

At Last, Russia Conquers Europe

One gas pipeline at a time.

BY IRWIN M. STELZER

Adam Smith never met Vladimir Putin or Hugo Chávez, but, as with so many other things, he anticipated their appearance on the scene. No one can accuse the Great Scot of protectionist proclivities, but he did warn that there are times when free trade takes second place to national defense. He proposed laying "some burden" on foreign commerce "when some particular sort of industry is necessary for the defense of the country . . . [since] defense is of much more importance than opulence."

America, Britain, and other free-trading countries have long welcomed foreign investment on the generally correct theory that such investment enriches the nation by bringing capital, jobs, and foreign know-how to the country. There have been exceptions, some sensible, some just plain silly. During World War II, America prevented German interests from acquiring radio stations, something modern-day enthusiasts for giving Al Jazeera access to U.S. and U.K. cable networks, while its owners broadcast pictures of the beheading of American and British citizens, might keep in mind. On the less sensible side, American law still prevents foreigners from controlling U.S. airlines, a measure needlessly broad to prevent a hostile power from gaining such control: We can, after all, distinguish between British Airways and Aeroflot.

In America, the approval by the government of the acquisition of

Irwin M. Stelzer is a contributing editor to THE WEEKLY STANDARD, director of economic policy studies at the Hudson Institute, and a columnist for the Sunday Times (London).

port facilities by an Arab company prompted a review of procedures so secretive and arcane that the president found out about the deal only when it leaked to the newspapers. Naturally, the deal-making community fought to prevent any tightening of review procedures, since they agree with Adam Smith only when he argues for limiting government powers, and not when he quite wisely suggests that—to put it in modern-day terms—homeland security is of much more importance than bonuses for investment bankers and a bit larger GDP.

Now the Western democracies have to decide what to do about acquisition-minded Russian companies, flush with cash and ordered by Vladimir Putin to extend their global reach. The U.S. government has agreed to allow the Russian steel company Evraz to acquire Oregon Steel Mills for \$2.35 billion. The Committee on Foreign Investment (CFIUS) finds nothing troubling in the deal, which does seem odd, for two reasons. First, Oregon Steel is an important supplier of armor plate to the U.S. military, which, in addition, is increasingly dependent on steel from China. Second, Evraz's main investor is Roman Abramovich, the Russian billionaire currently living in London.

Alone among the so-called oligarchs, Abramovich retains the favor of Putin, for reasons about as clear as Kremlin personnel shuffles in the good old days of the Soviet Union. And not because the high-living émigré has used a tiny portion of his wealth to turn the Chelsea football team into a worldwide sports power, a development of little interest to Putin. Abramovich is also the man the Rus-

sian president appointed governor of Chukotka, in remotest Siberia (the region that is home to the prison in which another oligarch, Mikhail Khodorkovsky, former head of Yukos, is housed), so that Abramovich could prove his undying (literally, these days) loyalty by bankrolling its economic development. Which he has done. Abramovich now wishes that this cup would pass, but Putin has ordered him to stay on. This, despite Abramovich's perhaps infelicitous statement, "I believe my mission is accomplished. Life in Chukotka is now no worse than in any other part of Russia."

One might say that while relations between Putin and other expatriate Russians have been poisoned, those between the Evraz owner and Putin have not. Which suggests that when Russia decides that it is in its interest to have Oregon Steel fall behind in deliveries of armor plate to the U.S. military, Oregon's management might decide that profit maximization is not the only *raison d'être* for the enterprise.

But this is trivial compared with the dilemma faced by Britain and the E.U. Putin has made it clear that he regards his nation's oil and gas reserves as a political weapon. No longer need the West fear Russian tanks rolling across the plains of Europe. Instead, it has to fear that Russian fuels will stop flowing through the pipelines to the homes and factories of Europe.

Russia has demonstrated in its disputes with Ukraine and Georgia that it will cut off supplies of gas if its terms are not met and, in its brawl with Belarus, that it is quite willing to stop the flow of oil through the pipeline transiting that country even if that creates supply problems in Germany, Poland, and other parts of Europe. In Russia's blockade of Belarus earlier this month, a significant 12.5 percent of Europe's crude supply was cut off for three days. Refineries in Poland, Germany, Slovakia, Hungary, and the Czech Republic had to dip into reserves to keep operating during the brief pipeline shutdown.

Only after Belarus's president, Aleksandr Lukashenko, agreed to eliminate all transit charges and, more important, cede control of his country's pipeline, would Putin allow Semyon Vainshtok, president of Russia's monopoly pipeline Transneft, even to open negotiations over future prices and fees. German chancellor Angela Merkel called the supply cut-off "unacceptable," which seems not to be worrying the Russians one bit.

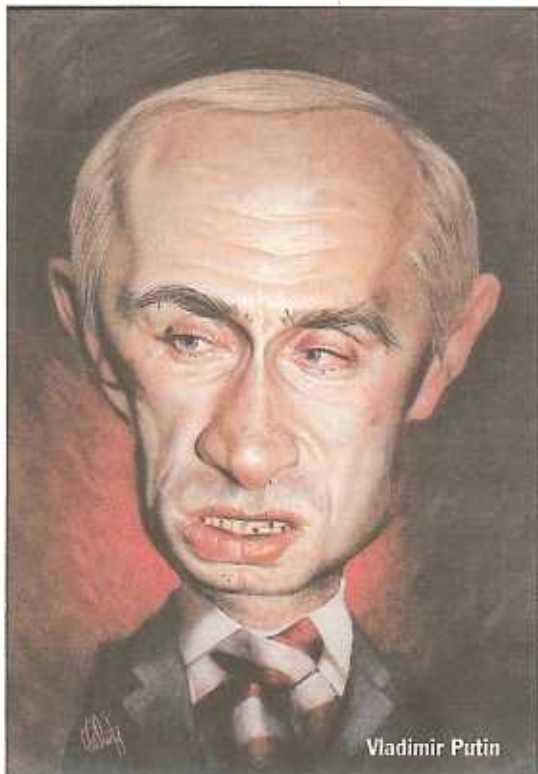
There is worse. Putin is determined to bring all oil and gas production under the control of the state. So his environment minister suddenly found that Shell and its partners were in violation of his agency's regulations, and ordered their operations in the giant Sakhalin field in the Russian far east closed down unless they sold their interests to state-owned Gazprom. BP is similarly being squeezed out because of "illegal logging" on its drilling site in Siberia. The *Economist* reminds us of an old KGB adage, "Give me the man, and I will find you the crime."

Shell had no choice but to capitulate. Two humiliations followed. Shell had to defend the price it was paid for this forced sale lest shareholders wonder what the company's managers had in mind when they risked billions in a lawless country. And, as with the old show trials, in which the accused were forced to praise their accusers, Shell's chief executive Jeroen van der Veer abased himself before his expropriator. "Thank you very much for your support," he told Putin in the presence of the press. Stalin would have been pleased.

Of course, none of this would have happened had European leaders heeded the warnings of Ronald Reagan. Acting on information from the CIA, Reagan decided early in his presidency that reliance by Europe on Russian energy supplies would inhibit it from siding with America in any showdowns. Reagan even placed sanctions on manufacturers of gas-compression turbines, used in pipe-

lines, to prevent them from supplying the builders of the link between Serbia's huge Urengoy gas field and Central Europe, via Ukraine.

Not for the first or last time, Europe's elite ignored American warnings. Now, those who believe in the efficiency-enhancing effects of the free flow of capital, the free traders among European countries, see their theoretical belief foundering on the rock of the hard reality of their energy dependence. Russia has bil-



Vladimir Putin

Thomas Elliott

lions available to invest in overseas companies. It refuses to allow foreign investment in its own energy infrastructure, which it has renationalized, but insists on its right to buy up the energy infrastructure of other countries. Result: Russian pipelines want to extend the reach of their monopolies beyond Russia's borders, deep into the heart of Europe.

Private-sector bidders that might go up against Gazprom in takeover battles can't possibly win, since the Russian company is buying strategic leverage in addition to purely commercial advantage. Gazprom is

believed to be planning to make a bid for Centrica, a large U.K. gas distributor as well as a supplier of gas and electricity to 1.5 million customers in eight American states through its subsidiary, Direct Energy. It then will move on to attempt takeovers of key energy infrastructure projects in America.

Putin, a gaggle of lobbyists, and the investment bankers representing Gazprom and other Russian state entities will undoubtedly argue that if the American government is content to have Venezuela-owned Citgo gas stations dotting America's highways, with virtual monopolies on some Florida roads, it should be even happier to see Russia enter the U.S. market. After all, President Bush pronounced himself satisfied after peering into Putin's soul, and, unlike Hugo Chávez, the Russian president has never used the U.N. to call Bush a "devil [who] smells of sulfur."

So America, Britain, Germany, and other countries with long histories of supporting free trade, and economists who believe that a "market in companies" is a good thing, now have to make the choice with which Adam Smith confronted policymakers over 230 years ago—defense or opulence; preventing hostile nations from gaining control over key resources, or adding a bit to national wealth by attracting inbound investment from hostile national governments. They will also have to decide whether Russia's state-run companies should continue to be given access to American and British capital markets so that they can float issues of securities, and raise funds for still more expansion.

Older readers will recall the insight recorded by Lenin: "[The capitalists] will furnish credits . . . and materials and technical equipment which we lack, [and] will restore our military industry necessary for our future attacks against our suppliers. To put it in other words, they will work on the preparation of their own suicide." ♦