

EU: Between an American rock and a Russian hard place

The geopolitics of Nord Stream 2

Tom Schoen and Alex Krijger

Nord Stream 2 (NS2), the \$11 billion dollar Baltic Sea pipeline project from Russia to Germany, has become subject of an increasingly tense political debate. Fears of increasing European dependency on Russian natural gas amidst a volatile geopolitical climate have caused discussions in both the European Union (EU) and within the transatlantic alliance. The prospect of American sanctions against companies involved in the project cannot be ruled out.

“Doing nothing means we will become ever more dependent on a few countries that do not hesitate to pursue ‘pipeline politics’, exerting an undesirable influence on the international affairs of the EU and its member states. I believe the EU should operate far more strategically in this context”, Prime Minister Mark Rutte of the Netherlands stated in his Churchill Lecture at the Europa Institut at the University of Zürich, Switzerland on 13 February 2019.

A week later, NS2 was subject of a plenary debate in Dutch Parliament. “Putin is using Nord Stream 2 as a sort of boa constrictor to strangle the last bit of life from Ukraine”, Sjoerd Sjoerdsma (D66) said. “Nord Stream 2 is nothing more than a geopolitical Russian weapon”. The Dutch Minister of Foreign Affairs, Stef Blok, emphasized the government’s position on the pipeline: “This is purely a commercial project”. According to Blok, it is not up to the government, but the companies involved to decide to proceed or stop the project.

On 12 December 2018, a vast majority of 433 EU members of parliament voted in favor of a European Parliament (EP) resolution that condemns NS2 and calls for the cancellation of the project. The resolution considers NS2 a ‘political project that poses a threat to European energy security and the efforts to diversify energy supply’. It exemplifies

the rift within EU politics between supporters and opposers of the new pipeline. The German Minister of Economic Affairs and Energy, Peter Altmaier (CDU), recently emphasized the German position that NS2 is a private, commercial project, not geopolitical. As a response to potential sanctions from Washington, Altmaier stated: “we have never been blackmailed and will not be so in the future”.

Import gap

The German stance has remained steadfast since Nord Stream’s operating company began exploring options in 2011 for an expansion of the Baltic Sea pipeline already in place. The two proposed additional pipelines, aimed to run parallel to Nord Stream 1 (NS1), would double the amount of gas that Russia’s state-owned oil and gas company Gazprom has been capable of transporting to Germany through NS1. NS2 enables the transportation of an extra 55 billion cubic metres (bcm) of gas to Gazprom’s

Europe should take more accountability and responsibility for its own energy security

Analysis

European clients, thereby totaling a capacity of 110 bcm annually.

The Nord Stream 2 consortium consists of Gazprom (sole owner) and five European partners who together provide up to 49% of the funding: Uniper (10%), Wintershall (10%), Engie (9%), OMV (10%) and Royal Dutch Shell (10%). Various other Western companies, including Dutch companies, are involved in the execution of the project. The pipeline, aimed to run from Russia's Baltic Sea coast to Greifswald in Germany, is expected to be operational at the end of this year.

With prospects of a rising EU demand for natural gas in the face of a steep decline in domestic European production, NS2 is said to provide the necessary capacity required to fill the import gap. This gap for OECD Europe (including Norway) is widening from around 200 bcm in 2016 to a total of 290 bcm in 2022.¹ To be even more clear, without Norwegian gas, the import gap for the EU would be 300 bcm in 2016 and 390 bcm in 2022.

The growing import gap is largely the result of a combination of economic growth in Europe and a declining production in the Netherlands, the United Kingdom and Denmark. Production of the Dutch 'Groningen field' will drop from 40 bcm to around 12 bcm annually and eventually cease by 2030.² Norway's production, on the other hand, is likely to remain at its current annual supply level of 117 bcm.³

To fill the widening import gap, the EU has tapped into a range of natural gas suppliers of which Russia, Norway, Algeria and Qatar are currently key. Russia is the main supplier of natural gas to Europe. According to Gazprom's delivery statistics, 192.2 bcm of gas were exported to Europe and Turkey in 2017, compared to 178.3 bcm in 2016 and 158.6 bcm in 2015.

Alternative options

With NS2 Russia will be able to meet Europe's increasing demand. Following its completion, the Nord Stream route will make it the main export corridor for Russian gas to Europe. This will result in growing energy security dependency of Europe on Russia. It is important to note, however, that Russia is dependent on Europe as well for its gas-exports. According to Gazprom's export statistics, the bulk of Russian gas exports are consumed by the Western European market (including Turkey). In 2017, Germany consumed the most (53.44 bcm) — followed by Turkey

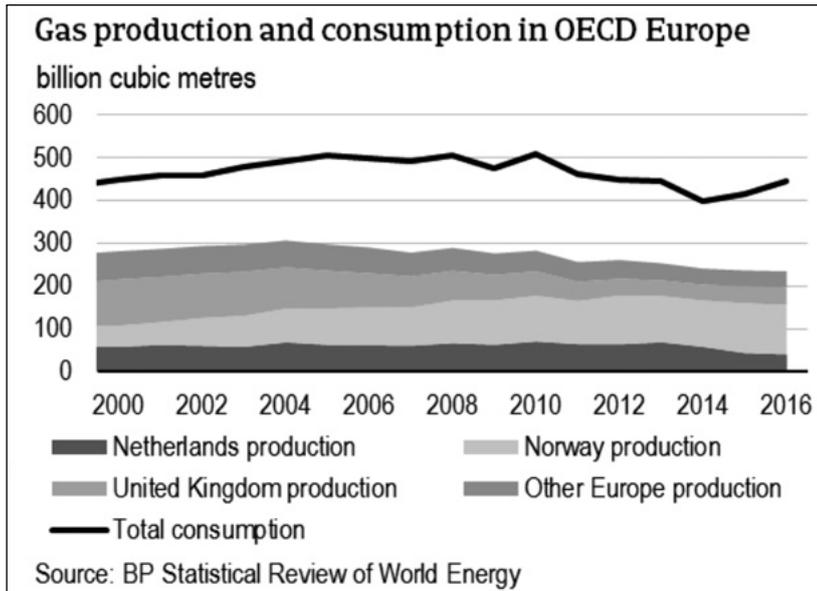
(29.03 bcm), Italy (23.81 bcm) and the UK (16.26 bcm). The Netherlands consumed 4.65 bcm from Gazprom that year.

The question is: are there any reliable, affordable alternatives available to NS2? Alternatives which are also in line with the EU climate goals and policies?

First, there is the option to increase the import of Liquefied Natural Gas (LNG). According to data from the European Commission, the share of LNG in 2017 accounted for around 14% of the EU import. In 2017, Qatar was the EU largest supplier (41%), followed by Nigeria (19%) and Algeria (17%). The import of LNG from the US to the EU was only 4% in that same year.⁴

Due to the recent shale gas revolution, the U.S. has been able to liquefy and ship huge quantities of natural gas across the world seas. The year 2017 witnessed a tipping point as the country became a net exporter of natural gas instead of importer for the first time in around 60 years, according to the U.S. Energy Information Administration (EIA).

The EU's capacity of LNG terminals capable of regasifying the LNG imports is 230 bcm. Ironically, only 20% of this capacity is currently used. The issue with LNG as an alternative source of energy for Europe is not its availability, but its price. At this moment, shipped and regasified American LNG stands at a higher price than Russian piped gas.⁵ In addition, the Asian market is more attractive for American producers of LNG due to higher prices. The expectation is that the price difference with Asia will decrease. According to Royal Dutch Shell CEO Ben van Beurden



American LNG will eventually make up 20% of the world market for LNG. In the coming years Europe should focus more on LNG import to diversify the energy supply. American LNG could play a significant role in this process. The new European Commission should give this key priority.

Second, to lessen the EU's dependence of Russian gas, construction of the Southern Gas Corridor (SGC) project, connecting the Azerbaijani Shah Deniz gas field in the Caspian Sea with the EU, was initiated. The SGC is a term used to describe planned infrastructure projects aimed at improving the security and diversity of the EU's energy supply by bringing natural gas from the Caspian region to Europe. Expected to be finalized in 2020, the SGC will offer the EU an initial annual capacity of 10 bcm competitive natural gas.⁶ This massive, roughly 3,500km long pipeline does offer an alternative to more gas from Russia, but its meagre capacity to fill the EU import gap is in sharp contrast to NS2. Therefore, it cannot be considered a realistic alternative for the foreseeable future.

Third, as stipulated in its Energy Security Strategy of 2014, the European Commission (EC) emphasizes the need for more renewable energy in order to face challenges to its security of supply in the long-term. Increasing the share of renewable energy in the EU's energy mix will eventually decrease the Union's dependence on large suppliers such as Russia and will create more energy diversification. However, the share of renewables in the EU energy mix will remain low — expected to account for 25% in the EU's total energy mix in 2035 — and therefore not sufficient to meet the import gap.⁷

Actors in a geopolitical struggle

United States (U.S.). On 11 December, 2018, a bipartisan bill was passed in the House of Representatives calling upon European governments to cancel NS2. U.S. Congress considers the project to be a “drastic step backwards for European energy security and United States interests” and “urges the President to use all available means to support European energy security”. A similar resolution was introduced by U.S. senators earlier this year, on 7 February. In addition, several U.S. Ambassadors in Europe have called upon their host-countries to cancel the project. Gordon Sondland, U.S. Ambassador to the EU, stated last November that the U.S. has “not deployed the full set of tools yet that could

significantly undermine if not outright stop the project”. In a letter sent to a Dutch daily, U.S. Ambassador Hoekstra in the Netherlands stated that the U.S. opposes NS2 “because it represents a geostrategic threat to our closest friends and allies”. His colleague in Berlin, Ambassador Grenell, explicitly argued that those companies working on the project “are actively undermining Ukraine and Europe's security” and should “consider the [...] sanctions risks associated with it”.

European Commission (EC). The EC has sought to prevent the completion of the project. Its proposal to ‘extend the bloc's internal energy market laws to offshore gas pipelines’ was passed with 41 votes in favor to 13 against by the European Parliament's industry committee in March 2018. These market laws force the separation of gas supplier and pipeline operator. A recent Franco-German introduced proposal to bring the pipeline under EU regulations in exchange for allowing Berlin to remain the authority on the project may change the project's outlook. Extending these EU regulations, however, is not something which is shared by all the Member States, as it transfers some of their sovereignty to the EC. But pressure is rising within the EU, especially with coming EP elections in May. *Spitzenkandidat* Manfred Weber (EPP), opposing NS2, has a good chance of winning the elections and becoming Juncker's successor. With Weber as President the EC may bring unexpected changes to the project. Yet time is of the essence. As a new EC will be in place in November at the earliest, all eyes are currently set on the Franco-German proposal which ought to be finalized prior to the May elections to be effective. If not, the momentum is lost.

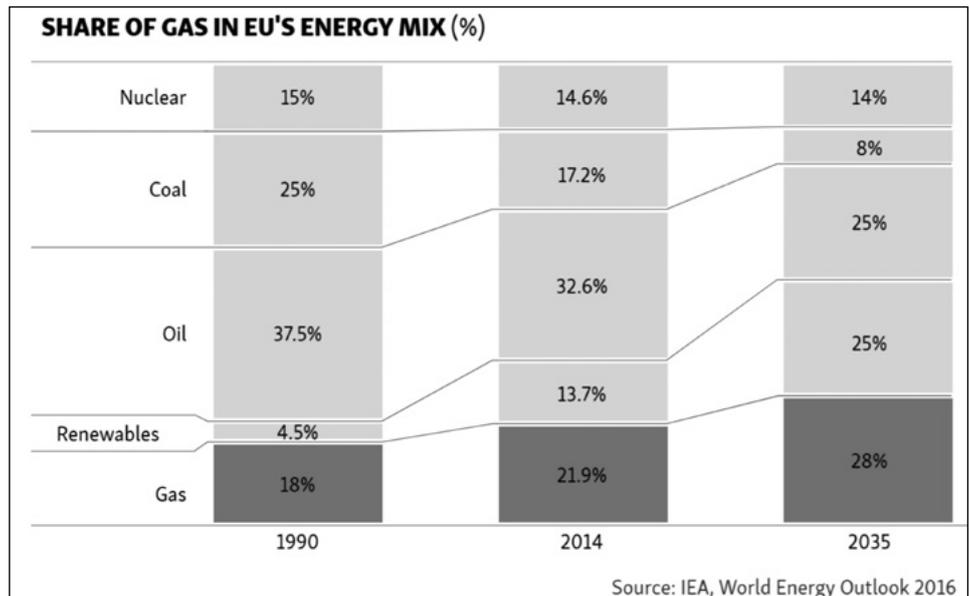
Analysis

Germany. The German line with regards to NS2 remains steadfast and seems to be driven by *Realpolitik*. The project ought to be perceived as a commercial enterprise, according to Chancellor Merkel. As pressure from the U.S. and within the EU rose, she admitted in April last year that the project had a political aspect to it as well. The Chancellor argued NS2 could only proceed as planned if Ukraine's role as a transit country remains.⁸ It remains to be seen, however, to what extent this role can be secured for Ukraine. Germany's stance in the matter puzzles U.S.

President Donald Trump, who called the country "a captive to Russia". In a response to Ambassador Grenell's letter, Annegret Kramp-Karrenbauer, Merkel's successor as leader of the CDU, called out to the Ambassador. She regarded Grenell to be acting in an "unusual diplomatic manner" and believed the German industry, targeted by the Ambassador, offered the "right response [...] which is that they won't allow themselves to be threatened and that they won't allow this type of intervention".⁹ Germany's former Chancellor, Gerhard Schröder (SPD) and head of the Board of Nord Stream AG and Rosneft, argued that "Europe needs Russia against China and the US" in an interview with *Der Spiegel*.

Netherlands. The position of the Netherlands is similar to that of the German government. The Dutch coalition partners support the German efforts to secure Ukraine's transit position. Minister of Foreign Affairs Blok recently stated that NS2 is a commercial project within which the Dutch government is not involved.¹⁰ In his Churchill Lecture, however, Prime Minister Rutte did acknowledge the geopolitical risks of Europe's energy dependency if Europe does not diversify. Currently, the EU is "still far too dependent on Russia and the Gulf States. So the logical step would be to enter into supply contracts with producers from the U.S., Canada, Norway, Africa and Central Asia". The debate regarding NS2 in the Netherlands shows the project is not without controversy. Dutch parliamentarians are increasingly worried about NS2; considering it a threat to EU security. The downing of flight MH17, Russian espionage activities at the OPCW in The Hague, and the Paris Climate Agreement only exacerbate this.

Russia. Following U.S. Ambassador Hoekstra's statements, the Russian Ambassador to the Netherlands, Alexander



Shulgin, responded with a message of his own. "The Netherlands should decide for itself what is best for the country — the cheap Russian gas or the expensive American gas".¹¹ Despite an upsurge of American intentions to sell more of its LNG to Europe, the continent remains the main importer of Russian gas for at least 19 years, according to the Russian Federation Ministry of Energy.

Ukraine. Traditionally, a large part of Russian gas flows through Ukraine and offers the country a lucrative income from transit fees. However, in the last 15 years we have seen various gas disputes between Russian and Ukrainian oil and gas companies over supplies, prices and debts. These disputes have resulted in disruptions of gas supply. Moreover, the conflicts between both countries in the last few years have resulted in increased uncertainties of reliable gas supplies through Ukraine to Europe.

For Europe and Ukraine it is politically and strategically important that Ukraine remains a transit country. Primarily because according to the Oxford Institute for Energy Studies, Ukraine's transit capacity is estimated to be 120 bcm. NS2 could have a negative impact on Ukraine's position in relation to Russia. With the completion of NS2, Russia will have an alternative route of another 55 bcm circumventing Ukraine — 110 bcm in total.

Furthermore, Russia's ability to transport gas to Europe around Ukraine will further increase once TurkStream, set to have an annual capacity of 31.5 bcm, is operational in late 2019. This Turkish-Russian pipeline project will run through the Black Sea from Russia to Turkey and from there on to Southern Europe. More importantly, prospects

Analysis

are that it is very unlikely Ukraine's pipeline capacity will be used at full capacity after the transit contract between Gazprom and Ukraine's oil and gas company Naftogaz expires on 31 December 2019.¹²

Conclusion

Europe has become the epicenter of a geopolitical struggle between two of the world's largest natural gas suppliers. Had the EU undertaken timely measures to diversify its natural gas supply, the inherent political ramifications could have been prevented. The companies operating on NS2 are now bearing the brunt as they might face sanctions. A situation that is largely the result of a lack of leadership and determination on the side of European political leaders to stay true to its energy policy strategy of diversification and becoming less dependent on Russian gas. Similar to the issue of defense, Europe should take more accountability and responsibility for its own energy security. This is in line with Prime Minister Rutte's remarks in his Churchill Lecture: Europe should be less naïve and take more ownership. Principles and power will avoid pipeline politics.

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