

HOUSE OF LORDS

SESSION 2002–03  
3rd REPORT

SELECT COMMITTEE ON  
THE EUROPEAN UNION

EU RUSSIA RELATIONS

WITH EVIDENCE

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- (Q) refers to a question in oral evidence.
- (p) refers to a page of written evidence.

# THIRD REPORT

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17 DECEMBER 2002

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By the Select Committee appointed to consider European Union documents and other matters relating to the European Union.

ORDERED TO REPORT

## EU RUSSIA RELATIONS

### Box 1

#### *Abstract*

Good relations between the EU and Russia are of increasing importance to the EU, Member States and Russia itself:

- The forthcoming enlargement of the EU will result in a geographical shift to the east, with consequent potential problems.
- The global threat of terrorism to all nations encourages even closer working relations between governments.
- Russia has changed significantly over the past decade. The EU and Russia will both benefit from working more closely together on matters such as energy supply, the environment and trade.

The Committee has investigated the EU institutional framework concerning Russia and Russian domestic developments.

The EU should encourage the development of a more systematic and productive relationship with Russia for the decades ahead.

The Committee's main conclusions are that:

- The institutional framework for EU/Russia relations requires renovation. There should be a single office within the Commission co-ordinating all matters relevant to Russia.
- The current EU/Russia agreements are out of date and no longer reflect the possibilities offered to both sides.
- The EU should embark on a major programme of educational assistance which would assist Russians on matters related to the EU and also develop a better understanding of the new Russia within the EU.

## PART 1: INTRODUCTION

### THE REASONS FOR THE INQUIRY

1. The Committee<sup>1</sup> decided to inquire into EU/Russia relations for three main reasons. First, the proposed enlargement of the EU to incorporate countries of East-Central Europe will, if successful, shift the geographical balance of the EU to the east and, at the same time, raise potential border problems with the Russian Federation. Second, the attack on the World Trade Center in New York on 11 September 2001 (hereinafter '9/11') prompted President Putin to align Russia with the West in confronting terrorism, a policy shift with implications of the greatest importance for the EU. Third, the Committee has already worked on the effectiveness of EU Common Strategies. In particular, we reported on the Mediterranean<sup>2</sup>. It seemed natural for us also to report on Russia.

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<sup>1</sup> Our membership is listed in Appendix 1.

<sup>2</sup> *The Common Mediterranean Strategy* 9th Report from the House of Lords European Union Committee, session 2000–2001, HL paper 51.

2. Moreover, and more generally, the Committee considered that reform in Russia has now advanced sufficiently to offer a serious prospect of fruitful co-operation between Russia and the EU. In particular, we see a growing convergence of interest on matters of practical significance.

#### THE SCOPE OF THE INQUIRY

3. In this report we examine the current state of relations between the EU and Russia, and then we examine what the future could and should hold.

4. The report has six sections:

- Russia's place in EU foreign policy
- The EU's place in Russian foreign policy
- Russia's economy
- Stability and Security
- Common Challenges
- Recommendations

5. We took evidence as part of this inquiry. A list of witnesses appears: Appendix 2 and the evidence is printed with this report.<sup>3</sup>

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<sup>3</sup> References in the form (Q00) are to questions in the oral evidence; and (p00) to pages of written evidence.

## PART 2: RUSSIA'S PLACE IN EU FOREIGN POLICY

6. Relations with Russia have hitherto been a low priority for the EU. They have been regarded more as a matter for NATO and for individual Member States than for the EU as a whole.

7. The end of the Cold War, finally signalled by the collapse of the Soviet regime in August 1991, did not immediately alter that situation.

8. The EU itself has in the meantime focused on reshaping its institutions and securing external enlargement. In this process trade relations have taken pride of place. Up to now, this has been understandable given that the EU accounts for 35 per cent of Russia's foreign trade while Russia takes up no more than 4 per cent of the EU equivalent.<sup>4</sup>

9. Nevertheless, neglect of EU/Russia relations in their generality can no longer be sustained, particularly because there is much common ground across a range of issues, not only in investment and trade, but also in transport, the environment, culture and much else. Former British ambassador to Moscow Sir Andrew Wood told the Committee: "We, in the EU, have to have a good idea of where we want Russia to end up in relationship to the EU." (Q252)

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<sup>4</sup> See Box 3, page 12—*EU and Russia Economic and Trade Indicators*.

**Box 2***The Current EU/Russia Political and Legal Structures***A Partnership & Co-operation Agreement (PCA) 1994**

The PCA came into force in December 1997 for an initial period of ten years. It establishes the legal basis for EU relations with Russia, in particular the institutional framework for bilateral relations, sets the principal common objectives, and calls for activities and dialogue in a number of policy areas. It covers:

- Trade and economic co-operation.
- Co-operation in science & technology (including energy, environment, transport, space and other civil sectors).
- Political dialogue on international issues of mutual concern and on co-operation relating to observing the principles of democracy and human rights.
- Justice and Home Affairs: Co-operation to prevent illegal activities, trafficking in drugs, money laundering and organised crime.

**B The Common Strategy on Russia (June 1999)**

The Strategy sets out the basic approach to EU relations with Russia. It is valid for a period of four years. This was the first of a series of strategies, written in response to recognition that there should be greater coherence between the EU and the Member States' foreign policies. The strategy provides an overall policy framework in the areas of:

- Consolidation of democracy, rule of law and public institutions.
- Integrating Russia into a common European economic and social space.
- Stability and security in Europe and beyond.
- Common challenges on the European continent (including environment, crime and illegal immigration).

**C TACIS programme**

This programme of financial assistance (created in 1991) provided Russia with assistance totalling €2.4 billion up until 2001. €90 million are allocated for the Tacis national programme for Russia in the indicative budgets for both 2002 and 2003.

Other sources of assistance are the European Initiative for Democracy and Human Rights, and the European Commission Humanitarian Office, which is active in the North Caucasus.

**D Sectoral Agreements**

Steel and textiles are the main industry sectors covered by bilateral trade agreements. The Steel Agreement concluded in 1997 expired at the end of 2001. Negotiations for its renewal are ongoing. A Textiles Agreement was concluded in 1998. It shall be in force for the duration of the PCA.

**PARTNERSHIP AND CO-OPERATION AGREEMENT (PCA)**

10. The PCA has served a major purpose. Much progress has been made in all four policy areas (set out in Box 2). Nevertheless, neither side has been wholly content with the agreement. The then Minister of State for Europe, the Rt. Hon. Peter Hain MP, told the Committee that Russia was unhappy with the PCA "as a mechanism". In turn, "the EU is constantly cajoling the Russians to meet some of those obligations, particularly on the trade side." (Q185)

11. Under the PCA two EU-Russia summits have been held each year. In addition, ministerial level talks (co-operative councils) have been held once a year and senior official level co-operation committees have met on an ad hoc basis (though rarely more than once a year). Nine sub-committees

deal at working level with technical issues.<sup>5</sup> A number of working groups on the Common Foreign and Security Policy also meet Russian counterparts twice a year. A Joint Parliamentary Committee also convenes, affording a regular opportunity for members of the European Parliament and the Duma (the lower house of the Russian parliament) to become better acquainted.

12. It may be, however, that the impetus for making useful and lasting changes in overall policy has been lost in a deluge of detail. It now seems evident that no individual of authority in Brussels is able to present himself or herself as fully conversant with “Russian issues”. This view was put forcefully in briefings to the Committee from the British embassy in Moscow—with the additional point that the EU’s focus on enlargement has tended to come at the expense of attention to Russia itself. Moreover, different aspects of the relationship tended to be dealt with in separate compartments within the EU. Responsibilities were divided between the Council of Ministers,<sup>6</sup> the presidency of which rotated among Member States, and the Commission.<sup>7</sup> The division further aggravated the problem.

13. **We recommend that the EU sets up a Russia office.** This would, from the EU’s point of view, offer a greater degree of co-ordination within its own organisation and would thereby better serve its interests. The Russians, on their side, would benefit by being able to deal through an office that co-ordinates the views of both the Council of Ministers and the Commission. It would make for greater clarity and consistency. Although the responsibilities of the Council and the Commission would be unchanged, such an office would act as a “progress-chaser” and as a good point of contact—provided it was headed by an official at a sufficiently high level.

14. The issue of human rights in Russia also formed part of the PCA. It has emerged in three forms: first, in the use of force against the threat of secession of the Republic of Chechnya; second, in discrimination against religious minorities; and, third, in the restriction of editorial freedom in the media. Because of human rights abuses Chechnya has received attention from the EU since 1995, eliciting condemnation of Russia at a high level. On 17 May 2001 the Joint Statement issued by Secretary General of the EU Council and High Representative of the CFSP Mr. Javier Solana, EU Commission President Mr. Romano Prodi, and President Vladimir Putin, emphasised the “urgency” of resolving the war in Chechnya. After 9/11, however, all “urgency” had apparently disappeared. Chechnya increasingly slipped down the agenda of business with Russia. The Joint Statement under the Belgian Presidency in Brussels on 3 October 2001 referred merely to EU support for a Russian political settlement in Chechnya. Then, finally, the Joint Statement issued in Moscow on 29 May 2002 under the Spanish Presidency omitted reference to Chechnya altogether. The issue in terms of human rights is not whether to deal firmly with the threat from terrorism, but how the Russian authorities treat the Chechen population as a whole. Since 9/11 the approach of both the EU and the United States to Chechnya has been more oblique obviously in the interests of securing Russian support for the international pressures against terrorism. Against this background little progress has been made on the human rights provisions of the PCA.

#### THE COMMON STRATEGY

15. The forging of an EU Common Strategy towards Russia on 4 June 1999 was the result of a recognition of the need for change in EU/ Russia policy. It was the first Common Strategy devised after the creation of the Common Strategy instrument under the Amsterdam Treaty. It aimed at maximising co-ordination of policy by decision at the highest level between the EU and other states. In practice the Common Strategy on Russia restated the essence of the PCA. It also recognised the change in relations since 1994. The strategy acknowledged “that the future of Russia is an essential element in the future of the continent.” Specifically, it argued that a “stable, democratic and prosperous Russia, firmly anchored in a united Europe free of dividing lines, is essential to lasting peace on the continent.” The EU therefore reiterated its staunch commitment “to working with Russia, at federal, regional and local levels, to support a successful political and economic transformation in Russia.”<sup>8</sup>

16. Co-operation between the EU and Russia has developed since the publication of the Common Strategy in June 1999. In December of that year relations between the two were highlighted in the Presidency Conclusions (Helsinki European Council): “Russia is a major partner for the European Union. The Union has constantly expressed its willingness to accompany Russia in its transition

<sup>5</sup> These are: 1. Trade and Industry; 2. Energy, environment and nuclear issues; 3. Science and technology, human resources, social co-operation; 4. Transport, telecommunications, and space; 5. Coal and steel mining and raw materials; 6. Competition, IPR, approximation of legislation, fight against crime; 7. Customs and cross-border controls; 8. Agriculture, fisheries, consumer protection; 9. Financial and economic issues, statistics.

<sup>6</sup> Mr Javier Solana.

<sup>7</sup> The Rt Hon Christopher Patten.

<sup>8</sup> Official Journal of the European Communities, 24 June 1999, L 157/1.

towards a modern and democratic state.”<sup>9</sup> The EU-Russia summit in Paris (October 2000) led to a joint declaration on ‘strengthening dialogue and co-operation on political and security matters in Europe.’ The Moscow Declaration of May 2001 extended that discussion. Following 9/11 President Putin made significant moves to further co-operation with the EU. The meeting in October 2001 approved a joint statement on “Stepping Up Dialogue and Co-operation—Political and Security matters in Europe.”

17. There followed President Putin’s controversial decision to share intelligence with the West on Islamic terrorist movements, which foreshadowed Russia’s gradual rapprochement with NATO. In his evidence to the Committee, former Chairman of the U.S. Joint Chiefs of Staff General John Shalikashvili emphasised the value of the Russia-NATO Council or “Council of 20”<sup>10</sup>, set up on 28 May 2002.<sup>11</sup> It includes Russia within the parameters of NATO decision-making, but without full membership or right to a veto. Further co-operation was discussed at the EU-Russia summit a day later, where the Russians put forward a proposal for “the formation of a single European security space” and envisaged “annual separate meetings of Defence Ministers of Russia and EU countries.”<sup>12</sup>

18. The expansion of NATO into Central-Eastern Europe, important for the new Member States to enable them to focus on domestic reform, has certainly not eased the anxieties of Russian officers still caught in the vice of “old thinking”. Prior to 9/11, the consequence was that NATO efforts at rapprochement were frequently neutralised. Dr Edwina Moreton, Diplomatic Editor and Deputy Foreign Editor of the *Economist*, argued that since the collapse of Soviet power the absence of personal contacts by the military was damaging. “Some Russian diplomats and military personnel recognise that but, if you need your commanding officer’s permission to go to the NATO bar, you are not using the structure in any way that would be appropriate, either for Russia or NATO.” (Q128)

19. The subsequent appointment of a Russian representative as liaison with EU Military Staff has, so far, been symbolic rather than substantive. Much will depend on the progress of further reform of the armed forces within Russia (see below, paras 58–60). More recently, on 20 September 2002, the concept of Russia-NATO peacekeeping was also agreed<sup>13</sup>. How all this fits in with the emergence of the EU’s Security and Defence Policy (ESDP) has yet to be seen. The ESDP has arisen as a consequence of the prospect that there may in the future emerge crises in Europe as in the Balkans in the early 1990’s, where the United States prefers to stand aside. Whether, and precisely how, Russia can assist in such circumstances has yet to be determined. Certainly, the Common Foreign and Security Policy has to lead to understandings on political matters before any discussion of military co-operation is realistic. Nevertheless, we note that Russian assistance is currently being used on an ad hoc basis, for example in transporting supplies by heavy lift aircraft to Afghanistan.

20. On economic matters, Commission President Romano Prodi and President Putin agreed on 17 May 2001 to set an agenda towards what would be known as a “Common European Economic Space” (CEES). A joint high level group (HLG) was established under the chairmanship of Commissioner Patten and Deputy Prime Minister Viktor Khristenko. Although the mandate was further clarified at a summit that October, progress is not to be reviewed until October 2003. Until then, the CEES remains in dignified obscurity. **True, the HLG has agreed the overall objective of enhancing trade and investment, but it is clear that over the long term regulatory convergence is critical to any progress. The areas of primary interest which have hitherto been agreed include standards, technical regulations, customs, financial services, auditing, transport, outer space launches, public procurement, telecoms and competition. It is not at all clear, however, precisely what progress is required and expected by either side in these various areas. The omission of the “social” dimension contained in the Common Strategy remains unexplained.**

21. Progress towards anything resembling a Common European Economic Space depends upon Russian accession to the World Trade Organization (WTO). The Russian Government first applied for membership in 1993, but serious negotiations began only recently. WTO Director-General the Rt Hon Mike Moore expressed a view widely held when he announced that the accession of Russia constitutes “a key element” in the process of reintegrating its economy into the world economy.<sup>14</sup> Any move by the EU towards the establishment of a free trade area with Russia has effectively been delayed until Russia joins the WTO. This underlines EU insistence that Russian domestic reform has to progress a

<sup>9</sup> Helsinki European Council: Presidency Conclusions Annex 2. December 1999.

<sup>10</sup> “Council of 20” Nations announced in the Declaration of Heads of State and Government of NATO Member States and the Russian Federation as the principal structure between NATO and Russia, establishing a new level of co-operation.

<sup>11</sup> See, for example, Shalikashvili, Q562.

<sup>12</sup> “Russia-EU Action Plan in the Field of European Security and Defence Policy”, 29 May 2002.

<sup>13</sup> Statement by NATO Secretary General Lord Robertson in his capacity as chairman of the NATO-Russia Council 20 September 2002. There was a Russian contingent to the NATO forces in Kosovo.

<sup>14</sup> Speech to the Fifth Annual Russian Economic Forum, London, 19 April 2002.

good deal further before commerce can take place unhindered. Negotiations for the WTO have, however, effectively ground to a halt, not least due to lobbying by protectionist interests in Russia (the car industry, banking, insurance and telecommunications) but also political concerns (maintenance of subsidised fuel) to keep the electorate on side. Furthermore, the strongly protectionist tradition pre-dating 1917 should not be forgotten. President Prodi's recent statement that the EU would treat the Russian Federation as a "fully fledged market economy" was of importance (also see para. 24). **Nevertheless we note that although the EU should support the goal of Russian membership of the WTO, there is very limited scope for flexibility over the conditions and in reality membership is still some way off.**

#### TACIS

22. The priorities laid down in the Common Strategy caused a shift in the priorities of the TACIS aid programme to Russia. TACIS began with no precedents to follow. It was never intended as an equivalent to the European Recovery Program (the Marshall Plan) which brought Western Europe back to prosperity from 1948. TACIS always had more limited objectives and a limited budget. Up to 2001 Russia received a total of €2.4 billion, with a further €90 million allocated for the years 2002 and 2003. Inevitably mistakes have been made and the results—along with those of other international aid efforts—have been widely acknowledged to be "mixed".<sup>15</sup> Much has been learned in practice. Nevertheless, the substantial impact has been difficult to assess. Its strength lay in selecting discrete areas for support and in targeting aid. These programmes have, on the other hand, "been rather cumbersome and slow",<sup>16</sup> not least because until the end of the decade they required initiatives from within Russia to get started. The programmes also suffered from the harsh realities of the institutional context in which the assistance was expected to operate.

23. The suspension of aid from December 1999 to July 2000 in protest at Russian brutality in Chechnya unavoidably complicated matters. Nevertheless aid is expected to continue through to the end of 2006. Since 1991 more than 500 projects have been implemented. Energy, enterprise support and human resources development absorbed most of the resources. As a consequence of the shift of emphasis heralded by the Common Strategy, the 100 projects in progress have been geared to broader goals: better transportation, improved frontier controls and environmental clean-up, as well as training to enhance the institutional infrastructure of democracy (notably the rule of law). There is, however, inadequate attention in the TACIS programme given to bad management and wasteful distribution in agriculture and the food industry (at least a third of the population lives in the countryside), the threat from poor nuclear safety, crime and corruption, and a low level of knowledge of the EU and how it operates among Russian officials (and ultimately the politically active in the population as a whole).

24. Change in EU policy towards Russia has been slow and the need for a substantial reworking of the political and legal foundations has been tacit rather than explicit. Further confirmation of that fact came when, at the EU-Russia summit on 29 May 2002, Commission President Prodi announced that the EU would grant the Russian Federation formal status as a "fully-fledged market economy." This gave Russia the benefit of the doubt in anti-dumping litigation. The statement which accompanied this announcement indicated strongly that the motive for it was inherently political,<sup>17</sup> a point subsequently emphasised to the Committee in Brussels.

#### EU/RUSSIA AND ENERGY

25. Oil and gas supplies were not part of the PCA or of the Common Strategy, but emerged separately as an issue after world oil price rises in September 2000, when Commissioner Prodi proposed an EU-Russia "Energy Dialogue". There was clearly a need for a coherent European policy towards energy supplies. Since that time it has been noted that the majority of the 9/11 terrorists originated in Saudi Arabia, which possesses the bulk of the world's oil reserves. A more determined policy is therefore urgently needed. Risks must be assessed, new options sought, and a fall-back position established, either through stocks or increased attention to alternative sources of supply.

26. Unlike the United States, the EU's ability to influence Israel and the Palestinians towards peace, and thus reduce the main source of instability in the Middle East, has been very limited. The Middle

<sup>15</sup> For a detailed assessment of the entire spectrum of aid, including TACIS—United States General Accounting Office Report to the Chairman and the Ranking Minority Member, Committee on Banking and Financial Services, House of Representatives: *Foreign Assistance—International Efforts to Aid Russia's Transition Have Had Mixed Results*. GAO-01-8 (Washington DC, November 2000). See, also, testimony from non-governmental organisations: House of Lords Select Committee on the European Communities, *Partnership and Trust: The Tacis Programme. The Environment of Russia and The New Independent States*, HL Paper 157, Session 1997-1998, 33<sup>rd</sup> Report (HMSO London 1998).

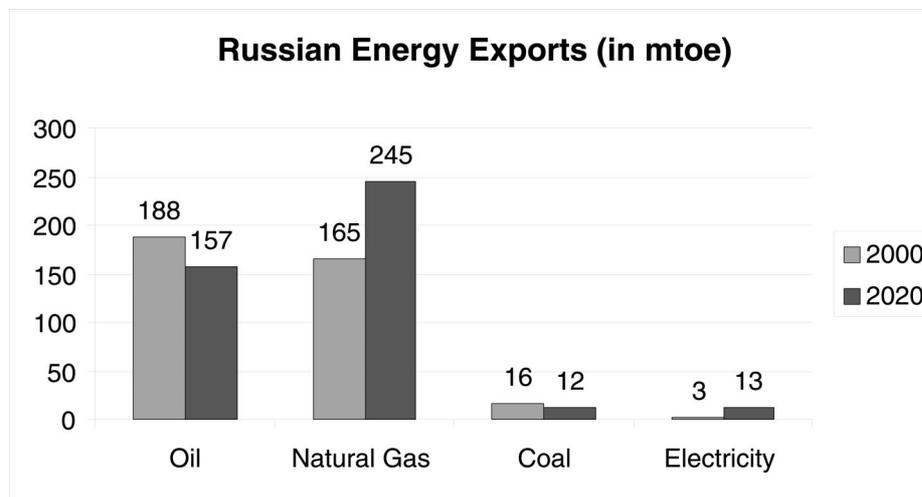
<sup>16</sup> See Dr Moreton (Q152).

<sup>17</sup> IP/02/775—Brussels, 29 May 2002.

East Quartet (EU, USA, Russia and UN) met in New York on 17 September 2002 and committed itself to settling the Israeli-Palestinian conflict. Compared to the United States, however, the EU is not a major actor in the region. Yet it is heavily dependent upon external sources of oil and gas. That dependence may result in acute economic and political vulnerability. The combination of dependence without power can and should be avoided. **Thus while the Middle East is so unstable, with potentially serious consequences for the world economy, the EU may benefit from looking elsewhere to secure more of its energy resources.**

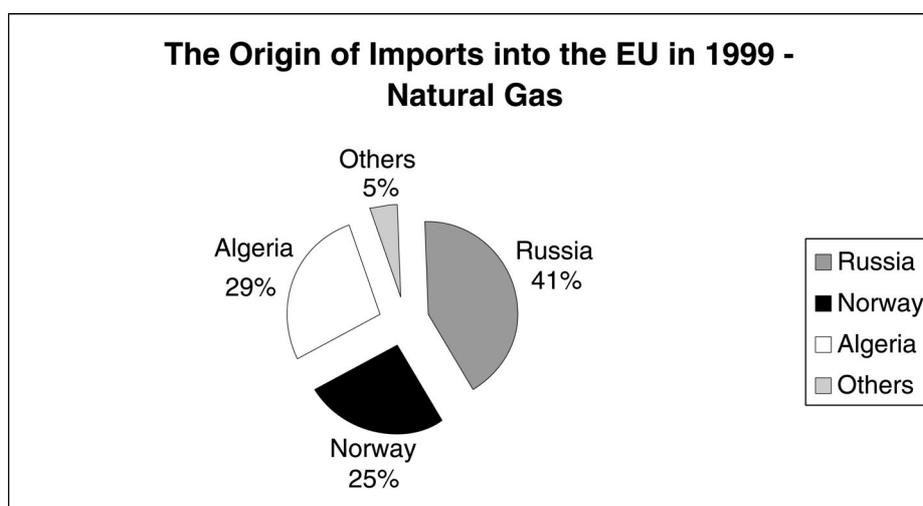
27. In the past the USSR neglected to sustain investment in the oil industry. Only now has Russia re-emerged on the world market as a major oil exporter in competition with OPEC. Together with gas, oil accounts for nearly two-thirds of equity on the Russian stock market. 53 per cent of Russian oil and 62 per cent of gas is exported to the EU. Together they account for 50 per cent of exports, 40 per cent of government revenue and 20 per cent of GDP. The Russians are thus crucially dependent upon their customers for energy sales. Moreover, the EU Delegation to Russia estimates that “some €150 billion will be required up to the year 2010, 30 per cent of which from foreign investment” to renew ageing capital stock and sustain a 4–5 per cent growth of the national economy (which is at the lower end of President Putin’s aspirations).<sup>18</sup> In the light of this evidence, we believe that it is extremely doubtful whether any Russian government could seriously contemplate abusing the sale of oil and gas for political purposes.

RUSSIAN ENERGY EXPORTS—(GRAPH)



Source: European Commission

THE ORIGIN OF IMPORTS INTO THE EU IN 1999—NATURAL GAS (PIE CHART)



Source: European Commission

<sup>18</sup> Delegation of the European Commission in Russia, “EU-Russia Energy Dialogue”: [www.eu.ru/eng](http://www.eu.ru/eng).

28. Russia provides some 16 per cent or more of EU oil consumption and 20 per cent of natural gas consumption (prior to the accession of new members from Central-Eastern Europe). Indeed, together with Norway, Russia has become a critical source of supply from outside the EU. Norway is a diminishing resource:<sup>19</sup> existing estimates suggest that at current rates of production it will run dry within eight years,<sup>20</sup> whereas Russia has at least twenty years yet to run (this estimate does not include neighbouring fields in Kazakhstan and the Caspian Sea as a whole). The flow from Russia can further increase with improvements in drilling and delivery. At present it is estimated that, with artificially low prices, Russians consume four times the amount they would consume at world market prices. By adjusting the domestic price level for oil, Russia could enhance exports significantly.

29. **British Petroleum argues that decisions on supply should be left entirely to the market.**<sup>21</sup> **The Committee does not agree.** Indeed, a former employee of BP, Mr. John Mitchell (now at the Royal Institute of International Affairs) favours building up stocks. He had proposed in the past “an emergency sharing scheme, which is based on companies who experience force majeure.” He also favours shifting dependence, where feasible, from oil to gas, which is one resource where “risks are quite different from those attached to oil and can be expanded very rapidly.”<sup>22</sup> The relevance to relations with Russia is clear since it is the world’s major supplier of gas; and long-term arrangements for supply and trans-shipment need to be secured for the EU.

30. The United States has already recognised Russia’s potential. But whereas the lines of supply to the American continent make for prohibitive cost, those to the EU are much less problematic. Nevertheless EU and American interest in diversifying their sources of oil and Russia’s interest as a major supplier coincide.

31. The same could be said for Russian and related Commonwealth of Independent States’ oil interests in the Caspian Sea. Here a valuable series of deposits under a common seabed, once divided evenly between Iran and the Soviet Union by treaty (1921 and 1940), has its ownership disputed between Iran and the new littoral states (Russia, Kazakhstan, Azerbaidzhan and Turkmenistan). It is in EU interests, as it is in US interests, to see the dispute settled to the mutual satisfaction of all parties.

32. In addition to those objectives laid out in the Common Strategy and in recent acknowledgement of Russia’s market status, issues vital to the future security and prosperity of the EU such as energy supply, as well as those related to the CFSP and ESDP, take us far beyond the limits of the PCA. **We conclude that the time has arrived for the entire framework for relations with Russia to be recast to take fully into account the import of recent events for EU-Russia relations, not least as a result of the strategic shift in Moscow’s foreign policy.**

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<sup>19</sup> See Eurostat publications: *EU Trade with OPEC* and *EU trade in energy products* (Brussels 2002).

<sup>20</sup> Source: Mining and extraction, Statistics Norway (2001).

<sup>21</sup> Memorandum by BP to the inquiry by the House of Lords European Union Committee (Sub-Committee B) into Security of Energy Supplies in the European Union. See also testimony to the Committee from Scott Kerr and John Baldwin, 13 June 2002.

<sup>22</sup> Testimony to Sub-Committee B, 22 October 2001: House of Lords, Select Committee on the European Union, *Energy Supply: How Secure are We?*, HL Paper 82 (TSO, London 2002) p33.

## PART 3: THE EU'S PLACE IN RUSSIAN FOREIGN POLICY

33. Until relatively recently Russia has been surprisingly indifferent to the rise of the EU. That attitude is, however, plainly changing in step with the emergence of the CFSP and the broader evolution of Russian foreign policy.

34. The change in outlook parallels Russia's decline, to the point where the United States now regards the Federation as merely a "potential" great power alongside China and India.<sup>23</sup> In these circumstances, and faced with both NATO expansion and EU enlargement eastwards, anxiety is evident in Russia at the prospect of a reappearance of the "dividing line" between Russia and the rest of Europe.

35. Russian concern is reflected in the manifesto, "Russia's development strategy to the year 2010" published in President Putin's first year in office. It opened with a dramatic statement: "By the beginning of the 21st century our country has been confronted with a real danger of finding itself on the periphery of the civilised world as a result of its growing lag in the social, technological and economic fields."<sup>24</sup> Here and later President Putin emphasised the indissoluble link between progress at home and Russia's standing abroad after "decades of stagnation."<sup>25</sup> Later we will consider the state of domestic reform, on which will depend, at least to some extent, on the EU's relationship with Russia, below (paras 58–60).

36. Moving from words to action has taken time. Since 9/11, however, Russia's decade-long and troubled transition to a functioning democracy within a market economy has been pursued with greater vigour and determination. Meanwhile, abroad Russia has realigned itself with the United States and reorientated itself towards full integration with all international institutions.

37. Until recently, conflicting views in Moscow kept Russian foreign policy along the familiar tram line "driving wedges" between the power centres in the West. This the then Minister for Europe characterised as the "old agenda", which was "still lurking—not even lurking sometimes—in the shadows." (Q170)

38. Such an agenda no longer seems realistic. Explaining why Russia would not bother to play off the EU against the United States, former ambassador to Moscow Sir Bryan Cartledge, highlighting the inconsistencies in the EU, told the Committee: "the European Union is not a sufficiently choate entity at the moment. It does not—regrettably, in my view—have an effective common foreign policy, it does not have a tangible defence identity." (Q48)

39. This is still an issue for debate, even if the incentive to "drive wedges" has diminished. Bilateral relations continue to predominate. One European ambassador is quoted as saying, "Europe has no relations with Putin. It is the personal, bilateral ties, particularly with Schröder and Blair that count, because we have no integrated foreign policy, let alone a policy towards Russia."<sup>26</sup> While Member States still find unilateral advantage by operating on the bilateral plane, this trend is likely to persist.

40. The proposed enlargement of the EU<sup>27</sup> to Russian frontiers and the emergence of the CFSP have significant implications for the conduct of Russian foreign policy. The 'Foreign Policy Concept' of the Russian Federation approved by President Putin on 28 June 2000 noted: "Of key importance are relations with the European Union (EU). The on-going processes within the EU are having a growing impact on the dynamics of the situation in Europe." In particular it stated: "The EU's emerging military-political dimension should become an object of particular attention."

41. Since 9/11 President Putin has stressed that "Russia's foreign policy will continue in future to be purely pragmatic." This pragmatism amounts to weighing up Russian power against those of its new partners. "Tight competition is a norm in the international community and in the modern world, competition for markets, investments, economic and political influence. Russia must be strong and competitive in this fight." He is absolutely firm, however, that while using combative language, ("no one is going to war with us in the modern world. No one wants this, and no one needs this") he adds "But no one is really waiting for us either. No one will help us especially. We have to fight for our place under the 'economic sun'."<sup>28</sup>

**42. Whatever doubts linger about the EU as a political entity, its role as a major and growing trade partner with Russia is self-evident. Russia's declared need for direct foreign investment is**

<sup>23</sup> President Bush's National Security Strategy transmitted to Congress, 20 September 2002.

<sup>24</sup> "Russia's development strategy to the year 2010", 10 May 2002.

<sup>25</sup> Annual Address by President Putin to the Russian Federal Assembly, Moscow, 18 April 2002.

<sup>26</sup> "Links with Putin leave Europe out in the cold", Financial Times, 22 May 2002.

<sup>27</sup> As discussed by the General Affairs and external Relations Council, 2459th Council Meeting.

<sup>28</sup> Annual Address to the Russian Duma 18 April 2002.

unlikely to be satisfied without Western European involvement. As EU enlargement continues, the EU and Russia are likely to become ever more interdependent economically. Thus within Russia's larger goal of maximising integration with the external world, the EU potentially plays a pivotal role.

### Box 3

#### *EU and Russia Economic and Trade Indicators*

	EU	Russia
Population (million)	377.9	144.8
Area (1000 km <sup>2</sup> )	3191	17 075
Population Density (inhabitans per km <sup>2</sup> )	115	9
GDP (euro billion) ( 2001)	8 814	346
GDP per capita (euro billion) (2001)	23,170	2,398
Exports (million euro) (2001)	972, 080	115,049
Imports (million euro) (2001)	1017,54	59,612
Balance (million euro) (2001)	-45,460	55,438
Russia's share of EU trade/ EU's share of Russia trade	3.3%	39.4%
Exports as share of total world exports (2000)	17.5%	1.65%
Imports as share of total world imports (2000)	18%	0.67%

Source: Eurostat

- The EU is Russia's main trading partner, accounting for approximately one-third of its total trade in 2000. EU 15 is followed by the rest of Europe (mainly Poland and Switzerland) and Asia, accounting for 25 per cent each. The United States and Japan only account for a very small share of Russia's external trade (6 per cent and 1.3 per cent respectively).
- Russia is a small trading partner for the EU, ranking 5th on imports and 6th on exports.

43. The Common Strategy emphasises that "the main responsibility for Russia's future lies with Russia itself." Russia's progress towards further integration with the West, and with the EU in particular, hinges upon advancing the reform programme. The Committee therefore devoted significant attention to the strength of forces making for continued political stability within Russia and the degree to which institutional obstacles to prosperity have yet to be overcome.

44. From the beginning of Russia's transition, the EU has sought to influence the future shape of Russia's economy and society through a programme of economic assistance. The initial understanding, that merely economic advice was needed, has latterly given way to a belief that the institutional framework for economic reform is equally important. Institution building has thus now become the focus of assistance. Conversion to Western practices is to Russia's advantage in seeking full integration with the global economy and society. The EU is playing its part. The EU should also mark out and seek to further its own specific interests.

45. On both sides of the EU-Russia relationship a better understanding of the other party would make for greater progress. Ignorance of the Union and its operations is widespread within Russia, even at the top of government. **The Committee therefore believes more should be done to draw the EU and Russia closer together through education and training within member countries to familiarise the Russian officials and, through them, the population at large, with the EU. We also believe that EU officials would in turn benefit from greater familiarisation with Russia.**

## PART 4: RUSSIA'S ECONOMY

46. The Committee's attention was drawn to advances already apparent in the transformation of the Russian economy. Nevertheless, witnesses also recognised, as have President Putin and the reformers, that the Russian economy is growing at too slow a rate to compensate for chronic under-investment since the mid-1970's. Indeed, Russia needs to grow at least twice the current rate (less than 4 per cent) to catch up with the poorer countries within the EU. Russia is classified by the World Bank as a "lower-middle-income economy" alongside countries such as Albania, Peru, Guatemala and Egypt. Its gross national income per capita (GNI), for instance, now stands at one half that of Portugal.<sup>29</sup> It is equally apparent that the level of growth pivots precariously on the production of raw materials (most notably oil and gas), whose prices are subject to world market volatility, rather than the more stable axis of manufacturing and services.

47. Moreover, the task of modernising the economy has been complicated by the need simultaneously to sustain electoral support among a population sceptical that the sacrifices required will result in the promised reward. The tension between these Russian attitudes and the needs of the country creates a major challenge to the political leadership. The path of reform will be long and difficult; but a great deal is at stake.

48. A crucial element underpinning the resurgence of the economy since the financial crisis of 1998 has been the emergence of political stability under President Putin. The Head of the Russian Business Unit at BP Mr. Scott Kerr advised: "The biggest move over the past few years has been to economic and political stability in Russia, which has allowed people to invest in very long-lead projects such as oil and gas and be assured of a return." (Q357) The Director of Sovereigns Group, Fitch Ratings, Mr. Edward Parker went further: "the consolidation of the power of President Putin over the Duma, over the regions, over the business oligarchs, and, perhaps, less encouragingly, over the media, have been an important factor in improving stability in Russia and reducing political and economic risk." (Q322) Russia's Fitch Rating<sup>30</sup> is currently BB-, this is three notches below investment grade. (Q319)

49. Much has therefore come to depend upon Putin's presence and his persistence in accelerating change. In turn his own continuation in power has come to depend upon the success of reform. This symbiosis is both reassuring and worrying. Putin's close identification with change will, we hope, ensure its success. Nevertheless if the reform process yields mass unemployment and social deprivation he will become vulnerable to any credible opposition. The political hurdles of parliamentary elections (due in December 2003) and presidential elections (spring of 2004) have to be overcome before the more radical elements of the reform programme can attain their full potential.

50. For the President the present institutional obstacles to economic progress are critical. In his annual address in 2002 he railed against "the cumbersome, clumsy and ineffective state apparatus" which was blocking the "colossal potential of the country." It was, he argued, "conducive to corruption...Any administrative barriers are overcome with the help of bribes. The higher the barrier, the more bribes and the more officials that take them."<sup>31</sup>

51. President Putin's focus on bribery was echoed in evidence we heard. Professor Archie Brown of Oxford University told the Committee that "Business tycoons find it much more reliable to buy state officials, whether in the presidential administration or in ministries, than to rely on the law courts." He added that this was "a huge disincentive to foreign direct investment because foreign companies do not have the same contacts, they may have a greater unwillingness to bribe officials, and they will then see themselves at a disadvantage in the Russian market." (Q6) Former Deputy Prime Minister and Finance Minister of Russia Dr. Boris Federov recalled that the Swedish furniture chain IKEA spent several unrewarding years negotiating for land with the local authorities in Moscow. "Basically, everybody was asking for bribes. These people did not want to pay, and that means they started their shop four years later than they could have done. I think that is damaging the Russian economy." (Q507)

52. At present bad practice in Russia is easy to hide. Managing Director of Lazards Mr. John Shakeshaft cited the "wonderful letter from Anatoly Chubais, who has, after all, been described by Federov as 'the darling of the West' on privatisation, refusing to disclose his salary as President of

<sup>29</sup> *World Bank Development Indicators Database* (World Bank, August 2002).

<sup>30</sup> Fitch Ratings is an international rating agency with a presence in 75 countries. International credit ratings assess the capacity of states, for example, to meet foreign currency or local currency commitments. Investment grade ratings of international long-term "AAA" to "BBB" categories indicate a relatively low probability of default, while those in the "speculative" or "non-investment grade" categories, international long-term "BB" to "D", either signal a higher probability of default or that a default has already occurred.

<sup>31</sup> Annual Address by President Putin to the Russian Federal Assembly, Moscow, 18 April 2002.

Unified Energy Systems of Russia (UES)<sup>32</sup> on the grounds that it is a state secret.” (Q329) It was initially expected that greater integration with the West would improve standards. Never the less significant problems remain, as instanced by the gas monopoly, Gazprom. Seven of its companies (Purgaz, Rospan, Tarkosaleneftegaz, Sibneftegaz, Achimneftegaz, Vostokogaz and Severneftegaz) accounting for nearly 10 per cent of its reserves and worth \$5,805 million to Gazprom were sold off for a mere \$325 million (a loss of \$5,480 million). As a result investors called for an independent audit. Instead Gazprom requested a confidential audit from its own auditors, PricewaterhouseCoopers who, it is reported, remarkably, gave it a clean bill of health.<sup>33 34</sup> This was not the only example of doubtful practices highlighted by concerned Western investors.<sup>35</sup>

53. In calling for the rule of law the Kremlin is fully aware, after a decade of mixed results from extensive legislation, that “adopted laws often contradict each other.”<sup>36</sup> Moreover, laws without enforcement are useless. The problem in Russia, former ambassador to Moscow Sir Rodric Braithwaite told the Committee, “is that getting good laws is not difficult; getting good laws implemented is very difficult” (Q88) even though President Putin has stressed the importance of cracking down on “racketeering, administrative lawlessness and corruption, the protection of the rights of owners and manufacturers.”<sup>37</sup>

54. A further problem for economic growth has been the chronic weakness of the banking system. Atomised and under-capitalised, it is “one of the most disappointing areas...in terms of economic reforms.” (Q311) Progress has begun, however, with the resignation of Mr. Viktor Gerashchenko and the appointment of Mr. Sergei Ignatiev as head of the Central Bank. Ahead lie the introduction of compulsory International Accounting Standards in 2004, followed by a mandatory deposit insurance system and the raising of capital requirements (10 per cent by 2005).

55. Reluctant investors from abroad mostly allude to the above issues when explaining the low level of inward investment and the persistence of outflow, including illicit capital flight.<sup>38</sup> Capital is in short supply in the Russian market. This has mostly been due to capital flight since the collapse of the Soviet Union and the breakdown of stringent controls on external trade and foreign currency movements. Professor Mario Nuti of the London Business School estimates flight as “of the order of \$25 billion a year” since 1994. (Q5) Initially this appeared to indicate widespread anxiety lest the Communist Party regain power and drive Russia back into the command economy. Since the end of the 1990’s and with the consolidation of democracy, reforms had advanced sufficiently to ensure that the route back to Communism was securely blocked. Dr. Federov assured the Committee that “Since 1996 the chances of really going back have been absolutely nil. The question is, how quickly and comprehensively and how civilised the progress will be.” (Q489)

56. All in all, it would be a mistake to conclude that no progress has been made. Larger Western companies like BP, which can deal at governmental level, are now confident that they can operate in the new climate. Even smaller companies such as software producer Delcam Plc, which centres its activities in Ekaterinburg in the Urals, can work to profit “if one plays the game right and knows who one is dealing with...”, according to its Managing Director Mr. Hugh Humphreys. (Q227) Expert assistance from the embassy in Moscow has played its part. It is, however, a cause for regret that Britain is less of a presence among small and medium size enterprises in Russia compared with Germany and other European competitors.<sup>39</sup>

57. The continuation of capital outflow has logically to be taken as a lack of confidence in the ability of the economy to deliver profit rather than fear of reversion to the past. Improvement here, however, is now noticeable. Professor Philip Hanson of Birmingham University told the Committee “that at the margin what we are seeing is a stabilisation or even slight fall in that capital flight, and a considerable increase in domestic investment.” (Q4) Thus, as reform succeeds, capital will return. The

<sup>32</sup> Unified Energy Systems of Russia—Russian joint stock company established 1992.

<sup>33</sup> Gazprom Gifts to ITERA “Review of PWC Audit of Itera”, March 2002. William F Browdes, Chief Executive Officer, Hermitage Capital Management.

<sup>34</sup> Meeting Report “Gazprom and Itera: A Case Study in Russian Corporate Misgovernance” – Carnegie Endowment for International Peace 22 March 2002.

<sup>35</sup> For details: Carnegie Endowment for International Peace, *Meeting Report—Gazprom and Itera: A Case Study in Russian Corporate Misgovernance*, 18 March 2002. Available at [www.ceip.org](http://www.ceip.org).

<sup>36</sup> Annual Address to the Duma by President Putin, 18 April 2002.

<sup>37</sup> Annual Address to the Duma by President Putin, 18 April 2002.

<sup>38</sup> National Investment Council, *The Problem of “Capital Flight” from Russia and Ways to Repatriate it to Russian Economy*, ed. S Glinkina et al. (Moscow 2002).

<sup>39</sup> The range of obstacles created by over-regulation remains formidable. The details of an extensive survey can be found in a recent publication from the Center for Economic and Financial Research and the World Bank, *Monitoring of Administrative Barriers to Small Business Development in Russia*, Round 1.

market, in that sense, rules. The EU, therefore, can do little directly to help. It is through indirect means—by bolstering the platform of reform—that the EU and Member States can do most to facilitate greater inward investment.

## PART 5: STABILITY AND SECURITY

58. Senior Russian officials expressed to the Committee their interest in the ESDP (European Security and Defence Policy) as having “a very promising future.” **The Committee concluded, however, that fruitful collaboration depends upon the reform of the Russian military. Thorough reform, which is expensive, will have to await an economic renaissance.** In compelling evidence to the Committee General Shalikashvili emphasised how devastating the cuts to Russian military capabilities had been in the past decade. An equally sober assessment was given by Ms. Oksana Antonenko and Colonel Langton of the International Institute of Strategic Studies. In this they were joined by Dr Roy Allison of the Royal Institute of International Affairs.<sup>40</sup> As a result of reduced expenditure, only 20 per cent of the equipment is still modern. The special forces and the submarine ballistic missile forces alone appear to have emerged relatively unscathed. Recruitment has plummeted. Russia now has little more than one million men under arms (such a low figure was last seen in the USSR in the first years of Stalin’s personal dictatorship). Waste is rampant, as is corruption at the top. In the words of General Shalikashvili: “Their training is dismal; in many cases it is really non-existent except for the few élite units, the airborne units and a few others, Spetsnaz. (Q552) Lack of necessary training and the resultant use of what amount to mercenaries on short-term contracts have had a disastrous impact on the war in Chechnya, the appalling conduct of which the EU has condemned.<sup>41</sup> In this context former ambassador to Moscow Sir Rodric Braithwaite characterised the army as both “brutal and incompetent.” (Q97)

59. Moreover, as was confirmed to the Committee in Brussels, Russians attached to NATO have subsequently been marginalised on returning home. Since 9/11, more effort has been made to accommodate Russian concerns and to respond positively to President Putin’s western orientation. But this has not proved easy. Even Russian legislators have had cause to complain at military secrecy. Deputy Chairman of the Duma’s Defence Committee Dr. Alexei Arbatov complains that the greater part of the contents of the military budget are still concealed from legislators.<sup>42</sup>

60. **It will take many years and huge expenditure before the Russian armed forces are able to play a significant role alongside NATO or EU armed forces in any major complex operation.** In this General Shalikashvili and former US Secretary of Defense Dr. William Perry agreed.<sup>43</sup> Requirements encompass a change of ethos, the development of a cadre of highly trained officers and non-commissioned officers, a major re-equipment programme and a core of professional servicemen. Moreover, and as a pre-condition for success of such a programme, the Russian government will have to make a fundamental political decision. They must decide, and perhaps decide soon, what role they wish their armed forces to play in the new strategic environment.

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<sup>40</sup> See, for example Q552, Q290, Q288, and Q289.

<sup>41</sup> See paragraph 14 for detail.

<sup>42</sup> Alexei Arbatov, “Komu nuzhna voennaya taina? [Who needs military secrecy?], *Moskovskie Novosti*, No 37, 24–30 September 2002.

<sup>43</sup> See General Shalikashvili Q552, and Dr Perry Q554.

## PART 6: COMMON CHALLENGES

## CRIME AND CORRUPTION

61. An area that was more dormant than active under the PCA was co-operation on combating crime and corruption. Not least, this was because the Russian Ministry of the Interior, in contrast to the office of the Prosecutor-General, steadfastly resisted efforts at engagement. It would be an exaggeration to claim that since 9/11 all has changed for the better. Minister for Europe Peter Hain acknowledged even now that “the Russian interior ministry is perhaps not the most progressive and efficient operator” in collaboration. (Q187)

62. There has, however, been evident progress in the sharing of intelligence with the West against sources of terrorism. This has brought Russia and the EU closer in sharing information on international white-collar crime. Mr. Thomas Firestone, Assistant US Attorney and Resident Legal Adviser at the US embassy in Moscow, explained to the Committee that organised crime arose as an extension of the corrupt privatisation of state assets that began to occur even under President Mikhail Gorbachev. The absence of an appropriate legal framework for business led directly to the emergence of “a system of private dispute resolution *“razborki”* and private armies protecting certain private interests.” (Q215) He distinguished sharply between this and the traditional Mafia hierarchy in Italy and the United States, in that Russian gangs formed themselves for specific tasks rather than permanent operations and then mysteriously disbanded. Whereas in the West “it is very clear who is in government, who is in business, and who are the leaders of the criminal community, and the three do not overlap”, in Russia these were frequently “one and the same.” (Q220)

63. In the 1990’s joint efforts by the FBI and its German counterpart the Bundeskriminalamt (BKA) to collaborate with the Russian authorities against money-laundering broke down when President Yeltsin refused to sign the appropriate legislation. The EU pressed onwards, however, and on 13 April 2000 it established an ‘Action Plan in Support of the Fight Against Organised Crime in Russia.’ A Committee of the Russian Federation on Financial Monitoring was finally set up in November 2001, and anti-money laundering legislation at last took effect from 1 February 2002. This enabled Russia to have itself removed from the list of countries failing to co-operate<sup>44</sup>. There was further movement on 25 September 2002, when an agreement was reached with Washington allocating \$1,900,000 to Russia to fight the drugs traffic and organised crime in general. This has been paralleled in Europe by direct discussions between Justice and Home Ministers of the 15 and their Russian counterparts, focusing on specific operational measures not just on organised crime but also on administrative and judicial reform in the Federation itself.

## THE PROBLEM OF KALININGRAD

64. The manner in which President Putin has handled the delicate and potentially explosive issue of Kaliningrad indicates just how seriously he weighs the EU in this new balance, just as the position finally taken on Iraq will indicate the limits and extent of Russia’s alignment with the United States. EU enlargement to encompass Poland and the Baltic States further complicates the anomalous situation of the Kaliningrad region. Formerly Königsberg, the city had been a major German port in East Prussia. After annexation by the Soviet Union (with Allied consent) in 1945, the German population was largely driven out and replaced by Soviet citizens. The region encompasses some 5,830 square miles. To the south stands Poland and, to the East, Lithuania. Kaliningrad lies 200 miles distant from the body of Russia.

<sup>44</sup> The list of non-co-operative countries in the fight against money laundering drawn up by The Financial Action Task Force (FATF). Information can be found at [www.oecd.org/fatf](http://www.oecd.org/fatf).

## “THE PROBLEM OF KALININGRAD”—(MAP)



65. To travel to Kaliningrad from north-western Russia by land or direct air route requires passage across Latvia or Belarus and then through Lithuania. Polish and Lithuanian implementation of the EU common tariff and the Schengen accord will mean that Kaliningrad will be cut off, for trade and, more important, for population movements, by land (though not by sea) from the body of Russia. For the Russians this has symbolic as well as material consequences. For the EU, however, there can be no question of making decisions that affect the vital interests of an acceding state without that country's wholehearted consent. The European Commission has been wrestling with this problem at least since January 2001, when it issued its first communication on the subject. The issue featured prominently in discussions at the EU-Russia summit in Moscow on 29 May 2002, when the Russians were handed proposals on “EU-Russia Co-operation on Kaliningrad: 2002 and beyond.”

66. Kaliningrad can only benefit from increased EU attention. GDP is 35 per cent below the Russian average. Industrial production has dropped by 60 per cent since 1990. It is estimated that nearly one third of the population lives below subsistence levels. In addition, the problems of disease (notably AIDS), environmental pollution, crime and corruption are here even more serious than in Russia as a whole. Since these ills are not easily confined to Kaliningrad by even the most stringent border controls, the EU has long recognised the need to raise Kaliningrad to a position where its circumstances are comparable with those of the surrounding acceding states.

67. Accordingly, the EU has committed some €40 million for resolution of the problem to date. Of this amount a significant proportion (over 25 per cent) has been allocated to the construction and renovation of border crossings. There are currently 23 crossing points with Poland and Lithuania. Estimated movement across frontiers in 2001 is of 960,000 crossings by train and 620,000 by car, from a population totalled at 947,000. Of these journeys the greater part go via Lithuania (some 1,500,000). Up to now €14 million has been dispensed to underpin business, trade and technological development, plus €3 million allocated to the energy sector.

68. On 11 November 2002 the European Union and Russian Federation issued a joint statement on “Transit between the Kaliningrad region and the rest of the Russian Federation”

The joint statement includes (i) The provision of a Facilitated Transport Document (FTD) Scheme from 1 July 2003 for Russian citizens travelling between Kaliningrad and other parts of Russia by

land. To be reviewed by the EU no later than 2005. (ii) A Facilitated Rail Travel Document (FRTD) for Russian citizens intending to make a return trip by train through the territory of the Republic of Lithuania without alighting in Lithuania. (iii) A feasibility study in 2003 considering the Russian proposal for visa free transit by high speed non-stop train. (iv) An agreement to continue discussions between the Russian Federation and the EU on the transit of goods, within the PCA framework. The Committee welcomes this agreement.

69. These measures effectively delay matters to allow further time to reach a solution satisfactory to all parties and in so doing they defuse existing tensions for the short-term. Nevertheless, problems still lie ahead, not least since there are no suitable high-speed trains of the kind envisaged. Furthermore, the Commission still insists on the Schengen provisions. By way of compensation, however, it is willing to co-operate more fully on organised crime, environmental hazards and economic development. The Committee note the electoral significance of the timing of the agreement. The Kaliningrad issue is one of great sensitivity within Russia and the election season does not end until the summer of 2004. This effectively leaves six months for a final agreement to be made by a Russian government bolstered by a clear mandate from its electorate.

70. Lithuanian worries arise from anxiety that, as a result of inadequate policing of the borders with Kaliningrad, the frontiers between themselves and the rest of the EU are subject to continuing controls even after accession. **They are therefore seeking written guarantees to ensure that this does not happen. The burden of a solution to the problem of Kaliningrad is thus effectively shifted towards Brussels. The Committee favour such a move.**

71. Kaliningrad has benefited from external support for environmental improvement. This falls within the Action Plan for the Northern Dimension agreed at Feira on 13 June 2000. The Plan treats environmental problems common to the littoral states of the Baltic Sea and touches on an issue of critical importance since the disaster at Chernobyl in the Ukraine.

#### THE ENVIRONMENT

72. The improvement in the environment falls logically within the process of reform within Russia, in the sense that any improvement would raise the standard of living and life expectancy of the population and hence contribute to greater political stability and economic prosperity. Yet progress can only be at the expense of diverting economic resources that are as yet in short supply. In short, it would be unreasonable to expect President Putin, facing an agenda of change that already tests the tolerance of the population, to grasp this particularly unpleasant nettle with enthusiasm in current conditions. The problem is complicated by the decay of nuclear facilities and by the military, who resist encroachment into their own domain. It is for this reason that the EU's role can only be one which looks to the medium, or even the long, term.

73. Although environmental conditions within Russia have improved since the early 1990's, even Russian government scientists admit that 15 per cent of the country is unfit for human habitation and that nearly one third of the population suffers from pollution at levels which are far higher than any which are generally accepted internationally.<sup>45</sup> One third of all water pipes and 17 per cent of sewage pipes urgently require replacement. 1.8 billion tons of toxic waste has been accumulated and is further accumulating at a rate of 108 million tons per annum. Air pollution from heavy vehicles and factory emission is dangerously high. As a measure of the effects of environmental pollution life expectancy is now estimated for men at between 58 and 60 years as opposed to 75 years in the United Kingdom.<sup>46</sup>

74. The EU has contributed to what effort there has been since the signature of the PCA. Areas receiving attention have included wasteful use of energy resources, disease arising from pollution, management of waste (including radioactive material) biodiversity and pollution of inland and partly closed seas (the Baltic, Barents, Caspian and Black Seas).<sup>47</sup> But the problems are far from going away. For instance, it is reported that there still exist 200 reactors in 110 decommissioned nuclear submarines in Barents Sea naval bases.<sup>48</sup>

75. Between 1991 and 2000 the EU provided some €774 million to the Commonwealth of Independent States as a whole. Yet only €25 million in the past five years has gone to Russia itself.

<sup>45</sup> "Environment Problems in the Russian Federation", Research & Analytical Papers, Eastern Research Group, Foreign and Commonwealth Office, October 2000.

<sup>46</sup> Communication from the Commission—"EU-Russia Environmental Co-operation", Brussels, 8 January 2002. COM (2001) 772 final.

<sup>47</sup> Communication from the Commission—"EU-Russia Environmental Co-operation", Brussels, 17 December 2001.

<sup>48</sup> European Voice, 10/11 October 2002.

76. It is freely accepted that more could and should be done. The then Minister for Europe Peter Hain regretfully acknowledged that “we do need a much better partnership with the Russian authorities on environmental matters.” Nevertheless “it is not really a shared priority between the European Union and the Russians.” (Q199) Yet by the Russians this priority has in fact been downgraded rather than upgraded or even maintained. The State Committee on Environmental Protection has been swallowed up by the Ministry of Natural Resources—only to be demoted and reduced in size. The consequence of this is, as the Department for International Development told the Committee on a previous occasion, that “powerful commercial interests and other Ministries can ignore environmental regulations.”<sup>49</sup>

77. If it is difficult to sustain Russian government attention to the general problem of environmental improvement, it is almost impossible to engage in serious debate on the most dangerous problem of all—fissionable material<sup>50</sup>. The problem is complicated by the Russian military. In areas where the military have been unable to influence events, they have had to accept new realities with sullen passivity. In areas where they can resist by inertia—as in this instance—they have done so and show every sign of continuing to do so. Thus Russia has dragged its feet in signing up to a legal framework under which nuclear clean-up programmes can sensibly proceed.<sup>51</sup> Indeed, where the EU has been active, lack of co-operation has been raised repeatedly as an obstacle to progress.<sup>52</sup>

78. The EU here, as elsewhere, is not alone. The United States has taken the lead in a programme to improve the security of installations holding or producing weapons-usable and weapons-grade isotopes. But, by contrast, cuts in military expenditure in Russia have made matters worse. Results have therefore been mixed. Security upgrades have to date extended to only 21 per cent of Russian weapons-usable materials. “Progress is most advanced at civilian institutes and Russian navy sites, and lags at Minatom [Ministry of Atomic Energy] facilities within the nuclear weapons complex—which contain most of the material of proliferation interest—because Russian security concerns prevent direct access to sensitive materials.”<sup>53</sup> Clearly, more must be done by the EU, but equally clearly, in close co-operation with the United States. We note, perhaps somewhat ominously, that Minatom has been working with Iran on nuclear matters.

79. In less sensitive areas the problem may be so great and any solution potentially so costly that this is unlikely to command anything near a high priority in Moscow. Nevertheless it was suggested that the best way to proceed might be to link aid for environmental clean-up with business profitability. If entrepreneurs could be shown that it was in their monetary interest, for instance, to invest in “clean” technology, the argument might be more persuasive. This is particularly true at local rather than national level, not least through the agency of local government.

80. In summary, Russia has over a decade engaged in a process of fundamental reform. **The transformation of a command economy and political dictatorship into a market economy and a presidential democracy has no historical precedent. It is therefore not surprising that the road to reform has been hard and uneven. Initially political uncertainty clouded the prospects for economic change. The accession of President Putin finally brought political stability, albeit at the price of reduction of media freedom. Combined with the restoration of Russia as a major energy exporter, this has enabled economic reform to accelerate.** The emerging rapprochement with the United States and Member States of the EU promises a further and more ambitious advance, once the elections scheduled in Russia for 2003–2004 are over.

<sup>49</sup> Memorandum from the Department, 3 June 1998: House of Lords, Select Committee on the European Communities, *Partnership and Trust: The Tacis Programme. The Environment of Russia and The New Independent States*, HL Paper 157. Session 1997–1998. 33<sup>rd</sup> Report (HMSO London 1998) p45.

<sup>50</sup> Fissionable materials are materials which are capable of undergoing nuclear fission (Oxford English Dictionary). Nuclear Safety Management 59 FR 15851 (April 5<sup>th</sup> 1994) defines fissionable material as a nuclide capable of sustaining a neutron-induced fission chain reaction (e.g. uranium-233, 235, plutonium-238, 239, 241, neptunium-237, americium-241 and curium-244).

<sup>51</sup> See map on page 24.

<sup>52</sup> From the European Commission: *Tacis Nuclear Safety—Indicative Programme 2002–2003*.

<sup>53</sup> *Annual Report to Congress on the Safety and Security of Russian Nuclear Facilities and Military Forces FY 2000*.

RUSSIA—DECLARED CHEMICAL WEAPONS STORAGE FACILITIES—MAP

81. The EU here, as elsewhere, is not alone. The United States has taken the lead in a programme to improve the security of installations holding or producing weapons-usable and weapons-grade isotopes. But, by contrast, cuts in military expenditure in Russia have made matters worse. Results have therefore been mixed. Security upgrades have to date extended to only 21 per cent of Russian weapons-usable materials. “Progress is most advanced at civilian institutes and Russian navy sites, and lags at Minatom [Ministry of Atomic Energy] facilities within the nuclear weapons complex—which contain most of the material of proliferation interest—because Russian security concerns prevent direct access to sensitive materials.”<sup>54</sup> Clearly, more must be done by the EU, but equally clearly, in close co-operation with the United States. We note, perhaps somewhat ominously, that Minatom has been working with Iran on nuclear matters.

82. In less sensitive areas the problem may be so great and any solution potentially so costly that this is unlikely to command anything near a high priority in Moscow. Nevertheless it was suggested that the best way to proceed might be to link aid for environmental clean-up with business profitability. If entrepreneurs could be shown that it was in their monetary interest, for instance, to invest in “clean” technology, the argument might be more persuasive. This is particularly true at local rather than national level, not least through the agency of local government.

83. In summary, Russia has over a decade engaged in a process of fundamental reform. **The transformation of a command economy and political dictatorship into a market economy and a presidential democracy has no historical precedent. It is therefore not surprising that the road to reform has been hard and uneven. Initially political uncertainty clouded the prospects for economic change. The accession of President Putin finally brought political stability, albeit at the price of reduction of media freedom. Combined with the restoration of Russia as a major energy exporter, this has enabled economic reform to accelerate.** The emerging rapprochement with the United States and Member States of the EU promises a further and more ambitious advance, once the elections scheduled in Russia for 2003–2004 are over.

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<sup>54</sup> *Annual Report to Congress on the Safety and Security of Russian Nuclear Facilities and Military Forces FY 2000.*

## PART 7: CONCLUSIONS AND RECOMMENDATIONS

84. The institutional framework for dealing with Russia would benefit from renovation. The division of views and competences between the Council of Ministers and the Commission, and differing responsibilities within creates problems for EU/Russian relations. A single office within the Commission, at high level, co-ordinating all matters relevant to Russia would be a sensible way forward. (paras 13 and 32)

85. The PCA has several years to run. Its current structure no longer fully meets demand and in practice is effectively circumvented. It was created to match the needs of the immediate post-Soviet period, when Russian reform had barely started. (para 32)

86. The Common European Economic Space is not a substitute for the PCA. It both promises too much and offers too little. It promises too much in appearing to Russia to offer the benefits of participating in the EU without the costs and obligations normally entailed. On the other hand, it offers too little in confining the EU-Russia relationship to questions of commerce. (paras 20 and 42)

87. The Committee believes it is time to consider ways which would hasten institutional reform, help Russia prepare for entry into the WTO, prevent damaging energy dependence for the EU, provide foreign and security policy co-ordination and the wider prospect of a greater convergence of values. (para 21)

88. The Committee recommends that the EU should consider a major programme of educational assistance that focuses on training the rising generation of Russians (especially officials, and not merely in the field of foreign affairs) in European universities on all matters related to the EU. It also proposes that EU officials dealing with Russian issues receive appropriate additional training. Sharing opportunities between European and Russian youth would secure a better mutual understanding in the long term. (para 45)

89. The EU may also wish to consider a more active role on behalf of Member States in seeking to lock in Russia as a major supplier of oil as well as gas over the next two decades, given uncertainties in the Middle East. (paras 26 and 28)

90. Since Chernobyl all Europeans have become more aware of the fact that pollution knows no political frontiers. To the extent that the EU can offer assistance, it has to draw Russia's attention to the fact that environmental concerns are a vital and not a secondary interest and that closer co-operation, particularly in the area of radiological protection, would be warmly welcomed. (para 77)

91. As for the enclave of Kaliningrad, the Committee recognised that the solution to its impending isolation will require considerable ingenuity, but is encouraged by the progress which has recently been made. The EU now stands firm by the Schengen agreement. A mixture of non-stop trains with what would amount to free passage, low-priced air transportation and with multiple entrance visas for local traffic by road may well provide a long-term solution. Lithuania, on accession, has to be assured that its borders will be fully open to the remainder of the EU. The task of ensuring the security of its frontiers beyond thus lies with the EU. (para 70)

92. If co-operation in CFSP is to extend substantially beyond anti-terrorism, there must be thorough reform of the Russian armed forces over the next decade. Such reform first of all requires a clear definition of the purpose of these forces. It would be to the EU's advantage to indicate where and how co-operation is envisaged in the longer term. Although it will be to Europe's advantage to promote links that lock Russia into a stable European security system, it will be no less important to avoid any dissonance between NATO's links with Russia and Russia's association with the CFSP. The greatest possible co-ordination will need to be maintained by the EU. (paras 58 and 60)

93. The Committee's overall conclusion is to warn that most of the changes advocated with respect to Russia itself, though immediately desirable, are unlikely to be fulfilled in anything closer than the medium-term (within a decade, not less). Unreasonable expectations of a dramatic transformation—perhaps raised by the rapid strategic shift made by President Putin after 9/11—will only undermine the sustained and steady progress towards solutions that benefit both the EU and Russia. (para 80)

94. The transformation of Russia will ultimately be completed primarily from within, from below as much as from above, and through a change in outlook as well as of institutions. The EU does, however, have a measure of responsibility. Where it can move effectively, it has the capacity to act more promptly in reordering its priorities and building the foundations for a more profitable future relationship. The advantages are self-evident. Her Majesty's Government should therefore press the EU to adopt a longer-term strategy towards Russia, one that will enable Europe to encourage this transformation and to develop a more systematic and productive relationship with Russia in the decades ahead.

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95. For these reasons, the Committee considers that the question of EU relations with Russia raises significant issues to which the attention of the House should be drawn. We accordingly make this Report for debate.

## APPENDIX 1

*Sub-Committee C (Foreign and Security Policy)**Members of the Sub-Committee*

Lord Bowness

Lord Harrison

Baroness Hilton of Eggardon

Lord Inge

Lord Jopling (Chairman)

Lord Maclennan of Rogart (from January 2002)

Lord Morris of Aberavon

Baroness Park of Monmouth

Lord Powell of Bayswater

Lord Watson of Richmond

Lord Williams of Elvel

Lord Williamson of Horton

The Specialist Adviser was Dr Jonathan Haslam, Reader at the Centre of International Studies, Cambridge University, and Fellow of Corpus Christi College, Cambridge.

## APPENDIX 2

**List of Witnesses**

The following witnesses gave oral evidence:

Dr Roy Allison, The Royal Institute of International Affairs (Chatham House)

Ms Oksana Antonenko, International Institute for Strategic Studies

Sir Rodric Braithwaite GCMG, Ambassador to the Soviet Union 1988–1992

BP plc

Professor Archie Brown, St Antony's College, Oxford

Sir Bryan Cartledge KCMG, Ambassador to the Soviet Union 1985–1988

Dr Boris Federov, former Minister of Finance of the Russian Federation

and a non-executive Director of Gazprom

Mr Thomas Firestone, Assistant US Attorney and Resident Legal Adviser, US Embassy, Moscow

Foreign and Commonwealth Office

Professor Philip Hanson, Department of Russian and Eastern European Studies,

University of Birmingham

Mr Hugh Humphreys, Managing Director, Delcam plc

Colonel Christopher Langton, International Institute for Strategic Studies

Embassy of the Republic of Lithuania

Dr Edwina Moreton, Diplomatic Editor and Deputy Foreign Editor, The Economist

Professor Mario Nuti, London Business School

Mr Edward Parker, Director, Sovereigns Group, Fitch Ratings

Dr William Perry, former US Secretary of Defense

Embassy of the Republic of Poland

Dr Alex Pravda, St Antony's College, Oxford

Mr John Shakeshaft, Managing Director, Lazard

General John Shalikashvili, former Chairman of the US Joint Chiefs of Staff

Mr Jonathan Stern, Fellow, Royal Institute of International Affairs and Imperial College

Sir Andrew Wood, HM Ambassador to Russia and Moldova 1995-2000

## APPENDIX 3

**List of Private Meetings**

The Sub-Committee held meetings in private with the following witnesses.

**Meetings held in Moscow—Monday, 8 April-Wednesday, 10 April 2002**

Ms Olga Danilova, Head of Department on Trade Policy and Multilateral Negotiations,  
Ministry of Trade and Economic Development

Members of the Federation Council Foreign Affairs Committee

Yevgeny Gusarov, Deputy Foreign Minister, Ministry of Foreign Affairs

Meeting at IMEMO (Institute of World Economy and International Relations)

chaired by Vladimir Baranovsky

Sir Roderic Lyne, HM Ambassador

Bob Nurick, Carnegie Centre

Dmitri Rogozin, Chairman of the International Affairs Committee of the State Duma

Andrei Ryabov, Carnegie Centre

Vladimir Ryzhkov, Duma Deputy and Chairman of the Russia in Europe Group of the State Duma

Dmitri Trenin, Carnegie Centre

Nina Vaskunlahti, Counsellor, Finnish Embassy

Richard Wright, Head of EU Commission Office, Moscow

Vitaly Zhurkin (Honorary Director), Institute of Europe

**Meetings held in Brussels—Monday, 24 June-Tuesday, 25 June 2002**

Ms Soledad Blanco, Director, Directorate-General for Environment, European Commission

Ms Bridget Brind, 1st Secretary, Former Soviet Union/Asia

Ms Carolyn Brown, Counsellor, External Relations

Mr Patrick Child, Cabinet of Commissioner Patten, Directorate-General External Relations,  
European Commission

Mr Robert Cooper, Director General, Council Secretaria/Policy Unit

Ms Hannah Corbett, 1st Secretary, Former Soviet Union/Asia

Mr Ian Holt, 1st Secretary, Industry, Energy, Internal Market and Transport

Mr Hiddo Houben, Deputy Head of Russia Unit, Directorate-General Trade, European Commission

Sir Emyr Jones-Parry, UK Permanent Representative to NATO

Mme Françoise Le Bail, Director of Russia Unit, Directorate-General Trade, European Commission

S.E.M. Vasily Likachev, Ambassador, Russian Embassy to the European Union

Mr Jaime Reynolds, Directorate-General for Environment, European Commission

Mr David Richmond, Political and Security Committee Representative and Deputy Political Director,  
United Kingdom Permanent Representation to the European Union

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Mr Kees van Rijs, Head of Task Force Policy Unit, Council Secretariat/Policy Unit

HE Sir Nigel Sheinwald KCMG, Ambassador, United Kingdom Permanent Representation  
to the European Union

Mr Tom Smith, 1st Secretary, Trade Policy

Mr Jonathan Sweet, Counsellor, Justice and Home Affairs

Mr David Turr, Deputy Head, Directorate-General External Relations, European Commission

## APPENDIX 4

**Glossary of Acronyms and Technical Terms**

BJA	Bundeskriminalamt
CEES	Common European Economic Space
CFSP	Common Foreign and Security Policy
ESDP	European Security and Defence Policy
EU	European Union
FATF	Financial Action Task Force
FRTD	Facilitated Rail Travel Document
FTD	Facilitated Travel Document
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
GNI	Gross National Income
HLG	High Level Group
IPR	Intellectual Industrial and Commercial Property Rights
MAP	Membership Action Plan
Minatom	Ministry of Atomic Energy
NATO	North Atlantic Treaty Organisation
OPEC	Organisation of the Petroleum Exporting Countries
PCA	Partnership and Co-operation Agreement
TACIS	EU Programme offering Russia financial assistance
UES	United Energy Systems of Russia
UN	United Nations
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

## APPENDIX 5

*EU Enlargement and NATO expansion*

<b>Country</b>	<b>Expected Accession Date to EU</b>	<b>Current Status in NATO Application</b>
Albania	Not negotiating	Participating in MAP
Bulgaria	2007	Participating in MAP
Croatia	Not negotiating	Participating in MAP
Czech Republic	2004	NATO member – joined 1999
Cyprus	2004	Not negotiating
Estonia	2004	Participating in MAP
FYROM*	Not negotiating	Participating in MAP
Hungary	2004	NATO member – joined 1999
Latvia	2004	Participating in MAP
Lithuania	2004	Participating in MAP
Malta	2004	Not negotiating
Poland	2004	NATO member – joined 1999
Romania	2007	Participating in MAP
Slovakia	2004	Participating in MAP
Turkey	Accession negotiations yet to start	NATO member – joined 1952

MAP            Membership Action Plan for joining NATO

FYROM\*      Former Yugoslav Republic of Macedonia