

DGAPbericht

Research Institute of the
German Council on Foreign Relations

N° 10

Looking East, Looking West: Key Challenges Facing the Atlantic Partners

High-Level Conference
November 15 and 16, 2007, Berlin

Compiled and edited by Anita Hurrel

Alfred von Oppenheim-Zentrum
DGAP

The background of the cover features a blue-tinted photograph of a conference room. In the foreground, a banner is visible with the text 'Alfred von Oppenheim-Zentrum' and 'DGAP' in large, stylized letters. In the background, several people in business attire are seated at a long table, engaged in a discussion. The overall aesthetic is professional and academic.

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Dear Reader:

2008 will be a vital year for the transatlantic relationship: The election of a new American president paves the way for a fresh look at a partnership that is bound to revisit its underlying premises and poised to find common answers to the tasks ahead of us.

George W. Bush's successor in the White House, be it a Democrat or a Republican, will most certainly look across the Atlantic and ask for European contributions to tackle challenges such as fighting the Taliban in Afghanistan and managing the re-emergence of Russia as an assertive power. Europe and the United States will also have to deal with growing insecurities in the international financial architecture.

The transatlantic relationship has for a long time been one of the key research areas of the German Council on Foreign Relations. In November 2007, DGAP's Alfred von Oppenheim-Centre in cooperation with the American Council on Germany (New York) and the Council for the United States and Italy (Rome) brought together prominent experts and practitioners from the realms of politics, business and the media to discuss the current state of the Atlantic partnership.

The conference began with a key-note address by former deputy national security advisor James Steinberg on the economic and political challenges facing the transatlantic community and the next U.S. president at the residence of the Italian ambassador in Berlin.

Among the group of high-level speakers were Richard Holbrooke, former U.S. ambassador to the UN, Karl-Theodor zu Guttenberg, MP and Chairman of the CSU's Foreign Affairs Committee in the Bundestag, and Pier Carlo Padoan, Deputy Secretary-General of the OECD.

DGAP hopes that this report will serve as a useful resource to help navigating the sometimes complex discourse across the Atlantic. I am confident that we were able to preserve some of the conference's productive spirit in the following pages, and I certainly hope you will enjoy following up on the results.



Prof. Dr. Eberhard Sandschneider
Otto Wolff-Director of the Research Institute





The Italian Ambassador, Antonio Puri Purini, welcomes conference participants to his residence in Berlin



James Steinberg addresses conferences attendees

Looking East, Looking West: Key Challenges Facing the Atlantic Partners

High-level conference, Berlin, November 15-16, 2007

Introduction

On November 15 and 16, 2007, the German Council on Foreign Relations (Deutsche Gesellschaft für Auswärtige Politik – DGAP) hosted a high-level conference in cooperation with the American Council on Germany (ACG) and the Council for the United States and Italy (CUSI). The DGAP's Alfred von Oppenheim Center for European Policy Studies worked with American and Italian partners to bring together prominent decision-makers and commentators from business, politics, and journalism to assess the most important challenges confronting the transatlantic partners. The discussion was broadly oriented around two principal issues: the transatlantic economy and world trade, and common transatlantic foreign policy challenges.

At the opening dinner hosted by Italy's ambassador to Germany, Antonio Puri Purini, the ambassador stressed that the transatlantic relationship rests on strong civilizational ties, but also needs constant effort and renewal. The conference addressed key areas where effort is needed: trade and investment, global financial markets, energy and relations with Russia, and Middle East policy. A year before US elections, questions about the impact of a new US administration on the approach to these policy areas, and on the transatlantic relationship in general, were at the fore of the debate. In his keynote address at the Italian embassy, James B. Steinberg, Dean of the Lyndon B. Johnson School of Public Affairs at the University of Texas and former US deputy national security advisor, stressed the importance of the upcoming presidential elections for transatlantic relations, in which foreign policy will play an exceptionally central role.

The Economic and Political Challenges Facing the Transatlantic Community—and the Next US President

Keynote Address by James B. Steinberg

Dr. Steinberg highlighted four key questions, the answers to which will shape US strategy and the transatlantic alliance.

Question 1: What is the appropriate organizing principle for US security policy? Should security policy be seen solely through the lens of the “Global War on

Terrorism” and subordinated to its goals? This question will determine what becomes of NATO. It will not, however, dramatically affect Iraq policy because the range of real options is limited in any case. It is unlikely any candidate will downplay the threat posed by terrorism, but Democrats are beginning to distance themselves from the “Global War on Terrorism” approach, the challenge being to come up with a new “strategic bumper sticker” to compete with it. In Dr. Steinberg’s view, credibility must be restored and political freedom must be promoted in effective ways and with patience, as in East Asia in the twentieth century.

Question 2: How should the United States relate to international institutions and international law? There are strong divergences between the parties and opposing strains within public opinion on this question of foreign policy means, a question whose resolution will have significant impact on transatlantic relations.

Question 3: What international economic strategy will the United States pursue? There are voices within both parties against free trade and open investment. But Dr. Steinberg warned against a retreat from globalization. While this would perhaps be welcomed by Europeans keen to ward off pressure to address their own trade restrictions, such a retreat would have enormous consequences for global growth and prosperity, adversely affecting transatlantic partners’ economic future but also that of emerging economies. This, in turn, would create instability and lessen the Transatlantic partners’ ability to deal with key problems such as terrorism and pandemic disease.

Question 4: How should the United States respond to emerging powers? Irrespective of the election outcome, “smooth sailing” in Sino-American relations is not guaranteed. And if the “China threat worldview” comes to dominate US strategy there is potential for growing transatlantic divergence, widening the gap in security assessments that already exists due to US military engagement in East Asia and involvement with Taiwan.

Dr. Steinberg ended by raising questions of how transatlantic relations will be affected by Europe’s evolution and the possibility of greater global strategic engagement, how to deal with Russia, and how to manage a long-term nuclear non-proliferation strategy. When asked about Iran he stressed the “enormous downsides” of war and said the Transatlantic partners had not come close to exploring the powerful economic tools at their disposal.

Panel I: Jobs, Competitiveness, and Investment Protectionism

The protectionist impulses in the United States and doubts about American commitment to a global investment regime that Dr. Steinberg remarked upon were addressed by the conference's first panel on Friday November 16 at the DGAP. Dr. Steinberg had pointed out that free trade has always been controversial in the United States, and conflicts with competitors, such as Japan in the 1980s and 1990s, have stoked protectionist tendencies. China's economic rise worries some, who are concerned about outsourcing and the undermining of labor and environmental standards, while the explosive growth of sovereign wealth funds and the foreign acquisition of US companies—from Unocal to IBM to Maytag—also cause alarm. Adam Posen, deputy director of the Peterson Institute for International Economics, picked up on the issues of trade and investment protectionism before commenting on energy and environmental policy as well as competitiveness.

Dr. Posen's argument on trade and agriculture was clear: freeing up agriculture could create enormous positive change; current US and European policies constitute a moral crime and, furthermore, do not serve these states' interests. Political leadership is needed on this issue. As long as this is lacking, states such as Brazil and India have great moral weight to fight against the Transatlantic partners in the Doha Round. Trade protectionism and immigration controls are likely to increase in the United States under any future administration; Europeans can either seek to restrain this or jump on the bandwagon. On investment Dr. Posen reiterated that talking about a barrier-free world is difficult due to national security concerns. He argued that process-based regulation like the Committee on Foreign Investment in the United States (CFIUS) is a mistake as it allows for too much protectionism and invests an inter-agency committee with great discretionary powers. Discretionary politicization should be limited by a rules-based system and in particular one which takes account of alliances and defense agreements that should allay security concerns. The decisive question should be “who it is you don't want to transfer technology to.”

Environment and energy should be the number one item in European-US cooperation, Dr. Posen argued. In his view a carbon tax would be the preferable policy option but the more likely cap-and-trade system would be a positive step for the United States and could be integrated with European initiatives to create a deeper transatlantic market and standard-setting—and thereby also an incentive for Japanese and further international cooperation. Transatlantic cooperation is also necessary to show that the Transatlantic partners are not going to be split

on the issue of competitiveness by players such as China. The fact that the euro has come up so much against the dollar creates opportunities. For Dr. Posen the main overall challenge is to show unity in the face of Chinese and Russian divisive efforts without being overly exclusionary or conflictual and without foregoing the benefits of the global value chain. There is currently no proper forum where the US and Europe can together take their concerns directly to the BRICs (Brazil, Russia, India, China) in a robust fashion, with the exception of very specific issues in the WTO. Merkel's transatlantic initiative was positive but insufficiently ambitious; whether the OECD can really move forward an agenda remains to be seen. Therefore, in the absence of strong institutions, the focus should be on issue-by-issue diplomacy, both within the partnership and with emerging states.

The rise of China and the other emerging states also provided the backdrop to the presentation by Pier Carlo Padoan, deputy secretary-general of the OECD, but Dr. Padoan did not share Dr. Posen's outlook on the lack of institutional arenas for engaging with emerging states. Dr. Padoan laid out four areas where "the new global environment" poses challenges to the Transatlantic partners in terms of competition and growth and highlighted policy implications for each case.

First Dr. Padoan stressed developments in global value chains. In terms of drivers of competitiveness, "the global value chain is the name of the game," Dr. Padoan said. Knowledge is produced and immediately diffused across value chains. The new players, China in particular, are becoming integral parts of this value chain: outsourcing is increasing and non-OECD states are increasingly not just receivers but producers of knowledge and innovation, with R&D locations no longer solely in "center" countries. For policy, this means partners across the Atlantic should concentrate on keeping market access open and working on how to manage the proliferation of preferential trade agreements (there are currently more than 200) in such a way that they do not act as an obstacle but rather as a stepping stone toward a more open global system.

Second, innovation and knowledge are replacing other factors of production as the main drivers of growth. Innovation is also increasingly important as an instrument to deal with global challenges including climate change, sustainable growth, and health. As innovation is mainly driven by private efforts the key question is how to formulate public policies that facilitate incentives for these activities—R&D, organizational innovation, innovation in service provision (with services now the "rising sector" of growth). Innovation policy may need some revision. It should enable the demand side of innovation, from both firms and

consumers, to be more effective in determining the paths of innovation. Policy also has to tackle the challenge of intellectual property protection in a world where firms create spontaneous innovation pools and innovation is open, global, and demand-driven. This issue is very important in relations with emerging states. The Transatlantic partners should back up the G-8 Heiligendamm Process, which establishes dialogue with the G-5 (Mexico, India, China, Brazil, and South Africa) on this issue as well as on energy, investment, and development.

Third, Dr. Padoan noted that we are witnessing convergence toward the internet platform to deliver services. Communication costs have dramatically declined and to a large extent ICT spending drives growth. The internet enables creativity and the global diffusion of cultural influences, with English not the only language driving the internet. The Transatlantic partners must build and implement the regulatory framework necessary to generate enough confidence in safe communication transmission and the production of new knowledge so that this system can develop and not be used in the wrong way.

Fourth, the new players are major investors in sovereign wealth funds. These funds have caught Transatlantic partners' attention because they have been growing at spectacular rates in countries with which Transatlantic partners have "a complex interaction" and whose domestic financial market authorities may not closely supervise the funds. The concern, Dr. Padoan said, is that investment



Dr. Pier Carlo Padoan

decisions by these players may be motivated by political objectives, including interests in strategic assets. For Dr. Padoan the appropriate response involves the Transatlantic partners providing a framework and common regulatory environment that avoids investment protectionism. After all, the United States and Europe together provide approximately 80 percent of global financial regulation; if these states agree they can “sell the standard” and ensure acceptance by other players.

The increasing importance of the emerging states emphasized by Dr. Padoan was also stressed by Stefan Zoller, a member of the executive committee of EADS. Dr. Zoller, assessing challenges for transatlantic relations from an industrial perspective, echoed Dr. Padoan’s comments on these states’ rise in R&D and innovation, citing as prominent examples Singapore as a center for biotechnology and nanotechnology and India as a new factor in the aerospace and defense industries. However, while cooperation was at the center of Dr. Padoan’s presentation, Dr. Zoller portrayed the continued prevalence of competition in transatlantic relations. When strategizing how to play globally Europe and the United States are more likely to compete in the new markets, Dr. Zoller said. The cooperation necessary for transatlantic adjustment to the new innovation landscape is lacking; the political will needed to push the development of an integrated industrial base simply is not there; jointly addressing global markets is impeded by technology transfer and export regimes not being granted in military, aerospace, and other sensitive areas; and protectionism is everywhere (including within Europe). But in the absence of cooperation or a joint industrial base, in Dr. Zoller’s view there is at least some hope for ongoing discussions on open markets and trade in sensitive areas.

A critical response to Dr. Zoller’s comments came from Ambassador John C. Kornblum of Lazard & Co., former US ambassador to Germany. Asking Dr. Zoller to “get real,” Ambassador Kornblum posed the question: “Why should the United States give any preferences whatsoever to EADS?” He remarked that European states have no defense markets or establishments to speak of, European governments have been opposing US security policy in recent years, and Europe is not a major player in the military security field. Ambassador Kornblum stressed moreover that “defense is not a market; defense is a politically controlled industrial operation.”

Interview with Adam Posen

Question: How can the Transatlantic partners deal with the challenge of emerging states?

Adam Posen: We have to coordinate and be sure that we don't fall prey to being played one off against the other, as the Chinese have done with the US and Europe on currencies or as the Russians have done with the US and Europe on Kosovo but also on energy supplies. At the same time we have to forswear setting up US-EU-only institutions. We have to think of ourselves as a common interested group but act as though there already is a global framework. One could try to come up with new institutions but in the short term that's not likely.

Question: How do you see the prospects for European-US cooperation on environment and energy?

Posen: I am convinced that the US Congress will pass some sort of major cap-and-trade legislation and there will also be plenty of grounds for coordinating on ethanol so there's room for integrating what's already in place in Europe with what's underway in the US, which will have economic efficiency gains as well as political clout gains. So I'm quite hopeful that that will be a source of real progress in the next couple of years.

Question: What can stem the negative tide on trade in the United States?

Posen: I'm hopeful there will be some progress on health care for the uninsured and the unemployed in the US and that will have some beneficial effect for its own sake but also will reduce anxieties about trade. I am still a little worried that there are groups like unskilled white males who are just congenitally going to be against trade because they can't scapegoat others in the society for their losing their privileges. You can try to make the case morally and politically, especially on the agriculture point, and you can try to build a coalition of people other than unskilled white males. But I must admit I'm less optimistic on this than I am on energy or on the domestic aspects of health care.

Interview with Pier Carlo Padoan

Question: What do you see as the most important challenge for the transatlantic relationship?

Pier Carlo Padoan: To agree on joint actions that can help provide better global governance; more precisely, to involve the new players, the BRICS, in a common shared framework.

Question: How do you see the prospects for such a shared framework emerging and for the engagement of the BRIC countries in that process?

Padoan: This is a very difficult task but it's unavoidable. Otherwise we will fall back into regionalism, protectionism, and conflict rather than cooperation. It is a very challenging task but if the transatlantic partners don't do it then there is a vacuum of leadership in the global system which will be filled otherwise. The new players are de facto filling the gaps from their own national perspective. So we have to involve them in multilateralism.

Question: What is the role of the OECD in this?

Padoan: The OECD is trying to achieve two mandates. One mandate comes from the G-8 presidency ... That mandate calls for the OECD to provide support to the dialogue between the G-8 as a group and the G-5 as a group and therefore hopefully turn that into a dialogue on ... a G-13 common approach. The OECD also has its own mandate which comes from its membership, not only to enlarge—and the next wave of enlargement should and will include Russia as a full OECD member—but also to pursue what is called “enhanced engagement” with five new players, India, China, Brazil, South Africa, and Indonesia, with, the statement says, “a view to possible membership.” This is the challenge the OECD has to face. In the future ... if we have to agree within the OECD about common rules, we will have to share them with the BRICs.

Panel II: Follow the Money: Global Financial Markets

The global economy’s current financial turmoil was clearly high among the concerns of conference participants. Marco Tronchetti Provera, chairman of Pirelli S.p.A. and Italian co-chairman of CUSI, began the conference day by raising the issue of the sub-prime crisis. The first panel also touched upon the implications of the devaluation of the dollar and the adjustment process. In the conference’s second panel these financial issues were taken up directly. David Helleniak, vice chairman of Morgan Stanley and American co-chairman of CUSI, introduced the panel with a reminder of just how much global financial markets have changed in recent years. The first panellist, Ignazio Visco, deputy director general of the Bank of Italy, underscored the scale of change, pointing to the main aspects of change before considering the strengths and weaknesses of what appears to be a new financial paradigm and outlining the key challenges posed for financial authorities and regulators by the new global financial landscape.

Dr. Visco presented three driving forces of change over the past ten years: firstly, economic and financial integration; secondly, population aging (one important consequence of which is the increase in assets managed by institutional investors, with individuals exposed to substantial financial risk); and, thirdly, the interaction between technical progress and financial innovation. With regard to the latter, Dr. Visco stressed how information technology has powerfully affected the financial system and there are now extremely complex new financial instruments in use worldwide. Foremost in this process is the dramatic increase in asset securitization, which significantly affects the way bank intermediation takes place. There has been a move from the “buy to hold” model to the “originate to distribute”

model that has been behind the extremely low volatility in asset prices but also the extreme turmoil linked to sub-prime mortgages.

According to Dr. Visco, the new model has many benefits: more liquid bank assets, a more efficient capital market, and distributed credit risk that can potentially make the system more stable and the allocation of risk more efficient. However, the model also brings new sources of risk: valuation of structured finance products is difficult and is model-based rather than market-based; the products are not traded much; rating agencies play a key role in certifying the quality of the products, but there is little proof that they value them correctly; banks have diminished incentives to monitor their borrowers so the quality of loans may deteriorate; and there is a lack of information about who is bearing the risk. Greater interdependence, which in good times enhances resilience, may make shocks more diffuse and difficult to cope with. This calls for international policy coordination on liquidity provision, regulation, and supervision, Dr. Visco argued.

Assessing recent financial turbulence, Dr. Visco said the short-term response had been successful. There was not a coordinated response across the Atlantic but there was consultation between central banks. Through prompt interventions central banks were able to preserve orderly market conditions and avert a liquidity crisis without modifying monetary policy stance or affecting short-term money market rates. However, the situation is still very delicate, especially with regard to



Dr. Thorsten Pöttsch, David Heleniak, Charles Winn and Dr. Ignazio Visco

longer money market maturities. Turbulence could still turn into crisis. To tackle the fragilities highlighted by the current turbulence, Dr. Visco believes that there is a long-term need for a financial regulation response to strengthen the foundations of the financial system. The Basel 2 framework will mitigate the problem of banks exploiting regulatory arbitrage and transferring activities that would otherwise require substantial capital to outside their balance sheets, to unregulated entities. But commercial banks, rating agencies, and other institutions must also be more efficient in their management of risk. The world is interconnected, so financial regulation must be changed in such a way that there is no regulatory arbitrage, with clear rules applied to the whole world.

Charles Winn of Goldman Sachs provided a different angle on changes in global financial markets. He pointed to three changes that have occurred in private wealth management in the past five to ten years. The first change is in the way managers define certain components of portfolio management. In building a diversified, well-balanced portfolio for a wealthy investor it is now more difficult to understand what is an “American” or a “German” company given current levels of interdependence. In building portfolios with low correlations and balanced volatility, potentially difficult questions of how to define an emerging market are likewise important. The second change is that building a client’s portfolio has been made more complicated by increased correlations between asset classes and between regions. As a result, a growth manager or a value manager is less sought after than a manager who is unrestricted and is simply picking the best ideas globally. The third and, in Mr. Winn’s view, most interesting change is in the profile of decision-makers, with more global investment decisions being made by hedge funds and private equity firms, and more individual decision-makers coming from backgrounds in academia and trading.

While Mr. Winn’s remarks picked up on Dr. Visco’s theme of change, Thorsten Pötzsch, deputy director general of the German Federal Finance Ministry, focussed on the need for international cooperation on regulatory and supervisory approaches to which Dr. Visco had referred. Dr. Pötzsch’s main message was that international cooperation on financial markets is needed so that the benefits of globalization can be reaped while the risks and dangers of economic and especially financial globalization and integration are minimized. Ensuring financial stability, Dr. Pötzsch said, requires international policy coordination and crisis prevention—including the early identification of risk—in international institutions such as the IMF, the G-7, the G-20, the Financial Stability Forum (FSF), and the Bank of International Settlement.

Dr. Pötzsch pointed in particular to the recent efforts of the IMF in financial market surveillance; the FSF's working group that was formed to discuss aspects of the crisis; Angela Merkel, Nicolas Sarkozy, and Gordon Brown's common position on transparency in financial markets; efforts by the German G-8 presidency to improve transparency in the hedge fund sector; and G-7 agreement on working toward best practices for sovereign wealth funds. He also commended private sector reactions to recent turbulence, including both Citigroup, JPMorgan Chase, and Bank of America's proposed master liquidity enhancement conduit and especially the Institute of International Finance's initiative to define best practices for market participants and monitor for imbalances, which, if successful, could form the basis for a more structured dialogue with governments on these issues.

Interview with Ignazio Visco

Question: What lessons can be learned from the period of turbulence that the global financial system is currently experiencing?

Ignazio Visco: The interesting thing is that this, against all expectations, was a crisis that hit commercial banks and not the hedge funds or other institutional investors that are not regulated. So it hit exactly the intermediaries that were regulated. This calls for better regulation in the sense that we need cooperation; we have to avoid some regulatory arbitrage and we need transparency in the assessment of risks and attention in handing on the books of banks all the assets and liabilities of related companies.

Question: What are the most important challenges posed by the new global financial landscape?

Visco: The key difficulty is how to make the new financial structure products tradable and actually traded in the market so that their value comes from market exchanges and not only from models.

Panel III: Coping with a "New Russia?" Energy and Security

Moving on from the transatlantic economy and world trade, the third panel turned to the conference's second broad issue, common transatlantic foreign policy challenges, and addressed the twin challenges of Russia and energy security. All the panellists concurred on a picture of a new, assertive Russia whose more confrontational foreign policy behavior disrupted the expectations of the 1990s. Planting the Russian flag on the seafloor at the North Pole; announcing the building of its own missile defense system and issuing clear warnings on the stationing of a US missile defense system in Europe; blocking a Security Council decision on the final status of Kosovo; announcing possible difficulties in the supply of oil and gas to Europe. These are just some of the instances highlighted

by Ruprecht Polenz, a CDU MP and chairman of the Foreign Relations Committee in the German parliament, to illustrate Russia's "dramatic turnaround" in foreign policy. Russia now speaks less of shared values with the West and it is clear, Mr. Polenz said, that Russia no longer seeks integration with the West. Economic cooperation forms the basis for European-Russian relations but "irritations are growing" in Europe as Russian companies seek out European markets and strive worldwide to secure access to scarce natural resources to maintain their monopoly in important markets, while foreign companies are not granted similar investment rights in Russia. Beyond this, Russia is also deliberately positioning itself as an alternative to the European Union with its own understanding of the international order and the application of power.

Paolo Garimberti, a columnist for *La Repubblica* and director for foreign affairs for the *Gruppo Espresso*, added to this picture of the "new Russia." He argued that it is very important to understand why Putin is so popular and offered five explanations. First, Russians do not like leaders who are too much like the average Russian and want a real "chief" (*vozhd*) who is sufficiently strong and nationalist. Putin is thus being prepared as a new kind of "father of the nation" even as his presidency is to end, saying he has a moral right to maintain an influence in Russia after he steps down next year. Second, Russians do not care very much about democracy and the democrats are not very popular in Russia. It is not a scandal when Putin speaks of "managed democracy;" for the average Russian this is enough. Third, citing the dissident Sergei Kovalyov, Dr. Garimberti said Putin has given Russians what they had been longing for: a feeling of relative stability and security. Fourth, there is nostalgia for the Soviet past. Fifth, Putin appears to have charisma, partly as a result of his control of the media.

So how should the transatlantic partners deal with this Russia? Mr. Polenz first noted that Europe and Russia both have a strategic interest in maintaining good relations. He underscored the critical importance to the West of not neglecting relations with this state which is rich in energy reserves, is a permanent member of the UN Security Council, and has a vital role to play in helping to resolve international conflicts like those surrounding Iran's nuclear program and Kosovo's final status. He said Russia, on the other hand, has an interest in growing economic exchange with the West since it relies on the income it receives from the sale of oil and gas. Russia needs technology transfer and enormous sums of money to modernize its industry. Gazprom alone has to contend with investment shortfalls into the billions which are holding up the development of new production sites and creating more obstacles to gas production. To undertake vital internal modernization and meet the challenge of a looming

demographic crisis, Russia needs the West, Mr. Polenz said. His recommended European policy response toward Russia was consensus and unity in Europe and legal certainty in relations with Russia. This means taking action when Russia does not comply with the spirit of organizations such as the G-8, working more energetically on Russian-European agreements like the Partnership and Cooperation Agreement, and creating internal European codes of conduct for concluding agreements with Russia so that bilateral agreements—favored by Russia—do not erode European unity.

Janusz Reiter, Polish ambassador to the United States, presented a view that made dealing with Russia appear more problematic for Europe. The new “sense of mission” Russia has chosen for itself has deeply affected the dynamics of European politics, Ambassador Reiter said, bringing the return of Russia as a self-confident player in European politics, aided by oil and gas wealth. According to Ambassador Reiter this presents Europe with exactly the kind of dilemmas it wanted to escape, with Russia forcing Europe to take a geopolitical stand. He posed questions that capture these dilemmas: Do we accept Russian behavior in Central Asia, the Caucasus, and Ukraine and Belarus, or do we state that it challenges our geopolitical interests? If Russia were to impose a ban on Polish agricultural products would it be a Polish or a European problem?



Former Polish Ambassador to the United States, Janusz Reiter

Ambassador Reiter agreed Western states should respond to these dilemmas by making and following rules. For him, the rule, put simply, must be that Russia will be admitted into the European market to the extent that it admits European companies into its own market. Gazprom is not like Western companies but it must be made to play by the rules (if the European Commission is able to control Microsoft in Europe, why can the commission not deal with Gazprom?). Ambassador Reiter was, moreover, in agreement with Mr. Polenz on the vital importance of a common EU policy toward Russia. Russia, he argued, is the reason for Europe to come to a common foreign and security policy. Russian policy also demands cooperation in the transatlantic community to back up a policy of “cooperation where possible and confrontation where necessary.”

However, despite this core agreement, differences emerged on the question of what exactly is acting as an obstacle to a common European position on Russia. Dr. Garimberti referred to Putin’s preference for relations with single states rather than the European Union. Mr. Polenz referred to the divide between those in the European Union who want to see Russia contained and those who want to see Russia integrated, saying that the German EU presidency would have desperately liked to start the negotiations on the Partnership and Cooperation Agreement with Russia had they not been prevented by Poland. Ambassador Reiter replied that negotiations with Russia could not have started at the expense of not only Polish national interests but also European solidarity. “It was a test; Russia was testing European solidarity,” Ambassador Reiter said. On the issue of special bilateral energy relationships with Russia, Mr. Polenz also tried to allay Polish fears, saying special bilateral treaties with Russia need not contradict a common approach if they are embedded in a common European interest, as shown by Germany’s proposal for a more common European energy policy, including linked gas and electricity networks. If Germany has good gas treaties with Russia its Polish neighbors could get gas from Germany if they had problems, Mr. Polenz said. Dr. Frank Umbach of the DGAP then questioned Italian representatives about the bilateral deal that ENI concluded with Gazprom shortly after agreement on common energy policy at the EU summit in March 2007. Ambassador Puri Purini responded that he did not see any difference between the dealings of ENI and the dealings that Gazprom has with a number of significant German companies. Overall it would seem that the necessary “compromising spirit” of which Mr. Polenz spoke is still somewhat lacking.

Interview with Janusz Reiter

Question: What do you see as the greatest challenge in relations with Russia?

Janusz Reiter: I think the challenge comes from the imbalance between Russia and the European Union, between a highly-centralized country and a group of 27 countries whose foreign policies are not integrated and who may have common interests, as in energy security policy, but who for a lot of reasons follow their national instincts. Another expression of this imbalance is the strong self-confidence of Russia, which is economically not one of the most powerful countries in the world but which has a tradition of self-confidence in foreign policy, while Europe as a block has no tradition of foreign policy.

Question: Are you hopeful about achieving greater cooperation on European policy toward Russia?

Reiter: This is what I hope for but if you ask whether I see it coming, I couldn't say yes. The open question is whether the Russian challenge will unify Europe or disintegrate it. It can work the one or the other way. I hope very much it will unify Europe, not overnight, but I hope that by dealing with Russia Europe will see the incentives of coming to a common position. But I'm realistic enough to know that it is a very, very long way.

Question: How do you see Russia policy impacting the transatlantic relationship?

Reiter: Russia is not only a reason to come to a common European position, Russia is also a reason to redefine and reinvigorate our Atlantic community. Europe doesn't have enough self-confidence to deal with Russia. The US does. I think we are better prepared for dealing with Russia if we go along with the United States. We have common interests with the US. I cannot see any contradictory interests between Europe and the US, whether it's energy security or Iran or North Korea. In the Cold War time ... we had a common consolidating enemy; we now have a challenging partner.

Comment by Paul Taylor, Reuters European Affairs Editor, on Panel III

What we heard from the panellists sounded like a great deal of agreement on the approach to Russia: that we needed to get tougher; that we needed to insist on the rule of law; that we needed to have a common European stance. In reality, the big member states of the European Union all feel that they have a special relationship with Russia of one sort or another—energy relationships, political relationships—and they privilege those over a common European approach. And therefore my question is what Germany is prepared to do, what it is prepared to give up—to put into the common pot—so that we do have a common European approach. It's fine to say in principle that we should have a common European approach and it should be based on the rule of law but ... you then have the North Stream pipeline, which is a Russian-German deal signed behind the backs of the European neighbors ... [and] you have ENI's deal ... with

Gazprom, signed just after the European Union committed itself to a common energy policy. In each of these cases there seems to be an absence of consultation and European spirit.

Panel IV: Pandora's Box? Prospects for Peace in the Greater Middle East

Paul Taylor, who chaired the final panel, began with the remark that the greater Middle East is characterized by “mayhem, menace, and muddle.” He started the panel by portraying the main developments in the region: The West has the semblance of a joint strategy on Iran’s nuclear program—is this working, how can it be made to work, and what happens if it does not work? In Iraq there may be a slight lull in the violence but no sustainable political settlement is in sight, the United States is experiencing fatigue, and there is the constant danger of Iraq’s neighbors being sucked in as the instability continues. Turkey is poised on the Iraqi border with the Kurdish problem. There is instability in Lebanon with Syria still trying to determine who rules there. In the Israeli-Palestinian situation Hamas is controlling Gaza and Fatah is sort of controlling the West Bank as weak leaders are fumbling toward Annapolis. Over the wider North Africa region there are concerns about Al Qaeda spreading as well as rising economic, demographic, and environmental pressures. On the other hand, Mr. Taylor pointed out, there are timid signs that the Arab world is trying to reform to meet the challenges of globalization, and there is some democratic reform, albeit often local and in a partial form that does not fundamentally undermine the states that are ruled by authoritarian leaders and their security services. The question, Mr. Taylor said, remains: how sincere has the West been about spreading democracy and does it want to continue or has it had its fingers burnt?

Karl-Theodor zu Guttenberg, a CSU MP and chairman of the CSU’s Foreign Affairs Committee in the German parliament, started by responding to Mr. Taylor’s question on where the transatlantic partners stand on democracy promotion today. Strains occurred in the transatlantic relationship because most in the German foreign policy community never shared the vision of creating a “new” Middle East by promoting democracy and freedom in an isolated way, Dr. Guttenberg said. Most Germans saw talk of democracy and freedom as ambiguous, especially in view of treatment of Saudi Arabia. Dr. Guttenberg reported that democracy-building had previously held a very significant place in German political party programs but in the recent re-phrasing of these programs by several parties the idea of transporting democracy has lost ground to the idea of pro-

moting stability. In Bush's second term, US-European relations recovered somewhat from the transatlantic rift, and Bush reached out to Europeans, making clear that he welcomes and more capable and coherent European Union that can help shoulder burdens in the Middle East. But the Middle East still has considerable potential to divide the transatlantic community. Dr. Guttenberg said the United States should demonstrate that it takes European advice seriously and that it sees Europe as a partner. Should the partnership continue and deepen it would have enormous potential to bring positive changes to the region, Dr. Guttenberg said.

Dr. Guttenberg then turned to the Iran issue. Dr. Guttenberg argued that going through the UN Security Council to reach a solution to the Iran problem is the priority. He spoke of the necessity of keeping the unity the group of six has preserved over the past one and a half years despite difficulties, including the new ideas of Germany's "hyperactive neighbor in Paris." But he also said the European side should think about the possibility of autonomous sanctions if unity in the group of six falters. This would involve doing much more within the European Union to creatively form a package that works for all players. It would involve addressing the reluctance of the German business community, which has different concerns from its French and British counterparts as many small- and medium-sized German companies are involved in commerce with Iran, and persuading them that limited timeframe sanctions are less harmful to them than a nuclear-armed Iran.



Dr. Karl-Theodor zu Guttenberg

Umberto Ranieri, chairman of the Foreign Affairs Committee in the Italian Chamber of Deputies, further stressed that Transatlantic partners must continue to pursue all diplomatic efforts to keep Iran from acquiring nuclear weapons. A new round of sanctions may have to be considered but if sanctions are to be effective, Transatlantic partners must try to reach a Security Council resolution and involve all the main states in a sanctions strategy. In the case that Russia and China delay a resolution a situation like that which occurred in 2003 must be avoided; European must remain united and must cooperate with the United States in order to employ effective measures that can prevent the Iranian authorities from acquiring nuclear weapons and avoid a military initiative with potentially very dangerous consequences. Dr. Ranieri suggested his support for an international nuclear fuel bank to help non-nuclear states develop new sources of nuclear energy. He also highlighted differences within Iranian society and between Ahmadinejad's leadership on the one hand and reformists and conservative pragmatists on the other—and the importance of strengthening the opposition groups in anticipation of 2008 legislative elections and 2009 presidential elections in Iran.

Dr. Ranieri also spoke of the potentially enormous negative effects of a Turkish military initiative in northern Iraq. He raised his fear that the issue is being underestimated by the United States and to some extent the Europeans, especially in terms of the risk involved in weakening political links between Turkey and Euro-Atlantic structures. The role played by Turkey is fundamental for the future of the greater Middle East, Dr. Ranieri contended, pointing to the positive evolution of Turkey's political system—and its eventual integration into the European Union—as one of the most important conditions in fighting extremism and radicalism in the Islamic world and showing that Islam is not a force against democracy.

The US decision to hold a Middle East peace conference is the first positive initiative since 2001, said Dr. Ranieri. It is fundamental that the conference is able to define principles on the basis of which balanced and concrete answers can be found to the problems of borders, settlements, Jerusalem, and refugees, he claimed. Assessing prospects for Annapolis, Dr. Ranieri said on the negative side that the protagonists have a credibility problem. Whereas at Camp David Arafat would have been able to respect the conditions of an agreement but had no intention of signing one, Abbas seems to be intending to reach an agreement at Annapolis but may not be able to carry it through. Israel is also divided and its leadership enjoys low public support. On the positive side, there has been a change in the Arab position since Camp David, with Arab states willing to recognize Israel if it withdraws from the occupied territories. The Arab states are

aware that without an agreement it is difficult to avoid the growing influence of Iran in the region, said Dr. Ranieri.

Marc Otte, the EU special representative for the Middle East, acknowledged that on the negative side the list can go on and on with obstacles to success at Annapolis. But he said the question should be a different one, namely: what are the costs of failure? Ambassador Otte's central message was: "we cannot afford failure so we have to find a way for Annapolis to be a success." In opening "Pandora's box," one has to start somewhere, and the Arab-Israeli conflict is the central place to look in order to deal with both the challenge of Iran having a strong hand in Lebanon, Palestine, and Iraq and becoming "everybody's bogeyman," and the challenge of the West—Europe included—losing legitimacy and credibility in the perceptions of people in the Middle East. The two-state solution is the starting point because there is currently a convergence of interests on this option between Israel, most of the Arabs, and the West. The reasons do not matter, said Ambassador Otte, what matters is that there is an opportune moment and there is a bargain. Between the Arab states and the US administration the bargain runs as follows: "We'll help you on Iraq and the coalition against Iran and you help us on the resolution of the Arab-Israeli conflict because that is what is enflaming our public opinion and radicalizing our societies." Many Arabs now believe there are two problematic states in the region, Israel and Iran, but have decided Iran is the more troublesome so an alliance can be made with Israel.

Bill Drozdiak, president of the American Council on Germany, questioned, even if there were to be some resolution of the Israeli-Palestinian conflict, how much stability this would bring to the Middle East and how far it would combat wider international problems, given there are so many other factors at work. He said there exists a rather scornful view in the US toward its Arab allies such as Egypt and Saudi Arabia who have touted the conflict for so many years as an excuse for not undertaking domestic reform. He conveyed the increasingly common view from Washington and New York that in the context of the "war on terror" the greatest fear is that the next terrorist attack will come from Europe and its Muslim minorities, groups who, according to French scholar Olivier Roy, have no real concern for the Israeli-Palestinian conflict but who are marginalized and discriminated against at home. To this, Ambassador Otte reiterated that Annapolis is a starting point and, while not solving all problems, could be a first step and could have a positive snowball effect.

Presentation by Marc Otte: The Costs of Failure at Annapolis

1. The rise of extremism. The risk especially concerns the extremism fed by the misuse of religious beliefs, which encourages confrontation between models of society. The rise of Hamas is an indication of the beginning of an anti-Western trend and islamicization in Palestinian society. This is not only a question of West versus East but a cultural conflict within the Islamic world. Failure at Annapolis would be a victory for radicals everywhere in the Middle East.
2. Non-state actors as strategic threats. In the 1990s Hamas was an annoyance to Israel, not a strategic threat. Now Hamas is building in Gaza something that looks much more like an army than a militia. Hezbollah and Al Qaeda are of course also strategic threats to Israel and to other countries in the region.
3. The proliferation of weapons of mass destruction. The question of WMD proliferation in the Middle East is no longer “if” but “when.”
4. Problems in Western societies. Transatlantic states should pay attention when there are riots in the streets of Brussels between two communities because of something that happens at the border between Iraq and Turkey.
5. Closed doors because of leadership transitions. In the two main Arab states there could be transition problems; Mubarak and the king of Saudi Arabia are both quite old. People say we can wait; some Israeli politicians say, “Olmert will fail, I’ll solve the problem with Hillary.” But we cannot afford the luxury of waiting without it having serious consequences. If Annapolis fails, a generation of Palestinian leaders will disappear. They will have lost credibility with the people. Who are we going to deal with? People who are less Westernized and who have not studied abroad like the PLO and Fatah people who have been around the world and have a lot of connections with political parties and with democratic institutions in the West.
6. International economic disruption. If things go backward in the Middle East the region risks missing the train of globalization. This is a danger because the region is crucial for the long-term future of the global economy. The Middle East’s share in world oil supplies will increase greatly in the future. A major conflict—a war between Iran and its neighbors, a major conflict between Iran and the US, a renewal of the sectarian conflict in Lebanon—could create instability in the Gulf that could have a major impact not only on the price of energy but on the world economy.
7. The disappearance of the project of a Palestinian state and the death of Israel as a Jewish state. The Palestinians and the Israelis are engaged in a “dance of death.” If the Israeli-Palestinian conflict remains unresolved the

Palestinians will vanish as a nation, the project of a Palestinian state will disappear, and Israel's nightmare will come true: the Palestinians will win by demography.

Conclusions and closing dinner

In his concluding remarks, Cesare Merlini, Italian executive vice-chairman of CUSI, expressed his skepticism about the prospects for Annapolis, stating that he sees two possibilities: open failure or—more likely—disguised failure. He spoke of his concern at the number of problems in the Middle East that have remained unsolved and are now becoming unsolvable. Professor Merlini underscored, however, that many more optimistic conclusions could be drawn from the conference's other panels. Moreover, he alerted conference participants to the promising results of public opinion polls, which show a great deal of similarity between the two sides of the Atlantic. Professor Merlini also articulated his hope that the US elections would bring a return to a foreign policy debate involving “the right idealism,” which means for him not the spread of democracy but institutions and multilateralism, and “the right realism,” which means dealing with a multipolar world.

It was with a return to the topic of the US elections that the conference ended. ACG president Bill Drozdiak remarked that the panels showed just how



Ambassador Richard Holbrooke

much work lies ahead for the Transatlantic partners and spoke of the importance of the United States rebuilding its moral authority and regaining its leadership position at the head of the world's democracies by reinvigorating its relationship with the democracies of Europe. This will require a much more multilateral and shared concept of leadership to give Europe more of a stake in sharing responsibilities, he said.

Then, in his keynote address at the closing dinner, Richard Holbrooke, vice-chairman of Perseus LLC and former US ambassador to the United Nations, reemphasized the importance of the US elections to transatlantic relations. Ambassador Holbrooke gave an insightful portrayal of the Democratic campaign, the positions of the candidates, and the consequences of a Democratic victory for joint ventures with Europe, particularly in Afghanistan. He focussed specifically on his expectations regarding events in the Balkans, especially in Bosnia, and gave his opinions on Russian assertiveness in the post-Soviet space, negotiations with Iran, strategies of partition or federalism in Iraq, dealing with the challenge of Chinese actions in Africa, and the role of US public diplomacy and communication. Ambassador Holbrooke was clear: for Europe it matters a great deal who becomes the next president of the United States.

Compiled by Anita Hurrell

Annex: Conference Agenda

Looking East, Looking West: Key Challenges Facing the Atlantic Partners

High-Level Conference

November 15 and 16, 2007, Berlin

Thursday, November 15, 2007

19:00

**Opening dinner at the Residence of the Italian
Ambassador to Germany**

Welcome by: **H. E. Antonio Puri Purini**, Italian Ambassador
to Germany

Keynote address: **The Economic and Political Challenges Fac-
ing the Transatlantic Community – and the
Next U.S. President**

Dr. James B. Steinberg, Dean of the Lyndon B.
Johnson School of Public Affairs at the University
of Texas in Austin and former Deputy National
Security Advisor



Dinner at the Residence of the Italian Ambassador

Friday, November 16, 2007

8:45-9:00

Welcome and Overview at the German Council on Foreign Relations (DGAP)

Prof. Dr. Eberhard Sandschneider, Director of the Research Institute, German Council on Foreign Relations (DGAP)

Issue I:

The Transatlantic Economy and World Trade

9:00-10:30 Panel I:

Jobs, Competitiveness, and Investment Protectionism

Speakers:

Amb. Pier Carlo Padoan, Deputy Secretary-General, OECD

Dr. Adam Posen, Deputy Director, Peterson Institute for International Economics

Dr. Stefan Zoller, Member of the Executive Committee, EADS

Moderated by:

Dr. Marco Tronchetti Provera, Chairman of Pirelli and Italian Co-Chairman, The Council for the United States and Italy

11:00-12:30 Panel II:

Follow the Money: Global Financial Markets

Speakers:

Jörg Asmussen, Head of Directorate Financial Markets Policy, German Ministry of Finance

Dr. Ignazio Visco, Deputy Director General, Bank of Italy

Charles Winn, Private Wealth Management, Goldman Sachs

Moderated by:

David Helleniak, Vice Chairman, Morgan Stanley, Investment Banking Division

Issue II: **Common Foreign Policy Challenges Facing Europe and the United States**

14:00-15:30 Panel III: **Coping with a “New Russia”? Energy and Security**

Speakers: **Dr. Paolo Garimberti**, Columnist for La Repubblica and Director for Foreign Affairs of Gruppo Espresso
Ruprecht Polenz, Member of the Bundestag (CDU) and Chairman of the Foreign Relations Committee, Deutscher Bundestag
Janusz Reiter, Former Polish Ambassador to the United States

Moderated by: **Alison Smale**, Managing Editor, International Herald Tribune



Conference in action: DGAP's Robert Bosch Room

16:00-17:30 Panel IV:

**Pandora's Box? Prospects for Peace in the
Greater Middle East**

Speakers:

Dr. Karl-Theodor zu Guttenberg, Member of
the Bundestag and Chairman of the CSU's Foreign
Affairs Committee, Deutscher Bundestag

Amb. Marc Otte, Special Representative for the
Middle East Peace Process, European Commission

Dr. Umberto Ranieri, Chairman of the Foreign
Affairs Committee, Italian Chamber of Deputies

Moderated by:

Paul Taylor, European Affairs Editor, Reuters

17:30-18:00 Closing Remarks

Speakers:

William M. Drozdiak, President, American
Council on Germany

Prof. Cesare Merlini, Italian Executive Vice
Chairman, The Council for the United States and
Italy

19:00 Closing dinner at the Opernpalais

Keynote address: **H.E. Richard Holbrooke**, Vice Chairman of Perseus LLC and former U.S. Ambassador to the United Nations

Introduced by: **Philip Stephens**, Associate Editor and Senior Commentator, Financial Times

With generous support from:

- The German Marshall Fund of the United States
- The Transatlantic Program of the Federal Republic of Germany with funds from the European Recovery Program (ERP) of the Federal Ministry of Economics and Technology
- Allianz SE
- Pfizer Inc.
- EADS.



Ambassador Richard Holbrooke addresses conference participants at the Opernpalais

Impressum

Februar 2008
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