, 21.

<sup>18</sup> Edward Lucas, *The New Cold War* (New York: Palgrave MacMillan, 2008), 10.

<sup>19</sup> *Ibid.*, 12.

readiness, is still the world's largest. And Moscow's seat on the UN Security Council gives it disproportionate power to block U.S. international initiatives.

But Russia is a pale shadow of the former Soviet Union. It represents no conventional threat to Europe. It possesses no worldwide network of client states. And it offers no comprehensive ideology capable of challenging democratic capitalism. Even its domestic regime under President and now Prime Minister Putin, though hardly liberal, is still far from the all-encompassing totalitarianism that reigned in the Soviet Union from the 1920s to the 1980s. At home and abroad, Putin is no Hitler; he is not even Brezhnev. Rather, he is a fairly straightforward Russian nationalist with strong authoritarian tendencies at home and a practitioner of old-fashioned *realpolitik* abroad.<sup>20</sup>

As Lucas and many others have pointed out, Western European dependence on Russian gas may be a problem. The countries of the EU can clearly do more to liberalize their internal gas markets in ways that reduce Gazprom's ability to wield disproportionate market power; Germany, in particular, is in need of reforms to bring more competition to its domestic gas distribution system.<sup>21</sup> Short of such liberalization, the EU has taken some steps to improve the energy security of East European countries. For instance, in April 2009, Ukraine signed a pact with the EU and several banks, pledging their mutual cooperation "to encourage investment and avoid a repeat of the dispute...[in early 2009 between Russia and Ukraine], which resulted in a temporary cut-off in Russian gas supplies." Projects discussed between the parties include funding the modernization of Ukrainian pipelines, underground storage, and gas metering systems, as well as the proposed construction of two new pipelines.<sup>22</sup>

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<sup>20</sup> Simes, for instance, postulates that the Medvedev–Putin tandem "want to restore Russia's greatness and enhance its influence, especially in its neighborhood, but not at the cost of self-isolation, economic disaster or an all-out arms race with the United States." He urges U.S. policymakers to avoid distorting facts and not to consider false options like moving forward with U.S. interests in the region without considering Russia's reactions and interests, or assuming Russia to be a "junior partner" and only seeking support for mutual interests (nonproliferation, counterterrorism, etc.), and not compromising on other U.S. positions (NATO, missile defense systems in Eastern Europe, etc.). Rather than a "New Cold War," Simes warns against ignoring the possibility of a "real shooting war" if the West carelessly expands alliances or allows circumstances in states like Iran, Georgia, Venezuela, and Ukraine to manipulate U.S.–Russia tensions. (Simes, "Russian Roulette.")

<sup>21</sup> Marshall Goldman, *Petrostate: Putin, Power, and the New Russia* (New York: Oxford University Press, 2008), 167–8.

<sup>22</sup> "Russia, Ukraine discuss resuming talks after pipeline row," NOVOSTI, Russian News & Information Agency, April 10, 2009, <http://en.rian.ru/russia/20090410/121043734.html>.

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But Europe's dependence on Russian gas is assuredly much more a European problem than an American one. The fate of the "West," however defined, is hardly at stake. The EU has a population of more than 300 million and a gross domestic product (GDP) higher than that of the United States. Why Washington should insert itself into issues related to Russian gas exports to Western Europe is unclear. If we are concerned about the vulnerability of Eastern European countries, such as Poland and Ukraine, we should be prepared to help finance projects—liquefied natural gas terminals, pipelines from the North Sea—that will help them diversify their gas supplies.

Western Europe's relatively sanguine view of its dependence on Russian supplies is not without merit. First, the Soviet Union and now Russia have, with a handful of minor exceptions, been reliable suppliers of gas to the countries of Western Europe. Why Russia—an altogether weaker and less hostile state than the former Soviet Union—would use the gas weapon against Western Europe when the Soviet Union did not is unclear. Any such attempt would, in the short term, exact huge economic costs to Russia in terms of forgone export revenues; in the medium to long term, it would guarantee that ongoing, if fitful, European efforts to diversify its gas supply would accelerate.

Moreover, some of Russia's most criticized actions in the energy arena are—at least in part—understandable in purely commercial terms. Ukraine's natural gas imports were in fact receiving huge subsidies prior to renegotiation. And Moscow's efforts to build a pipeline route directly linking Russia to Western European markets reflect a truth little acknowledged in the West: if Western Europe's dependence on Russian gas opens it to "Russian blackmail," Russia's dependence on Eastern European transit routes open it to "Ukrainian blackmail."

What about NATO expansion—a key tenet of those who see a New Cold War with Russia? The Russo-Georgian war illustrates the huge risks of over-hasty expansion of NATO. Moscow's actions may have been both illegal and disproportionate. But the proximate cause of the bloodshed was Georgian president Mikheil Saakashvili's impetuous attempt to seize South Ossetia. Some argue that NATO membership would prevent Russian military action against Georgia in the future. Perhaps. But it might well prompt even more reckless action by the

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Georgian government in an effort to secure NATO military support in its efforts to regain South Ossetia and Abkhazia. Article 5 of the North Atlantic Treaty—which declares that an attack on one member country will be considered an attack on all—is a solemn pledge of mutual defense. To extend that pledge to Georgia at the current time means that the United States should be prepared to dispatch U.S. combat troops if the Russo–Georgian dispute descended again into violence. Needless to say, this is not an appealing prospect, even if the U.S. military were not already heavily committed in Iraq and Afghanistan.

The United States simply cannot allow the “tail to wag the dog” in places like Georgia and Ukraine. While humanitarian support for Georgia is appropriate, prudence demands that the United States carefully assess the risks and benefits of supporting early NATO membership. Other NATO members, especially Germany, are very wary of being drawn into the Russo–Georgian conflict. The NATO ministerial meeting of early December 2008 called for further cooperation with Georgia and Ukraine but stopped short of endorsing fast-track membership for either. It is a sensible compromise. The Roman injunction *festina lente* (“make haste slowly”) should be the motto of Washington’s approach to expanding NATO.

The same holds true for plans to deploy missile defense in Eastern Europe. The Bush administration’s public rationale for providing missile defense to Eastern Europe—to protect Europe from a strike from Iran or North Korea—was disingenuous on its face. North Korea does not have a missile that can reach Europe. Iran does not have nuclear weapons; it is, moreover, unclear if and when Tehran will acquire them. While Iran has an established missile program, actually developing a deliverable nuclear warhead is an additional and daunting challenge. Even assuming that the purpose of the shield is to protect against Russian attack, deployment still makes no sense. If, for whatever far-fetched reason, Moscow *did* want to launch a nuclear strike on Eastern Europe, it possesses enough missiles to overwhelm any shield. Eastern European missile defense, in short, lacks any clear strategic purpose. It provides false security to the Eastern Europeans; it unnecessarily irritates the Russians.

The Obama administration has shrewdly offered to forgo deployment of the Eastern European missile shield in return for Moscow's support on Iran's nuclear program.<sup>23</sup> While President Medvedev rejected a strict quid pro quo, the idea certainly deserves reviving.

At a time of extraordinary challenges elsewhere—financial meltdowns, economic recession, wars in Iraq and Afghanistan—talk of containing Russia is not just misguided. It risks further overstretch of U.S. commitments at a time when they are already spread extremely thin.

### IV. The Economic Crisis: Losers and Losers

Beginning in mid-2008, energy prices began a sharp decline. How much they will ultimately decline and how long a buyers' market in oil and gas will last is anyone's guess. Much depends on the duration of the current global recession and, in the case of oil, the ability of OPEC to cut output in the face of plummeting prices. But the picture is bleak. There is little doubt that we are facing a sharp recession, not just in the United States, but in Western Europe and Japan. Many less developed countries are also being hurt hard, as export markets weaken and foreign investors flee in search of safer assets, notably U.S. Treasury instruments.

There is little sense in talking about winners and losers from the decline in energy prices. At a superficial level, such a decline clearly benefits importing countries. But, in large part, those lower energy prices in turn reflect weak demand because of recessions in major economies. Lower oil and gas prices may be a good thing for importing countries; but recession is a steep price indeed to pay for them. Rather than resorting to the rhetoric of "winners" and "losers," we should refer to "losers" and "losers."

To mix metaphors, Russia's ace in the hole—its oil and gas exports—is also its Achilles' heel. The size of Russia's energy sector—especially oil and gas—also makes it extremely dependent upon the vagaries of world energy prices. In 2007, the fuel sector—which also includes coal—contributed roughly a fifth of Russia's gross domestic product. The same year, the oil and gas

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<sup>23</sup> Ewen MacAskill, "Obama offers to drop missile project if Russian helps deal with Iran," *The Guardian*, March 3, 2009, <http://www.guardian.co.uk>.

sector generated nearly two-thirds of the country's export revenues and represented 30 percent of direct foreign investment. Revenues from oil and gas are a mainstay of Russia's federal budget, contributing over a third of total revenue.

Russian economic growth in 2009 is expected to be negative. The federal budget will go into deficit for the first time since the financial collapse of 1998. The ruble has weakened dramatically, dropping roughly 30 percent against both the euro and the dollar since mid-2008. The government has declared its intent to dip into its reserve funds to offset the budget deficit. The Russian Central Bank, for its part, is unloading dollars in an effort to keep the ruble's decline orderly, expending over \$30 billion in one week in January 2009 alone. Gazprom—once the third-largest firm in the world in terms of market capitalization—is now thirty-fifth and falling. The gas giant is in debt to the tune of perhaps \$50 billion and has, indeed, asked the Russian government for financial assistance.

On its face, this picture suggests a much-weakened Putin and much-diminished Russia. Certainly, the current financial crisis will test Putin's political leadership as it has not been tested since he assumed power. He has enjoyed immense public approval during Russia's fat years; it remains to be seen how well he maintains it during lean ones. A decline in the central government's largesse could lead to a shift of power from Moscow to the regions. In economic terms, there will be fewer rents to distribute to political allies.

Russia may see its international options constrained as well. At a minimum, the usefulness of energy as an instrument of foreign policy will be much diminished in an environment of declining prices. Eroding foreign currency reserves raises the downside risk of oil and gas cutoffs. The short interruption of gas shipments through the Ukraine in January 2009, for instance, reportedly cost Gazprom as much as \$1.5 billion dollars. At a minimum, Russia will be ill-placed to provide aid and credit packages like the one Moscow reportedly extended to Bishkek to encourage Kyrgyzstan to close a U.S. base in that Central Asian country.<sup>24</sup>

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<sup>24</sup> Sue Pleming, "U.S. sends senior diplomat to Russia for talks," *Reuters*, February 12, 2009.

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But the picture is far less clear than a first glance might suggest. There is some evidence that the Russian government is using the current financial crisis to extend its control over the country's banking and industrial sectors. In the face of rising discontent, Putin may use the economic emergency to further limit domestic opposition. The impact of Russia's economic distress on Moscow's foreign policy is also unclear. Putin has gained immense popularity, in part, by taking a strongly nationalist position against domestic separatists—the Chechens—and recalcitrant neighbors, like Georgia. It is not inconceivable that, facing a slide in domestic support, the Russian government will resort to even more assertive policies toward its smaller neighbors.

Nor should we forget that Russia's neighbors are also moving into difficult economic times. Like Russia, Azerbaijan and Kazakhstan are heavily dependent on energy exports. And, like Russia, they experience sharp drops in export earnings and government revenue. Moreover, much of the “Near Abroad” is heavily dependent on trade with Russia. A severe economic turndown in Russia will have a negative impact on growth. Not least, a number of countries in the region receive significant remittances from nationals working in Russia. This includes Georgia, despite a crackdown on Georgians working in Russia. Ukraine, for its part, seems poised to suffer a collapse in output. Moscow, in short, may be weakened, but so will its neighbors. There may be little change in relative power.<sup>25</sup>

Not least, the United States, too, may see its power declining. The vast costs associated with stimulating a sluggish U.S. economy and recapitalizing a near-insolvent banking system will certainly both a) diminish available resources for major new security and other international commitments, and b) reduce public support for any such commitments. While U.S. moral standing may increase with the closure of Guantanamo and the repudiation of torture as an instrument of U.S. foreign policy, the U.S. position as an economic role model has surely been battered by its role in the largest global financial collapse since the Great Depression.

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<sup>25</sup> The authors are grateful to Dr. Martha Brill Olcott of the Carnegie Endowment for International Peace for this useful insight.

### V. Obama: More of the Same?

Barack Obama famously won the presidency on a platform of “change.” Yet, at least when it comes to foreign policy, it is far from clear that his administration will diverge significantly from its predecessors. We should recall that, other than Iraq, the 2008 campaign revealed few deep substantive differences between Republican candidate John McCain and Barack Obama. Only two gained any particular political salience: Obama’s willingness to engage Iran without preconditions, and his support of anti-Al Qaeda military strikes in Pakistan without Islamabad’s permission. Candidate Obama’s response to the Russo–Georgian war of August 2008, for instance, may have lacked the histrionics of McCain, who declared that “We are all Georgians now.” But Obama’s statements condemning Russia’s action, calling for humanitarian assistance to Georgia, and supporting eventual NATO membership for Tbilisi closely paralleled those of the Bush administration. Unlike McCain, Obama stopped short of calling for Russia’s expulsion from the G-8. But so did the Bush administration.

Will the Obama administration mark a clear break with Bush administration foreign policy? In a few areas, perhaps. The new administration is unlikely to take as obstructionist a stance as its predecessor on efforts to address global climate change; it is moving to shut down Guantanamo; it is likely to press for a quicker withdrawal of U.S. forces from Iraq than planned under the Bush administration. There will clearly be a change in tone: The new administration’s rhetoric is decidedly less strident on a number of issues, including Russo–U.S. relations.

There is certainly nothing particularly pathbreaking about President Obama’s foreign policy appointments. Indeed, if personnel alone were the clearest indication of the new president’s approach to foreign policy, one should expect to see a resumption of the centrist foreign policy of the Clinton administration. Even on the matter of Iraq, Obama’s choice of Joe Biden as vice president and Hilary Clinton as secretary of state—both of whom supported the Senate resolution authorizing the invasion—has clearly signaled that early opposition to the war was not a litmus test. Though his administration is still in its infancy, all evidence suggests that Obama’s views are those of a fairly mainstream member of the foreign policy establishment. He calls for no massive retrenchment of U.S. engagement abroad; no repudiation of human rights as a foreign

policy goal; no return to economic protectionism; no grand new organization for global governance.

This relative conservatism will likely shape the administration's policies toward Russia. McFaul is a case in point. While certain critics on the left exaggerate when they call McFaul a "hardliner" toward Russia, he is nonetheless a fairly consistent proponent on what could be called the bipartisan orthodoxy on Russia. A harsh critic of Putin's regime, he has argued, "Putin is building a more autocratic regime," resulting in the "erosion of democracy." On the other hand, McFaul has suggested a change in U.S. policy to improve its strained bilateral relationship with Russia, not by a return to containment, isolation, or confrontation, but by continuing to "support the development of Russian civil society" by following the recommendations of the U.S. Russian Democracy Act of 2002 and by increasing "support to help consolidate democracy in Georgia and Ukraine."<sup>26</sup> He has also called for further expansion of NATO, support for the independence of countries in Russia's "Near Abroad," and continued pressure on Moscow for its human rights practices. Notes McFaul, "The United States does not have enough leverage over Russia to influence internal change through coercive means. Only a strategy of linkage is available...Cooperation on nuclear issues should be the cornerstone of a renewed bilateral relationship with Russia. At the same time, a Russia more integrated into Western economic institutions is more likely to become a stakeholder in the system."

At minimum, there is little in the statements of either Obama or his foreign policy advisers to suggest that his administration is prepared to accept—even tacitly—an informal Russian sphere of influence in return for Russian cooperation elsewhere. This stands in stark contrast to the views of traditional realists, such as Anatol Lieven<sup>27</sup> or Dmitri Simes.

Early statements by the Obama administration certainly suggest more of a change in tone than of substance. The most revealing expression of high-level administration views of U.S.–Russian

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<sup>26</sup> "Russia: Rebuilding the Iron Curtain," testimony of Professor Michael A. McFaul, House Committee on Foreign Relations, May 17, 2007.

<sup>27</sup> Anatol Lieven, a senior research fellow at the New American Foundation, is a harsh critic of U.S. policy toward Russia. See, for instance, his "The West Shares the Blame for Georgia," in the *Financial Times*, August 13, 2008.

relations is found in Vice President Joe Biden's February 7, 2009, remarks to an international security conference in Munich. Referring to Russia, the vice president said:

“The United States rejects the notion that NATO's gain is Russia's loss, or that Russia's strength is NATO's weakness. The last few years have seen a dangerous drift in relations between Russia and the members of our Alliance. It is time—to paraphrase President Obama—it's time to press the reset button and to revisit the many areas where we can and should be working together with Russia.

“Our Russian colleagues long ago warned about the rising threat of the Taliban and Al Qaeda in Afghanistan. Today, NATO and Russia can, and should, cooperate to defeat this common enemy. We can and should cooperate to secure loose nuclear weapons and materials to prevent their spread, to renew the verification procedures in the START Treaty [Strategic Arms Reduction Treaty], and then go beyond existing treaties to negotiate deeper cuts in both our arsenals. The United States and Russia have a special obligation to lead the international effort to reduce the number of nuclear weapons in the world.

“We will not agree with Russia on everything. For example, the United States will not—will not recognize Abkhazia and South Ossetia as independent states. We will not recognize any nation having a sphere of influence. It will remain our view that sovereign states have the right to make their own decisions and choose their own alliances. But the United States and Russia can disagree and still work together where our interests coincide. And they coincide in many places.”<sup>28</sup>

The tone is clearly conciliatory; the absence of any direct reference to the Russo-Georgian war, doubly so. The desire to set a “reset button” on Russo–U.S. relations—a headliner in many

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<sup>28</sup> “Remarks by Vice President Biden at 45th Munich Conference on Security Policy,” February 7, 2009. Available at <http://www.whitehouse.gov>.

stories emanating from Biden’s remarks—will be welcomed in Moscow.<sup>29</sup> So will the idea of further talks aimed at reducing the two countries’ nuclear arsenals.

But Biden’s direct rejection of a Russian “sphere of influence”—indeed, apparently of any “sphere of influence”—may be a harbinger of continued difficulties ahead.<sup>30</sup> Final decisions on accelerated NATO membership for Georgia and Ukraine, as well as the deployment of an anti-missile defense system in Poland and the Czech Republic still lie in the future. Western European opposition to the former has given the Obama administration breathing space. A carefully hedged statement on the latter—Biden says deployment is contingent on technological feasibility and cost effectiveness—gives the United States additional wriggle room.

As far as the Kremlin has demonstrated, President Medvedev is inclined to “build mature bilateral relations” with the United States, based on the Strategic Framework Declaration signed by the two countries in 2008. In a *Washington Post* article in March 2009, Medvedev prioritized collective action to resume disarmaments for both parties and to address the increasing turmoil in Afghanistan. He stated “overcoming our common negative legacy is possible only by ensuring equality and mutual benefit and by taking into account our mutual interests.”<sup>31</sup> However, his commitment to such efforts is called into question as just weeks before Medvedev announced a comprehensive rearmament plan. His reason? To “increase the combat readiness of [Russia’s] forces, first of all our strategic nuclear forces” as Medvedev feels Russia is under threat by expanding NATO forces, U.S. missile plans, and its own outdated military equipment. The plan<sup>32</sup> focuses on modernizing the Russian army and navy and spending \$140 billion on arms purchases by 2011.<sup>33</sup>

There is clearly broad scope for arms controls agreements between the two countries. And, indeed, Presidents Obama and Medvedev have agreed, in principle, to negotiations aimed at

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<sup>29</sup> Craig Whitlock, “‘Reset’ sought on relations with Russia, Biden says,” *The Washington Post*, February 8, 2009.

<sup>30</sup> In Barnes’ opinion, it will be seen in Moscow as sheer hypocrisy; and, Moscow might have a point. There *is* something a bit odd in the statement coming from the vice president of a country which, beginning with the Monroe Doctrine, has staked out its own—expanding—sphere of influence.

<sup>31</sup> Medvedev, “Building Russian-U.S. Bonds.”

<sup>32</sup> Tim Whewell, “Russia announces rearmament plan,” *BBC News*, March 17, 2009, <http://news.bbc.co.uk>.

<sup>33</sup> In the author’s opinion, the odds of Russia moving forward with this plan, given its financial distress, are frankly slim.

steep cuts in the two countries' strategic arsenals.<sup>34</sup> President Obama has gone even farther, invoking the vision of a world free of nuclear weapons.<sup>35</sup>

### VI. Conclusions

When asked what represented the greatest challenge confronting a statesman, British Prime Minister Harold MacMillan memorably replied: "Events, my dear boy, events."

This is nowhere more true than in ongoing U.S. relations with Russia. There is no idea at this point of the ultimate effect of plummeting energy prices and a global recession on Russia's domestic political economy. Nor is the effect yet known, if any, this might have on Russia's foreign policy. This should not be surprising. With the onset of a global economic crisis of unknown scale and duration, Moscow, like Washington, is moving into uncharted territory.

To date, the Obama's administration's differences with the Bush administration on policy toward Russia are more of tone and nuance than of radical change. Tone and nuance do, however, matter. A lowering of the rhetorical temperature by Washington—particularly if it were to be matched by Moscow—can go far in keeping relations on an even keel. U.S. policy toward Russia under the Bush administration seemed to suffer from a kind of bipolar disorder; early over-optimism led to late disenchantment. To the extent that the Obama administration enters without either, it will be better able to identify areas of cooperation based on mutual interests—arms control, combating international terrorism, and containing Islamic fundamentalism in Afghanistan are just three cases in point—while limiting the fallout from differences.

But those differences remain. Moscow will continue to assert, however implicitly, a special claim of influence in the countries surrounding it. In the UN and elsewhere, it will join countries like China in opposing what it considers international endorsement of UN unilateral action. Whatever Washington chooses to call it, the United States will likely continue—though at a pace uncertain at this time—to maintain and, indeed, expand its sphere of influence in Eastern Europe,

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<sup>34</sup> Christi Parsons and Megan Stack, "U.S., Russia agree to seek warhead cuts," *The Los Angeles Times*, April 2, 2009.

<sup>35</sup> Matt Spetalnick and Michael Winfrey, "Obama sets out plan for nuclear-free world," *Reuters*, April 5, 2009.

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the Caucasus, and, to a lesser extent, Central Asia. These clashing interests will not be going away. The job of the Obama administration will be to manage them.