



The limits of the EU direct Foreign Gas Policy : Lessons from the Southern Corridor policy

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Introduction

Before 2003 European Union tended to only act by Soft Power in foreign energy policy:

- EU influence by multilateral approach: seeking interdependencies by trade
- Extension of regulation and market rules
 - In Energy, extension of « market regulation » to neighbour countries in the framework of « Partnerships »
 - Example of Energy Charter Treaty initiated by the EU around 1990
 - Example of the so-called Energy Community with several Eastern european countries

After entries of 10 new members and the 2006 and 2009 Ukraine-Russian crises:

Perception of « Russian » risk : geopolitical & market power risks

- Political will to speak with a « single voice » to foreign gas exporters
- Strategic Energy Reviews: diversification of sources , routes, LNG terminals etc.

• Lisbon treaty : art. 184 : power to the EU in matter of Energy Policy

Definition of a foreign gas policy besides Gas Security Regulation focused on internal measures

Policy of diversification of routes for helping diversification of sources:

- Financial support (priority projects)
- Political support to regional association of member states, or consortium of companies to commit in long term purchases (ex. Caspian development corporation CDC)

But under the constraints of market rules

- Need of Exemption of Third Party access on new transit pipe-lines (as for interconnectors)
- Possible conflict with competition policy

But energy security policies remain mainly under sovereignty of members states :no binding agreements for members states and national companies

Introduction

Strong Politization of project

Proposal of **4th corridor** to access Caspian and/or Middle East resources

« Nabucco was **the first attempt at forging a common energy policy to reduce its dependence on Russian gas.** The basis of Nabucco is to bring gas to Europe from new suppliers. We are well on track, ... »

Commissioner Pielbags (2007)

Political project in the vein of the Hard Power

It is reflected in the weak economic grounds of Nabucco

« Merchant pipe line » : supposing to attract by itself new gas sources to be developed

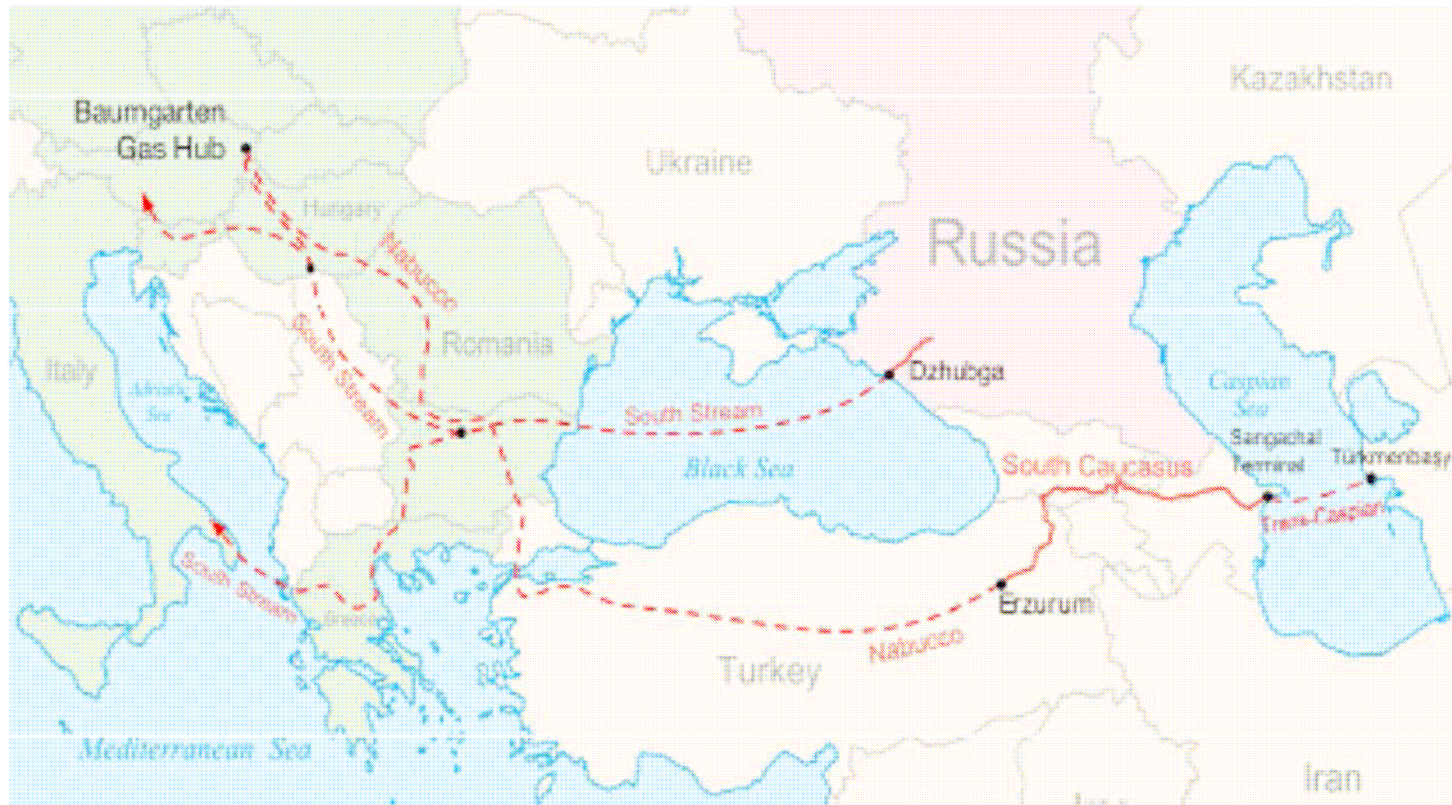
But a new transit pipe line needs **gas, markets and finance: After four years it has no gas and consequently no finance.**

Adoption of several perspectives to understand the possible fiasco

Content

- 1. Caspian gas chessboard:
 - How Russian part can systematically answer to Nabucco project?
- 2. First economic perspective : competition theory
- 3. Second economic perspective: transaction cost theory
- 4. What lessons ?

1. Caspian gas Chessboard



1. Caspian Gas Chessboard Game

	NABUCCO to reach Caspian gas (Turkmen, Azeri) & M.East	SOUTHSTREAM as Russian answer with large European companies
2005	Launching (with Aus, H, Ro, Bu, & Turkey and their gas companies (OMV, Mol, Botas,..)	Gazprom already in Bulgarian gas company
2006/2007	Decision EU to set it in priority projects (guarantee funds)	<ol style="list-style-type: none"> 1. Annoucement by Gazprom , ENI 2. Agreement Gazprom-Turkmenistan on 30 bcm/y + pipe 3. Agreements with Bu, H, Serbia for location and participation in local segments
2008	EU Gas directive :unbundling and anti-Gazprom provision »	Gazprom in Baumgarten hub (50%) Russia –Azeri Agreement
2009	EU cooperation with Turkmen Caspian Dev. Corp (RWE, OMV , Turkmen) Iraqi project in June (OMV, MOL, etc.) Political treaty in Ankara (July 2009)	Annouce of doubling (30 to 60 bcm:y) Agreement with Turkey (location) August 2009 Entry of EDF (10%) Agreement Slovenia
But	April 09: Nabucco outside Priority Projects (German pressures)	South sStream not in Priority Projects and not in South corridor scheme

2. Perspective from competition theory

- Who will be the first in construction? Deterrence for the follower
- Who loose the most in case of failure ?

- **Two level of competitions**

Downstream for markets on Central and South Europe markets

- Nabucco 's advantage : firms supporting the project belong to the same countries that want to import.
- But for Southstream , Gazprom has also cross- relations with large companies in Italy, Bulgaria, Serbia etc.

Upstream for accessing resources: Russia foreclosure on Turkmen gas

- The Russian project benefits from Gazprom's ability to control multiple sources of supply (own's resources, relation with Turkmen) Kazakh, Azer.)
- Russia accepts a higher purchase price, in order to ensure its exclusive access to Turkmen gas.

Linkage between the two competitions : **comparison of commitments costs**

- For Nabucco , huge cost to be built without contractual gas (Azeri gas: maxi. 5bcm)
- Symmetrically : To buy Turkmen gas, no need to be sure to build South Stream

3. Perspective from TCT: A flaw in the concept of Nabucco as merchant line to carry Caspian gas on a strictly commercial basis

- **Nabucco project was conceived** as if Euro Asian Regional gas markets was completely integrated and mature:
 - No need of direct relation by new long term contracts (LTC) between producers and gas suppliers
 - BUT The upstream part of Eurasian gas sector is not mature and it is not within the regulatory jurisdiction of the EU-type legislation
- **Ignorance of basic economics of pipe line development in a non mature gas system**
 - The **virtue** of **the old contractual and industrial model** of development of gas infrastructures
 - LTC between producers and first tier buyers : sharing volume risk and price risk
 - Combination of LTC on gas with infrastructure development :
 - export /transit pipe line or LNG liquefaction/regaseification
 - Valuable Model in a context of gas system development

A flaw in the concept of Nabucco as merchant line

- So a risky approach to design a project without no prior gas relations with producers: need to have producers involvement
- Example of the Azeri opportunism: initial announcement of Shah Deniz II gas 15 -20 bcm/y
- **Nabucco is not redeployable upstream on a 15-year time – horizon:**
 - Effort with Caspian development corporation for contracting with Turkmenistan: complete uncertainty
- The so-called opening up of options to access to Middle East gas (Iran, Iraq , Egypt)
 - Pure rhetoric ignoring time and economics
 - For Iran LNG is much cheaper and not politically risky for Iranian gas in the future
- **Only Former Industrial Model is valuable as for Nordstream**
 - Partnership from wellhead to consumers:: so mutual commitment
 - Contractual integration suppressed opportunism risk (ex. Turkmen going to North after Nabucco and TCP installation)

4. Complexity and fragility of Nabucco coalition

Non binding agreements in the foreign energy policy

Complexity of Nabucco coalition: Players (European Commission + 4 Member States+ small companies (exc. RWE) + Turkey)

Two competing coalitions of Nabucco with major members states & large companies

- Southstream: Gazprom with large MS and large European companies ENI / Italy and now EDF/France
- Nordstream: Gazprom with EON, BASF, Gasunie & Germany
- **No costs for Bulgaria, Hungary, Austria to be also in Southstream coalition**
 - They pay for the local part of the pipe
 - Even with Turkmen gas, Nabucco would need TCP pipe and participation could be more costly than an entry in Southstream
 - With Southstream, the routes diversification benefit is there for them

Turkey could play trump cards with Russia as well as with EU

5. Lessons about external gas policy from transit projects motivated by geopolitical competition

- **Soft Power best for Europe :**
 - 1. EU must not confront head-on to Hard Power : no political means to do it
 - Major member-states do not want to relinquish their sovereignty on gas matters: example of Germany
 - Europe progression is stopped on
- **2. Do not forget economics in a Hard Power game:**
 - South Stream is also a political project, but it has much more economic grounds (gas and markets)
 - Indeed behind Russian hard power, there is a regional monopolist & dominant gas market player.

5. Lessons... (following)

- Diversification of sources will **not occur by spectacular political pipe-lines development to reach Caspina and Mid-east sources.**
- **But is it so problematic?**
 - Private actions could contribute efficiently to the energy security of Europe
 - The dependence from Russia will decrease because LNG imports increase
 - Also progressive and cheapest solutions to reach Azeri gas(ITGI, then BTE) must be supported

- Relevant Issues:
 - interconnectors and solidarity with Central European and Balkanic states
 - Actions on MS to improve their resilience to crisis (Gas security regulation)
 - EU is more skilful when acting inside EU
- Eu needs to improve its skilfulness to act in the framework of its external policy by avoiding ill-grounded projects
- EU is best to act by staying in Soft Power vein:
 - Go on quietly in the post -Energy Charter era
 - « Russian Energy Architecture » could bring to recognition access to transit pipe-line