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The profits of power: Commerce and *realpolitik* in Eurasia

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ABSTRACT

Although the energy trade is the single most important element of nearly all European countries' relations with Russia, Europe has been divided by both worldview and practice. Why, in the face of the common challenge of dependence on imported Russian gas, have national reactions to such vulnerability varied so dramatically across the continent? And why have a handful of French, German, and Italian corporations somehow taken responsibility for formulating the energy strategy – and thus the Russia policy – for essentially all of Europe? The resolutions of these two puzzles are, I show, interlinked; they also demand theoretical innovation. With several case studies – of Gazprom's decision-making during the 2006 and 2009 gas crises, and of the response of western and central Europe to their gas dependence – I find that: firms are driving these political outcomes; those firms are motivated by profits but employ sociological conventions along their ways; and firms generally seek the necessary inter-firm, cross-border cooperation that will deliver corporate performance. Finally, I conclude that the field will ultimately require a framework that puts firms at its center.

KEYWORDS

Business–government relations; multinational firms; geopolitics; energy; Russia; Europe; Gazprom.

The nations of central Europe seem haunted by Gazprom, as though it were a specter of the Communist past and Russian domination. All the corporate powers of old Europe have entered into business alliances to welcome this specter: the French Électricité de France (EDF) and GDF SUEZ, the German E.ON and BASF, the Italian Eni. Although the energy trade is the single most important element of nearly all European countries' relations with Russia, Europe has been divided by both worldview and practice.

While central Europe pleads for European solidarity to show the Russian natural gas behemoth, whose majority shareholder is the Russian state, a unified front, this handful of west European firms have continued to cultivate their longstanding bilateral relationships with Gazprom. As the European Commission in Brussels promotes new pipelines to bring non-Russian gas to European markets and thereby diversify the continent's dependence, the German and Italian firms have pushed for new routes to pipe higher volumes of Russian gas westward to maintain their consumption. Central European and US leaders have expressed alarm at the separate peace made by the French, German, and Italian firms.

In part this is because the resulting patterns of international politics – organized by great powers, without sentiment or regard to the express preferences of smaller neighbors – seem anachronistic in an integrated Europe that is now more than 50 years beyond the Treaty of Rome. The patterns have acquired a patina of *realpolitik*, as the strong have done what they would, and the weak have suffered, despite their belief that the entire point of having joined Europe was that they no longer must.

In this paper I resolve the two fundamental puzzles represented by these international politics. Why, in the face of the common challenge of dependence on imported Russian gas, have national reactions to such vulnerability varied so dramatically across the continent? And why have a handful of French, German, and Italian corporations somehow taken responsibility for formulating the energy strategy – and thus the Russia policy – for essentially all of Europe? The resolutions of these two puzzles are, I show, interlinked.

Explanations informed by conventional theories of international political economy (IPE) cannot resolve these puzzles. Because these patterns of international politics share a surface resemblance to *realpolitik*, realist theory may seem potentially useful. A realist account would, however, identify neither the most important agents nor their essential logics. Instead of states' pursuing security amidst anarchy, we find firms' pursuing profit in the face of uncertainty. The geopolitics of European energy have fundamentally commercial and ideational origins.

Yet the theoretical frameworks based primarily on commercial logics, such as the varieties of liberalism and open economy politics (OEP), or ideational constitution and causation, such as constructivism, are also insufficient to answer satisfactorily the pressing questions of Eurasian politics. For one, the preferences of the corporate actors cannot be deduced from the standard variables, and even then the firms' preferences are not aggregated by institutions before influencing policy. The firms' preferences led to firms' strategies, which became *de facto* policies. Although constructivist theories are potentially useful for explaining the origins of corporate preferences and practices, in fact scholarship informed by constructivism has to date not systematically dealt with the differences between firms' and governments' decision-making.

Fundamentally, then, it is the second puzzle – the centrality of firms – that demands theoretical innovation. Firms are, literally, creating these politics, while state leaders are the supporting actors in the drama (Abdelal *et al.*, 2008a, 2008b, 2008c, 2009; Abdelal and Tarontsi, 2011a, 2011b).[1] 'Firms', suggests EDF's Bruno Lescoeur, who has championed his firm's relationship with Gazprom, 'are making energy policy for Europe, by default'.[2] In order to understand the political economy of contemporary Europe, then, we have to understand the way in which firms' practices beget the structure of international politics.

Contemporary IPE scholarship can unfortunately claim only modest insights into what actual firms do and why. The imaginary firms that inhabit the dominant theoretical frameworks of the field are, alternately, assumed irrelevancies, stylized abstractions, or the private epiphenomena of public choices. Corporate preferences cannot be straightforwardly deduced from economic variables, or from simplistic beliefs about state incentives. The field needs a more sophisticated understanding of the ways firms both influence and, in some cases, actually produce political outcomes (see Stopford and Strange, 1991; Pauly and Reich, 1997; Doremus *et al.*, 1998; Sell, 2003; Avant *et al.*, 2010).[3] IPE scholars must also recognize that firms are organizations with meaningful pasts, which inform distinct local cultures that, in turn, shape the contingent worldviews of their managers. As Gary Herrigel argues, firms 'actively create themselves and collectively define the context in which they act' (Herrigel, 2010: 7).[4]

In this paper I first record the existing weaknesses of recent IPE scholarship in explaining the role of firms in international politics. Then I propose that the field of IPE revisit and systematize the insights of a previous generation of scholarship that took more seriously the role of firms and business–government relations within and across nations. With several case studies – of Gazprom's decision-making during the 2006 and 2009 gas crises, and of the response of western and central Europe to their gas dependence – I demonstrate that: firms are driving these political outcomes; those firms are motivated by profits but employ sociological conventions along their ways; and firms generally seek the necessary inter-firm, cross-border cooperation that will deliver corporate performance. Finally, I conclude that the field will ultimately require a framework that puts firms at its center. I offer preliminary thoughts about such an understanding of these agents and their direct and indirect influences on world politics

COMMERCE AND POWER POLITICS

The broad realist tradition in international relations theory and its varieties – classical, neo-, offensive, and neoclassical – are not directly useful to explain the *realpolitik* that emerged in Europe's post-Cold War energy diplomacy.[5] Theories derived in that tradition discount the possibility that the practices of firms exert any independent influence on international political outcomes. The standard reasoning is that state power sets the international political context within which firms operate, and without state action the vast majority of cross-border economic activity simply could not take place at all (Gilpin, 1975; Krasner, 1978). Multinational enterprise is thereby endogenous to state choice.

Although this is an important insight about the development of international capitalism during the nineteenth and twentieth centuries, that logic of the argument no longer gives us purchase on contemporary political outcomes. In a sense, the insight is instantiated in an international political order, in Europe particularly, that is so institutionally robust that firms have become ever more adventurous outside their home markets. Though this era of globalization may rest on fragile foundations, many important questions will go unanswered if we rely exclusively on frameworks that privilege the state's grand strategists. Even Jonathan Kirshner's sophisticated refashioning of realist political economy identifies the effects of globalization on states' pursuing the national interest in an environment defined by anarchy as essentially second order: globalization affects state autonomy and capacity at the unit level, and it affects the balance of power in the system through its differential effects on growth rates (Kirshner, 2009: 36, 40–2). It is time to recognize that firms' practices are, politically, first order.

The liberal tradition takes corporate preferences and practices more seriously. Andrew Moravcsik's recasting of liberal theory retains the realist emphasis on 'intergovernmentalism' but locates the origins of state preferences within national societies generally, and their material circumstances in particular (Moravcsik, 1997, 1998). Moravcsik's calibration of these material circumstances balances the preferences of producers and the regulatory and fiscal priorities of states (Moravcsik, 1998: 35ff). The possibility that the firms' practices are themselves the political outcomes of interest is again, however, eliminated largely by assumption. Firms, for Moravcsik, prefer or reject government policies based primarily on material interests that can be deduced. The puzzle of Europe's energy trade, however, is that the firms' interests are historically contingent and based on convention. Firms undertake strategies not to influence political outcomes; they are the outcomes.

Compared to these modern refinements of liberalism and realism for an era of globalization, a newly dominant paradigm, open economy politics represents an interpretive step backwards. The OEP perspective has led to a more sustained analytical engagement with firms' varied preferences for and influences on policy outcomes, especially monetary, exchange rate, and trade policies (see Lake, 2009). The standard OEP mode of reasoning adopts an unreasonably and unnecessarily spare understanding of what motivates firms, however. The relevant material reality from which firms' preferences are deduced is almost exclusively economic. That is, governments face a range of plausible policy stances, which affect firms differentially. The core debates are narrow: whether, for example, factors or sectors carry greater causal weight; how different institutional arrangements aggregate domestic preferences; or how, once established, the different aggregations interact with one another in the international system. As Thomas Oatley has written in a devastating critique, the OEP paradigm suffers from potential omitted variable bias, a discounting of network effects, and problems of temporal sequencing (Oatley, 2011).

The energy industry in Europe presents a context in which the basic assumptions of the OEP perspective are violated to an extraordinary degree. In particular, the OEP approach, if applied to this sector and these politics, omits the cross-border relationships among firms, relationships that are themselves the result of their historical interactions with one another. The empirical affronts are manifold. The basic OEP starting point, as David Lake observes, is the 'small country' assumption: 'that production and consumption in any single state are sufficiently small relative to global totals that all actions, including government policy, have no noticeable effect on world prices' (Lake, 2009: 233). In this case, Russia is one of the major producers, and France, Germany, and Italy are major consumers. The price of the product is set by historical convention through bilateral bargaining and a formula that connects the price of natural gas to the prevailing price of fuel oil. Unlike oil, however, natural gas is not fungible; because of the infrastructure required to deliver gas, it is almost always sold simply at the end of the existing pipeline. This is an industry, in other words, for which everything – prices, delivery routes, contracts, joint ventures – is endogenous to the practices of a handful of large firms. Those firms cannot discern their interest by abstracting from their own practices; those practices make the markets.

Firms exist, instead, in a world defined by commercial and geopolitical uncertainty, differing corporate cultures, cognitive biases, and divergent interpretive frameworks (see Katzenstein, 2005; Abdelal *et al.*, 2010). These analytical descriptions are generally associated with constructivist theories of IPE. I do not, however, propose that the answer exists in constructivist IPE, or at least not yet. Although the analytical language promises to be useful, in fact scholars working in this theoretical tradition have generally not explored this promising corporate terrain. This is especially ironic, since decision-making under uncertainty, as opposed to calculable risk, is one of the core conceptual contributions of that theoretical tradition. That very formulation was, however, borrowed not from the study of international politics, but from the study of firms. The economist Frank Knight's classic was, after all, concerned mostly with profit (Knight, 1921).

One notable exception is Cornelia Woll, whose work on firms' preferences over multilateral trade negotiations revealed dramatic divergences from the standard deductive models of political economy that focus exclusively on firms' putative material circumstances (Woll, 2008).[6] In comparative political economy, the work of Gary Herrigel represents deep insights into the ways in which firms pragmatically make and re-make the contexts in which they operate (Herrigel, 2010).

Although contemporary IPE scholarship has not taken adequate account of the variety of business–government relations that prevail in international politics, an earlier generation produced insights that may be profitably incorporated and, ultimately, systematized into a more useful analytical framework. The scholarship of Raymond Vernon in particular presents myriad intellectual opportunities (see Vernon, 1971, 1972, 1974).[7] Vernon has unfortunately been relegated to a dismissive footnote in contemporary scholarship for *Sovereignty at Bay* (1971), which, to add insult to injury has usually been read to mean almost precisely the opposite of his actual arguments. For Vernon, the contemporary predilection for discerning who is the master of whom – the state or business –would surely seem strange. Vernon observed instead that firms worked 'in concert with their governments', often through informal consultation. A firm might be the 'agent' or 'chosen instrument' of a government (Vernon, 1972: 111–4). Vernon also emphasized how the 'corporate environment' was characterized by the 'pervasive presence of ignorance and uncertainty in the decision-making process' (Vernon, 1971: 115).

Surveying the world of multinational enterprise, Vernon also rejected as decisive the 'formal nature of the ownership' of firms: 'it is rather the complex system of relations between the governmental apparatus in the economy' (Vernon, 1972: 116–7). That is, we cannot deduce the balance of commercial and political logics from the size of the state's shareholding in particular firms. We must, instead, investigate prevailing, largely informal patterns of business–government relations within nations to understand the ways in which firms, always one way or another in coordination with policy-makers, engage in strategies that affect international outcomes.

The relationship between firms and the state in the energy industry presents particular interpretive challenges. Energy firms have, throughout the twentieth and into the twenty-first centuries, tended to be large, vertically integrated, and oligopolistic, with transnational interests that intersect with the core security concerns of states. The decisions of energy firms therefore produce unavoidable security externalities. Corporate and state power in the energy industry are comingled. In most countries, states continue as major, often dominant shareholders and regulators of their energy firms. When a majority of the shares of a firm are privately owned, the state is essentially delegating critical aspects of public and foreign policy to private agents (see, for example, Avant, 2005).

IPE scholarship on the energy industry largely confirms Vernon's general observations. Peter Cowhey, for example, emphasized that the geopolitics of energy emerged from the interplay of companies and governments, with neither taking systematic pride of place (Cowhey, 1985: 82, 123ff). Merrie Klapp observed the importance of distinguishing among the so-called majors, the independent energy firms, and nationally owned corporations. For Klapp, the most persistent pattern was that the majors, with stakes in resources outside their home countries, sought generally to preserve control over flows and, for a time, prices; independents sought to 'strike deals with state oil companies of host governments' (Klapp, 1987: 22). For Germany and Italy and their firms, which according to Cowhey and Klapp would be independents, their inevitable role as consumers push them toward the dominant firms in neighboring resource rich nations. They have, according to Jentleson, 'neither the national natural resources nor the foreign holdings to supply their own energy needs' (Jentleson, 1986: 39).

More recently, the sophisticated, eclectic work of scholars such as William Keller, Louis Pauly, Simon Reich, John Stopford, and Susan Strange have produced insight into the practices of multinational firms (see Stopford and Strange, 1991). Although we have collectively learned a great deal about how firms operate across national borders, the elusive generality and halting convergence of corporate practices have, unfortunately, prevented the theoretical debates of the field from fully engaging our increasingly well-known reality. Pauly and Reich find that firms continue to operate within 'durable national institutions and distinctive ideological traditions' (Pauly and Reich, 1997: 1). Doremus *et al.* together demonstrated that national structures continue to shape corporate practices, even as those practices take on greater importance in world politics (Doremus *et al.*, 1998). These findings suggest that the simplistic accounts of multinational firms in the dominant approaches of the field have missed out on the most important points. The long simmering debate between realism and liberalism is resolved by the conclusion that firms indeed became more important than in the past, but in ways that emphasized their distinctive national origins and therefore the institutions of states. For OEP, however, the resolution is more troubling: firms have continued to differ in their interpretations of and reactions to similar material circumstances and putative incentives.

In sum, the role of firms in international politics has been either systematically misinterpreted or relegated to the status of an input. This has led to fruitless debates about whether business or the state rules the other. Instead, the many manifestations of business–government relations, one of which is the direct production of political outcomes by corporations, must be made central to IPE scholarship. Doing so necessarily means that scholars must analyze the actual logics and practices of firms, as well as explore their environment of uncertainty, of complex and historically contingent relations, and of diverse institutional patterns. A great deal of excellent IPE scholarship on firms exists, but our theoretical debates have abstracted from it.

In two case studies I uncover these logics and corporate politics. First, I demonstrate that Gazprom, despite the size of the state's share of its equity, has made decisions that are difficult to understand other than through the lens of profit maximization. Although international relations scholars and Western policy-makers have assumed that Gazprom is primarily a tool of the Kremlin for advancing state interests abroad, students of comparative politics have long observed that the Russian state, like all states, want from this most important Russian firm things that go beyond and often deviate from the maximization of Russian influence in neighboring post-Soviet Eurasia. The incentives that Russia has created for Gazprom, incentives that west European firms share, allow us to consider corporate strategy in terms of fairly conventional profit motives, albeit under conditions of geopolitical uncertainty. In the second case study I examine the responses of Gazprom's west European partners to that uncertainty, responses that have taken the form of competing and complementary gas pipeline projects.

CASE 1: PROFIT-MAKING, RUSSIAN STATE-BUILDING, AND THE UKRAINIAN TRANSIT MONOPOLY

The Russian state is majority owner of Gazprom with 50.002 per cent of the shares. One would logically expect Gazprom to act as an agent of Russian energy policy in pursuit of the state's interests. Those interests have, however, changed over time: from an emphasis on the short-term political gains from subsidies to the long-term influence of economic strength.

Capitalism without the state

The first post-Soviet decade brought economic disaster to the vast majority of Russian people and threatened the country's unity. Instead of prosperity, the transition to capitalism led Russia into an economic abyss (see, for example, Bunce, 1999; Klein and Pomer, 2001; Hough, 2001). De-industrialization intensified the dependence of the Russian economy on hydrocarbon exports, which traded at very low prices for most of the 1990s. Privatizations, particularly of the country's vast oil, gas, and other mineral resources, were for the most part corrupt fiascoes that created a small coterie of wildly rich and politically influential individuals who became known as 'oligarchs', some of whom lived even above the laws that they paid legislators to write. The central government failed to collect the taxes it was owed and was therefore nearly unable to function. In August 1998, the downward spiral culminated spectacularly: the Russian government defaulted on its domestic debt, devalued the ruble, and imposed a moratorium on repaying foreign private debt (on the 1998 crisis, see Illarionov, 1999; Malleret *et al*., 1999).

With the great benefit of hindsight, we know now that creating new institutions is hard work.[8] Russian reformers succeeded in tearing down an old, broken Soviet state. But they failed to create a new, effective state quickly enough to save Russian capitalism from the great defect of insufficient governance. The Russian state was not capacious enough to perform even the most basic functions that capitalism requires: protecting property; enforcing laws and contracts; maintaining a coherent monetary order; and collecting taxes (Gustafson, 1999; Colton and Holmes, 2006; Herrera, 2001, 2005; Holmes, 1997; McFaul, 1995; Smith, 1999; Sperling, 2000; Stiglitz, 1999; Woodruff, 1999).

Capitalism with the resurgent state

For Russia's political elite, well-educated and capable individuals who presided over the decline and fall of a great power, the whole experience was deeply humiliating. The downward trend decelerated and slowly reversed only after Vladimir Putin succeeded Boris Yeltsin as the country's president in 2000. Putin's election coincided with the onset of an extended period of higher hydrocarbon prices on world markets. Higher oil and gas prices alone could not, however, arrest Russia's political, economic, and social atrophy without more effective public authority.

Putin's priority then was to restore the state's ability to collect taxes (see, for example, Easter, 2006; Appel, 2008; Ericson, 2009).[9] Russian state-building thus implied wresting power from oligarchs. Putin's team successfully recast the state's relationship with the oligarchs whereby the oligarchs could avoid review of their assets' privatization with concomitant criminal penalties so long as they paid taxes and eschewed politics.[10]

The centrality of Gazprom: profits and the state

In the context of the Russian state's policy of maximizing power internally in the Putin era, Gazprom's role was to sustain domestic industry by providing natural gas at subsidized prices and contribute to state-building by filling federal coffers, a schizophrenic assignment to a firm to act both as a capitalist and socialist enterprise.[11] A look at Gazprom's income statement reveals the company's contradictory nature. (See Table 1.) Gazprom sells roughly two-thirds – by volume – of its gas within Russia and post-Soviet Eurasia each year. Prices within Russia, however, are regulated and have often been a fraction of prevailing prices in Europe. The Russian price has

Table 1 Breakdown of Gazprom's natural gas sales by broad regions for 2009

	Volume (bcm)	Sales $ million
Russia	262.6	16,366
Former Soviet Union	67.7	12,274
Far abroad	152.8	36,475

Source: Compiled from data in *Gazprom in Figures* (2005/2009: 55–6).

occasionally been below Gazprom's cost of production. Gazprom does not make money selling gas to Russians.

Gazprom makes money selling gas to Europeans. Western Europe accounts for some 32 per cent of sales by volume, but these are good customers who pay cash on time. By tradition, the long-term contracts between Gazprom and its European partners have set the price of gas by a formula based on the price of fuel oil. Recently, those European sales accounted for almost 60 per cent of the firm's revenues. Asia, while not relevant as a source of income, is a potentially important market in the future: Gazprom began in 2009 to deliver gas liquefied on Sakhalin by tanker to Japan and smaller volumes elsewhere in the region (Gazprom, 2009a: 12). Europe is where Gazprom makes its money.

The firm is, in fact, desperately dependent on that European market. Consequently, the state's interests directed Gazprom, or at least its exporting business unit, to act as an efficient, profit maximizing firm. Political goals of the state, in other words, required non-political behavior by Gazprom Export. Meanwhile, Gazprom came under attack for allegedly furthering the political goals of the Russian state in smaller neighbors.

Ukraine and the transit monopoly

After the division of Soviet assets, Ukraine inherited part of the natural gas transit pipeline system that spanned 1100 km across its territory from Russia to Slovakia and onward to western Europe. The share of Russian exports reaching Europe through Ukraine averaged 97 per cent, decreasing to 80 per cent (110–120 bcm a year) after Yamal–Europe, a 33 bcm a year pipeline running from Russia to Germany through Belarus and Poland, reached its full capacity in the 2000s.[12]

The dependence of Gazprom on the Ukrainian transit grid strengthened the negotiating position of Naftogaz Ukrainy, the state-controlled owner of the pipelines, in talks on the price and volume of Russian gas supplies to Ukraine. Contracts signed in 1998 linked the prices Naftogaz would charge for transit and the prices that Gazprom would charge for gas. They also established that transit fees would be paid in-kind – that is, with gas. In 1998, Ukraine negotiated a gas discount from $80 per thousand cubic meters (mcm) to $50/mcm with, in principle, unlimited volumes and a transit discount from $1.75/mcm/100 km to $1.09/mcm/100 km. A few years later, as Moscow sought to strengthen its hand, a new intergovernmental agreement limited Gazprom's commitment to supply gas at $50/mcm to only 26–28 bcm, with the rest of Ukraine's imports sold at $80/mcm and in cash.[13] In August 2004, Gazprom transferred to Naftogaz $1.25 billion as partial pre-payment for transit of gas between 2005 and 2009; $1.09/mcm/100 km was thereby fixed for the transit tariff. Considering the discount compared to European prices, Naftogaz Ukrainy had evidently achieved a highly favorable arrangement for Ukraine. The discount came out of Gazprom's bottom line.

Although the eventual termination of gas subsidies was likely inevitable, it appears that the Ukrainian government initiated the transition to a new commercial logic in their contract negotiations. On 28 March 2005, Gazprom CEO Alexei Miller welcomed in the company's Moscow headquarters Ukraine's Minister of Fuel and Energy Ivan Plachkov and his deputy, Naftogaz Ukrainy CEO Alexey Ivchenko. After the meeting, Miller issued a statement:

> ... we can't but welcome the Ukrainian side's aspirations to ensure the maximum transparency and market-based mechanisms of interaction between the firms. We're backing Ukraine's proposal to shift over to settling gas transit via the Ukraine services in cash and to increasing the gas transmission tariff rate to the level adopted in Europe. Gazprom, on its part, is committed to fully meeting in 2006 Ukraine's needs in Russian natural gas at market-based prices fitting with the European standards. (Gazprom, 2005)

This obscure press release undermines the dominant view that it was Gazprom that took the first step to alter the shaky system of its gas trade with and transit through Ukraine.[14] Did Ukraine's president and negotiators expect that Gazprom would pay higher transit fee but continue to sell gas to Ukraine at price three to six times lower than in Europe? Perhaps. Throughout 2005 Gazprom tried to negotiate a higher price for the coming year, but the Ukrainian government refused to accede to it. Russia offered to keep prices low in exchange for a stake in the Ukrainian gas transport system. Ukraine rejected that proposal as well.

Ukrainian gas crises

The negotiations fell apart. Russia and Ukraine were left without a new contract for 2006. The old contract was set to expire, as usual, at 10:00 am on 1 January 2006. Gazprom continued on New Year's Day to compress and ship the amount of gas for which its European customers had paid, but it cut the shipment of gas intended for Ukraine's own consumption.

Table 2 Effect of the January 2006 gas crisis on Europe

	Drop in gas supply (%, by January 2)	Russian gas consumed (% of total, 2005)
Hungary	40	62
France	30	26
Austria	30	70
Poland	14	47
Slovakia	30	100
Romania	30	23
Italy	24	30

Source: Adapted from 'Country analysis briefs. Russia. Natural gas', Energy Information Administration (US Department of Energy), www.eia.doe.gov/emeu/cabs/Russia/NaturalGas.html (accessed 18 March 2008); 'Ukraine "stealing" Europe's gas', *BBC News*, January 2, 2006.

Reminding Naftogaz that Gazprom had pre-paid for the transit of gas to its European customers, executives in Moscow insisted that Ukraine continue to transit the gas to Slovakia. Not all of the gas slated for Europe made it across Ukraine, however, as the pressure in the pipeline exiting Ukraine registered a sharp decline.

The result was unhappy for European customers, which received 25–40 per cent less gas than they expected and for which they had already paid. (See Table 2.) Although the dispute was resolved in a matter of days, with Gazprom and Naftogaz agreeing to terms for 2006 on January 4, the media frenzy was intense. Gazprom's preferred narrative, in which an irresponsible Ukrainian leadership unraveled existing contracts and then blackmailed Gazprom for a discount, found few sympathetic ears in the West. Alexander Medvedev, Deputy Chairman of Gazprom and head of Gazprom Export, posed a rhetorical question about the supply contract's expiration: 'What should we have done if they had not come back to the talks before the New Year?'[15]

Instead it was Ukraine's narrative that dominated Western media and policy-making circles: Gazprom, an instrument of the Russian state, was being used as a weapon to punish Ukraine's new government, brought to power by the Orange Revolution, for reorienting the nation from Russia toward the West (see Wilson, 2005; Åslund and McFaul, 2006). The Orange Revolution referred to the hotly contested 2004 presidential election that had pitted continuity against radical change. On one side was Viktor Yanukovich, prime minister under current President Leonid Kuchma and thus representing, broadly speaking, a continuation of policies that balanced Ukraine's Western aspirations with the reality of dependence on and close relationship with Russia. Moscow supported Yanukovich. On the other side was Viktor Yushchenko, who had been Ukraine's central bank head during the 1990s and, briefly, Kuchma's prime minister. Yushchenko joined with wealthy gas trader and anti-Kuchma activist Yulia Tymoshenko to form the Orange coalition. The Orange Coalition enjoyed considerable support from governments and non-governmental organizations in the West (see Bunce and Wolchik, 2011, Chapter 5). Eventually, the contest was decided by three rounds of voting, a constitutional court decision, and massive street protests.

The new gas agreement increased both transit fees for Russia and gas prices for Ukraine. The transit tariff was increased to $1.6/mcm/100 km through January 2011. Gas prices and delivery volumes were set through a complicated arrangement: Gazprom would sell about 17 bcm at the market price of $230/mcm; the rest would come from Central Asia. The average price of the Russian and Central Asian gas came to $95/mcm.[16] Even at less than half of prevailing price in Europe, Ukraine now had to contend with an almost twofold price increase for its gas imports.[17]

Gazprom used the incident to push for market-based prices as a matter of consistent policy for the rest of the former Soviet Union as well. Thus was the 1990s-era Russian policy of subsidizing allies ended. Russian grand strategy had, it seems, evolved considerably.[18] Rather than requiring Gazprom to forego profits in the interest of purchased influence, Moscow bade Gazprom to sell its gas to paying customers.

Over the next several years, however, Ukraine proved persistently unable to pay for its gas. Negotiating directly, Putin and Timoshenko agreed in March 2008 on the price that Ukraine would pay for Russian and Central Asian gas imports arranged by Gazprom for the remainder of the year, as well as for 2009 and 2010. The 2008 price would be $179.5/mcm, while in 2009 the price would increase to $250/mcm. (The price of the Russian gas at the German border in October 2008, when Putin and Timoshenko were negotiating 2009 price, was $577/mcm. Insofar as that price was pegged to fluctuation of oil product prices with a six-to-nine-month lag, the negotiating parties could calculate the average German price six to nine months ahead. The price averaged $504/mcm in the first quarter of 2009, $407/mcm in the first half, and $319/mcm during the entire year.)[19] Naftogaz Ukrainy, however, seemed unable to bear the burden. The company missed its September gas payment, failing to pay for its gas deliveries in October as well. When Ukraine also failed to pay for November deliveries, Gazprom reckoned that the outstanding debt had reached $2.4 billion, including penalties for missed payments. During the month of December Gazprom and Naftogaz continued to wrangle over the accounting of Ukrainian debts and penalties. Gazprom sent letters to EU leaders and heads of governments of gas importing countries to inform them that disruptions of Ukrainian transit were possible. On New Year's Eve, the Naftogaz delegation left Moscow, the negotiations having broken down. Ukraine and Russia were at an impasse yet again.

At 10:00 a.m. Moscow time on 1 January 2009, Gazprom cut the volume of gas entering Ukraine by 110 million cubic meters (mmcm) per day – the approximate amount that Ukraine would have consumed, but continued to compress and pump enough gas for its European customers. The Ukrainian government offered to pay $201/mcm and announced that it would take 21 mmcm per day to maintain the necessary gas pressure to allow for the functioning of compressor stations. Gas supplies exiting Ukraine to the west dropped between 6 per cent, for Poland, and 30 to 40 per cent, for Romania.

During the first week of January the recriminations continued from both sides, with Gazprom accusing Naftogaz of 'stealing' gas, until finally, on January 7 Gazprom, taking a measure it had never used before, completely halted the supply of gas into Ukraine. Russia and Ukraine finally reached a new agreement on prices for gas and transit on January 19, clearing the way for gas flows to resume on January 20. Another new contract did away with the practice of fixing terms for the year, with both gas prices and transit fees set according to a standard formula and any remaining subsidy relative to prevailing European prices to be phased out within one year.

In early 2010, Viktor Yanukovich, whose election in 2005 had been thwarted by the Orange Revolution, defeated Yulia Timoshenko in elections to become the next Ukrainian president. As Gazprom's Kochevrin notes, 'with the new government, the issue with Ukraine is calmer'.[20] During the spring of 2010, Yanukovich and Russian president Medvedev signed an agreement to extend the lease of the Russian naval base in Ukraine, the base that gives Russia a presence on the Black Sea, until 2017. For the naval base lease, Ukraine will receive from Russia cash and cheaper gas: $100 million per year and $100/mcm off for gas priced above and $30/mcm for gas priced below $333/mcm. The discount would be worth tens of billions of dollars. By reducing Gazprom's export duties to Ukraine, the discount would come not from the government's obligation of a non-market price, but instead from its own budget. The government, rather than the firm, is picking up the bill.[21] For Gazprom, the Ukrainian relationship remains an economic liability to be minimized, not an asset worth saving.[22] From Gazprom's point of view, if the Ukrainian relationship is a strategic asset for the Russian state, then the state itself should pay for it.

For the past 10 years, the state obliged Gazprom to act as a private firm in order to maximize profits, outside of Russia at least, and, thereby, the tax revenues and dividends earned by the state.[23] Gazprom's yearly revenues made up approximately eight per cent of the nation's gross domestic product. The taxes and dividends paid by Gazprom to the Russian state accounted for roughly 12 to 13 per cent of the federal budget (Gazprom, 2009b). For Russia, Gazprom's profit-making is state-building. And

Russia's desperate need to rebuild state authority derived in large part from an elite consensus on Russia's role, as well as status, as a great power in world politics (Mankoff, 2009, Chapter 1; also see Trenin, 2002; Tsygankov, 2006; Clunan, 2009).

CASE 2: PIPELINES, INTERPRETATION, AND MATERIALITY

The Ukrainian gas crises vividly displayed Gazprom's, and by extension Russia's, dependence on Europe and Ukraine. The crises also exposed Europe's risks in the gas trade with the east: Europe was vulnerable to disruption of Ukrainian transit and depended on Gazprom for supplies (see Table 3). The ensuing debate in Europe following these shocks produced an agreement that Europe's energy security should be strengthened through diversification. Disagreement, however, persisted whether Europe should prioritize diversification of transit routes with continued reliance on Russia as supplier or diversification of both transit routes and suppliers. Supporters of the first approach tended to blame Ukraine more than Russia, while advocates of the second policy condemned Russia at least as much as, if not more than, Ukraine.

These two interpretations were informed by essentially the same material facts about Russia, Ukraine, and Gazprom. The interpretation that dependence on Gazprom was a security threat to both individual EU members and the region as a whole predominated in the Western media and among European mass publics.[24] According to a 2008 Financial Times/Harris Poll, Europeans considered Russia, after the Ukrainian gas crises, to be an unreliable energy supplier by considerable majorities in France (71 per cent), Germany (59 per cent), Italy (54 per cent), and the United Kingdom (70 per cent). Even larger majorities would prefer not to purchase gas or electricity from a Russian company: France (73 per cent), Germany (69 per cent), Italy (66 per cent), and the United Kingdom (77 per cent).[25]

This view has held sway just as strongly among US and central European policy-makers. US Vice President Dick Cheney argued in the aftermath of the crisis, 'No legitimate interest is served when oil and gas become tools of intimidation or blackmail'.[26] Also in the US government, Matthew Bryza, a senior State Department official, argued:

> Our approach is to help Europe and help our European allies achieve their goals in diversification and to put them in the strongest possible negotiating position with a Gazprom partner who will be around for a long time. Strength in negotiations comes from diversification.[27]

A Council on Foreign Relations task force report directed by Stephen Sestanovich and chaired by John Edwards and Jack Kemp severely criticized

Table 3 Gazprom's natural gas exports to Europe, 2000–2007 (bcm)

	2001	2002	2003	2004	2005	2006	2007	%[a]
Yugoslavia/Serbia	1.7	1.7	1.9	2.3	2.0	2.1	2.1	84
Croatia	1.2	1.2	1.2	1.1	1.2	1.1	1.1	34
Slovenia	0.6	0.6	0.7	0.7	0.7	0.7	0.6	60
Bosnia & Herzegovina	0.2	0.2	0.2	0.3	0.4	0.4	0.3	75
Macedonia	0.1	0.1	0.1	0.1	0.1	0.1	0.1	100
Romania	2.9	3.5	5.1	4.1	5.0	5.5	4.5	27
Bulgaria	3.3	2.8	2.9	3.0	2.6	2.7	2.8	90
Hungary	8.0	9.1	10.4	9.3	9.0	8.8	7.5	64
Poland	7.5	7.3	7.4	6.3	7.0	7.7	7.0	51
Czech Republic	7.5	7.4	7.4	6.8	7.4	7.4	7.2	81
Slovakia	7.5	7.7	7.3	7.8	7.5	7.0	6.2	100
Total Central/Eastern	40.3	41.6	44.5	41.8	42.9	43.5	39.4	
Greece	1.5	1.6	1.9	2.2	2.4	2.7	3.1	77
Turkey	11.1	11.8	12.9	14.5	18.0	19.9	23.4	67
Finland	4.6	4.6	5.1	5.0	4.5	4.9	4.7	100
Austria	4.9	5.2	6.0	6.0	6.8	6.6	5.4	61
Switzerland	0.3	0.3	0.3	0.3	0.4	0.4	0.4	14
France	11.2	11.4	11.2	14.0	13.2	10.0	10.1	24
Italy	20.2	19.3	19.8	21.6	22.0	22.1	22.0	28
Germany	32.6	32.2	35.0	40.9	36.0	34.4	34.5	42
Netherlands	0.1	1.4	2.3	2.7	4.1	4.7	5.5	15
Belgium	0	0	0	0	2.0	3.2	4.3	25
United Kingdom	0	0	0	0	3.8	8.7	15.2	17
Total Western	86.6	87.8	94.4	107.2	113.2	117.6	128.6	
Total Europe	126.9	129.4	138.9	148.9	156.1	161.1	168	

Sources: Adapted from Stern 2005, 110; data for 2005–2007 are from Gazprom's annual reports for respective years. Totals may differ from actual numbers due to rounding.
Notes: (a) The share of Gazprom's exports in the total consumption in 2007, calculated with data from *BP Statistical Review of World Energy*, June 2008, 27; the consumption data for Serbia, Croatia, Slovenia, and Bosnia and Herzegovina are estimates from *Natural Gas Information 2007*, IEA, II8. These numbers should be regarded as rough estimates, given the differences in measurement standards.

Russia's behavior in the episode and, generally, its use of 'energy exports as a policy weapon' and 'tool of political intimidation', with Ukraine as its most 'shocking and coercive application' (Council on Foreign Relations, 2006: 4, 31).

In the former Soviet satellites, this view found many sympathizers. An open letter from 22 former central European heads of state to President Obama warned, in the aftermath of the second Ukrainian gas crisis, of Russia's 'overt and covert means of economic warfare' (Adamkus *et al.*, 2009). 'The Russians are playing divide and conquer', according to Joschka Fischer, the former German foreign minister who served as an adviser to a consortium intent on building a new pipeline to bring non-Russian gas to markets in the West.[28] Gas dependence as a security threat for Europe was also a widely held view within the academy (see, for example, Cohen, 2006; Baran, 2007; Walker, 2007; Goldman, 2008; Lucas, 2008; Orban, 2008; Bugajski, 2009; Åslund, 2010).

If Gazprom were the problem, then the solution for Europe would be to diversify its source of gas, by looking to alternate, non-Russian suppliers, or its source of energy altogether, by embracing alternative forms of generation, such as nuclear, solar, and wind. This would be best accomplished by relying on multilateralism within Europe and presenting Russia with a united European front. This solution raises other difficult questions, however: the reliability of other suppliers; the expense of new transit routes; and the European skepticism of nuclear power, the most well established alternative technology.

The second, alternate interpretation held that although Ukraine was an unreliable supplier of gas transit, dependence on Gazprom was unproblematic. This was not a popular view in the media, among mass publics, or in the policy circles of Washington, DC, Brussels, Warsaw, and Vilnius.[29] This interpretation, perhaps surprisingly, won the day, for the minority who share this view include the decision-makers who matter most: the executives of leading French, German, and Italian energy firms.

The energy industry is always and everywhere deeply political, but these firms are obliged by their shareholders – sometimes including the state, and sometimes not – to earn profits. They are, most of all, trying to make money, amidst considerable uncertainty about the parameters of their business models: the price of oil, natural gas, and electricity; the stability and desirability of long-term gas contracts; rapid, unpredictable technological innovation in the extraction and delivery of gas; the future of Russia; and the political evolution of central Europe, central Asia, and the Caucasus.[30] This is no simple algorithm, and these European executives have been unable to assign probabilities to the plausible range of outcomes and make their decisions accordingly. They are, in a word, at sea, at least in terms of their calculable risks. Without a probabilistic theory of the future, they have relied on habits, conventions, and norms of trust.

These French, German, and Italian executives have relied on one of their longest-standing conventions: the Russians, they presume, aim to be reliable suppliers of gas. This convention is based on trust built up over decades, dating to their cooperation with Gazprom when it was a ministry of the Soviet state during the Cold War. The Germans and Italians have the longest-standing relationships.[31] Eni and Gazprom, then as a ministry, concluded their first contract in 1969. The first Ruhrgas–Gazprom contract dates to 1973, and Burckhard Bergmann, the CEO of Ruhrgas between 2001 and 2008, has served on Gazprom's board of directors since 2000.[32] Wintershall and Gazprom established their first of several joint ventures in 1993 with the creation of WINGAS, with the German firm owning 50 per cent plus one share.

For these firms, Russia was not a threat, but a long-standing partner. Gerhard König, the Chairman of WINGAS, speaks of 'trust and mutual understanding, built up over many years and interpersonally'.[33] Similarly, Ingo Neubert, Wintershall's primary strategist, suggests that his firm is not 'exposed to any particular Russia-specific risk. Partly this is because of our long, positive experience that has built up our trust'.[34] In this way firms have managed the parameters of their decision-making: they cannot know how prices will fluctuate or how technologies will change. But they believe that they can place their long-term bets on Gazprom. They have been doing so for decades.

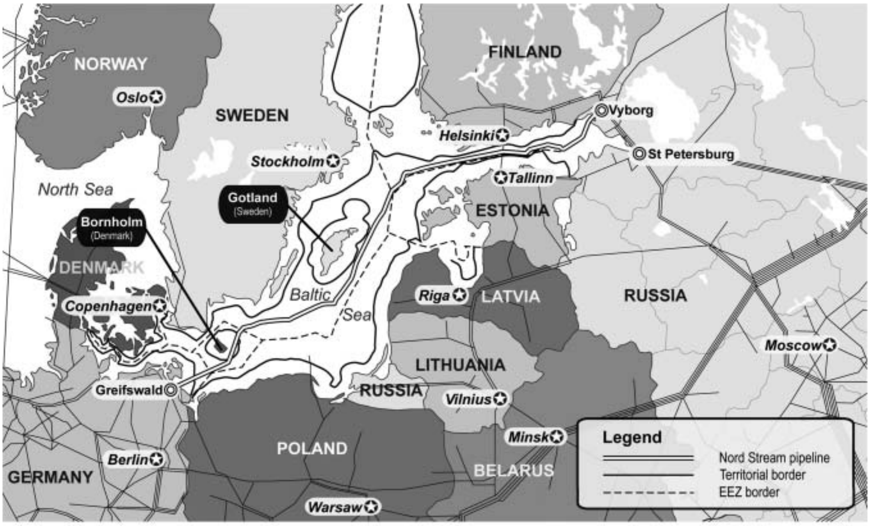
Firms thus were the agents that began projects to create a new structure to govern the continent's energy relations with Russia. That structure is both institutional and material. The institutional structure comes in the form of consortia of firms that govern contracts, regularize inter-firm relations, and build new pipelines. The pipelines represent a more literal recasting of the material structure, which, once in place, will become, as with this uneven rhythm of structural change, a new geopolitical reality as well.

One possibility was to take the northern route, across the Baltic Sea, directly to Germany. A second route, to the south, might run along the bottom of the Black Sea to Bulgaria (and westward). Still a third option would be for Russia to build up its export capacity to Turkey, Russia's having already built the Blue Stream underwater pipeline across the Black Sea. Any of these options would be tremendously costly, however. Gazprom and its European partners would have to decide just how much it was worth to them to go to the considerable expense and effort to acquire the permits for and build a new pipeline. The cost of the pipe should be at least equal to the value diminishing Ukraine's transit monopoly.

To simplify, Germany chose Nord Stream, Italy chose South Stream, and the French, having arrived unfashionably late, chose both.

Nord Stream

Nord Stream began, according to Gazprom's Kochevrin, as 'a joint German–Russian idea, which originated in the companies'.[35] The Nord Stream consortium was formed by Gazprom and German energy companies BASF and E.ON in 2005. The partnership had followed years of economic and technological feasibility studies: Gazprom had explored the idea as early as 1997 with a Finnish partner. The project had been proven feasible, but the Finnish company dropped out. Gazprom then in 2001 had teamed up with long-time German business partners, Wintershall and Ruhrgas (BASF and E.ON, respectively, are their parent companies). The consortium expanded in 2008 when the Dutch gas infrastructure company N.V. Nederlandse Gasunie joined the consortium. Partners distributed the



Source: Author's illustration.

Figure 1 Route of the Nord Stream natural gas pipeline.

shares as follows: Gazprom 51 per cent, BASF 20 per cent, E.ON 20 per cent, Gasunie 9 per cent.[36]

From the point of view of German and Russian firms, the great advantage of the new route was its directness: from Vyborg in Russia under the Baltic Sea to Greifswald in Germany (see Figure 1). Nord Stream will 'enable for the first time delivery of Russian gas to Western Europe without crossing the territory of transit states', according to Gazprom's Medvedev. 'It will help avoid political and economic risks, related to the transit of gas through third states, which, undoubtedly, will raise the dependability of the export of gas from the Russian Federation'.[37] Or, as Wintershall's König put it, 'The Baltic Sea is the most reliable transit country'.[38]

Building pipelines under the sea is more expensive than putting them on land, however, so the absence of transit states has to be worth the extra construction cost. Another consideration was the demand that the new pipeline was supposed to meet. Neither Gazprom nor its European partners foresaw growing demand for Russian gas in Belarus or Poland. The potential expansion of Yamal–Europe was therefore unattractive because Gazprom, E.ON, and BASF would be taking on the additional business risk of hold-up in transit states without any additional reward deriving from gas sales. Instead, the firms decided to 'create a new structural reality' linking directly the buyer and seller of gas without 'transit countries that were not themselves markets'.[39] Nord Stream was conceived as a 55 bcm/year pipeline.

Gazprom's German partners, who were involved in the project before the 2006 and 2009 gas crises, nonetheless needed to interpret those crises through the lens of their history. After all, the investment decisions were made during those years. The German executives were not alarmed. According to König, 'the question of Gazprom's reliability never even came up in Wintershall. We have absolutely the full picture because we know them so well. There is no need for us to mistrust them'.[40] Similarly, Uwe Fip, the executive responsible for managing the gas supply of E.ON Ruhrgas, observes:

> Our relationship is now four decades old, our having signed the first contract in February 1970. It is a longstanding partnership. One has to be prepared for a few surprises now and then, but it is a good partnership. Gazprom has always been a reliable partner. We have never concluded that Gazprom is unreliable.[41]

Enhancing Gazprom's credibility, and thereby the trust of the German partners, was its own dependence. 'This is not', observes König, 'dependence, but interdependence. In fact, the dependence is more the other way around: Gazprom and Russia are more dependent on Europe'.[42]

The details of the 2006 and 2009 crises were interpreted through these lenses of trust, long-standing partnership, and Gazprom's dependence. König of WINGAS insists, for example, that 'Gazprom did everything possible to get the gas to its European customers'.[43] Where many Western commentators saw an upstart, Westward-leaning Ukrainian regime punished for its hubris and love of Brussels with price hikes and supply cut-offs, Gazprom's German partners observed primarily a commercial dispute. König complains of the political motivations misattributed to Gazprom's behavior:

> Just after the days of the Soviet Union, the West encouraged companies to become capitalistic. Now they act as we do. Gazprom is a company, which operates just as European and US companies do. Gazprom's decisions are driven by the same reasoning. Gazprom's largest shareholder does not change what Gazprom's management aims to do: to earn profits.[44]

Regardless of whatever fraternal squabbles arise between Russia and its neighbors, argues Neubert, 'We have never observed any non-market-conforming behavior by Gazprom in Europe'.[45]

'The gas crises do not', insists E.ON's Fip, 'make us nervous'.[46] Thus the Nord Stream project, which was already underway before the gas crises, likely received further impetus from those events. E.ON and Wintershall (as well as WINGAS) executives already trusted Gazprom's reliability as a supplier. The increasing unreliability of Ukraine encouraged them to make further progress toward the diversification of transit routes.

It was always certain that Nord Stream would be politicized, for it is itself constitutive of European geopolitics. While Gazprom easily secured the backing of its majority shareholder, E.ON and BASF coordinated their business strategies with one another and German government officials. 'When the time came', according to König, 'we presented our plan to the authorities, whose support we would of course need. This is not one or two meetings, but an ongoing dialogue. And the political authorities supported our idea'.[47] Neubert claims for Nord Stream 'the full support of the government'.[48] While these German energy companies could not and would not have proceed with Nord Stream without German policy-makers' having signed on to the project, the agenda was driven from within the firms, which then sought public consent. Neither is the master of the other, nor do E.ON and Wintershall appear to be agents of German policy in a way that resembles Gazprom's agency on behalf of the Russian state. These are, most simply, corporate decisions that have political consequences.

Those consequences were felt most acutely in central Europe. Polish and Baltic political leaders expressed grave concern over the meaning of the new transit route for Gazprom's gas. Pawel Zaleswski, a Polish representative in the European Parliament insisted that Nord Stream was designed 'to cut off the Baltic states from NATO and the EU' (*Global Post* 2010). Estonia in 2007 rejected Nord Stream's request to survey the seabed in its economic zone. The pipeline was rerouted through the territorial waters of Finland, which, along with Sweden and Denmark, approved the project in 2009, paving the way for construction. The prime ministers of Estonia, Latvia, and Lithuania expressed unhappiness with the behavior of their European colleagues. Lithuanian Prime Minister Andrius Kubilius complained about his country's lack of 'any legal rights to veto the project'. Prime Minister of Estonia Andrus Ansip was also blunt: 'To be absolutely honest, I don't like this project'. Latvian Prime Minister Valdis Dombrovskis echoed his colleagues: 'We feel this is not in line with [EU] common energy policy objectives' (Reuters, 2009).

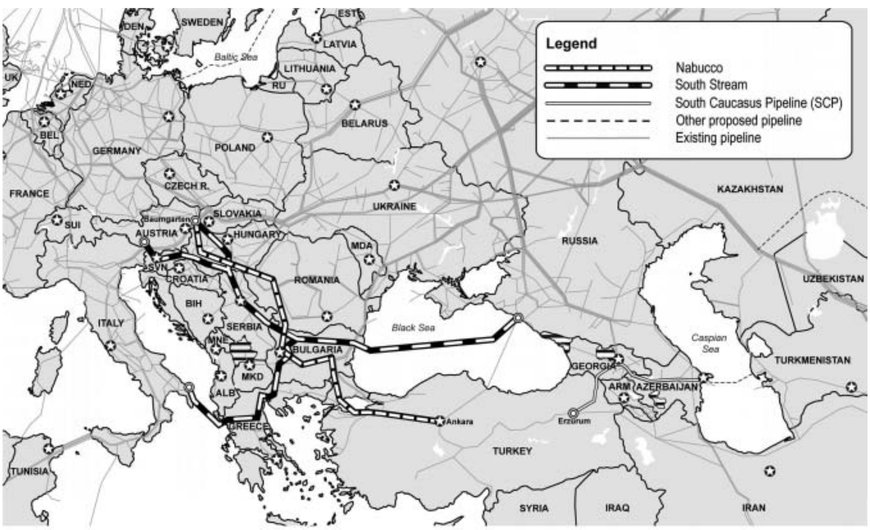
Even more concerning was the implication that Germany and Russia would work together, bilaterally, to establish new patterns of commerce and politics that the countries in between did not want and could not prevent. Most dramatically, Polish defense minister Radoslaw Sikorski referred in April 2006 to Nord Stream as the 'Molotov–Ribbentrop pipeline', invoking the 1939 treaty whose secret protocol divided central and eastern Europe into German and Soviet spheres of influence (Castles, 2006).

Although German political and business leaders worked to reassure Polish and Baltic leaders, even offering to sell some of the gas set to arrive in Germany to eastern neighbors, the plans for Nord Stream proceeded apace. In 2010, French energy company GDF Suez S. A. acquired a 9 per cent stake in Nord Stream, 4.5 per cent each from E.ON and Wintershall, thereby becoming the fifth shareholder.[49] By the spring of 2010, Nord Stream was all but a done deal, with only the technical challenges of finishing the pipeline and compressing and pumping the gas ahead. The Russians, Germans, Dutch, and French had dis-intermediated Ukraine to the north.

South Stream

The Italians, meanwhile, had begun cooperating with the Russians to dis-intermediate Ukraine to the south. During the second half of 2006, ENI and Gazprom executives developed a plan for a southern corridor for Russian gas: from Russia, under the Black Sea, across a handful of new transit states (to the southwest, Bulgaria and Greece, and to the northwest, Serbia and Hungary, with both branches terminating in Italy).[50] (See Figure 2.) Gazprom and ENI plan for the pipeline's capacity to be 63 bcm per year. The South Stream consortium, responsible for the offshore section of the pipeline, was incorporated in 2008 as a 50/50 joint venture between ENI and Gazprom.

Unlike Nord Stream, South Stream was, in 2012, still, to use the industry's parlance, only 'a project', though one that was quickly requiring the financial and administrative resources of senior executives in ENI and Gazprom. For ENI, the logic of the project required an interpretation of



Source: Author's illustration.

Figure 2 Proposed routes of the South Stream and Nabucco natural gas pipelines.

the Ukrainian crises and the goals of Gazprom. 'Russians have always fulfilled their obligations in gas contracts', argues ENI CEO Paolo Scaroni. 'Not once have the Russians failed to do so'.[51] Scaroni's framing implies Ukraine's culpability for the 2006 and 2009 fiascoes, and here the problem to be solved for Italian consumers is the unreliability of Ukrainian transit. This framing also reflects ENI's trust in Gazprom, trust built over decades of cooperation.

As German firms cultivated their close relationships with Gazprom, and the Italian firm ENI succeeded in becoming the Russian firm's southern partner of choice, French firms continued to scramble for a foothold in the emerging energy architecture of Europe. The German and Italian relationships were built on long-standing ties that pre-dated even the collapse of the Soviet Union. France was starting fresh. 'We first considered Nord Stream, but we were too late', admits EDF's Lescoeur, 'and there was no room for us'. EDF was obliged to scramble for a place among Gazprom's European partners.[52] In June 2010 Gazprom, Eni, and EDF issued a joint press release confirming that EDF would acquire at least a 10 per cent stake in South Stream, though it was not yet clear how much of their respective 50 per cent stakes Eni and Gazprom would relinquish.

A balancing act in Brussels

The decidedly national strategies being enacted by German, Italian, and French firms presented serious challenges to officials of the European Commission, who had to balance their sense of the inevitability of Russia, their lack of authority over member states' energy policies, and the persistent pressure from central European officials to do something about dependence on Russia. Responsibility for the energy trade between Europe and Russia was spread across the Commission, but the two most important positions were in Directorate–General (DG) External Relations and DG Energy.

The key strategist in External Relations, Faouzi Bensarsa, who is the Head of the Task Force on Energy Security, notes that although activities need 'to be in full compliance with EU legislation, the primary responsibility on pipeline routes is the companies and countries concerned'.[53] Another Commission official, Roland Kobia, who worked in the cabinet of former Energy Commissioner Andris Piebalgs, observes that a handful of close bilateral relationships between member states and Russia could be seen as 'useful' to Europe, despite the absence of multilateralism.[54] Thus the Commission's experts on energy and Russia recognize that Russia will be a part of Europe's energy reality, shaped primarily by Europe's energy firms. Central European leaders still did not see things that way, however, and they found their opportunity to shape EU strategy within the organization's more democratic settings.

The Council of the European Union, representing all member states and run with strong norms of consensus, responded to the gas crises by adopting a strongly worded statement favoring more 'solidarity' on energy issues in Europe and insisting to the Commission, its executive branch: 'Efforts for interconnection and diversification of energy suppliers, sources and supply routes must intensify, notably in the gas sector, as was proved during the recent unprecedented interruption of gas supplies from Russia via Ukraine to the EU'.[55] Thus the Commission, according to Kobia, received 'a mandate' from the Council to develop alternatives to Russia.[56]

This new mandate left Commission officials with an interesting challenge. While Europe's energy experts recognize Russia's inevitability, they are obliged by their legislative branch to pursue alternatives to Russian gas and Ukrainian pipes. Alternatives to the Ukrainian pipes – Nord and South Stream – were already under way by 2009. The question was where the Commission could find non-Russian gas to be transported along a non-Ukrainian pipeline route. In 2009, only one plausible alternative existed: a plan to bring gas from the South Caucasus and Central Asia across Turkey. (See Figure 2.) The project was called Nabucco.

Russian political and business leaders were, unsurprisingly, unenthusiastic about Nabucco. Occasionally the Russian reaction was hostile. While Russian skepticism about Nabucco's prospects was clear, that skepticism and hostility may also have affected the prospects for the project's success.

Nabucco

Austria's OMV approached Turkey's BOTAŞ in 2002 with the idea for a new pipeline to bring gas from Turkey's eastern and southern neighbors to Europe. The two companies then approached major energy companies in the countries along the pipeline's proposed route – BULGARGAZ of Bulgaria, TRANSGAZ of Romania, and MOL of Hungary – to explore the possibility of a consortium. Following their first meeting held in Vienna, the company representatives jointly attended the performance of Giuseppe Verdi's opera Nabucco at the famed Vienna State Opera and decided at dinner that evening to name the pipeline after the opera. The five founding members formally created Nabucco Gas Pipeline International Company in 2004. German energy company RWE joined Nabucco in 2008. All six members have equal shares of 16.67 per cent in the company (Abdelal and Tarontsi, 2011b).

The usual order in the type of international pipeline projects like Nabucco is for the supplier of gas to find a customer, sign a contract, and then, often with supplementary financing, build the pipe. Nabucco faced significant challenges by rearranging the usual order. The consortium includes some of the potential customers, but none of the suppliers, a fact that has created uncertainty about the eventual construction of a pipeline. Potential sources for gas that would fill Nabucco are Azerbaijan, Turkmenistan, Kazakhstan, Egypt, Russia, and Iraq. The Commission tried to help with an allocation of €200 million in 2009 – 'symbolic financing', according to Kobia – for preliminary development.[57] Although the company insists that it is on schedule to begin deliveries in 2014 (itself a revised date from 2013), EU Energy Commissioner Guenther Oettinger in March 2010 noted that the commissioning might be delayed until 2018 (Euractive.com, 2010).

Fischer speaks emphatically about the importance of the project. 'Does Nabucco', asks Fischer, 'make strategic sense? Yes!!! Does it make business sense? I think so, but that is the risk of the private investors'.[58] The main risk is that not enough gas can be found to fill Nabucco's pipeline, the capacity of which is expected to be approximately 30 bcm. In principle, plenty of gas exists in the Caucasus and Central Asia, but those nations have traditionally sold to Russia using the infrastructure and routes inherited form the Soviet era. Nabucco's failure, insists Fischer, 'would be geopolitical disaster'.[59]

According to Nabucco executives, the project can be economically feasible if it transports at least 15 bcm of gas a year, and that it could begin transporting as little as 8–10 bcm per year (Abdelal and Tarontsi, 2011b). By the autumn of 2010, the Nabucco consortium had failed to secure gas in excess of the 7 bcm committed by the Azerbaijani government in principle. For some Nabucco supporters, that initial 7 bcm would be enough to get the project started.[60]

The Nabucco project received support from Washington as well as Brussels. Richard Morningstar, the Obama administration's Special Envoy for Eurasian Energy in the state department, outlined the US point of view:

> First, a Southern Corridor could enhance US energy security by freeing up supplies and promoting increased production. Second, European energy security is in our interest because European countries are our allies and partners on many important policy priorities. We need a strong partner. Of course, we cannot preach to the Europeans; we cannot be more European than the Europeans in thinking about the region's energy security. Third, it is in US interests for countries in the Caucasus and Central Asia to have greater independence in their commercial and foreign policies.[61]

CONCLUSIONS AND IMPLICATIONS

A handful of Russian, French, German, and Italian firms are remaking the institutional and material foundations of the energy sector in Europe and Eurasia. Commercial motivations underpin the great power politics of

Europe and Eurasia. The stakes of these politics are considerable. The European governments that interpret dependence on Russian gas as a threat have worried most about the possibility that Russia will coerce policy changes among European nations. This fear is based on the asymmetric costs of exit: Russia could, in this way of thinking, plausibly forego the revenues of gas sales, while European nations cannot for long do without the gas itself to power their industry and heat their households (Hirschman, 1945/1980).[62] Because of Russia's and Gazprom's dependence on those revenues for political stability, this fear is overblown, and Europe's energy firms are, most likely, correct to discount it.

While some European and American policy-makers have fretted over the threat of Russian coercion, however, they have largely missed the more important effect of these economic relationships: what the economist Albert Hirschman described as 'influence' (Hirschman, 1945/1980: 14–16, 18, 28, 29, 34, 37). For Hirschman, influence derived from the subtle, yet powerful reshaping of domestic politics that resulted from such bilateral economic relationships. The very national interests of France, Germany, and Italy have been shaped by the close relationships between their powerful energy firms and Gazprom, just as Russia's own national interest has been influenced by Gazprom's dependence on E.ON, BASF, and Eni.[63] As WINGAS' König suggests, 'Our interests are now interwoven. The effect is similar to the founding principles of European integration: to make distinct interests into mutual interests'.[64]

The narratives of this paper also suggest further research into the mechanisms of such influence: when patterns of international economic relations recast domestic coalitions in specific, rather than general, directions. The energy interdependence of France, Germany, and Italy with Russia has drawn the European nations closer to the East, occasionally at the expense of their multilateral relations in the West. These three European states are not more interdependent with Russia than they are within the EU; in fact, in whatever quantitative terms one might choose – share of national output, share of exports and imports – their intra-EU exposure is greater. Their Russian interdependence is, however, more politically and strategically meaningful when it comes to their energy policies.

For Europe, then, the political challenges of the energy trade with Russia, the Caucasus, and Central Asia promise to divide more than they unite. For French, German, and Italian energy executives, this is just business – nothing personal. In Brussels, Riga, Tallinn, Vilnius, and Washington, DC, however, these divisions represent a profound diplomatic failure, which will be difficult to remedy even with a new pipeline that could reunite the transatlantic, European community. The absence of gas to put inside such a pipe is perhaps the smallest obstacle.

Thus enormous variations in Europe's cohesiveness remain. Europe's actorhood on energy policy remains among its weakest, despite the extraordinary achievements of actorhood on trade, customs, monetary, and competition policy (Krotz, 2009).[65] Because of the centrality of private firms to Europe's grand energy bargains and the extra-European location of the resources themselves, energy will likely remain on the nation-state end of the spectrum for decades to come. Central Europe will have to live with dependence on Russia in part because western Europe, and France, Germany, and Italy in particular, have chosen to do so on all of Europe's behalf.

Although these business decisions were cold, calculating, and profit-motivated, the executives who made them relied on history, politics, and trust to do so. Their preferences were not straightforwardly deduced from the material facts they faced, and certainly not by the executives themselves. The prevailing theoretical frameworks of IPE cannot account for these decisions and the politics that they created. Although the language and core logic of constructivism is necessary, the connection I propose here between firms' decisions and great power politics is novel and hopefully will push the constructivist research agenda into the world of firms.

We live, once again, in a world in which the flag often follows trade. This means that we have to understand the actually existing logic of trade – and, by extension, the practices of real firms – if we are to make sense of these new logics of world politics.

Thus the field of IPE must generally renew its interest in and understanding of firms. The deductive logics that inform mainstream approaches to political economy have allowed the field only limited progress because firms are confronted by Knightian uncertainty. For multinational firms, such uncertainty extends beyond purely commercial concerns, since geopolitics also influence the profitability of different decisions. Managers must resolve those moments of uncertainty with patterns of thought and action that reflect shared understandings, trust, and a sense of history. Firms are not atomized agents presented with discrete menus of options to which they assign probabilities (Herrigel, 2010). Firms are not mere participants in an international economy whose contours are defined by state action.

What is most needed, therefore, is a renaissance of scholarship – both empirical and theoretical – on the relations among firms and governments. For the most interesting questions of international political economy, neither the putatively crass commercial concerns of firms nor the apparently prosaic electoral considerations of governments can be seen as analytically prior to the other. The strategies of multinational firms are often inherently political; indeed they are sometimes, as in the narratives of this paper, literally policy. And the motivations of governments, particularly in a world defined by increasing state capitalism and developing country energy companies – a world with governments as both agents and owners, are unavoidably commercial.

This move toward firms is therefore an invitation to greater analytical complexity. The world of international business is itself often bewilderingly complicated for the managers that make the world economy function (and sometimes malfunction). Scholarly acknowledgment of that complexity – the interplay of identities and incentives, the mixing of high and low politics, the mutual constitution of geopolitics and business – will serve the field well intellectually and enhance its relevance to both policy and business practice. Theoretical innovation should come, in part, from the thinking and re-thinking that take place in the field and inside firms. A deeper understanding of market participants will, ultimately, afford IPE scholarship greater insight into the markets as well.

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NOTES

1 I do not deal in this paper with the different balances of power between the public and private sectors in France, Germany, and Italy. Of the three, the French government appears to play a more consultative role, while the German and Italian governments give freer rein to firms in their management of international transactions. Some of these patterns are long-standing. In Germany,

Ruhrgas played a decisive role in promoting German–Soviet energy cooperation. See Kreile (1978, 206–7). Alan Posner once noted that Italy's foreign policy was essentially the international operations of its major firms, including Eni. See Posner (1978). Similar observations are made by Vernon (1974) and Prodi (1974). On these patterns more generally, see Katzenstein (1978). In 2010 the French state owned 85 per cent of EDF, 35 per cent of GDF SUEZ, and no shares in Total. The Italian state owned approximately 30 per cent of both Enel and Eni.

2 Author's interview with Bruno Lescoeur, Paris, 9 June 2010.

3 The scholarly literature on 'private authority' also deals with firms' influence on international politics, but contributions to that literature have tended to emphasize their effects on rules and, more informally, 'governance'. See Cutler *et al*. (1999) and Hall and Biersteker (2002).

4 See also Chapter 1, more generally, which is a deeply insightful characterization of the relationship of firms to institutions and one another.

5 See Kirshner (2009) for an overview of realist political economy. On the variants, predictably: Waltz (1979), Mearsheimer (2001) and Lobell *et al*. (2009).

6 Also see Avant *et al*. (2010), who adopt an agnostic view on the possibility that firms may play decisive roles in establishing patterns of international politics beyond the so-called 'private authority' understanding of IPE.

7 For another excellent attempt to bridge international business and international politics, see Cohen (1986).

8 Some scholars did not require hindsight to reach the conclusion that institutions were both essential and unlikely to emerge spontaneously. See, for example, Bunce (1994).

9 On the evolution of Russia's fiscal regime and its relationship to the energy industry, see Jones Luong and Weinthal (2010, Chapter 5).

10 A good overview is Rutland (2005). The distinction between 'wild and unconstrained' and 'tamed and restricted' oligarchs is drawn by Winters and Page (2009: 733).

11 A good overview of Gazprom's place in the Russian economy is Stern (2005). Also see Abdelal *et al.* (2008b) and Boussena and Locatelli (2011).

12 See Kommersant (1993a, 1993b). Also see Stern (2005: 119). On Ukraine, see Naftogaz Ukrainy (2010). The total output capacity of Ukraine's gas transit system to Europe is 142 bcm per year.

13 In the interest of space, I do not delve into the unusual arrangement in which opaque intermediaries received the right to buy and ship Turkmenistani gas through Gazprom-owned pipes to Ukraine. In practice the intermediaries were not central to the politics about which this paper deals, though they provided rents to Ukrainian oligarchs. See Balmaceda (2008).

14 Jonathan Stern, a long-time expert on the Soviet and Russian gas industry, makes this case more strongly, observing that a 'dramatic early initiative from the Yushchenko administration in March/April 2005' began negotiations for the transition to 'European' pricing for gas transit tariffs. See Stern (2006: 5).

15 Author's interview with Alexander Medvedev, Moscow, Russia, 31 October 2006.

16 *Ukrainskaia Pravda* (2006).

17 *Regnum* (2006).

18 On the international relations of Eurasia and the connection between Russia's implicit subsidies and the foreign policy trajectories of post-Soviet states, see Abdelal (2001). For the best account of the role of elite ideas in shaping post-Soviet international relations, see Darden (2009).

19 Calculated from data from IMF, *International Financial Statistics*.
20 Author's interview with Ilya Kochevrin, Moscow, 7 June 2010.
21 See http://www.kremlin.ru/news/7514; http://www.unian.net/rus/news/news-374534.html; http://www.vesti.ru/doc.html?id=356467&tid=79873.
22 As was increasingly the case for the Soviet Union's informal empire in central and eastern Europe. See Bunce (1985).
23 See the insightful interpretation by Balzer (2005a, 2005b, 2006) of Putin's own writings on the subject.
24 See, among many examples, *Washington Post* (2006). Also see MacKinnon (2007).
25 Harris Poll (2008). These sentiments can also be recovered in media reactions to the events. On France, see Le Monde (2006); Lamm (2006); Barré (2006); Mével (2009). On Italy, see Jadeluca (2006); Panara (2006). On Germany, see Dohmen *et al.* (2006) and Beste *et al*. (2009).
26 Press release of the Office of the Vice President, White House, 4 May 2006.
27 See http://www.america.gov/st/business-english/2008/May/20080530170946liameruoy0.919903.html.
28 Author's interview with Joschka Fischer, Berlin, 18 June 2010.
29 This divide is longstanding and dates at least to the Reagan-era sanctions against the Soviet Union that were disregarded by French, German, and Italian firms. See Jentleson (1986). On the symmetries in European and Soviet dependence, respectively, on gas imports and export earnings, see Stern (1982).
30 On the influence of uncertainty on decision-making, see Knight (1921), Keynes (1936), Blyth (2002) and Katzenstein and Nelson (2010).
31 On the predominance of bilateralism in these energy politics, see Westphal (2006). On the German–Russian bilateral relationship, see Stent (1999, 2007).
32 On those early German–Soviet negotiations, see Stent (1981, 166–9). Also see Stent (1982) and Bethkenhagen (1985).
33 Author's interview with Gerhard König, Kassel, 30 November 2010.
34 Author's interview with Ingo Neubert, Kassel, 30 November 2010.
35 Author's interview with Ilya Kochevrin, Moscow, 7 June 2010.
36 See http://www.nord-stream.com.
37 Author's interview with Alexander Medvedev, Moscow, 31 October 2006.
38 Author's interview with Gerhard König, Kassel, 30 November 2010.
39 Author's interview with Ilya Kochevrin, Moscow, 7 June 2010.
40 Author's interview with Gerhard König, Kassel, 30 November 2010.
41 Author's interview with Uwe H. Fip, Essen, 29 November 2010.
42 Author's interview with Gerhard König, Kassel, 30 November 2010.
43 Author's interview with Gerhard König, Kassel, 30 November 2010.
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47 Author's interview with Gerhard König, Kassel, 30 November 2010.
48 Author's interview with Ingo Neubert, Kassel, 30 November 2010.
49 See http://www.nord-stream.com.
50 Author's interview with Paolo Scaroni, Rome, 15 June 2010.
51 Author's interview with Paolo Scaroni, Rome, 15 June 2010.
52 Author's interview with Bruno Lescoeur, Paris, 9 June 2010.
53 Author's interview with Faouzi Bensarsa, Brussels, 12 October 2009.
54 Author's interview with Roland Kobia, Brussels, 13 October 2009.
55 Council of the European Union Press Release 6670/09, 19 February 2009.
56 Author's interview with Roland Kobia, Brussels, 13 October 2009.

57 Author's interview with Roland Kobia, Brussels, 13 October 2009.
58 Author's interview with Joschka Fischer, Berlin, 18 June 2010.
59 Author's interview with Joschka Fischer, Berlin, 18 June 2010.
60 Author's interview with Roland Kobia, Brussels, 13 October 2009.
61 Author's interview with Richard Morningstar, Washington, DC, 9 September 2009.
62 The most celebrated application of this Hirschmanesque logic of economic coercion is Krasner (1976).
63 On influence and its application to contemporary international political economy, see Kirshner (1995, Chapter 4), Kirshner (1998) and Abdelal and Kirshner (1999/2000).
64 Author's interview with Gerhard König, Kassel, 30 November 2010.
65 For an early statement, see Hoffmann (1966).

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