

## The North European Pipeline

Increasing Energy Security or Political Pressure?

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On 8 September 2005, German and Russian industry, in the presence of both Chancellor Gerhard Schröder and President Vladimir Putin, signed an agreement on the construction of the much-discussed natural gas pipeline running offshore through the Baltic Sea. The Russian monopolist *Gazprom* has been intensely interested in this pipeline over the past years, as it would create an alternative gas transport route to Western Europe, which has traditionally led through Belarus, Ukraine, and Poland. However, while a key selling point for this deal, German energy security will, in fact, not be increased by the pipeline,—especially, if compared to its alternative, the expansion of existing continental pipelines. The traditional transit countries have expressed concern over the German-Russian move, since they fear that their interests have not been taken into account. These concerns could be addressed by including transit countries into the German-Russian Energy Dialogue.

During the 1990s, bilateral relations between Russia and Ukraine were noticeably strained by continuous theft of natural gas from the transit pipeline system on Ukrainian territory. As this issue could not be easily solved, *Gazprom* decided 1997 to initiate a joint venture with the Finnish gas supplier *Neste Oy* (since renamed to *Fortum*) to build the “North Transgas Pipeline” (also called “North European Pipeline,” NEP). Original plans had the pipeline supply gas to Western Europe from the yet undeveloped super-giant Shtokman field in the Barents Sea. Originating in Murmansk, the pipeline was to transit Finland down to the Russian Baltic Sea, then continue on

seabed through the Baltic Sea to Germany and Denmark with branches to Sweden.

After the EU awarded the project the status of a “Trans-European Network” in December 2000, *Gazprom* and *Fortum*, together with their most recent German partners, *Ruhrigas* and *Wintershall*, agreed upon a feasibility study a few months later. Even though the EU in June 2003 agreed to cover the cost of this study, it was never carried out. At about the same time, during a visit to London by President Putin, the UK signed a memorandum of understanding concerning the pipeline, as the country wishes to supply its anticipated gas deficits with Norwegian and Russian gas. Shortly

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The project comprises 900 km of pipelines on Russian territory to connect to the existing long-distance pipeline system and approximately 1200 km of sea-bed pipeline running from Wyborg to Greifswald. The gas will feed into the German grid, from where it can be transported to the UK. Several off-branches are planned, to Finland, Kaliningrad, and Sweden. Costs are estimated at \$2-\$6 billion, depending on the specific construction plans. A corresponding mainland pipeline would be significantly cheaper, while it costs transit fees during operation. The pipeline is planned to become operational in 2010 with a capacity of 27.5 bcm/y—a possible parallel extension later on may double this amount. Approximately half of initial (and extended) capacity is dedicated to Germany.

**Perspectives:** German natural gas imports in 2005 total 95 bcm, of which around 40 bcm originate from Russia. German gas imports are forecast to increase to 105 bcm in 2010 and rise to 150 bcm in 2030, half of which will probably come from Russia.

*Wintershall*, as part of its NEP activity, is engaging in a joint venture with *Gazprom* for production at the Western Siberian gas field Jushno-Russkoje. The produced gas will supply the pipeline with approximately 25 bcm/y for 30 years. *Gazprom* holds a majority stake of 51% in the venture, the rest being shared among *Wintershall* and *E.ON/Ruhrgas* or further additional Western partners.

thereafter, in October 2003, two other major European energy companies, TotalFinaElf and Royal Dutch Shell, expressed their interest in joining the project.

However, the pipeline project received a serious setback in March 2004, when *Gazprom* decided to export future Shtokman production by tankers as liquefied natural gas (LNG). As this made a pipeline through Finland pointless, the Finnish *Fortum* quit the consortium. Eliminating supply of gas from the Shtokman field, new plans connected the NEP to the existing Russian long-distance pipeline system that transports natural gas from the Western Siberian gas-producing regions to Europe. The German gas industry under the leadership of *E.ON/Ruhrgas* energetically pushed the pipeline project, with the support of Klaus Mangold, Chairman of the Industry Association's East-West Committee. Bit by bit, other foreign competitors abandoned the project. While this development could be interpreted as a successful move by *E.ON*, it could equally be understood as a highly efficient *Gazprom* strategy to sell its favorite project

to the highest bidder. The huge interest in the NEP project may seem surprising, as the project's cost efficiency is at best questionable, but demonstrates the success of Russian lobbying in promoting tightly defined Russian national interests.

### **Russian interests**

For state-controlled *Gazprom* and the Kremlin, a North European Pipeline allows the circumventing of traditional gas transit countries Ukraine, Belarus, and Poland. From the Russian perspective, this fulfils several strategic objectives. By significantly raising its bargaining position vis-à-vis the transit countries, *Gazprom* could renegotiate current transit fees and increase prices of gas exports to Belarus and Ukraine, which are currently far below European prices. Furthermore, the NEP would allow for an alternative export route should a disruption of the current pipeline occur—however unlikely this scenario is under the political situation among the countries involved. At the same time, the pipeline route envisages a branch to the Russian enclave of Kalinin-

grad (currently supplied through Belarus and Lithuania), thus ensuring Russian supply independence. From a geo-strategic point of view, the new pipeline is a move in the “great game” in Russia’s Western backyard that diminishes the economic weight of transit countries and the realm of potential anti-Russian behavior.

### **Alternative routes, interests, and fears of current transit countries**

Russian gas exports to Western Europe are mainly routed through the Ukrainian pipeline system, at a rate of 115 billion cubic meters per year (bcm). This network was originally designed to have a name-plate capacity of 175 bcm that could easily be attained with an overhaul of existing pipelines and construction of additional compressor stations. This renovation had been planned in June 2002 by the “Gas Transport Consortium” formed by Ukrainian President Leonid Kuchma, Russian President Putin and the German Chancellor Schröder. However, a clear division of tasks never materialized. Russia had favored obtaining a formal concession for operating the long-distance gas pipelines located on Ukrainian territory, but this idea faced heavy opposition in the Ukraine. Subsequently, Russia lost interest in the consortium. The sole pipeline constructed within the framework of this consortium is a pipeline that runs from Turkmenistan through Russia to the Ukraine.

At the same time, a pipeline alternative involving Belarus and Poland is currently on hold. The “Yamal-Europe” pipeline project, to be finalized in 2005, will add another 30 bcm of gas exports to Germany, with supplies originating from West Siberia, not yet from the Yamal Peninsula. From the beginning, plans called for the expansion of this project by a second parallel pipeline of same capacity. However, *Gazprom* seems to have lost interest in this expansion, giving higher priority to the NEP—a consequence of the fact that bilateral relations with Poland and Belarus

are not at their best right now. Specifically, Moscow did not appreciate Poland’s support for the 2004 Orange Revolution in Ukraine, nor is Russia enthusiastic about Belarusian President Alexander Lukashenko’s confrontational stance towards it, which has been motivated primarily by his country’s domestic fragility.

In 2004, Poland, Ukraine, and the Baltic states proposed a third option for Russian gas exports, the so-called “Amber Pipeline.” It was to be routed from Russia through Latvia and Lithuania, and then to join and parallel the Yamal-Europe pipeline in Poland. Nonetheless, due to lack of interest from the Russian side, this proposal is highly unlikely to be carried out.

Russia intends to increase gas exports to Western Europe from the current level of 140 bcm to 190 bcm in 2010 and to over 200 bcm in 2020, along the lines of a massive rise anticipated in European demand. This can be achieved by increasing transport capacities of existing pipelines through Belarus/Poland and the Ukraine or through the NEP or by LNG exports. The latter transport option would deliver gas from the gas fields in the Barents Sea or on the Yamal Peninsula to a world gas market, including to Europe—which would make additional pipelines through the transit countries unnecessary. In this case, the political and economic weight of the transit countries would clearly diminish.

### **German and European interests**

For reasons of energy security, European nations are intrinsically interested in a diversification of their energy imports and appreciate diversified import routes. Consequently, the EU supported the NEP from the start. Germany, backed during its reunification by the Russian side in 1990, enjoys very good relations to Russia and aims at a “strategic partnership,” bolstered by an “energy partnership.” Both sides see the NEP as an instrument and element in this partnership. At the same time, German energy industry seeks to secure long-term

Russian gas supply, and their partners in the construction industry expect massive orders during the building phase of the pipeline. Furthermore, the German side expects the NEP project to function as a role model for future cooperation between major German and Russian companies, as traditionally trans-border cooperation has been dominated by small to medium-scale investments.

When constructed around 2010, 40% of German gas imports from Russia (which amounts to 20% of total German gas imports) will transit the North European Pipeline. However, that does not mean that the NEP will automatically increase energy security for Germany, because current continental pipelines from Russia to the West have proven secure and can easily be expanded. It can be argued that two other particulars of Russian gas supply are far more important for German and European energy security: rapidly increasing gas production costs and excessive Russian domestic consumption, both of which heavily constrain export capacities.

Finally, Germany cannot achieve energy security solely based on Russian reserves and Russian willingness/capability to export. Supplies from Africa, the Middle East, and especially Iran will be necessary, and worldwide transportation of liquefied natural gas is set to become more important in the future. Such regional diversification of gas import sources would actually do much to increase energy security for Germany.

Insofar, pure economic advantages of the NEP are rather meager. In contrast to that, collateral damage has been rather large and quite distinct: the project weakens the position of Germany's Eastern neighbors vis-à-vis Russia and stokes fears and suspicions concerning Germany's foreign policy goals. In this regard, Poland's frantic reaction to the project becomes explicable, as deeply rooted Polish aversions against its two powerful neighbors are revitalized—neighbors who share a history of agreements to Poland's detriment. The EU and

especially Germany would be well advised not to ignore the new EU member states Poland, Estonia, Lithuania, and Latvia and their uneasiness towards the NEP. By the same token, European countries should best take into account Ukrainian worries concerning their marginalization in terms of energy policy.

### **Damage control**

While the pipeline has become a highly politicized project, it should prompt German policymakers to better coordinate future energy policy in Eastern Europe and to devote more time and effort to explaining policy goals to Eastern partners. This could be achieved if the German-Russian Energy Dialogue were opened for transit countries and bound more visibly into the parallel EU-Russian Energy Dialogue. It is also conceivable to revitalize the Ukrainian-Russian-German gas transport consortium and link it into such extended Energy Dialog. Finely tuned balancing of German-Russian relations within the context of EU Neighborhood Policy is necessary—with tactfulness on a notably higher degree than was applied during the NEP project. Such foreign and energy policy would avoid the misleading and critical impression that Germany was carrying out its own special projects—outside the core of European policy towards Eastern Europe.

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