



PISM

POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

STRATEGIC FILE

NO. 1 (93), APRIL 2021 © PISM

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Nord Stream 2 —What Germany Should Discuss with Its Allies

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The controversies surrounding Nord Stream 2 (NS2) since the beginning of the investment have not been addressed and some of them have grown even stronger. Russia has not given up its aggressive foreign policy, and despite that, the German authorities are advocating NS2 and support closer cooperation with Russia, for example, on climate change. This raises concerns about the consequences of Russo-German NS2 cooperation for long-term EU decarbonisation policy, as well as for EU and NATO cohesion. These issues and common policy on Russia should be the subject of open debate between the allies.

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The disputes around NS2 are fuelled by the political impact of the project and the very fact that there is no need to build additional gas pipelines from Russia to the EU.¹ Since 2015, when Gazprom and five European companies decided to construct NS2, these controversies have not been addressed and many concerns about the pipeline expressed by critics have proven to be true. While the arguments originally used to support NS2's construction have been refuted and Russia continues to employ aggressive policy, German government support for the pipeline has not weakened. Such an approach has negative consequences for the EU and NATO.

Europe Does not Need Nord Stream 2

The EU will not need more (Russian) gas

The rationale behind NS2 is doubtful given the projected decrease in EU gas consumption. The projections used by the Nord Stream 2 AG (NS2AG) consortium were very optimistic: the demand for natural gas in Europe in 2050 is to remain at roughly the same level as in 2015, but due to decreasing EU gas production, import demand should increase by around 22%.²

This projection has been refuted by independent forecasts. In 2018, projections by DIW Berlin and others pointed out that NS2AG overestimated the future gas demand, which in fact will decrease.³ A decrease in gas demand in Germany is also projected in an independent analysis of German entities prepared in subsequent years.⁴

The scenarios submitted by NS2AG are even less likely to materialise as the EU has become more ambitious on climate policy and plans to develop green technologies. At the end of 2020, EU countries decided to increase the greenhouse gas reduction target for 2030 from 40% to 55%. The European Commission's projections published the same year project that in order to meet this target the EU's gas imports will decrease by 13-19% in 2030 and 58-67% in 2050 (compared to 2015).⁵

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Despite that, the German government still sticks to the forecasts used by NS2AG to justify the government's support of NS2. During debate in the Bundestag in 2020, a government official claimed that the EU's annual gas import demand will increase by at least 100 bcm (to compare, gas consumption in Germany in 2019 was 88.7 bcm). The government official referred to forecasts used by NS2AG, which suggests that the

government does not have its own scenarios for gas consumption or that it favours NS2 by citing the project's own reports supporting its construction.⁶

Europe does not need more gas pipelines from Russia

Independent projections of European gas imports support the opposite view. NS2, when launched, will not bring additional gas to the EU but simply allow Russia to bypass Ukraine as a gas transit country, which is one of Russia's long-term goals. The existing pipelines have enough capacity to cover the EU's gas demand, and NS2 (unlike Baltic Pipe, which diversifies gas supplies and transport

¹ A. Gawlikowska-Fyk, M. Terlikowski, B. Wiśniewski, S. Zaręba, "Nord Stream 2: Inconvenient Questions," PISM Policy Paper, No. 5 (165), July 2018.

² "The EU Needs Additional Imports," Nord Stream 2 AG, www.nord-stream2.com.

³ A. Neumann, L. Göke, F. Holz, C. Kemfert, C. von Hirschhausen, "Natural gas supply: no need for another Baltic Sea pipeline," *DIW Weekly Report*, 27/2018, www.diw.de.

⁴ F. Heilmann, "The Future of Gas in the (German) Energy Transition," E3G, March 2021, www.e3g.org.

⁵ *Commission Staff Working Document. Impact Assessment*, European Commission, 17 September 2020, <https://ec.europa.eu>, p. 72.

⁶ G. Ismar, "Bundesregierung arbeitet mit Gazprom-Zahlen," *Tagesspiegel Background*, 28 September 2020, <https://background.tagesspiegel.de>.

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routes to an importer) does not have Project of Common Interest (PCI) status. What is more, EC representatives have criticised NS2 on many occasions.⁷

EU pipeline imports of Russian gas in 2019—before the fall in demand due to COVID-19—was around 170 bcm. That same year, Ukrainian gas pipelines, which have a total capacity of more than 140 bcm to Europe, transported 86.6 bcm. It means that the existing unused capacity is sufficient to ensure additional annual supplies of about as much as NS2 (55 bcm). Even a report by Sberbank analysts points out that NS2 will not lead to an increase in Russia's gas export volume.⁸

Furthermore, new options for imports of non-Russian gas have appeared. For instance, the construction of the TANAP and TAP pipelines allows Italy to import Azeri gas. Poland in 2022 will finalise Baltic Pipe, which will allow it to import 10 bcm of Norwegian gas. These imports essentially replace Russian gas. Polish PGNiG decided to not extend the long-term Yamal gas contract, which expires at the end of 2022, and in 2019 the Polish company imported about 9 bcm of gas under this contract.⁹

There are also new opportunities to import liquefied natural gas (LNG) to Europe. The LNG market has become more competitive and flexible, and the average prices have decreased,¹⁰ making it more attractive for importers. European LNG terminals allow it to import more than 200 bcm of natural gas per year, while the actual imports of LNG in 2019 were around 107 bcm (more than 75% year-on-year increase), replacing the lower production and pipeline imports.¹¹

All this creates additional import options for countries that take Russian gas but also have LNG terminals (e.g., Italy, the Netherlands, France).¹²

Therefore, Germany's motivations behind NS2 seems not to ensure new gas supplies or to guarantee the security of supply. Despite the country's strong support of the Russo-Ukrainian gas transit negotiations¹³ and assurances that Ukraine should remain a gas transit country,¹⁴ the launch of NS2 will have the opposite effect. The aim behind the pipeline is to bypass Ukraine and make Germany the central "distribution point" of Russian gas in the EU.¹⁵

Nord Stream 2 undermines the EU's ambitious climate policy

The estimated €9.5 billion investment in NS2 might also complicate more ambitious EU climate policy. In the long term, natural gas usage in the European Union is to be replaced by hydrogen, a non-polluting energy source.¹⁶ This gas can be produced using renewable energy sources (RES), natural gas, or nuclear energy. The EU's hydrogen strategy prioritises the production of hydrogen from RES, which is consistent with the Union's ambitious plans to develop green technologies. Russia and Gazprom lobbying aim to depict NS2 (e.g., by Germany) as environmentally friendly, despite not helping the EU to achieve its climate goals. Germany might support, among others, plans to import hydrogen via NS2 or to use the surplus of Russian gas to produce it in the EU. In this context, the

⁷ "EU leaders to debate Nord Stream 2 gas pipeline," *Argus Media*, 1 December 2015, <https://www.argusmedia.com>.

⁸ "Russian Oil and Gas. Tickling Giants," Sberbank CIB, May 2018, pp. 11-12.

⁹ "PGNiG: mniej gazu z Rosji, rośnie import LNG," PGNiG, 27 January 2020, <https://pgnig.pl>.

¹⁰ "2020 World LNG Report," International Gas Union, April, 2020, pp. 21-26.

¹¹ "Shell LNG Outlook 2020," Shell, p. 20, www.shell.com.

¹² "2020 World LNG Report," International Gas Union, April 2020, p. 78.

¹³ B. Bielińczuk, "Negotiations on Maintaining Gas Transit via Ukraine," PISM Bulletin, No. 108 (1179), 14 August 2018, <https://pism.pl>.

¹⁴ "Merkel: No Nord Stream 2 without guarantee for Ukraine's gas transit role," EurActiv, 10 April 2018, www.euractiv.com.

¹⁵ A. Gawlikowska-Fyk, M. Terlikowski, B. Wiśniewski, S. Zaręba, "Nord Stream 2: Inconvenient...", *op. cit.*

¹⁶ B. Bielińczuk, "Clean Gas: Prospects of Hydrogen Energy Development in the EU," PISM Bulletin, No. 168 (1598), 12 August 2020, <https://pism.pl>.

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German authorities have already started to suggest that the pipeline might help to develop the EU's hydrogen sector.¹⁷

Such an approach might petrify the EU's dependence on Russian gas or slow down the development of RES-based hydrogen. Russia wants to produce hydrogen from natural gas and nuclear energy,¹⁸ both sectors that the Russian authorities strongly support. Russia might also artificially keep its natural gas and hydrogen prices low or hide the carbon footprint associated with their production. As a result, the Member States could be importing Russian energy resources produced at a greater GHG emissions cost than in the EU, which would slow the achievement of climate goals, especially since the future of the Union's hydrogen sector depends on the ambitious development of RES.¹⁹

While European companies are spending more money on RES, in recent years Gazprom has strongly supported the construction of new gas pipelines to the EU, China, and Turkey at a total cost (including the necessary infrastructure investments inside Russia) of more than \$90 billion.²⁰ Gazprom prioritises maintaining its share of natural gas markets. The company tries to promote its own decarbonisation plan for the EU, according to which the energy industry would turn to mainly natural gas, replaced by hydrogen in the longer term (a so-called three stage approach).²¹ However, this plan would increase the dependence of Europe on Russian gas, imperilling the EU's ambitious climate policy.

Nord Stream 2 Undermines EU and NATO Cohesion

Nord Stream 2 divides the EU and NATO

Germany's actions in support of NS2 harm political cohesion in the EU and NATO. In recent years there have been numerous appeals to stop the pipeline from some EU Member States, the European Parliament, and even some German politicians.²² The European Commission is also critical of it: EC President Ursula von der Leyen even stated that the construction of NS2 is not in Europe's interest. One of the initiatives of the countries critical of NS2 was to amend EU law so it would apply transparent rules to the pipeline once it is operational.²³ The aim behind it was to address at least some of the controversies surrounding NS2. Germany and Austria did not support the effort and even tried to stall work on such amendments and tried to block them (the changes were eventually adopted though). Such moves by these two countries were no accident: already in 2015, Sigmar Gabriel (then vice-chancellor and minister of economic affairs and energy) during his meeting with Vladimir Putin in Moscow suggested that Germany would seek to keep NS2 under German authority.²⁴

When the U.S. imposed sanctions on NS2, the German government supported the EU's efforts to counter them and spurred on the debate about the unacceptability of American sanctions on NS2²⁵

¹⁷ B. Wehrmann, "German economy minister defies Nord Stream 2 sanctions, says more Russian gas needed," Clean Energy Wire, 19 February 2020, www.cleanenergywire.org.

¹⁸ B. Bieliszczuk, "Paint It Green: Russia and the Energy Transformation," PISM Policy Paper, No. 5 (180), 8 June 2020, <https://pism.pl>.

¹⁹ F. Heilmann, "The Future of Gas..." *op. cit.*

²⁰ "Russian Oil and Gas ...", *op. cit.*, p. 12.

²¹ B. Bieliszczuk, "Paint It Green..." *op. cit.*

²² V. Dezem, B. Jennen, "Sanctioned Nord Stream 2 Faces Another Risk: Germany's Greens," Bloomberg, 19 March 2021, www.bloomberg.com; "Nord Stream 2 schadet Europa," Frankfurter Allgemeine Zeitung, 19 February 2018, www.faz.net.

²³ B. Bieliszczuk, S. Zaręba, "The Gas Directive Amendment and Nord Stream 2: Legal and Political Consequences," PISM Bulletin, No. 88 (1334) 2 July 2019, www.pism.pl.

²⁴ *Meeting with Vice-Chancellor and Minister of Economic Affairs and Energy of Germany Sigmar Gabriel*, President of Russia, 28 October 2015, <http://en.kremlin.ru>.

²⁵ B. Bieliszczuk, "The Dispute over Nord Stream 2 after the Navalny Poisoning," PISM Bulletin, No. 202 (1632), 2 October 2020, <https://pism.pl>.

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(before then, the German authorities had consistently avoided discussion about the negative impacts of NS2). The German authorities have also reached out to the U.S. administration, offering their support for LNG imports to Europe if the Americans give up the sanctions. Simultaneously, Germany became a more vocal supporter of Europe countering U.S. sanctions.

Germany's support for NS2 has negative political consequences

Even when Russia was aggressive, the German authorities focused on ensuring that the strategic cooperation between the countries—in this case, on NS2—would not be impacted. One of the most recent examples of this came with the assassination attempt on Alexei Navalny by Russian security services. After Navalny was poisoned, some German politicians criticized NS2, namely the Greens, the fiercest political opponents of the pipeline, whose support is growing. However, key German leaders immediately assured Russia that the pipeline was not at risk. Peter Altmaier, one of Merkel's closest associates, even questioned the effectiveness of sanctions.²⁶ Such rhetoric did not change even after Russian authorities started to suggest that Navalny's poisoning was a German plot with other NATO and EU states. These kinds of reactions from Germany signal to Russian leaders that their aggressive policies (as well as military involvement in Ukraine, repression of political opponents, etc.) will not threaten strategic Russo-German cooperation.

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This raises concerns about the willingness of countries like Germany to respond to Russia's aggressive actions in the future. Germany could use the economic interdependence to try to influence Russia, for example, by signalling the possibility of withdrawing political support for NS2. Instead these key German leaders avoid such declarations, with some even suggesting that NS2 is an important element of political cooperation with Russia.²⁷

At the same time, Russia's diplomacy signals that the country can take radical steps in response to EU actions. The Russian foreign minister, Sergey Lavrov, stated that if the Union imposed sanctions for the arrest and imprisonment of Navalny, Russia would be ready to "break the ties" with the European Union.²⁸ This should be interpreted as the readiness of Russia to confront individual EU Member States. Despite Russia taking such an approach, Germany continues to seek closer cooperation with Russia, for example, on climate policy,²⁹ which raises questions about the long-term impact of investments like NS2 on Germany's Russia policy. Selective engagement does not require the Russian leaders to change their aggressive policy and could lead to weakening sanctions policy.³⁰

Germany's Political Support for NS2 is not Weakening

Germany's option to stop the project

Despite the claims that NS2 is a business project in which the German government is not involved, the German authorities had and might still have some ways to stop the project or at least contribute to stopping it. One significant factor that influenced the calculations of the NS2 investors were

²⁶ *Ibidem.*

²⁷ "Germany's Steinmeier angers Kyiv with his comments on Nord Stream, WWII," *Deutsche Welle*, 9 February 2021, www.dw.com.

²⁸ "Russia 'ready' to break ties with EU if sanctions imposed—Lavrov," *Deutsche Welle*, 12 February 2021, www.dw.com.

²⁹ M. Peel, "Germany urges new outreach to Moscow on climate change," *Financial Times*, 7 March 2021, www.ft.com.

³⁰ A. Legucka, "The Risk of Selective Engagement in Relations between the EU and Russia," PISM Bulletin, No. 148 (1394), 23 October 2019, <https://pism.pl>.

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German assurances that the application of EU law to NS2 would be opposed. A mere declaration that Germany might withdraw political support for NS2 (which could have come, for example, after Russian hackers targeted the Bundestag or in the wake of the assassinations of Putin's enemies in Europe), could, together with the U.S. sanctions, prevent NS2 from being launched. Such a declaration would mean that Germany would not try to shield companies involved in the NS2 from U.S. sanctions.

If the German authorities were really willing to stop NS2 they could have lobbied to introduce the EU economic sanctions. There are also some opportunities based on Germany's Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*),³¹ which allows restrictions to achieve a specific goal if a given investment could lead to a "disturbance of the peaceful coexistence of nations". Such decisive steps, or at least signalling the willingness to take them, would be Germany's best response to Russia's aggressive policy. However, this is unlikely since the German authorities have for years assured that NS2 is politically and economically beneficial.

The German initiatives protect NS2, not Ukraine

The German government is focused protecting NS2 through completion and launch. The recent offers to the U.S. for it to give up the sanctions in exchange for German guarantees purportedly to counter the negative impact of NS2, should be regarded as serving Germany's own interest. One such offer is a mechanism that would reduce the amount of gas via NS2 if Russia limits transit via Ukraine. Neither the automatic nor non-automatic version of that mechanism (the latter one being preferred by Germany) will not guarantee maintaining Ukraine's transit role, especially because NS2 is meant to replace Ukraine as a transit route altogether. A formal regulation like the automatic mechanism not only does not have Germany's support but even if adopted, it could be challenged in court (e.g., by Gazprom) as incompatible with EU law.³² On the other hand, the non-automatic mechanism would mean that the reaction to any disruption of Russian gas flow via Ukraine depends on a political decision among Germany's leaders. Their actions so far demonstrate that they are not ready to take any decisive steps against Russia, much less during the winter, especially if the Russians claim that the disruptions occurred due to technical reasons. Further, the German authorities would not even acknowledge such actions as politically motivated and would not risk deteriorating relations with Russia during the winter.

Another Germany offer is the promise of supporting green technological development, including hydrogen production, in Ukraine.³³ This hardly addresses the controversies around NS2. It also reflects Germany's attempt to use existing investments of German companies in Ukraine at the negotiating table with the U.S. The German companies are interested in Ukraine's renewable market regardless of NS2. Moreover, Germany also want to cooperate on green technologies with Russia, which proves that this proposal is rather about supporting Germany's own economic interest.

Perspectives and Recommendations

The U.S. sanctions and the attack on Navalny increased the intensity of the debate on NS2. However, for the German authorities, completing the pipeline remains a top priority. This position weakens the trust between Germany and its EU and NATO partners and puts in doubt Germany's readiness to respond to Russia's aggressive policy, such as the escalation of the Donbas conflict or political repressions.

³¹ B. Bieliszczuk, "The dispute over Nord Stream 2...", op. cit.

³² B. Bieliszczuk, "Nord Stream 2 and the Biden Presidency," PISM Bulletin, No. 46 (1742), 4 March 2021, <https://pism.pl>.

³³ M. Zaniewicz, "Ukrainian Energiewende: German Engagement in Ukraine's Energy Transition," PISM Bulletin, No. 55 (1751), 12 March 2021, <https://pism.pl>.

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Germany's declared intent to strengthen trans-Atlantic relations requires cooperation with European allies on common policy, including towards Russia. Such a strategy cannot focus on supporting Germany's economic interests at the expense of other members of the EU and NATO.

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It is in Poland's interest not only to seek a halt to NS2 but also to engage Germany in a discussion about countering the real risks of the pipeline.

This must also include a discussion about Germany's long-term policy on Russia. Poland might propose focusing on the following points:

- 1. Wide consultations on NS2.** Bilateral talks between Germany and the U.S. on NS2 undermine the trust between NATO allies. This can be changed by including countries like Poland in the dialogue and also embrace Ukraine's perspective on NS2. Withdrawing German political support to NS2 is still possible, as well as preventing its launch once the pipeline is completed, which might be used as leverage on Russia regarding, for example, Crimea or Donbas.
- 2. Adjusting NS2 to EU law.** Applying the gas directive to NS2 will ensure the transparency of the pipeline's operation if it is launched. EU Member States and institutions should work to minimise the risk of Russia circumventing EU law.³⁴ Doing so would bolster the EU's image as a promoter of transparent market rules.
- 3. Common Strategy on Russia.** Work on a common long-term strategy on Russia by EU and NATO countries should include the perspective of allies like Poland. Such a policy cannot focus on seeking closer cooperation with Russia at any costs (e.g., through selective engagement), but on finding effective instruments of pressure on the Russian authorities. In the current situation, the mere threat of halting NS2's launch could be one such tool.
- 4. Signalling a readiness to broaden the sanctions against Russia.** Such a joint signal on broadening sanctions levied by NATO and EU states on Russia would be a proper reaction to its aggressive policy.
- 5. Maximum reduction of the EU's dependence on Russian gas.** The diversification of gas sources and import routes, as well as the development of RES, create the opportunity to make Europe more independent from Russian energy sources and, as a result, from Russia's political influence. At the same time, Germany's efforts to seek closer cooperation with Russia in the hydrogen sector and other areas could petrify this negative relationship. Poland and Germany should work together so the development of green energy helps to achieve climate goals and also ensures the security of the EU.
- 6. Cooperation with Ukraine.** Germany and its EU partners should prioritise energy cooperation with Ukraine, a country that fell victim to Russia's military and economic aggression. Pushing forward with cooperation with Russia in this sector might lead not only to maintaining energy dependence on that country but also sends the wrong signal to Ukraine, which will be directly hit by the launch of NS2.

³⁴ B. Bieliszczuk, "Competition under Control: A Perspective on the Application of EU Law to Nord Stream 2," PISM Bulletin, No. 122 (1564), 6 December 2017, www.pism.pl.