

The first person to speak about a “liberal empire” was Anatolii Chubais, the privatization tsar of the 1990s. The idea was to ensure Russia’s leadership position outside of the EU and NATO. This was to come

Russia: Can an Empire Really be Liberal?

ENERGY

by Fernando Orlandi

about through the political use of the energy weapon. And now it is happening. As the January agreement between the Russians and Ukrainians shows, and as **east** can now reveal in this exclusive report.

Towards the end of the nineteenth century Tsar Alexander III liked to relate how the Romanov Empire had only two real allies: the Russian army and the Russian navy. At the beginning of the twenty-first century, while Moscow was trying to re-establish its supremacy over the post-soviet region, we can paraphrase Alexander III and say that the Kremlin can now rely on only one real ally: Russia’s energy resources.

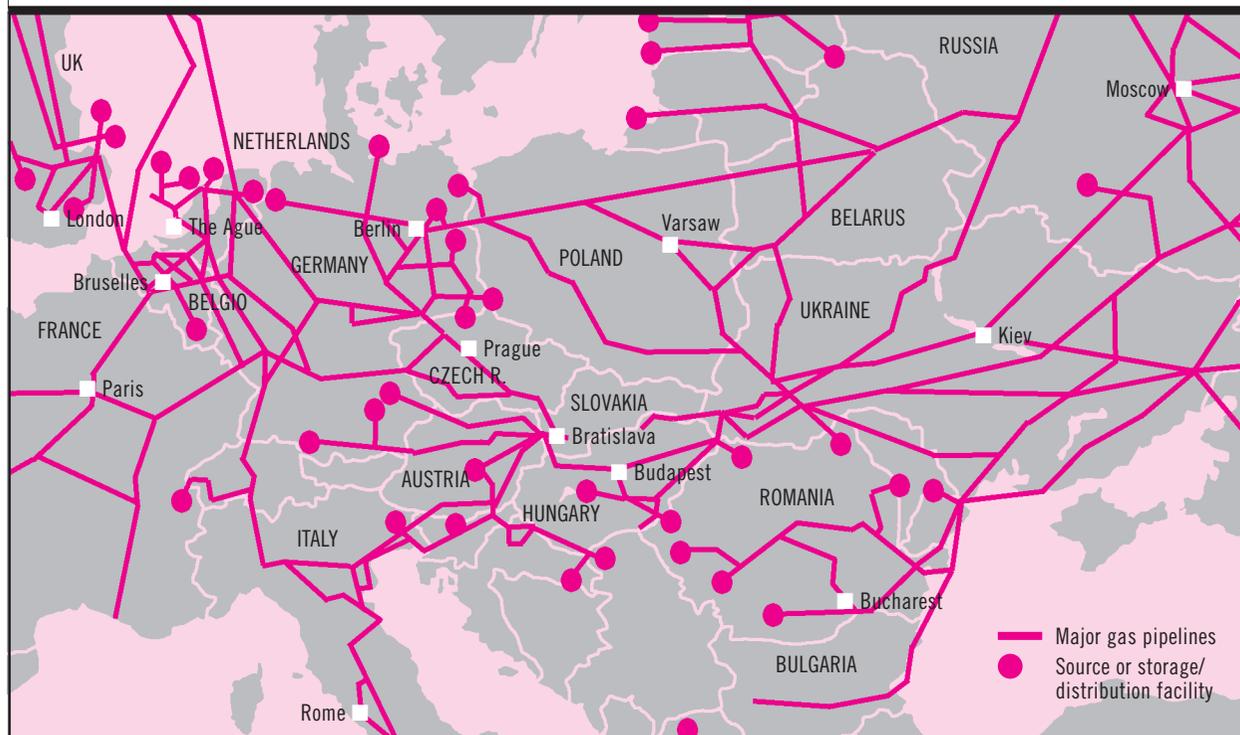
In a speech in Saint Petersburg on September 25, 2003, Anatoli Chubais, the unpopular tsar of privatizations in the 1990s and now the head of RAO EES Rossii, the electric energy monopolistic conglomerate, publicly proposed his theory of “liberal empire”, borrowing some ideas from Alexander Dugin, one of the ideologues of ‘Eurasianism’.

According to Chubais, Russia can expect to become the leader of the Community of Independent States (CIS) if it unscrupulously uses its economic leverage, and turns its energy resources into its principal weapon. For Russia in the post-Cold War world, there would be no room in either NATO or the EU, but “we have a different mission” and therefore “we can’t allow ourselves to remain passive”. A few days later he was invited by Vladimir Posner to appear on the TV program

Vremena, Chubais explained that the Russian leadership should have made economic expansion in the so-called “near abroad” the linchpin of its policy. “This leadership mission should not be limited to just a simple slogan but rather become the policy of the Russian state”. Therefore Russia must become a “liberal empire”. Referring to the work of RAO EES in the “near abroad” Chubais said: “I don’t like slogans without action. And this is probably why I began to speak up, because we have already seen some clear successes...The result of having the Georgian economy controlled by our company. We will bring it back into the fold, just as we are now reintegrating the Russian energy industry. Then we will take over the Armenian energy industry and following that we’ll negotiate with Ukraine and Kazakhstan, and I think we will go even further”.

All this would be “a guarantee against the development of any extremist foreign policy by Georgia”, which was in upheaval during that period. A few months later, referring to the attempts by RAO EES to acquire a part of Ukraine’s energy sector, Chubais declared: “We are taking it over for Russia” Actually, RAO EES quickly assumed a quasi monopoly position in the Georgian electric energy

THE GAS NETWORK IN EUROPE



system.

The Chubais thesis met with lively opposition. Grigorij Yavlinskii, President of the liberal party called Yabloko, attacked him, while Chubais hammered away that a combination of market economy practices and aggressive expansion could become the foundation for the country's foreign policy: without economic and political expansion, Russia would be able to maintain neither its territorial integrity nor its resources. Only by combining liberal values with a program aimed at re-establishing its empire "will Russia be able to take its natural position alongside the United States, the EU and Japan, a position reserved to it by history". According to the economist Anders Aslund, a policy of "liberal empire" will lead to the political integration of the post-soviet region under the leadership of Moscow. In addition to Yavlinskii, one of the most determined opponents of the Chubais thesis at the end of 2003 was Andrei Illarionov, at the time economic advisor to President Vladimir Putin. For Illarionov, the idea of "liberal empire" was absurd and abhorrent", because in actual fact the emphasis was placed on "empire" at the expense of any "liberal" idea whatsoever. In 2005 Illarionov had criticized the re-nationalization of the oil and gas

industry (Russia suffers from the "Venezuelan Disease") and for this his invitation to attend the G8 meeting was withdrawn. He resigned last December. Now free to speak out, he said that his country currently suffers from the "Saudi Disease", because it uses its energy exports to exert pressure on other States; energy resources have become "a weapon".

Leveraging Energy

Over the years Russia has not hesitated to use its energy resources to achieve political goals. For example, the "energy weapon" was used against the Baltic States in 1992 in retaliation against their demand that Russian troops be withdrawn from the region. In 1993-94 Russia reduced its gas for Ukraine in order to obtain payment for previous shipments, but especially to force Kiev to give up control of the Black Sea fleet and the energy facilities in the country (interruptions to supply occurred again in subsequent years). In 2004, it was the Byelorussian ally Alyaksander Lukashenka who had to face this energy blackmail (and Lithuania and Poland both suffered indirectly), until Minsk ceded control of its gas pipelines to Moscow. Between 1998 and 2000, in attempting to stop the sale of a refinery, its port facilities and an

oil pipe line to an American company, Transneft interrupted supplies of crude oil to Lithuania on nine different occasions. During the past two years, crude oil supplies to Latvia have been interrupted in order to gain control of the oil terminals in the port of Ventspilis. The reality is that there is nothing particularly surprising in what Moscow is doing. This behaviour is stated with unexpected honesty on the first page of the very official "Russian Energy Strategy until 2020", which was approved by the Russian government on August 28, 2003 and which characterizes the energy resources and facilities of the country as "an instrument for carrying out domestic and foreign policy" and states that "the role of the country in the world energy market is very important in determining its geopolitical importance".

Vagit Alekperov, president of LUKoil, was particularly explicit in an interview when he linked Russian foreign policy and the activities of the energy companies. Referring to how the expansion and investments of the petroleum industry in the countries of the "near abroad" and in Central and Eastern Europe had helped strengthen relations with Moscow, he said, "I am sure that Bulgaria, whose oil industry is almost completely owned by Russian companies, will not adopt an anti-Russian foreign policy in the near future". Like LUKoil, Gazprom is also "one of the principle instruments of Moscow's foreign policy". What the leadership in Moscow might be thinking after the "gas war" was stated clearly by the Vice Prime Minister and Minister of Defence Sergei Ivanov (a former KGB official) in an article published by the Wall Street Journal, and therefore intended specifically for a western audience: "Our major concern is the situation of certain members of the CIS". And being more direct, he warned about trying to "change the reality of geopolitics in a region of strategic interest to Russia.

Ivanov's call for a "strong" Russia constitutes the "essence of Russia's new muscular policy" toward its neighbours in the CIS and toward the West. Several days before, Grigorii Karasin, Vice Minister for Foreign Affairs in charge of the "Near Abroad", had stated the same position, using greater diplomatic finesse and less military brutishness: the West can not cultivate interests in the CIS in the same way that Moscow does.

The Ukrainian Crisis

The year 2006 is starting with Moscow chairing the G8 for the first time. Russia was welcomed into the club of the most industrialized nations in 1997 even though it was not yet at the level: on the scale of development it ranks number 16 behind South Korea, Mexico and Brazil. And in terms of democracy, the less said the better. The choice was mistaken and when the new year arrived, the chancelleries were apprehensive. The group at the head of the Russian Federation is composed of too many former KGB officials, freedom of information has been dramatically reduced and there is concern for the state of civil rights which have been weakened by the law on non-governmental organizations. During the Soviet era foreign radio broadcasts in Russian were interfered with, but now they are simply interrupted because they deal with subjects that are not appreciated by the Kremlin as happened in December with the BBC Russian Service and Deutsche Welle. Tom Lantos, member of the House International Relations Committee in the American Congress does not adhere to the soft language of diplomacy: "We opened the door to Russia and suddenly find that they are moving towards an authoritarian society dominated by the Kremlin, where businessmen are sent off to Siberia, governors are appointed and the Parliament is no longer a true legislative body but just a paper-pusher for Putin. If we continue to believe that this is a democracy, then we are prostituting ourselves". Moscow's "economic miracle" is owed mainly to an increase in the price of raw energy materials, oil and gas, that constitute the main export items and the major source of revenue for the national treasury. The first item on the Russian President's agenda at the G8 is "energy security". Paradoxically, this security was put into jeopardy by Moscow itself when it shut off gas supplies to Kiev. The "gas war" in Ukraine ended quickly (it lasted longer in Moldova, Armenia and Georgia). On January 4, at 2:30 AM (Moscow time), an agreement was reached, a compromise that satisfied both parties and was trumpeted as a great success. "The political battle has been won" declared President Viktor Yushchenko. But when it was time to provide concrete information on the agreement and its implementation, only vagueness, as the press conference held by

Oleksiy Ivchenko, the head of Naftohaz, attests. But Yushchenko was triumphant: “We have ensured a stable equilibrium of gas for five years”. Aleksei Miller, the head of Gazprom, observed that “a long term contract was negotiated to supply Russian gas; the initial price is \$230 per 1000 cubic meters”. He then explained that this amount will be paid by an intermediary, RosUkrEnerg, which will mix Russian gas with a much cheaper type from Central Asia. This mix will be sold to Ukraine at an average price of \$95 dollars. Both Kiev and Moscow are claiming victory, but there is one immediate loser: the Kremlin, which, in a very tangible way, has demonstrated to the West that it is not a trustworthy partner and that it’s willing to use the “energy weapon” without any scruples. The Austrian Minister of the Economy, Martin Bartenstein (his country currently holds the EU presidency) quickly observed that what happened should serve as “a lesson for the future” and he immediately organized a meeting of the Gas Coordination Group in Brussels. Some analysts have begun to notice that Moscow is capable of acting just like the OPEC countries did in the past.

Which Agreement?

If things had gone this way for Ukraine, all in all it would not have been such a bad deal. But the contract signed on January 4 tells a different story, much different from what emerged in official statements. The agreement has three contracting parties, Gazprom represented by its President Miller; Naftohaz was represented by Ivchenko, and the Swiss company RosUkrEnerg Aktiengesellschaft was represented by its

Executive Directors O.A. Pal’cikov and K.A. Chuichenko.

The agreement stipulates that until January 1, 2011, a royalty equal to \$1.60 American dollar for every 1000 cubic meters of gas per 100 kilometres will be paid for Gazprom gas (using Gazeksport) and for RosUkrEnerg gas which transits through the Ukraine, and that this rate may be changed only if all three parties agree. The agreement also designates RosUkrEnerg to become the sole supplier of gas to Ukraine as of January 1, 2006. Naftohaz and RosUkrEnerg will develop a joint venture that will supply gas to the Ukraine domestic market and the share capital will come out of cash and other equally unclear assets. The parties will enter into the necessary contracts so that from the first of January, 2006, RosUkrEnerg will manage:

PURCHASES:

41 billion cubic metres of Turkmen gas to be purchased from Gazeksport and Naftohaz;

up to 7 billion cubic metres of Uzbek gas to be purchased from Gazeksport;

up to 8 billion cubic metres of Kazakh gas to be purchased from Gazeksport;

up to 17 billion cubic metres of Russian gas to be purchased by Gazprom at a price fixed at 230 dollars per 1000 cubic meters.

SALES:

in 2006, 34 billion cubic metres of gas at a price of 95 dollars per 1000 cubic metres will be sold to the joint venture to be formed by Naftohaz and RosUkrEnerg. The price will remain fixed for the first six months of 2006. Until the joint venture is formed (February 1), the gas will be sold to Naftohaz. This gas is intended for the domestic market and may not be exported ;

starting in 2007, up to 58 billion cubic metres of gas will be sold to the joint venture to be formed by Naftohaz and RosUkrEnerg. This gas is intended for the internal market and may not be exported;

15 billion cubic metres of gas for export will then be transferred within the framework of joint programs with Gazprom.

As you can see, the contract only guarantees a few things: a royalty fixed for five years for the transport of gas on Ukrainian territory, a price of 95 dollars for the first six months of 2006 and a price of 230 dollars for Gazprom. The price is not specified, nor is any guarantee given as to the volume of gas supplies from Central Asia. There is no indication what the price will be for gas in the second six months of 2006 and 2007. Nothing is mentioned, in fact, about the following years, surely an unusual

_Below: Russian President Vladimir Putin (right) with Gazprom CEO Aleksei Miller



feature in a five-year contract. Finally, it is feared that the assets to be used in setting up the joint venture between Naftohaz and RosUkrEnergo will cause Ukraine to lose control over its national distribution network which has been coveted by Gazprom for a long time. All this because that country, as Igor Ivanov, Secretary of the Russian Federation Security Council has made very clear, is the “keystone of Moscow’s energy strategy”. Many Russian newspapers maintain that the Kremlin is trying to gain control of the gas pipelines, not only throughout the post soviet region but even farther a field, as a means to gain influence and even to control the region. Not limiting itself to the so-called “near abroad” but expanding beyond, for example into Bulgaria and even toward Serbia. According to the “Economist”, Gazprom’s expansion into national distribution systems is very “alarming”.

In addition, the January 4 agreement is not a binding document, but more like a declaration of intent, and badly drafted, as Putin’s former economic advisor Andrei Illarionov has observed. The guarantees in this agreement go instead to Gazprom and RosUkrEnergo: Gazprom because the royalties it has to pay and the price of gas are both frozen: 230 dollars, almost five times the previous price; RosUkrEnergo because it is assured control of all supplies to Ukraine and the sale abroad of any surplus.

Neither the methane companies (Gazprom and Naftohaz) nor the governments themselves will administer this elaborate scheme; instead it will be a joint venture registered in Zug, Switzerland. RosUkrEnergo is projected to become the exclusive supplier to Kiev and this company will make huge profits. It’s a strange situation. RosUkrEnergo is a mysterious organization and really the key to the whole operation.

The Mystery of RosUkrEnergo

In 2005, Ukrainian State Security (SBU) started an investigation of EuralTransGas and RosUkrEnergo, which had succeeded it as an intermediary in the sale and transport of gas from Turkmenistan. This investigation was apparently covered up following the ousting of Yuliya Tymoshenko as prime minister. RosUkrEnergo was registered on July 22, 2004 in the tax haven of Zug, in Switzerland. 50% of the share capital is owned by

Gazprom, through ARosgas Holding AG, a subsidiary of GazpromBank, and 50% by Raiffeisen Investment AG, a fiduciary company of the Austrian Raiffeisenbank (held for Centragas Holding AG). A symbolic percentage (one share apiece) belongs to two individuals: the director of Raiffeisen Investment, Wolfgang Putschek, and another manager of the group, Jorg Windbichler, both considered close to Gazprom. Raiffeisen has repeatedly maintained that its activity is limited to managing the company on behalf of its clients... who do not wish to have their identities revealed.

Roman Kupchinsky, Director of RFE/RL Organized Crime and Terrorism Watch, has revealed that RosUkrEnergo is only a mailbox in Zug: it has just a few bank accounts, some computers and some very expensive Mercedes. The sole services offered are the compilation of transit documents and customs declarations and the payment of bills. All the contracts it has signed are wrapped in mystery.

According to Kupchinsky, RosUkrEnergo will earn huge profits just like the company it replaced, Eural Trans Gas, which is headquartered in a Hungarian village, Csabadi, and included as stated owners a lawyer in Tel Aviv who apparently represents Semen Mogilevich (who has had legal problems in the past), and three Romanians: an unemployed actress, and a couple of rather penniless young men. RosUkrEnergo will actually sell from 13 to 15 billion cubic metres of gas in western markets, with a profit close to 2 billion dollars.

This is not an unimportant scandal. The January 4 agreement could have been signed directly by Gazprom and Naftohaz without any third parties. But if it had been transparent, there would have been no opportunity to divert large sums of money. According to information provided by Ukrainian journalists, some famous Ukrainian politicians are probably secretly behind Centragas.

It’s a truly unusual situation: an agreement to supply energy from one country that is administered by a company whose address is just a mailbox number in Switzerland and whose real corporate structure is unknown. For Yuliya Tymoshenko this can only be a company created expressly to guarantee the interests of certain individuals connected to the government.



_Above: Anatolii Chubais, the unpopular czar of the 1990s privatisations, who now heads the conglomerate with a monopoly on electricity, RAO EES Rossii. Top: a gas production plant on the outskirts of the Ukrainian town of Poltava

Another Embarrassing Matter

The creation of the consortium of North Europäische Gas Pipeline Gesellschaft (NEGP), the so-called Baltic gas pipeline, was undertaken by then German Chancellor Gerhard Schröder almost unbeknownst to the EU. The project dangerously increases the energy dependence of Berlin and is onerous (the maritime gas pipeline will cost from 30 to 50% more as compared to one that crosses land). This is why it was criticised in detail by Fatih Birol, chief economist of the International Energy Agency. It's a highly political project, one that "punishes" the Baltic States and Poland, as it replaces the planned and much more economical doubling of the existing gas pipeline in Northern Europe. It's a decision that affected an EU member state and that reminded some commentators of past agreements between Berlin and Moscow. In any case, it's an initiative that shed new light on "the incredibly benevolent attitude of the Chancellor toward Putin". The NEGP risked dealing a mortal blow to EU policies toward Moscow and raised questions about the ethical behaviour of statesmen. The agreement was signed on September 8, 2005, during the final days of the Chancellor's term, with both Putin and Schröder present. He was then hired, at a sizable salary, by the same company that was the beneficiary of the agreement. Actually Schröder's decision to accept the presidency of the NEGP Oversight

Council is controversial in many regards, a company 51% controlled by Gazprom (and with a minority position held by the German companies BASF and E.ON) and which is headed by Matthias Warnig, an former agent who worked for Stasi, the secret police of the GDR, and a colleague of Vladimir Putin when he wore the uniform of the KGB in Dresden at the end of the 1980s. Warnig, whose code name was "Okonom" and "Arthur", gave up his Stasi uniform, became an officer in the Dresdner Bank, and in 2005 was brought into the top management of Gazprom. Dresdner Bank, after having carried out especially delicate assignments for the Russian government (for example in the Yukos affair), acquired a third of Gazprombank's shares. The situation became particularly embarrassing for Schröder when it was learned that the NEGP consortium was formally constituted, with capital of one million Swiss francs, on December 8 in Zug, one of the Swiss tax havens, in the law offices of the fiduciary lawyer Urs J. Hausheer, (owner of Hausheer & Partner and associated with the Swiss Lawyers Group). Hausheer, who is now in the position of director, is known for having worked for the Stasi in the 1980s, and in particular for the "Kommerzielle Koordination" headed by Alexander Schalck-Golodkowski. The NEGP consortium can avoid taxes because it is registered in Zug, has its headquarters address as a mailbox, at 6 Untermüli. Not far away, in another mailbox, this one at 7 Bahnhofstrasse, is the RosUkrEnergog. This legal headquarters, in a famous tax haven, and the biographies of those involved, have raised lively discussion in the Bundestag. Most of all, this matter has dealt a serious blow to EU policies.

Setting Clear Policies

If in the past Brussels and Washington turned a blind eye and remained silent when Moscow used the energy lever, things have changed with the "gas war" that started off the year; it impacted the EU, rousing it from its apathy and calling into question the mantra according to which Russia is the major, dependable supplier of Europe's energy needs. For Ukraine, the situation that was created and the sympathy it brought have instead opened an unexpected window of opportunity. But is Kiev now capable of becoming a dependable partner for Brussels? Ukraine, drifting and unable to reform an economy that squanders

its energy resources, doesn't offer much hope. The legacy of the orange revolution was wasted and the pre-election political crisis that began on January 10 with a vote of no confidence has brought the institutions to a standstill. It would be difficult in this context to deal with the issue of restructuring the energy system, making it more democratic and transparent. Nevertheless, the EU must quickly develop a position vis a vis Kiev and overcome its past hesitations. But the EU must also draw other lessons. It must think about distinguishing between suppliers and the supply circuits, so as not to fall hostage. It must think about a scenario in which the position in which Ukraine finds itself is taken by an EU country, like Poland (and it is known that relations between Warsaw and Moscow are problematic). Most of all, it must think about developing a clear policy on energy security and an equally clear policy vis a vis the Kremlin. These policies must be shared by the member states and be binding. No unilateral policies should ever be introduced like the German Baltic Sea gas pipeline initiative. The RosUkrEnergoprofit is sure to become a litmus test for Kiev. That an opaque company such as RosUkrEnergoprofit is now running a system of monopolistic supply to Ukraine and manages a share of the gas that goes to Western markets cannot be acceptable to Brussels.

Finally, Moscow: The EU must finally define its policies toward Russia, because the void in political decision-making could become dangerous. The EU must pressure Moscow to ratify the Energy Charter that it signed a number of years ago. Monopoly positions over pipelines (gas and oil) are contrary to the principles of this charter and the EU must therefore take action to democratize these energy highways and ensure the free movement of energy raw materials. In the coming years the Russian energy industry will need to make huge investments and technology transfers (amounting to several hundreds of billions of dollars) and the EU participation in this requires a framework of certainty and transparency.

Respect for the principles of the Energy Charter will also help in the process of democratic transformation in the nations of Central Asia that are currently forced to give up all of their energy resources to the Russian monopolists. While Moscow wishes to build

an "OPEC of Natural Gas" with the countries of Central Asia, it is in the interest of the EU to see a free market emerge.

The idea of an "OPEC of Natural Gas", or of a "Euro-Asian alliance of gas producers" was put forward by Putin on January 21, 2002 during a meeting in Moscow with Saparmurad Niyazov, President of Turkmenistan. The idea was again proposed in February 2003 by the then Prime Minister Mikhail Kasyanov at the Economic Forum of Eurasian Economic Community. The following April 11 at the Kremlin, Niyazov signed a series of agreements in which he turned over his country's gas to Gazprom for 25 years, at less than half the price offered by the market. And his country has one-third of world reserves. On December 22, during a meeting of the Russian Security Council, Vladimir Putin sketched a scenario in which Russia should assert itself as an "energy superpower". "Energy is the most important power for world economic progress. It has always been and will be so for a long time". Russia possesses "competitive, natural and technological" advantages that can put it in a position of leadership in the global energy sector. Putin also stated that this is the only "area in which it can claim leadership".

Europe must begin to look into this issue and make some quick choices: Should Moscow be considered simply an indispensable supplier of raw material (closing ones eyes to everything else) or must it be involved in a credible way in a system of international rules aimed at promoting transparency and democratization of societies, with verifiable goals and objectives? The "gas war" with Kiev is a fairly good illustration of the danger posed by the emergence of Russia as an energy superpower, resulting in the creation of new vulnerabilities. On January 27, in what could have been a revisiting of the Hapsburg Empire, eight Central European countries (Austria, Croatia, Poland, Czech Republic, Romania, Slovakia, Slovenia and Hungary) met in Budapest. They decided to coordinate their energy policies and asked the EU for help in reducing their dependency for energy on Russia. These countries need to be supported and the EU in particular must exercise its leadership and quickly set out a clear, assertive, and shared political agenda on energy and relations with Russia. This is a challenge that must be faced without hesitation, because the European Union's very future could depend on it. ■■■■■