A market between us

Addressing Europe's Problems with Russian Gas

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Larsen – EDF Gas Seminar -- Paris, 9 April 2010

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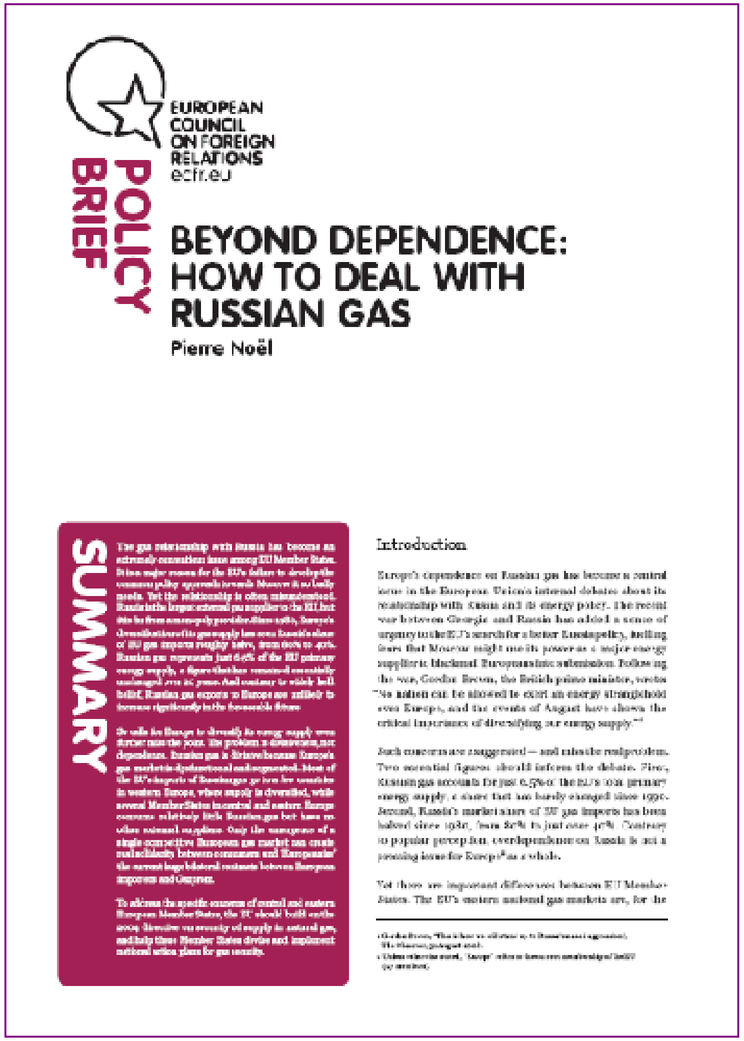
The political value of a single gas market



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POLICY BRIEF

BEYOND DEPENDENCE: HOW TO DEAL WITH RUSSIAN GAS

Pierre Noël

SUMMARY

Introduction

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A Market Between us: Reducing the Political Cost of Europe's Dependence on Russian Gas

EPRG Working Paper 0916

Pierre Noël

Abstract

The geopolitical implications of Europe's reliance on Russian gas are a prominent source of concerns among European (and even American) policy makers. We analyse the dynamics of the European Union's gas supply since 1970 and find that while imports have been growing consistently, dependence on Russia has gone down considerably. The trend towards diversification of supply sharply accelerated after 1990. But gas supply diversity is confined to Western Europe: Eastern Europe's small gas markets are highly dependent on Russian gas. We conclude that the emergence of a single European gas market, where national markets would be integrated through pan-European competitive trading, would significantly reduce the energy security and foreign policy implications of the EU-Russia gas relationship.

Keywords: European Union, Natural Gas, Russia, Foreign Policy, Market Integration

JEL Classification

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Publication: May 2009

www.electricitypolicy.org.uk

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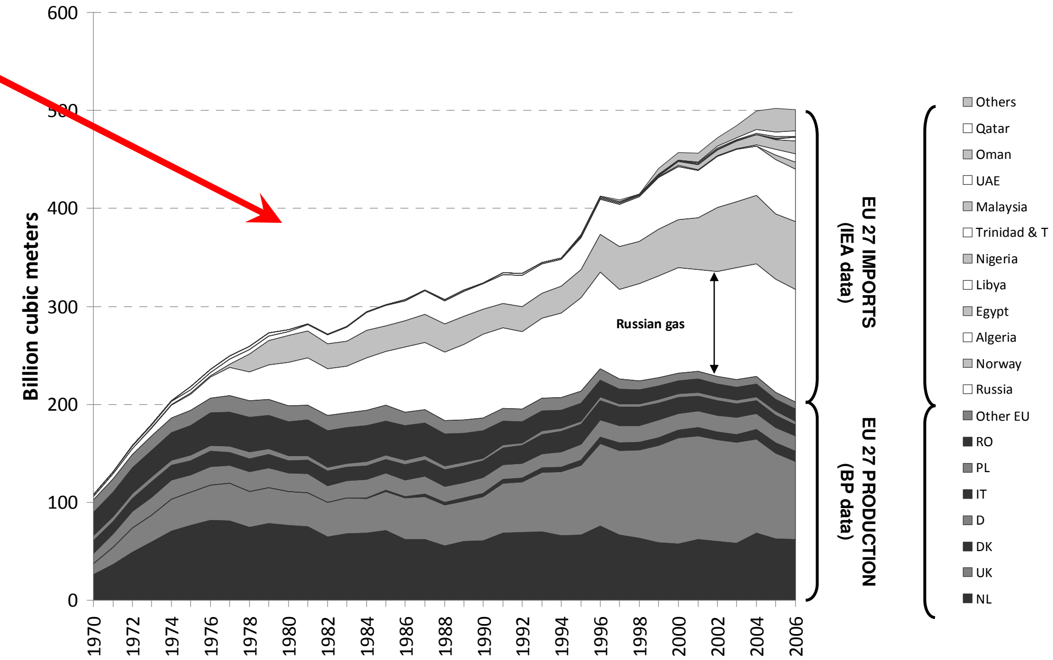
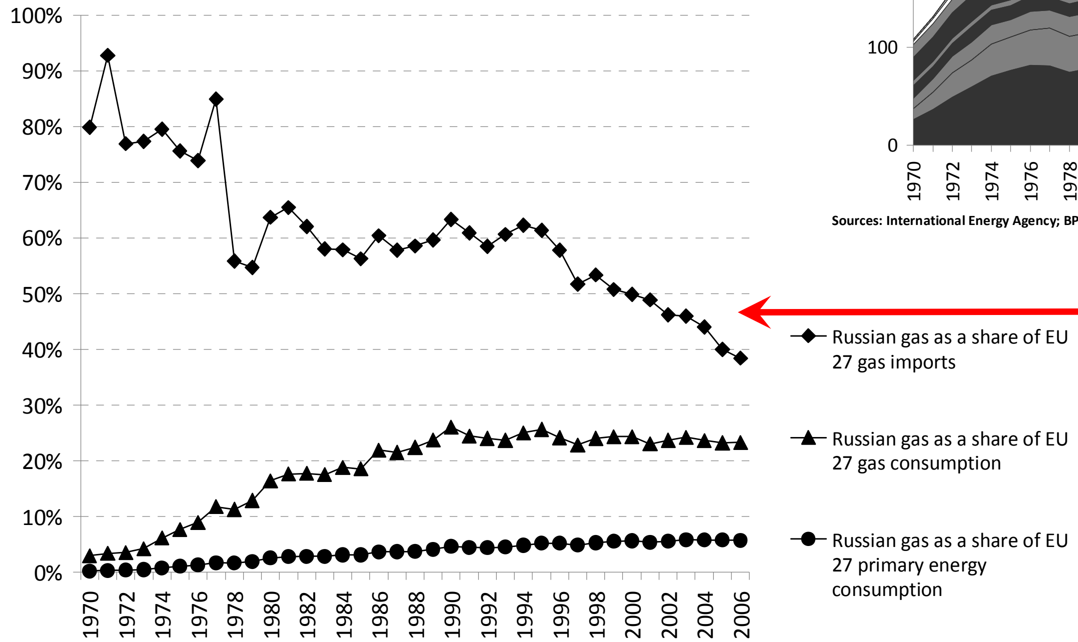
Declining EU dependence on Russian gas

IMPORTS UP

Since 1990, EU imports rose from 43% of consumption to 60%



Sources: International Energy Agency; BP Statistical Review of World Energy



Source: BP Statistical Review of World Energy; International Energy Agency

DEPENDENCE DOWN

Since 1990, Russian gas went from 65% of EU imports to 39% (28% of consumption to 23%)

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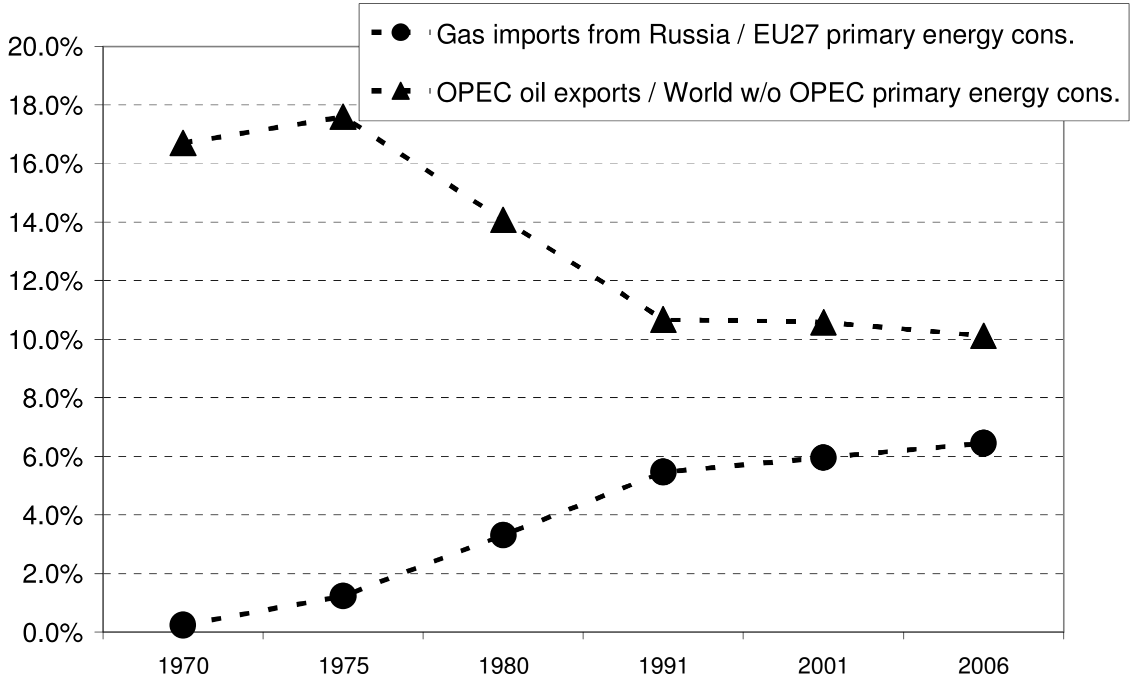
Europe’s dependence in perspective



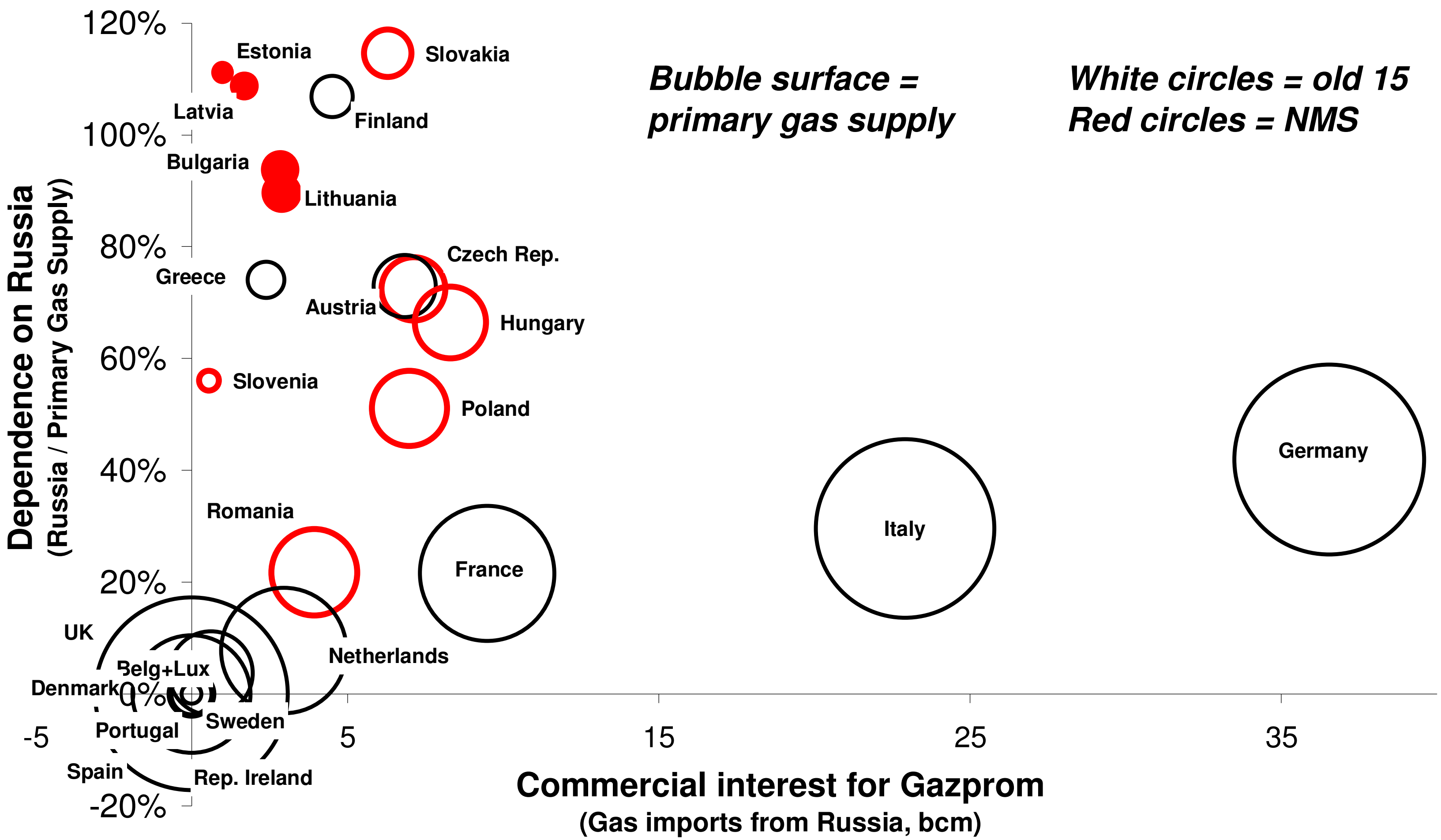
Sources: Gazprom; BP Statistical Review of World Energy

The way markets work has a big impact on the political implications of ‘import dependence’ -- Commoditisation makes power politics ineffective (for producers) and redundant (for consumers)

At least two problems

- Geopolitical problem
  - Russia's 'transition to autocracy' (P. Hassner)
  - Russia's revisionist foreign policy in Europe
  - No more Chinese wall between gas export policy & foreign policy – was the enabling bargain of the cold war gas trade
- Gas supply security problem
  - Russian-Ukrainian relationship reverberates on Europe
  - Alert in 2006 – Very large, sustained disruption in 2009
- Central & Eastern Europe much more impacted by both – Russian gas divides Europe politically

Russian gas in Europe



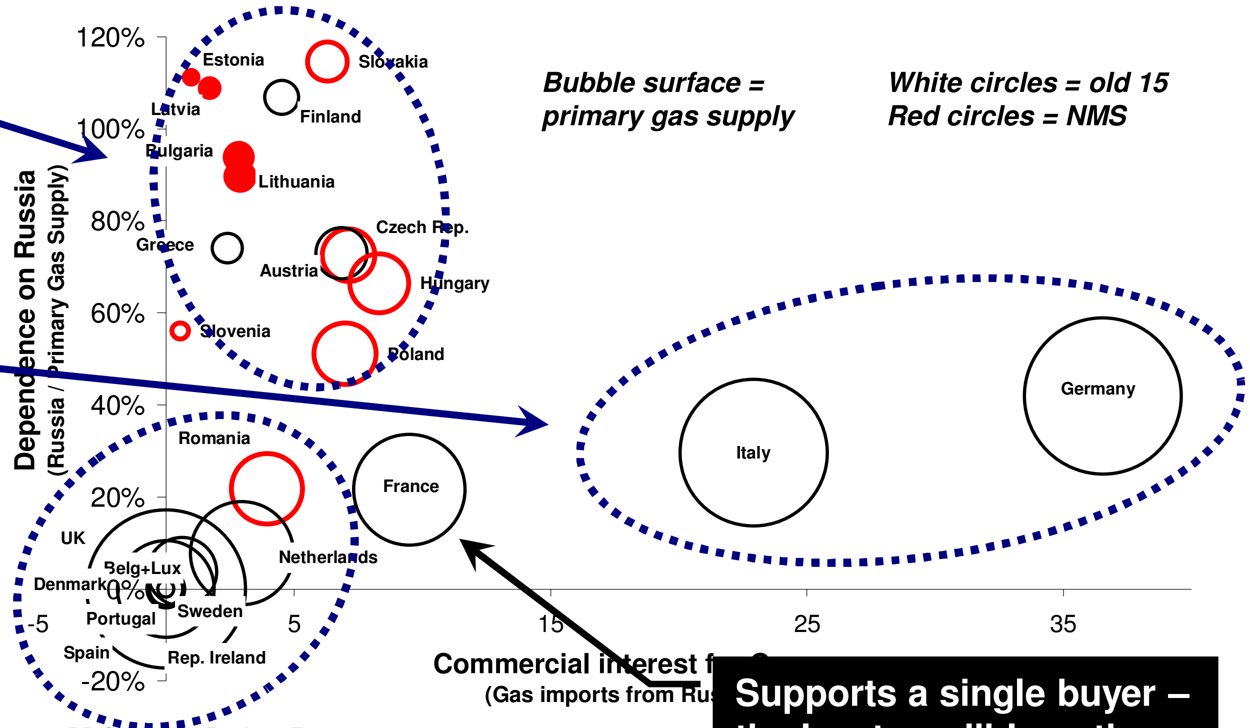
Source: BP Statistical Review; Eurostat

Neither 'solidarity' nor 'co-operation' – A market!

Call for 'solidarity' amongst EU member states – in gas and foreign policy

Call for 'co-operation' and 'interdependence' between EU and Russia

Supporters of a European gas market are to be found here



Source: BP Statistical Review; Eurostat

Supports a single buyer – the least credible option of all…

A single competitive gas market would: move diversity eastward; make Europe more attractive for LNG; increase the system's resilience to external shocks; 'Europeanise' import contracts

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Unholy alliance: gas incumbents and pro-Russian gov.

ECFR EU-Russia Power Audit

Foreign policy attitude towards Russia (ECFR)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Trojan horses		
Cyprus	●	
Greece	●	
Strategic partners		
France	**● (leader)**	
Germany	**● (leader)**	
Italy		
Spain		●
Friendly pragmatists		
Austria	●	
Belgium		●
Bulgaria	●	
Finland		●
Hungary		
Luxembourg	●	
Malta		
Portugal		
Slovakia	●	
Slovenia		●
Frosty pragmatists		
Czech Republic		
Denmark		●
Estonia		
Ireland		
Latvia	●	
Netherlands		**● (leader)**
Romania		●
Sweden		**● (leader)**
United Kingdom		**● (leader)**
New cold warriors		
Lithuania		
Poland		

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Mark Leonard and Nicu Popescu, *A Power Audit of EU-Russia Relations*, London: European Council on Foreign Relations, 2007, p. 26-50. Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

Izvestia "Русский вопрос" расколол Европу" (2 Sept 2008)

Foreign policy attitude towards Russia (Izvestia)	Oppose 'ownership unbundling'	Support 'ownership unbundling'
Russophobes		
Poland		
Lithuania		
Latvia	●	
Estonia		
UK		**● (leader)**
Sweden		**● (leader)**
Moderate Critics		
Czech Republic		
Hungary		
Romania		●
Denmark		●
Pragmatics, Centrists, Neutrals		
Slovakia	●	
Slovenia		●
Bulgaria	●	
Spain		●
Finland		●
Netherlands		**● (leader)**
Austria	●	
Ireland		
Portugal		
Malta		
Russia's Lobbyists		
France	**● (leader)**	
Germany	**● (leader)**	
Italy		
Belgium		●
Luxemburg	●	
Greece	●	
Cyprus	●	

Source: Categorising of EU countries according to their foreign policy towards Russia, from: Izvestia, "Русский вопрос" расколол Европу ("Russkii vopros" raskalol Evropu), http://www.izvestia.ru/politic/article3120068/ (2 Sept 2008). Position towards ownership unbundling of gas transmission from supply activities, from: Letter from the Ministers in charge of energy of eight EU member states to Angelika Niebler, Chairwoman of the ITRE Committee, European Parliament, dated 29 January 2008; "'Third Option' mooted on energy liberalisation", Euractiv.com, 27 November 2007.

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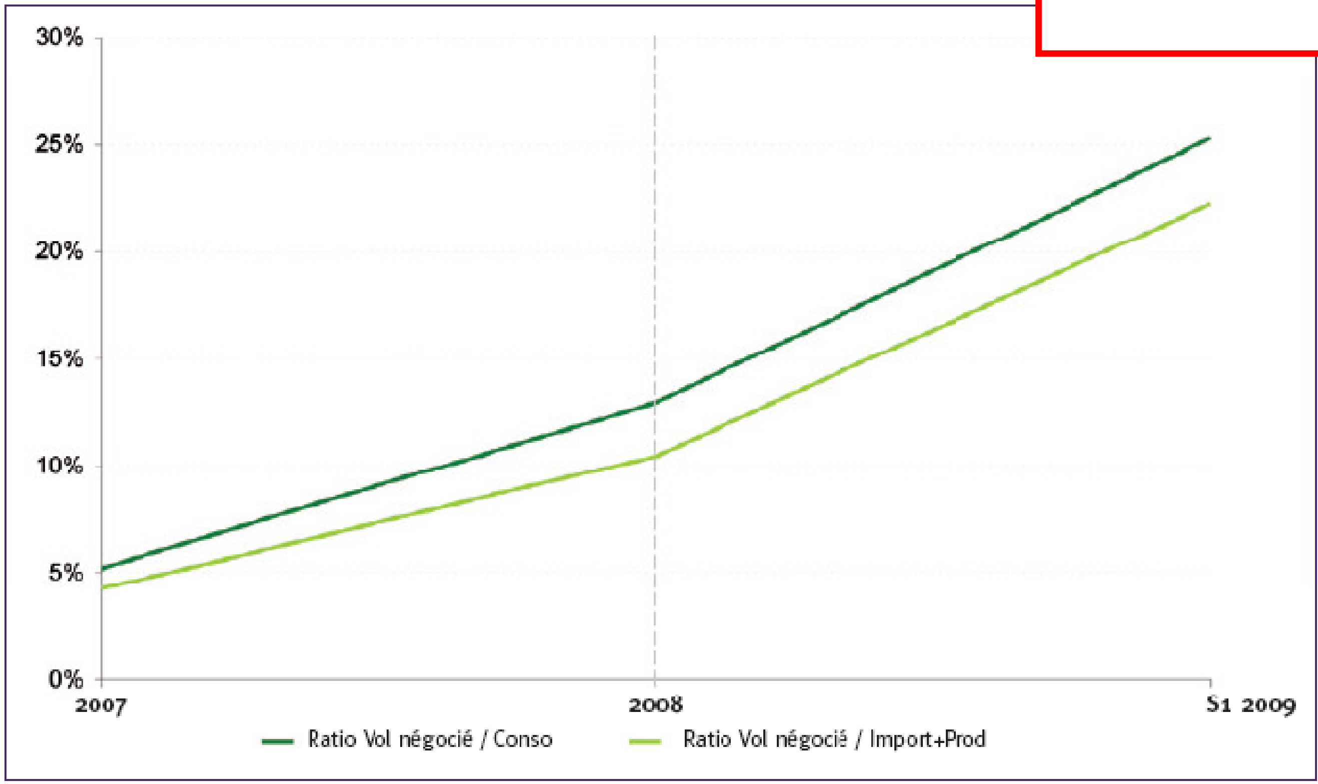
Recent developments

- Changing interest of pan-European gas companies
  - Diversified supply portfolio; pan-European client base
  - Value a better-functioning wholesale market
- DG Competition's big push on energy
  - Cases against E.On (elec); RWE (gas); ENI (gas); E.On (gas); GdF (gas) – meaningful remedies obtained
- Regulatory developments
  - Regional Initiatives
  - National regulators more aggressive (FR; DE; BE; AT; IT…)
- Europe is awash in non-Russian, spot-priced gas
  - Liquidity rises / Contract re-negotiated
  - Gazprom's business model is tested

Rising liquidity: France

Graph from Commission de Regulation de l'Energie (French regulator)

Traded gas on the French market: from 5% in 2007 to 25% in 2009



Sources : Brokers, Powernext, GRTgaz, TIGF   Analyse : CRE

A few questions to conclude

- How can large entry-exit zones be combined into a single market? *How to book long-term, firm capacity from Zeebruge to Baumgarten?*
- Will Europe embrace an administrative approach to transmission investment planning? *The 10 year investment plan process looks a lot like central planning*
- Will Central European countries effectively reform their gas markets?
- What will be the impact of Nord Stream on gas trading in western and central Europe?