

## **RUSSIAN ENERGY POLITICS IN POLAND, UKRAINE AND BALTIC STATES**

**Imagine traveling in Latvia and Estonia during the unpleasant winter of 1992-1993, when Russia had cut off oil exports to those countries. Although Moscow claimed that the disruption was due to a conflict over pricing, the real reason was obviously political; to pressure the Baltic States into rescinding their demand that Russian troops be withdrawn from Estonia, Latvia, and Lithuania. This was my first experience with Moscow using its energy power to influence policies in neighboring countries.**

**Russia interrupted oil supplies to the Baltic States in 1990 in an attempt to crush the independence movements, but many of us had assumed that this was part of a last gasp attempt to hold on to the empire. The 1992-93 event, however, left me uneasy about Russia's projection of its energy power to influence the domestic policies of its neighbors.**

**The Lithuanian Government decided to search for a Western strategic investor that could manage its oil facilities and reach a crude supply agreement with Russia. Russia was strongly opposed to Lithuania's attempt to bring in a Western company. After negotiations started with the Williams Company of the U.S. Russia turn off the supply of oil to Lithuania at least nine times during 1998-99; each time Lukoil claimed it was for a "technical reasons". In reality, the disruptions were intended to halt Lithuania's negotiations with the Williams Company of the U.S., so that Lukoil could take full control of the country's oil facilities.**

**Lukoil also prevented a Kazakh oil company from fulfilling a 1999 contract to supply Mazeikei Nafta with crude oil. The threat to the Kazakhs was to have all of their westward shipments through the Transneft system stopped if the contract with Lithuania went forward.**

**During the height of negotiations between Lukoil and Williams, Moscow sent a former KGB officer, who had been the agency's liaison with Lukoil, to Lithuania as Russia's ambassador, on order to stop the sale of the assets to a Western company and to support a Lukoil takeover. His arrival in Vilnius coincided with stepped up "public opposition" to the negotiations with Williams and an increase in rumors being spread**

**alleging corruption by Williams. There was also an increase in nationalist attacks by some parliamentarians and journalists who had been long-time supporters of Lukoil. There were private warnings from Moscow of damage to Lithuania's relations with Russia if the American company took control of the facilities. This was the first time in my 35 years as a diplomat that I had seen any country send out an intelligence officer as ambassador in order to influence a commercial negotiation.**

**Incidentally, Moscow recently sent a former Minister of Fuels and Energy as ambassador to Latvia. As minister, he had called for a total oil boycott of Lithuania in order to support Lukoil's proposed takeover.**

**Of course, it was not coincidental that over five years ago, the former head of Gazprom and Russia's energy czar, was sent to Ukraine as Moscow's ambassador. Mr. Chernomyrdn has succeeded in helping Russian companies gain control of over 80% of Ukraine's refinery capacity, much of the country's product industry and its oil retail trade. Chernomyrdn has also helped block Western attempts to gain Ukrainian support for the Odessa-Brody pipeline system which would bypass Russia in carrying Caspian Sea oil to the West. Chernomyrdn is quoted as saying that Russian interests will prevail. And he succeeded. After nine meetings between Presidents Kuchma and Putin in the first eight months of 2004, the two men signed an agreement giving a Russian company (TNK) access to the pipeline, effectively killing this important project which was supported by the EU. Russia also warned Kazakhstan not to participate in the Odessa-Brody line. Weakening Russia's stranglehold over east-west oil and gas pipelines would not be permitted by Moscow.**

**Over time, the bargaining over ownership of Lithuania's energy assets involved Lukoil, TNK and Yukos, Russia's three largest oil companies, but with Moscow clearly favoring Lukoil. Some Russian negotiators representing the three companies were former KGB or GRU officers. They made little effort to conceal their past affiliations.**

**Before the 2000 Lithuanian parliamentary elections, Lukoil Baltija established a company named Vaizga, to funnel money to various political groups in Lithuania and Latvia. At least two political recipients of Lukoil's money admitted to Western embassies that they had accepted campaign funds from Vaizga. Russian companies, particularly**

**Lukoil and Gazprom make enormous profits from their sale abroad of cheaply secured energy resources. They are encouraged by the Kremlin to use these profits to advance Moscow's foreign policy goals. Russian energy company funding of political groups in the states of the former Soviet Union, has by and large been successful in buying influence for the Kremlin. The largest political recipient of Vaizga's generosity was the Social Democratic Party, who went on to win the largest share of the vote and control of the government.**

**Another technique, particularly used by Gazprom, is to establish alleged "independent" gas distributors, such as Itera, Eural Trans Gas and Dujotekana (in Lithuania) which are then used to "reward" local politicians and act as instruments of Moscow's intelligence services.**

**I became acquainted with a Polish company that had been chosen by Gazprom as its conduit for Russian natural gas shipments to Poland. I began to recognize that the most powerful economic leaders in many of the post-communist countries are in the energy field. Almost all have, or have had, close personal ties with someone within one of Russia's energy companies, in most cases Lukoil and Gazprom. Coincidentally, all of these individuals had been influential communist leaders in their countries before the collapse of the Soviet Union.**

**In my visits to Moscow over the past six months, I have been struck by the number of Russian economists and energy specialists who believe that the greatest crime committed by Yukos and its head, Mikhail Khodorkovsky, was that of becoming too independent of the Kremlin. In addition, he demonstrated an unwillingness to work with the country's power ministries, i.e. defense, interior, energy and security services. Foreign observers in Moscow can clearly see that the dramatic increase of former intelligence officers occupying high level positions in the government and energy firms, has led to a return to a period when energy companies were more political instruments than profit centers.**

**Russia's is clearly using its energy monopoly power in the region of the former Soviet Union to influence the political and security policy in neighboring countries. If this is the case, one must ask whether Russian behavior goes beyond the natural support that Western governments provide for their companies abroad. Russian energy policy is used as an instrument by the Kremlin and its power ministries as leverage to affect**

**foreign and security policy in importing countries, particularly in East Central Europe.**

**Why should we in NATO care?**

**Because the destructive effect on democracy and free markets in the importing countries can result in the following:**

- **It can reinforce the already serious problem of corruption and lack of transparency in East Central European countries.**
- **It can reward leaders with strong, traditional ties to Moscow, rather than more modern individuals with democratic values.**
- **It can create or perpetuate a class of powerful economic leaders who have inordinate influence over their countries' political systems.**
- **It can reinforce the views of those present and former members of Russia's power elite who believe that economic and political subversion remain acceptable methods of promoting state-to-state relations. This is a serious problem among nations once part of the Soviet Union or members of the former Warsaw Pact.**
- **It can deprive the Central Europeans of investment by Western energy companies who feel reluctant to compete with the non-transparent Russian companies for privatized assets and investment opportunities.**
- **It can reduce competition for energy resources, thereby increasing costs above what they would have been in a real competitive market.**
- **Last, it reinforces unethical business practices in Russia itself, delaying the development there of an open, transparent society.**

**The United States and the European Union have a direct stake in the successful transformation of the former communist states of East Central Europe into dynamic, open societies that are able to bring their**

**living standards closer to West European levels. The success of democracy in these countries is vital in order to reduce the security threat in a region that has been a cauldron for war and instability for the past half-millennium.**

**Membership in NATO and the EU brings a higher degree of security to these countries (with the current exception of Ukraine), in addition to a certain amount of improved transparency. Nevertheless, the exceptional dependency of these countries on Russian energy resources gives Moscow an opportunity to wield much greater political influence, even after their formal integration into Western institutions.**

**There are four major reasons why the EU and the U.S. have not yet focused adequately on the issue and are reluctant to confront Moscow on a diplomatic level over the issue:**

- The assumption exists that NATO and EU memberships automatically protect new members from any potential threat from abroad;**
- The view in Brussels and Washington that substantial energy resources may be needed from Russia to replace, possibly on short notice, oil and gas now coming from increasingly unstable producer countries, such as Saudi Arabia, Venezuela, Nigeria and Indonesia;**
- A recognition that expanding exports from the Caspian Sea region is, to a large extent, held hostage to Russia's control of the pipelines to the West. Russia is also successful in applying political and economic pressure on producers, such as Kazakhstan, Azerbaijan, and Turkmenistan to not develop independent energy ties to the West;**

**For these reasons, I believe that East Central European governments, with the help of trans-European institutions, must work together with the intent of implementing policies that will provide greater energy security to those countries that are now overly dependent on Russia for their oil and gas supplies.**

**The EU should address the issue with more urgency. In the short run, EU energy policies in the Baltic States are now working to increase, rather than decrease, dependency on Russian. EU policies call for closing Lithuania's nuclear power plants and for drastic reductions in emissions from oil shale in Estonia and the burning of coal and peat in Latvia. New domestic energy sources must be developed with EU help.**

**The most important step, however, is to increase significantly business transparency in the Baltic nations and in the wider neighborhood. Transparency and non-corrupt governmental institutions must be strengthened. This is not only fundamental to the search for technical and resource solutions to the issue of energy dependency. Such measures will encourage Russia and its energy power groups to adopt business practices that will also speed Russia's real integration into the international community.**

**October 19, 2004**

**Keith C. Smith  
Senior Associate  
Center for Strategic and  
International Studies  
Washington D.C.**