



The Importance of Natural Gas Trade for the War in Ukraine

Simon VAN HOEYMISSEN¹

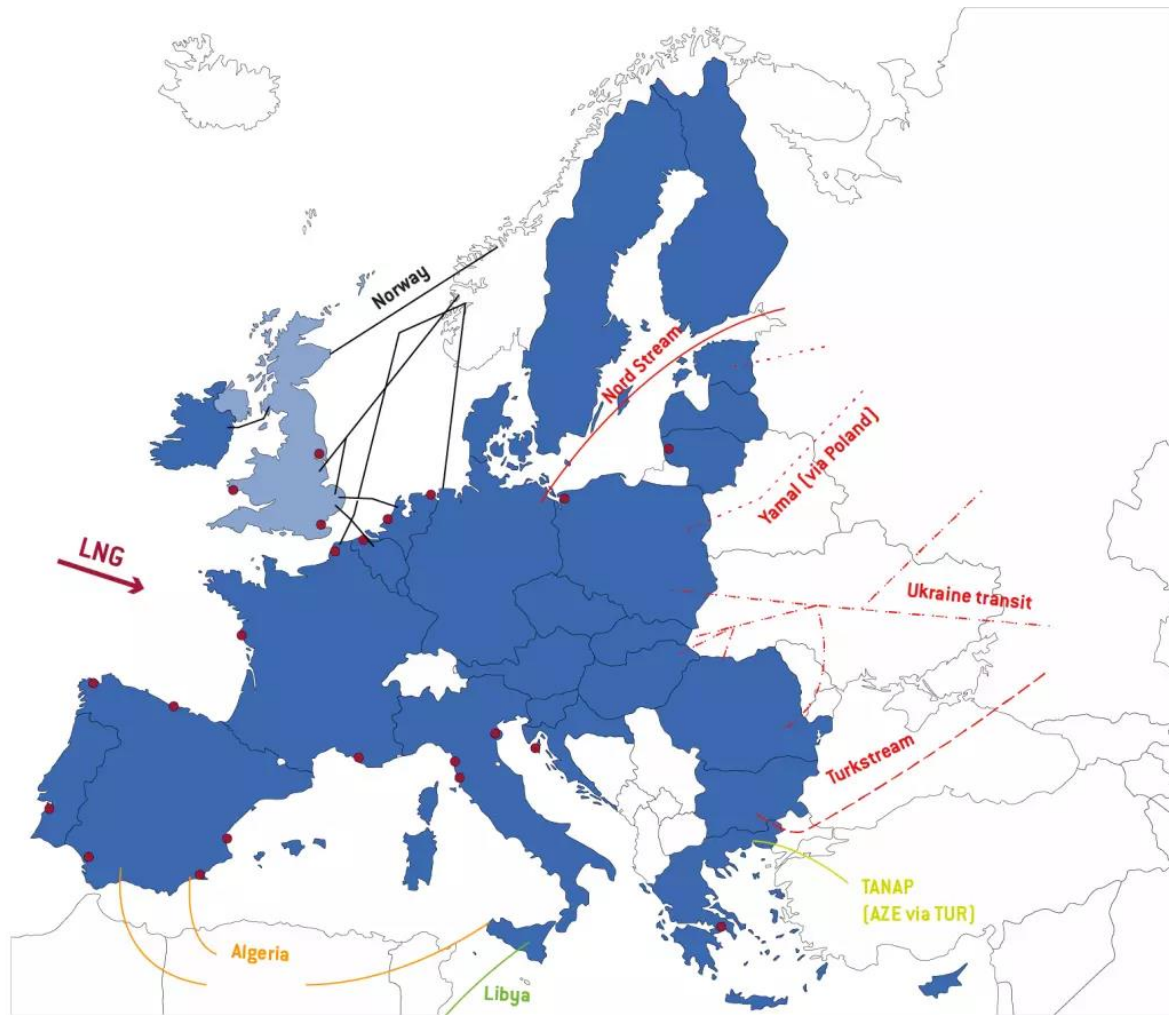
Image purchased under Standard License from Shutterstock.com, reference order ID CS-0A32D-286B.

The importance of natural gas in EU-Russia relations

Russia's natural gas export to EU countries has long been a highly politicised issue. On the one hand, it was crucial for Russia's domestic stability. The revenue it made from its gas exports allowed the Kremlin to shore up its popularity by selling gas to Russian households at lower prices than it costs to produce. It also financed Russia's social expenditures and military build-up. On the other hand, gas trade was a direct instrument of the Kremlin's foreign policy. Until recently, many Central European countries were critically dependent on gas imports from Russia. These countries inherited gas transportation infrastructure that dated from the Soviet era, designed to orient their economic and political life towards Moscow. It enabled the Kremlin to set gas prices for each importing country in line with its obedience. As such, governments were strongarmed into adopting pro-Russian policies. Famously, in early 2022 former German chancellor Gerhard Schröder was nominated to sit on Gazprom's advisory board². Today, we continue to see this dynamic play out in Russia-dependent countries.

¹ Researcher on European security and defence policy at the Centre for Security and Defence Studies (CSDS). The views expressed in this document are those of the author and do not necessarily reflect the views of the Belgian Defence or the Royal Higher Institute for Defence.

² Laurenz Gehrke, "Former German Chancellor Schröder nominated for Gazprom board," *Politico*, February 4, 2022, <https://www.politico.eu/article/outrage-germany-ex-chancellor-schroder-gazprom-board-nomination/>.



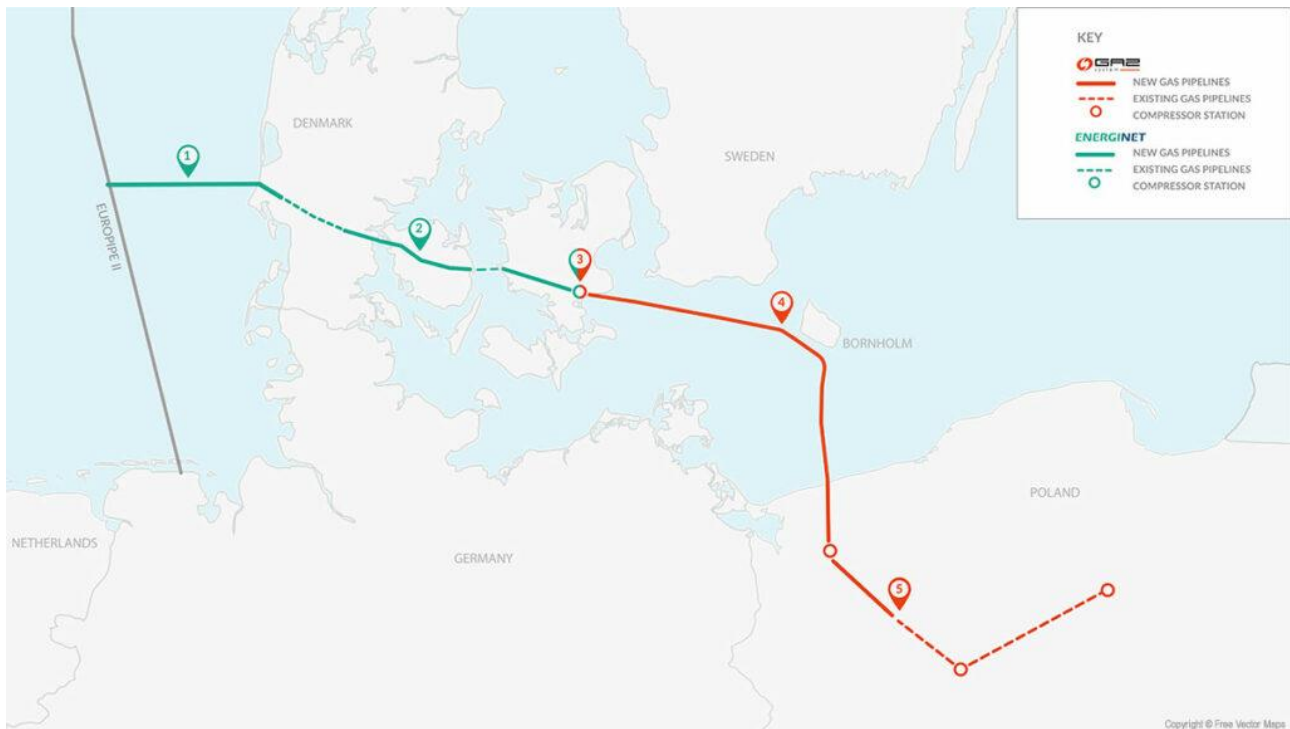
Major gas pipelines to Europe³ (Source: [Bruegel](https://www.bruegel.org))

However, gas transportation infrastructure also gives influence to the transit countries they cross. In 2006 and 2009, amidst gas price disputes between Ukraine and Russia, the latter reduced the flow of gas to Ukraine. However, European countries further downstream depended on the same pipelines and faced shortages of supply. This gave Ukraine an advantageous bargaining position. However, Russia successfully overcame this by building (together with a host of West-European partners⁴) the Nord Stream I and II pipelines, which delivered Russian gas through the Baltic Sea directly to Germany. The bypass of traditional transit countries such as Poland and Ukraine caused such anger that they prompted the Polish Foreign Ministry to repeatedly refer to the Nord Stream pipelines as the “Second Molotov-Ribbentrop pact”⁵. Since the actual Molotov-Ribbentrop pact set the stage for the mass execution of 22,000 Polish elites and destruction of the state, this shows the sensitivity of the issue for Poland.

³ Georg Zachmann, Ben McWilliams, Ugnė Keliauskaitė, and Giovanni Sgaravatti, “European natural gas imports,” Bruegel, accessed August 26, 2024, <https://www.bruegel.org/dataset/european-natural-gas-imports>.

⁴ Five major companies are involved in Nord Stream: Russia’s Gazprom (51%), Germany’s Wintershall Dea AG (15.5%) and E.ON (15.5%), the Nederlandse Gasunie (9%) and France’s ENGIE (9%). (Nord Stream, “Our Shareholders,” accessed August 26, 2024, <https://www.nord-stream.com/about-us/our-shareholders/>.)

⁵ Dominik Istrate, “Polish minister compares Nord Stream 2 with Molotov-Ribbentrop Pact,” Emerging Europe, August 29, 2019, <https://emerging-europe.com/analysis/polish-minister-compares-nord-stream-2-with-molotov-ribbentrop-pact/>.



The Baltic Pipe that transfers Norwegian gas to Poland opened in September 2022⁶ (© Free Vector Maps)

Over the last decade, we have observed several trends that depoliticise Central Europe's gas trade. Firstly, the EU's Third Energy Package of 2009 served to break up monopolies of gas giants and liberalise the gas market. This "unbundling" separated the ownership structures of companies involved in the generation, transportation and supply phases of natural gas trade⁷. This blocked them from leveraging a dominant position in one phase to undermine competition in other phases. Secondly, the sprawling infrastructure for liquified natural gas (LNG) (which, crucially, is transported by ships instead of pipelines) enabled a strategic shift away from long-term agreements towards spot-market price setting. For example, transit on the Polish section of the Yamal pipeline was until May 2020 arranged by a long-term transit agreement with Gazprom⁸. Since then, the EU Capacity Allocation Mechanisms Network Code regulation 2017/459, openly auctions its usage on a yearly, quarterly, monthly, daily and intraday basis. In July 2021 Gazprom decided not to book an annual contract, signalling that Gazprom might no longer use that pipeline for the entirety of the ensuing twelve-month-period to transport gas to Europe⁹. Since 2022, the Yamal pipeline has been shut down and Gazprom's ownership shares have been fully transferred to Poland¹⁰. Thirdly, European countries, the European Commission's Connecting Europe Facility (CEF), and other formats such as the Three Seas Initiative

⁶ Nadja Skopljak, "Final preps underway for Baltic Pipe pipelaying," Offshore Energy, May 7, 2021, <https://www.offshore-energy.biz/final-preps-underway-for-baltic-pipe-pipelaying/>.

⁷ European Commission, "Third energy package," accessed August 26, 2024, https://energy.ec.europa.eu/topics/markets-and-consumers/market-legislation/third-energy-package_en.

⁸ Jo Harper, "Poland's gas company won USD1.5bn compensation claim from Gazprom," May 23, 2020, Obserwator Finansowy, <https://www.obserwatorfinansowy.pl/in-english/polands-gas-company-won-usd1-5bn-compensation-claim-from-gazprom/>.

⁹ Mariusz Marszałkowski, "Gazprom decided not to book the Yamal pipe, but it doesn't mean it will abandon it," July 9, 2021, Biznes Alert, <https://biznesalert.com/gazprom-decided-not-to-book-the-yamal-pipe-but-it-doesnt-mean-it-will-abandon-it/>.

¹⁰ Interfax, "Poland transfers Gazprom's stake in gas transmission JV EuRoPol GAZ to Orlen", October 11, 2023, <https://interfax.com/newsroom/top-stories/95326/>.

Investment Fund¹¹ invested heavily in a more diversified network of gas transportation infrastructure. Poland represents a particularly interesting case. In 2019, Piotr Wozniak, president of Poland's PGNiG energy company, stated the company's intention to move away from Russian gas and not to extend the Yamal contract that was due to expire at the end of 2022¹². To that end, it planned to leverage the regassification facility in Świnoujście and the Baltic Pipe to allow for gas imports from Qatar, the US and Norway.

In the long term, this could even make Poland a net exporter that services the markets of its neighbours, including Ukraine. This pipeline not only gave Poland and Ukraine the prospect of becoming independent of Russian gas, but also the ability to block gas transfers to the West through the pipelines on their territories¹³. A salient detail of recent developments is that the Baltic Pipe was opened on 27 September 2022, the day after Nord Stream was sabotaged. All these developments were set to undermine Moscow's traditional instrument of power over Central Europe, prompting some to argue as early as 2019 that Russia may launch a full-scale invasion of Ukraine in the beginning of 2022¹⁴. After Russia's annexation of Crimea and its initial invasion of the Donbas, Ukraine stopped buying Russian gas¹⁵. While Russia's full-scale invasion in 2022 prompted many EU countries to do the same, some continued to buy Russian gas. Of the Russian gas transiting Ukraine in 2023, 6 billion cubic meters (bcm) went to Austria, 6.5 bcm to Slovakia and 1 bcm to Hungary¹⁶. Consequently, Gazprom continued to pay Ukraine 7 billion US dollar for the use of its transit infrastructure as part of a five-year agreement that will end in December 2024. As an alternative, Russia can use the TurkStream pipeline to transport gas via Bulgaria to Serbia, North Macedonia, Hungary and Austria¹⁷. This leaves Russia with major influence over, and interest in, the Western Balkans.

A final point to make about the current situation, is that Germany's Uniper has won a legal case against Gazprom before an arbitration tribunal in Stockholm. This verdict sentences Gazprom to repay 13 billion euro in damages linked to its failure to deliver gas to Uniper since mid-2022 and grants the latter the right to terminate existing contracts, which it did.¹⁸

¹¹ Three Seas Initiative Investment Fund, "Three Seas Initiative Investment Fund signs agreement to invest in greenfield gas infrastructure in Romania," May 24, 2022, <https://3siif.eu/news/three-seas-initiative-investment-fund-signs-agreement-to-invest-in-greenfield-gas-infrastructure-in-romania>.

¹² Dominik Istrate, "Poland ready to halt import of Russian gas," Emerging Europe, October 24, 2019, <https://emerging-europe.com/analysis/poland-ready-to-halt-import-of-russian-gas/>.

¹³ Krzysztof Wojczal, "Do 2022 roku Rosja wywoła wojnę w Europie lub na Bliskim Wschodzie" ("By 2022, Russia will start a war in Europe or the Middle East,") September 24, 2019, <https://www.krzysztofwojczal.pl/geopolityka/europa-wschodnia/rosja-europa-wschodnia/do-2022-roku-rosja-wywola-wojne-w-europie-lub-na-bliskim-wschodzie/?fbclid=IwAR2-48NOMjUe6wvGh7vng-mRyXlthfQlq01X4kbTGwOaRXjD2mOXz4VJ8Sg>.

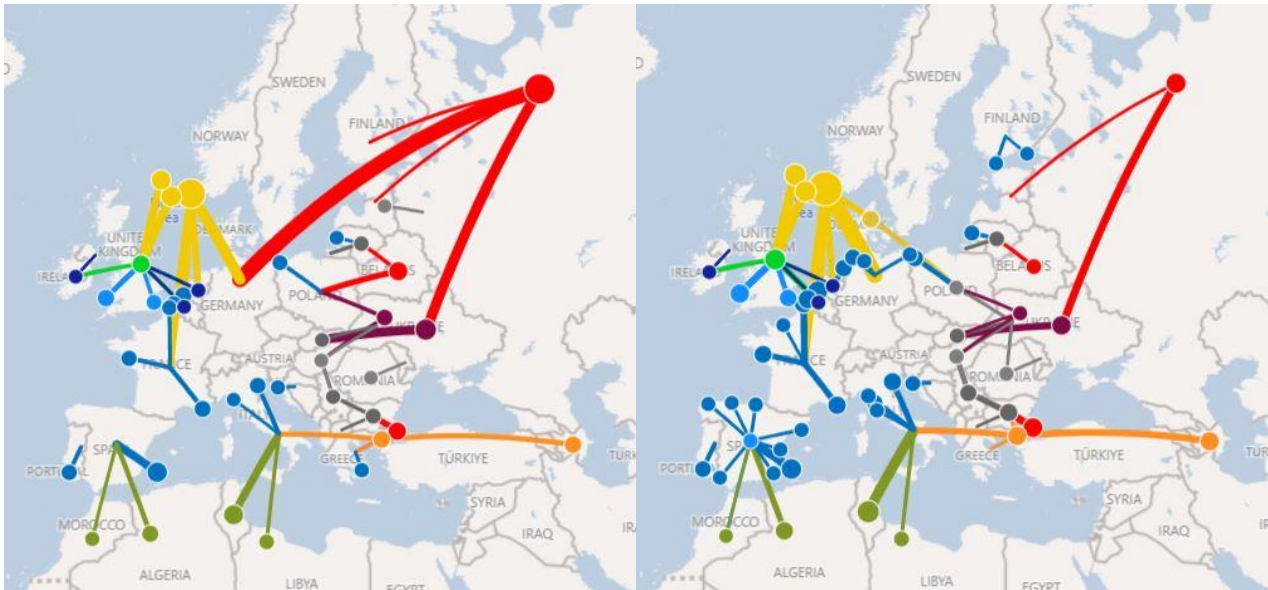
¹⁴ Wojczal, "Do 2022 roku Rosja wywoła wojnę w Europie lub na Bliskim Wschodzie".

¹⁵ Ukraine stopped buying gas directly from Russia in November 2015, but still buys it indirectly from traders in the EU as part of the Russian gas that transits through Ukraine via the so-called "reverse flows". (Euractiv, "The Brief – Russian gas to Europe changes route," August 27, 2024, <https://www.euractiv.com/section/global-europe/opinion/the-brief-russian-gas-to-europe-changes-route/>.)

¹⁶ Euractiv, "The Brief – Russian gas to Europe changes route."

¹⁷ Euractiv, "The Brief – Russian gas to Europe changes route."

¹⁸ Uniper, "Uniper terminates Russian gas supply contracts," June 12, 2024, <https://www.uniper.energy/news/uniper-terminates-russian-gas-supply-contracts>.



Overview of physical gas flows to Europe (2021, left, compared to 2023, right)¹⁹ (Source: [ENTSOG AISBL](https://entsog.eu/))

How does Ukraine's Sudzha offensive fit into this?

Many commentators were stunned by the Ukrainian incursion into Russia starting on 6 August 2024. At a time of dire manpower and material shortages on the Eastern front, high quality Ukrainian units were used along a part of the border that had not been the stage of any major combat operations by Russia. Moreover, Ukraine employed Western equipment in the offensive, running the risk of triggering condemnation and the withdrawal of material support by allies. Several goals for the operations have been discussed. This includes drawing Russian forces away from their offensive on the Eastern front, the topping up of the “exchange fund” of prisoners of war and the seizure of the nuclear power plant in Kursk²⁰. The exact military objectives of the offensive have been the object of much speculation. An interesting and plausible possibility is that its primary objective is not of a military nature, but is the seizure of the gas metering station in Sudzha.

In the Ukraine war, both sides have prioritised each other's energy infrastructure as targets of strategic bombing campaigns. Russia has mainly targeted Ukraine's electrical power grid (whose Soviet-era infrastructure is in some parts critically incompatible with aid provided by its Western allies²¹), focusing on nodal substations, but also thermal and hydro-electric power stations (e.g., the destruction of the Kakhovka station)²². By contrast, Ukraine is known to have used drones and cruise missiles to attack Russia's oil production infrastructure (e.g., the Proletarsk oil depot).

¹⁹ LNG deliveries are displayed in blue. Russian gas imports are displayed in red (cf. “The European network of transmission system operators for gas (Entsog)”, accessed August 26, 2024, <https://gasdashboard.entsog.eu/>).

²⁰ George Beebe, “The hazards of Ukraine's incursion into Russia,” Responsible Statecraft, accessed August 20, 2024, <https://responsiblestatecraft.org/russia-ukraine/>.

²¹ Suriya Evans-Pritchard Jayanti, “Winter is coming: Is Ukraine's power grid ready for new Russian attacks?,” Atlantic Council, August 12, 2023, <https://www.atlanticcouncil.org/blogs/ukrainealert/winter-is-coming-is-ukraines-power-grid-ready-for-new-russian-attacks/>.

²² Kostia Andreikovets, “Russia has damaged almost all TPPs and HPPs in Ukraine,” Babel, November 22, 2022, <https://babel.ua/en/news/87349-ukrenergo-russia-damaged-almost-all-thermal-power-plants-and-large-hydroelectric-power-plants-in-ukraine-with-missile-strikes>.

Gas trade infrastructure has also played a major role during the war. Since 11 May 2022, Kyiv has blocked the transit route from Rostov via Sokhranivka to the EU, as the Ukrainian Transmission System Operator had no control over it²³. Pipelines have also been subjected to sabotage, including Nord Stream I and II and the Balticconnector pipeline between Finland and Estonia. While we can infer responsibility for each of these sabotage acts based on public statements and interests, they officially remain disputed.

After the Nord Stream and Yamal pipelines ceased operation, the Urengoy-Pomary-Uzhhorod-pipeline (commonly referred to as the “Brotherhood”-pipeline) that runs through Sudzha is the only remaining route to deliver gas directly to European customers in Slovakia, Hungary and Austria. These three landlocked countries have no option to shift towards direct maritime supply of LNG. Only Slovakia has sought to remedy its near 100% reliance on Russian gas. The country’s government is turning to natural gas imported via Poland and from Azerbaijan as a substitute²⁴. The Brotherhood pipeline’s survival after two and a half years of war is due to the precautions taken by both Russia and Ukraine not to inadvertently damage it. Its continued transit of Russian gas to Europe brings foreign currency to both Moscow and Kyiv²⁵. Therefore, Russia’s loss of Sudzha creates major risks for Gazprom. Firstly, it prevents its personnel from performing maintenance. Also – and this is crucial – Sudzha houses the last metering station on Russian soil for the Brotherhood-pipeline. In Sudzha, the gas flow to Ukraine and the rest of Europe is measured. The mere possibility that others interfere with metering equipment undermines Gazprom’s ability to meet contractual obligations and to provide documentation that determines its domestic taxation requirements. In short, “Gazprom can no longer trust the system that proves and details a large part of its exports and therefore its revenues”²⁶.

Conclusion and possible scenarios for the future

So far, Gazprom has not halted deliveries through the Brotherhood-pipeline. The state company’s dire financial outlook may play a role in this decision. It netted a loss of 0.5tn Ruble (5.4bn USD) in the first half of 2024 alone. It cannot afford also losing the 5bn USD yearly revenue it receives from gas sales to the EU. However, Gazprom is not simply a commercial enterprise but also, and primarily, a political instrument. Despite the major financial losses that Gazprom would incur should it stop exports through the Brotherhood-pipeline, strategic calculations may prompt the Kremlin to take that step. The Kremlin may reason that this would put pressure on downstream EU states (Slovakia, Hungary and Austria) to force Ukraine to withdraw from Russia’s territory, or even to cede its defensive positions in the five oblasts that Russia claims and attempts to conquer.

²³ Clara Marchaud, “Ukrainian incursion: Important Russian gas hub exposed to fighting,” Euractiv, August 21, 2024, <https://www.euractiv.com/section/europe-s-east/news/ukraines-seizure-of-a-russian-gas-hub-casts-uncertainty-over-europes-energy-supply/>.

²⁴ Gaurav Sharma, “Central Europe left fretting over 15 bcm of piped Russian gas via Ukraine,” Forbes, August 27, 2024, <https://www.forbes.com/sites/gauravsharma/2024/08/27/central-europe-left-fretting-over-15bcm-of-piped-russian-gas-via-ukraine/>.

²⁵ Euractiv, “The Brief – Russian gas to Europe changes route.”

²⁶ Sergiy Makogon, “Ukraine has its foot on Gazprom’s throat,” Centre for European Policy Analysis, August 22, 2024, <https://cepa.org/article/ukraine-has-its-foot-on-gazproms-throat/>.

Just as political reasons may prompt Russia to take commercially illogical steps, so too Ukraine may prioritise the political over the military and diplomatic importance of Sudzha and go on pouring resources into holding on to this patch of Russian territory. With its control over Sudzha's metering station, Ukraine has its hands on the jugular of Russia's economy, public finances and Central European politics. This yields considerable leverage should the warring parties go into negotiations. It may even incentivise the Kremlin to broaden the scope of occasional negotiations to exchange prisoners of war. In the best-case scenario, Russia may give up territorial claims over Ukraine in return for renewed access to gas contracts that offers acceptable prospects for Russia's economy and foreign policy. However, what is at stake is not just Ukraine's own economic "decolonisation" from Moscow, but also the independence of other former communist countries further downstream the Brotherhood-pipeline. For Ukraine's future integration in the Western and Central European security architecture to be viable, Kyiv will need to induce domestic political reorientation in the countries to its West that currently show susceptibility to Russian gas trade power politics (i.e., Hungary and Slovakia). By controlling the gas trade between its Eastern and its Western neighbours, Ukraine gains ample leverage over both of them and creates room for commercial and political tensions among them.

While the EU has long sought to depoliticise its gas trade, Ukraine's control over Sudzha has a considerable impact on the EU's gas trade as well as internal politics. Without the ability to measure and verify gas flows, Gazprom cannot determine its contractual and fiscal obligations. On Russia's domestic front, Ukraine's seizure of Sudzha adds to an already dire outlook for its fossil-fuel export-dependent economy. In the best-case scenario, the diminished usefulness of Gazprom as an instrument of foreign power politics and a panacea to maintain domestic stability may set off manageable shifts in Russia's domestic distribution of power. Russia may reorient its economy away from fossil fuel trade towards economic sectors that are less centralised and prone to corruption. Ideally, this may even set the country on the path towards more democratisation and the rule of law. However, this scenario hinges on the assumption that financial exhaustion will be the first critical point of failure to be reached by the Kremlin were it to pursue the war and that the Kremlin recognises that economic reform is necessary and possible. This seems a highly unlikely prospect.

The most likely scenario is that military contestation over the Sudzha-region will endure, given its political-strategic significance. Russia will all but certainly try to reclaim its territory militarily, if possible while continuing to export gas through the Brotherhood-pipeline. Conversely, Ukraine seems to have no incentive to damage the pipeline. As long as Kyiv controls Sudzha, it will be able to create some commercial, and possibly political, tensions between Russia and Ukraine's allies that are most susceptible to Russia's economic power politics. Rising energy costs for households may strengthen opposition parties in these countries and wean them away from Russia's orbit. However, it may also prompt those in power to double down and more forcefully block EU aid to Ukraine. As for the wider Eastern European region, Ukraine's seizure of Sudzha and the expiration of its transit agreement with Gazprom at the end of 2024 makes TurkStream the only pipeline that Russia can use to export gas to its remaining customers in Europe. That creates a host of externalities for the Western Balkans. It increases Russian interest in the region (particularly the transit country of Bulgaria) and makes TurkStream's importers (Serbia, North Macedonia, Hungary and Austria) the last European countries upon which Russia's energy weapon has traction. This makes TurkStream an interesting target for Ukraine to attempt to sabotage. However, Türkiye's role in negotiations (e.g., the export of agricultural products through the Bosphorus Strait) may simultaneously deter Ukraine from undertaking acts of sabotage and stop Russia from coercing countries in the region that depend on TurkStream for their energy needs.

The most dangerous scenario would be a combination of sudden catastrophic failure of Russia's internal political system and the expansion of hostilities to the Balkans. Russia has a rich history of revolutions during wartime. Based on the observably dwindling inventories of armoured vehicles and tanks, Russia seems to be slowly nearing the point of exhaustion of some types of offensive military capabilities²⁷. Russia's caustic political culture may make it prohibitively difficult for military commanders to inform the political leadership when such shortages become critical. If Russia reaches military exhaustion before it redresses its strategic and fiscal situation by pushing Ukraine out of Sudzha, the status quo may ultimately push Russia off an economic or social cliff. The ensuing political change inside Russia could be unexpected, quick and uncontrolled. Moreover, Türkiye may fail to deter the warring parties from seeking to extract strategic advantages by sabotaging TurkStream (in the case of Ukraine) or coercion of its importing countries (in the case of Russia).



The views expressed in the document are those of the author and do not necessarily reflect the position of the Royal Higher Institute for Defence, the Belgian Defence or the Belgian Government.

www.defence-institute.be

© RHID – All Rights Reserved

Image purchased under Standard License from Shutterstock.com, reference order ID CS-0A32D-286B.



DEFENCE

²⁷ Dominik Presl, "Russia's war machine is peaking. Next year it runs out of steam. (Decoding Geopolitics with Dominik Presl)," interview by Dr. Jack Watling, accessed August 28, 2024, https://www.youtube.com/watch?v=t8wB_5LR6d4.