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ECONOMIC NEWS UPDATE

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Adam Smith never met Vladimir Putin, but, as with so many other things, he anticipated his 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” upon 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.

In America, approval by the government of the acquisition of port facilities by an Arab country 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 City folk agree with Adam Smith only when he argues for limiting government powers, and not when he quite wisely suggests that defense takes precedence over opulence, which in modern-day terms means homeland security over bonuses for investment bankers.

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. America’s Committee on Foreign Investment (CFIUS) last week agreed to allow Russian steel company Evraz acquire Oregon Steel Mills for \$2.35 billion. Its members found nothing troubling in the deal, although Oregon Steel is an important supplier of armor-plate to the US military, and Evraz’s main investor is Roman Abramovich. Alone among the so-called oligarchs, Abramovich retains the favor of Putin, and not because the high-living emigré

has used a tiny portion of his wealth to turn Chelsea into a worldwide sports power. Abramovich is also the man the Russian president appointed governor of Chukotka, in remotest Siberia (the region in which another oligarch, Mikhail Khodorkovsky, former head of Yukos, involuntarily languishes), so that Abramovich could prove his undying (literally, these days) loyalty by bankrolling its economic development. Which he has faithfully done.

One might say that while the 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 to have Oregon Steel fall behind in deliveries of armor plate to the US military, Oregon's management might decide, perhaps over dishes of sushi, that profit maximization is not the only operative consideration.

But this is trivial compared with the dilemma faced by Britain and the EU, and by extension its US ally. Putin regards his nation's oil and gas reserves as a political weapon. When challenged, he has cut off gas supplies to Ukraine and Georgia, and stopped the flow of oil through the pipeline transiting Belarus, forcing refineries in Poland, Germany, Slovakia, Hungary and the Czech Republic to dip into reserves to keep operating.

Only after Belarus's President, Aleksandr Lukashenko, agreed to eliminate all transit charges and, more important, cede control of Belarus'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 cutoff "unacceptable", which will not worry Putin unless Europe unites to solve its dependence problem, not a likely prospect.

This follows on the heels of Putin's sudden discovery that Shell and its partners' operations in the Sakhalin gas field were in violation of environmental regulations. Given the choice of abandoning their investment entirely, or selling to state-owned Gazprom, Shell and its Japanese partners chose the lesser of the available evils.

Of course, none of this would have happened had European leaders heeded the warnings of Ronald Reagan. The then-president decided that European reliance on Russian energy supplies would inhibit it from siding with the US in any showdowns. Reagan even placed sanctions on manufacturers of gas-compression turbines to prevent them from supplying the builders of the link between Serbia's huge Urengoi gas field and Central Europe, via Ukraine.

Not for the first or last time, Europe ignored American warnings. Now EU free-traders who believe in the efficiency-

enhancing effects of the free flow of capital see their theoretical belief foundering on the rock of the hard reality of their energy dependence. Russia has billions available to invest in overseas companies. It refuses to allow foreign investment in its own renationalized energy infrastructure, but insists on its right to buy up the energy infrastructure of other countries. Result: Russian pipelines have monopolies into Europe, and want to extend the reach of those monopolies beyond Russia's borders, deep into the heart of Europe.

Gazprom is believed to be planning to make a bid for Centrica, the UK gas distributor which also supplies gas and electricity to 1.5 million customers in nine American states. It then will move on to attempt takeovers of key energy infrastructure projects in America.

So America, Britain, Germany and other countries with 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 policy-makers 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 more in-bound investment.

One Gazprom spokesman defends any such acquisition as extending consumer choice; the dealmakers, eager to make 2007 bonuses a repeat of 2006, will throw their considerable weight behind approval. But they won't be able to cite Adam Smith in support of opulence over defense. Which will be a comfort to Gordon Brown when the time comes to choose.



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