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OPINION

Kremlin 'Capitalism' Is a Threat to the West

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Moscow has much more than a military threat to intimidate countries in its neighborhood. Long before its foray into Georgia, Russia was using its market strength in oil and gas resources to strong-arm its neighbors and outmaneuver the United States and the European Union. As NATO considers how to respond to Russian troops in Georgia, the West should also consider how to counter Kremlin capitalism.

Ever since Vladimir Putin became Russia's president in 2000, Russian authorities have used the power of the state to gut Russian companies and seize their assets for a fraction of their value. Yukos, once Russia's largest oil producer, was seized by Russian authorities allegedly for back taxes. Its assets were auctioned off at bargain prices to Russia's state-owned energy giants, Rosneft and Gazprom, while its CEO and other company officials were arrested and imprisoned.

The government's seizure also deprived ExxonMobil and Chevron from buying major stakes in Yukos. Sibneft, Russneft, and other Russian hydrocarbon companies have suffered similar fates.

More recently, TNK-BP, Russia's third-largest oil company and a joint venture between British Petroleum and a group of Russian billionaires, has been the target of Russian government investigations. BP calls the government's scrutiny a campaign of harassment. The company's British head, Robert Dudley, was forced to flee Russia two weeks ago, and its British CFO abruptly resigned. This after Gazprom wrested control of the $22 billion Sakhalin-2 oil and gas project from Royal Dutch Shell for a fraction of market value.

BP vows to use "all legal means" to protect its investment. But lawyers won't be enough. For the TNK-BP dispute is about geopolitics and Russian hegemony as much as it is about money.

Since Mr. Putin became president, the Russian government has renationalized much of the energy sector; it now owns 50% of the country's oil reserves and 89% of the gas reserves. Beyond ownership, the Kremlin has positioned high-ranking government officials and other Putin-loyalists -- elites in the security services known as ***siloviki*** (men of power) -- to key positions in leading Russian companies, even while they keep their government jobs.

Before becoming Russia's current president, Dmitry Medvedev was both Gazprom's chairman and Russia's first deputy prime minister. ***siloviki*** also control major companies in metals, mining and other strategic sectors. While profits are fine, the Kremlin ensures that these companies promote Russia's foreign-policy goals.

This strategy extends beyond energy. Two weeks ago, Moscow announced the formation of a state grain-trading company to control up to half of the country's cereal exports, which are the fifth-largest in the world. Its purpose, most analysts believe, is to provide the government with greater leverage over food-importing nations at a time of rising food costs and shortages.

But it is in the natural gas sector where the Kremlin wields the most power. Numerous Western European countries depend heavily on Moscow for natural gas to heat homes and produce electricity, with some Eastern European countries almost completely dependent. Beyond supply, Russia also enjoys a near monopoly of the pipelines transporting gas to Europe from the east. In a further bid to extend its grip on gas supplies, Russia -- along with such anti-U.S. governments as Iran and Venezuela -- is supporting the Gas Exporting Countries Forum, which some fear will become an OPEC-like cartel.

While Russia may or may not intend to start a new Cool War, it is not afraid of leaving Europeans out in the cold -- literally. In the middle of winter 2006, it cut off gas supplies to Ukraine and parts of Western Europe. It has also cut off gas to Moldova, Belarus and Georgia.

This past spring, critics charge that, in part due to Russian pressure, Germany opposed Membership Action Plans for Ukraine and Georgia, the first step toward NATO membership. They point to a Gazprom-led consortium building the Nord Stream gas pipeline from Russia underneath the Baltic Sea directly to Germany, while circumventing pro-U.S. countries like Poland, Ukraine, and the Baltic states. (Former German Chancellor Gerhard Schroeder's role as Nord Stream chairman could not have hurt Russia's influence.)

Last month, after the Czech Republic supported an antiballistic missile system opposed by Russia, the flow of Russian oil dropped 40%. President Medvedev had promised "retaliatory steps."

Aware of their vulnerability, in March 2007 the Europeans developed an "Energy Policy for Europe" to coordinate energy security, competitiveness and sustainability. But agreeing on principles has been far easier than acting on them.

Moscow continues to exploit differences among EU member states -- whose dependence on Russian gas, voracity for lucrative pipeline transit fees and desire to tap into Russian energy markets vary considerably -- in order to promote greater European dependence on Russian gas and pipelines.

Thus, when a consortium of European countries proposed the Nabucco pipeline, to pump gas from Central Asia and the Caucasus to Europe without going through Russia, Mr. Putin earlier this year personally met with foreign government and corporate leaders on behalf of South Stream, a rival pipeline that would go from Russia across the Black Sea to Bulgaria and the rest of Europe. To ensure that South Stream would have gas to transport, Gazprom upped its offer to Caspian region suppliers to pay higher rates for natural gas. It also just signed a deal with Turkmenistan to invest in its gas infrastructure. Meanwhile, the Nabucco pipeline's future is cloudy, with one of its original sponsors, Hungary, switching to South Stream due in part to European dithering and skillful Russian negotiating.

Just as NATO's response to Georgia will be crucial for American credibility throughout Eastern Europe, the Caucasus, and Central Asia, so too U.S. leadership is vital to maintain Europe's energy security.

Short of sanctions, the West does not currently have much economic leverage. European, Japanese and American export credit agencies could refuse to finance any deals involving Russian companies that have acquired assets expropriated from foreign investors. European countries could also bar such Russian firms from operating in Europe, or could impose a special fee to reimburse expropriated investors. And rather than expel Russia from the G-8 as John McCain has proposed, members should demand that Russia respect the rights of foreign investors and ratify the Energy Charter Treaty.

Longer term, the U.S. needs to use its diplomatic and financial clout to push forward alternative energy routes. Washington's backing was vital to building the Baku-Tbilisi-Ceyhan oil pipeline in five years. One of the longest of its kind, the pipeline bypasses Russia and carries crude oil from offshore fields in the Caspian Sea across Georgia to the Mediterranean. Washington must make financing and constructing the NABUCCO gas pipeline a top priority.

Washington also needs to reach out to Central Asia, and should push for a Trans-Caspian pipeline from Kazakhstan and Turkmenistan across the Caspian Sea to Azerbaijan and west to Europe. Years of Russian domination have made these countries open to Western investment. Moreover, they understand the strategic importance of diversifying sales and transport options for their oil and gas. Western companies also offer superior technology.

But after Russia's use of military force in Georgia, these countries are wary of antagonizing their former overseer. Without a strong American presence, it is impossible for the West to compete in the region. Yet Turkmenistan has lacked a full-time U.S. ambassador for more than a year.

The markets can also help hold Russia accountable for its heavy-handedness. Two weeks ago after Mr. Putin targeted Mechel, a steelmaking giant -- suggesting that Russian antitrust and tax authorities investigate the company -- Russia's stock market lost $60 billion. Market forces may not protect BP's Russian investments or save Georgia, but they could make it far more costly for the Kremlin to proceed.

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