

A VISION FOR A GAS UNION IN CENTRAL AND SOUTH-EAST EUROPE

Peter Poptchev

March 30, 2015

We will never have a unified European energy policy as long as Central and East European gas markets remain fragmented and divided, writes Peter Poptchev. Now, however, under the impetus of the Energy Union, the EU has a unique opportunity to put its Eastern gas house in order. Poptchev sets out the main steps that need to be taken to achieve this goal.

The Energy Union's goal is to prepare the ground for a fundamentally improved energy system in Europe. The energy markets in Central and South East Europe (C&SEE) will be a crucial testing ground for the viability of this new stage in European integration. In this article I will focus on the gas markets in C&SEE.

From the outset it should be noted that gas is only to play its traditional role while other energy sources and solutions are expected to make a breakthrough in the new energy system. The thrust of the Energy Union targets is aimed – quite reasonably – at renewable energy, energy efficiency and cost-efficient greenhouse gas emission reductions. These priority measures require, among other things, the construction of new and upgraded national and regional grids and electricity interconnections. By far the larger part of the envisioned public-private partnership investments will go to the integrated electricity market, broadly speaking. A new strategy on research and innovation will also be geared towards renewable technologies, storage solutions, smart grids, smart home solutions, etc.

Nevertheless, gas represents both a necessity (for heating and industrial processes) and opportunity (as a relatively low-carbon fossil fuel). Some people have criticized the Energy Union plans for what they consider an “excessive focus on gas”. But this should rather be seen as a correction of previous strategic neglect and a necessary review of the unaddressed omissions and discrepancies in the implementation of the Third Internal Energy Package by some Member States in C&SEE. Their uncoordinated external gas policy has led to internal divisions. Newly emerging threats and challenges to the region’s security and stability could exacerbate further the temptation in some quarters to stick to narrow national energy interests. Such developments could delay the completion of the internal energy market.

In other words, taking specific measures to involve the C&SEE countries, including the Western Balkans, in a process of regional gas infrastructure development and market integration is in a sense a precondition, a stage rehearsal, which should ensure the smooth development and implementation of the Energy Union as a whole.

Strategic partners

The European Commission’s holistic Energy Union strategy encourages “dedicated cooperation arrangements” intended to facilitate “the better integration of these markets into the wider

European energy market which would improve the liquidity and resilience of the energy system and would allow full use of the region's energy efficiency and renewable energy potential”.

This is of course a very challenging goal. Negotiating specific arrangements in the natural gas sector in C&SEE with the participation of more than a dozen countries, some of them having different interpretations of EU energy acquis and regulation, is a task that has not yet been tackled by either the European institutions or the countries themselves. New ground has to be covered in many respects. The new regulations and strategies planned by the Commission in the next one or two years – i.e. on security and transparency of gas supply, LNG, storage, effective regulatory framework – have to be awaited in order to be factored adequately into the new multilateral arrangements.

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At the same time, the necessity to implement the Third Package strictly and fully is there to stay. Unbundling, independent regulators and the development of cross-border network codes are the three areas in which most countries in the region will have to intensify their efforts and work in unison. Indeed, it seems advisable for the Commission to involve, right from the start, experts from these countries, including TSOs (transmission system operators) and regulators, in the elaboration of the new strategies. What is needed is a combination of a top-down (Commission, European Parliament, ENTSO-G, ACER) and bottom-up approach. The views of Energy Union-minded NGOs should also be taken into account.

What do we mean exactly by Central and South East Europe? Ideally, those EU Member States which have a territorial, infrastructural and/or commercial stake in the future market, as well as all 9 Contracting Parties to the Energy Community, should join in a collective effort to establish an integrated regional gas market as part and parcel of the continent-wide single integrated market. This inclusive framework should not obstruct “asymmetric” or sub-regional initiatives, such as the roadmap towards a regional gas market established by the Visegrad (V4) group (Czech Republic, Hungary, Poland and Slovakia), the initiative for a North-South gas corridor, the idea for a vertical Greece-Bulgaria-Romania corridor, a Bulgaria-Greece-Turkey gas price hub, etcetera, provided such projects do not conflict with the agreed market design. Ukraine and Turkey should be invited to take their respective places as permanent and reliable participants or “strategic partners” in the regional gas market. The case of Turkey is specific and it might require a new creative strategic approach.

High-level group

An integrated and well-functioning C&SEE gas market involves national and regional infrastructural projects as well as developing new sources of gas, most of all through a revived Southern Gas Corridor and an LNG strategy. Under the circumstances, the countries in C&SEE should agree to the principle that all regional initiatives should evolve in a coherent way and

contribute to a fully integrated internal energy market: any new infrastructure development idea with a potential impact on the overall market should first be put to the scrutiny of consultation.

With this purpose in mind, the High-Level Group which sat for a first meeting in Sofia on 9 February should be adequately enlarged, mandated and staffed. Given the lack of traditions in a regional approach to energy, it might be necessary to establish the position of an Energy Union Coordinator whose task will be to liaise among the European institutions and national authorities and facilitate bridge-building.

It is typical of C&SEE that many regional countries consider themselves or aspire to become gas hubs, often overstating their comparative advantages which they want to commercialize. The various hub concepts should be analysed in terms of their utility to a previously agreed regional market design and/or a regional gas target model (such as the one recently developed by ACER). A regional hub integration strategy should be addressed.

The sudden emergence of so many new long-haul pipeline ideas only goes to show that the operators do not expect the new system of interconnections and storage facilities to function satisfactorily unless adequate gas liquidity is ensured from outside the EU.

Historically, for example Austria, and less so Slovakia, have proven their hub status. Vienna has successfully developed the Central European Gas Hub at Baumgarten, which features a modern trading platform but lacks sufficient liquidity and a developed regional market. Turkey aims to be a dominant transit and trading hub, its weak point being regulation and sufficient storage capacity. Greece, with its strategic location, is in a position to transit and distribute gas flows from the Caspian, East and West Mediterranean, and now possibly Russia, along two vectors – West and North. Both Turkey and Greece are somewhat off the big European gas markets in Central and Western Europe and are therefore heavily dependent on North West- and North-bound interconnections as well as bigger throughput capacity pipelines to Europe.

Monumental

Thus, the ambition to develop the Southern Gas Corridor into a “monumental” supply project to Europe faces a real infrastructure bottleneck at the Union’s outer border. This has been further aggravated by Russia’s intention to supply its EU customers with 30 to 45 bcma (billion cubic meters per annum), already contracted, also at the Turkish-Greek border.

For the purpose of this analysis, if Gazprom limited its supply volumes at a hub on the Greek-Turkish border to just 30 bcma and TANAP (the Trans Anatolian Pipeline that will run from Azerbaijan through Georgia and Turkey to Europe) would bring the same quantity, the EU would have to provide for transmission of roughly 60 bcma of gas at that border. Presently, TAP, which will connect TANAP with Italy, is scheduled for a 10 bcma capacity, with the possibility to increase this to a maximum of 20 bcma by installing additional compressor stations. In addition, the Interconnector Turkey-Greece-Italy (ITGI) pipeline could in principle offer 5 to 8 bcma to the same destination, but this would leave Greece without any spare transit capacity for its coveted East Mediterranean gas.

Note that the construction schedules and throughput capacity for both TAP and TANAP have already been finalised. As declared by the Presidents of Turkey, Azerbaijan and Georgia recently in 10 years' time TANAP is planned to be transmitting 30 bcma from alternative sources of gas, which will be most valuable to Europe's energy security.

Overall, Europe will either have to double or even triple the throughput capacity across Greece or revert to a sensible but formerly rejected option – opening a second outlet for Southern Corridor gas from Turkey into Bulgaria/EU – in other words: to revive the Nabucco project or an identical dedicated pipeline under a different name. This will necessitate the construction of a 130 km long interconnection (of about 48" diameter) between TANAP and the Bulgarian gas transmission system as well as a new wide-diameter pipeline (23–30 bcma) from Bulgaria to Baumgarten across Romania and Hungary. With projected volumes of 30 bcma by 2026, and a possibility to increase this further, a second Southern Gas Corridor outlet through Bulgaria to Europe seems advisable even without a massive rerouting of Russian gas.

European gas hub

The keen observer of EU-Russia gas relations would have noticed that President Putin has been prudent enough, on two key occasions in Ankara and Budapest, to stipulate that his intention for Turkish Stream (the new South Stream) is dependent also on the gas policies of the European Commission. Moscow is of course perfectly aware of the possible implications of the Energy Union on the final market design in C&SEE and will probably opt for market-based solutions to its gas supply strategy rather than insist on a geopolitical approach (like building a new pipeline through Macedonia and Serbia, dubbed TESLA by some interested parties). From this point of view and given the unclear long-term arrangements for gas supplies to Ukraine, Russia, very much like the EU, has no reason to make haste. With one exception: Gazprom needs to find as soon as possible a commercially viable utilization of the pipes already built for the first one or two strings of South Stream (each has a 15.7 bcma capacity), presently stocked at Varna and Bourgas ports.

Under the new circumstances, and in the spirit of the rational Energy Union approach, we might expect that what, until yesterday, was deemed unthinkable, namely, the flow of both Russian and non-Russian gas in the same pipeline to Europe across Bulgaria, would now be perfectly feasible

Against the backdrop of these developments, Bulgaria has come up with some potentially enabling moves in support of the general thrust of the Energy Union's approach to C&SEE. The first such move is Sofia's initiative to establish "a European gas hub". This involves actually two hubs: one, a gas hub proper, to be built near Varna (in case Moscow were, miraculously, to revert to South Stream) or at another national location, dependent on any new external gas flows. Two, offering to turn the entire circular-shaped national gas transmission system, appropriately renovated and extended by four interconnections to Greece, Romania, Serbia and Turkey, into a multidirectional regional gas hub. This specific configuration of the Bulgarian gas transmission system, plus a sizeable free transmission capacity, has been noted by the European Commission and independent experts years ago (and dubbed "a wheeling hub" or "a gas roundabout").

Bulgaria, for reasons I won't go into here, has declined until now to develop this circular hub and to build the four interconnections. The change of heart has occurred only recently, signaling a most welcome "Europeanisation" of the country's energy policy. The hub, once realized in its totality, will "physically open up the regional gas market" and facilitate the establishment of entry-exit points for gas trade at numerous borders in the wider region. The Energy Union Strategic Framework encourages the establishment of "liquid gas hubs with multiple suppliers", such as the one Bulgaria has proposed.

The second move is Bulgaria's interest in reinvigorating Nabucco-West – or a variation thereof, namely, a PCI-listed gas pipeline that will run from Bulgaria to Austria via Romania and Hungary, 1318 km long, with a minimum capacity of 23 bcma. Such a project would have the advantage that all EU-required permits have already been issued in 2013 for the full length of the route across 4 countries. The cost of such a pipeline, including a detailed return scheme, is also well established.

Alternatively, any other new pipeline following broadly the same direction – TESLA or Eastring – will take at least 2 years to develop the route and obtain the SEIAs (social and environmental impact assessments) and building permits issued, if at all approved by the European Commission. On the other hand, the sudden emergence of so many new long-haul pipeline ideas only goes to show that the operators do not expect the new system of interconnections, and storage facilities, in C&SEE to function satisfactorily unless adequate gas liquidity is ensured from outside the EU. This is, above all, in the interest of Central Europe.

It is in this context that attention to Nabucco-West seems to be growing. Azerbaijan, formerly the key partner to the project, has recently supported Sofia's initiative. Other European capitals, and the Commission, are carefully weighing, keeping all options open. At a certain level Turkey, too, has indicated it might return to Nabucco – a sign, if confirmed, that Ankara might have new ideas on the best way to develop TANAP, and to transit Russian gas without upsetting its European position. Austria's involvement, for obvious reasons, could be taken for granted.

With a few exceptions, the energy companies from the region will not be in a position to cope with the new challenging business environment unless they undergo corporate restructuring and financial reinforcement

The Nabucco-West concept has always envisioned reaching full capacity in stages, depending on quantities ensured. Under the new circumstances, and in the spirit of the rational Energy Union approach, we might expect that what, until yesterday, was deemed unthinkable, namely, the flow of both Russian and non-Russian gas in the same pipeline to Europe across Bulgaria, would now be perfectly feasible – to the extent that, in this case, both the Russian and non-Russian gas would have been already contracted.

Serbia, and other Western Balkan countries, should also view this development as in their own interest in the absence of an onshore South Stream pipeline. For example the planned Interconnector Bulgaria-Serbia (IBS) could be substantially increased from the present 1.8 bcma,

and the Banatsky Dvor strategic storage facility could take a prominent market role in the regional gas system.

Ultimate arbiter

Managing piped gas to C&SEE is not the whole story. It is the new LNG terminals and FSRUs (floating storage and regasification units) in Poland, Lithuania, Greece, Turkey, Italy and, hopefully, Croatia, which will complete the diversity and security of supply picture in the regional market. Obviously, this picture will take some time to surface, at least for the sake of developing and adopting an EU LNG Strategy which is planned for 2016. In the intervening time, Bulgaria, and all others concerned, should prioritize and accelerate the construction of the regional gas interconnections (Greece-Bulgaria in particular), and sit together to agree on all necessary reforms and amendments that will lead to an effective regulatory framework.

The ultimate arbiter of new plans and designs in the energy markets of C&SEE will be private investors and private initiative, including IT and high-tech companies. Facilitating the provision of necessary investments would be the real change that the Energy Union could bring to this part of Europe. With a few exceptions, the energy companies from the region will not be in a position to cope with the new challenging business environment unless they undergo corporate restructuring and financial reinforcement. Asset swaps, including with entities from outside the region as well as cross-border joint-ventures, will make the companies stronger and more competitive. The EIB and other investment specialists should advise the regional operators on, for example, “productive quantitative easing” (i.e. offering “free” money for large infrastructure projects) as an instrument more applicable to large infrastructure projects.

Making the Energy Union work in Central and South East Europe, including through strategic cooperation with Turkey and Ukraine, will improve the business climate and boost the economic prospects in this crucial part of Europe.

Editor’s Note

Ambassador Peter Poptchev is a career diplomat, with over 30 years of contribution to Bulgaria’s bilateral and multilateral diplomacy in Lagos, Geneva, Brussels, Dublin and Vienna. From 2007, he was Ambassador-at-large for Energy, Security and Climate Change at the Bulgarian Ministry of Foreign Affairs. He was on the Bulgarian delegation negotiating the South Stream intergovernmental agreement (IGA), headed the team negotiating the Nabucco IGA and helped establish an international programme on energy security at the Diplomatic Institute. He has also held a number of elected positions at UN and specialised international organisations. A series of international treaties, conventions and protocols have been negotiated under his chairmanship and drafting. The author of four books and numerous articles in Bulgarian and English, he researches in particular the development of the EU and NATO in the framework of globalisation and asymmetric threats and challenges to security, including energy security, and climate change. For Energy Post he earlier wrote an analysis advocating a rethink of the Nabucco pipeline project, which is still relevant today, as well as extensive analysis of the South Stream project, A modest proposal on South Stream – for the EU’s new VP Energy Union.