



BULLETIN

No. 7 (7) • January 28, 2009 • © PISM

Editors: Sławomir Dębski (Editor-in-Chief), Bartosz Cichocki, Mateusz Gniazdowski,
Beata Górka-Winter, Leszek Jesień, Agnieszka Kondek (Executive Editor), Łukasz Kulesa

Implications of the Russia–Ukraine Gas Dispute for the Construction of Nord Stream

Ernest Wyciszekiewicz

The feud between Russia and Ukraine over natural gas shipments is not going to exert any decisive influence upon the future of the Nord Stream pipeline, but it will be used as an argument to speed up the project. A likely consequence of the crisis will be polarization among EU member states, with ammunition provided for the venture's advocates and opponents alike. Over the coming months Russia will seek broader political support from EU member states to make it easier for the Nord Stream consortium to get all the permits required for the project to take off.

Background. The ongoing financial crisis, coupled with the expectation of declining gas prices, has prompted doubts in recent months about Nord Stream's capacity to raise adequate resources. The shareholders (Gazprom, E.ON, BASF and Gasunie) have already provided most of their capital contributions—30% of €7,4 billion, with the rest (70%) expected to be garnered in financial markets. What remains unknown is the influence of Gazprom's deteriorating condition on a scaling-down of its investment plans. It should be expected that the development of Russian gas deposits dedicated to the Baltic pipeline will decelerate. The consortium's chances, though, are boosted by the adopted method of raising external finance for the project, where the credit decision is linked to project profitability evaluation, rather than the consortium's creditworthiness. Consequently, the decisive factor will not be finance, but rather the permission to go ahead with project construction from the countries whose territorial waters or exclusive economic zones are to be involved (Russia, Finland, Sweden, Denmark, Germany). Towards the end of 2008, Sweden rejected a request from the consortium, which has until the early months of 2009 to supplement its blueprints. Nord Stream hopes to receive all the required permits in the first half of the year and thus avoid further delays (after last year's announcement that the first leg of the pipeline would open in late 2011 rather than in 2010).

The consortium's optimistic message about project implementation was undermined by Prime Minister Putin, who warned in November 2008 that Western partners' procrastination could lead to Gazprom's withdrawal from the scheme. Obviously, the controversy surrounding the project has slowed down the whole process so much as to necessitate recourse to political pressure.

Gas Dispute and Support for Nord Stream. The impact of the gas dispute on Nord Stream's fortunes will depend not so much on who is to blame for the disruption of deliveries to the EU, as on the effectiveness of Russian lobbying efforts. The European Commission has apportioned responsibility between both sides—but only as a diplomatic evasion, reflecting its unwillingness to get involved in shady relationships between Russia and Ukraine. While the positions taken during the crisis by individual EU member states were carefully balanced, their assessment of developments may prove entirely different, which will also fuel controversy around Nord Stream.

Depending on interpretation, the dispute provided strong arguments for both the protagonists of the project and its critics. Russia, during the crisis, sought clear political support for Nord Stream from Germany and France, and it managed to obtain such assurances from the German chancellor. For financial and political reasons, Russia is running against time. The position of Sweden, in particular,

is assuming great importance, with the country taking over the EU presidency in the second half of 2009. But Sweden may find it risky to consent to the pipeline, as this could jeopardize a major goal of the presidency, namely the adoption of the EU's Strategy for the Baltic Sea. Nord Stream consortium realizes the great weight of the coming months and will seek to obtain start-up permits from all the parties concerned as soon as possible, drawing on Russia's diplomatic assistance.

Ukraine Discredited. Russia argues that the need to reduce risks involved in transit through an unstable and unreliable Ukraine has now become more obvious, and it will play up Nord Stream's relevance for the security of natural gas supply to the EU. The deteriorating technical condition of the Ukrainian pipeline network will also be cited as an argument for lessening the dependence on transit. Moscow will seek to weaken the opponents' line of reasoning that the project poses a threat to the EU's energy security. Strangely enough, the Russian government accused Ukraine of abusing its monopolistic position for political gains—a charge previously leveled against Gazprom.

Costs. Russia will seek to alter the character of Nord Stream pipeline costs discussion, confined so far to juxtaposing the estimates of the Baltic and overland routes. The centre of gravity will now be shifted towards the opportunity costs that would emerge in the event of the project's abandonment and recurring disputes with transit countries in the future. The project's economic rationale will be built around the Ukrainian route's uncertainty and the need to disperse risks, something which will very likely fall on appreciative ears in some quarters in the European Union.

Counterarguments. Gazprom has vitiated the image of a solid supplier it seeks to project. An unprecedented disruption of EU-bound supplies will produce major psychological consequences—remembering that confidence in the supplier is also influenced by subjective factors—and also give a boost to the development of a European energy policy. A possible repetition of similar action towards EU suppliers will now have to be factored in risk analyses and crisis management plans even by the West European buyers, whose dependence on Russian supplies will increase once the Nord Stream project is completed.

Expecting such an interpretation, Prime Minister Putin described Nord Stream as the EU's insurance policy against repeated Ukraine-linked crises, thus modifying one of Gazprom's arguments. Previously, the monopolist argued that Nord Stream would not compete with, but only complement, the Ukrainian routes. And that argument actually remains relevant, given that even after Nord Stream's completion, the most important export route for natural gas will continue running through Ukraine. But if, instead of the EU as a whole, the focus is shifted to individual member states buying Nord Stream gas (e.g. Germany, Belgium), then the project can indeed provide a safeguard against possible crises in the future. The emergence of the pipeline will weaken the transit position not only of Ukraine, but also of Slovakia and Poland, thus making even more asymmetrical the interdependence between Central European transit and consuming countries on the one hand, and Russia on the other. This will weaken the EU's cohesion, with a higher level of energy security of some member states thus achieved at the expense of others.

The crisis is likely to help the EU in developing a common position on the diversification of sources, not just supply routes. The Union's determination to work out a coherent energy policy, full with crisis response mechanisms, will be crucial. Otherwise, member states will be inclined to favor unilateral initiatives. Russia is likely to question the advisability of Community-wide arrangements, as has been indicated by its suggestions sent to Central Europe, to the effect that part of the blame for the crisis lay with the European Commission, incapable as it was to exert pressure on the key transit country.

Conclusions. The Russia–Ukraine dispute has come at a time when Nord Stream-related decisions are expected from Baltic countries, and so it may be used in project promoters' arguments for speeding up the process. Although much seems to indicate that Nord Stream will be carried out—backed by Russia, the European Commission, major member states and large corporations—a failure to get Sweden's go-ahead in the coming months could cause further time and cost overruns. More vigorous Russian activity should, therefore, be expected to press for a final settlement of the political and financial conditions for North Pipeline construction.