

Roundtable on Nord Stream II
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Pierre Noel (Senior Fellow, IISS)

1. The independence of Ukraine in 1991 established it as a large gas transit country between Russia and Europe, as well as a client of Gazprom desperate for very low gas prices. Cheap gas was required to feed Ukraine's non-competitive energy-intensive industry and its gas-fired district heating systems, which give away heat to leaky apartment blocks in most Ukrainian cities. Quite apart from the political relationship between Ukraine and Russia, it was an inherently unstable situation, as Ukraine could abuse its dominant transit position to obtain cheap gas and/or high transit fees from Gazprom. The independence of Ukraine therefore created a major risk to the reliability of Russian gas exports to Western Europe. The rise in the international price of gas after year 2000 escalated tensions, as Ukraine, indeed, did not hesitate to take European gas consumers hostage in its gas bargaining with Russia. The January 2006 crisis convinced Russia that Ukraine should be circumvented. The January 2009 one allowed it to bring Western Europe on board. The bypassing of Ukraine is a joint energy security project by Russia and a few of its large Western European gas clients, supported by their governments. This project, however, was carried out in a rapidly deteriorating geopolitical environment where Ukraine became a major point of contention in the relationship between Russia and the west. It blurred its rationale, made it toxic and might prevent its completion.
2. In the past ten years, the Russia-EU gas relationship has been profoundly restructured because of European gas market integration. As the arbitrage between spot-priced gas and contract gas became widely available in North-West Europe, a long period of cheaper spot prices left no other option than to replace oil-indexed formulas in long-term contracts with spot-indexed ones. This change was fiercely opposed by Gazprom, but it had no leverage to prevent it. As its pricing adapted to the new European gas market, Russian gas regained market share by displacing LNG, leaving Western European terminals with very low utilisation rates.
3. The renewed growth of Gazprom in Europe has been interpreted, especially in the US but not only, as a sign that nothing was being done to counter 'dependence on Russia'. This is a misconception, which overlooks the political benefits of European gas market integration. The gas relationship with Russia became very divisive within the EU after the 2004 enlargement. Central and Eastern member-states felt threatened by Putin's Russia, while totally dependent on Russian gas and isolated from more diversified markets to the west. Gazprom's large partners in western Europe were resented as betraying European solidarity. These tensions markedly increased with the gas crisis of January 2006, the Georgian war of August 2008 and the gas crisis of January 2009. As I argued in a policy paper for ECFR published in December 2008, effective European market integration was the only solution to make the EU-Russia gas relationship compatible with an enlarged EU. In an integrated gas market, any bilateral relationship is contestable, all import contracts and entry-points

become essentially 'European' -- without the need of a centralised import agency -- and supply diversity spreads across the market, from west to east. A competitive, integrated gas market makes it impossible for Russia to weaponise gas exports to central and eastern Europe; it makes the gas relationship politically benign for Europe.

4. Europe delivered market integration -- as testified, precisely, by the restructuring of Gazprom's long-term contracts, under pressure from commodity markets -- starting with North-West Europe, gradually spreading east and south. Yet the gas relationship with Russia is still contentious within Europe and, critically, became a hot topic in the security dialogue between the US and Europe. The reduction and possible termination of gas transit through Ukraine (the circumventing project) generates significant tensions and is portrayed by opponents as aggression against Ukraine, a danger to central and eastern Europe, a reflection of Germany's dependence on Russian gas, which in turns will deepen further. In short, by-passing Ukraine would be an anti-European project. A Polish foreign minister described Nord Stream as "a new Molotov-Ribbentrop pact"; South Stream was killed at an advance stage of planning, by a sustained campaign from the US and the tactical, political use of its own rules by the European Commission; Nord Stream II, and the German-Russian gas relationship in general, was lambasted by the US president himself at a recent NATO summit; the US Senate might soon enact sanctions against the companies involved in NSII. Europe, in other words, did not reap the political benefits of gas market integration. What happened?
5. Market integration is not perfect and never will be -- the European gas market model, especially transmission regulation, remains defective. But the key limitations, from a political perspective, have been alleviated by the building of LNG terminals in the Baltics and Poland. Maybe politicians in Europe and the US do not understand the political implications of market integration, including the fact that the location of entry points and the nationality of the firms signing import contracts, are more or less irrelevant now that gas flows according to price signals. Surely, a lot of them do not understand -- and perhaps do not want to understand -- that European gas importers were taken hostage by Ukraine for many years, in order to extract billions of dollars of subsidies from Russia (\$17bn worth of cumulative implicit subsidies between 2002 and 2011, according to my former colleague and co-author Chi Kong Chyong). However, the main reason is that, after Georgia, Dombass and Crimea, the geopolitical status of the gas relationship between Russia and Europe has changed for most decision-makers and analysts among the transatlantic security community. From an energy trade relationship, potentially problematic from a European security perspective, it is now perceived as a tool that should be mobilised to punish Russia for its 'revisionist' foreign policy actions in Europe, especially Ukraine. In that perspective, Gazprom's expansion plans in Europe must be frustrated; shrinking the gas relationship is consistent with the partial economic isolation of Russia that US and EU sanctions aim at; more specifically, circumventing Ukraine would deprive it from its remaining transit revenue, while it must precisely be supported as it fights Russian aggression. Blocking Nord Stream II ticks all of these boxes.
6. Irrespective of the merits of this policy, one must realise that it means for Europe breaking the original bargain that allowed the gas relationship with the Soviet Union to flourish.

According to the bargain, the gas trade was to be kept strictly isolated from cold war politics. In the post-Georgia, post-Crimea context, most of the US foreign policy community and a large fraction of the European foreign policy community -- especially its most committed Atlanticist fraction -- seem to think that the Europe-Russia gas relationship cannot and should not be isolated from post-cold war politics. Europe must be protected against Russian aggression and revisionist challenges, and Ukraine's integrity should be defended and restored. The gas relationship provides Europe with a way to frustrate and possibly hurt Russia; Europe should make use of it. This narrative allows the US to align its foreign policy position with its commercial interests, pressuring European countries to sign up for US LNG contracts -- "Freedom Gas", as the US Energy Secretary recently described it.

7. It is not just Europe 'sandwiched' between Russia and the US. There is, within Europe, a coalition of countries (plus the European Commission), along with the US, facing the countries that originally built the gas relationship with Russia (Germany, France, Italy). Increasingly, there is also an implicit opposition between the perceptions of the foreign and security policy elites, and the European gas industry. I believe that the non-politicisation bargain can and should be maintained in the new geopolitical context. Nord Stream II -- completing the circumventing of Ukraine -- is actually a condition for this to happen, as it isolates the Russia-Ukraine relationship from the Russia-EU gas trading relationship. The key enabler was European gas market integration, which is an important success of the EU in energy policy (there are not that many to speak of), underrated and even overlooked by the foreign policy community. What is lacking is strategic leadership and initiative from France and Germany, which would at the same time bring their political weight behind the circumventing of Ukraine, underwrite politically the gas 'solidarity' brought about by market integration, and mediate a political settlement between Russia and Ukraine. Such bold strategic initiative would require a willingness to antagonise Brussels, a few member states and -- critically -- Washington. If 'strategic autonomy' is to be anything else than a slogan, it could be the price to pay.