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The great troublemaker: Nord Stream 2 in Russia's foreign energy policy

Abstract: The main aim of the paper is to analyze the Nord Stream 2 project from the perspective of Russia's foreign energy policy and strategic goals and interests of all stakeholders (the state, Gazprom and other Russian entities). While it is unclear whether the investment will bring economic benefits to Russia or to Gazprom alone, it is known that Moscow will derive a specific political dividend from it. By building a controversial gas pipeline, it has contributed to deepening divisions in the European Union and weakening the coherence of actions for a common energy policy. The Nord Stream 2 project is also presented as a case study describing different European approaches towards energy cooperation with Russia. Neoclassical realism has been adopted as the theoretical framework for the analysis. The paper includes basic facts regarding the history of the project and the key data concerning the pipeline.

The Nord Stream 2 project is one of the most discussed issues in EU–Russia relations, attracting the attention of politicians as well as numerous scholars and experts.¹ The purpose of the following paper is to show why the Nord Stream 2 project is important to the Russian

¹ Among the most interesting reports on the consequences of constructing the Nord Stream 2 pipeline, the following papers deserve special attention: P. Kotek, A. Selei, B. Takácsné Tóth, *The impact of the construction of the Nord Stream 2 gas pipeline on gas prices and competition*, Regional Centre for Energy Policy Research, February 27, 2017. Available online: https://rekk.hu/research_paper/63/the_impact_of_the_construction_of_the_nord_stream_2_gas_pipeline_on_gas_prices_and_competition (accessed on February 27, 2017); A. Goldthau, "Assessing Nord Stream 2: regulation, geopolitics & energy security in the EU, Central Eastern Europe & the UK," *EUCERS*

Federation, Gazprom and other Russian economic entities, and examine the consequences it has for Russia and European countries, including those in Central Europe. The analysis of the potential impact of Nord Stream 2 is preceded by a section on the choice of theoretical paradigm and a synthetic description of the most important assumptions, parameters and facts relating to the project.

Paradigm

Considering the way the Russian Federation operates and the nature of the energy sphere, realistic theories appear to have the greatest applicability in analyzing Russia's external energy policy.

Among the different branches of realism formed over several decades,² neoclassical realism seems to be the most adequate in the context of the material scope of this paper. In contrast to classical realism, which recognizes states as the main actors in international relations, neoclassical realism emphasizes the key role of state leaders.³ According to the theoretical framework adopted here, there are two types of power – the power of the nation and the power of the state. The first of these is measured by means

Strategy Paper, No. 10, 2016. Available online: <https://www.kcl.ac.uk/sspp/departments/warstudies/research/groups/eucers/pubs/stra-tegy-paper-10.pdf> [accessed on December 20, 2019]; K. O. Lang, K. Westphal, "Nord Stream 2 – A political and economic contextualization," *SWP Research Paper*, 3, 2017. Available online: https://www.swp-berlin.org/fileadmin/contents/products/research_papers/2017RPO3_Ing_wep.pdf [accessed on December 20, 2019]; S. Pirani, K. Yafimava, "Russian gas transit across Ukraine post-2019: pipeline scenarios, gas flow consequences, and regulatory constraints," *OIES Paper*, NG 105, 2016. Available online: <https://www.oxfordenergy.org/publications/russian-gas-transit-across-ukraine-post-2019-pipeline-scenarios-gas-flow-consequences-and-regulatory-constraints/> [accessed on December 20, 2019].

² In addition to classic realism, several other branches have been developed over the decades, among which the most important are (structural) neorealism, defensive and offensive realism, and neoclassical realism. See more: J. Czaputowicz, *Teorie stosunków międzynarodowych. Krytyka i systematyzacja*, Warsaw: Wydawnictwo Naukowe PWN, 2007, pp. 57 – 102; J. Donnelly, Realism, [w:] S. Burchill, A. Linklater, R. Devetak, J. Donnelly, M. Paterson, C. Reus-Smit, J. True, *Theories of international relations*, Basingstoke–New York: Palgrave Macmillan, 2005, pp. 29 – 54; A. Wojciuk, *Dylemat potęgi. Praktyczna teoria stosunków międzynarodowych*, Wydawnictwo Uniwersytetu Warszawskiego, Warszawa 2010, pp. 23–76; G. Česnakas, "Energy resources in foreign policy. A theoretical approach," *Baltic Journal of Law & Politics* Vol.3, No. 1, 2010, pp. 30–52.

³ G. Česnakas, op. cit., pp. 45-48.

of certain objective indicators, such as military potential, GDP, share of international trade or population.⁴ While the power of the state is a function of the power of the nation – the ability of the leaders and the state apparatus subordinated to them to use the power of the state to achieve specific policy goals. Thus, neoclassical realism – in contrast to classical realism – considerably underlines the significance of internal factors, the importance of internal structures and perceptions of the international environment among the ruling elite.⁵ It is, therefore, a more useful research approach, enabling a more accurate explanation of why the Russian Federation is so interested in implementing export infrastructure projects. It is argued in the paper that projects like Nord Stream 2 are driven not only by the foreign policy goals designed by the current Russian ruling elite but also by the interests of other Russian stakeholders, particularly subcontractors who gain significant financial benefits from the construction work.

Moreover the mode of strategic decision-making in the energy sector in Russia confirms the usefulness of using neoclassical realism to analyze Nord Stream 2. Although formally the initiator and main contractor of the project is Gazprom – Russia's largest state-controlled gas company – key decisions regarding strategic projects are taken by the Kremlin or with its consent. Vladimir Putin is the main decision-maker in matters concerning internal and foreign policy – both because of his formal constitutional legitimacy and informal position in the system. Therefore, the Nord Stream 2 project is not only the subject of talks between the companies involved, but also of intergovernmental consultations conducted by the Russian president, prime minister, foreign minister and other senior officials. This is confirmed by messages published on Gazprom's website and the official portals of the Kremlin, the government, the Ministry of Foreign Affairs of the Russian Federation and websites of other state institutions.⁶

⁴ Ibid

⁵ F. Zakaria, *From wealth to power: The unusual origins of America's world role*, Princeton: Princeton University Press, 1998, pp. 9, 19, 35–39.

⁶ For example see <https://www.gazprom.ru/projects/nord-stream2/>, <https://minenergo.gov.ru/node/11419> <http://kremlin.ru/events/president/news/62565> [accessed on December 20, 2019] or https://www.mid.ru/web/guest/foreign_policy/news/-/asset_publisher/ckNonkJE02Bw/content/id/3984282 [accessed on December 20, 2019].

Nord Stream 2 in light of Russia's strategic documents

After Vladimir Putin came to power in the Russian Federation, expanding into external energy markets became one of Moscow's key political goals, which constituted a fundamental change from his predecessors' policies. Part of this involved expanding the gas export infrastructure, and this was reflected in Russia's official doctrinal documents. References to energy infrastructure projects can be found in Russia's energy strategies, general schemes for gas sector development and federal transport planning schemes. The Energy Strategy of Russia for the period up to 2020, adopted on August, 28, 2003, emphasizes that the fuel and energy sector is an important of internal and foreign policy tool and that strengthening the state's position on international energy markets serves to increase Moscow's geopolitical influence.⁷ Furthermore, involving Russian companies in infrastructure projects for the export of oil, gas or electricity is seen as an important goal, and one that is to be accompanied by state support (at the diplomatic level as well).⁸ The revised energy strategy Russia adopted in 2009 emphasizes the strategic importance of the first two Nord Stream pipelines.⁹ It may be altered in the Energy Strategy of the Russian Federation for the period up to 2035, the latest draft of which was published in December 2019. Although it notes the implementation of the Nord Stream 2 gas pipeline, it is clear that one of the most important goals will be moving away from prioritizing infrastructure projects and towards advanced processing.¹⁰

Plans to build Nord Stream 2 also appeared in the Russian government's territorial planning scheme for federal transport (in relation to pipeline transport), presented by the Russian government in August 2013.¹¹ In

⁷ "Россия располагает значительными запасами энергетических ресурсов и мощным топливно-энергетическим комплексом, который является базой развития экономики, инструментом проведения внутренней и внешней политики. Роль страны на мировых энергетических рынках во многом определяет ее геополитическое влияние". See "Energy Strategy of Russia for the period up to 2020." Available online: <https://minenergo.gov.ru/node/1026> (accessed on December 20, 2019). p. 4

⁸ Ibid, p. 42.

⁹ Ibid

¹⁰ "Energy Strategy of Russia for the period up to 2035 (draft project)." Available online: <https://minenergo.gov.ru/node/1920> (accessed on December 20, 2019).

¹¹ "Распоряжение Правительства Российской Федерации от 13 августа 2013 г. N 1416-р г. Москва, Схема территориального планирования Российской Федерации в области федерального транспорта (в части трубопроводного транспорта)." Available online: <https://rg.ru/2013/08/26/truby-site-dok.html> (accessed on December 20, 2019).

February 2014, the Nord Stream AG consortium announced the results of its analysis indicating the legitimacy of extending Nord Stream by two pipelines.¹² In May 2014, Gazprom conducted another round of talks with GDF Suez regarding the possible expansion of Nord Stream.¹³ In January 2015, the Russian media published information that Gazprom was considering abandoning these plans,¹⁴ and although the media cited Gazprom sources, the company did not issue an official statement. Finally, the new version of the Territorial Planning Scheme of the Russian Federation for federal transport (in relation to pipeline transport) published in May 2015 again makes reference to extending the pipeline by two more lines.¹⁵

The genesis and basic parameters of the Nord Stream 2 project

The construction of the third and fourth Nord Stream lines should not be considered a new project, but the resumption of plans announced when the first two branches of the gas pipeline were being constructed.¹⁶ The Nord Stream AG consortium announced that work would commence on analyzing the construction feasibility study as early as in spring 2011. In October 2012,

¹² "Газпром обсудил возможность строительства дополнительных ниток Северного потока." Available online: <https://spb-tr.gazprom.ru/press/news/2014/02/gazprom-obsudil-vozmozhnost-stroitelstva-dopolnitelnykh-nitok-severnogo-potoka/> [accessed on December 20, 2019].

¹³ "Газпром и GDF SUEZ обсудили вопросы сотрудничества." Available online: <https://www.gazprom.ru/press/news/2014/may/article191583/> [accessed on December 20, 2019].

¹⁴ "Газпром отказался от расширения Северного потока." Available online: <https://www.vestifinance.ru/articles/52513> [accessed on December 20, 2019].

¹⁵ "Распоряжение Правительства Российской Федерации от 6 мая 2015 г. N 816-п г. Москва, Схема территориального планирования Российской Федерации в области федерального транспорта (в части трубопроводного транспорта)." Available online: <https://rg.ru/2015/05/15/truby-site-dok.html> [accessed on December 20, 2019].

¹⁶ In September 2005, Gazprom signed a preliminary agreement with the German companies BASF and E.ON on the construction of a gas pipeline from Russia to Germany. In the same year, they established a joint venture, the North European Gas Pipeline Company, renamed Nord Stream AG at the end of 2006. The final shareholders' agreement was signed in July 2007, Gazprom holds 51 per cent shares in the company, while Wintershall and E.ON have 15.5 per cent each, and Gasunie and GDF Suez (now Engie) hold 9 per cent each. The construction of the pipeline began on April 9, 2010. The first line was commissioned on November 8, 2011, and the second in October 2012. Officially, the total construction cost of the first two lines comes to €7.4 billion.

at the launch of the second Nord Stream line, Gazprom representatives stated that the construction of Nord Stream 2 was economically justified and that Great Britain was to be the main destination for gas exported through the new infrastructure. In January 2013, Gazprom announced that another branch would be built by a different consortium from the one responsible for the construction of the first lines.¹⁷ On April 8, 2013, Gazprom signed the first memorandum on the expansion of Nord Stream – with the Dutch company Gasunie (participating in the construction of the fourth line).¹⁸ In June 2013, Gazprom held talks with GDF Suez (now Engie)¹⁹ and BP on expanding the gas pipeline.

The first multilateral, though non-binding, agreement on the expansion of Nord Stream²⁰ was concluded in June 2015 at the International Economic Forum in St. Petersburg. The memorandum between Gazprom and the European energy companies Shell, E.ON and OMV provided for the construction of a pipeline from the Russian Federation via the Baltic Sea to Germany.²¹ The next step in the project implementation process took place on September 4, 2015, in Vladivostok, when five European companies – German BASF, Austrian OMV, German E.ON, Dutch-British Shell and French Engie – concluded a shareholder's agreement with Gazprom regarding the construction of Nord Stream 2. The total cost of implementing the 55 billion m³ capacity gas pipeline was €9.9 billion. The project's completion and commissioning was initially planned for the end of 2019, on the assumption that construction would begin in April 2018. However, the initial construction work in the Bay of Greifswald in Germany did not begin until May 2018, and construction of the offshore section in Finland's exclusive economic zone started in September 2018. By January 2020, Gazprom's sources indicated

¹⁷ “Новые нитки «Северного потока» построит не Nord Stream AG – А. Миллер,” January 16, 2013. Available online: <https://oilcapital.ru/news/transport/16-01-2013/novye-nitki-severnogo-potoka-postroit-ne-nord-stream-ag-a-miller> (accessed on December 20, 2019).

¹⁸ “‘Газпром’ и Gasunie начинают работу над проектом по расширению ‘Северного потока.’” Available online: <https://www.gazprom.ru/press/news/2013/april/article159798/> (accessed on December 20, 2019).

¹⁹ “‘Газпром’ и GDF SUEZ подписали документ по изучению возможности расширения ‘Северного потока.’” Available online: <https://1prime.ru/gas/20130621/764316903.htm!?sp=40> (accessed on December 20, 2019).

²⁰ Since then it was named Nord Stream 2.

²¹ “‘Газпром’, E.ON, Shell и OMV договорились развивать газотранспортные мощности по доставке российского газа в Европу.” Available online: <https://www.gazprom.ru/press/news/2015/june/article229540/> (accessed on December 20, 2019).

that the Nord Stream 2 pipeline was about 93 per cent ready. Construction works were suspended on December 21, 2019, when the US Congress voted to impose sanctions.²² The measures imposed by the United States are a continuation of US policy toward the Russian Federation since 2014, in which sanctions are both a direct response to Russia's aggressive policy toward Ukraine and a reaction to interference in the US presidential elections in 2016.

Contrary to the announcements made in September 2015, a project financing model was not adopted for Nord Stream 2, largely because of antitrust proceedings initiated in December 2015 by the Polish Office of Competition and Consumer Protection (UOKiK).²³ Eventually the concerns raised by UOKiK²⁴ forced the signatories of the agreement establishing the consortium into resolving the issue. At present, the construction of the gas pipeline is formally being financed by Gazprom alone, since the Russian company is the only shareholder of Nord Stream 2 AG. In addition to the company's own funds, however, the money also comes from loans granted to Nord Stream 2 AG by the Western European companies involved in the project. Although UOKiK's allegations prevented an international consortium

²² These concern "the provision of certain vessels for the construction of Russian energy export pipelines" and are imposed on foreign entities that have knowingly sold, leased, provided or facilitated (for example, by way of financial transactions) the provision of vessels that engaged in pipe-laying at depths of 100 feet (30 meters) or more below sea level for the construction of the Nord Stream 2 and TurkStream gas pipelines. The measures envisaged include freezing the assets and blocking the transactions of such entities and denying US visas to individuals engaged in such activity. See: "National Defense Authorization Act for Fiscal Year 2020." Available online: <https://www.congress.gov/bill/116th-congress/house-bill/2500> (accessed on December 20, 2019); A. Łoskot-Strachota, "Sanctions against Nord Stream 2 in the US defence budget," December 18, 2019. Available online: <https://www.osw.waw.pl/en/publikacje/analyses/2019-12-18/sanctions-against-nord-stream-2-us-defence-budget> (accessed on December 20, 2019).

²³ See: R. Bajczuk, S. Kardaś, "Antymonopolowe problemy projektu Nord Stream 2," Center for Eastern Studies, Warsaw, August 24, 2016. Available online: <https://www.osw.waw.pl/pl/publikacje/analizy/2016-08-24/antymonopolo-we-problemy-projektu-nord-stream-2> (accessed on December 28, 2019).

²⁴ In July 2016, UOKiK issued an official announcement in which it expressed serious reservations about the planned concentration, signaling that it could restrict competition. UOKiK's official statement also indicated that Gazprom had a dominant position in supplying gas to Poland, and that the transaction could further strengthen the company's negotiating position with the Polish contractor. See: "Zastrzeżenia wobec koncentracji – Nord Stream 2," Available online: https://www.uokik.gov.pl/aktualnosci.php?news_id=12476 (accessed on December 20, 2019).

from being established, in practice BASF/Wintershall, OMV, E.ON/Uniper, Shell and Engie are all involved in implementing Nord Stream 2.

Nord Stream 2 and Russia's goals

Using neoclassical realism to study the importance of Nord Stream 2 to Russian policy allows us to analyze the goals guiding Russia in implementing the project. In neoclassical realism, internal factors have to be included in the state's external activities, making it possible to identify the goals of the three groups: 1. the state; 2. Gazprom – a state-controlled but nonetheless commercial company; and 3. subcontractors. On the one hand, projects like Nord Stream 2 are a useful tool for Russia to achieve its key foreign policy goals in relation to the EU and its member states and toward Ukraine. On the other hand, implementing large infrastructure projects is in the economic interests of Gazprom, enabling it to pursue greater flexibility in trade policy, and the subcontractors who make significant financial gains from the construction work.

The goals of the Russian Federation

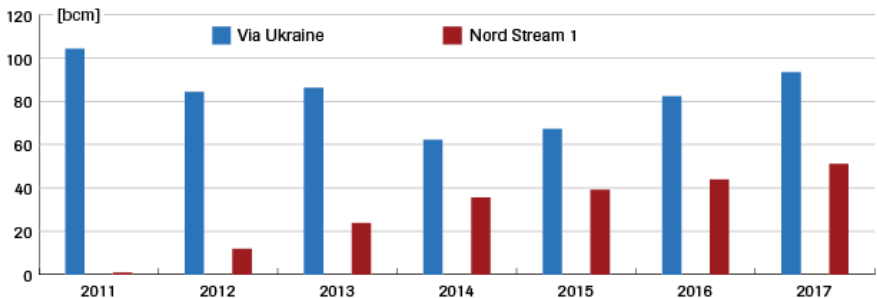
Large energy infrastructure projects, such as Nord Stream 2, TurkStream and Power of Siberia, are treated by the Russian authorities as important instruments for achieving the state's political goals. Nord Stream 2 appears to be a particularly useful tool in Moscow's policy toward Ukraine and the EU.

One of the key political goals of the Nord Stream 2 project is to build the infrastructure that would allow the Russian Federation to cease using Ukraine as a transit country for Russian gas exports. Since Gazprom has sufficient transmission capacity to meet its existing contractual obligations,²⁵ there was no need to launch new gas pipeline export projects. Therefore Russia's decision to build Nord Stream 2 shows that Moscow has consistently pursued its strategic political goal of building infrastructure to enable it to end gas transits through Ukraine. Transit through Ukraine could be reduced from approximately 90 billion m³ (2019) to approximately 40 billion m³ gas per year if up to half the transmission capacity of the new pipeline in the Baltic

²⁵ The Nord Stream gas pipeline has a capacity of 55 billion m³. The Yamal–Europe gas pipeline has a capacity of 33 billion m³, the gas pipeline through Ukraine has 140–170 billion m³ according to various estimates, and the Blue Stream gas pipeline has 16 billion m³.

Sea was used (as allowed under the third energy package restrictions), and reduced by up to 25 billion m³ if deliveries were redirected via the first Turkish Stream pipeline. This scenario would not only lead to a fall in Ukraine's transit revenues, but above all would make it unprofitable for Kyiv to maintain the Ukrainian pipeline network (it is estimated that at least 35–37 billion m³ of gas has to be transported annually to make it profitable). The thesis that Russia's main goal is to reduce transit dependence on Ukraine is supported by data showing that the routes for transporting Russian gas have changed since the first two Nord Stream lines were launched (see Figure 1).

Figure 1. Russian gas flows to Europe through Ukraine and Nord Stream 1, 2012–2017 (billion m³)



Source: Gazprom's data used in the OSW paper by R. Bajczuk, S. Kardaś, A. Łoskot-Strachota, "Nord Stream 2 divides the West." Available online: <https://www.osw.waw.pl/en/publikacje/osw-commentary/2018-06-18/nord-stream-2-divides-west> (accessed on December 20, 2019).

Although the new transit deal between Gazprom and Naftohaz signed on December 30, 2019, guarantees the minimum volumes of Russian gas that have to be shipped via Ukraine for the next five years (65 billion m³ in 2020 and 40 billion m³ annually in 2021–2024),²⁶ the current deal expires in 2024. There is no obligation to renew the contract after 2024 which allows Gazprom to remain flexible in developing its medium- and long-term trade policy. Regardless of its present problems, Gazprom will finalize the Nord

²⁶ S. Kardaś, W. Konończuk, "Temporary stabilisation: Russia-Ukraine gas transit deal," Center for Eastern Studies, Warsaw, December 31, 2019. Available online: <https://www.osw.waw.pl/en/publikacje/osw-commentary/2019-12-31/temporary-stabilisation-russia-ukraine-gas-transit-deal> (accessed on December 31, 2019).

Stream 2 project within five years. It is also very likely that the infrastructure in European countries that will enable use of the second TurkStream branch at full capacity will also be ready.

The expansion of Russia's Northern Gas Corridor is another important political tool that Moscow can use in its relations with the European Union. On the one hand, it allows it to strengthen its political influence in selected EU countries (mainly Germany, but also France and the Netherlands), and on the other it can use it to antagonize EU member states, weakening EU unity, especially in relation to developing the common energy policy. The signing of the agreement on establishing the Nord Stream 2 consortium was met by harsh political reactions in Central European countries (mainly Poland, and to some extent Slovakia)²⁷ who were openly critical of the project and of the EU countries giving it political support (Austria, Germany, the Netherlands). The countries opposed to Nord Stream 2 argue that its implementation will increase gas dependence on Russia, reduce the attractiveness of projects aimed at diversifying gas supply sources to the EU and undermine the solidarity principle in energy cooperation within the EU. The readiness of some countries to support Russian enterprises makes it easier for Moscow to pursue its policy of splintering EU unity, preventing Brussels from pursuing a coherent policy toward its eastern partner (which benefits Russia).

Gazprom's goals

New export pipelines are also important to Gazprom's attempts to achieve its own economic goals. The construction of new gas pipelines is intended to maintain and, in the long term, even strengthen Gazprom's position on the European market (in recent years its share has regularly exceeded 30 per cent, and in 2018 reached 36.7 per cent). The official justification for the construction of Nord Stream 2 is the need to increase gas transmission capacity given the projected increase in gas demand in Europe, taking into account the decline in European gas production. According to Gazprom's estimates, by 2020 demand will have increased by around 80 billion m³, and by 2030 by around 200 billion m³ compared to 2014. Although these assumptions may seem unrealistic, in the coming years it is likely that Russian gas exports to the European market will remain high (in 2018 they were 205 billion m³, and in 2019 around 199 billion m³).

²⁷ A. Sadecki, A. Łoskot-Strachota, J. Groszkowski, T. Dąborowski, "Europa Środkowa i Południowo-Wschodnia wobec projektu Nord Stream 2," October 14, 2015. Available online: <https://www.osw.waw.pl/en/node/23747> [accessed on December 20, 2019].

From Gazprom's perspective, Europe is a key export market in terms of the volume of gas sales and revenues generated. The EU market, whose share of Russian gas imports has increased significantly in recent years, is of fundamental importance to buyers of Russian gas – in 2011 it accounted for 54.1 per cent, and in 2017 for 71 per cent. Once non-EU recipients are added to this (including Turkey), Europe's share increases to almost 85 per cent. The data is presented in Table 1.

Table 1. Share of Russian gas exports to individual markets

Year	EU member states	Former Soviet republics *	Non-EU countries in Europe	LNG customers
2011	54.1 per cent	32.6 per cent	12.0 per cent	1.3 per cent
2012	55.7 per cent	29.6 per cent	13.7 per cent	0.9 per cent
2013	61.7 per cent	24.6 per cent	12.8 per cent	0.9 per cent
2014	61.0 per cent	22.2 per cent	14.5 per cent	2.3 per cent
2015	66.4 per cent	16.6 per cent	14.6 per cent	2.3 per cent
2016	71.5 per cent	13.6 per cent	12.6 per cent	2.3 per cent
2017	71.0 per cent	13.4 per cent	13.7 per cent	1.9 per cent

* The official statistics published by Gazprom include supplies to the Baltic States (Lithuania, Latvia and Estonia) in this category. However, only the former Soviet republics outside the EU are shown in this table.

Source: own calculations based on data published by Gazprom and Gazprom Export

Particularly dynamic growth in Russian gas imports is recorded in countries that have companies involved in implementing Nord Stream 2. This is especially the case in Germany, where imports increased from approximately 34 billion m³ in 2011 to 58.5 billion m³ in 2018.

Table 2. Russian gas exports to countries involved in Nord Stream 2 (billion m³)

Country	2011	2012	2013	2014	2015	2016	2017	2018
Germany	34.0	33.2	40.2	38.7	45.3	49.8	53.4	58.5
Austria	5.4	5.2	5.2	3.9	4.4	6.1	9.1	12.3
France	9.5	8.0	8.2	7.1	9.7	11.5	12.3	12.9
The Netherlands	4.4	2.3	2.1	3.5	2.4	4.2	4.6	7.9

Source: Gazprom and Gazprom Export

Exports to European markets, especially EU member states, is important both in terms of volume and share of turnover. Inflows from the sale of gas to European customers (without customs duties and other taxes) currently constitute approximately 70 per cent of total gas sales revenue for the Gazprom Group. By way of comparison, the Russian internal market accounts for less than 22 per cent of the Group's gas turnover.²⁸

The development of the transmission infrastructure increases Gazprom's ability to respond flexibly to changes taking place on the European market. Thanks to the new pipelines, the Russian gas giant can choose its gas transport route and redirect deliveries depending on the situation in parts of the continent. The variety of options available allow it to increase or decrease supplies on spot markets as needed, and thus influence gas prices in Europe. Ultimately, Gazprom has an instrument for manipulating the gas market in Europe (decreasing or increasing gas supplies to influence prices). The Electronic Sales Platform launched by Gazprom in August 2018 may prove to be a useful tool in this respect.²⁹

The Russian plan to increase Nord Stream's capacity can also be interpreted as a response to the greater interest among EU countries (especially in the Baltic Sea region) in diversifying gas supply sources. The construction of LNG terminals in Poland and Lithuania, and plans for alternative transmission routes such as the Baltic Pipe, pose a potential threat to Gazprom that could lead to a loss of markets. It is therefore arguing that cheap Russian gas delivered through the new infrastructure will be able to compete against the more expensive liquefied gas from the Middle East or (potentially) the United States. This policy, pursued by Gazprom with the political support of the Russian authorities, is aimed at undermining the profitability of these projects, including the new LNG infrastructure in the Baltic Sea. However, it is difficult to predict whether Gazprom's expectations can be fulfilled. In 2019 the average long-term contract price of Russian gas delivered by Gazprom was \$202 per 1,000 m³, while the average price at the TTF gas hub in the Netherlands (the biggest gas hub in the EU) was \$164

²⁸ In the financial reports, Gazprom provides the aggregated data on gas sales revenues for the Gazprom Group. Apart from the joint-stock company Gazprom, it also includes all Gazprom's subsidiaries, including the GazpromNeft' group and the Gazprom Energy Holding company.

²⁹ "Gazprom export LLC presents electronic sales platform for sales of natural gas," August 17, 2018. Available online: <http://www.gazpromexport.ru/en/presscenter/press/2211/?year=2018> (accessed on August 17, 2018).

USD per 1,000 m³ and the average price of US LNG delivered to Western European countries was \$173 per 1,000 m³.³⁰

In the event that even part of the gas currently sent via the Ukrainian transmission system is diverted via Nord Stream 2, transiting gas through Ukraine will cost Gazprom less. It is not clear who will operate the new gas pipeline and on what terms; however, if the model adopted at Nord Stream is used at Nord Stream 2, a proportion of the transit fees would go to Gazprom. On the one hand, the revised gas directive³¹ severely restricts the implementation of Nord Stream 2, with the same solution being adopted as was the case with the first Nord Stream pipelines (transit fees are paid by Gazprom to Nord Stream AG, in which Western European companies have a 49 per cent stake and Gazprom 51 per cent).³² On the other hand, Nord Stream 2 AG has already asked for Nord Stream 2 to be exempt from the restrictions.³³

Subcontractors' goals

The implementation of costly infrastructure projects is extremely important to the economic interests of Russian construction companies, with links to top members of the Russian ruling elite, whose profits are boosted significantly through state procurement. The Russian companies OMK and Chelyabinsk Tube Rolling Plant (Russian: Челябинский трубопрокатный завод) supplied 60 per cent of the pipes to be used in the construction of the offshore section of Nord Stream 2 (33 per cent and 27 per cent respectively). The construction of the new export gas pipeline also required new infrastructure in Russia, especially the Bovanenkovo-Ukhta 2, Ukhta-Torzhok 2 and Gryazovec-Ust-Luga gas pipelines. Contracts for these investments were concluded with

³⁰ "Газ заглянул в колодезь. Цены на сырье идут к историческим минимумам." January 24, 2020. Available online: <https://www.kommersant.ru/doc/4227867> (accessed on January 24, 2020).

³¹ "Directive (EU) 2019/692 of the European Parliament and of the Council of 17 April 2019 amending Directive 2009/73/EC concerning common rules for the internal market in natural gas." Available online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L0692> (accessed on December 20, 2019).

³² Wintershall Holding GmbH and PEGI / E.ON each hold a 15.5 per cent stake in Nord Stream AG, while the Dutch company N. V. Nederlandse Gasunie and the French group Engie hold 9 per cent each. See: "Who we are." Available online: <https://www.nord-stream.com/about-us/> (accessed on December 20, 2019).

³³ "Gazprom wants to withdraw its gas pipelines from the EU gas directive," January 17, 2020. Available online: <https://en.topwar.ru/166829-gazprom-hochet-vyvesti-svoe-gazoprovody-iz-pod-dejstvija-gazovoj-direktiv-es.html> (accessed on January 17, 2020).

companies controlled by oligarchs with connections to the Kremlin – Gennady Timchenko (Stroytransneftegaz and Stroytransgaz) and Arkady and Boris Rotenberg (Stroygazmontazh)³⁴. These companies are not only involved in the implementation of large infrastructure projects for the European market, but also in investments aimed at strengthening Russia's economic ties with Asian partners. An example is the Power of Siberia pipeline, officially launched in December 2019, for exporting Russian gas to the Chinese market.³⁵

The consequences of Nord Stream 2

For Russia

While the project will bring Russia a number of significant political dividends, it is unclear how Moscow will benefit economically.

The construction of the gas pipeline will reinforce the political divisions in the European Union over some of the directions of common energy policy and the energy union regarding diversification of supply sources and decrease the EU's dependence on dominant suppliers. Strengthening bilateral energy cooperation between Russia and the EU countries supporting the project – Germany, Austria, France and the Netherlands – may weaken the voices of countries such as Poland and Lithuania, who wish to prioritize the diversification of gas supply sources to Europe.

Moreover, there is a serious risk that once the new gas export infrastructure is in place, Moscow will try to resolve the legal questions by seeking far-reaching exemptions from EU energy regulations. This has happened before. Russia sought exemptions from the TPA rule (Third Party Access) in relation to the OPAL gas pipeline, a Nord Stream land extension.³⁶ Although the decision was

³⁴ For more on the links between oligarchs and the power elite in Russia, and the benefits that result from them see: I. Wiśniewska, "Priceless friendship. The Kremlin's support for Vladimir Putin's cronies," Center for Eastern Studies, *Point of view*, October 26, 2018. Available online: <https://www.osw.waw.pl/en/publikacje/point-view/2018-10-26/priceless-friendship> (accessed on December 20, 2019).

³⁵ S. Kardaś, "Wątpliwa Siła Syberii: uruchomienie pierwszego gazociągu z Rosji do Chin," Center for Eastern Studies, December 5, 2019. Available online: <https://www.osw.waw.pl/pl/publikacje/komentarze-osw/2019-12-05/watla-sila-syberii-uruchomienie-pierwszego-gazociagu-z-rosji> (accessed on December 20, 2019).

³⁶ "Gas markets: Commission reinforces market conditions in revised exemption decision on OPAL pipeline," European Commission, October 28, 2016. Available online: https://ec.europa.eu/commission/presscorner/detail/en/IP_16_3562 (accessed on December 20, 2019).

annulled by the European Court of Justice in September 2019, one cannot rule out the possibility that Gazprom may apply for new exemptions in the future.³⁷ An additional argument in favor of adopting a more assertive attitude in this respect may be the outcome of the WTO proceedings. In April 2014, Moscow appealed against some of the third energy package regulations under the World Trade Organization Dispute Settlement Mechanism. The Panel of Arbitrators partly supported its arguments.³⁸

It can also be expected that Nord Stream 2 will be used as an example of tighter energy cooperation with key EU countries to support intensifying discussions on the need to improve Russia's political relations with the EU, which have deteriorated dramatically since the dignity revolution in Kyiv (2013–2014) and Russian aggression against Ukraine in 2014 (annexation of Crimea and armed intervention in the Donetsk and Luhansk regions). Although there is common EU agreement on maintaining sanctions against Russia, more and more voices (in Italy, Austria and Hungary) question the legitimacy of Brussels' current course. Maintaining this consensus may be prove more complicated with the resignation of Germany's chancellor Angela Merkel, who is the main guarantor of the sanctions imposed on Russia.

The economic benefits of Nord Stream 2 are less certain for Russia and Gazprom. Firstly, the current uncertainty in global and regional energy markets means that future EU gas demand is unclear. In recent years, the trends have been favorable to Russia – a rise in consumption, a fall in EU production (especially in the Netherlands), low LNG imports to Europe (particularly from the US) – but it is not known whether these will persist in the long-term. The long-term prospects for gas demand are particularly uncertain. According to recent forecasts by the International Energy Agency, gas demand in Europe will be 555 billion m³ in 2030 and 450 billion m³ in 2040.³⁹ Many EU countries are taking steps to promote electromobility,

³⁷ S. Kardaś, A. Łoskot-Strachota, "Gazprom's interests hit by CJEU judgment on OPAL pipeline," September 11, 2019. Available online: <https://www.osw.waw.pl/en/publikacje/osw-commentary/2019-09-11/gazproms-interests-hit-cjeu-judgment-opal-pipeline> (accessed on December 20, 2019).

³⁸ "European Union and its member states – certain measures relating to the energy sector. Report of the panel," World Trade Organization, August 10, 2018. Available online: https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds476_e.htm (accessed on December 20, 2019).

³⁹ "World Energy Outlook 2018," International Energy Agency. Available online: <https://www.iea.org/reports/world-energy-outlook-2018/gas#abstract> (accessed on December 20, 2019).

which may present a challenge to energy source producers and exporters, primarily crude oil, but also natural gas. The forecasted increase in gas prices on the European market by some analytical centers may encourage exporters from the United States or the Middle East to increase their supply volumes. It is therefore uncertain whether Russian pipeline gas will be the main source for meeting potential growing demand in Europe. The preliminary data for 2019 gas exports to the EU market show Russia's share is increasing, but that it is mainly down to growth in Russian LNG supplies, especially from the Jamal LNG terminal controlled by Novatek.⁴⁰ Moreover, there are no new long-term contracts for the transmission of Russian gas through the new Nord Stream lines (only Austria has extended its supply contract to 2040, and increased the contracted annual volume by 1 billion m³).⁴¹

Secondly, despite efforts by Russian officials and Gazprom's PR efforts and promotional or lobbying companies working on its behalf, there is a widespread view (politicians' speeches and industry and media debates) that projects to build new gas pipelines to Europe are largely political and a concern – a tool in the hands of the Kremlin.⁴² Nord Stream 2 simply reinforces this image. Gazprom is therefore not seen as a business-oriented enterprise in the energy market; instead Russia's political goals dominate. Although this has positive aspects – from the point of view of some contractors the state umbrella is the best guarantee of safety – there is a risk it will lose the trust of other market players. Good examples are the loss of the Ukrainian gas market and the potential loss of the Polish market after 2022. Interestingly,

⁴⁰ "Не смыкая газ. Газпром и НОВАТЭК обеспечили почти половину импорта ЕС," January 20, 2020. Available online: https://www.kommersant.ru/doc/4225372?from=main_1 (accessed on January 20, 2020).

⁴¹ "Газпром и OMV подписали Дополнение к контракту на увеличение объема поставок газа в Австрию," November 5, 2018. Available online: <https://www.gazprom.ru/press/news/2018/november/article465991/> (accessed on December 20, 2019).

⁴² For example: "Resolution on energy security in the OSCE area," OSCE. Available online: <https://www.osce.org/eea/37917> (accessed on January 20, 2020); "European Parliament resolution of 12 March 2019 on the state of EU-Russia political relations." Available online: http://www.europarl.europa.eu/doceo/document/TA-8-2019-0157_EN.html (accessed on January 20, 2020); A. Sytas, "EU leaders sign letter objecting to Nord Stream-2 gas link," *Reuters*, March 16, 2016. Available online: <https://uk.reuters.com/article/uk-eu-energy-nordstream-idUKKCNOW11YV> (accessed on December 20, 2019); "We are against Nord Stream 2: Polish and Lithuanian presidents," *PolandIn*, February 21, 2019. Available online: <https://polandin.com/41420670/we-are-against-nord-stream-2-polish-and-lithuanian-presidents> (accessed on December 20, 2019)..

the economic legitimacy of this investment has also been questioned by experts from countries that officially support the project.⁴³

Thirdly, new Russian gas pipeline projects are more expensive than would appear from Gazprom's official declarations. This is shown in calculations in a report prepared by Sberbank analysts, indicating that the actual cost of all the infrastructure projects that have been implemented is higher than declared. According to official data provided by Gazprom, Nord Stream 2 is expected to cost about \$11 billion,⁴⁴ while Sberbank analysts put it at \$17 billion. The investment will not pay off until twenty years after the commissioning of the pipeline.⁴⁵

Impact of Nord Stream 2 on member states' energy policies and intra-EU energy relations

Russian energy policy and energy cooperation projects coordinated by Moscow and selected European countries, particularly Nord Stream 1, Nord Stream 2 and TurkStream, generate political disputes between EU member states, making it difficult for EU institutions to develop a common EU energy policy.

On the one hand, countries such as Poland and Lithuania, motivated by negative experiences of energy cooperation with Russia (overpriced gas supplies, supply disruptions), have taken decisive steps to reduce their energy dependence on Moscow. For example, the launch of the LNG terminal in Świnoujście, Poland, in 2016. Part of that project involves the construction of the Baltic Pipe (gas pipeline), through which Norwegian gas could be exported to Poland. The strategy behind the project is to give Poland the option of not extending its gas supply contract with Russia, which expires in 2022. The Polish authorities have also concluded agreements with neighboring countries to construct bilateral gas connections with Lithuania, Ukraine and Slovakia. In Lithuania's case, the main achievement was the launch in 2014 of "Independence," a floating LNG terminal that has enabled the Lithuanian

⁴³ "Natural gas supply: no need for another Baltic Sea pipeline," DIW Berlin, July 27, 2018. Available online: https://www.diw.de/sixcms/detail.php?id=diw_01.c.593668.en [accessed on December 20, 2019].

⁴⁴ "Минэнерго оценило стоимость Силы Сибири в \$21 млрд, Северного потока 2 – в \$11 млрд." Available online: <https://www.interfax.ru/russia/631641> [accessed on January 20, 2020].

⁴⁵ "Russian oil and gas. Tickling giants, Sberbank CIB," *Global Stocks*. Available online: <http://globalstocks.ru/wp-content/uploads/2018/05/Sberbank-CIB-OG-Tickling-Giants.pdf> [accessed on January 20, 2020].

side to negotiate more favorable conditions for short-term gas supplies from Russia. The policy of reducing energy dependence on Russia can also be seen in the decision to desynchronize Russia and Belarus from the power grid and synchronize them with the EU power system. It is also worth noting that the European Commission supports, both politically and financially, the actions of member states aimed at strengthening the EU internal market (an example is the list of PCI projects – Projects of Common Interest).

But many EU countries are interested in intensifying energy cooperation with Russia. Germany and Austria are currently playing a key role in this respect, as they are politically and commercially involved in implementing joint projects with Russia.

Germany is the largest single recipient of Russian gas, 58.5 billion m³ in 2018, which accounts for almost 22.5 per cent of all Russian gas exports and almost 33 per cent of all Russian exports to the EU market. In turn, Austria has recorded the most dynamic increase in Russian gas imports in the last few years – in 2014 it imported less than 4 billion m³ of gas from Russia, and by 2018 that had risen to 12.3 billion m³. The main companies advocating implementation of new infrastructure projects with Russia – such as Nord Stream 1 (the first gas pipeline was completed in 2011, the second in 2012) and Nord Stream 2 (started in 2015) – are German (Uniper, Wintershall) and Austrian (OMV). Implementing joint projects with Russia has the potential to provide substantial economic benefits. For Germany, the construction of Nord Stream 2 means it can have an important Russian gas distribution center on its own territory. German determination to strengthen economic cooperation with Russia, despite the Western sanctions imposed on Moscow, is not only antagonizing other EU member states (Poland, Slovakia, the Baltic States), but also undermining the coherence of EU energy law and energy policy. Since the announcement of Nord Stream 2, Germany – supported by Russia – has taken actions to reduce EU legal restrictions that would impact its future operation. Berlin has been blocking legislative work launched by the European Commission in November 2017 on revising the gas directive, and in the last stages, following a push by the Romanian presidency, it attempted to soften it to reflect the interests of the entities involved in Nord Stream 2. Although the final version of the amendment extends EU law to Nord Stream 2's cross-border infrastructure, it limits the geographical scope to the territorial sea of the country in which the gas pipeline ends, creating additional mechanisms for excluding the infrastructure from parts of EU energy law.

Hungary and Bulgaria are also heavily engaged in bilateral energy cooperation with Russia. The Russian state company Rosatom is involved in the Hungarian Paks project, and Hungary is developing internal gas infrastructure so it can start receiving Russian gas via the land extension of the TurkStream gas pipeline in 2021. Bulgaria is showing ambitions of becoming a gas hub in Southern Europe. It supported the land extension of the TurkStream project and is one of three European countries to start receiving Russian gas via TurkStream on 1 January 2020.⁴⁶

Conclusions

The new Russian gas pipeline will almost certainly be finished, despite such difficulties as the American sanctions against companies involved in the project. Although it is unclear whether it will bring economic benefits to Russia or just to Gazprom (apart from the subcontractors who have already benefitted), it is known that Moscow will derive political benefits from it. The implementation of the Nord Stream 2 projects together with the construction of TurkStream pipeline will bring the Russian Federation closer to achieving one of its key foreign policy goals – abandoning the use of Ukraine as a transit country for gas supplies to Europe. Moreover, by building a controversial gas pipeline, Moscow has deepened divisions in the European Union and weakened the coherence of common energy policy actions, especially diversification of supply sources and reducing dependence on Russian gas supplies to Europe. Moscow has thereby strengthened its position in bilateral energy relations with Brussels. What is more, it has also created (perhaps unexpectedly) tensions in transatlantic relations, becoming a great troublemaker even before commissioning.

Adopting the neoclassical realism paradigm as the theoretical framework is very useful in analyzing the Nord Stream 2 case since it underlines the importance of internal factors in shaping Russian foreign policy. On one hand, it explains the importance of personal views and the approaches of the Russian ruling elite, particularly President Putin as key decision maker. It is only during his presidency, that Moscow started perceiving the energy sector as a useful foreign policy tool, especially vis-à-vis EU member states

⁴⁶ "Bulgaria starts receiving Russian gas via TurkStream pipeline," January 1, 2020. Available online: <https> (accessed on January 1, 2020).

and former Soviet republics (Ukraine, Belarus, Armenia etc.). On the other hand, neoclassical realism encourages the researcher to take into account the individual interests of other internal stakeholders who gain from projects like Nord Stream 2, especially Russian oligarchs such as Boris and Arkady Rotenberg or Gennady Timchenko (owners or co-owners of companies involved in the construction).

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