GoodGov
NUPI Norwegian Institute of International Affairs
PISM POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

BULLETIN

No. 122 (717), 13 October 2014 © PISM

The Paradox of a Stable Supplier: Norway in the European Union's Gas Strategy

Lidia Puka

The risk of a reduction of Russian gas supplies to the European Union highlights the importance of Norway—the second biggest gas exporter economically integrated with the EU. An increase in exports of Norwegian gas temporarily raises the security of gas supplies to Europe. Nevertheless, internal conditions limit the potential of Norwegian gas to replace supplies from Russia. In the long term, Norway's ability to remain a stable supplier will depend on the discoveries of new gas fields. Thus, the EU and Norway should strengthen energy cooperation and prepare responses to the various future development scenarios.[1]

Sustainable Supply. After Russia, Norway is the second largest supplier of gas to the European Union (103 billion cubic metres, or 24% of EU gas consumption in 2013, mainly to Western Europe). The country has gained this position over the past 20 years, during which time exports to the EU increased fourfold. Trade relations are characterised by a very high degree of trust—the country is part of the single European market through the Agreement on the European Economic Area. It also adjusts national policy to EU policies (for example in foreign policy, with Norway applying the same sanctions on Russia). Regulatory stability and in-depth dialogue with the industry is a country priority. As a result, over a quarter of Norway's gas resources are in the hands of nearly 40 of the biggest European extraction companies, including subsidiaries of the major global players in the sector (BP, ConocoPhillips, ExxonMobil, Talisman, Shell, Total, Marathon, ENI and GDF Suez). Other deposits belong to Statoil and Petoro, in which Norway is the majority shareholder (holding 67% and 100% of the shares, respectively).

At first glance, increased production and regulatory stability make Norway the "dream" gas supplier to the EU, suggesting it could once again overtake Russia. This indeed happened in 2012 (with gas exports of 107.6 bcm), but it did not last long. In 2013, after renegotiations of contracts resulting in a price reduction, Gazprom returned to the leading position, replacing part of the supply of liquefied natural gas on the EU market (imports from other suppliers to the EU were halved to 36.5 bcm). At the same time, the sale of Norwegian gas decreased by 5%, due to technical problems in the production of gas from the main field, Troll.

The export of gas from the shelf is limited by the capacity of the gas transport infrastructure, including pipelines (120 bcm) and the LNG liquefaction terminal in Melkøya (5.7 bcm annually). They correspond to the level of gas production from existing fields. Increase in gas supply is only possible when the maximum pipeline capacity is not in use, mainly throughout the summer period. The shale revolution in North America stopped Norway's plans to build additional liquefaction terminals, as these plans were intended for the export of gas to the United States.

The uncertainty of the prospective gas fields is also significant. Confirmed gas reserves—15 times smaller than Russian reserves—suffice to maintain exports to the EU at the current level until 2033 (1.97 trillion cubic meters). Perspective estimates of gas deposits are larger (up to additional 3.7 tcm), but they assume intensive exploration and production in the Arctic region of the Barents Sea. If they are successful, a decade will pass from discovery to production and export, in order for production and transmission infrastructure to be developed.

[1] The research leading to these results has received funding from the Polish-Norwegian Research Programme operated by the National Centre for Research and Development under the Norwegian Financial Mechanism 2009-2014 in the frame of Project Contract No Pol-Nor/202499/39/2013.

Short-term Convergence of Interests, Long-term Uncertainty. In the short run, the expectations of the European Union are realistic and consistent with the capabilities of Norway. The European Commission—while appreciative of the role of Norway in the event of gas supply disruptions—recognises the limits of increasing gas production and export capacities. According to EC estimates from June 2014 ("In-depth Study on European Energy Security"), Norwegian gas production and export to Europe could by next spring increase by approximately 14 bcm (roughly 8% of Russian gas reaching Europe, and 17% of that transited through Ukraine). The commission notes that most of this gas would be destined for Western Europe, and that increased production could be incentivised by an increase in gas prices if supplies fall short.

The commission's engagement is direct, and above standard. On 25 September, during the Energy Conference "In-depth Energy Partnership with Norway," Commissioner Günther Oettinger tried to guarantee increased gas supplies from Norway to Europe. This is a qualitative change in the bargaining position between the parties. Before the Russian-Ukrainian conflict, Norway had to maintain its market (as the EU receives 98% of the country's gas exports). Moreover, the financial state of the companies has weakened in the last three years, due to the rising cost of production on the shelf, and a shrinking market (gas consumption in Europe fell by 15%). Now it is Norway that is approached and asked to produce and sell more. This could mean an increase in gas prices in Europe, both on spot markets (which are the bases of the pricing formula of Statoil contracts), as well as in new contracts. At the same time, there are new market opportunities in Eastern Europe, which the Norwegian companies embrace. In August, Statoil signed a contract with Litgas to supply 0.55 bcm of gas annually (2015–2019), to the floating re-gasification terminal in Klaipeda. The terminal is chartered from the Norwegian company Höegh, and the loan for the expansion of the land-based section came from the Nordic Investment Bank. On October, 3, Statoil and Naftogaz announced the signing of a contract for the supply of gas to Ukraine through Slovakia (the terms of which, however, have not been revealed, but the press speculated on a volume of between 2 and 6 bcm, while the capacity of the Slovak reverse gas flow system is 10 bcm). Those actions, however, do not change the priority of the Norwegian policy, which is the stabilisation of exports, and of gas production. Neither are there many macroeconomic stimuli to incentivise a radical increase in production—Norway's GDP is growing, unemployment remains low, and capital reserves in the form of the state investment fund are abundant.

On the other hand, Norway's interests, and the EU's energy and climate policy goals, might diverge as early as 2030. The paramount interests of the gas provider and the fear of losing markets push the government of Norway to question the commission's proposal for a binding energy efficiency target of 30% in 2030, and to promote long-term gas consumption in Europe. So far, however, there has been no guarantee that Norwegian gas could cover the demand. Moreover, conflicts of interest could occur in relation to the cost of gas. The ability of Norway to remain a gas supplier after 2030 depends on new discoveries, and expectations are based upon the hard to access Arctic region of the Barents Sea, and the results of exploration as part of next year's licensing round. This means, however, that the price of Norwegian gas will not be low. Today, it needs to be high enough to justify the cost of the Arctic exploratory drilling. If successful, the price of gas will in the future need to cover the costs of production and infrastructure development in the region.

Conclusions. The crisis in Ukraine has put relations between Norway and the EU to the test. The developed dialogue, and direct communication between the government and the European Commission, consolidates interests on both sides. The European Commission actually performs the role of negotiator of additional gas supplies to Europe. This, in turn, strengthens the negotiating position of the suppliers of Norwegian gas, also in relation to the new markets.

In the next five years, supplies of Norwegian gas are likely to increase to fill transmission capacity to its limits. During this period, high gas prices will encourage investment in exploratory drilling in the Barents Sea—the condition for the continued delivery of Norwegian gas after 2030. In the short term, an increase in production of Norwegian gas reserves can postpone the negative effects of interruptions in supplies of Russian gas. However, such an increase means neither that Russian gas can be replaced at the current level of consumption, nor that prices will fall significantly.

The problems might occur in the medium-term and long-term perspectives. Without the deployment of additional technology, gas is not directly compatible with the EU's objectives of transformation towards a low-emissions economy. Moreover, as long as the government of Norway pursues the interests of the gas supplier exclusively in relations with the EU, it will simultaneously improve conditions for other gas providers, including Russia.

The results of the gas exploration on the shelf will create the basis for defining future relations with the EU in the gas sector, but already now both sides should be working out alternative scenarios for cooperation. The EU is currently at a critical time for determining policies for the 2020 and 2030 period, while Norway will publish its national energy policy assumptions next year. It would be of benefit to European energy security, as well as the Norwegian economy, to develop consistent plans that assess different scenarios for gas development on the Norwegian shelf. The scenarios could be either on the high end (thus allowing for several decades of cooperation and involving the supply of technology development), or low end (assuming the failure of further exploration on the shelf, and increasing competition regarding the supply of LNG to the EU).