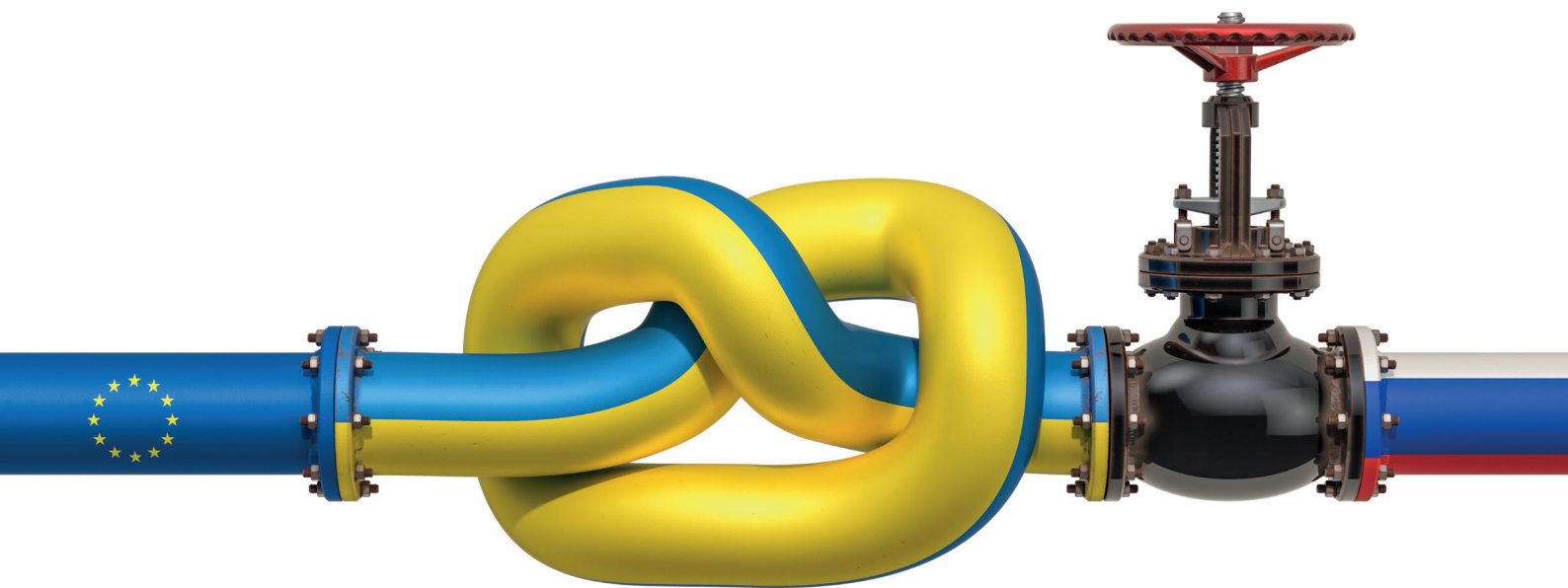


# NORD STREAM 2: MYTHS, ILLUSIONS AND REALITIES

BY DR ALAN RILEY, SENIOR FELLOW,  
ATLANTIC COUNCIL



**RUSSIA &  
EURASIA  
STUDIES  
CENTRE**

Published in 2021 by The Henry Jackson Society

The Henry Jackson Society  
Millbank Tower  
21-24 Millbank  
London SW1P 4QP

Registered charity no. 1140489  
Tel: +44 (0)20 7340 4520

**[www.henryjacksonsociety.org](http://www.henryjacksonsociety.org)**

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Title: "NORD STREAM 2: MYTHS, ILLUSIONS AND REALITIES"  
By Dr Alan Riley, Senior Fellow, Atlantic Council

ISBN: 978-1-909035-68-3

£9.95 where sold

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Cover image: <https://www.shutterstock.com/image-illustration/gas-conflict-between-ukraine-russia-concept-1309206907>

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DEMOCRACY | FREEDOM | HUMAN RIGHTS

**RUSSIA &  
EURASIA  
STUDIES  
CENTRE**

June 2021

## **About the Author**

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## About Us

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### About The Henry Jackson Society

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**The Henry Jackson Society** is a think-tank and policy-shaping force that fights for the principles and alliances which keep societies free, working across borders and party lines to combat extremism, advance democracy and real human rights, and make a stand in an increasingly uncertain world.



### About the Russia and Eurasia Studies Centre

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The **Russia and Eurasia Studies Centre** undertakes in-depth, analytically-focussed research into domestic and foreign policy issues in Russia and the other post-Soviet states. Established in 2010 as the Russia Studies Centre, the programme's geographical scope has widened since 2014, mirroring the high level of importance attached to the region.

## 1. Introduction

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This paper seeks to address the myths, illusions and then the actual realities surrounding the controversial Nord Stream 2 project. Ever since the project was launched in St Petersburg in June 2015 it has been sustained by a welter of myths and disinformation. This disinformation has operated on such a scale that even respected analysts and commentators have absorbed many of the myth-making arguments supporting the pipeline.<sup>1</sup> This paper seeks to dispel the main myths surrounding the project: that Nord Stream 2 will provide additional natural gas for Europe; that in particular Nord Stream 2 will provide Germany with gas; that the pipeline poses no threat to European supply security because of the completion of the single market in gas; that there is no energy security threat to Europe because of the availability of liquid natural gas (LNG); that Ukraine will benefit from the opening of Nord Stream 2 and the closure of the Ukrainian transit pipeline network; and that Nord Stream 2 will reduce CO2 emissions. Taking each in turn, this paper will debunk these claims.

The paper then proceeds to examine the illusions that have underpinned German support for the project. These encompass guilt, the myth of Eastern riches and memories of *Ostpolitik*. These illusions are each examined and dismissed in turn. Finally, the paper turns to the realities of Nord Stream 2 for Germany, the European Union, and the United Kingdom. For Germany, it is argued that Nord Stream 2 has significantly damaged German national interests: its direct supply security interests are undermined by the pipeline. In addition, Germany's credibility as a Western ally and a green champion of the energy transition has suffered substantial damage. It is open to question how far the German state will be trusted by many EU Member States following the Nord Stream 2 saga. It is at least likely that other Member States will require cast iron legal guarantees to protect their own security interests with respect to any project substantially supported by Berlin.

For the European Union, Nord Stream 2 casts a long shadow over plans to develop European Strategic Autonomy (ESA). If the EU's most powerful state can so easily cast aside the security interests of several fellow NATO and EU Member States – and work hand in glove with a hostile foreign power – what credibility does the development of ESA have with most capitals east of the Oder? The reality for the United Kingdom is that, regardless of Brexit, its European security interests and its security obligations under the Washington Treaty require that it remains fully engaged with the continent. It is perhaps understandable that the United Kingdom remained on the sidelines of the Nord Stream 2 controversy over the last few years as it was consumed by the Brexit process. As Brexit is now complete, the UK needs to re-engage with its broader security interests across the continent.

The paper concludes by arguing that, although Nord Stream 2 has had significant negative geopolitical consequences within the European Union, it may yet result in positive consequences for the Atlantic Alliance. Nord Stream 2 has triggered a recognition across Central and Eastern Europe (hereafter CE Europe) that, where their key security interests are concerned, their safety is assured by their relationship with the United States and the region's commitment to NATO. In addition, the long-running controversy over the pipeline and the damage it has done to German interests may lead politicians in Berlin to reassess the direction of their Russia policy and their relationships with Western allies.

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<sup>1</sup> See for example, Wolfgang Münchau, "Biden vs Merkel: the battle over Russian gas is heating up", *The Spectator*, 13 February 2021, <https://www.spectator.co.uk/article/biden-vs-merkel-the-battle-over-russian-gas-is-heating-up> and Daniel Gros, "Nord Stream 2 – a red herring at the bottom of the sea", *CEPS*, 18 March 2021, <https://www.ceps.eu/nord-stream-2-a-red-herring-at-the-bottom-of-the-sea/>.

## 2. The Nord Stream 2 Project: Pipeline and Controversy

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President Putin launched the Nord Stream 2 pipeline at the St Petersburg International Economic Forum in June 2015. It was envisaged that the pipeline would be modelled on its precursor pipeline, Nord Stream 1, in terms of the route, capacity and business structure. The new pipeline would be approximately 2300km in length from Narva Bay on the Russian Baltic coast to Greifswald on the German Baltic coast. For most of its length, it would follow the same route as Nord Stream 1. As with the Nord Stream 1 'pipeline', Nord Stream 2 would consist of two undersea pipelines each with a carrying capacity of 27.5 billion cubic metres (bcm). The total cost is estimated at \$11 billion.<sup>2</sup>

According to the initial plan, Nord Stream 2 was due to be constructed and fully functioning by the end of 2019, replacing gas flows that came via the Ukrainian pipeline transit system.<sup>3</sup> Unfortunately for Nord Stream 2's owner, Gazprom, this plan foundered. Somewhat surprisingly, Moscow seemingly assumed that it would be as easy to launch and execute Nord Stream 2 in 2015–2019 as it was to realise Nord Stream 1 between 2004 and 2010. However, the political context had changed drastically, particularly after the invasion, occupation and annexation of parts of Ukraine, and Russian interference in the 2016 US Presidential election. Also, it appears that Gazprom did not appreciate the extent to which European energy law had developed after the implementation of the Gas Directive 2009, which significantly limited Gazprom's room for manoeuvre. Nor did it appreciate the greater skill and understanding of governments of CE Europe in operating the legal and political levers of the EU, and their capacity to mobilise support within the United States to impose sanctions.

So, we find ourselves in June 2021, almost six years after the initial launch of Nord Stream 2, with the project close to completion but not actually complete. Almost all the pipeline has been laid and just two 75km lengths of pipe, each largely in Danish waters, remain to be completed.<sup>4</sup> However, hardly any pipeline has been laid since the US Congress imposed sanctions on Nord Stream 2's pipelaying operations in December 2019 under Section 7503 of the National Defense Authorization Act 2020. Congress expanded sanctions to a broad set of pipelaying support and service activities in January 2021 under Section 1242 of the National Defense Authorization Act 2021. This expansion of US sanctions led to the flight of the certification, supply and service companies who had supported the pipelaying of Nord Stream 2. At the time of writing, Gazprom has two Russian pipelaying ships, the *Fortuna* and *Akademik Cherskiy*, gearing up to lay the remaining pipes. However, both ships have less efficient pipelaying technology which means it will take some months to complete construction, even assuming US sanctions do not stop the project in the meantime.<sup>5</sup>

Nord Stream 2 is controversial because of the underlying security threat that the pipeline poses to the states of CE Europe and to Ukraine. Much of the discussion focuses on the technical

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<sup>2</sup> If one counts the connecting pipelines to the Russian landfall site on the Baltic coast which carry gas from the gas fields in Siberia, the total construction cost of Nord Stream 2 is approximately \$17 billion. See "Russian Oil and Gas: Tickling Giants", *Sberbank*, Moscow, May 2018.

<sup>3</sup> "Gazprom will not transit gas across Ukraine even if the sun will replace the moon", *Interfax*, Moscow, 22 January 2015.

<sup>4</sup> Julian Wettengel, "Gas Pipeline Nord Stream 2 links Germany to Russia, but splits Europe", *Clean Energy Wire*, 4 June 2021, <https://www.cleanenergywire.org/factsheets/gas-pipeline-nord-stream-2-links-germany-russia-splits-europe>.

<sup>5</sup> Despite the recent waivers announced by President Biden the current mandatory sanctions contained in Sections 7503 and 1242 of respectively the National Defense Authorizations Acts 2020 and 2021 may yet stop the pipeline in its tracks. The reason for this is that these targeted sanctions focus on the provision of a number of highly technical services such as technical certification of the pipeline. Technical certification is a complex process for a major undersea pipeline and only three or four companies in the world are competent to deliver such a service. On the coming into force of Section 1242 in January 2021, the Norwegian company that had been contracted by Nord Stream 2 to undertake the technical certification of the pipeline DNV GL withdrew. It is currently unclear how Nord Stream 2 will be able to obtain technical certification services to demonstrate compliance with safety and quality standards.



issues affecting the energy security of states in the region. These energy security issues feed into a national security profile that will be aggravated for many states in the region if Nord Stream 2 comes into operation and is permitted to operate at full capacity. Such a pipeline will undermine the single market in gas, splitting the CE European gas market from Western Europe, and enhancing Gazprom's market dominance and political influence. Full operation of the pipeline will result (as explained below) in the termination of gas transit across Ukraine. This will remove an important source of gas flows over which, although Russian in origin, Gazprom has very little control. This removal will reinforce Gazprom's market power and political influence, potentially undermining the region's security gains since NATO membership was achieved in 1999 (for most states in the region) and EU Membership in 2004, and 2007.

The security consequences for Ukraine are much worse. Although much of the discussion has focused upon Ukraine losing transit fees from Russian gas flows across the Ukrainian pipeline network, this is the least of Kyiv's worries. As explained below in detail, Ukraine has managed to avoid buying gas directly from Gazprom since 2014. Instead, it has been able to use EU energy market liberalisation rules to buy gas on 'reverse flow' from Poland, Hungary and Slovakia. The origin of the gas is Russian, contracted by Gazprom and flowing down the Ukrainian pipeline network, but Kyiv purchases it on resale and then reverses the gas back to Ukraine. Hence Kyiv has managed to avoid dealing directly with Gazprom, instead buying gas on the open market and at lower prices than buying from the Russian gas giant. If, as expected, Moscow terminates the Ukrainian transit, the ability to maintain reverse flow gas will be severely damaged. The other understandable fear in Kyiv is that once Ukraine is no longer a transit country, interest in supporting Ukraine, particularly in Western Europe, will disappear, leaving it at Moscow's whim.

These energy security concerns feed into Kyiv's national security evaluations. These assessments are defined by Ukraine's state of war with the Russian Federation. Russia has annexed Crimea and currently occupies parts of eastern Ukraine. One major factor for the limitation of the scope of the conflict is Ukraine's role in delivering natural gas to the rest of Europe. Gazprom's export earnings make up approximately two-thirds of its revenue, and Gazprom provides approximately 5% of Russian federal tax revenues. Once Ukraine is no longer a transit country, these financial implications will disappear. The Russian military will have a much freer hand in conducting operations across the country. They may also calculate that, without Western help, Kyiv will be more dependent on Moscow for gas supplies and have fewer levers to request assistance.

In addition to the controversy over the pipeline and the consequent national security concerns, there is also the question of its broader geopolitical impact. From Moscow's perspective, Nord Stream 2 is not only a pipeline but also an effective means to split the West by undermining US-German relations and dividing the European Union. So far, this geopolitical ploy has been tremendously successful. Once built and in operation, the pipeline will provide a means of further increasing Russian influence in Germany, and further dividing the European Union and the broader Western Alliance.

Even if the pipeline is completed, the controversy will not end. A second battle will then commence over the correct application of EU energy law to the pipeline, with Poland likely to lead several other states into the EU courts to challenge any decision of the German authorities to grant EU certification to the pipeline.<sup>6</sup> Notwithstanding the recent comments of President Biden, it is also possible that the US may well be able to impose further targeted and effective

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<sup>6</sup> Gas pipelines post-construction are subject to a technical certification process to check that they have been safely constructed. There are only a handful of technical certification firms worldwide. The US focused on the certification process as a weak link in the pipeline's construction process and targeted any firm that certified Nord Stream 2, resulting in the certification firm DNV, which had been contracted to undertake certification for the pipeline, withdrawing from the project.

sanctions to limit the ability of Gazprom to bring the pipeline into operation.<sup>7</sup> Furthermore, as explained below, proactive countermeasures by the United States and its allies in Europe may be able to undermine the impact of the pipeline. In any event, it is likely that the controversy over Nord Stream 2 will continue for several more years to come.

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<sup>7</sup> For a discussion of the further sanctions options see: Dr Alan Riley, "Nord Stream 2: Sanctions, Snapbacks and Solutions", *Huri*, Harvard University (April 2021), [https://huri.harvard.edu/files/huri/files/riley\\_-\\_nord\\_stream\\_2.pdf?m=1618864282](https://huri.harvard.edu/files/huri/files/riley_-_nord_stream_2.pdf?m=1618864282).

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### 3. The Myths

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Over the last six years, the following key myths have underpinned the case for the Nord Stream 2 project:

1. Nord Stream 2 Will Provide Additional Natural Gas for Europe.
2. Nord Stream 2 Will Provide Natural Gas for Germany.
3. There Are Few Energy Security Issues as Gas Can Flow Easily around the Single Market.
4. There Are No Energy Security Issues because Europe Can Rely on Liquid Natural Gas (LNG).
5. Ukraine Will Benefit from Nord Stream 2.
6. Nord Stream 2 Will Reduce CO2 Emissions.

Many of these myths can be found in the documents, speeches and publicity materials generated by officials and bodies connected to the Russian Federation, as demonstrated below. They are also unfortunately deployed by officials of the German government, some of the key Western energy partners of Nord Stream 2, and members of the policy community who have absorbed much of the Nord Stream argument into their thinking over the last six years of debate.<sup>8</sup>

This section seeks to debunk each of these myths in turn.

#### **3.1: Nord Stream 2 Will Provide Additional Natural Gas for Europe**

Nord Stream 2 does not in fact bring any new gas to Europe.

In its promotional materials, Gazprom has implied that Nord Stream 2 will bring additional gas supply into the EU, arguing that, against the decline in European gas production, the new pipeline will deliver additional sources of gas.<sup>9</sup> This argument has been supported by Western partners to the project, as well as officials, analysts and commercial actors.<sup>10</sup>

However, the current and historic pattern of behaviour of the Russian state and its overall geostrategic objective in relation to the Ukrainian transit pipeline tell a different story. As soon as Nord Stream 1 was commissioned, and gas began to flow through the pipeline, gas flows via the Ukrainian transit pipeline network fell.<sup>11</sup> In 2016 the European Commission permitted Gazprom to make greater use of Nord Stream 1's connecting pipeline, OPAL. Almost immediately, gas flows rose via Nord Stream 1 and the OPAL pipeline, while gas flows fell in the Ukrainian transit pipeline network.<sup>12</sup> Even more recently, the opening of the Turk Stream 2 pipeline, which runs from Russia across the Black Sea to Turkey, and then through Greece, Bulgaria and Romania, has resulted in another fall in gas flows via Ukraine.<sup>13</sup> The Balkan market

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<sup>8</sup> See, for example: Gros, *Nord Stream 2: A Red Herring*. See also Wolfgang Munchau, *Biden vs Merkel*.

<sup>9</sup> "Nord Stream 2 A New Gas Pipeline Running from Russia to Europe Across the Baltic Sea", *Gazprom*, <https://www.gazprom.com/projects/nord-stream2/>.

<sup>10</sup> For example, "Demystifying Nord Stream 2: OMV's rationale for participating in the project", *OMV*, 13 May 2019, <https://www.omv.com/en/blog/190513-demystifying-nord-stream-2-omvs-rationale-for-participating-in-the-project>; see also the justification provided by Nord Stream 2 partner Wintershall: "Nord Stream 2: The next milestone", *Wintershall*, <https://wintershalldea.ru/en/where-we-are/nord-stream-2>. See also Gaurav Sharma, "Opposition to Nord Stream 2 ignores market fundamentals", *Energy Post*, 14 December 2018, and Allister Thomas, "Groningen production cap shows need for controversial Nord Stream 2 says analyst", *Energy Voice*, 8 March 2018, <https://www.energyvoice.com/oilandgas/165546/groningen-production-cap-shows-need-controversial-nordstream2-says-expert/>.

<sup>11</sup> Aurélie Bros, "There will be Gas: Gazprom's Transport Strategy in Europe", *IFRI Paris*, October 2015, [https://www.ifri.org/sites/default/files/atoms/files/ifri\\_rnr\\_21\\_eng\\_aurelie\\_bros\\_october\\_2015.pdf](https://www.ifri.org/sites/default/files/atoms/files/ifri_rnr_21_eng_aurelie_bros_october_2015.pdf).

<sup>12</sup> Hirte and Grund, "Deutschland braucht die Nord-Stream 2 Gaspipeline", *Handelsblatt*, 25 February 2018.

<sup>13</sup> Kostis Geropoulos, "Gazprom's Turkstream draws less heat than Nord Stream 2", *New Europe*, 11 February 2021, <https://www.neweurope.eu/article/gazproms-turkstream-draws-less-heat-than-nord-stream-2/>.

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was traditionally served by gas that was transited via Ukraine and then down the Balkan pipeline from Ukraine to Greece. With the coming into operation of Turk Stream 2 in May 2020, gas flows via the Ukrainian and Balkan pipeline route have virtually dried up.<sup>14</sup>

In addition to the current and historic pattern of Russian behaviour that has sought to use any alternative pipeline route it can establish to reduce Ukrainian transit flows, there is the over-arching geopolitical aim of the Russian Federation to weaken Ukraine. Terminating the Ukrainian transit route will deprive Ukraine not only of transit fees but, much more importantly, it will remove the supply security hedge Ukraine obtained from 'reverse flows'. In essence, Ukraine contracted with its neighbours, Poland, Slovakia and Hungary, to buy spare gas, which flowed through the Ukrainian transit pipeline network, under their contracts with Gazprom. This was a means of providing Ukraine with cheaper gas, but it also significantly reduced Ukraine's direct supply dependence on Russia.<sup>15</sup> 'Reverse flow' gas will be a much more limited source of supply with the advent of Nord Stream 2 as gas flows across Ukraine will be significantly reduced, if not terminated. In addition, the termination or significant reduction of remaining gas flows across Ukraine would also reduce the strategic importance of Ukraine to the European Union, making it easier for Moscow to strengthen its influence and control over Kyiv.

Russia's broader geostrategic objective to terminate Ukrainian gas transit flows has been evident for almost 20 years, seen first with Nord Stream 1, then the ill-fated South-Stream project,<sup>16</sup> Turk Stream 2 and now Nord Stream 2. The initial Russian plan for Nord Stream 2 was to terminate gas flows across Ukraine to coincide with the end of the 2009 transit contract which expired in January 2020. As the CEO of Gazprom, Alexi Miller, explained in 2015, "under no circumstances" even "if the sun will replace the moon" would Gazprom enter into a new transit contract with Naftogaz (the Ukrainian state-owned gas company) after 2019.<sup>17</sup>

Unfortunately for Gazprom, the difficulties of completing Nord Stream 2, and crucially the imposition of sanctions by the United States under Section 7503 of the National Defense Authorization Act 2020, brought all pipelaying operations to a halt in December 2019. Gazprom had no choice but to enter into a transit agreement with Ukraine until 2024 and agree to ship at least 40bcm of gas via the Ukrainian transit system.<sup>18</sup>

It could be argued that Nord Stream 2 is not a diversionary pipeline because of the December 2019 transit arrangement. Now Europe will be able to receive gas via Ukraine as well as gas via Nord Stream 2. However, given the long-running objective to terminate the Ukrainian transit route, it would be extremely unwise of Kyiv to rely on the guarantees of that transit contract once Nord Stream 2 becomes operational. An ordinary commercial entity would have to comply with the transit agreement. However, Gazprom is arguably not an ordinary commercial entity, with many analysts arguing that it operates primarily in the geopolitical interests of the Russian Federation.<sup>19</sup>

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<sup>14</sup> Alex Barnes, "Why Nord Stream 2 is Actually a Good Deal for Europe", *The Baltic Times*, 8 March 2021, [https://www.baltictimes.com/why\\_nord\\_stream\\_2\\_is\\_actually\\_a\\_good\\_deal\\_for\\_europe/](https://www.baltictimes.com/why_nord_stream_2_is_actually_a_good_deal_for_europe/).

<sup>15</sup> Robert Sedlacek, "Development of gas infrastructure in the CEE and the impact on cross-border trade", *Eustream*, September 2019.

<sup>16</sup> South Stream was envisaged as a 63bcm capacity pipeline carrying gas across the Black Sea landing in Bulgaria and then providing gas across South-Eastern and Central Europe. For a discussion of the debacle of the South Stream project and the way it was upended by the application of Union law, see Jonathan Stern, Simon Pirani and Katja Yafimava, "Does the cancellation of South Stream signal a fundamental reorientation of Russian gas export policy?", *OIES*, January 2015, <https://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/01/Does-cancellation-of-South-Stream-signal-a-fundamental-reorientation-of-Russian-gas-export-policy-GPC-5.pdf>.

<sup>17</sup> "Gazprom will not transit gas across Ukraine", *Interfax*.

<sup>18</sup> Riley, "Nord Stream 2".

<sup>19</sup> Andrey Vavilov (ed), "Gazprom: An Energy Giant and its Challenges", *Macmillan*, London, 2016.

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Moscow could for instance simply terminate the agreement and let Kyiv sue. This is the arbitration option. Moscow would be able to spend a decade arguing substantive and procedural legal points in an arbitration tribunal under the judicial hierarchy of Sweden or the Netherlands before there would be any prospect of Kyiv being able to obtain any recovery in damages. Whether damages are obtained in a decade's time or not, the geopolitical objective of undermining Ukraine's supply security and undermining national independence would have been achieved.

The less attractive option for Moscow would see the legal battles over Nord Stream 2 take until the end of 2024. In that case, on termination of the transit agreement, Russia could just stop using the Ukrainian pipeline network and then re-route gas flows to the EU via its new pipeline. This option would mean waiting several years beyond the original 2019 start date for the new pipeline to come into operation. This breathing space would also give Ukraine more time to boost domestic gas production, roll out more renewables and find gas import substitutes. Hence, it is probably the least favoured option for Moscow, but may yet end up being the only option available if the legal battles over Nord Stream 2 take several years to resolve.

### **3.2: Nord Stream 2 Will Provide Natural Gas for Germany**

A frequent argument in favour of Nord Stream 2<sup>20</sup> posits that the project is necessary to assist Germany with an energy supply crunch caused by the progressive closing of the Groningen gas field,<sup>21</sup> and the de-commissioning of Germany's remaining nuclear power plants.<sup>22</sup>

However, there is no new gas from Nord Stream 2 and most of the gas from the pipeline is destined not for Germany but for CE Europe. Nord Stream 2's connecting pipeline, EUGAL, which is able to take the entire capacity flow of the pipeline at 55bcm, does not head westward but eastward from the landing point at Greifswald on the German Baltic coast to the Czech border. Consequently, there is no new gas and most of the gas coming into Germany via the pipeline will be sold outside Germany.

### **3.3: There Are Few Energy Security Issues as Gas Can Flow Easily around the Single Market**

This argument has been made consistently by advocates of Nord Stream 2, notably by Andreas Goldthau,<sup>23</sup> Severin Fischer,<sup>24</sup> Karel Beckman<sup>25</sup> and, more recently, Kirsten Westphal.<sup>26</sup> According to this argument, following the liberalisation of the EU gas market over the last two decades, the construction of Nord Stream 2 poses little or no harm to European supply security. Should Gazprom, on instruction from the Kremlin, seek to cut supplies to European customers, gas would be re-routed through west to east interconnectors or alternative supplies would be brought into the European market through Norwegian or Algerian pipelines or via LNG terminals (the LNG issue is discussed further below).

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<sup>20</sup> For instance, "Groningen Production Cap Shows Need for Controversial Nord Stream 2 Says Analyst", *EnergyVoice*, 8th March 2018, and Gross, "Want a Green Future? Let Nord Stream 2 Go", *Foreign Policy*, 6th May 2021.

<sup>21</sup> Bart H. Meijer, "Netherlands to halt Groningen gas production by 2022", *Reuters*, 10 September 2019, <https://www.reuters.com/article/us-netherlands-gas-idUSKCN1VV1KE>. To put this announcement in context, as late as 2013 the Groningen field was still producing 50bcm - approximately 60% of annual UK consumption.

<sup>22</sup> Kerstine Appunn, "The History behind Germany's nuclear phase-out", *Clean Energy Wire*, 9 March 2021, <https://www.cleanenergywire.org/factsheets/history-behind-germanys-nuclear-phase-out>.

<sup>23</sup> Andreas Goldthau, "Assessing Nord Stream 2: Regulation, Geopolitics and Energy Security in the EU, Central, Eastern Europe and the UK", *EUCERS*, King's College London, 2016.

<sup>24</sup> Severin Fischer, "Nord Stream 2: Trust in Europe", *Policy Perspectives*, Vol. 4/4 (March 2016), CSS.

<sup>25</sup> Karel Beckman, "Who is afraid of Nord Stream 2?", *Energy Post*, 24 October 2016, <https://energypost.eu/afraid-nord-stream-2/>.

<sup>26</sup> Kirsten Westphal, "Nord Stream 2 - Germany's Dilemma", *SWP*, April 2021.

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It is true that the electricity and gas markets represent successful developments within the single market. Over the last two decades, the European Commission, with the assistance of a number of economically liberal Member States led by the United Kingdom, has forced three liberalisation directives through the Council of the EU and the European Parliament. The most significant liberalisation directive was the third gas directive adopted in 2009 which required: all new energy infrastructure to be unbundled (i.e., an energy firm could either supply energy through the infrastructure or own the infrastructure but not both); third party access to energy infrastructure; a transparent tariff regime.<sup>27</sup> This legislative campaign was reinforced with a litigation campaign in which the Commission deployed its antitrust rules to break up the power of dominant continental energy companies such as EDF,<sup>28</sup> GDF<sup>29</sup> and RWE<sup>30</sup> in national markets.

Given that energy market liberalisation commenced well before the entry of Central and Eastern European Member States into the Union, the initial focus was naturally on Western Europe. Most of CE Europe operated sealed national gas markets each with a long-term supply contract with Gazprom. Gas flowed from east to west through the former territories of the USSR and the Warsaw Pact via the Ukrainian pipeline network into Western Europe and latterly via the Yamal pipeline<sup>31</sup> running from Russia to Poland via Belarus.

As CE Europe accession to the European Union approached, there began a process of opening disparate national markets and subjecting dominant monopoly companies to the rigour of competition. However long-term supply contracts, combined with Gazprom's market dominance and reinforced by limited infrastructure access between CE states and Western Europe, made liberalisation for most CE states an option in form rather than substance. There is a compelling argument that a major reason for the development of the Nord Stream 1 project was that it provided a means for Moscow to undermine the process of liberalisation of CE gas markets within Western Europe and was a way to ensure that liberalisation remained something that existed in form not substance.<sup>32</sup>

The most significant development which gave substance to liberalisation in CE Europe was the two-week-long gas crisis between Ukraine and Russia in 2009.<sup>33</sup> The disruption of gas flows across CE Europe and into Western Europe led to a collective European decision to physically integrate CE with Western European markets and connect the CE markets themselves. A European fund was established to help part-fund gas interconnectors to connect national markets; compressor stations to increase capacity; and reverse flow pipelines to minimise the risk of isolation to certain countries.<sup>34</sup> Building physical infrastructure took time but did begin

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<sup>27</sup> Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas, OJ 2009 L211/94.

<sup>28</sup> *Contrats Long Term France, Engagements d'EDF au titre de l'article 9 du reglement no. 1/2003 du conseil*, COMP/39/.386, European Commission, 11 August 2010.

<sup>29</sup> *GDF*, COMP/39.316 Decision, European Commission, 3 December 2009.

<sup>30</sup> *RWE Gas Foreclosure*, COMP/39.402, European Commission, Brussels, Decision 13 March 2009.

<sup>31</sup> This pipeline, with a capacity of 33bcm, runs from Russia into Belarus and then on into the European Union via Poland. It first came on stream in 1997.

<sup>32</sup> By providing a direct route to Gazprom's richest markets in Western Europe and removing gas flows from the Ukrainian transit network, Gazprom gained more control over the direction of gas flows into European markets, undermining the impact of gas market liberalisation.

<sup>33</sup> For a discussion of the 2009 Russian-Ukrainian gas dispute see the interview with Jeffrey Mankoff, "The Business and Politics Behind the Russia-Ukraine Gas Dispute", *Council on Foreign Relations*, 8 January 2009, <https://www.cfr.org/interview/business-and-politics-behind-russia-ukraine-gas-dispute>.

<sup>34</sup> This was the European Energy Programme for Recovery which provided approximately €2.7 billion in additional infrastructure funding for electricity and gas markets. The aim was that the EU funding would then lever in additional national, local and private capital to maximise the impact of the funding. The legislation on which it was based can be found as *Regulation (EC) No 663/2009 of the European Parliament and of the Council of 13 July 2009 establishing a programme to aid economic recovery by granting Community financial assistance to projects in the field of energy*, OJ 2009 L200/31.

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to integrate the entire European gas market. As greater physical interconnection took place, the liberalisation rules then started to impact local markets, encouraging new firms to enter the market, providing more choice for consumers, and introducing price competition.

Despite the installation of a significant amount of infrastructure, the east-to-west structure of the legacy Soviet gas pipeline network in CE Europe means that the region remains less integrated than most of Western Europe.<sup>35</sup> Gazprom has retained a significant amount of market power and influence across the region even if it has been forced to offer more gas subject to gas market hub-based prices rather than prices linked to the oil price.<sup>36</sup> It remains the dominant provider of gas in most of CE Europe with incomplete interconnection infrastructure and legacy contracts continuing to underpin that dominance.

Nord Stream 2 must be considered within the context of the Soviet legacy pipeline network and Gazprom's continuing market power. At least 80% of the gas which will flow via Nord Stream 2 will not enter the Western European market but will instead flow eastwards via its EUGAL connecting pipeline.<sup>37</sup> Possibly all the gas that flows through Nord Stream 2 will enter CE Europe. Already Nord Stream 1 provides approximately 13bcm to its eastward connecting pipeline OPAL<sup>38</sup> which will operate on a parallel route to that of EUGAL. Consequently, between 58 and 68bcm will flow from west to east into CE Europe from Nord Stream 2. Essentially, Gazprom is flooding the west to east interconnectors, making it much more difficult for competitors to enter CE gas markets. This reduction in competition from western markets is particularly critical as the principal direction of any competition for Gazprom is likely to concern gas flows from west to east. In addition, the very existence of gas flows of this scale could disincentivise investors from developing any further infrastructure in the region.

The additional market power that Gazprom will obtain from crowding out competition in CE Europe is reinforced by the impact of Nord Stream 2 on Ukrainian transit. As explained above, one of the Kremlin's principal objectives is to use the pipeline to terminate the Ukrainian transit route. However, the operation of the Ukrainian transit route has been one of the most successful case studies of EU energy liberalisation. Ironically, Nord Stream 1, which resulted in a fall in gas flows through the Ukrainian transit route into Slovakia, resulted in spare pipeline capacity. The spare capacity was then deployed to allow Slovakia, Poland and Hungary to sell some of their Russian-contracted gas (and other available gas supplies) to Ukraine. This is why Ukraine no longer had to buy gas direct from Gazprom and was able to pay a lower price.<sup>39</sup>

However, once Nord Stream 2 is fully operational, these gas flows will cease. The ability of CE states to sell and resell natural gas among themselves – including to Ukraine – will become more difficult, even if it would still theoretically be possible to sell gas from west to east. At the moment, once Gazprom's gas has crossed the Russian border, Gazprom has little influence on the direction of the gas and its ultimate end user. However, once the gas passes not through Ukrainian transit but through Nord Stream 2, it will remain under Gazprom control, especially

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<sup>35</sup> *EU 2020 Energy Policy Review*, IEA, Paris, 2021, 253-262. A further point to note is that much of the infrastructure cited in the Energy Policy Review appears not to have reached a final investment decision and EU funding support. This is particularly the case for a number of the proposed LNG regasification plants. See p.248 *et seq.*

<sup>36</sup> *Ibid.*, p.255.

<sup>37</sup> Like its predecessor Nord Stream 1, Nord Stream 2's landing point is at Greifswald on the German Baltic Coast. Nord Stream 1 then relies on two connecting pipelines to carry its gas further into European markets. The first is NEL (20bcm capacity) which takes gas westward and OPAL (36bcm) which takes gas eastward through Brandenburg to the Czech border. Nord Stream 2's connecting principal pipeline is EUGAL which can take all the capacity of the Nord Stream 2 pipeline (55bcm). It follows the same route as OPAL through Brandenburg to the Czech border.

<sup>38</sup> Although OPAL has 36bcm of capacity under the operation of a European Commission exemption decision adopted in 2009 it can only currently use 13bcm of that capacity.

<sup>39</sup> Colin Harrison and Zuzana Princova, "A Quiet Gas Revolution in Central and Eastern Europe", *Energy Post*, 29 October 2015, <https://energypost.eu/quiet-revolution-central-eastern-european-gas-market/>.

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as EUGAL, its connecting pipeline, is also under the control of Gazprom and its allies.<sup>40</sup> Furthermore, the level of control will be reinforced by Gazprom's enhanced market dominance in the region.

Even before the Nord Stream 2 project was launched, Gazprom sought to suppress the impact of EU energy liberalisation in the shape of Slovakian, Hungarian and Polish reverse flows to Ukraine. Gazprom did not succeed in suppressing flows to Ukraine in 2014–2015 (although Slovakia, Hungary and Poland did experience gas cuts).<sup>41</sup> However, without Ukrainian transit flows, and with Gazprom influence and control over most of the delivery pipeline networks, the company will be in a much better position to ensure that Ukraine does not receive any gas on reverse flow.

As such, the issue is not simply that the EU gas market is incomplete, which leaves states in CE Europe unable to avoid Gazprom's market influence – now enhanced by Nord Stream 2 – but also that the pipeline itself degrades the operation of the existing single market in gas. In effect, it seeks to split the single market in two: one part focussed on North-West Europe, which is supplied from multiple sources and operates with liquid gas hubs, and one part focussed on the market in CE Europe, which is dominated by Gazprom.

Therefore, it is not surprising that CE governments have objected to the development of this pipeline from almost its very inception.<sup>42</sup> A number of states have sought to complete interconnections before Nord Stream 2 is operational, with the reaction of the Polish Government particularly noticeable. Poland has moved at speed to expand the capacity of its LNG terminal at Swinoujscie and to complete the Lithuanian-Polish gas interconnector.<sup>43</sup> Furthermore, and perhaps most significantly, it has commissioned a 10bcm Baltic Pipeline, drawing on gas from the Norwegian fields.<sup>44</sup> These steps will protect Poland and parts of North-East Europe by providing an alternative source of supply to Russian gas. However, the scale of supply provided by these measures will still leave Gazprom in a much stronger position in large parts of the region than it is now.<sup>45</sup>

### **3.4: There Are No Energy Security Issues because Europe Can Rely on Liquid Natural Gas (LNG)**

This LNG argument<sup>46</sup> is a subsidiary of the 'we can rely on the single market' argument. Proponents of this view correctly state that Europe has 210bcm of LNG import capacity,<sup>47</sup>

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<sup>40</sup> Nord Stream 2 is owned 100% by Gazprom as shareholder. For EUGAL, its connecting pipeline, 50.5% of the shareholding is held by Gascade, which itself is a joint venture between Gazprom and BASF (also a financing partner of Nord Stream 2). Gasunie, another shareholder in EUGAL, is also a shareholder in Nord Stream 1.

<sup>41</sup> Agata Loskot-Strachota, "Central European Problems with Russian Gas Supplies", *OSW (Centre for Eastern Studies)*, 17 September 2014.

<sup>42</sup> This was given concrete form in a letter by eight EU heads of government opposing Nord Stream 2 in a joint letter to the then President of the European Commission in March 2016. See Andrius Sytas, "EU leaders sign letter objecting to Nord Stream-2 gas link", *Reuters*, 16 March 2016, <https://www.reuters.com/article/uk-eu-energy-nordstream-idUKKCNOWI1YV>.

<sup>43</sup> For details of the Swinoujscie LNG terminal and its expansion see: <https://terminallng.gaz-system.pl/en/lng-terminal/lng-terminal-in-swinoujscie/>. For details of the completion of the Lithuanian-Polish pipeline see: <https://en.gaz-system.pl/our-investments/integration-with-european-gas-transmission-system/poland-lithuania/>. There are also plans to develop a small-scale LNG facility in Gdansk.

<sup>44</sup> For details of the Baltic pipeline project see: <https://www.baltic-pipe.eu>.

<sup>45</sup> One potential way forward is to develop the proposed Three Seas Initiative which would seek to develop a more integrated and prosperous CE Europe by funding developments in the transportation, energy and digital sectors. However, funding by states in the region has not currently matched the level of key commitments. As of April 2021, nine of the 12 states involved in the initiative have pledged \$1.2 billion against a minimum proposed target of \$3.6 to 5 billion. There is, however, in addition the prospect of significant EU funds and US funds (the Trump Administration pledged \$1 billion through the US International Development Finance Corporation). For an overview of the Three Seas Initiative see *The Three Seas Initiative*, CRS, Washington DC, 26 April 2021.

<sup>46</sup> Gros, *Nord Stream 2 – a red herring*.

<sup>47</sup> *The Role of LNG in the energy sector transition: Regulatory recommendations*, Frontier Economics, London, October 2020: 9.



but fail to question where the LNG terminal capacity is located and how much capacity is truly available. For instance, the largest European LNG capacity can be found in Spain, which has 60bcm of capacity.<sup>48</sup> However, there is only one small 7bcm pipeline between Spain and France, rendering the overwhelming majority of Spanish LNG capacity useless to even supply Western Europe.<sup>49</sup> The second largest European LNG capacity is British. The UK has approximately 56bcm of capacity. It can provide up to 20bcm on full reverse flow on the cross-Channel interconnectors.<sup>50</sup> Again, however, the key figure is the exit capacity from the receiving state, which is almost always significantly less than its receiving capacity. Hence the 210bcm capacity is far less impressive when the actual exit figures are taken into account.

From the perspective of the CE states, most of Europe's LNG capacity is inaccessible as it is located on the Western seaboard. In the northern CE region, there is Swinoujscie, with 7.5bcm, and Klaipeda with 4bcm. In southern Europe, there is the Greek terminal at Revithoussa, with 5.2bcm, and the Alexandroupolis terminal with 5.5bcm capacity which is due to come on stream in 2023. However, incomplete infrastructure makes it difficult to maximise the value of the Greek LNG terminals. The Bulgarian-Greek interconnector remains incomplete<sup>51</sup> and an existing Gazprom supply contract makes it currently difficult to use the reverse flow capability of the Balkan pipeline to provide Bulgaria, Romania, Moldova, and Ukraine with gas.

### **3.5: Ukraine Will Benefit from Nord Stream 2**

Proponents of this argument claim that Nord Stream 2 is good for Ukraine as the end of gas flows will be a net positive for the Ukrainian economy and civil society.<sup>52</sup> According to this argument, the transit fees Ukraine receives are distortive rent on the functioning of the economy. Some have likened the impact of transit fees to the rents the Netherlands received in the 1970s from gas production in the Groningen field. Greater economic activity in the gas sector and a stronger currency undermine economic activity in other sectors of the economy, generating the condition known as the 'Dutch disease'.<sup>53</sup>

The fundamental problem with this analysis is that transit fees in Ukraine are small in comparison with the size of the Ukrainian economy. Under the 2019 transit contract with Ukraine, Gazprom has pledged to pay for transit of a minimum of 40bcm. This is approximately €1000 million annually. Ukraine's total GDP in 2020 was approximately \$142 billion. The transit fees therefore represent less than 1% of GDP.<sup>54</sup> By contrast at the height of Dutch gas production in the 1970s, income from the gas fields amounted to 20% of annual government *revenues*.<sup>55</sup> With such a small impact on total GDP it is extremely difficult to see how any 'Dutch disease' effect is likely to exist.

Furthermore, Daniel Gros, in his recent CEPS paper, suggests that the effect of the transit fees is to undermine incentives to develop a gas export industry. Aside from the small size of the

<sup>48</sup> ENAGAS *LNG Services and Capabilities*, Madrid, October 2020.

<sup>49</sup> For an extensive discussion of the failure for 30 years to expand capacity across the Franco-Spanish border see Juan Vila, "The Elusive Gas Connection Between Spain and France", *Energy Post*, 23 August 2016, <https://energypost.eu/elusive-gas-connection-spain-france/>.

<sup>50</sup> This is via the UK Gas Interconnector, connecting into Belgium, and the BBL pipeline connecting into the Netherlands.

<sup>51</sup> Despite the fact that the interconnector is only 182km in length, has grant support from the EU and soft loans from the European Investment Bank, and despite construction commencing in 2009, the interconnector has not been completed.

<sup>52</sup> For example, Alexei Bayer, "Could Nord Stream 2 be Good for Ukraine?", *Kyiv Post*, 23 March 2021, <https://www.kyivpost.com/article/opinion/op-ed/alexei-bayer-could-nord-stream-2-be-good-for-ukraine.html>.

<sup>53</sup> Gros, *Nord Stream 2 - a red herring*.

<sup>54</sup> By contrast, if one looks at the value of natural gas to the Dutch economy in 1970, its discounted value was 90% of GDP; even in 2008, it represented 20% of GDP. Looking at the value of the Ukrainian transit contract, which only runs till 2024, it has a total value of no more than 2% of annual GDP. For the Dutch figures see: Frits Bos, "The Dutch Fiscal Framework: History, Current Practice and the Role of the Central Planning Bureau", *OECD Journal on Budgeting*, Vol. 8 No.1 (2008): 22.

<sup>55</sup> Gustafson, *The Bridge: Natural Gas in a Redivided Europe*, HUP, Harvard, 2020, 20.

transit fees, that argument overlooks the fact that Ukraine has enormous transit capacity. It is only using 40bcm of capacity for transit, while it has transit capacity of 146bcm. Consequently, Ukraine can happily transit gas, export gas if that is possible, and also use its substantial gas storage facilities to import gas for storage.

Furthermore, unlike Russia, Ukraine has fully adopted EU energy liberalisation rules, unbundled its state-owned gas company, and created an independent gas transmission system operator, GTSO. This means that Ukraine has an entity with significant incentives to encourage use of the transit system. Hence, rather than disincentives to develop the Ukrainian gas market, there are in fact significant incentives to do so, as a result of liberalisation. The transit fees do not act as any barrier to the economic development of the gas market or place any other barrier on the Ukrainian economy.

### **3.6: Nord Stream 2 Will Reduce CO2 Emissions**

Some have also argued that Nord Stream 2 will result in a small but significant reduction in CO2 emissions. For example, Gros argues that the utilisation of a new pipeline will result in lower CO2 emissions compared to the existing Ukrainian pipeline network.<sup>56</sup> This argument overlooks two rather significant points. First, the Ukrainian pipeline network can be refurbished to suppress any gas venting. As such, a new pipeline provides no decisive CO2 advantage. Second, as Korchemkin has demonstrated, the Kremlin's geopolitical aim to terminate the operation of the Ukrainian transit pipeline network will incur environmental consequences that should not be ignored.<sup>57</sup>

Korchemkin explains that as with Nord Stream 1, Nord Stream 2 comprises essentially steady state pipelines with a constant flow of gas running through the pipelines across the seasons. This means that, unlike the Ukrainian pipeline network, there is not much capacity to surge gas flow in winter at peak demand. Ukraine has enormous additional capacity and substantial storage capacity. That means in a cold winter, the Ukrainian pipeline network can go into surge mode, providing more gas for Europe. Crucially, as more and more renewables come onto the grid across Europe, the Ukrainian gas network could provide the surge gas balancing to renewables as demand accelerates during the winter. However, without access to Ukraine's surge capacity, European power grids will have to switch to coal to balance the load at times of peak demand.<sup>58</sup>

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<sup>56</sup> Gros, *Nord Stream 2 - a red herring*.

<sup>57</sup> Mikhail Korchemkin, "The Real Cost of Nord Stream 2 for the EU and for Russia", *EU House*, March 2018.

<sup>58</sup> *Ibid*, p.8.

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## 4. The (German) Illusions

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One of the strangest factors in the entire Nord Stream 2 saga has been the support for the pipeline of the German Government and much of the German political establishment. As explained below, the pipeline is not in the German national interest; it undermines trust in Germany amongst Germany's allies in Europe and on the other side of the Atlantic. Yet despite these factors – and the wall of criticism from across the West – the German Government has sustained its support of Nord Stream 2 over the last six years. Trying to understand the reasons for such steadfast support is difficult but one can identify three illusions which seem to underpin much German support for the pipeline: guilt, the promise of eastern riches, and memories of *Ostpolitik*.

### 4.1: Guilt

According to this narrative, Germans should support Nord Stream 2 because Germany owes a debt of guilt to Russia for the atrocities of the Second World War. Germany's President Steinmeier advanced this narrative in a recent interview, arguing that, in addition to the question of fuel sales, for Germans there is “another dimension”, noting that June 2021 would mark 80 years since the launch of Operation Barbarossa, the Nazi invasion of the USSR. He did say that the history “does not justify any wrongdoing in Russian politics today” but added, “we live in the presence of a difficult relationship, but there is a past before and a future after.”<sup>59</sup>

However, this view of the German-Russian relationship amounts to a substantial misplacement of German guilt. As Professor Timothy Snyder makes clear in *Bloodlands*, the force and brunt of Nazi atrocities fell upon Poland, the Baltic States, Ukraine and Belarus – the “bloodlands” of Soviet and Nazi terror.<sup>60</sup> It was these states within the Western USSR, or adjacent territories occupied by the USSR, that experienced some of the worst of the Nazi terror. If Germany wants to account for the moral burden of its Nazi past through its current foreign policy relations, it should surely also address the “bloodlands” states. Nord Stream 2 threatens the energy and supply security of at least two of those states: Poland and Ukraine.

### 4.2: The Myth of Eastern Riches

The deep belief in the potential commercial opportunities of the riches of Russia is deeply embedded in German culture. It goes back at least to the days of Catherine the Great and her encouragement of Germans to emigrate to Russia.<sup>61</sup> In the 19th century, the scale of German investment in Imperial Russia<sup>62</sup> was the focus of much German hope and interest. This myth of the promise of Russia lives on in Germany's prioritisation of its relationship with Russia and the prospects of commercial opportunities there. This is despite the fact that there is no modern basis for such commercial prioritisation. Germany exports far more individually to Poland, the Czech Republic and Hungary than it does to Russia.<sup>63</sup>

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<sup>59</sup> “Germany's Steinmeier angers Kyiv with his comments on Nord Stream, WWII”, *DW*, 9 February 2021, <https://www.dw.com/en/germanys-steinmeier-angers-kyiv-with-his-comments-on-nord-stream-wwii/a-56515956>.

<sup>60</sup> Timothy Snyder, *Bloodlands: Europe Between Hitler and Stalin* (New York: Basic Books, 2010). On this issue of misplaced German guilt, it is also worth listening to Professor Snyder's lecture given in the Bundestag in 2017 on *Germany's Historical Responsibility towards Ukraine*, [https://www.youtube.com/watch?v=wDjHw\\_uXeKU](https://www.youtube.com/watch?v=wDjHw_uXeKU).

<sup>61</sup> Roger Bartlett, “Foreign Settlement in Russia under Catherine II”, *The New Zealand Slavonic Journal*, no. 1 (1974): 1-22.

<sup>62</sup> Julia Bersch and Graciela L. Kaminsky, “Financial globalization in the 19th century: Germany as a financial center”, GWU Working Paper, September 2008, <https://home.gwu.edu/~graciela/HOME-PAGE/RESEARCH-WORK/WORKING-PAPERS/Germany-center.pdf>.

<sup>63</sup> According to Germany's statistical agency, exports to Poland were in excess of €64 billion, the Czech Republic €39 billion and Hungary €24 billion in 2020. By contrast, exports to Russia in the same year were only €23 billion. The statistics of the German statistical agency can be accessed here: [https://www.destatis.de/EN/Themes/Economy/Foreign-Trade/\\_node.html](https://www.destatis.de/EN/Themes/Economy/Foreign-Trade/_node.html).

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Nor is it feasible to argue that the import of natural gas constitutes the vital ‘riches’ of Russia which Germany must prioritise over its EU relationships. The world is awash in natural gas as a result of the twin revolutions in the gas market of shale gas production and the expansion of LNG capacity. In addition, the expansion of low-cost renewables further undermines any significant value of natural gas and, particularly in this context, Russian gas.<sup>64</sup>

### **4.3: The Memory of Ostpolitik**

The memory of *Ostpolitik*, the process of normalising and improving relations with the former East Germany, other states within the Warsaw Pact and the USSR, also plays a part in the underlying German commitment to supporting projects like Nord Stream 2.<sup>65</sup> But, as Von Studnitz explains in a recent essay, *Ostpolitik* was based on conditions that no longer apply. It was guided by German interests in making the division of Germany more bearable and keeping the prospect of eventual reunification open. For the Soviet Union, it was a matter of achieving recognition of the territorial reality that arose from Yalta.<sup>66</sup> The renunciation of the use of force contained in the 1975 Helsinki Final Act underpinned the *Ostpolitik* objectives.

However, the underlying problem with the concept of *Ostpolitik* in 2021 is that the Russian Federation is not the USSR. In the late Cold War period, the USSR within the European continent was a pacific power whose aim was to just hold on to its territorial gains from World War Two, resulting in its willingness to sign the Helsinki Final Act. By contrast, the Russian Federation is a disruptive power that seeks to overturn the European post-Cold War settlement. *Ostpolitik* may be able to generate benefits with a power that broadly accepts the current European state structures and territorial divisions and seeks recognition of what it holds. It is far harder to develop co-operation and work together on projects with a power that seeks to overturn the existing European settlement. Offers of co-operation and common projects are far more likely to be used to further the objectives of creating division and undermining the stability of the European democracies. This has proved the case with Nord Stream 2, as the controversial pipeline has divided European states, and Germany and the USA, all to Russia’s advantage.

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<sup>64</sup> Nord Stream 2 does not in any case result in Germany receiving any additional gas resources. Germany has created an energy supply problem for itself by closing down its fleet of nuclear power stations. However, Nord Stream 2 provides no new resources and is largely going to be exported from Germany. Thus, it will not provide any solution. The most likely solution in fact is that Germany will use more coal.

<sup>65</sup> Frederick Studemann, “‘Ostpolitik’ Breathes its Last in The Nord Stream 2 Pipeline Controversy”, *The Financial Times*, 12 February 2019, <https://www.ft.com/content/04903cb0-2eb0-11e9-ba00-0251022932c8>.

<sup>66</sup> Ernst-Jörg von Studnitz, “Deutsche-russische Beziehungen – wie kann es weitergehen?”, *Redoute Papers*, February 2021.

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## 5. The Realities

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This paper argues that there are essentially three uncomfortable realities which flow from Nord Stream 2. First, Germany must contend with the reality that Nord Stream 2 is immensely damaging to its own direct supply security and reputational interests. Second, the EU must recognise that the Nord Stream 2 controversy undermines the prospects for developing EU 'strategic autonomy'. Third, the United Kingdom must face the uncomfortable reality that – Brexit or no Brexit – its security interests are tied up with the European continent. It cannot ignore or disengage without threatening its own security. Disengagement on issues such as Nord Stream 2 carries a major security cost.

### **5.1: The German Realities**

Germany must address three issues resulting from its approach to Nord Stream 2. The first has already been extensively discussed above: Nord Stream 2 does not actually bring any new gas for Germany. Notwithstanding the extensive propaganda over the last six years, it will not help to fill any supply gaps left by the closure of the Dutch Groningen field or mitigate power losses due to the premature closure of the German nuclear fleet. Moreover, it certainly does not assist German supply security.

The second issue is that Nord Stream 2 undermines German (and EU) supply diversity. Currently, Germany and the EU have three distinct gas supply routes from Russia in northern Europe: Nord Stream 1 with 55bcm of capacity; the Yamal pipeline with 33bcm; and the Ukrainian pipeline network with approximately 146bcm (albeit only carrying approximately 40bcm). If Nord Stream 2 comes into operation, with the Ukrainian pipeline network then taken out of operation, German and European route diversity shrinks to Nord Stream 1 and Nord Stream 2 – with 110bcm of capacity operating for most of the way along one common route, as well as Yamal. In essence, German and European route diversity shrinks by one entire pipeline network.

This route diversity shrinkage is an even greater supply security risk than it first appears because, for most of the route for Nord Stream 1 and Nord Stream 2, each set of pipelines is laid approximately 500 metres apart along the Baltic seabed. It is a significant supply security risk to place 110bcm of annual gas flow in a narrow two-kilometre channel in a shallow sea. Aside from the risk of terrorist attack, a ship collision in the busy Baltic Sea or another accident could cause a rapid supply crisis.

The supply security risk is reinforced by the loss of the Ukrainian pipeline network. What is often overlooked in discussions surrounding Nord Stream 2 is that the Ukrainian pipeline network underpins European gas security. Not only does it have enormous transit capacity at over 146bcm, but it consists of a network of pipelines allowing it to provide gas to a number of delivery points at the EU/Ukrainian border. This gives it great supply flexibility. In addition, Ukraine has 32bcm of gas storage which makes it much easier to ramp up gas supply in the winter months.<sup>67</sup> All this European supply security resilience will be lost once Nord Stream 2 comes into operation as the network needs a significant flow of gas with which to maintain its operational efficiency.<sup>68</sup>

The third uncomfortable reality for Germany is the reputational damage caused by the Nord Stream 2 project. Germany, an EU Member State and NATO member, has promoted a project

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<sup>67</sup> Korchemkin, *The Real Cost of Nord Stream 2*.

<sup>68</sup> With little or no gas in the Ukrainian transit system it will be impossible to sustain the mass capacity of the system. It needs a minimum amount of gas flow to maintain the operation of the pipeline network.



which undermines the actual supply security of EU and NATO members. Moreover, it has pursued this project despite multiple objections from EU Member States and the USA. Four times the European Parliament has supported cancellation of the project by large majorities.<sup>69</sup> The EU Council was even able to put together a sufficiently large majority that Germany would not be able to apply a blocking minority to legislation extending the liberalisation provisions of the 2009 Gas Directive to import pipelines such as Nord Stream 2. The US has also intervened to support its European allies by directly applying two sets of sanctions: Section 7503 of the National Defense Authorization Act 2020 and Section 1242 of the National Defense Authorization Act 2021.

None of this transatlantic opposition has deterred Germany from continuing with the project. The consequence has been a significant loss of trust in the German political establishment. It is an open question as to whether Brexit or Nord Stream 2 has done more to damage EU Member States' trust in the UK and Germany respectively. From the point of view of many non-German politicians across continental Europe, the British Brexit political establishment may be unhinged and/or ideological but at least they did not work hand in hand with a hostile power to undermine the security of other European states.

The likelihood is that Germany will continue to suffer considerable reputational damage among European states and the United States. Even if the pipeline is completed the focus of the battle will shift from the question of the scope of US sanctions to the application of EU energy law, with years of conflict in the EU courts.<sup>70</sup>

Worse still, if the pipeline is completed but not fully operational because of legal battles in the EU courts, it is likely that Moscow will try to pressure the EU to use Nord Stream 2 by terminating the operation of the Ukrainian transit pipeline network, for example by terminating the transit agreement and being prepared many years of arbitration litigation. None of these legal battles and the prospect of Moscow seeking to provide Berlin with more leverage by terminating the operation of the Ukrainian transit network will do much for Berlin's reputation across the continent over the next decade.

Nord Stream 2 has also undermined Germany's green reputation. Over the last decade, Nord Stream 2 is the energy project that has taken up more of the Chancellor's and the German Government's time than any other project. Yet it did not meet any major green objective. Germany has spent this valuable political capital not on a multi-billion-dollar euro solar power capacity facility, or on establishing city-scale battery facilities to back up renewables, or on developing an integrated resilient grid capable of coping with renewable power and storage flows. Instead, it poured its political capital (and reputation) into a 55bcm natural gas pipeline. Green Germany has alienated its allies and undermined trust across the Union in return for just another natural gas pipeline.

## **5.2: Undermining the Development of European Strategic Autonomy**

From its earliest days, the EU has entertained the concept of developing strategic autonomy. This was first expressed by President De Gaulle in the early 1960s, with the idea of positioning the then EEC as an independent actor between the two superpowers of the United States and the USSR.<sup>71</sup> The modern development of European Strategic Autonomy (ESA) stems from a number of factors, some geopolitical, including the rise of China, Russian aggression on the

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<sup>69</sup> The latest resolution against Nord Stream 2 was passed on 29 April 2021 by 569 votes to 67.

<sup>70</sup> Riley, "Nord Stream 2".

<sup>71</sup> "Europe as a power, European sovereignty, strategic autonomy: a debate that is moving toward a more assertive Europe", *Fondation Robert Schuman*, 1 February 2021, <https://www.robert-schuman.eu/en/european-issues/0582-europe-as-a-power-european-sovereignty-strategic-autonomy-a-debate-that-is-moving-towards-an>.

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Union's eastern flank, the election of President Trump in 2016, and the consequent questioning of the solidity of the American security guarantee.<sup>72</sup> This was combined with a number of economic concerns, including Chinese control over rare earths, Huawei control over the 5G roll out, and the power and influence of US tech firms.<sup>73</sup> The EU was worried it could become lost in the slipstream of US/Chinese competition, while no longer being so sure of the solidity of the transatlantic alliance.

The controversy over Nord Stream 2 has had a very negative impact on the development of the ESA. German behaviour in relation to the pipeline raises a serious question over the capacity of the EU's Member States to recognise and respect others' key security interests. If the largest and most powerful Member State is willing to set aside the security interests of other Member States, what scope is there for a credible ESA? This is particularly concerning in cases where the state, Germany, is seeking to do a deal with an authoritarian third state that has hostile intentions towards a number of EU Member States and, arguably, the European Union itself. This demonstration of German unwillingness to take solidarity between EU states seriously, instead prioritising its own interests, was reinforced by its behaviour in the recent *Germany v. Poland* case.<sup>74</sup> This case involved a dispute over how much capacity Gazprom could use of the OPAL pipeline, the connecting pipeline for Nord Stream 1. The German Government, before the Court of Justice of the European Union (CJEU), tried to remove any legal obligation to limit Gazprom's pipeline capacity by arguing that the energy solidarity principle contained in the energy provision of the EU Treaty, Article 194(1), was devoid of legal effect. The German Government's lawyers sought to argue that Berlin owed no legal duty of solidarity to any other Member State despite the interdependence resulting from the creation of a single market in gas and despite German support for the ESA, which is underpinned by principles of mutual support and solidarity.<sup>75</sup>

The sense that the ESA is more hyperbole than policy is reinforced by the China-EU Comprehensive Agreement on Investment (CAI).<sup>76</sup> There are a range of concerns with the CAI, not least its unwillingness to address the human rights concerns relating to the treatment of Uyghurs in Xinjiang province. As with Nord Stream 2, the CAI appears to be another example of Germany being willing to sacrifice the values and interests of other EU Member States for what it perceives as its own economic interests. Germany is by far the largest EU exporter to China. In 2020 it exported over €120 billion of goods and services and had a trade surplus with China of over €22 billion.<sup>77</sup> The agreement was 'steamrolled' through the Commission in the last days of the German Presidency of the Union, much to the concern of a number of smaller Member States.<sup>78</sup> Unfortunately for Berlin, the subsequent behaviour of the Chinese

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<sup>72</sup> For further discussion, see Giovanni Grevi, "Strategic Autonomy for European Choices: The Key to Europe's Shaping Power", *EPC*, 19 July 2019, <https://www.epc.eu/en/publications/Strategic-autonomy-for-European-choices-The-key-to-Europes-shaping-p-213400>.

<sup>73</sup> Ulrike Franke and Tara Varma, "Independence Play: Europe's Pursuit of Strategic Autonomy", *ECFR*, 18 July 2019, [https://ecfr.eu/special/independence\\_play\\_europes\\_pursuit\\_of\\_strategic\\_autonomy/](https://ecfr.eu/special/independence_play_europes_pursuit_of_strategic_autonomy/).

<sup>74</sup> Case C-848/19 P *Germany v. Poland*.

<sup>75</sup> Judgment has not yet been handed down by the CJEU. However, on 18 March 2021, Advocate General Sanchez-Bordona did hand down his opinion. As a consequence, it is possible to see the arguments laid out by the German Government in the case. It is perhaps worth quoting the argument of the German Government as laid out by the Advocate General in his opinion at paragraph 88: "According to the appellant [Germany], energy solidarity is no more than a 'purely political notion' and not a legal criterion capable of supporting the inference of rights and obligations for the European Union or the Member States. In the appellant's view, owing to its abstract and indeterminate nature, solidarity in the energy sector cannot be 'relied on before the courts'."

<sup>76</sup> For full details and documentation of the EU-China Comprehensive Agreement on Investment see: <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2115>.

<sup>77</sup> "German exports post surprise rise as China trade sizzles", *Reuters*, 9 March 2021, <https://www.reuters.com/world/china/german-exports-post-surprise-rise-china-trade-sizzles-2021-03-09/>.

<sup>78</sup> "Germany's Drive for EU-China Deal Draws Criticism from other EU Countries", *Politico*, 1 January 2021, <https://www.politico.eu/article/germanys-drive-for-eu-china-deal-draws-criticism-from-other-eu-countries/>.

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government in Hong Kong and the sanctioning by China of British and EU officials including 5 MEPs, resulted in the CAI being placed in the deep freeze by the European Parliament. It voted on 20th May 2021 by 599 to 30 votes to refused to debate or consider endorsing the agreement until all Chinese sanctions are lifted. While Chinese behaviour has probably scuppered the CAI this emerging reality of Germany willingness to prefer its own perceived interests over the interests and values of other Member States will undermine the capacity of the Union to develop a comprehensive and credible ESA policy.

Instead, the EU will be left with at best a narrow ESA policy that seeks to strengthen Union capabilities within a deeper single market; strengthening the euro; enhancing the EU's regulatory power, particularly in the technology sphere, and improving supply chain security. Member States will still understandably be concerned about any proposed ESA measure which does not provide a legal regime that effectively protects the rights and interests of all Member States and prohibits the most powerful Member State from sacrificing their interests in negotiation with third states.

### **5.3: British Security and Continental Engagement**

Nord Stream 2 is not just a gas pipeline. It is a geopolitical development which threatens the security of several NATO states. Should Nord Stream 2 come fully into operation, the supply security of several states will be undermined and Russian influence enhanced. More dangerous still, the success of the project will encourage Moscow to take further measures to destabilise European democracies. From the Kremlin's perspective, despite the ostensible opposition to the project by the US and a number of European states, and in the teeth of its invasion of Georgia and Ukraine, and its ongoing occupation of the Donbass, the Kremlin would see that it could push the project to a successful conclusion. The lesson that the Kremlin will draw from a successful conclusion to the Nord Stream 2 project is that the European states are weak, or can be co-opted, and that the Americans are losing their influence on the continent. A successful conclusion (from a Russian perspective) to Nord Stream 2 will indicate to Russia that it could, with relative impunity, increase the pressure on NATO states on its eastern edge, all of which the UK is pledged to ultimately defend under Article 5 of the Washington Treaty.

The UK also has a significant security interest in Ukraine. As long as Ukraine remains an independent sovereign state, Russia's capacity to attack NATO states, by military or hybrid means, remains much more limited. This security interest has already been recognised in the Comprehensive Political, Free Trade and Strategic Partnership signed by Prime Minister Boris Johnson and President Zelenskyi in October 2020. Notably, the package included £1.25 billion in foreign export credit for a naval shipbuilding programme constructed to NATO standards to include a missile cruiser and frigates for the under-powered Ukrainian navy. This was part of a larger foreign export credit support package amounting to £2.5 billion. The UK is also providing a programme of support in eastern Ukraine. The Partnership Agreement also provides initial tariff reductions for goods and services, which could provide the basis for a broader trade agreement.<sup>79</sup>

Even if Nord Stream 2 is stopped by US sanctions or emasculated in the EU courts, Moscow is unlikely to give up seeking ways to destabilise NATO states and Ukraine. It has had some success recently with Turk Stream 2.<sup>80</sup> It will no doubt seek to develop new energy leverage

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<sup>79</sup> Bate C Toms, "Britain and Ukraine Unveil a New Strategic Partnership", *Atlantic Council*, 13 October 2020, <https://www.atlanticcouncil.org/blogs/ukrainealert/britain-and-ukraine-unveil-new-strategic-partnership/>.

<sup>80</sup> Stuart Elliott, "Russia's Turk Stream 2 link continues to redraw SE European gas map", *S&P Global Platts*, 8 February 2021, <https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/020821-russias-turkstream-link-continues-to-redraw-se-european-gas-map>.



mechanisms to increase Russian power and influence across NATO states and in Ukraine, as well as other mechanisms, spanning disinformation, corruption and cyber warfare. The lesson from Nord Stream 2 is that – Brexit or no Brexit – the UK cannot ignore threats that ultimately engage its own security obligations.

The hard reality here is that the cost of engagement with Nord Stream 2, and the manifold other security threats largely emanating from Moscow, is much lower than ignoring these threats only to see an aggravation in the overall security profile of Ukraine and the eastern flank of NATO. At that point, the cost of repelling these threats would be much higher.

Given the distractions of Brexit, it is perhaps understandable that the United Kingdom has been largely absent in opposing the Nord Stream 2 project. However, now that it has left the European Union, there is less justification for a lack of engagement with our broad security interests across the continent. The UK can work with the states of CE Europe, Ukraine, the European Union and the United States to enhance regional security. For instance, whatever happens with Nord Stream 2, the West should be looking at developing a proactive energy security strategy to disarm Russian energy power across the region. This would involve further integration of European and Ukrainian energy markets in the gas sector as well as finding greater access to LNG sources. It would also involve providing alternatives to Russian gas by completing electricity market synchronisation, strengthening the grid networks, and rolling out more renewables. Given the UK's historic role and experience in energy liberalisation across Europe, its experience in the renewable sector and its range of experienced energy investor funds, London could play a significant role in improving regional supply security.

The UK can also play a major role across several other fronts, including by promoting the rule of law, anti-corruption and anti-disinformation policies across the region. All such engagement in co-operation with key allies will reduce the scale and number of security threats, in turn making it less likely that the UK will need to act upon its fundamental security obligations. Proactive engagement is surely a much cheaper strategy than the alternative of reacting after the security situation has already dramatically worsened.

## **6. Conclusion. Nord Stream 2: Reinforcing the Transatlantic Alliance?**

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Clearly, there are a significant number of negative consequences to Nord Stream 2. The pipeline undermines the supply security of CE Europe and threatens the independence of Ukraine. It has also engendered considerable division and distrust within the European Union, and it has divided Germany from the United States. These are obvious negatives for European security that would be welcome in Moscow. However, in the longer term, the controversy over the pipeline may give rise to positive consequences for NATO and the Western alliance that will not be so welcome in Moscow.

The Nord Stream 2 controversy in Europe has reinforced the belief across the capitals of CE Europe that the United States remains the principal guarantor of their security. The pipeline controversy has also undermined much of the credibility of the concept of European Strategic Autonomy. Consequently, many European states are likely to conclude that the only credible security system remains with NATO and the broader transatlantic relationship.

In addition, as the security and reputational damage of the controversy over Nord Stream 2 becomes ever clearer in Germany, it appears to be causing a rethink in Berlin over the value and effectiveness of its Russian policy. Ironically, the longer Russia persists in pursuing Nord Stream 2, and the greater consequent damage to German reputation and interests, the greater the likelihood that Germany will shift position. This shift in position may well be assisted by the advent of a new government in Berlin in September which has a significant Green Party component. Any new Russian policy would have to be rooted in the common security interests of Germany and its allies with the admittedly difficult task at the same time of seeking to maintain an open door to Moscow.<sup>81</sup>

Much to Moscow's alarm, the end result of the Nord Stream 2 controversy may well be to strengthen the Western alliance. It may also result in the UK, EU and US co-operating to finally disarm Russian energy power in CE Europe and Ukraine.

### **Policy Recommendations**

In light of the above, this report makes five policy recommendations:

#### **Developing a Proactive Energy Security Strategy**

The principal policy recommendation is to develop a proactive European energy security strategy. There is a compelling case that the response of the West to the two decades of Russian pipeline strategies from completing the Yamal pipeline in 1997 to Nord Stream 2 today has been largely reactive. What is now required is a proactive energy security strategy that can dismantle Russian energy power in CE Europe and Ukraine. This should involve completing the gas infrastructure network in the region and ensuring alternative non-Russian supplies were available. With those gas resources in place, it should then be possible to undertake a significant roll out of renewables and enhance the capabilities of regional power grids, thereby further reducing the need for dependence on Russian energy. If this programme were supported by the US, UK and EU and undertaken at scale, the new greater capacity, cleaner and green regional energy market would render Nord Stream 2 irrelevant.

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<sup>81</sup> Von Studnitz, "Deutsche-russische Beziehung". Von Studnitz makes a compelling case that all the models of German-Russian co-operation in the 20th century are outmoded and that Germany needs to develop a new model of co-operation. That model would be rooted in its own values and those it shares with the other members of the alliance, while taking the long road of seeking to guide Russia onto a better path.

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## **Supporting Ukraine's Energy Sector**

Ukraine has always been the principal target of Nord Stream 2. From Moscow's perspective, Nord Stream 2 would weaken Kyiv, making it more dependent on Moscow and less relevant to Western Europe. This would make it easier for Russia to expand the scope of the war without undermining its gas exports. A functioning Nord Stream 2 pipeline will always be a threat to Ukraine. The US, UK and EU should support Ukraine by doing the following:

- a) First, Ukraine should be part of any Western proactive energy strategy. This should include fully integrating the Ukrainian energy market with that of the European Union. Such a policy would permit maximum use to be made of Ukrainian gas storage facilities. These are Europe's largest storage facilities with 32bcm of capacity and located usefully to CE Europe in Western Ukraine. Full integration and interconnection would allow Ukraine to not only become a customer but also a supplier of energy security to its neighbours-as full access to storage would provide a significant energy security hedge.
- b) Second, the UK, EU, and USA should support Ukraine to full exploit both its own significant gas resources and the roll out of renewables and the enhancement of its power grid. This should both enhance energy security and provide a basis for faster decarbonisation.

## **Developing an Energy Security Shield**

Germany should never have supported Nord Stream 2. Given the negative impact it has had on Germany it is doubtful that Berlin will support a similar project anytime soon. However, the prospect of other energy projects supported or sponsored by hostile powers continues to pose a threat. It is not difficult to imagine a situation in which other powers seek to increase their influence over states across the continent via 'investment' in their energy infrastructure: 'Investment' in one state as Nord Stream 2 illustrates, can lead to security risks in one or more other states. One way to deal with this threat via mechanisms such as the EU's Foreign Investment Screening regulation (EUFIS). This at the moment is a relatively weak coordinating instrument. There needs to be a stronger energy security shield against foreign investment hostile powers.

## **United Kingdom Participation in European Energy Security**

Brexit or no Brexit, the energy security of the continent remains relevant to British interests. The UK should play a greater role in European energy security especially as it has the experience and know-how. Energy liberalisation, largely initiated by the UK, is at the core of European energy security. The more diversified, transparent and open the market the less likely that third powers can control the market. In any supply crisis, the UK would be likely to be an exporter of energy security importing LNG and exporting gas via the Cross-Channel Interconnectors on full reverse flow. Given the mutual interest in energy security, the United Kingdom should engage on energy security issues with its European neighbours both at national and EU level.

## **United Kingdom Support for Energy Security in Ukraine**

In particular, the UK should assist Ukraine in developing a truly open, transparent and liberalised energy market bound by the rule of law and appropriate security safeguards. This is an area in which the UK could add significant value. UK knowhow, funding, technical support and encouragement of new investor flows could assist Ukraine in developing a more secure and cleaner energy system. The UK should also support the roll out of renewables and the strengthening of its power grid, alongside support for enhanced gas production permitting an effective means for the balancing of green power. The twin effect of more renewables and greater gas production would reduce the energy security threat posed by Nord Stream 2 and Gazprom regional market dominance.

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Title: "NORD STREAM 2: MYTHS,  
ILLUSIONS AND REALITIES"  
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