

Economist.com**OPINION
LEADERS**

PRINTABLE PAGE VIEW SPONSORED BY

[About sponsorship](#)**Vladimir Putin's Russia****Don't mess with Russia**

Dec 13th 2006

From The Economist print edition

Russia's habitual abuse of its energy muscle is bad for its citizens, its neighbourhood and the world[Get article background](#)

FOR over a decade Royal Dutch Shell, along with its Japanese partners, Mitsui and Mitsubishi, has been struggling to coax oil and gas out of the frozen seas off Sakhalin Island, in Russia's far east. Over the years the scheme has run into environmental protests, its projected cost has doubled to \$20 billion and its completion date has receded. But it is now nearly finished. With oil and gas prices high and a flood of revenue imminent, it is an odd time for the three owners to reduce their shareholding. Yet that is exactly what they offered to do this week, by selling a majority stake in the project to Gazprom, Russia's state-owned gas giant (see [article](#)).

Gazprom's masters in the Kremlin have made no bones of their desire to keep big energy projects in the family, so to speak. Russian officials had been making life difficult for the Sakhalin project by threatening dire consequences for minor environmental lapses. The shareholders, perhaps mindful of the fate of Yukos, a big Russian oil firm bankrupted by over-zealous tax inspectors, presumably concluded that Gazprom was making them an offer they could not refuse.

Neighbourhood bully

When it comes to energy, Vladimir Putin's Russia seems prone to loutish behaviour—despite constant claims that Russia is a reliable partner. In addition to mugging Yukos, it has often intimidated its neighbours with threats to cut off their oil or gas supplies. Earlier this year, when Lithuania had the temerity to sell an oil refinery to a Polish firm instead of a Russian one, the pipeline that supplies the refinery with Russian oil suddenly succumbed to a mysterious technical fault. Last winter Gazprom appeared to blackmail Ukraine's new pro-Western government by

cutting off the country's gas amid a dispute over prices. The episode sent a chill throughout Europe, which relies on Gazprom for about a quarter of its gas. Japan, the future recipient of most of the gas from Sakhalin, will now also find itself at Gazprom's mercy.

Russia's government, of course, is not the only one to try to grab a bigger share of the takings as oil and gas prices go up. Britain recently raised taxes on production from the North Sea. And Russia has a strong incentive to rewrite the rules, since it agreed to generous terms for projects like Sakhalin back in the 1990s, when it had no money to develop its resources itself and was desperate to attract foreign investment. But its brutish behaviour will probably backfire. The next time the oil price falls or money runs short, it might end up having to offer even more munificent terms to lure the oilmen back. Russia risks scaring off investors of all stripes, as well as potential customers for its oil and gas.

Moreover, Russia still needs the expertise of foreign firms. Gazprom and its state-controlled counterpart in the oil business, Rosneft, are hopeless at increasing their output—except by buying up other firms' assets on the cheap. So the Russian state's insistence on developing its oil and gas by itself is not just bad news for the shareholders of Shell, Mitsubishi and Mitsui. It is also bad news for ordinary Russians, who will not see as much oil wealth as they otherwise might.

What explains these self-defeating tactics? Mainly Mr Putin's belief that energy is a weapon with which to restore the lost greatness of the Soviet Union. No longer need Russia go to the West cap-in-hand for money, as it did in Boris Yeltsin's day. Now it can stand tall once more, not least in the neighbouring ex-Soviet countries that many in Moscow have never reconciled themselves to losing. Whenever these places seem to look to the West, still more aspire to join such Western clubs as NATO or the European Union, the Russians have reacted petulantly, as they did earlier this year by imposing trade embargoes on Georgia and Moldova.

From Russia with polonium

Mr Putin's use of energy as a weapon is only one instance of a Russian assertiveness that nowadays seems to border on gangsterism. Perhaps the most spectacular recent example is the murder in London of a former Russian agent, Alexander Litvinenko. Though it is not clear whether the Kremlin ordered the killing, that this even seems possible says something about the internal state of Russia (see [article](#)). With the parliament largely emasculated, television under state control, the press muzzled and once-autonomous regions shackled, the presidency has acquired enormous clout. It is increasingly the Kremlin that decides who runs Russian business and finance. Although an election is due in March 2008, Mr Putin will in practice choose his own successor.

Such authoritarianism, like the muscular use of energy, is driven partly by weakness. Russia's army is chaotic, its population is shrinking and its economy is dangerously dependent on natural resources. That is why Mr Putin is so keen to keep a firm grip on power at home; it is also why he is so anxious to keep Russia's seat at the top table, not just in the UN Security Council but also the G8 club of rich countries.

If Russia continues on this course—and especially if Mr Putin meddles with the constitution to grab a third term—it does not deserve to stay in the G8. But it is also worth noting that Russians, Russia's put-upon neighbours and the shareholders in the Sakhalin project are not the only people who stand to suffer as a result of the Russian economy and political system being mismanaged this way. The Russian state's insistence on developing its oil and gas by itself is bad news for almost anyone in the world who consumes power or fuel.

In the early part of the decade new production from the former Soviet Union accounted for most of the growth in the world's supply of oil and gas. But when Mr Putin began his campaign to take control of Russia's resources, that growth stalled, just as China's demand for energy was taking off. The present high prices for oil and gas are the result. With exploration prospects drying up in much of the Western world, and with the countries of the Organisation of the Petroleum Exporting Countries unwilling to open the taps, Russia is one of the few countries that could produce more oil—if only Mr Putin changed his thuggish ways.