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Norway: A Model for Shale Gas Exploration and Production in Poland?

by Lidia Puka

The Norwegian model of exploration and production (E&P) of gas can to a limited extent be implemented in Poland. The external limitations stem, first, from the differences in the profitability of natural and shale gas, and, second, from the restricted possibility of introducing Norwegian interventionist measures due to EU regulations and liberalisation of the European gas market. On the other hand, the Norwegian model highlights the challenges connected with resource management, and these challenges should be taken into account even at the early stage of the E&P.

For the time being, the amount and accessibility of shale gas reserves in Poland remain uncertain, but it is nonetheless worthwhile to examine the successful Norwegian model of natural resource management to highlight the challenges involved in the E&P of gas. This model is based on economic and legal actions of the state aimed at minimising the negative consequences for the economy often associated with resource production (the so-called "resource curse") and at safeguarding a managed distribution of profits among citizens.

Prospects for the adoption of the Norwegian model of E&P of gas are examined below by comparing the economic and legal elements of the model with the current situation in Poland.

Economic Aspects. The initial lack of experience has resulted in the cautious approach of Norwegian political elites towards the E&P of oil and gas. The first strategy for resource management was outlined in Parliamentary Report no. 25 in June 1974. It provided for a moderate and limited rate of production, careful infusion of the oil revenues into the domestic market, and the state's majority stake in future E&P projects. The state introduced stricter conditions for granting concessions for North Sea exploration by linking them with the right of the state to participate in the process of production. Foreign investors were soon surprised by changes in political and social conditions, i.e. stricter labour regulations, influential trade unions, rising state presence in E&P and higher taxes, but these impediments were compensated for by the rising oil prices in the 1970s. In the case of Poland, falling gas demand and prices are undermining the negotiating power of the state, while the process of obtaining concessions for the exploration of hydrocarbons remains formally unconnected with the process of granting concessions for production.

The Norwegian state's participation in and control over the E&P was also assured through its fiscal policy and its twofold system of high taxation and high incentives. The taxes on petroleum companies currently reach to 78%, but in fact the companies pay much less, as the state participates up to 78% of the documented costs of exploration. This twofold system enables Norway to control foreign investor activity directly and indirectly. In the case of Poland, a low taxation rate is the main incentive for foreign investors at the exploration stage. The main obstacle to the introduction of a twofold taxation lies in the differences in the production of conventional and unconventional gas. The E&P of shale gas requires vast capital, extensive drilling and the ability to constantly shift to new locations, which means lower revenues than in the case of gas from conventional sources.

To avoid the risk of overheating the economy and run-away inflation, Norway has been isolating the revenues generated by its natural resources. Instead of being directly consumed domestically, the money is exported through buffer fund investments, and generate additional profits. The creation of such a fund in Poland remains theoretical, as due to lower profitability of shale gas production (if the experts are right) it would be more sound economically to re-invest the revenues into the sector's development.

Last but not least, the Norwegian model provides for the creation of a strong state energy player. Hence the vertically-integrated Statoil (present in all segments of the sector, from exploration to distribution) was created in 1972 and merged with Norsk Hydro in 2007, strengthening the company's ability to act on global markets. Although the Polish gas market remains fairly consolidated, the creation of an "energy champion" could encounter financial and regulatory obstacles. Moreover, unpopular political decisions would be required at the initial investment stage to transfer budgetary resources with a view to rather uncertain future profits. On the other hand, this was a risk that the Norwegian Labour Party had decided to take, consolidating its presence on the political scene as a result.

Legal Aspects. Norwegian legislation has followed a pattern of strengthening state participation and control over foreign companies which usually has an adverse effect on market competition. In Poland, any action that might hinder competition must be done within the framework of the EU's competition legislation. Despite strong pressure in the European Commission to liberalise the gas market, this goal is unlikely to be achieved in the foreseeable future. Exceptions to EU regulations are commonly used by such member states as France or Germany to support a rather awkward model of liberalisation of the energy market through consolidation of the companies.

Although Norway is not an EU member state, it is bound by EU law since 1 January 1994 through the European Economic Area Agreement. But EU regulations were no obstacle to the Statoil-Norsk Hydro merger, which the European Commission approved on 3 May 2007. In fact, consolidation of enterprises as such is not forbidden by the EU law unless it has a negative impact on competition, as defined in the EC Merger Regulation.

The Norwegian model embraces the introduction of high national environmental standards. It provides for enhanced transparency of foreign investors actions and an indirect state control over the market. The implementation of the rules on a national rather than an EU level offers the state greater flexibility. Moreover, certain Norwegian regulations aimed at protecting people, animals and plants at the same time fall within the scope of exceptions to the ban on the quantitative restrictions on the free trade of goods.

Recommendations. Although the Norwegian model cannot be directly implemented in Poland, it highlights the needs to ensure the transparency of and control over the actions of foreign investors by imposing high environmental standards or a twofold system of high taxation and tax incentives. It also shows that in the long run investments in the development of the national education and research as well as a strong position of the national gas player, are economically viable. In view of the forecasted increase in gas demand in Europe and the EU's low-emission energy policies, Poland should come up with a long-term resource management strategy as soon as its deposits of shale gas are confirmed. Until then, it would be worthwhile to enhance contacts and coordination between the local and central authorities. Surprisingly, the EU gas market liberalisation process need not hinder the consolidation of energy players, but shale gas E&P could change Poland's position in the EU forum from a supporter of liberalisation to an advocate of consolidation.

On the other hand, Poland will not become "the Norway of the South" in a fortnight. Global oil and gas prices are among the factors that should reckoned with, while the long tradition of Norwegian state intervention in the economy has made it easier to reach a consensus on the implementation of interventionist measures there. Last but not least, Norway has consistently followed the welfare state model. The tradition of a managed distribution of energy profits was applied to the development of hydropower in the early 20th century, while in Poland's case the launch of a comparable system would evoke the still-vivid memories of the inefficiency of the socialist system.