

Part 4.

FOREIGN POLICY

Relations with the USA and the EU – political cooling against the background of an investment boom

In 2007, Russia's relationship with the West was determined by the situation in international relations as well as by domestic political processes inside Russia. The rising energy demand in the West and Russia's ability to meet this need can be attributed to the former. **Besides the battle over resources, the following key foreign policy issues maintained their importance:** the pendency of the Iran nuclear issue, the lack of progress on the Kosovo issue, and also the crisis of government in Pakistan (who is a nuclear power).

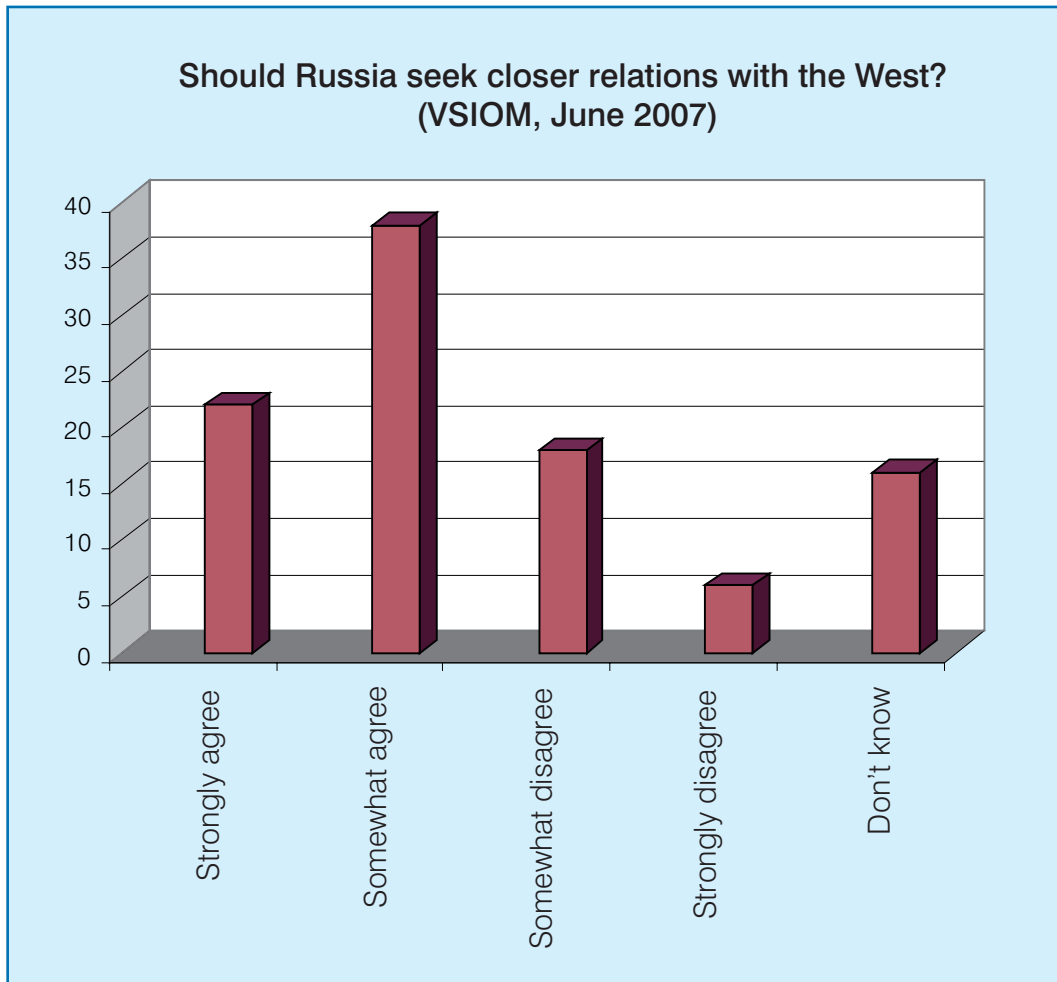
2007 passed under the banner of the consistent realization of the Russian leadership's strategy (which was pronounced in 2006) of being an "energy superpower". It became especially topical in regard to the reformatting of government in March of 2008 in the Russian Federation and the prospective redistribution of key government assets.

At that, Russia held a flexible position in their relationship with the EU and especially the US: on the one hand they periodically (often in a harsh form) reminded the American and European elites of the "sovereignty" of Russia's democracy but on the other tried to prevent a serious cooling of relations.

2007 was marked by the signing of a series of important contracts between Russian companies and their European partners. Moreover, the past year could be called the year of the mutual investment boom. With the departure of Jacques Chirac in 2007, the "Euro-triangle" Moscow-Berlin-Paris came apart once and for all.

The new elites of the largest European powers – Germany, France, Great Britain, and Italy – placed their bet on "Atlantic principles" in foreign policy. This manifested itself mainly with solidarity with Washington on key foreign policy issues (the Iran nuclear problem, Kosovo, lowering Russia's energy footprint in Europe). However, thanks to support "from across the ocean", the leaders of these countries are planning to mainly solve their own problems.

In particular, Angela Merkel, who became Chancellor in 2005, is planning to consolidate the European community – at that, Berlin is being summoned to be the



leader of this process. With analogous theses, the Gaullist Nicolas Sarkozy came to power in France. His pro-American stance was in sharp contrast to the moderate views of his successor.

Italy is one of the few countries of the EU, where after a change in leadership and the exit from the political scene of Putin's "personal friend" Silvio Berlusconi, as before there was an effort to keep stable relations with the Russian Federation.

Even under Prodi, Rome demonstrated Moscow its loyalty, for example, during the Russian-Belarus energy crisis. The point is that Italy and Russia are working together on the same energy project which lowers the dependence of the domestic market on the political situation in the transit countries. According to the agreement signed between Gazprom and the Italian oil and gas company ENI in November of 2006, the Russian monopoly got the chance to export the "blue fuel"

to the third largest (After Germany and Great Britain) export market in Europe and ENI was promised the chance to buy fuel assets in Russia. The volume of deliveries will increase incrementally to 3 billion cubic meters until 2010.

In 2007, the Italians asked whether their large energy companies could (ENI and the electric energy company ENEL) buy up a part of Gazprom. According to the Minister of Industry and Energy, Victor Khristenko, today, 49% of the shares of the government company belong to foreign businesses. Within this 49%, there may be a redistribution of shares in favor of one party or another. It is characteristic that when president Nikolas Sarkozy made the same request, the Russian leadership's response was rather skeptical. This shows Moscow's readiness to make some concessions to Rome in exchange for access to the end-consumer in Italy's capacious and profitable energy market.

Moreover, in January of 2008, ENI, with the approval of the Russian authorities, bought some assets in Russia – Arcticgaz and Urengoil. There are active contracts on the delivery of Russian gas to Italy till 2035.

The domestic political situation in Italy is also playing out to Russia's advantage. At the end of January in 2008, the prime minister Romano Prodi, who wasn't able to overcome the opposition within his own party, resigned from his post. Now, Putin's long-time ally Silvio Berlusconi is looking to return to this job. However, even Prodi (as he was in the latter part of his term) was entirely acceptable for the development of this partnership.

The signing of the Supplement to the Memorandum of mutual understanding by the main participants of the South Stream project – Gazprom and ENI, which provides for the creation of a joint venture company for conducting a feasibility study, shows Gazprom's serious intentions to realize its strategy. It is planned, that just like in the Northern gas pipeline, Gazprom will get a controlling block of shares (51%) in the operating company while the other international participants will share the rest with ENI.

Against the backdrop of an analogous Russian energy success during negotiations with the prime minister of the Netherlands, Yan Peter Balkenend, progress on South Stream looks like another win for Moscow in the realization of its energy strategy in Europe. More over, ENI offered Gazprom to take part in a number of projects in North Africa. This makes Italy the only assured Russian ally in the EU.

A peculiar triumph of South Stream was the addition of Serbia to the project in February of 2008. This deal has more of a political than an economic character to it. It shows president Boris Tadic's (the "pro-Western" leader who

was reelected on February 3) sufficient loyalty to Russia. Moreover, according to our assessment, the success of another large Russian-Serbian deal – the sale of a controlling block of shares in the oil and gas group NIS to Gazprom – was directly connected to the prospectives of the territorial integrity of Serbia: It can't be ruled out that the signing of this agreement happened in exchange for the softening of Russia's position on Kosovo. Previously, Tadich was skeptical about such an expansion by Russia into Serbia's energy market. That's why there are grounds to believe that the "Kosovo question" was behind this deal.

The serious advancement of Russian-European cooperation is a positive sign for Western Businesses. Last year, for example, the Yuzhno-Russkii oil field (which is supposed to become the resource base for Nord Stream) began operating. The format of the launch of the oil field demonstrated Moscow's new principles in its relations with its foreign partners. Gazprom realized the first large energy deal in Europe, where a German company will get access to a Russian gas field in exchange for Gazprom acquiring European energy assets.

This means that **from now on Russia is ready to give large Western energy companies access to its oil and gas fields on a parity basis** – in exchange for Russian companies getting access to European assets including hydrocarbon transportation, storage and distribution assets. There was also a political context to these deals: Putin's successor demonstrated his will to expand cooperation on a mutual basis. The fact that government officials of such a high rank (Russia was represented by the first deputy premier Dmitri Medvedev, while Germany was represented by their Foreign Minister Frank-Walter Shtainmaier) took part in the ceremonial pushing of the button shows the importance of this project.

Most of the media, especially in the West, is paying most of its attention to the political aspect of this deal. It was symbolic that practically at the same time that the gas field was launched an agreement was signed between Russia, Turkmenistan, and Kazakhstan about the construction of the Caspian Sea gas pipeline and the creation of a joint venture company with Greece and Bulgaria so it can carry out a feasibility study on the construction of the oil pipeline Burgas-Aleksandropolis. Thus Moscow is counting on pressuring critics in the European Union with the aim of demonstrating that they don't have an energy alternative.

On the eve of the launch ceremony, Berlin corrected its public position concerning the political process in Russia. If after the parliamentary elections in December a representative of the administration of the chancellor, Tomas Shteg criticized the election process and called Russia an "undemocratic" country, then on the eve of the visit to Gazprom's office, Shtainmaier publicly distanced himself

from the criticism of the Russian leadership and the election procedures in the Russian Federation.

In this way, the Germans again demonstrated their willingness to close their eyes on politics when it came to their economic interests. Other companies of the large European powers are doing the exact same thing. French Total was allowed to take part in the Shtokman gas field. In return Gazprom was given access to the distribution power-grid of these countries, and French and Italian officials were more and more careful in their statements concerning political processes in Russia and became less inclined to support the rhetoric about the “threat of Europe becoming dependent on Gazprom”.

In particular, pretty friendly relations have developed with between Moscow and Paris after the “conservative” Nikolas Sarkozy won the elections in France. Coming to power on anti-Russian rhetoric, he nevertheless clearly divides politics and economics which manifests itself in the active penetration of French businesses into the Russian energy sector and the rejection of anti-Russian initiatives (In February of 2008 it became known that Gaz de France would no longer be participating in the gas pipeline Nabucco – an alternative to South Stream).

The French group AXA (The largest insurer in the domestic market) and the main shareholders of the Russian Group RECO signed an agreement on the creation of two joint venture life insurance companies. **According to the conditions of the deal, AXA will receive a minimum of 50% of the shares of the joint venture life insurance company and 36.8% shares of the joint venture company that deals with the other types of insurance**, in which the EBDR will maintain 6,2%. The other shares in the mentioned joint venture companies will be proportionally divided up among the shareholders of OCAO RECO-Garantiya. The investments of the French side in the joint-venture company that deals with other types of insurance (other than life) will total 810 million euros. As far as the life insurance company is concerned, the French investment will be determined after the sides come up with a 3-5 year strategic development plan for the company. An integral part of the plan is for the French side to open a 5 year, \$1 billion credit line for Group RECO.

Russian insurance companies continued to be bought up by foreigners all year and now, practically all of the major insurance companies are active in Russia. However, this deal can be classified as one of the largest in the history of the insurance market. A comparable (by investment) deal was the one between Allianz and ROSNO. Foreigners are continuing to penetrate the Russian market, which is

in large part due to the stability of the investment climate and certain political expectations that Europeans have about the up coming transition of power in the Russian Federation.

Throughout the year Moscow intensified its contacts with the “small” countries of Europe. It is thus counting on strengthening its energy (and hence political) positions in Europe. In October of 2007, the prime minister of the Netherlands, Yan Peter Balkenend made a visit to Moscow. **The Netherlands were Russia’s second largest trading partner in Europe after Germany and the largest direct investor in Russia’s economy.** And this is in spite of the fact that Amsterdam is oriented towards Washington in its foreign policy and that Balkenend is the leader of the Christian-Democratic Appeal (CDA) party – the largest party in parliament. **However, in its relations with Russia, the government of Holland, contrary to the political mood in the EU, places it bet on common economic interests.** The main point of cooperation with Amsterdam is the all-relevant sector of energy. It is in this direction that Moscow is counting on realizing its long-standing conception of penetrating the European end-consumer market. The result of Balkenend’s visit to Moscow was that Gazprom and the Dutch company Gasunie signed an agreement according to which the latter will receive 9% of the authorized capital of Nord Stream. This means that Gazprom automatically gets an outlet to Great Britain’s market. This is because it gets the option to buy out 9% of BBL Company. This gas company owns the gas pipeline that connects the Netherlands and Great Britain.

And in April, Vladimir Putin held a meeting with the representative of another “small” EU country – the Austrian chancellor Alfred Guzenbaur. **Austria, from the point of view of energy influence, is of great interest to Russia.** This country is one of the largest distribution centers in Europe. The Austrian leadership has on multiple occasions stated that it is interested in increasing its imports of gas from Russia. In particular, in 2006 its representative in the European Council Martin Bukovich stated that his country is ready to increase its imports of gas from different sources, and first of all, from Russia. This statement was made after the Russian –Ukrainian gas crisis. However, in contrast to Germany, Austria’s reaction to the conflict was relatively mild.

Nevertheless, the political relations between Russia and the west, notwithstanding significant economic accomplishments, are, as before, not easy. **Not of small importance, from the point of view of the relationship between Russia and the West, became the “successor” theme.** The conclusion came about in December of 2007 when Vladimir Putin supported the candidacy of the

first deputy premier for the post of president of the Russian Federation. The calm and sometimes positive reaction of the US and the EU to the presentation of the “successor” should be noted. This can be explained by Medvedev’s liberal image, and also by the fact that the question of whether Putin will stay for a third term had disappeared. If Putin had stayed on for a third term, this would have been perceived in the West as an open violation of Russia’s constitution. The nomination of Medvedev, a “lawyer” and “moderate liberal”, is directly addressed at the European Union and first of all, to Russia’s strategic partners in the EU; those countries such as Germany, Italy, and France.

In the political dimension of international relations, the Russian Leadership is seeking to “diversify” its risks. So, the Russian Federation carried out its threat to put a moratorium in place on its participation in the CFE (Conventional armed forces in Europe) treaty, all the while continuing to insist upon the need to find a compromise that would convince Russia to cancel the moratorium in the medium term (On December 12, 2007, president Vladimir Putin’s order to suspend Russia’s participation if the CFE treaty took effect).

Over the long term, the negotiations with NATO will continue and will resemble a political bargaining session. Russia’s moratorium on the treaty is a certain foreign policy defeat for Washington, because this situation has demonstrated the George Bush Administration’s “limited” influence over the leadership of the Russian Federation.

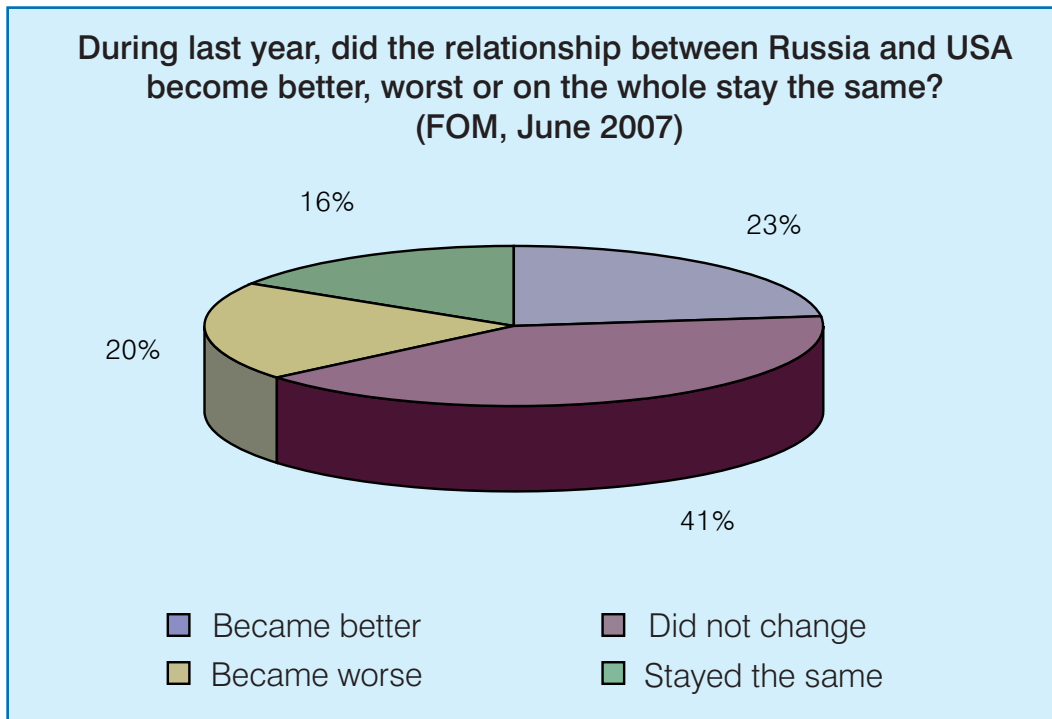
In December of 2007, Russian-British relations were again further strained because of Russia’s intention to close all the regional offices of the British Council with the exception of its Moscow and St. Petersburg Offices. In defiance of London’s (and of the prime minister Gordon Brown) calls to disavow this decision the Russian Ministry of Foreign Affairs has stated that this step is its principle position.

If, in relations with Great Britain Russia is using the “stick”, then with another critic of Russia – Poland, relations have stabilized: In this case, the determining factor is the relatively constructive position that the new Polish premier Donald Tusk has taken regarding bi-lateral relations. After the “moderate” Tusk came to power after the parliamentary elections of October 21, 2007, Russia lifted the restrictions on the delivery of Polish meat. As soon as this was announced by the Ministry of Agriculture of the Russian Federation, Tusk, in ones turn, said he was ready to lift the Polish veto on the signing of the base agreement between the EU and the Russian Federation. With the “liberal” Tusk coming to power in Poland, the anti-Russian forces that are headed by the neo-conservative president Lech Kachinski, became fractured.

However, Moscow's relations with Washington over the past year have been characterized by conflict. If Russia's cooperation with the countries of the EU was determined by the energy potential of the former, then with its relations with Washington the military factor topped everything else. These relations are often viewed within the context of international military security. NATO would like to position itself as the guarantor of this security. First of all, at the current point, there is no political-military organization that is an alternative to NATO that has a comparable level of influence. This, in many respects, hurts the interests of the Russian Federation who is trying to lay claim to the status of "great power". Lately the Russian leadership has been trying to find allies among the former-Soviet republics and also farther abroad. If on the territory of the former USSR, Moscow is counting on becoming the leader of the Organization of the Agreement of Collective Security (OACS), then in Asia, Russia is trying to draw in India and China and lately, Pakistan.

The second aspect is a direct consequence of the first. The point is that **Russia is still suffering setbacks in the negotiation process about missile defenses in Europe**. Not a single one of its counter initiatives (the threat to aim ballistic missiles at the EU, the proposal to use jointly with the USA the Gabalinsk radar in Azerbaijan – Putin made this offer during the June G-8 summit, the establishment of the moratorium on the CFE treaty) had any effect on the Pentagon's plans. It is indicative that practically all of the NATO countries supported Washington, in spite of the fact that earlier they couldn't come to any definitive agreement. However, the democrat's (in the USA), who are vying for the top posts in the country after the presidential elections in 2008, are categorically against fielding anti missile defenses. That is why the missile defense project can be seen as an image campaign by the Republican administration of George Bush whose aim is to flex its muscles and demonstrate that it is more powerful than Moscow.

The US, just like the Russian Federation is in the midst of a presidential campaign. However, unlike in Russia, where the foreign policy to a large extent is oriented towards the future successor, **in the US, president Bush's intensity on the foreign front is intended to save his reputation**, and also to give at least a small boost to the Republicans in the upcoming elections. The following factors have contributed to the USA's worsening image around the world: the war in Iraq and the instability in the Middle East as a whole, the barbaric execution of Saddam Hussein, the Lebanon-Israel war, which was to a large part inspired by Washington, the continuing Iran nuclear problem, and the geo-political loss of Latin America (traditionally considered Washington's patrimonial estate).



At that, **both sides are trying to keep the current state of relations and not return to an arms race**, which characterized Soviet-American relations between 1950 and 1980. As far as the missile defense system in Europe is concerned, it is a long process, both from the military and legal point of view – which proves once again that the threat of another arms race is being used as psychological pressure against Russia. The United States tried (and most likely will continue to try after the presidential elections) to accuse Russia of human rights violations by publishing sociological studies and data in this field, and also periodically demonstratively putting into question Dmitri Medvedev’s (the most likely winner of the presidential campaign) legitimacy.

In fact, **with the nomination of Medvedev, a very popular business technique began to be used against Russia**. It involves continuously putting pressure on your negotiating partner until he gives up all of his positions. An extra bonus is the concessions that the other side has already made. In the case with Russia, such a concession can be considered the nomination of the moderate liberal Dmitri Medvedev and not a representative of the *siloviki*. Now more concessions are expected from Russia – that is why strong political pressure is being applied is being applied from abroad on the eve of the elections.

Thus the decision to boycott the elections was announced by the leading monitoring groups one after another. Besides the ODIHR, the parliamentary assembly of the OSCE, which represents the parliaments of 65 countries and then the Northern Council, which represents monitors from Denmark, Norway, Sweden, Finland and Iceland all decided to boycott the Russian elections.

The problem is that Russia and its Western partners have different definitions of democracy. According to the Russian leadership, the Russian Federation is already a democracy and when extra demands are made in relation to the monitoring of its elections, Russia sees this as an infringement on its sovereignty. The Europeans on the other hand don't consider that "democracy has completely won" in Russia, which in turn means that its elections must be closely monitored.

The tone of the European press on the whole didn't differ from the rhetoric of the international election monitors. Most publications were inclined to accuse the current and future Russian leadership of rejecting democratic practices. In this way, they tried to put into question the legitimacy of Russia's leadership. **However in this case politics and economics don't mix.** European politicians will take into account the fact that the monitors from the OSCE and the Northern Council refused to go to Russia, however in the end they will accept the legitimacy of the new Russian president. The EU, just like the US, is counting on Medvedev's victory, the nomination of whom was positively perceived by practically all the Western institutions.

The relationship with China: a new friend or dangerous adversary?

The PRC is laying claim to being an alternative center of world influence. The consistent expansion of Chinese capital gives one reason to believe that in the medium term, China will become a serious political and economic alternative to the U. S and Russia. Another reason is that it is a model of a so called "non-Western" democracy which is actively building up its presence in the third world. **China is Russia's partner in the informal BRIC association.** The other members of this club are Brazil and India. Within this framework Russia's key partners are China and India while Brazil is considered as a possible ally in Latin America. Beijing and New Delhi together with Moscow are often seen within the framework of a "strategic triangle", where (like with its Western partners) the key

area of cooperation is the energy sector. At the same time, Russia and China are beginning to compete in certain areas.

In particular, **this competition can be seen within the framework of the Shanghai organization**, to which resource rich Central Asian countries such as Kazakhstan, Uzbekistan, and Tajikistan also belong. In February of 2007, **the leader of the PRC, Hu Jintao took a tour around Africa. Russia is also looking to spread its influence in Africa.** Recently China has practically become the main investor in the African economy. China's advantage consists of the fact that it provides cheap labor and gladly works with authoritarian regimes – in particular Sudan where the Darfur conflict remains unresolved.

China's growing economy demands more and more raw materials. Because there aren't enough in China itself, their government has begun to expand its sphere of influence, and as we stated earlier, they don't have any qualms about working with "non-democratic" regimes in places such as Sudan and Liberia. What is more, China's growing influence is beginning to be felt around the world, and the fact that they are predominating in the resource rich (oil, gas, gold, forests, diamonds) African market just gives China added political points in the informal leadership struggle against the USA and Russia.

Lately, China has become a lot more active in Central Asia, using the uncertain political orientation of the republics of the region to spread its influence. In the beginning, the PRC was in a less advantageous position than its competitors. In contrast to Russia, China was never in the same government with the new countries of Central Asia, and as a consequence didn't have those cultural and economic ties. In contrast to the USA, it couldn't mount a wide-ranging economic and military expansion in the region, to a large extent because of the suspicious attitude of the Central-Asian republics to its Eastern neighbor.

That is why, from the beginning, Beijing picked a cautious approach for penetrating the region, putting its emphasis on economic cooperation and drawing the Central Asian countries in with economic aid – for example, in the form preferential loans.

As far as **Russian-Chinese relations are concerned**, the PRC is interested in Russian energy resources because its high industrial growth rate needs to be fed with energy. Moreover, China is providing its northern neighbor with cheap industrial goods, which increases Moscow's role as a large importer in the local economy.

However, it is too early to talk about any break-throughs in the Russian-Chinese friendship. First of all, China's pretensions on having a larger say in the

process of making global foreign policy decisions is having its effect. This manifests itself in the special role China is playing in the discussion of the North Korean problem and in determining the status of Kosovo. The rivalry between China and Russia is being felt more and more in third world markets.

There is also a serious slow down in Russian-Chinese cooperation in the energy sector, which indirectly bears witness to the victory (inside Russia) of the liberal project over the “*siloviki*” project. The choice of which direction for energy expansion should be made the priority became a point of conflict between the *nomenclatura*-political groups in the Russian halls of power. However the construction of the pipeline eastern Siberia – Pacific Ocean practically froze over the past year. In Western Europe, Gazprom is placing promising routes through Italy, Germany, Bulgaria, and Serbia because there, there are players who are willing to buy Russian Resources at market prices. In North-East Asia there are only two such countries – South Korea and Japan. But the “land of the rising sun” is already invested into the Sakhalin oil and gas projects and thus doesn’t really have a need to invest in ESPO.

As far as South Korea is concerned, there is first of all, a geographic problem: It will be difficult to place an oil pipeline through North Korea and unprofitable to do it through China and then across the bottom of the sea. At that, it is important to note that the PRC isn’t planning on paying market prices for oil or for gas. Since the threat of selling “black gold” with a significant discount remains, it is absolutely necessary to develop relations with South Korea and Japan so that China doesn’t end up being in the role of monopoly buyer.

The same situation can be observed in the gas sector. Beijing is actively trying to get a lower price. Gazprom and the Chinese National Oil and Gas Corporation (CNPC) are continuing negotiations on the price for Russian gas. The overall length of the pipeline from western Siberia to China is supposed to be 2.7 thousand km. The feasibility study for the Altai project was concluded in May of 2005. In light of China signing an agreement to purchase Turkmenistani gas, in July of 2007, for \$90 for one thousand cubic meters, China is insisting upon the same price in its negotiations with Gazprom. But Russia uses the price its European partners pay for gas as an example (\$230-250 for one thousand cubic meters) and instead offers China to pay a minimum of \$125 for one thousand cubic meters.

2007 exposed problems in Chinese-American relations on the background of a consumer boom in the economically developed countries (especially in the US), which was caused by increasing exports of Chinese light industrial goods. Indeed,

it is important to note that China isn't ready for a confrontation with Washington, because its current leadership is satisfied with the US stance towards China. Even the tension over the low quality Chinese toys didn't have any long-term consequences. This is because China is ready to continue to finance America's foreign and domestic debt. Beijing has gigantic foreign currency reserves totaling \$1.33 trillion. These savings are held mainly in American currency (not less than 75%) and American bonds. According to the forecasts of economic analysts, if China were to put all these assets on the market at once, there would be a crash in the dollar and as a consequence world markets would tumble – the harbinger of which was the January international financial crisis.

Relations with the former Soviet republics: the focus is on the energy potential of Central Asia

Russia has chosen a policy of persistently advancing its economic interests. More and more often its policy in foreign countries is being labeled as energy expansion. This strategy of expanding Russia's energy interests is occurring not only in Europe but also in the republics of the "near abroad". **This policy is built entirely around furthering the preferences of Gazprom, who represents the interests of the government.**

Russia's positions in the former Soviet territories are determined by the energy potential of the former socialist republics. Being, on the one hand, energy producers, and on the other, transit countries, many of them are laying claim to becoming large geopolitical players in their regions. The republics of Central Asia (Especially Turkmenistan and Kazakhstan) are demonstrating this most of all. Because they have significant energy reserves and stable political regimes, they are trying to strengthen their positions not only in respect to Russia but also to other geo-political players. Their policy of bilateral relations and their increasing desire to diversify their delivery routes allows these countries to conduct a relatively independent energy policy.

Vladimir Putin, placing his bet on retaining Russia's influence in the former Soviet republics, came out as a supporter of integration processes. Russia actively took part in "unifying" events such as CIS summits, the meeting of the heads of state from the CIS, meetings within the framework of the OACS military block.

It is still too early to say that Russia has lost some of its positions in the CIS, but a tendency of these positions weakening can be observed. This shows itself in

Russia's inability to influence the political situation in the republics other than by economic means. However, if the CIS country has its own resource base then this kind of pressure practically can't be applied. That is why the Russian leadership has chosen a soft-pragmatic approach in relation to those countries of the CIS who also export energy. This concerns the countries of Central Asia (Turkmenistan and Kazakhstan) where Russia doesn't have the same political influence that it previously had. Nevertheless, these countries see Russia as an advantageous economic partner because Asian gas deliveries to Europe are made through Russian territory.

The political situation in Central Asia has created favorable conditions not just for Russia but also for the other large global players (USA and China) who are trying to open up its energy potential. In this sense, Turkmenistan is the most attractive. There are several factors that are influencing its energy policy.

First of all, this republic has the largest gas reserves in the region, even in comparison to the gas-bearing regions of Kazakhstan and Uzbekistan. Secondly, the somewhat uncertain vector of Ashkhabad's foreign policy after the death of Saparmurat Niyazov in December of 2006 created the conditions that allowed the great powers to try to turn Turkmenistan into its "protectorate" and as a result gain control over its natural resources. Formally, the new president Gurbangul Berdimukhamedov proclaimed that he was going to follow the multi-vector course of his predecessor. Overall, this is a positive fact for Russia.

At the same time, **Berdimukhamedov's team isn't against having closer relations with other global contenders for its gas.** China has the best chances of this since the intense development of this relationship would give Ashkhabad the opportunity expand its export base and significantly lower its dependence on Russia as its main buyer. Moreover, Turkmenistan could greatly increase its export possibilities by exporting to the European Union, which announced its intention to diversify its energy suppliers and to lower its energy dependence on Russia.

Central Asia is also traditionally the arena where Russian and American Interest clash. Owing to this fact, Russian businesses in the region are facing serious geopolitical challenges. In particular, the foreign policy uncertainty and the periodic demonstration of Turkmenistan's loyalty to Moscow have forced American officials to agitate for projects that would to one degree to another hurt Moscow's business interests (Transcaspian gas pipeline).

Russia needs Turkmenistan's gas to insure itself against the risk of falling short on its energy contracts with Europe. Then Russia would be able to fulfill its contracts and "save face" with Europe recommending itself as the "guarantor of

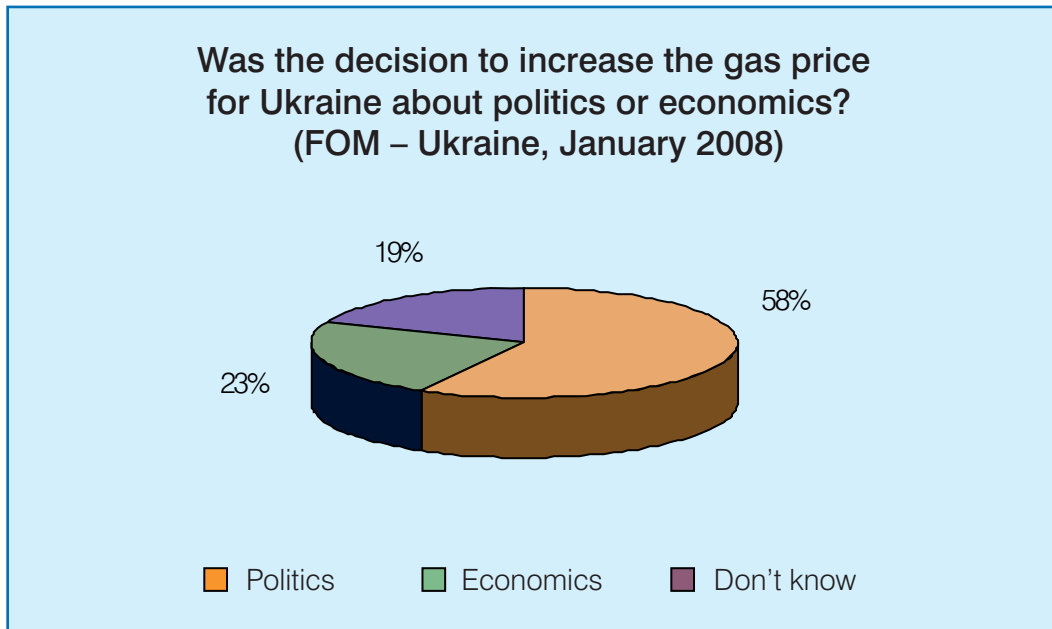
energy stability”. At this moment Russia has every chance to remain the monopoly supplier of Turkmeni gas to the European market because the vast majority of the exported gas is going to West, while the Chinese direction can’t compete with the Russian one because of its low volume.

In order to keep its access to Turkmeni gas, Moscow had to agree to Berdimukhamedov’s proposal to increase prices step by step starting in 2008 (the negotiations for this happened on November 27, 2007). This happened notwithstanding the fact that when he entered his post in February of 2007, the president of Turkmenistan confirmed the long-term contract that was signed under his successor with the Russian Federation. From Ashkhabad’s point of view, this contract only fixed the fact that there was an obligation to supply gas to Russia and that all other conditions of the delivery are supposed to be agreed to afterwards. Berdimukhamedov used this “loophole”, and already stated his intention to increase the price of gas exports.

The agreement with Berdimukhamedov’s conditions shows that the negotiating positions of Gazprom’s top management have weakened. The fact that the previous agreement that was signed with Niyazov was abandoned bears witness to this. In 2003, Russia and Turkmenistan signed a strategic agreement on gas cooperation for 25 years, which, as it seemed, was supposed to guarantee a reliable supply of gas for a long time. However, practice showed that the legal implementation of the agreement for Turkmenbashi wasn’t an obstacle for its revision, which happened a number of times in connection with the price of gas when there weren’t any levers of pressure to be applied to Niyazov’s self-sufficient regime and Russia had to agree to his terms.

Ashkhabad’s positions are aided by the competition for Turkmenistan’s gas between Russia and Ukraine. Ukraine tried to diversify its gas supply by turning to Turkmenistan, in order to decrease its dependence on Russian gas. However Kiev hasn’t yet been able to realize the projects that would find an alternative route that would bypass Russia. To a large extent this was the consequence of a deep political crisis that the country came to as the result of inter elite conflicts.

The reformatting of the political system brought a new ruling coalition to power with the “orange princess” Yulia Tymoshenko at its head. Her key foreign policy position was the revision of the energy agreements with Moscow. Included are contracts that were signed on December 4 between the CEO of Gazprom, Aleksey Miller and the former Minister of Fuel and Energy Yuri Boiko about increasing the price of gas for Ukraine.



At that, in 2007 Moscow was able to keep one ally in each region of the CIS. On its western borders, partner-like relations continued to develop with Belarus notwithstanding the January energy crisis. The development of Russia-Belarus relations grew especially quickly in the second half of 2007 with the approach of the parliamentary elections in the Russian Federation. It was necessary for Moscow to get Minsk's backing in order to demonstrate to its Western partners that it can field an "asymmetrical response" to the American anti-missile defense system in Eastern Europe and to "electoral" pressure.

In the middle of February in 2008, the president of Belarus, Alexander Lukashenka took a trip to Sochi to meet not only with Putin but his successor in an informal environment. When Russia's relations with a number of Western countries began to worsen, Moscow significantly increased its militaristic rhetoric which was based on the concept of an "asymmetrical response" against the possible deployment US anti missile defense systems in Easter Europe. **Under these conditions, Minsk is seen as a potential military partner in an "anti-American campaign"**. It wasn't an accident that the end of 2007 saw frequent stories in the media about the possible deployment of Russian nuclear weapons on Belarusian territory. According to gathered information, the \$1.5 billion loan that Belarus received was really an advance for the upcoming partnership in this area.

There wasn't any official information about the meetings, however there are grounds to believe that the real motive behind Lukashenka's visit was to discuss the "gas question"; more specifically to extend the time period that the price of Russian gas will be \$119 from the first half of 2008 till the rest of the year. The fact that the prime minister of the Russian Federation, Victor Zubkov attended that meeting points to the fact that after the vote in the Gazprom board of directors in June of 2008 (for the chairman of the board), it will be he who will represent the government's interests in the gas monopoly. Now Russia is waiting for reciprocal "integration-type" steps from Minsk which would also disavow the harsh rhetoric that the Belarusian leader made in December of 2007. Then, on the eve of the parliamentary elections in the Russian Federation, Lukashenka, in a harsh form, made a statement regarding the "predetermined" result of the Russian parliamentary campaign, although in the end he was forced to acknowledge the result as fair.

In this way, Minsk, notwithstanding the cooling of relations with Moscow in the previous year, is continuing to 'play both sides of the coin'. On the one hand, they demonstrate complete loyalty to their eastern neighbor, while on the other they are expanding their room for maneuver in case Russia increases its energy pressure.

Russia's stable partner in the Trans-Caucuses is, as before, Armenia. In many respects, Armenia's sticking to the pro-Russian course is determined by the presidential elections in the country. President Robert Kocharyan has for a long time withheld from making any "cardinal" statements about his political future because according to the constitution he doesn't have the right to run for a third term. With that, he has a large chance retaining his saved up political and financial "capital". These guarantees can be provided to him by the prime minister and head of the ruling Republican party, Serge Sarkisyan. Moscow is placing its bet on him as the person who will secure Moscow's influence in Armenia.

As far as its relations with Georgia are concerned, Moscow has lost interest in this former Soviet republic. The reason for this became the increasing dependence of Georgia on Russian hydrocarbons and the absence of any full-fledged alternative. The fact that Russia's leadership was practically indifferent to the political processes in this nation including the presidential elections on January 5, where Saakashvili retained his post, bears witness to this loss of interest. The point is that, the mass demonstrations that took place in the beginning of November in 2007, which were organized by the pro-Western opposition, didn't bring about a radical change in power (or the exclusion of the former "revolutionaries") in Georgia. Most of them kept their posts, which is, first of all, testament to the strong

support “from across the pond” and secondly, about the inability of the opposition to come out as a united front against the government in Tbilisi.

In Central Asia, Russia is placing its bet on Uzbekistan, who together with Turkmenistan and Kazakhstan, is one of the largest gas producers in the region. The republic of Uzbekistan is one of the few former Soviet republics with whom relations with Russia are developing in a relatively constructive manner. To a large extent this can be explained by the pro-Russian stance of the Uzbek political elite (especially after the events in Andijan), and also the fear of the rising influence of Islamic extremists – this forces the authorities to look for allies outside its own borders. The most practical partner for Tashkent is Moscow, who is loyal to the regime of Islam Karimov.

Karimov’s February 2008 visit to Moscow became a confirmation of Uzbekistan’s loyalty to the Russian Federation. Against expectations, the meeting didn’t touch upon the possible rise in the price of Uzbek gas – in contrast to Turkmenistan. The key subject of the meeting (practically a monologue by Karimov) was his regret that Vladimir Putin was leaving his post and that Dmitri Medvedev would be taking his place.

The problem of Kosovo’s independence and Russia’s “game” in the Balkans

It must be noted that at the end of 2007, beginning of 2008, the Russian leadership pretty actively “played their game” in the Balkans, especially in Serbia where there were two factors that determined that practically all the local political forces would be pro-Russian – the presidential elections and the problem of the independence of the Albanian populated Kosovo region. Russian diplomacy used this to its full advantage. In between the two rounds when the chances of the current head of Serbia, Boris Tadic and his opponent, the nationalist Tomislav Nikolic were about equal, the Russian leadership decided to diversify its risks. And if Vladimir Putin met with Tadic and closed a deal with him that involved Gazprom buying a controlling block of shares in the Serbian oil company NIS, then the first deputy premier and the successor, Dmitri Medvedev met with the head of the Serbian radicals, Tomislav Nikolic, who was leading after the first round. In beginning it was planned to limit Nikolic’s visit to just the speakers of both chambers of parliament. However, to all appearances, **Moscow didn’t really know who was going to win in the second round of the presidential elections on February 3.**

That is why the Russian leadership decided to insure itself incase Nikolich won. This risk diversification allowed Moscow to, first of all, guarantee the loyalty of any Serbian regime, and secondly, to increase it influence on the political processes in this Balkan country.

This became all the more important after the “centrist” Vojislav Kostunica refused to support either candidate. Kostunica, notwithstanding his moderate views, firmly defended the territorial integrity of Serbia, which draws him closer to the Serbian radicals. Incidentally, besides the unswerving nationalists, the liberal Tadich also played on the nationalist-patriotic feelings by firmly coming out against Kosovo’s independence and selling the local oil monopoly NIS to Gazprom.

In this sense, a Kostunica – Nikolich alliance would have been logical. However this would have contradicted the principles on which Kostunica came to power on in 1999 – a wave of democratization and the end of isolation after the downfall of the Milosevic regime. **The position that Kostunica took during this election turned out to be optimal.** All the more so because he employed all three popular slogans in the campaign – keeping Kosovo inside Serbia, the necessity of Euro-integration while at the same time furthering cooperation with Russia.

In the meantime, *Tadich’s European positions took a severe hit in the week before the* elections, which in large part was due to his necessary pro-Russian stance. On January 28 in Brussels, there was a meeting of the heads of the foreign ministries of the European Union. The key topic of discussion was the question of Kosovo’s future and Serbia’s Euro-integration. During the course of the meeting it was planned to sign the stabilization and association agreement on relations between Serbia and the EU. This was seen as a symbolic step on the road to the EU for Serbia. However, the Netherlands came out against this agreement saying that Serbia first had to deliver the former heads of the Bosnian Serb leadership – the general Radko Mladic and Radovan Karadzic.

In any case, the urge to institutionally formalize the EU and Serbia coming together was determined by, first of all, by the upcoming second round of the presidential elections on February 3. Brussels was interested in power remaining with the loyal and as they assumed the pliable Boris Tadich. The demonstration by the EU officials of their willingness to integrate Serbia was supposed to mobilize the Serb electorate to vote for their current head of state.

Moscow was also interested in this scenario playing out. It seemed that lately Russia had accepted the fact that a significant part of the Serbian population wanted closer relations with the EU, who they saw as a potential “employer”. In

this connection, Gazprom's purchase of a controlling block of shares in the Serbian oil company NIS was supposed to significantly increase the rating of the pro-European-integration Tadich in the upcoming elections.

However, already a few days before the voting, it became clear that if Tadich were to win, he was ready to review his priorities, especially when taking into account that the EU countries didn't give him the support that they promised him earlier. Moreover, *on the eve of the elections, the West started to suspect Serbia of fueling nationalistic sentiment in multi-national Bosnia and Hertsegovina*, where the prime minister of the Serbian Republic, Milorad Dodik stated that he would like to see a new article in the constitution about "the right of self-determination and secession from the federation".

This change in the geo-political lay of the land in the region testifies to the fact that the *in the beginning the West wasn't ready to come to an agreement with neither Tadich, nor Nikolich on the Kosovo question*. So, regardless of who won the election, Kosovo's independence was just a matter of time. This happened on February 17, 2008 when the Kosovars unilaterally declared their official secession from Serbia. Under these conditions, Moscow's firm position on the Kosovo issue (in particular, its refusal to recognize the sovereignty of the autonomous region) is, in many respects, a win-win position. On the one hand, the Russian leadership demonstrated its solidarity with its "Slav brothers", and on the other will some trump cards for its game with the breakaway republics (Abkhazia, South Osetiya, and Transdnestria). Just like before, and especially after Kosovo's declaration of independence, Russia's diplomats actively started promoting the idea that Kosovo's independence set a "precedent".

2008: prospects in international relations

A few tendencies should be noted when discussing Russian foreign policy priorities for 2008. Europe, as before, will remain Russia's key energy partner. The many contracts that were signed in 2007 between Russia and Europe bear witness to this. This means that Moscow isn't planning on abandoning its strategy of becoming an "energy superpower" since hydrocarbons are the strategic base of the Russian economy.

In connection with this, Russia is going to increase its presence in Central Asia, since the hydrocarbon reserves of this region, in many respects will guarantee Russia's stable relations with the European Union.

At the same time it is necessary for Moscow to make a “safety net” for itself, both economically and politically incase the competition for energy resources among the largest world powers intensifies. This role is set aside for the developing economies of the South-East Asian region (first of all, as a key consume of Russian weapons), resource rich Africa, and the ideologically like minded governments of Latin America.

Nevertheless, the Russian Federation faces the prospects of serious foreign policy problems in connection with the worsening situation in the international arena, especially after the West unilaterally recognized the independence of Kosovo. First of all, the EU and the U. S have for the second time (after the Iraq invasion) ignored international institutions (UN Security Council) and have put into question the expediency of the existence of these institutions and the veto rights that its members have. Secondly, this situation has added confusion to the question on what is more important: the right of self-determination of a people, or the territorial integrity of a government? Arguments that Kosovo’s situation is “unique” are ungrounded and the further development of the situation will only serve to spread separatist feelings around the world. Incidentally, this can b used by Moscow which will receive the ability to blackmail the West and its allies in the CIS with the possible recognition of Abkhazia, South Osetiya, and Transdnestria. Nevertheless, the actual recognition of the independence of these territories isn’t likely to happen. For example the official recognition of Abkhazia will unavoidably destabilize the situation in the region. When taking into account the upcoming Olympics in Sochi in 2014 (Vladimir Putin’s personal Russian image enhancement project), the development of this situation wouldn’t suit the Russian leadership.

Moscow will also face attempts by its energy customers in Europe to limit Russia’s presence in regional energy markets. Some of these projects are already underway; however they are still unable to prove their effectiveness because they are still unprofitable. The main accusation against Russia is the forecasted fall in hydrocarbon production. In connection with this, it is essential for Moscow to place their bet on, not developing a non-resource based economy but to optimize its technology for finding and extracting hydrocarbons.