



A podcast about the economics of trade & policy
with Chad P. Bown

Episode 178. Why sanctions to stop Russian gas pipelines backfired

[Episode webpage](#)

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Transcript

(lightly edited)



Chad Bown: Russia invaded Ukraine in February 2022. There has now been a year of brutal war in Europe. In addition to the human tragedy, two other important parts of that war involve energy and sanctions.

On energy, Russia weaponized natural gas sales to Europe. Russia cut off supplies going through its pipelines. The result was sharply higher prices that hurt the European economy and created serious political problems across Europe.

On sanctions, the European Union, United States, United Kingdom and other countries have imposed wave after wave of export bans, import bans, financing bans – all seeking to target various parts of the Russian economy.

But even before the war, energy supplies and sanctions had a long and controversial history affecting the relationships among Russia, countries in Europe, and the United States.



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In this episode, we are going to tell the story of three Russian pipelines and the sanctions that arose during their construction. We will also describe the problems those sanctions caused for allies, as well as lessons from those sanctions for today.

To do all that, I will be joined by a very special guest.

Agathe Demarais: I am Agathe Demarais, the Global Forecasting Director at The Economist Intelligence Unit.

Chad Bown: Agathe Demarais has had an amazing career. Before her current job, she worked for the French government in the Treasury. She actually worked for the French Treasury as a diplomat in Moscow when Europe and the United States were imposing sanctions on Russia for its annexation of Crimea.

Agathe also has an incredible new book on US sanctions – called *Backfire* – some of which I have asked her to share with us today.

Chad Bown: Hi, Agathe.

Agathe Demarais: Hi, Chad.

Chad Bown: You are listening to an episode of *Trade Talks*, a podcast about the economics of trade and policy. I'm your host, Chad Bown, the Reginald Jones Senior Fellow at the Peterson Institute for International Economics in Washington.

PART I. THE SIBERIAN NATURAL GAS PIPELINE (02:14)

Chad Bown: The story of the Siberian Natural Gas Pipeline begins in the early 1980s. In Europe, much like the United States, the economy was suffering. Europe faced high inflation after OPEC, the energy cartel, had cut global energy supplies in the 1970s. Many European economies were in recession, with lots of unemployed workers.

Agathe Demarais: This was after the two oil shocks of 1973 and 1979, so very high energy prices, few alternatives, Europe being reliant on the Middle East for energy. There was this view



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in Europe that Europe needed to diversify away from the Middle East for its energy supplies. That's the first thing.

The second thing is that Europe was in a recession and the economic conditions were terrible. There was very high unemployment. The idea was that the pipeline could create lots of jobs in European companies that would be producing the steel, the pipe, the turbines, and other components that the massive pipeline project would need.

Chad Bown: For Europe, the alternative to oil from the Middle East was natural gas going through a pipeline that would start in Russia.

Agathe Demarais: Picture, Russia, picture the Arctic, and then picture the middle of nowhere, literally, in the Arctic for Russia – that is where the pipeline starts from. It's called the Urengoy gas field. The pipeline was going from Urengoy over land throughout Russia and then Ukraine, and then finally it would serve some central and eastern European countries such as Slovakia, Hungary and Romania, and then Western Europe.

The capacity of the pipeline was about 32 billion cubic meters per year – that is huge. That is really huge. That would have been a lot of supply for the European economy, which at the time it is worth remembering, was much smaller. Really the idea was to rely less on Middle Eastern energy and to have a stable supply of energy.

Chad Bown: This pipeline would be a major alternative source for Europe – its economies needed to diversify their energy supplies away from OPEC and the volatile Middle East. The pipeline would go over land, all the way from the Arctic in Russia and end up in Western Europe.

Along the way the pipeline would pass through the territory of the Soviet Republic of Ukraine – yes, Ukraine, was part of the USSR at the time. That part of the geographical pathway of the pipeline would turn out important for reasons later in the story.

In the early 1980s, Europeans debated whether the pipeline project with the Soviet Union was a good idea.



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Agathe Demarais: Of course, there was the ideological problem of doing business with communist USSR and the communist regime in general. Some people from this ideological perspective weren't too keen on building the pipeline.

The main argument of proponents of the pipeline was to diversify Europe's energy mix, and that was really appealing because it just makes sense to have different suppliers of energy. And the other thing is that at the time the political mood in the European Union was all about détente – i.e., a strategy to engage with Russia in the economic sphere to get some political concessions. Also, keep in mind, a socialist government was elected in France in 1981, with President François Mitterrand.

I would say that the climate was reasonably positive about building this pipeline, except for those who were really hardcore and against doing any business with the Soviets.

Chad Bown: In Europe's ally – the United States – the climate for building this pipeline with the communists in the Soviet Union was not positive.

Agathe Demarais: The United States was, to say the least, not enthusiastic about the project. It didn't really share Europe's optimism and view that the project was a good one. Obviously it was the Cold War at the time, and the US wasn't very keen to see Europe do business with communist Russia, and it was actually very worried to see Europe turn towards the USSR.

Chad Bown: The Soviet Union and United States were deep into the Cold War that had now been ongoing for more than 30 years. In 1979, the Soviet Union had invaded Afghanistan. The Carter administration imposed an embargo on grain exports to Russia. The United States boycotted the Summer Olympics the Soviet Union was hosting in Moscow.

The European pipeline project presented new concerns. The new Reagan administration worried that the revenue the Soviets would earn from the Europeans buying their gas, year after year, would be used to fund the Russian military. It was also concerned that Europe would become dependent on the Soviet Union for its energy needs. The United States saw the Soviet Union as an even less reliable source for European energy needs than the OPEC countries that had caused global turmoil by restricting energy supplies in the 1970s.

But there was more.



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Agathe Demarais: An additional argument from the US perspective was that there was a problem with the technology used by the pipeline. The idea from the US side was that the technology used to build the pipeline was dual use, with civilian and military purposes. The US was very worried that western countries would send Russia some technological secrets that could be used for the advancement of the Russian military.

To give two examples of this, there were French high-tech computers to control gas flows from French company Thomson-CSF. There was also surveillance equipment to control everything going smoothly throughout the pipeline from the French company Alcatel. The US was saying, 'These are red flags. These are going to be used for military purposes. They will take the equipment out of the pipeline and do something else entirely with it. Just don't do that.'

Chad Bown: The European allies' counterarguments kept coming back to the economics.

Agathe Demarais: European companies had signed lots of contracts to build the pipeline and they really needed the money because Europe was in a recession. For instance, there were contracts for about \$4 billion with the USSR to build the pipeline. There were 20-odd metallurgy and machinery firms involved in Europe for the construction of the parts of the pipeline. And in Germany alone, it was estimated that this would support the creation of 1,000 jobs.

From the European perspective, this was really a no-brainer. It had economic benefits and it would lead to a more stable supply of energy.

Chad Bown: The pipeline project started, despite these disagreements between Europe and the United States.

Agathe Demarais: The pipeline parts were being produced in 1981, and the US was really adamant that the pipeline couldn't be built. It was a strange situation. European companies were manufacturing all the parts of the pipeline. At the same time, the US was saying through diplomatic channels, 'Don't do that, we're telling you not to do this.'

Chad Bown: And then something happened in Poland, one of the Soviet Union's satellite states as part of the Warsaw Pact.



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PBS News (December 14, 1981): *Good evening. Poland's Solidarity Union claimed today that its workers were on strike in many mines and factories in defiance of the martial law imposed yesterday. But the extent of the stoppages could not be checked by western newsmen hampered by the almost total shutdown of communications. Telephone, telex and telegraph services were cut yesterday when Poland's military leaders announced a state of emergency. Hundreds of leaders of the Solidarity Union were taken into custody...*

Agathe Demarais: In Poland, December 1981, there were pro-democracy protests, and these were crushed with military force. Dozens of protestors were killed and Poland imposed martial law in a huge crackdown in late 1981.

Washington argued that the crackdown on the pro-democracy protestors was ordered directly by Moscow and said, 'This is unacceptable, and we're going to impose sanctions on the Soviet Union.'

And what were the sanctions? Essentially they were sanctions against the pipeline project.

Chad Bown: Thirty years of Cold War meant the United States did not engage all that much economically with the Soviet Union. It had little direct leverage to impact the Russian economy.

What the United States did have was the ability to tighten export controls on companies using American technology for that pipeline project.

Agathe Demarais: There were a number of companies in Europe that were manufacturing parts of the pipeline using American technology because there were some American companies involved in the project.

The US took a decision. Essentially it revoked the export licenses that allowed European companies to export components to the former Soviet Union that had been made using American technology. And the turbines in particular of the pipeline were made using US technology.

Chad Bown: The United States revoked export licenses for certain technologies being used to construct the pipeline. Allied governments in Europe were not happy.



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Agathe Demarais: The Europeans were absolutely furious. They didn't know this was coming. They were only given five hours of notice.

But they thought that not all was lost because, in the beginning, the measures were not retroactive. If the measures were not retractive, that would mean that European companies could just continue doing business with their Soviet counterparts for all of the contracts that had been signed previously. Everything was going to be more or less OK.

Chad Bown: But that was not all. The Reagan administration also wanted Europe to impose its own penalties on the Soviet Union for the crackdown taking place in Poland.

If they didn't do so, the US threatened to make those US export controls retroactive. That would impact contracts that those European companies had already signed on the Soviet pipeline project.

Agathe Demarais: Europe really wasn't happy about that. But it was caught between a rock and a hard place. On the one hand, it really wanted the pipeline project to proceed, and also it knew that it was really important for European companies. It had no intention to break relations with the USSR. On the other hand, it didn't want to have huge issues with the US. It was really, really a complicated situation.

What came out of it is that the EU announced a cut of \$150 million in imports from the USSR. This was a symbolic gesture. Even at that time, that wasn't a lot of money.

Chad Bown: The Reagan administration was not impressed with the European announcement that it planned to restrict imports from the Soviet Union by only \$150 million.

At the same time, some in the United States were increasingly worried about starting a fight with Europe over the Soviet pipeline project. To be clear, there were serious debates within the Reagan administration about what to do. The declassified documents from internal, National Security Council meetings from this period are fascinating.

On one side was Secretary of State Alexander Haig. Haig led a group that wanted to back off. While they did not like Europe's pipeline project, they did not want it to jeopardize the trans-Atlantic alliance. Haig did not want to push Europe too far.



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Secretary of Defense Caspar Weinberger led a more hawkish group on the other side. They wanted to threaten the Europeans with sanctions if the Soviet pipeline project continued.

In June 1982, things between the US and its European allies came to a head.

Agathe Demarais: The G7 Summit in Versailles in France started negotiations again late at night. But both sides, the US and the EU, just couldn't find an agreement. And so after the G7 summit in Versailles, the US announced that the export controls would become retroactive and also target the European subsidiaries of US firms.

Chad Bown: The US export control decision hurt not only European companies but also the subsidiaries of American-headquartered firms like General Electric who were making things for the pipeline in Europe.

Losing access to this American technology meant companies on the ground in Europe could no longer make all of the stuff needed to complete their contracts to build the pipeline. This would have had big economic effects on jobs and those companies.

Agathe Demarais: And of course there were some very, very angry declarations from European capitals. For instance, the French Ministry for Foreign Affairs declared, "The United States has just declared what amounts to economic warfare on her allies in Western Europe." That was pretty much the mood at the time in Europe.

Europe was really unhappy because in parallel, the US had just dropped the grains embargo on the USSR because it hurt US farmers. So optics were disastrous.

Chad Bown: To Europe, the United States was being hypocritical. In 1981, Reagan had dropped the grain embargo on the Soviets, recognizing that the trade restriction was causing economic pain to American farmers.

With the new export controls impacting the pipeline, these trade restrictions were now hurting the European economy.



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Within the Reagan administration, divisions were now out in the open. Alexander Haig – the Secretary of State – resigned in part because he felt that the United States should not be sanctioning its European allies.

In the allies, even British Prime Minister Margaret Thatcher, perhaps America's closest ally, called out the Reagan administration on the floor of Parliament by saying, "The question is whether one very powerful nation can prevent existing contracts from being fulfilled. I think it is wrong to do that."

But Washington pushed ahead.

Agathe Demarais: That was really a tense standoff. What happened is that European countries, mostly led by Paris and London, had decided that they had a Plan B. They ordered European firms to fulfill the contracts with the Soviet Union.

Otherwise, if companies said that they wouldn't do business with the USSR, France and the UK threatened to requisition businesses complying with US sanctions. That's actually pretty tough.

Firms knew that they didn't have a choice. This really wasn't a choice. They restarted deliveries to the Soviet Union for spare parts of the pipeline.

Chad Bown: Europe was now forcing its companies to disobey the American sanctions, threatening to nationalize the firms if they did not fulfill those Soviet pipeline contracts.

The Reagan administration did not back off. It ended up sanctioning a bunch of European companies who were following orders from their governments. This led to a diplomatic standoff between the Reagan administration and its European allies.

Until finally, in November 1982, the Reagan administration caved.

Agathe Demarais: In November, 1982, after one year of very tense diplomatic relations, Reagan gave in and he said, 'OK, just build your pipeline, do whatever you want. We are revoking the sanctions. Just do it. Build your pipeline. You will regret it, of course, but just do it.'



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Chad Bown: After a year of difficult transatlantic relations, the saga was finally over. The pipeline would be built after all.

Stepping back from this first pipeline story, there are a lot of important takeaways.

Agathe Demarais: The key lesson for the US was probably that sanctions were not a magic bullet that could completely kill the pipeline project, which was certainly a realization that sanctions have a huge impact, but they can't do everything.

There was really a number of views emerging in the US that this was at best an ineffective thing to do for the US, to try to kill the pipeline. It was clear the pipeline would be built. US businesses would lose some money, about \$6 billion (in today's money), and there would be a strain in transatlantic ties.

Another aspect of this, and this is something that Margaret Thatcher repeatedly said, is that there was a lot of reputational damage for American firms. So many people will say there is no point in making a contract with the US if at any time they can just cancel the contract.

Chad Bown: The pipeline incident exposed the self-harm that US sanctions can cause.

The US sanctions reduced the future credibility of American companies. Who would want to partner with them or become reliant on their technology, if the US government could suddenly just take that away.

The experience also began to reveal the limits of US sanctions, showing how foreign governments – in this case European allies – could work around them when pushed too far.

Finally, the US sanctions had put a massive strain on the foundation of the transatlantic alliance. This point was also captured by an interesting book published in 1987.

Agathe Demarais: Antony Blinken, who would later become the US Secretary of State under the Biden administration, was at the time a young student at Columbia University and he even wrote a book arguing that the US should preserve unity and transatlantic relations over the pipeline.



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Chad Bown: For Europe, the pipeline incident revealed other important lessons. Those included new concerns about its own dependencies – not only with the Soviet Union – but also now with the United States.

Agathe Demarais: The first one is that Europe was able to stand up for its interests. And to tell the US, ‘Sorry. No, we’re going to continue with the pipeline project. We understand your concerns, thank you very much for raising them. But we will still go ahead.’

The second lesson was that European companies were still vulnerable to American export controls because they were using American technology.

A final lesson, from the European perspective, was that the US was an ally, but it was also keen on imposing economic coercive measures on its own allies to advance what it sees as its in own interests.

PART II: THE NORD STREAM 1 PIPELINE (21:55)

Chad Bown: Within a decade, the Cold War was over. The Soviet Union dissolved in 1991. Remember that exclusive club of 7 western economies that had met in Versailles in June of 1982? Russia was asked to join, turning the G7 into the G8, or Group of 8 major economies.

Things were not perfect. Twice, Russia went to a war in Chechnya. And in 2008, Russia started fighting with Georgia. Nevertheless, the West was trying. The Obama administration announced a policy goal seeking to “Reset” relations with Russia in 2010. And in 2012, the World Trade Organization even welcomed Russia as its 156th member country.

Overall, this was a period of hope and improving economic and diplomatic relations between Russia and the West. It was also a period during which a second important pipeline was being built.

Agathe Demarais: The Nord Stream 1 pipeline was completely different from the Siberian Natural Gas Pipeline. Nord Stream 1 was going to go under sea, in the Baltic Sea, connecting Russia near St. Petersburg directly to Germany, passing through the territorial waters of Russia, then Finland, Sweden, Denmark, and Germany.



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It was about 750 miles long, or 1,200 kilometers long, and 70 percent bigger than the Siberian Natural Gas Pipeline. The capacity was 55 billion cubic meters – so really, really huge. It was really expensive and a complicated project to build. Under sea is really tricky, and you have fairly extreme conditions with very fierce winter storms. It was really quite a technological feat.

Chad Bown: A technological feat, but relatively little drama. Sanctions were not part of the story this time around. It was a new world.

Agathe Demarais: The initial idea to build a pipeline came in 1997, and it took 14 years for the pipeline to be completed and integrated in November 2011. By 2011 something that is really important to keep in mind is that times were completely different between Russia and Western countries.

I was a diplomat in Russia at the time. I remember welcoming President François Hollande on a presidential visit, meeting Vladimir Putin, complete with dozens of French CEOs of big companies. Russia was an ally in the war against terror, exchanging intelligence with Western countries.

There were disagreements of course, but times were completely different, especially for Europe. US-Russia relations, were always a bit more strained, but relations between Europe and Russia were very decent. Actually there were a number of people in Europe saying, 'Maybe we should be working with Russia.' This was a completely different era.

PART III. THE NORDSTREAM 2 PIPELINE (25:15)

Chad Bown: The third pipeline in our story would ultimately come after Russia's popularity and engagement with the West had peaked. But first, fast forward to February 2014.

Agathe Demarais: In February, 2014, Russia organized the Sochi Olympics in the Caucasus region of Southwest Russia. It was a huge success with lots of foreign delegations. It was a huge platform for Russia to present itself as a developed country that is working hand in hand with Western countries.



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And at the same time, in parallel, things were not going very well in Ukraine. Actually, the Ukrainian revolution started at around the same time. Ukraine wanted to turn towards the European Union with an association agreement.

For Moscow this was completely unacceptable. Moscow did everything it could to prevent this from happening. Ukraine, from Moscow's, perspective was part of Russia's sphere of influence.

Chad Bown: Ukraine had become independent when the Soviet Union dissolved in 1991. But a Ukrainian political turn away from Russia and toward western Europe was too much for Russian President Vladimir Putin.

In March 2014, he decided to act.

PBS News (March 18, 2014): *Russia has signed a treaty to incorporate Crimea into its territory following a referendum in which residents of Ukraine's region overwhelming backed the move. President Vladimir Putin signed the document along with Crimea's prime minister and parliament speaker. Putin has accused the west of encouraging unrest in Ukraine, in order to break its historic ties with Russia and dismissed western criticism of the Crimean vote as illegitimate.*

Agathe Demarais: Russia annexed Crimea, started to back rebels in the Donbas region of Eastern Ukraine, and this led to the imposition of the first Western sanctions against Russia – in only a few weeks between the Sochi Olympics and the annexation of Crimea – this was a set of very, very fast unfolding events.

Chad Bown: At the time, Agathe was still at the French embassy in Moscow, working for the French government. One day, she was in Sochi helping celebrate Russia's Winter Olympics. The next, she was part of a team tasked with putting together sanctions against Russia for its actions in Ukraine.

Agathe Demarais: I was told, 'Agathe, you're part of a sanctions task force. We're joining forces with the French Ministry of Foreign Affairs and the French Treasury in Moscow, Paris, in close collaboration with Brussels in Washington and other western allies.'



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Most European sanctions targeted individuals or companies linked to Russia's annexation of Crimea and the backing of separatist rebels in the Donbas region. Actually, it led to a lot of debates with the other side of the Atlantic, the US, who wanted to go bold and big and fast and strong from day one against Russia. To be honest, the 2014 sanctions were reasonably mild from the European perspective.

Chad Bown: In the United States, the Obama administration took a different approach to sanctioning Russia in 2014.

Agathe Demarais: The US imposed sectoral sanctions. That was a new concept – it was against entire sectors of the Russian economy, mainly the financial sector (Russian banks), the military sector, and also the energy sector. And these sanctions are really going to be the most effective against the Russian energy sector.

Sanctions on the Russian energy sector make it very difficult for Russian companies in the energy field to get access to financing and technology from Western countries. And for Russia, this was a huge problem because a number of Russian energy fields are coming to maturity. This means that their reserves are fast depleting. Russia needs to develop new oil and gas fields. The reserves are mostly located in the Arctic and are very, very difficult and expensive to develop. And without Western technology, this will be impossible.

Chad Bown: Despite the US and European sanctions, things then quieted down. Russia weathered the storm of the sanctions. It had annexed Crimea and was backing separatists in eastern Ukraine. And the world had mostly moved on.

But then, the announcement came of another gas pipeline.

Agathe Demarais: In 2015, Gazprom, the Russian gas giant, and five European companies in the energy field announced the construction of Nord Stream 2, a gas pipeline that was essentially the same one as Nord Stream 1, doubling the capacity of the Nord Stream 1 pipeline using the same route under the Baltic Sea. It came with a huge price tag – \$11 billion paid mostly by Gazprom, and then the five European partners.

Chad Bown: The Nord Stream 2 pipeline would follow the same path through the Baltic Sea as Nord Stream 1, the relatively noncontroversial pipeline that had opened in 2011.



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Similar to the early 1980s, some of the European arguments in favor of the project were economic.

Agathe Demarais: On paper, that was a good idea because Europe needed that energy, especially in countries that were really gas dependent, such as Germany or Austria. The German economic model relies on cheap gas from Russia, and this was really important for the German manufacturing sector to have access to more gas supplies.

Another argument was the Fukushima accident. It led Germany and other countries in Europe to decommission nuclear power plants, and at the time, especially in Germany, to replace them by coal-powered plants that were highly polluting. There was a need to replace those with other sources of cleaner energy.

Chad Bown: After the Japanese nuclear accident in Fukushima, Europe faced political pressure to close its own nuclear reactors. To maintain energy supplies, Europe was increasingly burning dirty coal. Without more natural gas, European countries would struggle to meet their carbon emissions reductions to tackle climate change.

At the same time, other European environmental advocates came out against Nord Stream 2.

Agathe Demarais: The environmental question was really huge. There were a lot of people, especially in Germany, asking whether it was a great idea to go for more gas, more Russian gas, at the time when the energy transition was supposedly a top policy priority. And also the pipeline was to be built undersea – i.e., not too great for maritime ecosystems.

Chad Bown: There was also European skepticism about building another pipeline with Russia because of what Russia had been doing in Ukraine.

Agathe Demarais: There was definitely a lot of pushback in Europe against Nord Stream 2. I think this has sometimes been lost in the debate in America, but actually a lot of people in Europe were definitely against building Nord Stream 2, partly because of ideological arguments saying that, 'Russia's just annexed Crimea and has started to back separatist rebels in the Donbas region of Eastern Ukraine. Is it really a great idea to increase our dependence on Russian gas and to do more business with Russia and to finance Russia's actions?'



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At the time already 40 percent of Europe's gas imports were coming from Russia. The question of the dependency on Russia was really a huge one.

Chad Bown: There was a separate argument that building another Baltic Sea pipeline would further hurt Ukraine. The reason related to our story's first pipeline, the Siberian Natural Gas Pipeline, that had been built in the 1980s.

Agathe Demarais: This was a bit of a tricky one, but Ukraine used to receive money – about \$3 billion per year – from Russia for the transit of gas from Russia en route to Europe via Ukraine. A big worry at the time was that Russia would just stop sending gas via Ukraine. So Ukraine would lose the \$3 billion in transit fees. Actually that was really useful for Ukraine who was already at war against Russia, in the Donbas region, to finance its economy and its government expenses.

Chad Bown: As part of its military conflict with Ukraine, Russia had been threatening not to pay those transit fees and to cut off supplies of that gas. So building Nord Stream 2 would potentially hurt Ukraine by reducing its leverage over Russia's gas sales.

From this perspective, for Europe, it was also unclear how much additional net capacity Nord Stream 2 would bring online. For example, total gas supplies would not increase all that much if, after Nord Stream 2 was built, Russia's plan was to weaken Ukraine by reducing the flow of gas through the overland pipeline to Europe.

On the other side of the Atlantic, the American response to the Nord Stream 2 announcement was not positive.

Agathe Demarais: The US response to Europe's plan to build Nord Stream 2 was, 'Haven't you learned the lesson that it's not a great idea to do more business with Russia? You realize that Russia has just annexed Crimea is backing rebels in the Donbas region. Do you really want to finance that? That makes no sense.' That was essentially the US response, with a lot of ideological arguments against doing any business with the Kremlin. A lot of people at the time were calling the pipeline "Putin's pipeline." It was really personalized as if Putin was going to receive the money himself in the Kremlin.



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Chad Bown: At the same time, Europeans were having a hard time reading the American signals. In part this was because of US policy. Remember, the US had announced sanctions on the Russian energy sector. What was unclear was the Americans' seriousness at enforcing those sanctions.

Agathe Demarais: A few months earlier, there was a story with Exxon that really got the attention of European capitals. In September 2014, i.e., not too long after the annexation of Crimea, about six months afterwards, Exxon and Rosneft, the state-owned oil giant in Russia, found a giant oil field in Russia that they planned to develop together. The oil field was called Pobeda, which means victory in Russia.

Of course, sanctions in theory prohibit this project to happen between Exxon and Rosneft, but it took Exxon seven months to put its projects on hold. What was really grating from the perspective of European companies was that in similar situations, European companies were told to cancel their projects immediately. Exxon eventually got in trouble with OFAC, the US Treasury Agency in charge of designing and implementing sanctions. It got hit with a \$2 million fine, which was a rounding error because Exxon's revenues in 2014 were \$412 billion. But it nonetheless appealed and it won. It never paid a penny.

From the European perspective, this really made it look like sanctions from the US had double standards with sanctions being much more stringent for foreign firms than for US firms.

Chad Bown: Then, in 2016, there was the ultimate level of confusion. Donald Trump was elected President of the United States.

Agathe Demarais: European countries had no clue what to think. Because, on the one hand, Trump had just been elected as president and he seemed to have a very good relationship with Putin. They had summits together and seemed to be best friends.

On the other hand, the US was still making noises, especially the US Congress saying, 'This pipeline is an absolute red flag, a no-go, and you will not be building it. We promise you, you will come under sanctions. This is not going to happen.'

From the European side, they had no idea what to think.



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Chad Bown: As President, Donald Trump was confusing for a number of reasons.

His first Secretary of State was Rex Tillerson, who had been the CEO of Exxon, the giant oil company involved in that Russian project. Tillerson himself had well-known ties to Russian President Vladimir Putin. But Trump fired Tillerson only one year into the job.

On policy, Trump was turning out to be hardly a friendly ally. In June 2018, Trump put tariffs on European exports of steel and aluminum to the United States, saying they were a threat to America's national security.

In July of that year, at a NATO meeting, Trump threatened that the U.S. could "go our own way" – which some interpreted as withdrawing from the military alliance – if European countries did not meet his demands to increase their military spending.

Later in 2018, construction of the Nord Stream 2 pipeline started.

Agathe Demarais: Starting in September 2018, the pipe laying starts under sea in the Baltic Sea. But a few months earlier, there had been a first alert about potential US sanctions targeting the project. It was Congress that applied sanctions against Russia that could have derailed the construction of the pipeline. But in the end, there was guidance from the State Department saying that this was not going to apply to projects that had already been approved.

Chad Bown: Since the Europeans had already approved Nord Stream 2, it looked like the project could go ahead.

But the US Congress getting involved here was also something new. Russia had become a bigger worry for the United States. Aside from its annexation of Crimea, Russia had also been accused of interfering in the 2016 US election of Donald Trump.

In part this was Congress saying – despite President Trump's potential mixed feelings toward Vladimir Putin – we, Congress, want to send a clear message that we do not think Nord Stream 2 is a good idea.

Agathe Demarais: The construction of the pipeline starts. The building of the pipeline proceeds super quickly. By the end of 2019 – i.e., essentially one year later – all the bits going through



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Russia, Finland, and Sweden were completed. That was really the vast majority of the pipeline. The noises coming from Russia were that the pipeline was going to be finished in 2020 and start operations then. That was really fast. Two years to build a pipeline and put it into operation.

Chad Bown: Not so fast. In the final days of 2019, Congress imposed secondary sanctions on companies building the pipeline.

Agathe Demarais: When the US adopts secondary sanctions against a country, it essentially tells all companies around the world, American or foreign, that they're free to do business with, say Russia. The US says, 'Be our guest that's no problem. You want to do it, we don't have any issue. But just so you know, you will need to leave the American market, stop using the US dollar, and won't have access to Western financial channels anymore.'

The US did exactly that. It imposed secondary sanctions on the project. That was a huge threat. And the company called Allseas that was laying down the pipes undersea – it's a Swiss Dutch company – it completely pulled out of the project after only a few hours. They didn't want to take any risks, and they didn't want to fall under US secondary sanctions.

Chad Bown: Would the US sanctions work? The new secondary sanctions meant the European companies were no longer willing to risk finishing up the pipeline.

But the Russian government and Gazprom – the Russian gas company – had anticipated these sanctions and planned ahead. They had purchased two specialized ships allowing Russia to do the remaining pipe-laying itself.

Agathe Demarais: It had bought a vessel called the *Akademik Cherskiy* to lay the pipe. The only problem was that the *Akademik Cherskiy* was in Japan at the time, in the Sea of Okhotsk. That is far, far away, and so it just needed to take it to Germany. That was a four month voyage because the ship couldn't transit via other Suez Canal because it had a crane to build pipes under sea, and the crane couldn't fit under the bridge of the Suez Canal. The Russian Navy even escorted the vessel just to make sure everything was going to be okay.

And in addition to the *Akademik Cherskiy*, Russia also had another vessel called the *Fortuna* that was going to build the pipeline undersea as well. No problem anymore with sanctions. That was Russia's plan.



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Chad Bown: Russia had made the last phase of pipeline construction sanctions-proof by buying its own ships. It didn't matter that US secondary sanctions took out the pipelaying ships from European companies.

As one more attempt to stop the pipeline, Congress threatened to impose sanctions on German workers in the tiny port city of Mukran. These workers were providing pipes and other supplies to the Russian pipe-laying ships.

Agathe Demarais: That was a really bad idea because Congressmen said they would impose "crushing sanctions" on port employees, German port employees, but Mukran in Germany wasn't exactly thriving. It was hit by high unemployment. People were raised there during communist times – this was former East Germany. When the US says we're going to impose sanctions against you, and you are on the minimum wage, you don't really understand what is happening.

German political parties went into complete overdrive, sending letters to the US government asking how the US would react if Germany were to impose sanctions on American port employees.

So that was the Mukran saga, and the US really shot itself into foot in doing that. And that was really an example of US sanctions being really unpopular abroad.

Chad Bown: The United States made a few more attempts at sanctions, but to no effect. By the end, Russia did not even need the Mukran workers to finish completing the project.

Despite lots of American sanctions and big diplomatic and public fights with military allies in Europe, just like the 1980s, another pipeline was going to be built.

In November 2020, Joe Biden was elected US President.

Agathe Demarais: Remember the book guy? The one who wrote a book to say that building the Siberian Natural Gas Pipeline and that the US should prioritize relations with allies over killing the project? That guy, Antony Blinken, became US Secretary of State.



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And the US knew after four years of Trump that improving ties with Europe from a very low base, a very bruised base, was really a top priority. Four months into the Biden presidency, sanctions against Nord Stream 2 were lifted. Actually, Blinken made exactly the same argument as the one he had made in the book, 'OK, Europe wants to make a mistake, let them do it, we're not going to impose sanctions on them. That's their problem.'

And in September 2021, nine months after the inauguration of Joe Biden, the pipeline was finally completed.

Chad Bown: Despite the pipeline being completed, Nord Stream 2 was never put into operation. It never supplied natural gas to Europe.

In February 2022, the actions of Russian President Vladimir Putin made sure of that.

Agathe Demarais: On February 24th, Russia invades Ukraine and Germany decides that it is not possible to proceed with the Nord Stream 2 project anymore. Germany puts an end to the Nord Stream 2 project.

And throughout the year 2022, Russia showed that the critics of the Nord Stream 2 project were right. Russia didn't shy away from weaponizing energy supplies and also energy infrastructure, for instance, in Ukraine to advance its military interests.

PART IV. PAINFUL LESSONS (46:36)

Chad Bown: To wrap up this episode, I wanted to look at the totality of these three events. Three different pipelines. Lots and lots of US sanctions. And then Putin's war.

One worry is if America's main reaction is, 'We told you so. We warned you this would happen.'

I am not sure how useful that is. Europe does not need to be reminded that it made a huge mistake. It is living with the consequences. The German government has been upfront about its failures.

Here is Jörg Kukies, the State Secretary of the German Chancellery in Berlin, at an Aspen Institute Germany event in February 2023,



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Jörg Kukies, State Secretary of the German Chancellery (February 15, 2023): *Of course we as Germany having gone through one of the biggest mistakes both in public policy but also private investment decisions on overreliance on Russia as a source of energy and seeing the massive implications – the adverse implications - of that over the year of 2022 not only limiting the scope of policymaking but also the economic costs to our society...*

Furthermore, America focusing on what others got wrong means the United States misses out on what it needs to learn from these pipelines and its increasing use of sanctions.

I asked Agathe what she thought were important lessons – especially for the United States – from these three experiences.

Agathe Demarais: Sanctions didn't stop Europe from building the pipeline. The pipeline was constructed. It was only when Europe decided that it should get rid of the pipeline on its own, and that it was its own decision, that this happened. And I think this is a big lesson for US policymakers.

That was a waste of time from the US perspective. All the time in these meetings and all this acrimony for nothing, the pipelines got built. That's quite a waste of time. And reputational damage.

A third lesson from the European perspective is that the US needs to engage allies. It probably shouldn't go with unilateral sanctions against allies because it is only fueling transatlantic tensions that, in the end, only benefit rogue countries such as Russia. And I would hope that there could be more room for discussions instead of punishment with US sanctions to discuss the real issue, such as Russia's behavior, instead of arguing and bickering over a pipeline.

Chad Bown: The Nord Stream 2 sanctions – even the ones applied to Russia – revealed further limits to the effectiveness of US sanctions when a country could anticipate that they were coming.

Agathe Demarais: Russia had really planned ahead. Remember, it bought the *Akademik Cherskiy* three years before it started to build the pipeline because it knew that the project would fall under US sanctions. It decided that if the fleet was completely Russian, if everything was Russian with strictly no ties to the US, then it would be completely shielded from US sanctions.



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And this is exactly what Russia does these days to export oil under the radar using a ghost fleet of Russian tankers.

Chad Bown: Our story of these pipelines is just one part of her amazing new book about sanctions. As my last question, I asked Agathe how sanctions – and the world’s response to US sanctions especially – were evolving.

Agathe Demarais: Sanctions are important. We don't have anything better. They suck, but we have nothing better. Declarations are not great. Military interventions are really not great. We have nothing better, but we need to make sure that we use them judiciously.

Sanctions have a lot in common with antibiotics when you think about it. If you overuse antibiotics, you get side effects, and you get resistance. Of course, nobody's saying we should get rid of antibiotics. They are critically important. They save lives.

It's really the same with sanctions. They are important, a very important tool for the US to advance its diplomatic interests.

But if you overuse sanctions, you will get side effects, and you will get sanctions resistance. And this is exactly what we are seeing emerge these days.

Chad Bown: Agathe, thank you very much.

Agathe Demarais: Thanks for having me.

Chad Bown: As my last point, I wanted to highlight the timeliness of Agathe’s book. Some of its messages are subtle and yet also super important.

It is also a really uncomfortable book to read today, in the midst of a war and huge period of sanctions.

The one big difference between America’s pipeline sanctions and those being done today, is that today’s sanctions against Russia for its invasion of Ukraine are being imposed collectively by a huge group of countries. Not everyone is participating of course – China, Turkey, and



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others are refusing to sanction Russia. But it is much better than the United States acting unilaterally.

Today, we really do want these sanctions against Russia to work in helping to stop a brutal war. At the same time, there is a need to be realistic. We have to realize that sanctions are imperfect. Russia can sometimes work around them. We need to prepare for the fact that, even with the best intentions, the sanctions will likely not work as quickly or as thoroughly as we would hope.

It is just that there are no more attractive alternatives.

GOODBYE FOR NOW

Chad Bown: And that is all for *Trade Talks*.

A huge thanks to Agathe Demarais at The Economist Intelligence Unit. Do check out her amazing new book titled “Backfire: How Sanctions Reshape the World Against US Interests.”

Thanks to Melina Kolb, our supervising producer. Thanks to Sarah Tew, on digital.

As always, thanks to Collin Warren, our audio guy.

Do follow us on Twitter or Mastodon, we’re on @Trade__Talks. That’s not one but two underscores, @Trade__Talks.

<insert super funny double underscore joke here>. ■

REFERENCES

Agathe Demarais. 2022. [Backfire: How Sanctions Reshape the World Against US Interests](#). Columbia University Press.