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The Chances of Regional Integration of the Romanian Gas Market

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2013 can be a crucial year for the Romanian gas sector: the government gave the green light to shale gas exploration and the fate of the Nabucco West pipeline project will also be decided this year. A series of energy company privatisations are in store as well. However, without the authorities' commitment to an in-depth restructuring of the gas sector, Romania runs the risk of repeatedly failing to live up to its potential to become a meaningful player in the region. Bilaterally and via the V4 platform, Poland has the means to transfer energy policy best practices to Romania and thus hasten the process of regional energy market integration.

Romania has a balanced energy mix of 35.7% natural gas, 29% oil, 18.1% coal and 10.3% hydropower. Annual natural gas consumption in the country is around 14 bcm, out of which 11 bcm originates from domestic production, the rest being imported from Russia. Romania's energy dependence currently stands at 21.34%, ranking the country third in the EU behind Denmark and Estonia. But, as a result of the decades-long unsustainable exploitation and a yearly decrease in production, there is only 109.2 bcm of natural gas left, enough to cover consumption for no longer than the next 15 years.

Prospects of Further Gas Sources. Although the proven reserves are quickly depleting, new sources are in sight. One is a natural gas reserve of some 42-84 bcm under the Black Sea continental shelf, the extraction of which could begin at the end of this decade.

Romania is also assumed to hold shale gas reserves, yet currently there are no exact estimates as to their size and accessibility. After the issuance of licences in 2011, the new government (formed in May 2012) imposed a moratorium on exploration. However, with its expiration last December, the government again announced support for shale gas. U.S.-based multinational energy corporation Chevron plans to start drilling work in the second half of 2013. Unfortunately, there is hardly any full-fledged public debate on the topic with the participation of all the stakeholders. The first channel of public information was last year's demonstrations rather than official communication. As a result, the public is still unsure of the risks and opportunities of shale gas exploration. The confusion is escalated by an inconsistent approach on the part of the authorities over the past year and a half.

Meanwhile, Romania is also looking to diversify its gas import sources via membership in the Nabucco West project.[1] What makes Romania particularly attractive for this project is the country's vast network of deposits (seven in all with a total capacity of 3.2 bcm) some of which need only minor investment to be modernised. Romania is also exploring the possibility of building an LNG terminal at Constanța as part of the AGRI project, which, however, is still at the feasibility study phase.

Hurdles on the Internal Gas Market. The European Commission has referred Romania, together with several other Member States, to the European Court of Justice for failing to fully transpose the EU's internal energy market rules. Competition is hampered by high market concentration at the production level together with bilateral long-term supply contracts. A partial solution is expected from further privatisations under the pressure of the IMF, which

[1] A. Sobják, K. Zasztowt, "Nabucco West—Perspectives and Relevance: The Reconfigured Scenario," *PISM Policy Paper,* no. 44, November 2012.

exceptionally imposed a set of sectoral conditions in its agreement with Romania signed in 2011. Under these rules, 15% stakes in gas grid operator Transgaz and gas producer Romgaz are due to be sold this year. A further problem is the absence of an organised wholesale market and a spot market. The gas exchange to be set up is still not operational. The market is currently largely regulated and the 2012 energy roadmap foresees phasing out end-user price regulations as well as ensuring protection of vulnerable customers by the end of 2018.

The dynamics of the Romanian gas market is largely determined by a law from the 1990s defining the so-called "gas basket." Under this law, at least 25%–30% of consumption has to be covered from imports, so that the country's own reserves are not depleted too quickly. Since the price of domestic gas is around three times lower than that of imported gas, large industrial consumers seek to benefit from 100% domestic gas, while suppliers are constrained to buy imported gas and sell it at a regulated, below-the-market price, facing considerable losses. Moreover, in 2011, the government put a temporary ban on gas exports for the duration of the crisis. Upon an infringement procedure launched by the European Commission last November, the law was repealed this March.

Nevertheless, for the time being, there are only virtual exports, as for physical ones considerable infrastructure investments would be needed. Reverse flow has to be implemented on the interconnectors with Hungary and Bulgaria (the latter is part of the transit pipeline from Ukraine to Bulgaria). The construction of a further interconnector to Moldova is scheduled for later this year and a second one with Bulgaria is also planned. For the purpose of supply diversification, all these transit lines should be physically linked to the national gas system and full third-party access should be guaranteed too.

Conclusions. With a balanced energy mix and prospects for an enlarged pool of both domestic and imported gas supplies, Romania has far fewer energy dependency concerns than other countries in the region. It even has the potential to become a net gas exporter. However, regional integration is hindered by a series of factors, including the lack of competition on the internal gas market, inefficient management of several state-held energy companies, the absence of a wholesale gas market, low external trade, and the lack of interconnectivity. Slow progress in eliminating all these obstacles ultimately boils down to a lack of genuine political and business commitment to developing a transparent and competitive gas market. As long as vested interests prevail, state monopoly will continue to feed corruption and rent seeking rather than entrepreneurship. A further problem is a highly introverted energy policy due to which decision making seems to be decoupled from that on the regional or EU levels. All these shortcomings doom the Romanian gas market to further isolation, which means lost opportunities in terms of both commercial gains and supply security.

Recommendations. Due to its favourable geographical location, combined with proven and potential gas sources and the already existing infrastructure (especially storage facilities), the Romanian gas market will be a significant part of the future European internal energy market. But much needs to be done in terms of market liberalisation and regional integration. The pressure applied on energy sector reforms as a condition of the preventive agreement with the IMF and EU has already brought partial successes. If the loan is to be renewed this summer, such conditionality with updated targets should continue.

Energy security is one of the main pillars of the Polish-Romanian Strategic Partnership signed in 2009. The integration of the region's gas markets as well as diversified import supplies are in the shared interest of the two countries. If the Nabucco West and AGRI pipelines are built, gas transited via Romania can be of potential interest to the Polish market. Since regional integration is hampered on the Romanian side by a series of domestic operational flaws, solving these can be in the indirect interest of Poland too. Therefore, a bilateral framework for best practice transfer is highly recommendable. This would produce the most results at the company level, but institutional initiatives are necessary to give the first impulse. Poland could share its experience in LNG terminal construction and shale gas development, as in both areas Poland is at a far more advanced stage than Romania. Innovative solutions, such as the new private-equity-style state-run infrastructure investment fund set up by the Treasury Ministry, can also be inspirational. Debates on draft legislation on hydrocarbons should be analysed in Romania, where updating the energy strategy and complementing it with a long-term view on non-conventional sources is of the utmost urgency. In turn, Romania, with its more than century-long tradition of gas production, can share its geological, technical and infrastructure know-how. Romania is also a few steps ahead of Poland in certain aspects of the electricity and oil sectors.

Apart from bilateral relations, a further platform for cooperation is the Visegrad Group. Romania is already occasionally involved in the V4+ format on energy issues, particularly in the development of the North-South Gas Corridor. However, Romania could also be engaged in the regular political and expert-level consultations of the V4 on EU energy initiatives, such as the TEN-E regulation, the Connecting Europe Facility or developing a European approach to shale gas. With a similar scope, but in a closer and more efficient circle, the V4+ should create a routine consultation mechanism on internal market liberalisation, modelled after the South-South East Gas Regional Initiative coordinated by the European Agency for the Cooperation of Energy Regulators.