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Energy Empire

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Vice President Richard Cheney warned Russia against using oil and gas sales as "tools of intimidation or blackmail" in that strongly worded speech in Vilnius. Since then, Secretary of State Condoleezza Rice and other senior U.S. officials have affirmed that Cheney's remarks represent the Bush administration's consensus view. Although this newly confrontational approach has provoked the expected hostile response in Russia, it might eventually engender greater international energy cooperation.

The rest of the world would benefit from additional Russian energy production. More Russian oil and gas would help curb rising global energy prices and further diversify international supply sources. Increased production would also generate extra revenue that the Russian government could use for social welfare, economic development, and other priorities.

Yet, Russia cannot substantially increase its oil and natural gas production without implementing major changes in government policies and private practices. Russia has the world's largest reserves of natural gas, and at least the fourth largest oil reserves. Many of these deposits, however, are located in remote areas with challenging geophysical characteristics. Russia needs foreign capital and technologies to exploit these fields and upgrade its aging energy transportation infrastructure.

Attracting the necessary foreign investment will require the Russian government overcome outsiders' perception that political factors determine its energy policies. Moscow has repeatedly exploited Russia's status as the dominant corridor for almost all Eurasian energy transit routes by cutting exports and imports of oil and gas from governments that pursue independent economic and political policies. Most prominently, Moscow's abrupt suspension of natural gas deliveries to Ukraine immediately before that country's parliamentary elections earlier this year has reinforced the appearance that Russian officials wield energy as a political instrument. Attempts to gain control over energy pipelines in Belarus and other countries also undermine foreign confidence in Russia as a reliable energy supplier.

At home, the Putin government's efforts to retain absolute control over national energy assets dampen foreign interest in developing Russia's energy resources. Pledges to allow opportunities for private actors, whether Russian or foreign, to own energy fields and pipelines remain unfulfilled. Attracting substantial foreign capital to modernize and expand Russia's energy

transportation infrastructure will require the Putin administration to end Transneft's and Gazprom's monopoly ownerships of Russia's oil and gas pipelines. Policies that discriminate among investors, undermine property rights, and sustain corrupt practices also discourage foreign direct investment.

To gain the confidence of Western investors, Russian energy companies must make their ownership and pricing decisions more transparent. The influence of these firms on Russian energy policy is immense. Gazprom already is the world's largest natural gas producer. Many current and former members of the Putin administration sit on its corporate board and those of other Russian energy firms. These owners and managers too often appear preoccupied with redistributing existing income and assets. Instead, they should devote more attention to expanding Russia's energy exports through increased production and conservation.

As the main markets for Russian energy exports and the most important sources of investment and technology, Western countries enjoy some influence over Russian policies. Western leaders must highlight to Russian officials the negative consequences of their counterproductive behavior. They also should discourage their own energy firms from tolerating illiberal Russian practices in the hopes of receiving special treatment.

Some Russians rejoice at their newfound status as an energy superpower. They see oil and gas as replacing the army and navy as the key pillars of Russian foreign policy. More far-sighted Russians recognize that energy wealth alone will not transform Russia into a strong, technologically advanced economy that is better integrated into Euro-Atlantic institutions. Additional revenue from oil and gas exports will not ensure that Russia becomes a liberal democracy underpinned by free market principles. Nor will most Russians prosper if their country becomes an energy empire dominated by an oligarchy of wealthy business leaders and their political allies.

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