

The South Stream versus Nabucco pipeline race: geopolitical and economic (ir)rationalities and political stakes in mega-projects

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All was quiet in the European ‘southern energy corridor’ in the first months of 2010, after the rather embarrassing fiasco of the Batumi summit in January, which failed to gather in this Georgian port. Yet when the new EU Energy Commissioner Günter Oettinger mentioned in an interview that the Nabucco project would not be completed before 2018, its international lobby instantly mobilized and put pressure on him to confirm the next day that there was no change of plan. The Russian leadership celebrated the start of the controversial Nord Stream pipeline construction and kept insisting that the South Stream would follow suit.¹ These developments justify a second look at the sequence of high-profile conferences and summits in spring and summer 2009 that sought to give shape and content to the new channel for delivering gas to the European market.

The design of this channel is structured by two prospective pipelines—Nabucco and South Stream—organized respectively by a consortium of six European companies and a joint venture between Gazprom and Italian-owned ENI. Both projects were conceived in the early years of the last decade and gained momentum in the middle of it against the background of a breathtaking climb in oil prices. The sharp break in economic trends in 2008 should have forced the parties in the ‘race’ to reconsider their rationales and goals—but instead the competition between them has only intensified.² Each project has undeniable advantages: Nabucco has half the price tag (current cost estimates are of limited value, but the South Stream underwater leg across the Black Sea is going to be expensive) and has a great PR

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¹ On President Medvedev’s speech at the Nord Stream ceremony, see Anatoly Medetsky, ‘Medvedev delivers Putin’s brainchild’, *Moscow Times*, 12 April 2010. Oettinger’s unfortunate remark was reported in Cerstin Gammelin, ‘Nabucco-Pipeline kommt später’, *Süddeutsche Zeitung*, 25 March 2010. On the Batumi non-event, see ‘Georgian energy summit runs out of gas’, RFE/RL Newline, 14 Jan. 2010, http://www.rferl.org/content/Georgian_Energy_Summit_Runs_Out_Of_Gas/1929462.html, accessed 26 Aug. 2010.

² The history and key parameters of each project are nicely presented at their respective websites, <http://www.nabucco-pipeline.com/> and <http://south-stream.info/?L=1>, accessed 26 Aug. 2010. The articles in Wikipedia are also useful, even if Nabucco (http://en.wikipedia.org/wiki/Nabucco_pipeline) is presented in a rather more positive light than South Stream, http://en.wikipedia.org/wiki/South_Stream, accessed 26 Aug. 2010.

profile (its fan club keeps producing a stream of upbeat articles);³ South Stream has guaranteed supply sources (taking in half of current Russian transit through Ukraine) and a sound organizational structure (Gazprom and ENI have experience with projects on this scale). In contrast to the famous Soviet–American ‘race to the moon’ in the 1960s, the question now is not who will get there first, but what the final outcome could be. Four options are possible: both pipelines are constructed (Austria, Bulgaria and Hungary would benefit most); Nabucco materializes and South Stream does not (Romania favours this outcome and Turkey has nothing against it); Nabucco falls apart but South Stream comes to life (Russia’s dream comes true); and both projects are cancelled (Ukraine keeps its transit privileges).

The aim of this article is not to assess systematically the costs and benefits of each outcome but rather to arrive at a guesstimate of their probability, informed by analysis of the motivations of key actors and an evaluation of the stakes which they have placed on the implementation of their plans. Our underlying assumption is that, contrary to received wisdom, the parties to the pipeline projects are involved neither in a classical geopolitical competition with an energy twist, nor in a straightforward economic competition for profits to be gained from privileged access to the south-eastern quarter of the European energy market. To be sure, there are strong economic incentives behind both projects, and these material interests translate into abundant ‘Great Game’-type commentary. We take issue with the latter but only briefly address the former, given the existing body of analysis on economic strength and weakness.⁴ We presume that there are powerful political drivers that have propelled these two ambitious enterprises through the uncertainties of the financial crisis—and that these intangible motivations, related to such elusive matters as prestige and credibility, need to be investigated with due care.

The first question concerns the actors involved in the two projects. The list of companies involved in each supplies only a partial answer, because the national gas companies of Bulgaria, Hungary and Austria (Bulgargaz, MOL and OMV) are involved in both, and the Turkish BOTAS is also a key partner to Russian Gazprom, while Germany’s RWE (holding a 16.67 per cent stake in Nabucco) is not known for shrewd political lobbying. It is sufficiently clear that South Stream is driven by the unique symbiosis between Gazprom and the Russian state leadership, with ENI and the Italian Prime Minister Silvio Berlusconi involved in a supporting role.⁵ Nabucco has a camp of promoters, among them states including Poland and the Czech Republic that have no material interest in this pipeline (Romania’s interest needs no explanation), and is followed by a noisy fan club with

³ Andrea Bonzanni, ‘Turkey–Azerbaijan meeting keeps Nabucco alive’, *World Politics Review*, 21 Jan. 2010; Vladimir Socor, ‘Nabucco gas project retains political and business momentum’, *Eurasia Daily Monitor*, 5 Feb. 2010.

⁴ One up-to-date analysis is Katinka Barysch, ‘Should the Nabucco pipeline project be shelved?’, CER Policy Brief, May 2010, http://www.cer.org.uk/pdf/pb_Nabucco_5may10.pdf, accessed 26 Aug. 2010.

⁵ On Putin’s involvement with Gazprom, see Natalya Grib, *Gazovyi Imperator* [Gas emperor] (Moscow: EKSMO, 2009); Valery Panyushkin and Mikhail Zygar, *Gazprom: novoe russkoe oruzhie* [Gazprom: new Russian weapon] (Moscow: Zakharov, 2008). On the Italian connection, see Evgeny Utkin, ‘Sorting out the Southern Stream’, *Expert*, 12 April 2010.

a distinctively hostile view of Russia.⁶ Crucial to the organization of this camp is the commitment of the European Commission, which sees Nabucco as 'the flag project of the diversification efforts of the EU for our security of supply', in the words of Andris Piebalgs, the former Energy Commissioner.⁷ Even if Oettinger is somewhat less enthusiastic about Nabucco, he still diligently confirms the priority attached by the EU to opening the southern corridor; so it is on the motivations and stakes of the EU that this analysis will focus.

The article will not offer an extensive critique of the popular geopolitical interpretations of the pipeline intrigue, pointing merely to their shortcomings; neither will it go deep into their economic pros and cons. It will instead examine the phenomenon of politicized 'mega-projects', on the basis that this perspective might shed some new light on the prospects for further gratuitous competition between Nabucco and South Stream.

The folly of geopolitical interpretations

From the moment the first contract on developing oil fields in Azerbaijan was signed in mid-1994, the rather lame competition for the Caspian hydrocarbons has been mislabelled the 'New Great Game'. The 'race' between the Nabucco and South Stream pipelines is typically portrayed as its latest episode. Popular as these geopolitical interpretations are, there is an inherent and irreducible oversimplification in their underlying assumptions about power balances, vacuums and fault-lines, determined by clashing interests of competing state actors. The portrayal of Russia as a rising and revisionist power has certainly gained in political currency since the Russian–Georgian war in August 2008, which delivered a profound shock to the European security system even if it failed to make a serious impression on the energy markets. However, a closer look at this alleged 'predator' inevitably reveals that its military power is profoundly degraded and its 'soft power' is so compromised that even the closest allies, like Belarus, are drifting away rather than gravitating towards Russia. Assertive rhetoric may reflect Moscow's high ambitions, but revisionism is hardly a consistent trait in Russia's international behaviour.

Classical geopolitics assumes that military capabilities are the central element of state power and the ultimate arbiter in competition for dominance over contested space, and that military capability depends on access to natural resources and strategically important locations. Such arguments may never go entirely out of vogue, and the Russian–Georgian war has supplied some fresh support for them.⁸ Far

⁶ See e.g. Zeyno Baran, 'Oil, oligarchs and opportunity: energy from Central Asia to Europe', testimony to the US Senate Committee on Foreign Relations, 12 June 2008, http://www.hudson.org/index.cfm?fuseaction=publication_details&id=5640, accessed 26 Aug. 2010.

⁷ Andris Piebalgs, 'Making Nabucco a reality', *My blog*, 4 Nov. 2008, <http://blogs.ec.europa.eu/piebalgs/making-nabucco-a-reality/>, accessed 1 March 2010 [This blog is no longer available as Piebalgs moved to the now position of Commissioner for Development and started a new blog neglecting to archive the old one.]

⁸ Gregory Gleason, 'Georgian war and great power politics', *CACI Analyst*, 17 Sept. 2008, <http://www.cacianalyst.org/?q=node/4938>, accessed 26 Aug. 2010. A more elaborate analysis is Ronald D. Asmus, *A little war that shook the world* (New York: Palgrave Macmillan, 2010).

more fashionable, however, are neo-geopolitical compositions that treat energy, and in particular oil, as the main driving force of international affairs, and the Caspian region certainly provides a fertile ground for such interpretations.⁹ There is much to be said about the importance of hydrocarbons; however, the real track record of their development in the Caspian basin bears little resemblance to the imagery of fierce struggle for control conjured by geopolitically minded authors. Even the Baku–Tbilisi–Ceyhan (BTC) pipeline—trumpeted by its lobbyists as a crucial breakthrough in this struggle—has been functioning since the celebrated launch in 2006 as a regular business venture.¹⁰

In the specific case of competition between South Stream and Nabucco, one-dimensional petro-geopolitical explanations are particularly unsatisfactory, since the parties to this ‘clash of pipelines’ are not vying for control over any particular source of supply or a choke-point. It is a stretch of imagination to interpret Russia’s preference for going underwater and eliminating transit dependency as an evil geopolitical plot aimed at subjugating any particular producers or consumers. It is hardly a plausible proposition that Moscow aims to establish dominance in the energy market of south-eastern Europe (and geopolitics has questionable applicability to such a business strategy), because Gazprom is planning only limited increases in delivery to these states, many of which have solvency issues. In any case, gaining control over the energy supply of Bulgaria or Slovakia, with their shallow markets and small say in Brussels, is hardly going to yield much political dividend or financial profit.

There is no denying the validity of the axiom that geography matters both for interstate cooperation/competition and for the energy business; the plain fact that Russia has a common border with Azerbaijan, for example, means that the latter has to take the interests of its northern neighbour into serious consideration. From a purely geopolitical perspective, it would be inadvisable for Baku to channel all its oil and gas exports to the West, which would most probably consider an opposition attempt at toppling the Aliyev dynasty as a laudable development. Diversification that would grant Russia a share of Azeri gas, to the contrary, would spread transit risks, deterring possible cut-offs and creating competition between export channels that could keep transit costs down.¹¹ Above all, Baku acknowledges that granting Moscow its wishes in respect of gas would reduce its propensity to support Armenia on the Nagorno-Karabakh question, while at the same time sending a firm message to Turkey to go slow in its unilateral *rapprochement* with Armenia.

Arguably, what really matters is not the ‘objective’ correlation of power and the ability to project it but the perceptions of the pattern of interactions that

⁹ An example is Ariel Cohen, ed., *Eurasia in balance: US and regional power shift* (London: Ashgate, 2005).

¹⁰ For an upbeat perspective, see Frederick S. Starr and Svante E. Cornell, eds, *The Baku–Tbilisi–Ceyhan pipeline: oil window to the West* (Washington DC: Johns Hopkins University Press, 2005).

¹¹ On Azerbaijan’s choices, see Alexandros Petersen, ‘Will Azerbaijani gas export to China scuttle the southern corridor?’, *CACI Analyst*, 9 Dec. 2009, <http://www.cacianalyst.org/?q=node/5234>, accessed 26 Aug. 2010; Stanislav Pritchin, ‘Baku corrects its energy vector’, *Nezavisimaya gazeta*, 29 March 2010. On the prospects for this gas diversification, see Paul Goble, ‘The Azerbaijani–Russian gas accord: a milestone on more than one road’, *Azerbaijan in the World*, 1 July 2009, <http://ada.edu.az/biweekly/issues/vol2no13/20090719071201217.html>, accessed 26 Aug. 2010.

are prevalent among the political elites of states involved in these interactions. This is the realm of critical geopolitics, which deals more with mental maps than with physical actions and reactions determined by the spatial positions of actors.¹² Indeed, it has been perceptively argued that the Russian leadership still lives in a Hobbesian world of competing Leviathans, while the European political elites assume that the process of EU-building has delivered them to a Kantian world where rules and norms regulate political behaviour.¹³ One particular corollary of this thesis is that the European Commission as a political actor in its own right is far less inclined than Russia to adopt a geopolitical perspective on their bilateral interactions.

Overall, the geopolitical reasoning that saturates both expert analysis and media commentary on almost any petroleum-related development in Eurasia, and on the Caspian pipelines in particular, offers an attractively straightforward but seriously misleading 'zero-sum' framework for analysis. Pipelines—linear and materially simple as they are—require a more nuanced examination than just measuring the relative pulling power of Russia and the EU in the tug-of-war that is ultimately about control over energy sources.

The ambiguity of energy security

It was during Russia's controversial chairmanship of the G8 in 2006 that the topic of 'energy security' came to the forefront of international debates as the idea of harmonizing 'security of supply' with 'security of demand' was floated by President Putin—and quietly dropped as 'in principle, interesting'. The practical objectives of producers and consumers were to all intents and purposes going in diametrically opposite directions, and the rapid rise of oil prices up to mid-2008 had enriched the former and seriously aggravated distortions in the financial positions of the latter. That contradiction was one of several that brought about the ensuing global financial crisis, one of shocking proportions, in the course of which it has been mitigated—but not resolved. The sharp disruption of macroeconomic trends has rendered irrelevant even the most competent and authoritative energy demand forecasts; it has not, however, prompted a correspondingly deep revision of the key assumptions related to energy security.¹⁴ Russia maintains the article of faith that 'the era of cheap hydrocarbons is over' and resolutely rejects the 'discriminatory' Energy Charter.¹⁵ The EU, for its part, sticks to the 'green agenda' of increasing the share of alternative energy sources, despite the embarrassing fiasco of the UN climate summit in Copenhagen; it also shows no interest

¹² One good work is Simon Dalby and Gearoid O Tuathail, eds, *Rethinking geopolitics* (London: Routledge, 1998).

¹³ Strobe Talbott, 'Dangerous Leviathans: Russia's bad philosophy', *Foreign Policy*, http://www.foreignpolicy.com/story/cms.php?story_id=4827, accessed 26 Aug. 2010.

¹⁴ Thus the 2009 *World Energy Outlook* (Paris: IEA, 2009) predicted in its reference scenario that world primary energy demand would grow by 1.5% a year in 2007–30, and that demand for natural gas in Europe would increase from 541 bcm in 2007 to 590 bcm in 2020 and 651 bcm in 2030 (p. 478).

¹⁵ In August 2009 Prime Minister Vladimir Putin signed a special order on Russia's non-participation in the Energy Charter Treaty and Protocol: see Ali Aliev, 'Charterless', *Expert*, 7 Aug. 2009.

in discussing the new 'conceptual approach' to energy cooperation advanced by President Dmitri Medvedev.¹⁶

The deep drop in European demand for Russian gas in the first half of 2009 was interpreted by Gazprom as validation of its policy of keeping a tight rein on upstream investments, so the investment programme for 2009–2010 was curtailed by as much as 30 per cent, while expert opinions about a possible gas crunch were dismissed out of hand as groundless speculation. Demand has mostly recovered, but in January 2010 Russian deliveries to the EU were still 5 per cent lower than in January 2008, while Norway and Qatar increased their joint share of the EU market from 18 per cent to 27 per cent in these two years.¹⁷ Gazprom now aims at reaching the pre-crisis production level only in 2013, assuming that European demand will remain flat.¹⁸ The only way to maintain a modicum of stability in this turbulent market, as far as Gazprom is concerned, is the policy of long-term contracts that must include the 'take-or-pay' clause. This policy, however, is undermined by the 'unprecedented prevalence of supply over demand' in the European market, so Gazprom is compelled to sell a portion of its export volume at spot market prices.¹⁹ One way to uphold the faltering policy is to secure it against interference from the transit states, which Moscow seeks to exclude from the main loop of energy-political relations. This idea was spelled out by one of Medvedev's aides: 'There are two key parties in energy policy—producer and consumer. Transit states perform a service, so they should not be treated as independent players.'²⁰

Every proposition in this energy security agenda goes directly against the vision adopted by the European Commission, which is by no means clear and is further clouded by multiple layers of euphemism. Removing them is an analytical task akin to peeling an onion, but a decisive cut reveals that there is a core composed of three elements: diversification, liberalization and degasification. Starting with the last (which is certainly never called by this name), it is necessary to note that assessing the feasibility of the ambitious environmental goals goes far beyond the limits of this analysis. European states appear to be sticking to the commitments made in order to secure the success of the UN Copenhagen climate summit, but in this zeal (which is by no means convincing for China or Russia) they boldly defy the prescriptions of common sense. Natural gas remains the most efficient and clean source of fossil energy, so setting green targets for reducing its consumption and subsidizing alternative sources of energy actually amounts to 'carbon

¹⁶ Commentators discovered with some surprise that Medvedev suggested expanding regulation to cover the supply of and demand for brushwood: see Dmitri Butrin, 'Rules of the game', *Kommersant*, 27 April 2009.

¹⁷ One sharp commentary is offered by Mikhail Korchemkin, 'Europe increases gas import from Gazprom's competitors', *Vedomosti*, 13 April 2010.

¹⁸ Gazprom's best year was 2006 with 556 bcm; the drop to 461.5 bcm in 2009 made it the worst year ever. See Elena Mazneva, 'Four years to the record', *Vedomosti*, 15 April 2010. On Gazprom's uncertain prospects, see Catherine Belton and Isabel Gorst, 'Energy: progress frozen', *Financial Times*, 25 March 2010.

¹⁹ The assessment of oversupply was produced at the meeting of the Gas Exporting Countries Forum in April 2010: see Natalya Grib, 'Gas would profit from oil', *Kommersant*, 20 April 2010. On Gazprom's flexibility, see Sergei Sumlenny, 'Compromise on the sacred article', *Expert*, 1 March 2010.

²⁰ As quoted in Natalya Grib, 'Turning the gas valves', Business Guide in *Kommersant*, 14 May 2009.

protectionism'.²¹ The underlying assumption is that extra resources are available for financing a feel-good factor, which is not entirely rational.²² Another hidden problem is that the limits on energy consumption, if observed or enforced, might inhibit the accelerated development of the poorest EU member states, which happen to be concentrated in the south-eastern quarter—and have a long way to go in catching up with the EU average in every measure, including electricity use per capita.

Liberalization may appear to be an economically sounder policy, as its main thrust goes in the direction of creating a real market for natural gas in the EU in place of the system of non-transparent bilateral deals and fixed prices. The problem with this policy is that it is aimed directly against the interests of such European 'champions' as Gaz de France or E.ON, which are able to mobilize support from their parent states; so France and Germany have worked towards reducing this reform to a very low common denominator. What has unexpectedly helped the liberalization agenda is the surge in 'unconventional' (primarily, shale) gas development in the US, which has redirected LNG flows towards the European market and exerted competitive pressure on prices. The European Commission has not taken full advantage of this market saturation but is still, step by legislative step, dismantling the national gas 'bastions'; its main focus is on interconnecting pipelines, which the companies do not want to build and no other agency is capable of taking on.²³

Gazprom's positions on the European market are to a large extent based on business alliances with gas giants from three key states—France, Germany and Italy—that were until recently eager to engage in asset swaps in order to secure their access to supply sources in Siberia. Such deals would be prohibited under the so-called 'third energy package' approved by the European Parliament and the EU Council in mid-2009, because one of its provisions stipulates that gas infrastructure cannot be owned by the producer or supplier.²⁴ This 'unbundling' is perceived in Moscow as direct discrimination against Gazprom, which is the main target of the controversial 'third country clause'.²⁵ The European 'champions', in the meanwhile, have started to re-evaluate the profitability of their deals with Gazprom and to have doubts about the closeness of its links with Putin's 'court'.

Diversification is the policy most directly aimed at reducing dependence on gas imported from Russia, though Gazprom is never mentioned in official documents

²¹ Medvedev took this stance at the meeting of the Russian Security Council on 17 March 2010. An official translation of his remarks is at http://eng.kremlin.ru/speeches/2010/03/17/1931_type82913_224806.shtml, accessed 26 Aug. 2010.

²² Valuable current information can be found at the EU web portal 'Energy policy for a competitive Europe', http://ec.europa.eu/energy/index_en.htm, accessed 26 Aug. 2010.

²³ One recent example is the decision of the European Commission to impose heavy fines on German and French 'majors' for forming a cartel: see 'Antitrust: Commission fines E.ON and GDF Suez €553 million each for market-sharing in French and German gas markets', Brussels, IP/09/1099, 8 July 2009, <http://eng.kremlin.ru/news/140>, accessed 26 Aug. 2010.

²⁴ Gazprom's requests for exemptions were mostly rejected in mid-2010: see 'Gazprom and other Russian companies will accept our demands', interview with Günter Oettinger, *Kommersant*, 30 July 2010.

²⁵ In the course of consensus-building, the 'package' was much diluted, so its real impact will be moderate: see Natalya Grib and Mikhail Zygar, 'Package of problems for Gazprom', *Kommersant*, 23 April 2009.

for the sake of avoiding offence. Strictly speaking, the aim of importing gas from multiple sources means different things to different member states: to Finland it means building LNG terminals (which it is not planning to do), while for Spain it means getting access to piped gas from Russia (on which plans are under discussion), since it already receives ample quantities of LNG from Algeria. The fundamental problem with the concept of diversification is that reserves of natural gas are far more concentrated than oil reserves, so minor suppliers in Africa and the Caribbean cannot make much difference, while Qatar has set a deliberate ceiling for its production and Iran—as far as the EU is concerned—remains off limits.²⁶ Energy-deficient states such as Poland are now placing great hopes in the development of shale gas, but these unconventional sources have not yet been evaluated with sufficient accuracy.²⁷

The Nabucco project is based on the hope of channelling Caspian gas to the European market, but the chance of getting access to the poorly explored gas fields in Turkmenistan via the envisaged trans-Caspian pipeline is slim, and Azerbaijan can deliver only a trickle. The boldest ambition of the Nabucco lobbyists is 30 billion cubic metres (bcm) of gas to bring into the EU market (of which half could reach Austria); this amount would not meet 5 per cent of the total demand in the EU, even conservatively estimated, so the real contribution to energy security is quite small. It is possible to expect more of a psychological effect from opening a new corridor, but this effect might turn out to be not entirely positive as Russia, which is likely to remain the major supplier no matter what, is certain to be irritated.

Overall, the strong energy connection between Russia and the EU, often conceptualized as ‘interdependence’, should have been a major stabilizing factor in their relations; instead, in the prolonged negotiations on a new Partnership and Cooperation Agreement (PCA), energy issues constitute perhaps the main obstacle.

The issues about cost efficiency

Ambassador Vaclav Bartuska, one of the key EU negotiators during the January 2009 ‘gas war’, remarked in his keynote speech at an energy seminar in Washington how deeply satisfying it was for him to mention to Prime Minister Putin that the Czech Republic was not at all concerned about the interruptions in the delivery of Russian oil.²⁸ Those interruptions in mid-2008 coincided quite disturbingly with the debate in the Czech parliament on the plan for deploying US strategic radar, but their impact was minimized by the oil pipeline connecting the Kralupy and Litvinov refineries with Ingolstadt in Bavaria, which was constructed in the mid-1990s.²⁹ The purpose of that investment was to diversify the sources of

²⁶ For a concise analysis of the limits of Qatar’s gas growth, see ‘Turning up the gas’, *The Economist*, 16 July 2009. See also *World Energy Outlook 2009*, p. 490.

²⁷ Russian evaluations fluctuate from firm dismissal to panic: see Ekaterina Grishkovets, ‘Powerful gas bubble is discovered in Poland’, *Kommersant*, 6 April 2010.

²⁸ The transcript is available at <http://www.jamestown.org/media/events/>, accessed 26 Aug. 2010.

²⁹ Vlad Socor, ‘Czech Republic offsetting Russian oil supply cuts from alternative sources’, *Eurasia Daily Monitor*, 29 July 2008.

supply, and Bartuska had no doubt that his little triumph signified a validation of this policy. Yet the plain economic fact remains that the Czech Republic has committed itself to importing oil from Germany, as well as gas from Norway, and that both are more expensive than what Russia was and still is supplying; so in strictly financial terms, the investment in this particular energy infrastructure is a net loss, or at best an expensive insurance.

This episode illustrates the fundamental problem that bedevils the Nabucco endeavour and looms over the South Stream enterprise: neither is a sound business proposition. One might argue that the irreducible uncertainty about the price of oil, which will probably but not definitely determine the price of natural gas, makes it impossible anyway to produce any meaningful calculations of cost efficiency for these projects, but in our opinion their design flaws go deeper than questionable profit margins.

The current cost estimate for Nabucco is about €8 billion, and a conservative projection for the final bill would be twice that; it is unlikely that the consortium of penniless gas companies led by the Austrian OMV could raise funds on this scale in the depressed financial markets.³⁰ Even assuming the loans are forthcoming, the next problem is to purchase gas so cheaply that selling it to end consumers (many of which are currently facing the prospect of bankruptcy or sovereign default) would generate sufficient returns to pay the hefty transit fee to Turkey and service the debt. Pundits may compare Nabucco to the BTC pipeline, but the big difference is that back in the late 1990s international majors led by BP were able to take the calculated gamble that the profits from trading the oil they were producing in Azerbaijan would cover the investment costs. The Nabucco consortium is not producing any gas and cannot realistically expect any profits; therefore, in much the same way as the Czech government accepted in the mid-1990s the costs of building energy infrastructure as investment in security, the European Commission has to define and implement Nabucco as a 'common good' project—in an area where it lacks both the means and the necessary experience. Pointing to these irreparable flaws, Germany tried in early 2009 to have the project dropped from the list of activities in the European Commission schedule, but the outcry from the 'fan club' was so loud that the attempt to return quietly to common sense had to be abandoned.³¹ The above-mentioned back-peddling performed by Energy Commissioner Oettinger followed the same pattern, so Nabucco receives the usual perfunctory support but in fact remains in limbo.³²

The South Stream project has an even weaker economic rationale. When the first draft was agreed by Gazprom and ENI in mid-2007, the prospect for delivering additional volumes of gas to the European market appeared unproblematic, so the extra profits could have been presented as returns on investment.

³⁰ Germany's RWE certainly stands out in this 'team', so Gazprom made it an offer to join the South Stream project. This was hardly a smart tactical move: see Natalya Grib and Elizaveta Kuznetsova, 'Gazprom takes over Nabucco from inside', *Kommersant*, 14 July 2010.

³¹ See Vlad Socor, 'Chancellor Merkel says nein to Nabucco', *Eurasia Daily Monitor*, 9 March 2009.

³² For a Turkish perspective, see Mete Goknel, 'Nabucco–South Stream: whose side is luck on?', *Eurasia Critic*, June 2010, pp. 50–56.

By the end of 2008, however, the European Commission had hammered out the Energy Security and Solidarity Action Plan with the so-called '20-20-20' targets, establishing specifically that with oil prices close to \$US100 per barrel, EU gas imports would be 3–5 per cent lower in 2020 than in 2005.³³ Gazprom was quite upset by this violation of its favourite principle of 'security of demand', but was inclined to interpret it as a triumph of wishful 'green' thinking.³⁴ In mid-2009, the astounding 30 per cent drop in the volume of European imports of Russian gas confirmed that stagnation was indeed on the cards in this market; but Putin's response aimed not at cutting the losses but at doubling the stakes. The planned capacity of the underwater pipeline was increased by one stroke of his pen from 30 bcm to 63 bcm—but the cost estimates were not revised accordingly, so Gazprom ventured a guess that the underwater part of the pipeline would cost €8.5 billion, which to all intents and purposes means that the company sees no pressing need to count the money needed for this investment.³⁵ This nonchalant attitude alarmed Paolo Scaroni, CEO of ENI, to such a degree that he suggested finding a way to merge the South Stream and Nabucco projects. Gazprom would have none of this creative redesigning and insists on sticking to the original plan, cost inefficient as it is.³⁶

The economic rationales of both projects could certainly be examined in far greater depth and detail, but conclusions would still be elusive. We argue that there are other forces at work here—and their exploration requires a step back from facts and figures.

The variations of the 'mega-project' phenomenon

After the emotional rejection of Soviet patterns and symbols in the 1990s, with Putin at the wheel Russia has gradually returned to old mental habits, particularly as far as the unaccountability and infallibility of leadership are concerned.³⁷ The theme of restoring Russia's greatness has been exploited by Putin to maximum effect in consolidating public support for such a 'tsarist' leadership, and one of the key elements in this theme is the advancement of large-scale projects that are supposed to demonstrate state capacity for organizing unique achievements. References to gigantic Soviet-style works, from the Dneproges hydropower station to the BAM railroad, are unmistakable, but there is also a new quality in this attempted over-achievement related to the shaky identity of the new Russian state. The ideology of Putinism remains after all not only underdeveloped in the propaganda campaigns but also incoherent in its basic premises (in particular on

³³ Pierre Noël, 'Beyond dependence: how to deal with Russian gas', Policy Brief 9, European Council on Foreign Relations, Brussels, Nov. 2008.

³⁴ Aleksandr Medvedev, Gazprom's deputy CEO, argued that the EU plan was based on 'political phobias related to greater dependence on Russian gas supplies' and as such was 'to put it mildly, devoid of sense'; the text of his speech at the 'Russian Gas—2008' forum is available at <http://www.europeanenergyreview.eu/index.php?id=392>, accessed 26 Aug. 2010.

³⁵ Mikhail Zygar, 'The war of streams', *Kommersant-Vlast*, 18 May 2009.

³⁶ Natalya Grib and Aleksandr Gabuev, 'Gazprom blocks the hostile merger', *Kommersant*, 16 March 2010.

³⁷ Dmitri Badovsky, 'Transfer of power: Hamlet question for the tandem', *Vedomosti*, 20 April 2010.

the content of confrontation/competition with the West), as well as hypocritical in the extreme in its use of quasi-democratic discourse to justify the overconcentration of real power in the Kremlin.³⁸

These ideological shortcomings, camouflaged by incessant PR activity, are of relevance here only insofar as they pertain to the execution of the South Stream project, and the connection can be established by examining the ideological load borne by high-profile state-owned projects. Dmitri Medvedev has expressed scepticism about the attempts to invent a 'national idea', but his orchestrated elevation to the presidency involved his being put in charge of the so-called 'national projects', which were designed as material representations of the proposition that petro-prosperity was fairly distributed. In fact, however, these much-trumpeted grand promises in such long-neglected areas as health care or housing were supposed to show that the authorities cared about the needs of the populace and thereby to secure Putin's own elevation to the status of 'national leader' who would retain real power after appointing his junior partner as successor in (or caretaker of) the presidential position.³⁹

The strong expansion of prosperity driven by the inflow of petro-revenues between 2005 and 2010 convinced the Russian leadership of its ability to set more spectacular goals than just rebuilding Grozny or providing for incremental improvements in health care. These ambitions generated a range of hyper-projects, from the conference palace on the Russky Island near Vladivostok for the 2012 APEC summit to the stadiums in Sochi for the 2014 Winter Olympic Games, and from the Moscow–St Petersburg highway to the Eurasia Canal connecting the Caspian Sea and the Black Sea.⁴⁰ Large-scale energy infrastructure projects, like the Baltic Pipeline System or the East Siberia–Pacific Ocean (VSTO) pipeline, are major illustrations of this trend, with the Nord Stream pipeline across the Baltic Sea becoming the flagship project and the South Stream shaping up as a close second.

The sudden arrival of profound economic crisis in the second half of 2008 broke the trend of rising prosperity; but during two years of psychologically painful but by no means unprecedented recession political stability was preserved, against many predictions—with the obvious exception of the North Caucasus. Channelling the shrinking resources towards social commitments in order to check the spread of discontent, the Medvedev–Putin duumvirate should have made a 'rational choice' on the costly and wasteful 'mega-projects' and let them expire quietly, like the Russia Tower, the barely started super-skyscraper in Moscow.⁴¹ Instead, new priority was given to them as symbols of Russia's resilience in the

³⁸ Sergei Shelin, 'Thick dreams', *Gazeta.ru*, 14 April 2010, http://gazeta.ru/comments/2010/04/14_a_3351188.shtml, accessed 26 Aug. 2010.

³⁹ On the launch of that initiative, see Aleksandr Privalov, 'On national projects', *Expert*, 6 March 2006; on Medvedev's ambition to keep them on track despite the crisis, see Irina Granik, 'I am fed up with these reports', *Kommersant*, 30 July 2010.

⁴⁰ It was Kazakhstan's President Nursultan Nazarbaev who had the idea for the Eurasia Canal: see John C. K. Daly, 'Rival Caspian canal projects compete for investors', *Eurasia Daily Monitor*, 25 June 2007.

⁴¹ On the cancellation of this high-profile private development project, see Andrew Osborn, 'Moscow dreams can't get off the ground', *Wall Street Journal*, 17 Aug. 2009.

face of crisis and as embodiments of confidence in the predestined return of petro-prosperity.

This obstinate policy might have worked if the high-profile projects were proceeding on schedule, but in fact embarrassing setbacks have become typical. Construction works, including work on Gazprom's super-tower in St Petersburg, have been bedevilled by worse than usual delays, but the projects that are supposed to represent President Medvedev's emphasis on innovation have experienced yet more spectacular failures.⁴² The new sea-launched ballistic missile Bulava, trumpeted as a central element of Russia's strategic deterrence shield, added a spectacular explosion over northern Norway in December 2009 to its record of failed tests; so the *Yuri Dolgoruky*, the first submarine of the new Borey class, which left dry dock after long delays in April 2007, remains idle.⁴³ The global satellite navigation system GLONASS, advertised as a high-quality alternative to the US-operated GPS system, is not functioning—not only because there are too few satellites in orbit but primarily because the navigator devices remain unreliable and user-unfriendly.⁴⁴ The most devastating disaster, however, struck where no one had expected, when the largest and relatively young (1978) Russian hydropower station Sayano-Shushenskaya was hit by a so-called 'water hammer' that claimed more than 70 lives.⁴⁵ This catastrophe starkly illustrated the risks associated with oversized and politically driven projects—but the response from Moscow was simply to rebuild the afflicted station as soon as possible and to rush ahead with the construction of the Boguchanskaya hydropower station in the same region.⁴⁶

In comparison with this obsessive-compulsive behaviour, decision-making in the EU might appear to be exemplary in its rationality; but in fact it is distorted by more than just the usual handicap of consensus-building on the basis of the lowest common denominator. The Union entered this century with ambitious plans for developing its institutions and expanding its borders, but was not able to secure the parallel implementation of both goals. The great success in 'widening' has greatly impeded the transformation of political mechanisms originally designed for half a dozen member states, and the exhausting ratification process of the Lisbon Treaty (2007) is hardly likely to reinvigorate the dynamics of 'deepening'. The introduction of the common currency, the euro, in 16 out of the current 27 member states in the early years of the last decade was the last major success in advancing integration, and quite possibly this achievement has aggravated the

⁴² Vladislav Inozemtsev, 'Modernizatsiya.ru: hopeless projects', *Vedomosti*, 10 Aug. 2009.

⁴³ After that setback, the navy command decided to postpone the construction of the fourth Borey-class submarine: see Albert Dubrovin and Sergei Makeev, 'Bulava might take off but it won't fly', *Nezavisimoe voennoe obozrenie*, 11 Dec. 2009.

⁴⁴ Visiting India in March 2010, Putin sought to engage both the Indian high-tech sector and the military in cooperation aimed at making GLONASS operational: see Andrei Kolesnikov, 'Nothing eternal—only business', *Kommersant*, 13 March 2010.

⁴⁵ Vladimir Milov, 'Heritage of irresponsible industrialization', *Gazeta.ru*, 24 Aug. 2009, <http://gazeta.ru/column/milov/3239687.shtml>, accessed 26 Aug. 2010.

⁴⁶ Aleksandr Kukolevsky, 'Silence of the turbines', *Kommersant-Vlast*, 24 Aug. 2009; on Putin's order to speed up these projects, see Igor Naumov, 'Siberia will get more electricity', *Nezavisimaya gazeta*, 3 Aug. 2010.

impact of the recent financial crisis on the weaker economies such as Greece.⁴⁷ The record low participation of voters in the elections to the European Parliament in the summer of 2009 showed the depth of public disappointment in the endeavour of building an 'ever-closer' union.⁴⁸

Already lacking a major common goal, the EU was then hit by the global financial crisis, which significantly strengthened the centrifugal trends as states executed stimulus packages with little coordination. Only a few optimists in Brussels argued that the painful recession would inject new momentum into the stalled European integration process because collective action was needed so acutely.⁴⁹ For most Eurocrats, on the contrary, it is clear that the capacity for joint action has diminished—so one of the few available means to preserve unity and to mobilize public opinion towards a visible goal is to focus on large-scale projects. Such projects must have a clear cooperative structure and a higher media profile than, for instance, the Eurofighter, which is renowned mostly for quarrels between partners even if production is now on track.⁵⁰ The Large Hadron Collider (LHC) could have been one such project, particularly as it symbolizes the European scientific edge, but it has acquired a rather negative reputation and its technical failures certainly do not help.⁵¹ Another potentially brilliant achievement could have been the global navigation satellite system Galileo, designed by the European Space Agency; but this project is bedevilled by delays and is even further from implementation than the Russian GLONASS.⁵² In this situation, it is the Nabucco pipeline that has emerged as the flagship project, enjoying the same immediately visible ability to connect as the Eurotunnel or the Øresund Bridge and attracting positive media attention despite its questionable rationale.

This comparison of the political 'load' borne by the South Stream and Nabucco projects raises the question: What makes a large-scale enterprise a politically driven mega-project? Clearly, it is not simply the physical size and economic cost of the endeavour; nor is media profile a sufficient criterion. Investment of political capital that links the project in question with a particular cause is essential, particularly when the advancement of the enterprise is used to compensate for the weaknesses of this cause or to consolidate the shaky identity of the political actor that assumes 'ownership' of the project. There are, however, two specific features of this politicization that justify the attachment of the 'mega' label to a project: one is the securitization of the economic area where it is implemented, as has happened with energy; another is direct competition with a 'hostile' project, for example the US–Soviet 'race to the moon', which as it happens had no economic content whatsoever.

⁴⁷ See Paul Krugman, 'The making of a Euromess', *New York Times*, 14 Feb. 2010.

⁴⁸ One concise evaluation is 'Playing the parliamentary game', *The Economist*, 16 July 2009.

⁴⁹ See Tony Barber, 'Could the EU find unity in crisis?', *Financial Times*, 7 Oct. 2008.

⁵⁰ The article 'Eurofighter Typhoon' in Wikipedia is informative: http://en.wikipedia.org/wiki/Eurofighter_Typhoon#Political, accessed 26 Aug. 2010.

⁵¹ David Shiga, 'Large Hadron Collider to restart at half its designed energy', *New Scientist*, 7 Aug. 2009, <http://www.newscientist.com/article/dn17566-large-hadron-collider-to-restart-at-half-its-designed-energy.html>, accessed 26 Aug. 2010.

⁵² The three-year-old assessment still rings true: see 'Struggling Galileo', *ViewsWire*, Economist Intelligence Unit, 22 May 2007.

The combination of these characteristics moves the project into the too-big-to-fail category, which constitutes a triple trap, escape from which involves not only material losses and damage to prestige but also humiliation through the triumph of an adversary. Embarking on the path of securitization, political actors who sought to harvest dividends from a particular accomplishment find themselves in the unenviable position of hostages whose fate is inextricably tied to the uncertain success of their 'mega-project'.

Ambitions and common sense: and the winner is ...

Conceptualization of South Stream and Nabucco as mega-projects may shed some light on the outcome of their competition, which the parties often find it convenient to deny.⁵³ The four options—as outlined at the beginning of this article—constitute an elementary matrix, but the peculiar logic of decision-making on mega-projects brings about a rather perverse version of the game model known as the 'prisoner's dilemma'.⁵⁴ Indeed, proceeding with either costly project would leave Russia or the EU with an 'asset' of questionable value, while abandoning the plan would mean granting a political victory to the adversary and incurring a loss of bureaucratic face. The only option that makes perfect economic sense is for the two parties to cancel their endeavours simultaneously, but that implies a level of mutual trust that is hardly achievable at the superficially friendly Russia–EU summits. Currently, the half-hearted invitations to Russia to pump its gas into Nabucco are about as convincing as suggestions from Moscow that the EU should grant priority to South Stream as a key part of its new energy corridor.⁵⁵ Both parties demonstrate commitment to their respective pet mega-projects, but so far it is done on the cheap, without putting real money behind the declarations, except for PR budgets.

The most probable option, therefore, appears to be the parallel implementation of both projects, resulting in the construction by the mid-2010s of excessive capacity which would bring about a sustained saturation of the gas market in south-eastern Europe. There is, however, a new development that might prompt both Russia and the EU to reconsider the rationale for their competition. This development is centred on the prospect—and it is as yet only a prospect—that the presidential elections in Ukraine in January 2010 have against all expectations brought into office a stable leadership that will make this troubled state governable. Whatever the ambitions about new energy corridors, there is a clear understanding in both Moscow and Brussels that the shortest route for the delivery of Russian and Caspian gas to Europe goes through Ukraine.⁵⁶ There is also joint

⁵³ US Special Envoy for Eurasian Energy Richard Morningstar and US Senator Richard Lugar expressed confidence that the two pipelines might coexist perfectly well at the joint press conference in Ankara in July 2009: http://turkey.usembassy.gov/statement_b_071309.html, accessed 26 Aug. 2010.

⁵⁴ Albert W. Tucker invented the context of choices faced by two criminals arrested on flimsy evidence: see William Poundstone, *Prisoner's dilemma* (New York: Doubleday, 1992).

⁵⁵ Vladimir Chizhov, Russia's ambassador to the EU, did not get far with such suggestions: see Andrei Terekhov, 'South Stream should be a priority project for the EU', *Nezavisimaya gazeta*, 18 May 2009.

⁵⁶ Visiting Kiev in summer 2010, Oettinger confirmed that Ukrainian pipelines were the best way to deliver

acknowledgement of the fact that the necessary modernization of the gas infrastructure in Ukraine would be approximately half as expensive as building just one new pipeline, but neither party has been prepared to make even a third of this investment in the corrupt and practically bankrupt Ukrainian Naftogaz.⁵⁷

At the time of writing in mid-2010, political tensions between Russia and Ukraine have eased and presidents Medvedev and Yanukovich are keen to demonstrate friendship and 'brotherly' cooperation. Nevertheless, it has proved to be far easier to strike an asymmetric deal, whereby Russia agrees to cut gas prices in exchange for an extension of the lease on the Sevastopol naval base, than to reach an agreement on pipelines.⁵⁸ Within the first month of his long-awaited presidency, Yanukovich made an offer to form an international consortium that would modernize and manage the Ukrainian gas infrastructure, but neither Moscow nor Brussels has expressed any enthusiasm about this economically sound proposition.⁵⁹

The Russian leadership presumes that the next Ukrainian government will again be ideologically pro-western, leaving Gazprom in the uncomfortable minority position in the trilateral consortium, which could thus become a trap that excludes the opportunity to extract political dividends from the gas business. The European leadership is reluctant to enter into binding agreements with the post-'Orange' Ukrainian authorities and is worried less about the 'brotherly' deals between Moscow and Kiev than about the pressure to rescue Ukraine's economy from looming sovereign default.

The influence of the Nabucco lobby should not be underestimated, but the European Commission is reluctant to leave the 'southern corridor' in Russian hands knowing that the South Stream is driven not just by Putin's personal ambition but also by Gazprom's corrupt practices, so that the costlier the project is, the greater are the profits made by insiders. Conspiracy-minded Russian politicians assume that the only way to advance the faltering Nabucco is to provoke a new 'gas war', which could strengthen the European Commission's authority over the EU energy business.⁶⁰ Typically, the urge to score a small point reduces a cooperative compromise to an option of last resort; but as the recession drags on, a rediscovery of common sense could be forced upon reluctant politicians.

The European Commission is perhaps better placed to downgrade Nabucco from a mega-project to an entry in the post-recession wish-list; then Moscow might be willing to follow suit, shelving the South Stream with minimal loss of face and money. Both sides can live with the fact that their energy interdependency is unbreakable, and neither is seriously interested in cutting Turkey in and Ukraine out of their gas business, because economies on transaction costs, if any, would be minimal, while the task of rescuing Ukraine cannot be dodged.

Russian gas and expressed doubt about the need for the South Stream: see Tatyana Ivzhenko, 'Kiev needs an ally in negotiations with Moscow', *Nezavisimaya gazeta*, 30 July 2010.

⁵⁷ In August 2009 Moody's agency cut Naftogaz's credit rating from Caa1 to Caa2, citing high risk of default: see Reuters, 7 Aug. 2009, <http://uk.reuters.com/article/idUKWLA082520090807>, accessed 26 Aug. 2010.

⁵⁸ Andrei Nikolsky and Elena Mazneva, 'Keep the base', *Vedomosti*, 22 April 2010.

⁵⁹ Andrew E. Kramer, 'Seeking lower fuel costs, Ukraine may sell pipelines', *New York Times*, 24 March 2010.

⁶⁰ Gevorg Mirzayan, 'There is no money', *Expert*, 26 June 2009.

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Overblown rhetoric definitely does not help in rediscovering the merits of cost efficiency, but neither of the two mega-projects has yet been talked up to the extent of becoming a survival test for its political sponsors. A useful reflection may be found in the gargantuan Soviet project for turning Siberian rivers southwards (which one of these authors saw gaining a seemingly unstoppable momentum)—it was cancelled when Mikhail Gorbachev asked for the bill.