

## Nord Stream 2. Implications for the Eastern Neighborhood

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### Executive Summary

Nord Stream 2, perhaps the most controversial existent gas infrastructure project, not only has divided the European Union in supporters and opponents of the project but is also shaping the transatlantic relation while directly impacting the Eastern Neighborhood of the EU. Supported by a Germany that insists on the economic viability and capacity to improve EU's energy security the project is maybe the most politicized project. Central and Eastern Europe led by Poland and the Baltic States have a limited timeframe until the project's construction is finished to negotiate their strategic interests and, together with the rest of the European opponents of Nord Stream 2, to consolidate the EU's energy priorities.

The repeated gas crisis in the Ukraine and the recent events such as the Kerch Strait incident polarized the regional and international agenda to an even greater extent and highlighted the security dimension of the project.

The present article revises the historical strategic energy interdependence between the Russian Federation and the European Union while emphasizing the importance of the relatively new regulatory aspect in setting the tone of the energy dialogue with the Kremlin. Russia's resilience to the normative constraints and the attempt to avoid the most recent provisions of the revised Gas Directive are presented while acknowledging that the Nord Stream 2 project is advancing even though it was prolonged until, most probably, 2020. Special attention is given to the future role of Ukraine as a consumer and transit country and the Republic of Moldova's perspectives of ensuring its energy security.

**Keywords:** *Energy security, energy diplomacy, energy geopolitics, Nord Stream 2, EU energy policies, Ukraine, Republic of Moldova, Russian Federation, foreign policy.*

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## Background - What is the current policy? Why is it being conducted this way?

Energy is the strategic commodity that represents the interface of Russia's relations with other countries. Hydrocarbons are the country's main exported goods, accounting for over 60 percent of the total.

In the last 60 years, western relations with Russia included all possible cooperation and coercive measures. From sanctions and even banning Soviet oil and embargo on large diameter pipeline exports such as was the case of Druzhba pipeline and all the way to détente. Many countries oscillated from cooperation to confrontation during the past six decades. These actions often divided the Western alliance<sup>2</sup>. The year 2000 became important in warming the energy relations between the West and Russia. At that time the authorities of the European Union and France, Germany and Great Britain initiated an Energy Dialogue with Russia. At the end of September 2000, the European Commission came forward with an initiative to further develop and expand energy cooperation between Russia and the EU. It was called "The Prodi Plan", according to European Commission President at that time, Romano Prodi. Key areas were defined, the most important being the doubling of Russian gas export to the EU, increasing oil deliveries from Russia to the EU, developing the infrastructure for transporting Russian energy resources with the participation of the European Union.

This was the year when Vladimir Putin came to Kremlin and set the plan to reconstruct the impoverished condition of the country. A short time after Putin's inauguration, the feasibility study and then in 2002 a schedule of project implementation of Nord Stream (I) was approved. The second mandate of Putin continued with the "fat years", when the western companies were eager to invest in Russian energy projects, while oil and gas generated wealth which contributed to the economic growth with GDP measured in purchasing power increased by 72%. A few years later, in 2007, South Stream project was launched, and the West was again segregated in supporters and opponents of the project<sup>3</sup>. Even though the project was meantime blocked, the most recent gas infrastructure project, the second line of Nord Stream 1, Nord Stream 2 is again dividing not only Europe, but also the transatlantic relation<sup>4</sup>.

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<sup>2</sup> "Who's Afraid of Russian Gas? Bridging the Transatlantic Divide", CSIS Briefs, May 3, 2018, <https://www.csis.org/analysis/whos-afraid-russian-gas-bridging-transatlantic-divide>

<sup>3</sup> "The Role of the Modernization of Economic Rhetoric in the Russian Federation. Policy Options for the East-European Countries", Leonela Leca, <http://www.esga.ro/wp-content/uploads/2017/11/Russia-collection-of-policy-papers2.pdf>

<sup>4</sup> The Nord Stream 2 will run parallel to the already existing predecessor Nord Stream 1

The economic reality proves that trade will occur and has occurred almost irrespective of politics for over 60 years<sup>5</sup>. Still, not all the actors involved (producers, transit countries and consumers) are acting in a purely commercial way. The complexity of dynamics between the actors is even higher when the same state-owned player, as is the case of Gazprom, is the producer, owner or co-owner of the infrastructure, and has solid, historical support from the main consumer's side.

*“On the saturated market a buyer is the King. On the market of scarcity, a seller is the King”<sup>6</sup>*

In the broader EU-Russia energy relationship<sup>7</sup>, the gas trade has been the main source of controversy and the most politicized topic. This is due to many factors that also include the structural differences between Western Europe's ability to ensure its natural gas supplies (thanks to various pipeline providers apart from Russia, easy access to LNG supplies, and rich transport and storage infrastructure) and the East European quasi-complete dependence on Russian export, transit-oriented infrastructure, difficult access to LNG and insufficient level of connectivity as well as their consequent vulnerability to disruptions in the flow of Russian gas. These differences allow Russia to exert its power through energy tools over its former partners or, in case of the Eastern Neighborhood over the former USSR countries.

Since the gas crisis in 2006 and 2009, when Gazprom cut off all supplies to Europe travelling through Ukrainian pipelines and continuing with the Russian aggression against Ukraine in 2014, fears about possible disruptions to the gas trade with Russia have increased. The EU and Russia have been locked in several disputes concerning their gas trade. The disputes concern the infrastructure through which Russian gas will be channeled to Europe in the near future, the commercial practices of Russia's state-run behemoth company Gazprom (which has a legal monopoly over Russia's pipeline gas exports), and European legislation liberalizing the EU energy market.<sup>8</sup>

The most recent infrastructure project, Nord Stream 2, consists of a natural gas pipeline system through the Baltic Sea following the route of Nord Stream 1. Pipelay of Nord Stream 2 started in summer 2018. The length of the pipeline is approximately 1,200 kilometers with two

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<sup>5</sup> *“Who's Afraid of Russian Gas? Bridging the Transatlantic Divide”*, CSIS Briefs, May 3, 2018, <https://www.csis.org/analysis/whos-afraid-russian-gas-bridging-transatlantic-divide>

<sup>6</sup> A proverb

<sup>7</sup> *The European Union is importing about 60% of energy products such as petroleum oils, gas and solid fuels from Russia.*

<sup>8</sup> *The EU-Russia Gas Relationship. New Projects, new disputes?*, Marco Siddi, Briefing Paper, <https://www.files.ethz.ch/isn/195367/bp183.pdf>

parallel lines running along the seabed. The total capacity of Nord Stream 2 will be 55 billion cubic meters of natural gas per year<sup>9</sup>. The \$21bn pipeline aims to carry more Russian natural gas under the Baltic Sea direct to Germany, bypassing Ukraine and Poland.<sup>10</sup>

Voices across Europe and in the United States have either championed it or warned against Nord Stream 2, and both sides do so for a multitude of reasons. The issue has returned to the fore in 2018 with the crisis between Russia and Ukraine in the Sea of Azov, and as Europe and the US consider strategies going forward regarding their relationships with Russia<sup>11</sup>.

### **The economic rationale of a geopolitical project shaped by regulatory provisions.**

The Russian monopolist and its European supporters are claiming that Nord Stream 2 is a purely economic project which will improve the energy security of the European Union. Many other states, especially from Central and Eastern Europe, are very skeptical in this regard. The regulatory and the geopolitical arguments remain unanswered. How Nord Stream 2 is meeting the three central objectives of EU Energy policy (security of supply, competitiveness and sustainability) developed by the Juncker Commission under the concept of EU Energy Union is unclear. The intensified energy ties between the Russian Federation and Germany could create a bilateral monopoly that also has impact on EU's foreign policy. In addition, the European and global gas markets have undergone a fundamental transformation since 2009 – 2010 and considerably more than half of the natural gas traded today is tied to hub prices.

From Gazprom's perspective, Germany is an extremely good choice as the hub for its westward gas exports. The country is the EU's largest gas market and the largest purchaser of Russian gas, with long-term contracts extending until 2034<sup>12</sup>.

On the other side, states from the Eastern Neighborhood, such as the Ukraine, will be bypassed by this new pipeline, a fact that could impact not only the energy security of Ukraine, but also the already hampered security and stability of the region. Moreover, knowing the high

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<sup>9</sup> "Demystifying Nord Stream 2: OMV's rationale for participating in the project", <https://www.omv.com/en/blog/190513-demystifying-nord-stream-2-omvs-rationale-for-participating-in-the-project>

<sup>10</sup> "Nord Stream 2 pipeline is against Europe's interests", <https://www.ft.com/content/1f6ac3d6-861f-11e9-97ea-05ac2431f453>

<sup>11</sup> *Nord Stream 2: Russia's Geopolitical Trap*, <https://harvardpolitics.com/world/nord-stream-2/>

<sup>12</sup> "Nord Stream 2 – A Political and Economic Contextualisation" Kai-Olaf Lang and Kirsten Westphal, [https://www.swp-berlin.org/fileadmin/contents/products/research\\_papers/2017RP03\\_lng\\_wep.pdf](https://www.swp-berlin.org/fileadmin/contents/products/research_papers/2017RP03_lng_wep.pdf)

dependence of Central and Eastern Europe on the Russian import of gas, the vulnerability of these states in terms of energy supply could increase. How is Germany taking into consideration Central and Eastern European countries' interests? How about the Eastern Neighborhood?

The intense debates over the pipeline project unfold in a multi-dimensional context. For the EU, the Nord Stream 2 discussion raises the question whether – assuming the pipeline is built – it will be able to pass a three-fold consistency and coherence test: firstly in connection with the rules for the internal energy market, which should be neither watered down nor bent for political reasons; secondly in terms of its foreign policy and security objectives, concretely towards the Ukraine, which should not be undermined by energy policy decisions; and thirdly, in relation to its internal cohesion, which Nord Stream 2 could erode. This erosion would be political, if the rifts between Member States over policy on Russia and energy widen, and economic, because the pipeline project could lead Member States to concentrate more strongly on national energy policy and above all energy security policy, thus exacerbating market fragmentation<sup>13</sup>.

Although the economic rationale as well as the geopolitical factor along with the regulatory one is important, it seems that from the Russian perspective, the regulatory concerns are the main issues that projects like Nord Stream 2 will have to address. The strategic documents developed in Kremlin are stating that “*intensification of the struggle for the liberalization of the transportation of Russian gas both inside Russia and abroad*”<sup>14</sup> is seen as one of the main problems and threats to Russian energy security in the gas field.

This explains Gazprom active lobby in postponing the revision of the Gas Directive. Nevertheless, following its postponing this year the EU Council approved the European gas directive on April 15, that is expected to delay commissioning of the Nord Stream 2 gas pipeline – and potentially leave it half empty.

*“This Directive seeks to address obstacles to the completion of the internal market in natural gas which result from the non-application of Union market rules to gas transmission lines to and from third countries. The amendments introduced by this Directive are intended to ensure that the rules applicable to gas transmission lines connecting two or more Member States are also applicable, within the Union, to gas transmission lines to and from third countries. This will establish consistency of the legal framework within the Union while avoiding distortion of competition in the internal energy*

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<sup>13</sup> “Nord Stream 2 – A Political and Economic Contextualisation” Kai-Olaf Lang and Kirsten Westphal [https://www.swp-berlin.org/fileadmin/contents/products/research\\_papers/2017RP03\\_lng\\_wep.pdf](https://www.swp-berlin.org/fileadmin/contents/products/research_papers/2017RP03_lng_wep.pdf)

<sup>14</sup> “Экономика России. Проблемы и перспективы”. Газовая составляющая энергетической безопасности России В. Ш. Уразгалиев, М. В. Титков, Санкт-Петербургский государственный университет, Вестник Санкт-Петербургского Университета, 2018

*market in the Union and negative impacts on the security of supply. It will also enhance transparency and provide legal certainty to market participants, in particular investors in gas infrastructure and system users, as regards the applicable legal regime”.*<sup>15</sup>

By extending EU rules to non-EU pipelines — particularly those outside EU territory — the directive will force Gazprom to “unbundle” or hand over the operation of the line to a company independent of Russia's state gas producer. However, Gazprom maintains a jealously guarded monopoly over gas exports from Russia and will be very reluctant to share the right to export with anyone. Currently, the only other entity allowed to export gas is privately owned Novatek, which is limited to exporting liquified natural gas (LNG)<sup>16</sup>.

According to the member states opposing the project, applying the EU's Third Energy Package to Nord Stream 2 – including unbundling, third-party access, and other rules – was supposed to limit the project's privileged status in comparison to other Russian export pipelines to Europe (including those running through Ukraine or Belarus and Poland). Initially, it was assumed that the adoption of the amendments and the challenges related to the implementation of the provisions of EU law (for example, the need for an independent from Russian exporter pipeline operator, or to cap the capacity available to Gazprom), would lead to the Nord Stream 2 project being abandoned. However, as the project's construction has progressed, it became clear that at this point the new legal regulations coming into force would mainly result in Nord Stream 2's limited profitability and a possible delay in its completion<sup>17</sup>.

Another delay in Nord Stream completion arises from the permits needed to finish construction. Russia, Germany, Finland, and despite the reservations, Sweden has given Nord Stream 2 the necessary permits. The project had to obtain approval from Denmark which has not responded to any of the two routes Nord Stream 2 applied for in 2017 and 2018 and asked for a third route to be investigated in March 2019. At the beginning of July 2019, Nord Stream 2 AG, has withdrawn its application to lay pipe in Danish territorial waters. Gazprom (who owns Nord Stream 2 AG) will now press for two other routes that are within Denmark's economic exclusion zone but outside its territorial waters. Because they skirt Danish territorial waters, these routes do not need the assent of Denmark's foreign affairs minister and Denmark would be obliged to give

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<sup>15</sup> *DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2009/73/EC concerning common rules for the internal market in natural gas*, <https://data.consilium.europa.eu/doc/document/PE-58-2019-INIT/en/pdf>

<sup>16</sup> “EU Gas Directive Approval Could Delay Russian-Led Nord Stream 2 Pipeline”, <https://www.themoscowtimes.com/2019/04/17/eu-gas-directive-approval-could-delay-russian-led-nord-stream-2-pipeline-a65265>

<sup>17</sup> “The gas directive revision: EU law poses problems for Nord Stream 2”, <https://www.osw.waw.pl/en/publikacje/analyses/2019-02-21/gas-directive-revision-eu-law-poses-problems-nord-stream-2>

approval under the United Nations Convention on the Law of the Sea, provided the pipeline meets environmental and ship safety standards.<sup>18</sup>

### Western supporters versus Eastern opponent

In March 2016, eight EU leaders, the prime ministers of the Czech Republic, Estonia, Hungary, Latvia, Poland, Slovakia and Romania and the president of Lithuania have signed a letter objecting the Nord Stream 2 project. The letter warns, that Nord Stream 2 would generate “potentially destabilizing geopolitical consequences.” A European Parliament resolution adopted in the same year, describes Nord Stream 2 as harmful to energy security, diversification and European solidarity.<sup>19</sup>

Germany, the biggest natural gas consumer in Europe, sees Nord Stream 2 as a step toward realizing the country’s *Energiewende* decarbonization policy and presents an opportunity to become an energy hub for Western Europe<sup>20</sup>.

Russia and Germany have mutual interest in further developing their ties. The bilateral cooperation in energy field represents a strategic pillar not only for Russia-Germany partnership, but in a wider context between Russia and the EU. Bilateral ties have successfully been seen since the 70’s when the German business was actually a pioneer in promoting large scale economic cooperation between the West and the USSR<sup>21</sup>.

The new (at that time) pipeline that brought the first Soviet gas to Europe came with a strong geopolitical tone. West German Chancellor Willy Brandt signed the first Soviet gas deal in 1970 as a key element in his Ostpolitik, aimed at reducing Cold War tensions, normalizing relations with the Soviet Union and Eastern Europe, and creating some common interest between East and West<sup>22</sup>.

In purely financial terms, Nord Stream is seen as a project from which Germany will make money at the expense of Ukraine, which currently receives income for gas transit, and at the

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<sup>18</sup> “Nord Stream 2 abandons quest to lay pipeline in Danish territorial waters”, <http://www.globalconstructionreview.com/news/nord-stream-2-abandons-quest-lay-pipeline-danish-t/>

<sup>19</sup> “The geopolitical impact of Nord Stream 2”, BALÁZS R. SZIKLAILÁSZL, Ó Á. KÓCZY, DÁVID CSERCSIK, <https://www.mtaki.hu/wp-content/uploads/2018/09/MTDP1821.pdf>

<sup>20</sup> “Nord Stream 2: Russia’s Geopolitical Trap”, <https://harvardpolitics.com/world/nord-stream-2/>

<sup>21</sup> “Energy Diplomacy”, Stanislav Zhiznin, Center of Energy Diplomacy and Geopolitics, Moscow, 2007

<sup>22</sup> “The Quest”, Yergin, Daniel, 2012, p. 336

expense of business opportunities of European Union member states which had hoped to benefit from South Stream<sup>23</sup>.

However, the project does not make economic or strategic sense from the perspective of the European Union<sup>24</sup>. In March 2016, eight EU leaders, the prime ministers of the Czech Republic, Estonia, Hungary, Latvia, Poland, Slovakia and Romania and the president of Lithuania have signed a letter objecting the Nord Stream 2 project. The letter warns, that Nord Stream 2 would generate “potentially destabilizing geopolitical consequences.” A European Parliament resolution adopted in the same year, describes Nord Stream 2 as harmful to energy security, diversification and European solidarity.<sup>25</sup>

In particular, the bypassing of transit countries in Eastern Europe has both economic and political implications. It may alter the flow of currently existing pipelines in Europe, such as the Yamal-Europe pipeline, whose route through Russia, Belarus, and Poland connects Western Siberia with Germany. It may also change the economics of the proposed Baltic Pipe, which would transfer natural gas from Norway to Denmark and Poland. As a result, the differences between prices for German and for other Central European consumers may deepen, a possibility arising from Gazprom’s ability to discriminate between countries in the region.

Germany will have to tackle all the political risks in case the project is to be delayed or cancelled.

Austria, maybe a less vocal but clearly an important actor in the Nord Stream 2 project supports the pipeline construction. Austrian Chancellor Sebastian Kurz repeatedly announced that Austria will continue promoting the Russian-led Nord Stream 2 gas pipeline project despite the negative stance of the United States on the issue.

OMV<sup>26</sup>’s senior vice president for gas Reinhard Mitscheck said Nord Stream 2 will be necessary not only for Northwest Europe but also Central-east and Southeast Europe supply:

*“Transit agreements will expire in 2019 and 2020 so it is important to have a reliable supplier. Of course, there is LNG, however, if global prices change LNG prices could*

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<sup>23</sup> “Nord Stream 2. ECFR Opinions”, [https://www.ecfr.eu/article/commentary\\_nord\\_stream\\_2\\_ecfr\\_opinions](https://www.ecfr.eu/article/commentary_nord_stream_2_ecfr_opinions)

<sup>24</sup> <https://www.ft.com/content/53a811c4-a481-11e8-926a-7342fe5e173f>

<sup>25</sup> “The geopolitical impact of Nord Stream 2”, BALÁZS R. SZIKLAILÁSZL, Ó Á. KÓCZY, DÁVID CSERCSIK  
<https://www.mtaki.hu/wp-content/uploads/2018/09/MTDPI821.pdf>

<sup>26</sup> OMV is an Austrian integrated oil and gas company which is headquartered in Vienna, Austria. The company is listed on the Vienna Stock Exchange. It is active in the upstream and downstream businesses.

*change from one day to another, therefore we need the existing pipes, new pipes like Nord Stream 2, Turk Stream and the southeast corridor, and LNG.”<sup>27</sup>*

Across the Atlantic, the **United States** are extremely vocal in opposing the Nord Stream project insisting that it will make U.S. allies and partners vulnerable to having their gas shut off at Moscow’s whim. The Nord Stream 2 pipeline will heighten Europe’s susceptibility to Russia’s energy blackmail tactics and Europe must retain control of its energy security.

*“The Nord Stream 2 pipeline will drastically increase Russia’s energy leverage over the EU. Such a scenario is dangerous for the bloc and the West as a whole. [...] Make no mistake: Nord Stream 2 will bring more than just Russian gas. Russian leverage and influence will also flow under the Baltic Sea and into Europe, and the pipeline will enable Moscow to further undermine Ukrainian sovereignty and stability”.*<sup>28</sup>

In this respect, the US representatives insisted that the EU revised the Third Energy Package’s Gas Directive and threatened to impose unilateral sanctions on all the companies involved in the Nord Stream 2. A group of U.S. Republican senators has introduced a bill called “The Escape bill” to sanction entities involved with a Kremlin pipeline project as Washington seeks to force its European allies to reduce their dependence on Russian energy. The aim of the bill is to delay the completion of the Nord Stream 2.

The bill authorizes U.S. sanctions on individuals offering investment, goods, or services to Russia to facilitate the development of energy export projects.<sup>29</sup>

## **Eastern Europe and Eastern Neighborhood**

### **Black Sea**

The Black Sea region plays an essential role both as significant import-export gateway for the Russian Federation and as an energy transit region. Unfortunately, the illegal actions of Russian Federation starting with the annexation of Crimea and following with the Kerch incident and de facto blockade of the Ukrainian ports of Mariupol and Berdyansk are hampering the security in

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<sup>27</sup> “Stakeholders confident in Nord Stream 2’s year-end deadline”, <https://www.icis.com/explore/resources/news/2019/06/12/10377406/stakeholders-confident-in-nord-stream-2-s-year-end-deadline>

<sup>28</sup> “Europe must retain control of its energy security”, <https://useu.usmission.gov/europe-must-retain-control-of-its-energy-security/>

<sup>29</sup> “U.S. Senators Submit Bill With Sanctions Targeting Russian Gas Pipeline”, <https://www.rferl.org/a/russia-nord-stream-us-senators-bill-ukraine/29998205.html>

the region and have direct impact on the commerce in the Black Sea, including the energy transit towards Europe.

Crimea has been the focus of a dramatic increase in Russian military build-up and capabilities since 2010. Rbs 68bn (\$1bn) have been allocated to modernizing it by 2020, and, since the illegal annexation of Crimea, there has been an exponential increase in the number of arms and military equipment (AME) in Crimea. Since 2014, Russia has added an airborne battalion to the naval infantry brigade that has guarded Crimea since the 1990s, doubling the total force there to an estimated 30,000 troops. Moscow plans to add another 13,000 within four years. The Russian military now has 81 airplanes and helicopters in Crimea. “The combat radius covers all Ukraine and beyond the Black Sea. It significantly increases their strike options, potentially extending to the Middle East”<sup>30</sup>.

According to estimated figures by the Center for Army, Conversion and Disarmament Studies (CACDS), the Russian Federation had 24 warships, 92 armored fighting vehicles (AFVs), 24 heavy gun systems, 59 combat aircraft and helicopters and 2 submarines deployed in the peninsula prior to the annexation; those numbers have now increased 6.8 times for main battle tanks (MBTs) and AFVs, 7.2 times for heavy gun systems, 2.2 times for combat aircraft and helicopters and 2 times for submarines. Russia has deployed to Crimea’s littoral areas its Bastion anti-ship missile systems as well as ground-based targets. Several BAL (SSC-6 Sennight) coastal defense missile systems were also redeployed from Russian Caspian Flotilla. The estimated total missile complement has been increased 1.5 times, from 142 to 264 missiles. Moreover, Kremlin is looking to build up even further its military capacities in Crimea. In the period through 2020-25, the number of Russian military personnel deployed in the peninsula is set to be increased to 43,000, MBTs to 100, AVFs to 1,150, artillery systems of various calibers to 400, combat aircraft to 150, helicopters to 95, coastal missile systems to 50, warships to 33 and submarines to 7.<sup>31</sup>

The military build-up in the Black Sea challenges both in terms of security and commerce the states that are bordering the Black Sea while it empowers Moscow with the capability to assert control over the region, including to deny freedom of movement at sea and in the air<sup>32</sup>. Moreover, the tensions between NATO and Russia as well as the unclear position of Turkey are also challenging the security and stability of the countries bordering the Black Sea. All these factors

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<sup>30</sup> “US Intelligence Officials and Satellite Photos Detail Russian Military Buildup on Crimea”, <https://www.defenseone.com/threats/2019/06/exclusive-satellite-photos-detail-russian-military-buildup-crimea/157642/>

<sup>31</sup> “Militarization of Occupied Crimea – A threat to global security”, <https://defence-ua.com/index.php/en/publications/defense-express-publications/914-militarization-of-occupied-crimea-a-threat-to-global-security>

<sup>32</sup> “The Impact of Russia’s Strategic Interest in the Black Sea Region on Imbalancing the Russian Economy”, Leonela Leca, ESGA, 2019, <http://www.themarketforideas.com/leonela-leca-j165/>

led to the substantial increase of the geopolitical risk that is directly influencing the perception of the potential investors in the energy field<sup>33</sup>.

The EU Member States bordering the Black Sea Region along with Ukraine and Republic of Moldova have geographic limitations about tapping into the international trade with liquefied natural gas (LNG), mainly because the tanker traffic through the Black Sea straits is already being virtually congested. The added security and geopolitical risks are postponing even further the possibility of the real LNG trade in the Black Sea.

Eastern Europe states have an insufficient level of interconnectivity, diversification versus integration challenges, high vulnerability to gas supply crisis and disruptions, a physically worn-out and mortally obsolete energy transport infrastructure (oil and gas pipelines), poor cross-border connectivity of gas and power networks. Even if a real diversification would be achieved, these countries would still need massive investments in infrastructure and interconnections.

In Ukraine, Moldova and Georgia, Gazprom sought for more than two decades to gain direct control over the gas pipelines, with various degrees of success. The pipelines were built in the times of USSR and especially the Ukrainian infrastructure is critical route of export to Europe. In all three countries, threats to discontinue gas supply, massive gas prices along with discounts for good behavior were used. Georgia and Ukraine manage to enhance to some extent their energy security by diversifying their gas supplies. Ukraine's negotiation position substantially improved after the arbitration in Stockholm<sup>34</sup>. But all three countries are facing poor governance which allowed Kremlin controlled entities to gain control over major energy assets<sup>35</sup>.

With the unsinkable Crimean Peninsula serving as a kind of aircraft carrier, Russia is quite capable in denying it naval or commercial access. This means that the Kremlin can prevent Georgia, Ukraine, and even Romania and Bulgaria from using their sea lines of communication and exclusive economic zones<sup>36</sup>.

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<sup>33</sup> "Riscuri, fiscalitate, decizii de investitii in sectorul offshore de titei si gaze naturale. Marea Neagra si Romania". Vasile Iuga, Radu Dudau, 2019

<sup>34</sup> "Historical Victory for Ukraine: Stockholm Arbitration", <http://www.naftogaz.com/www/3/nakweben.nsf/0/E62D5C9B21795281C225834B00537D4E?OpenDocument&Expand=2&>

<sup>35</sup> "Kremlin's Energy Policy as a Channel of Influence. A comparative assessment. Case studies from Ukraine, Moldova, Georgia, Romania and Hungary", Expert Forum, Romania, 2019, <https://expertforum.ro/en/kremlins-energy-policy-as-a-channel-of-influence-a-comparative-assessment/>

<sup>36</sup> "Occupational hazards: The Russian military in Crimea", [https://www.ecfr.eu/article/commentary\\_occupational\\_hazards\\_the\\_russian\\_military\\_in\\_crimea](https://www.ecfr.eu/article/commentary_occupational_hazards_the_russian_military_in_crimea)

## Ukraine

Unfortunately, the repeated episodes of 2006 and 2009 (when Gazprom cut off supplies and renegotiated gas prices), the Russian aggression against Ukraine in 2014 and the illegal annexation of Crimea as well as the latest Kerch Strait incident (2018) confirms that Kremlin will use also the energy tools in obtaining its foreign policy goals, one of the main being regaining its influence over its former satellites. By bypassing Ukraine and extending its infrastructure through Turk Stream, Russia will be able to consolidate as a regional monopolist and will strengthen its ability to pursue an aggressive policy. Moreover, by expanding through Turk Stream and Nord Stream 2, Russia will be able to extend its military presence not only in the Black Sea but also in the Baltic Sea.

The Kerch Strait incident is relevant also with regards to the European discussions about building up the EU's strategic autonomy so it can act in the military, economy, and sanctions domains. Russia has been enforcing sanctions on Ukraine since 2014. By slowly strangling its neighbour's goods exports through the Kerch Strait, Russia is not only hitting Russian-Ukrainian trade it is also hitting economic relations between eastern Ukraine and the EU (and between Eastern Ukraine and the Middle East).<sup>37</sup>

*"The Kerch incident should be a reminder to all of our European allies on why Nord Stream 2 is such a bad idea. The Kerch incident is a reminder that the less infrastructure you have, the less gas infrastructure you have bypassing Ukraine because of Nord Stream 2, the weaker the deterrent – deterrence is to Russian acts of military aggression".<sup>38</sup>*

In the public discourse concerning the illegal annexation of Crimea the military and strategic dimension were highlighted. But there is also a major energy dimension like the takeover of the reserves from the exclusive economic area of Crimea. Moscow is, thus, able to minimize the relevance of these resources for Ukraine. All the energy projects initiated by Ukraine before the annexations of Crimea were blocked, all the investors registering significant losses due to the sanctions<sup>39</sup>.

Launching the new pipeline that will provide an extra capacity of 55 billion cubic meters (bcm) will allow Russia to completely bypass Ukraine, depriving it of a badly needed \$3 billion a

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<sup>37</sup> "Nord Stream 2. ECFR Opinions". [https://www.ecfr.eu/article/commentary\\_nord\\_stream\\_2\\_ecfr\\_opinions](https://www.ecfr.eu/article/commentary_nord_stream_2_ecfr_opinions)

<sup>38</sup> "US warns EU to abandon Nord Stream 2 gas pipeline", <http://business-review.eu/energy/us-warns-eu-to-abandon-nord-stream-2-gas-pipeline-192670>

<sup>39</sup> "Riscuri, fiscalitate, decizii de investitii in sectorul offshore de titei si gaze naturale. Marea Neagra si Romania". Vasile Iuga, Radu Dudau, 2019, report distributed within the conference "Securitatea energetică în zona Mării Negre și proiectele de dezvoltare economică a României", organized by New Strategy Center, April 25<sup>th</sup>, 2019.

year in gas transit revenues<sup>40</sup> is another concern of both economic (in terms of revenues) but mainly geopolitical terms for Ukraine.

Delaying the finalization of the project will urge Russia to continue its gas flow through Ukraine and prologue the existing agreement that is valid until the end of the year. Gazprom is providing Europe about 30 percent of its natural gas, with 40 to 50 percent of that supply transited through Ukraine. In case Nord Stream 2 will be launched, not only as a consumer country, but mainly the transit role of Ukraine will be insignificant. The country will lose its revenues fees and will not have the same position when negotiating the natural gas price for its internal needs.

### **Policy options. What are the variables that can influence the project?**

Nord Stream 2 is a project that has implications on the national level (of Ukraine), the European one and the transatlantic level. If the last one is on the agenda of the US-EU dialogue, the sanctions regime against Russia and the future LNG deliveries to Europe, the first two (national and European levels) are still facing a strong debate regarding the future impact of the Nord Stream 2 project. Any policy options would have to take into consideration a wide range of factors.

Firstly, the situation in the **Ukraine** is still unfolding. After the presidential election, the parliamentary elections are due to be held on July 21<sup>st</sup>, 2019. Any negotiations concerning a new transit agreement with Gazprom will depend on the electoral campaign and the results of the elections. The same applies to possible gas deliveries from the European Union to the Ukraine. The condition for those is the maintenance of reforms and the implementation of the Third Energy Package. Unbundling is necessary for the signing of a new agreement between Naftogaz and Gazprom thus maintaining Ukraine's role as a gas transit country.

In line with the EU's Third Energy Package, Ukraine complied with proposed reforms to provide for the unbundling of Naftogaz. Breaking up the Ukrainian national gas and oil monopoly Naftogaz, separating transmission from production and supply, was the condition Ukraine had agreed to for receiving Western financing. The unbundling is crucial to attract investments from reliable EU companies and banks to help modernize the Ukrainian transit gas system.

The Ukrainian gas sector has been notorious for corruption and has been plundered by the country's political elites in the past. An estimated \$2-3 billion is estimated to have been siphoned

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<sup>40</sup> "EU Gas Directive Approval Could Delay Russian-Led Nord Stream 2 Pipeline", <https://www.themoscowtimes.com/2019/04/17/eu-gas-directive-approval-could-delay-russian-led-nord-stream-2-pipeline-a65265>

each year from the gas sector<sup>41</sup>. In May 2016, a management reform of Naftogaz was launched, but in 2017 however, reform progress was stalled. The Ukraine needs to divide Naftogaz and this is a precondition for future deliveries from Russia, as the EU has to see the Ukraine route as any other European route. Also, the viability of the Gas Transportation System of Ukraine (GTS), a system which is obsolete and needs modernization is another challenge that Ukraine is facing.

Naftogaz and Gazprom are having numerous legal disputes (although, in January 2019, Naftogaz quit one of its dossiers in order to negotiate a renewal of the transit contract with Gazprom). Important forces such as oligarch Igor Kolomoisky, associated with President Volodymyr Zeleński, have already argued in the past that Ukraine should give up foreign aid and painful reforms. At the same time, some of the opposition leaders in Ukraine have already been invited to Moscow to discuss gas supplies to the Ukraine. During the electoral campaign, these kinds of efforts, including pressure to persuade Ukraine to abandon reforms, will be intensified. The evolution in Crimea, including security issues and the bilateral sanctions regime, is also influencing the negotiation process.

At the **European** level, trilateral gas talks between Russia, Ukraine and the European Union were held in Brussels in January. Another round is expected to be held in September 2019. As Ukraine is preparing for the electoral campaign, the new European Commission is to be formed only in autumn. This also allows Gazprom to use its leverage in Ukraine. Although the results of the meeting in January were not public, Russia repeatedly declared its willingness to conclude a new transit agreement, although it highlighted the need for the legal dispute between Naftogaz and Gazprom to be resolved before that could happen.

Under these circumstances, most probably a new contract will be negotiated in late autumn or even at the beginning of 2020 (the existing agreement expires at the end of 2019). It is still unclear if the new agreement will be a short, medium or long-term one, although a short-term agreement is disadvantageous for Kiev. A compromise package (proposed to the parties a minimum 10-year contract for the transit of 60 bcm of gas per year<sup>42</sup>) proposed by Brussels in January is not confirmed by Gazprom.

Meanwhile, **Gazprom** is looking for strategies to avoid the application of the Gas Directive. One approach was to suggest that the pipeline could be run by two separate companies, one in German territorial waters and one outside such waters and thereby argue that EU law only applied to the company that was in the territorial waters. A further was to avoid the full application of the gas directive by arguing that the pipeline had been completed by May 23 (pipelines completed before the May 23 are subject to a less onerous legal regime). Therefore, they argued

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<sup>41</sup> "EU and Ukraine in tug of war over Naftogaz unbundling", <https://www.euractiv.com/section/energy/news/eu-and-ukraine-in-tug-of-war-over-naftogaz-unbundling/>

<sup>42</sup> "OSW: A 'last-minute' transit contract? Russia-Ukraine-EU gas talks", <https://biznesalert.com/osw-a-last-minute-transit-contract-russia-ukraine-eu-gas-talks/>

that as a result "completion" has taken place in German waters and as result the pipeline has been "completed" in EU territory<sup>43</sup>. At the same time, Gazprom's representatives understand that any delay in completion of the Nord Stream 2 will force the Russian monopolist to continue its gas supply through Ukraine.

*"Turning off the tap is not an issue," he said. "In principle, there is demand for gas in Europe, and the demand is high, and all corridors can take the gas."*<sup>44</sup>

## Conclusions and recommendations

Nord Stream 2, the second line of the Nord Stream I is a project of great importance for Vladimir Putin. It is considered one of the main Putin's legacy projects and might well succeed if not countered in isolating Ukraine through Nord Stream II and TurkStream and gaining enduring influence across the Balkans. Unfortunately, despite some progress due to the adoption of the revised Gas Directive in 2019, there is no clear Western Strategy in tackling the risks after the project will be finalized.

The position towards the Nord Stream II project is, still merely governed by self-interest. The risk of political erosion appears as the rifts between Member States over policy on Russia and energy widen. At the same time, the economic gap within EU might deepen because the pipeline project could lead Member States to concentrate more strongly on national energy policy and above all energy security policy, thus exacerbating market fragmentation.<sup>45</sup>

Despite of the continuous multilateral negotiations, Nord Stream 2, with the support of its West European partners is an advanced project of gas delivery from Russia to the EU. Although it does not yet answer the 3 priorities of the EU Energy Policy (security of supply, competitiveness and sustainability), its advocates highlight the modern and liberalized market of Germany and its capability to become a European gas hub that will consolidate the European energy security. Even if the project would be a purely economic one (as its supporters are claiming), all the scenarios are showing that the winners of the project are merely Germany and Russia and the losers are states

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<sup>43</sup> "Nord Stream 2: Gazprom's desperate moves", <https://euobserver.com/opinion/145087>

<sup>44</sup> Oleg Andreev, deputy head of the production department at Gazprom, <https://www.ft.com/content/1f6ac3d6-861f-11e9-97ea-05ac2431f453>

<sup>45</sup> "The geopolitical impact of Nord Stream 2", BALÁZS R. SZIKLAILÁSZL, Ó Á. KÓCZY, DÁVID CSERCSIK  
<https://www.mtaki.hu/wp-content/uploads/2018/09/MTDP1821.pdf>

from Central and East European states along with the Eastern Neighborhood states, hence the political stance to oppose Nord Stream 2 is rational.

The infrastructure in Eastern Europe and Eastern Neighborhood is transit-oriented (East-West running pipelines), the countries are also poorly connected to Europe's gas infrastructure. Connection to the European gas network and improving diversification has to remain a priority.

Any future scenario must unfold under the regulatory effects of the Third Energy Package and the renewed Gas Directive that must remain the framework that will ensure a competitive gas market.

Even that the risk that the Nord Stream II project will be delayed or will have a limited profitability exists, the negotiations must be held in trilateral format EU-Russia-Ukraine. The interests of the member states that are mostly affected by the project must be taken into consideration. Guarantees from Germany and Austria that future deliveries to Central and Eastern Europe will take place must be negotiated.

At the same time, the role of Germany, Austria and other supporters in the negotiation process has the capacity to take into consideration the interests of the Eastern Neighborhood countries thus to consolidate the security in the Black Sea. The evolution in the Black Sea is of paramount importance in both security and energy terms. The recent crisis in the Kerch Strait, the militarization of Crimea, along with the construction of the new gas infrastructure project, Turk Stream, not only is hampering Ukraine's security and energy security but is also reshaping the security environment and the energy transportation routes toward Europe.

USA is becoming an active player on the EU's gas market. The LNG deliveries from the USA are expected in Poland in 2023, after the contract with Gazprom expires<sup>46</sup>. At the same time, the bipartisan position of the USA against Nord Stream 2 is very vehement, Washington considering the Nord Stream 2 the Trojan Horse of EU and considering unilateral sanctions against all the companies involved in the project. The White House is arguing that the project would boost Russia's influence in Europe at a time when the West is at odds with Moscow over the latter's encroachments against Ukraine in Crimea and Donbass. This year, Donald Trump has announced the idea of establishing a US military base in Poland suggesting that troops will be moved from other European country to Poland, pointing at Germany and thus Nord Stream 2 became a project directly linked to security. Nord Stream 2 is often used by all interested countries (supporters or opponents, producers, transit or consumers) as a negotiation tool on different dossiers. The participation of the USA at the negotiation between EU and Russia as well as Ukraine's presence in the process is therefore important.

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<sup>46</sup> Polish PGNiG signed a contract with Venture Global (USA) in 2019. According to the agreement, Poland will buy 3.5m tonnes per year of LNG (or 4.73 bcm of natural gas after regasification).

Better maritime monitoring would be necessary in order to reduce the arising security and commercial risks at the Black Sea. A better cooperation between Romania, Ukraine and Georgia would help in tackling Russian control over commercial (including energy) routes towards Europe.

Eastern Neighborhood countries have the role to ensure that all the required criteria are met. The efforts to continue reforms implementation as well as the provisions of the Third Energy Package must continue. In the case of Ukraine, a solution for unbundling Naftogaz and modernization of the Gas Transportation System must be found in order to ensure the future deliveries of gas towards Europe.

The role of Romania in continuing the interconnection projects with all neighbors but especially with Eastern states is extremely important for the future energy infrastructure map and reverse flow capabilities. At the same time, Romania must ensure its internal pipes gas pressure in order to have the capabilities to export gas. Romania's role in monitoring and assisting the Eastern Neighborhood, specifically Republic of Moldova, Ukraine in the reform process must remain consistent.

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