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Commercial Project or Strategic Disorientation? The Controversial Nord Stream 2 Gas Pipeline

by *Frank Umbach*

The Nord Stream 2 natural gas pipeline has become a bone of contention of the EU's foreign policy – something that Germany is largely responsible for. While Berlin continues to hold the view that the planned pipeline is primarily a commercial project of Gazprom, Moscow emphasizes its geopolitical importance: Russian pipeline gas versus liquefied natural gas (LNG) imports from the United States? Potential strategic repercussions are largely ignored or marginalized in the political discussion in Germany. According to Brussels and Eastern European EU member states, Germany has pushed the project with no regard for their strategic interests or political solidarity, and in doing so, given the German-Russian special relationship priority over the EU's common (foreign) energy policy.

No other energy policy project of the EU and Germany is as controversial as the construction of the Nord Stream 2 natural gas pipeline (NS-2). Germany, which has championed the construction more than any other country, failed to win a political majority for the construction of the pipeline within the EU. In Brussels, both the European Commission and a vast majority of the European Parliament oppose the idea. Austria and, with reservations, the Netherlands and France were the only countries within the EU-28 to support the project. Notwithstanding the equally controversial Nord Stream 1 pipeline (NS-1), which has been in operation since 2011, Berlin has so far enforced NS-2 by arguing that it was a purely or at least primarily commercial project and that it strengthened European energy security. In doing so, the German Government has dodged discussions on foreign energy policy. In April 2018, German Chancellor Angela Merkel conceded “that it was not an exclusively economic project but that political aspects certainly had to be factored in as well.” In doing so, she referred to the future of the Ukrainian transit status for Russian natural gas exports after 2019 (when the current gas transit agreement between Russia and Ukraine will have expired), which Russia intends to uphold only temporarily until the bypassing pipelines NS-2 and Turkish Stream will be completed. In contrast, the EU-28, including Germany, wish to uphold Ukraine's transit status on a long-term basis.

The natural gas pipeline project not only raises strategic questions as to whether it contradicts the objectives of the gas import diversification strategy signed, among others, by Germany in the European Council as part of the EU's common energy policy. It moreover raises fundamental questions associated with the decision-making process of energy policy in Germany, because once more the country unilaterally and without prior consultations with Brussels and its neighbors endorsed such a key project (as had been the case with the turnaround in energy policy in 2011). What is more, the Federal Foreign Office was not consulted regarding the implications for EU policy *beforehand*, nor was the Federal Network Agency tasked with preparing an analysis of the repercussions for both the German and the European natural gas market. The government has based its position almost exclusively on the support of the two German gas companies involved, Wintershall and Uniper. This contradicts the approach of “comprehensive energy security” and a broad understanding of security, which should also take more extensive effects of economic and foreign policy into consideration.

The author has elaborated on the questionability of the NS-2 pipeline project's commercial profitability for Russia in other publications.¹ This was recently confirmed by a report published by Russia's state-owned Sberbank criticizing Gazprom for investing in the new and expensive gas export pipelines Power of Siberia, Turkish Stream and NS-2, i.e. in unprofitable projects with poor strategic planning.² The report similarly claims that the NS-2 project will not be profitable for Gazprom over the next 20 years. Pipeline projects are primarily a gravy train for Russian building contractors with close ties to the Kremlin, according to the report. This analysis aims to critically reflect the essential foreign energy policy arguments for the pipeline that are not, or only insufficiently, being discussed in Germany. The author of this analysis neither questions the importance of natural gas for a longer transition process toward a renewable energy age nor does he doubt the necessity of future natural gas imports from Russia. To what extent Germany and the EU should increase their existing dependence on Russian natural gas exports to Europe and to what extent the construction of the NS-2 pipeline contradicts the strategic objectives of the EU energy security strategy agreed and co-signed by consecutive German governments, however, are certainly issues that need to be discussed.

Just a Commercial Private Sector Project?

The Kremlin legitimized all recently designed Russian natural gas export pipelines – such as NS-1, South Stream, Blue Stream and NS-2 – with the strategic objective of bypassing Ukraine. If Ukraine remained exclusively dependent on Russia's natural gas exports and without diversification opportunities while Russia no longer exported its natural gas to Europe via Ukraine, Kiev would become entirely dependent on Moscow and vulnerable to political blackmail. The bypassing strategy of Russian natural gas exports to Europe is thus not only commercially motivated but also serves Moscow's geopolitical interests.

In Russia's natural gas pipeline export diplomacy, it is impossible to separate commercial interests from the Kremlin's strategic and geopolitical interests, as was confirmed by Russian experts in back channel talks, domestic policy discussions in Russia and even European natural gas executives. This has been openly acknowledged in Russia's official economic, foreign and security policy. As an arm of the Kremlin, Gazprom never decides on the construction of new natural gas export pipelines without the former's consent. What is more, it is the Russian president who will make the final call on liquefied natural gas exports to Europe by Novatek and Rosneft, two other natural gas producers from Russia. So far, Russian liquefied natural gas exports HAVE threatened to compete with Gazprom gas pipeline deliveries to Europe and reduce Russia's geopolitical influence in Europe. President Putin, however, recently allowed liquefied natural gas exports to Great Britain and Spain for the first time.

Reinforcing the Security of European Energy Supplies? – Gas Import Diversification in the EU

After the gas crisis of 2009, the EU-28 agreed to intensify diversification efforts for gas imports from other countries, encouraged related infrastructure measures and, with Germany's approval, even confirmed these measures after the Russian annexation of Crimea in 2014. The NS-2 gas pipeline contradicts the EU's gas diversification strategy, because it increases dependence on Russian imports instead of decreasing it and leads to route concentration instead of route diversification. The construction of NS-2 threatens to further increase Germany's dependence on Russian gas imports to 50 to 60 percent, up from about 45 percent in 2017. Also, repercussions on existing or planned gas import diversification projects enjoying political priority in the EU's common energy policy must not be ignored.

¹ See Umbach, Frank (2017): Das Nord Stream-2-Projekt und die Auswirkungen auf die gemeinsame Energiesicherheit und Außenpolitik der EU, in: *Österreichische Militärische Zeitschrift* 4, pp. 478-489; and Umbach, Frank (2017): The Myth of Cheap Russian Gas, in: *Geopolitical Intelligence Service*, <https://www.gisreportsonline.com/the-myth-of-cheap-russian-gas.energy.2323.report.html>

² Power of Siberia is to run from Russia to China and cost over USD 55bn; Turkish Stream from Russia to Turkey at USD 20bn; the costs for NS-2 currently amount to USD 17bn.

From a Polish perspective, the construction of NS-2 could have negative effects on the commercial operation of the Świnoujście LNG terminal and thus undermine Poland's gas import diversification efforts, including the offshore pipeline project Baltic Pipe from Norway to Poland via Denmark. While NS-2 provides Germany with the economic benefits of being a Central European hub for Russian natural gas to be distributed to other countries, former transit countries of Russian gas pipeline exports such as Ukraine, Slovakia and Poland will be the losers of this project as a result of dwindling gas transit fees. Germany would thus make economic gains at the expense of already economically and financially weaker EU member states, which would contradict the principle of political solidarity in the EU. The security of gas supplies and the construction of the Russian Turkish Stream pipeline with at least two pipes running through the Black Sea to Turkey are additional repercussions of the NS-2 project to take into account. Some of the natural gas is supposed to be distributed to Southeast European countries, which would contradict the gas import diversification efforts of these regional states. The strategic change of the European gas market in recent years is one major reason why NS-2 supporters argue that gas import diversification is no longer necessary in the EU and that, as a result, it no longer makes a difference where the gas is from and how large Gazprom's market share is. The European gas market has basically become a "buyer's market", but diverging liberalization trends and inadequate gas import diversification continue to stand in the way of a single European gas market. What is more, Gazprom continues to block reverse-flow capacities on the Ukrainian-Slovakian border, as Gazprom is in control of critical infrastructure there and fails to provide the necessary gas shipping codes.

Political Solidarity versus the German-Russian Special Relationship

Only occasionally has a connection between the "private sector" NS-2 project and Russian foreign policy been made in Germany. Green MEP Reinhard Bütikofer and Norbert Röttgen, a foreign policy maker of the CDU (Christian Democratic Union), criticized in November 2016 that violations of international law must not be rewarded with such deals, because Russian energy exports paid for the Kremlin's war policy in Ukraine and Syria. At a pipeline project meeting in October 2015, however, then Minister of Economic Affairs Sigmar Gabriel and Kremlin leaders argued in favor of a special bilateral energy relationship between Germany and Russia to avoid "political interference" by Brussels and to settle legal issues "with regard to the jurisdiction of German authorities." Critics argue that the interests of very few gas companies were thus given priority over EU standards, European solidarity and security. As a result, the NS-2 project jeopardized the EU's common foreign energy policy and the principle of solidarity laid down in the Treaty of Lisbon of December 2009, which was politically reaffirmed by the EU's Energy Union in 2015. While the Treaty of Lisbon upholds the sovereignty of member states with regard to the energy mix, national energy policy decisions must be made "in a spirit of solidarity between Member States" to "ensure the functioning of the energy market" and to "ensure security of energy supply" in the EU. The turnaround in the energy policy of 2011 had already violated this principle.

No German Interest in LNG Exports from the United States to Europe?

Annual LNG import capacities in Europe will rise to 214 billion cubic meters (bcm) by 2019. Most recent U.S. sanctions against Russia have caused a political outcry in Brussels and particularly Berlin, as they might affect German and European energy companies with business interests in Russia. The Trump Administration was accused of using the sanctions to pursue own gas export interests. The German Government has jumped on the bandwagon of unreflected criticism and, in doing so, overlooked several factors:

- (1) It is just as common for the German Government and for all other EU governments to support their own companies. Having said that, the U.S. Administration should have consulted with the EU before imposing new sanctions that directly or indirectly affect the EU. Two other factors, however, are key in this context:

- (2) Contrary to Russia and its state-owned companies, energy companies in the United States do not automatically adhere to the government's policy and a globally proclaimed "energy dominance", but as private and market-listed companies are rather bound by their shareholder's interest in profits. This is the reason why so far most LNG exports from the United States have gone to Asia, as prices and profits are currently higher there. As long as import demand in Asia remains at this level, there will be fewer LNG exports from the United States to Europe.
- (3) Most importantly, however, German criticism of LNG exports from the United States to Europe has ignored the fact that the EU-28, including Germany, have considered these exports key to their gas import diversification efforts for years and supported the construction of new LNG terminals, particularly in Eastern and Southeastern Europe. The facilitation of such LNG exports from the United States has been a focus of transatlantic energy policy and of the EU-US Energy Council for years – and has not just emerged as a subject of discussion under President Trump.

The shale gas revolution precipitated by fracking and an exceptional, flexible contractual basis for LNG exports from the United States are the factors that have enabled strategic change and a policy of liberalization on the European gas market in the first place. Germany's half-hearted expression of interest in LNG exports from the United States brushes aside the fact that the European LNG terminals will require a significant capacity increase in the medium term (more than the meager 27 percent in 2017) to become profitable commercial and private sector projects. For this reason, it is not enough for Germany to express a general interest in European LNG terminals and U.S. gas imports in order to boost them and make them commercially profitable in the long run pursuant to the EU's gas diversification strategy.

The Future of Ukraine's Transit Status for Russian Gas Exports to Europe

The EU-28 have long agreed to uphold, on a long-term basis, Ukraine's status as a transit country for Russian gas to Europe. The German Chancellery has repeatedly pointed out the political and economic need to do so without specifying the annual volume supposed to be shipped via the Ukrainian pipeline system. So far, Moscow has conceded a meager 10-15 bcm per year for a short transition period only. This amount, however, would be commercially insufficient to maintain and modernize the Ukrainian pipeline system. Until recently, Germany did not seem to be pushing a commercial business plan going beyond general political declarations. In 2017, Russian gas exports via Ukraine increased to 93 bcm (up from 67 bcm in 2015) – in line with an overall rise in exports.

While approx. 40 bcm of the Ukrainian pipeline system have already undergone modernization, no adjustments have been made to connect the Russian pipeline system to the Ukrainian system, because Moscow no longer intends to use the Ukrainian system for its gas exports to Europe. In April 2018, the German Chancellor stated, however, that the NS-2 project "is not feasible without establishing clarity on the future of Ukraine's transit status, from our point of view." Once again, however, the Kremlin failed to provide guarantees for Ukraine's permanent role as a transit country for Russian gas exports to Europe on the occasion of the most recent exploratory talks in Moscow. Moscow is both playing for time and building the NS-2 to create precedents and, in doing so, continues to undermine the EU's position on the unresolved transit issue with each passing day.

Germany's Reluctance to Play a Leading Role

German support for the construction of the NS-2 pipeline is often justified by saying that it was in line with national interests and that Germany's actions were not in any way different from those of other EU member states. At the same time, it is becoming clear that Germany has neither accepted nor internalized the role as political leader it was assigned because of its economic and political weight and also conceded by Eastern European member states. It was exactly this leading role that former Polish Foreign Minister Radoslaw Sikorski had called for in Berlin in November 2011 by saying the following: "I fear German power less than I am beginning to fear German inactivity." It is particularly in energy policy that this lack of German willingness for political solidarity within the EU is becoming manifest. As a result, there is a widening gap between Germany's EU-friendly declarations and its tangible (foreign) energy policy measures.

As long as Germany fails to set European priorities for this leading role and its national interests and does not exemplify political solidarity within the EU, the country will be unable to demand political solidarity from the economically weaker and smaller EU member states in other areas (such as the refugee issue). And if these German national interests are pushed ahead as part of the special German-Russian energy and business relationship at the expense of other EU member states, Berlin should not be surprised – neither at the reactions of EU member states nor at why the EU still fails to speak with one voice in foreign energy policy.

Strategic Conclusions

Moscow has never kept its geopolitical objectives of bypassing Ukraine and other transit countries a secret. Purely commercial projects can also have geopolitical effects and must be anticipated. European governments and the European Commission (not companies) continue to be responsible for analyzing such repercussions on the market, security of supply and the EU's common foreign energy policy in accordance with "comprehensive energy security" before decisions on major transnational energy projects such as NS-2 are made. In doing so, foreign energy policy must not be reduced to the appeasement of EU energy partners, despite Berlin's solo efforts in energy policy.

Germany will no longer be able to deny that the NS-2 project is a bone of contention of (foreign) policy. Its strategic importance and repercussions continue to be underestimated in Germany. From the perspective of Eastern European countries, it seems as if neither sympathy nor consideration should be expected from Berlin – not even in matters of national security such as the construction of NS-2; Brussels has to largely helplessly watch how the mutually agreed gas import diversification strategy is being thwarted, while Berlin sacrifices these strategic objectives on the altar of the special German-Russian gas policy relationship. As a result, this will only encourage renationalization efforts of Eastern European EU member states at the expense of the EU's common energy, foreign and security policy, and lead to enhanced bilateral energy and security relations with the United States. The German approach of insufficiently analyzing strategic interests in combination with "grit your teeth and get to it" tactics, including declaratory chill pills for Brussels and Eastern European neighbors, neither serves to conceal the numerous contradictions and the lack of credibility of Germany's foreign energy policy – nor is it purposeful in terms of strategy. Instead, Berlin finally has to accept and internalize the German leading role based on the principle of solidarity within the EU and manifest this role by means of tangible political actions.

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