

International Affairs Forum Interview

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By Jennifer Ashton

International Affairs forum speaks with former Ambassador Keith Smith about Russia's controversial energy policies. Mr. Smith is currently a senior associate in the Europe Program at the Center for Strategic and International Studies in Washington D.C. He served as U.S. ambassador to Lithuania from 1997 until 2000. From 2000 to 2002, he was a consultant on international energy affairs to the Williams Company, one of America's largest integrated energy companies.



International Affairs Forum: What you have previously referred to as Russia's "energy weapon" has been used since the early 1990s when Russia cut energy supplies to the Baltic countries and Ukraine to quell growing independence movements. What do you see as the reasons behind Russia's recent "gas war" with Ukraine?

Mr. Keith Smith: Well, it's kind of an extension of the same thing. I was at a conference at Berlin and spoke about this issue. It's kind of a kamikaze mission, I think. I was trying to tell some of our Russian colleagues of my views that this isn't good for the international system and not good for Russia and there are many Russians who agree with me. The young Russian economists agree with me. People my age have a hard looking at anything except the projection of Russia's strategic power. They see this as a power projection thing, that is, the energy. Power projection is important for many reasons, specifically for China and Western Europe. But its also a tool to kind of reign in what they see as countries abroad that are getting out of hand, becoming too Western, not responsive as much as they want to Russian economic interests, political interest, maybe becoming too enamored of joining NATO...these kind of things. I even heard this comment after my talk in Berlin. I was denounced by several Russians, although there was one young, quiet economist who came up to me afterwards and told me he agreed with everything I said but he wouldn't have said it in public.

What these Russians said reflects the view in Moscow. "Well, if they want to go to the West and be part of NATO and the EU, well hell with them. They can pay the world price." That's on one level. On the second

level, Putin really thinks like a KGB officer. He sees in terms of power projection. For example, it's not just if you want to be part of the West you pay Western prices, it's the fact is we want to pull you back in this sphere of influence. This affects our defense policies and our ability to station forces in the Crimea. It also affects our ability to dominate your economy, which has happened to the energy side of Ukraine. I have written extensively about the dominance of Russia's many oil facilities in Ukraine.

Now the goal is to get control of that pipeline that goes through [Ukraine]. If you get control of the pipeline, you get control of Ukraine. [Russia] has a way of bankrupting these energy companies. That's why they are gaining the Belarus pipelines. That's how they got the Moldavian pipeline. That's how they got the Armenian pipeline and they are trying to do the same thing with the Bulgarian pipeline. But the Ukraine pipeline, they have all these maneuvers going on. For instance, the Russian negotiators in January said that they had to use a very un-transparent company, RosUrkEnergo, as the go-between. Well, nobody knows who really owns it. It's known that Gazprom owns one half; the other half is a mystery. When the Ukrainians say who owns it, Putin has said, "well, it's up to you guys, it's your people". So when the Ukrainians then come back and say lets just have a straight Gazprom-Ukraine agreement, then the Russians object. Khristenko, the Energy Minister, and Deputy Prime Minister said, "No, no, we think it's a good agreement using RosUrkEnergo". There is obviously a lot of shady stuff going on. It's a power projection out of the Kremlin. It's not Gazprom so much. It's telling Gazprom what to do. Gazprom is becoming more and more an instrument of Kremlin policy as there continues the "verticalization" of energy industry in Russia after the destruction of Yukos.

IA-Forum: You mentioned Russian President Vladimir Putin. Do you believe his KGB background has had an influence in his approach to this situation?

Mr. Smith: Very much so. He's a tactician and that comes from his KGB background. He's also a person very concerned about Russia's power, in terms of hard power, not soft power. In 1999, in fact, he wrote a thesis on the use of Russia's energy and mineral resources as a way of projecting Russian power. Those in the KGB, some of them are sophisticated, worldly people. But they tend to see the world as win-lose. The idea of the win-win, it's a very difficult concept for them. Therefore, it's an idea that if Ukraine were to go to the EU, that's a loss for Russia. That's why they still see NATO membership for these countries as a loss and danger to Russia. There's still this feeling that NATO is a threat to Russia. It's so absurd when you sit down and think about it. Is Belgium or France going to attack Russia in any kind of scenario? It's just an

impossible scenario. Yet, that's the kind of mentality that you find within the *siloviki*, the former security people. There is the feeling that Russia has to have these tools to be accepted on the world stage, instead of being content, maybe for the moment, being a second-class power in building the economy in a balanced way and developing mutual confidence on the world stage, and then taking their place. They kind of have pushed their way into this. There is kind of paranoia within all of this. We have paranoia in American politics too. As President Bush uses the anti-terrorist thesis in the election campaigns, in Russia they use the idea that the West is out to weaken Russia. They really do believe that the West wants to see a weak Russia.

IA-Forum: How does Russia's energy policies affect their diplomatic ties with the Central Asian countries where much of the oil and gas originates?

Mr. Smith: That's one of the bones of contention between Russia and the West. Russia systematically supports very dictatorial governments along its border. This also increases the paranoia within these countries that the West, through its democratization campaign, is going to overthrow these dictatorships. You got Nazarbayev, Turkmenbashi, and these other people who are very nervous. In fact, in Uzbekistan, Russia was promoting the Uzbeks to expel the American airbase there. They use their power that way. Look at Belarus. Look at Lukashenko. Lukashenko wouldn't last that long if Russia didn't support his contradictory way of governing.

IA-Forum: So would you say there is any solidarity between these nations who feel they've been victimized by Russia's "energy weapon"?

Mr. Smith: In a sense, they resent that. For instance, the Kazakhs signed a deal to transport oil across Russia to Lithuania. They had all the agreements [with Russia]. They have the right to pump so many million tons of oil to the Baltic Sea. But after they signed the agreement, Transneft, which is the monopoly oil pipeline system, they realized that the Kazakhs were really interested in buying the Lithuanian oil refinery in Mazeikiai. The Russians want to control that refinery. So what did they do? They stopped the Kazakhs from shipping oil. The Kazakhs are in a weak position because all the pipelines go through Russia. They don't have any choice. Meanwhile, the leadership in these countries knows that Russia is going to support their government and their regimes against democratic movements in these countries. Back to the original question, in one way, they may resent it. But in another way, they depend on Russia to support their hold on power. That's most important than anything else. That's the number one objective: a hold on power.

IA-Forum: Yuri Ushakov, Russia's ambassador to the US, stated in a February 13th issue of *The Wall Street Journal* that Russian energy policies are not politically motivated, but that they have switched to a universal pricing formula dictated by the market to sell energy. He continues that selling gas "Soviet-style" at "heavily subsidized prices" translates to billions of dollars lost for Russia. What do you think of this argument?

Mr. Smith: Russia has lost a lot of money by giving special deals but special deals were the initiative of Russia. The cheap prices Ukraine had was from a 2004 agreement that Russia reached with Ukraine in order to support the candidacy of Yanukovich. It wasn't because they wanted to be good guys. Russia makes a distinction. They charge countries that are nice to them cheaper prices than they charge countries that they are mad at. Belarus pays \$70 for a 1000 cubic meters because they are willing to turn over their pipeline to them and because they are in the bag, so to speak. [Russia] makes distinctions all the time. So, this is ridiculous. The idea that these countries have to move overnight from prices negotiated two years ago to world market prices...Russia knows that 1) this will destroy their economies and 2) that if they reach a deal, it will be so that eventually they will give them a break but a break in way that they will be controlling the pipeline. The energy companies will go broke, just like they did in Belarus. They have to turn over the pipeline, just like they did in Armenia. That's part of the deal. Ushakov is not being as straight as he could be on this issue. Second thing is, when Russia was negotiating with Europe for WTO accession, the Europeans said, you need to raise the domestic price of your oil in Russia because it gives you an unfair advantage in your industry over the European industry. But Russia said no, we couldn't raise it very fast because it would really cause tremendous hardship and pain in our economy. The Europeans bought the argument. They said, ok, we'll give you a break because we understand you can't do it all at once. Of course, Russia isn't going to give the same break to other countries.

IA-Forum: How should Russia and the U.S. work together to create a new and improved mode of interaction on energy?

Mr. Smith: There are some things I think we need to do. Russian and the U.S. and can have very good energy relationships without it being at the expense of other people. That's what we need to do. We need to demand that Russia open up its markets to the same kind of treatment that we give companies. Total reciprocity, to begin with. Two, that Russia move fast toward a system where there is real competition in pipelines. There is a monopoly situation where [Russia] can monopolize the flow of energy going through Russia to landmark countries which

must also end. That is a monopoly. That is an anti-competitive practice that is banned by the EU and the United States. I think that is something that has to be done. What Russia does is plays off the Western companies against each other. The U.S. policy of energy toward Russia won't work unless it has the support of the Europeans. We have to work together on this. In the long run, I would argue, as many Russian economists argue, that in fact, it is in Russia's own long-term interest that verticalizing these companies and making these big industrial winners is not very efficient at production and innovation.

Yukos was the most innovative energy company in Russia. Now, Yukos is destroyed. The crown jewels of Yukos were taken over by Rosneft, which is not a transparent company. In Russia, they call it a *siloviki* company. Is that really good for Russia in the long run to create these monstrous companies that aren't really transparent, that put a lot of their money into political stuff either in Russia and abroad and reduces competition in Russia in the energy market for not only for shipment of energy but also for the production and exploration of energy? Russia would be much better off if it had a competitive situation where they could do that. Putin always says that in the West, you have vertically integrated state companies like Statoil in Norway. And that's true. Now, I have my own beef with Norway's Statoil. I've lived there. However, I would say that there are differences. 1) Statoil isn't a foreign policy arm of the government. 2) Statoil operates as a very transparent company whereas Russia's companies do not. 3) They have to abide by the European anti-competition rules. The Russian companies don't. Russia signed the Energy Charter with the EU back in 1996 and they never ratified it. They then said they wouldn't ratify it or imply it. If they had ratified it and implied it, they would have had to bring a higher degree of competition to the pipelines or competition within Russia and stop some of these monopoly practices. You can still have a state company and still have competition. In Norway, they have Statoil but they also have NorskHydro, which competes. So I think [Yuri Ushakov's] comparison of Statoil and Gazprom is not right. If Gazprom were an open and transparent company, wasn't an arm of the Kremlin, and you didn't have the deputy prime minister running the company, it would be a different company. You really can't make the comparison.

IA-Forum: Thank you, Ambassador Smith.