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Globalization in Practice

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Stephen J. Collier and Nino Kemoklidze

In January 2006, a dispute between Ukraine and Russia exploded into the international media. It stemmed from a deal that the two countries concluded in 2001. As an in-kind payment for transporting Russian gas to Europe, the parties agreed that Ukraine would divert a certain volume of Russian gas for domestic use. The amount diverted—a bit less than 20 per cent of Ukrainian consumption—established an implicit rate of exchange between gas and transport. Over time, however, rising world gas prices made these terms increasingly disadvantageous for Russia. The situation became particularly unpalatable from the Russian perspective in the wake of Ukraine's Orange Revolution in 2004. The victory of a Kremlin-backed presidential candidate—Viktor Yanukovych—was met by massive protests against what was widely assumed to be a fraudulent election. The Ukrainian Supreme Court annulled the result and Yanukovych lost a revote to one of the Orange Revolution's leaders, Viktor Yushchenko. In the event, the Russians were not inclined to continue providing former 'Soyuzniki' with cheap gas.

Russia demanded that, beginning on 1 January 2006, Ukraine pay higher rates. Ukraine initially refused. In response, Russia cut off Ukraine's gas supply. Although the two sides offered different accounts of what happened next, most observers agreed that Ukraine then diverted gas destined for Western Europe running through Ukrainian pipelines that, at the time, carried the vast majority of Russian gas exports. The event precipitated a crisis, as Western European countries were faced with gas shortages in the middle of winter. Pressure from European leaders rapidly mounted, and new tariffs were established.

But this passing spat was only a prelude to much bigger crises. In January 2009 another dispute between Moscow and Kiev left 18 countries in Europe without gas for weeks. A deal to end the crisis, which tied the price Ukraine paid Russia for gas to the global price of oil, was brokered by Prime Minister Yulia Tymoshenko, another leader of the Orange Revolution who in the 1990s had become one of the richest people in Ukraine through her dealings in the energy sector. After narrowly losing a run-off election for the presidency in 2010 (to her long-time nemesis Yanukovych), Tymoshenko's government fell. The General Prosecutor brought a series of criminal charges against her, based in part on allegations that she abused her office in concluding the 2009 gas deal, which, her political opponents claimed, had been ruinous for the Ukrainian economy, given rising oil prices. The Russian Foreign Ministry proclaimed that the charges against the former leader of the Orange Revolution had an

'anti-Russian undertone'; the Ukrainian government quickly assured the Russians that the trial's outcome would not be a factor in future negotiations about the price or transport of gas. But this agreement, too, fell apart. In early 2014 protests erupted in Kiev following Yanukovych's decision to abandon plans to sign an Association Agreement with the European Union in favour of deepening ties with Russia. Amid the deterioration of relations between the two countries that followed Yanukovych's eventual ouster—and the seizure of the Crimean Peninsula by Russian forces—Gazprom Chief Executive Alexei Miller announced an increase in the price Ukraine was charged for Russian gas and demanded payment of gas debts. Russian President Vladimir Putin insisted, implausibly, that the decision had 'nothing to do with the situation in Ukraine'. The renewed struggles about gas provoked fears about disruptions in global energy markets. But as of early February Russian gas continued to flow through Ukrainian pipelines and into Western Europe.[1]

Behind these flare-ups over gas lies a more enduring structural—or, better, infrastructural—story. In the Soviet period a system of pipes was constructed to deliver Russian gas to Western Europe. These pipes began in the massive deposits of north-west Siberia, passed over the Ural Mountains, through European Russia, into Ukraine, and from there to distribution networks in Western Europe. During the Cold War this system provided a reliable connection between adversaries. With Soviet break-up, political borders changed and economic systems—to one degree or another—were transformed. But the pipes' material set-up and geographic pattern persisted, of course, and, for better or for worse, producers, consumers, and transshippers were stuck with each other. Russia could not easily reroute its gas exports to avoid its neighbours when disputes arose. The Europeans could not simply buy their gas elsewhere when these disputes resulted in interruptions. For Ukraine, notwithstanding the conflicts that emerged around it, the pipeline initially appeared as a happy accident, offering the country leverage and revenue it would not have under other circumstances.

Conventional portrayals of globalization are filled with footloose commodities and geographically untethered corporations that set up shop in one locale only to zip off to another, choosing those economic interactions and national milieus that best fit a calculus of cost and benefit. But globalization in practice is also shaped by intransigencies, blockages, and points of friction. These often take the form of material structures—such as pipes and wires—that shape political and economic developments in surprising ways.

One useful economic term for thinking about the role of these intransigent features of the global economy is 'substitutability'. Substitutability concerns the extent to which an economic agent can replace one set of exchange

[1] Rushton, Katherine, 'Russia cancels Ukraine's gas discounts and demands $1.5bn', *The Telegraph*, 4 March, 2014.

relationships, geographical locales, or methods and instruments of economic production for another. An example of high substitutability—or high elasticity of substitution—is the remarkable capacity of global apparel manufacturers to change production locales in pursuit of lower costs. In other areas substitution is inelastic. Many forms of energy production, distribution, and consumption depend on capital-intensive and spatially fixed infrastructures. Relationships in this sector, thus, tend to be sticky, and less responsive to changing costs, whether these costs take the form of increased prices or political conflicts.

Even here, however, there is significant variation. Global oil production, distribution, and consumption are organized through relatively flexible relations of exchange, thanks to efficient tanker shipping and the energetic efforts of major powers to establish and maintain a liquid market in oil.[2] Most natural gas, by contrast, is delivered through fixed networks of pipes that lock in relationships between suppliers, transporters, and consumers. There is not a single global market for natural gas. Price levels, thus, are determined not only by supply and demand but also by bargaining, coercion, or the simple inertial weight of existing agreements or material relationships. Thus, low elasticity of substitution often means high politics, particularly given the amount of money involved.[3]

The examples are innumerable, and the political conflicts that take shape around these intransigencies of infrastructure are not always resolved in ways that allow free commodity flow across borders or advance the general tendency of economic globalization as usually understood. Take, for example, the case of post-Soviet Georgia. In 1992, immediately after the collapse of the Soviet Union, Russia cut off gas supplies to Georgia due to non-payment. As a consequence, the centralized gas-fired boilers that once delivered heat to households in Georgian cities went idle. The heating infrastructure was looted and sold for scrap. Georgians were left to find other means to heat their houses, using wood-burning stoves, often dangerous gas stoves (a leak from one allegedly killed then-Prime Minister Zurab Zhvania in 2005), or expensive electric heaters.

But these substitutes—particularly electricity—bear their own problems. During the 1990s, the Georgian electricity system spiralled into decline. A string of suspicious accidents at key facilities left the country with a significant supply deficit and increasingly dependent on imports from Russia and Armenia. These problems were compounded by rampant non-payment and corruption—much of the imported electricity was allegedly stolen by

[2] See Thomas W. O'Donnell, 'The Political Economy of Oil in the U.S.–Iran Crisis: U.S. Globalized Oil Interests vs. Iranian Regional Interests', GPIA Working Paper 2009-05 (New York: New School Graduate Program in International Affairs, 2009).

[3] See Daniel Freifeld, 'The Great Pipeline Opera', *Foreign Policy*, September/October 2009.

dispatchers and re-exported to electricity-starved Turkey, Georgia's neighbour to the south. By the end of the decade, Georgia's electricity system was in tatters.[4]

In the late 1990s Western donors began to pour money into Georgia to rehabilitate the electricity system—hoping, in part, to establish Georgia as a beachhead of influence in a Russian-dominated region, and to forge new energy geographies that would bypass Russia.[5] The most famous example—recounted in the 2003 documentary *Power Trip*—is the adventures of the American firm, AES, which in 1998 purchased the distribution network in the Georgian capital, Tbilisi, as well as some generation capacity in Georgia. The company planned a multi-pronged approach to reform. It would raise consumer rates, invest in the city distribution system to increase reliability, and import electricity from power plants it had acquired in Central Asia. Its efforts were backed by the United States Agency for International Development, which paid for subsidies to provide free electricity for poor households in Tbilisi (the subsidies, of course, went directly to the Tbilisi affiliate of AES).

But the stubborn materiality of infrastructure and the inconvenient facts of local and regional politics tripped up the company's plans. Reform efforts collided with Georgian citizens' deeply held expectations about government provision of electricity as a basic public good. Thus, notwithstanding substantial progress in the reliability of supply and in cost recovery—and alongside problems with corruption and bureaucratic entanglements—AES's managers were soon grappling with well-organized protests over the rate hikes and widespread efforts to physically bypass the electricity meters that the company installed throughout the city. AES's problems had an international dimension as well. The long-distance transmission wires that connected AES's Central Asian generation facilities to Tbilisi ran through Russia, then over the Caucasus and into Georgia. But AES did not control the transmission of electricity, and power it purchased for import was allegedly diverted by dispatchers.[6]

In 2003, after investing—and losing—hundreds of millions of dollars in Georgia (and after the murder of its chief financial officer Niko Lominadze), AES gave up and sold its shares in the Tbilisi grid.[7] The buyer was RAO-UES, the state-controlled Russian electricity giant, which was purchasing electricity

[4] For background see Transparency International Georgia, 'Georgia's State Policy in the Electricity Sector: Brief History and Ongoing Processes', (February 2008), <http://www.investmentguide.ge/files/160_158_615717_TIGeorgia-GovernmentEnergyPolicyandStrategy-3rdreport.pdf>.

[5] For an overview see Jim Nichol, 'Armenia, Azerbaijan, and Georgia: Political Developments and Implications for U.S. Interests' (Washington, DC: Congressional Research Service, 2011).

[6] The World Bank, Operations Evaluation Department, 'Project Performance Assessment Report: Georgia', (Washington, DC: The World Bank, 2003), <http://lnweb90.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/8E64AA33C4E92B3785256D900073CA80/$file/Georgia_PPAR_26439_light.pdf>.

[7] The rationale for the sale was called into question by some observers, who claimed AES's Georgian operation was on the cusp of profitability ('Georgia's State Policy', 4).

system assets in Georgia at a remarkable pace. The sale was met with protests in Tbilisi (one resident asked: 'Would we have died fighting in the [1992–3] war in Abkhazia…if we'd known they were going to sell Georgia back to Russia?'[8]). But the infrastructural connection between Georgia and Russia only expanded and stabilized in subsequent years, even amidst explosive political and military conflict. During the 2008 Georgia–Russian war, electricity supplies from Russia to Georgia were not cut off; and only months after the war RAO concluded a deal with the Georgian government to operate its largest electricity-generating facility, the Enguri hydropower plant. Today, RAO 'dominates the Georgia electricity market, from generation to end user'.[9]

The Georgian case is hardly atypical. Many European or American efforts to reshape energy politics in the region have been stymied by stubborn facts of geography, the intransigent materiality of infrastructure, and the weight of recent history. And over the first decade of the twenty-first century, RAO-UES has succeeded in reconsolidating its control over energy assets in the former Soviet republics. Indeed, this private Russian company (with intimate ties to the Russian government) is now close to realizing a 'long dreamed-of goal of Soviet planners' by creating a synchronized electricity grid across what is now *post*-Soviet space.[10]

Nothing is forever, of course. If in the electricity sector old relationships are being re-established, and Soviet dreams of an integrated regional system are being realized, new ties are also being forged. For example, RAO aims to link the consolidating regional grid with other desirable markets[11] (a new high-voltage transmission line through Georgia to strengthen this grid is currently planned). In the gas sector, meanwhile, the landscape is unsettled and shifting, and the region is teeming with plans for new pipelines. In 2011 Russia and Germany completed the first pipeline of the Nord Stream, which connects the two countries via the Baltic Sea, and Russia has been working with Turkey to build a South Stream pipeline in Turkish waters of the Black Sea. Meanwhile, competing plans to supply Europe with gas from other sources abound: the Nabucco pipeline, to supply European markets with gas from the Caspian region via Georgia, Turkey, Bulgaria, and Romania; a Turkey–Greece–Italy line to supply Europe with Azerbaijani gas; a trans-Adriatic pipeline that would cross Greece, Albania, the Adriatic Sea and reach the rest of Europe via Italy; and a trans-Anatolian pipeline that is currently favoured by the Turkish government. These plans reflect the complex dance of countries

[8] Quoted in Dima bit-Suleiman (2003) 'Georgia: Russian Hands on the Switches'. *Transitions Online*, 11 August 2003, <http://www.tol.cz> (accessed 23 February 2012).

[9] See Courtney Doggart (2009) 'Russian Investment in Georgia's Electricity Sector', USAEE Working Paper 09-035, p. 16.

[10] See Theresa Sabonis-Helf (2007) 'Unified Energy Systems of Russia (RAO-UES) in Central Asia and the Caucasus: Nets of Interdependence', *Demokratizatsia* 15(4): 429–44.

[11] Sabonis-Helf, p. 431.

with different relationships to production, shipment, and supply. Russia has been working to lock in major consumers while avoiding problems with intermediaries, in part by bypassing them, and in part by buying up their energy assets. Countries along a long arc from the Caucasus to the Baltics are jostling to position themselves as attractive routes for transshipment while avoiding the snare of Russian influence. Western European countries, finally, are playing a delicate double game: seeking to ensure that Russian gas is reliably delivered while diversifying sources of supply.

But building such structures takes a long time (witness the fact that over two decades after Soviet break-up a new pipeline geography is still taking shape). They involve monstrously complex political and economic arrangements (as often as not they simply collapse, as now seems to be the fate of the Nabucco line). And even completed lines that solve today's problems of geography, economics, and politics may well be at the root of tomorrow's. In practice, then, we can expect that globalization will continue to be shaped by struggles over the intransigent paths of pipes and wires.

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