

COMMENT: The EU needs to act at home to counter Gazprom's power

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There is a clear link between most Central and Eastern European gas markets still being government-run and/or fully monopolized, and Europe's vulnerability to decisions by Gazprom, with its considerable investments in the region, to turn off the gas tap. There have been many calls to unify the EU's gas markets in response, but no concrete proposals on how exactly to go about it. Yet a few antitrust cases in the new member states such as those launched in Western Europe against giants such as Gaz de France or ENI could do a big part of the job.

Well-established monopolies end up being swayed by the tides of economic or technological progress and smart competitors. Once they have been weakened, regulatory reform gives them the final shove. The rise of American cotton and English industrialisation in the 18th century forced the British East India Company to switch its core business from Indian calicoes trade to tea and opium, only to be brought down by shrewd drug smugglers on ever-quicker sailing ships, and the ultimate lifting of its trading monopoly by the Crown in the 19th century. Is a similar fate awaiting Gazprom?

Nobody wishes a vital company for both Russia and Europe to actually disappear, but everyone would gain from it acting on purely competitive and non-politicised grounds. Gladly, important ingredients for a decline of Gazprom's current business model with Europe have started coming together: technological progress embodied in liquid natural gas (LNG), and its main champion, the Qataris. The regulatory *coup-de-grace*, however, lags behind. The latter could come from the EU – if the bloc only seriously wanted to.

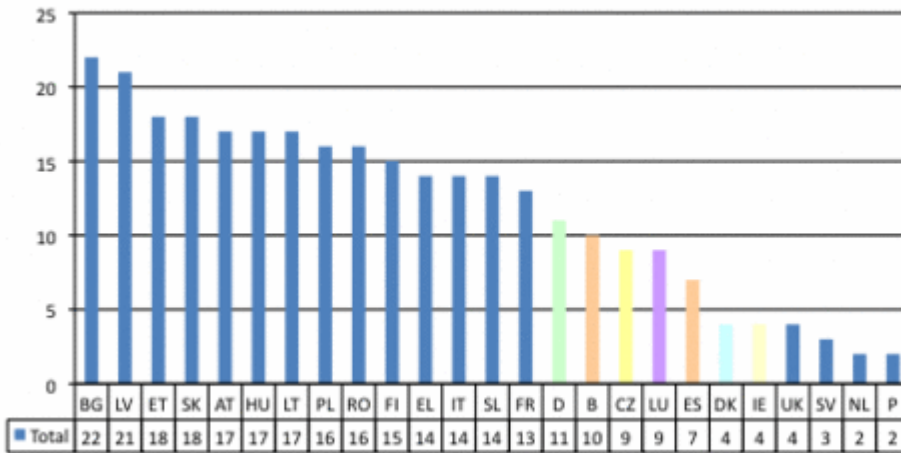
In thrall to the giant

Gazprom, the public-private behemoth with exclusive rights to control an antiquated Soviet pipeline system, holds Europe and Central Asia in thrall. Gazprom has not dared to shut the gas taps to its west so far this winter due to various circumstances that have temporarily weakened it. Even if the danger seems to have been averted, there hasn't been enough change in the structure of European markets since the last gas crisis of January 2009 to stop another gas cut-off occurring again. The psychological and political sway Gazprom – and by extension Russia – holds in Europe is quite rightly attributed to the excessive dependency on the Russian company of the small and mutually isolated markets of former members of the Soviet bloc on the one hand, and the unconditional willingness of the big players in the West to do business with the Russian giant on the other.

Many experts and policymakers have called for the unification of the EU gas market to put an end to the incentives that undermine any attempt of the EU to deal with Russia in a coherent way. But nobody has proposed how exactly to go about this. Yet a solution is quite straightforward when reasoned in the following way: first, as will be shown below, there is a clear interaction between the fact that the gas markets in Central Europe and the easternmost flanks of the EU are fully government-run or run by private monopolies, and their exclusive dependency on Gazprom for their gas deliveries. Second, regulations issued by the EU to remedy the situation have not worked. All these markets are either fully exempted or have refused to implement EU Directives aimed at opening them up to competitors. This exemption can be attributed to the fact that Gazprom, on top of delivering most of the gas, is directly invested in those markets. It is either the dominant intermediary trader or a major shareholder in the local gas monopolies. Under these circumstances, if anything is to be done quickly enough to address this imbalance in the relationship between European gas markets and Gazprom, the EU has no choice but to act forcefully and locally with its already existing market-integrating tools, including antitrust policy. This is why.

A new "Index of Vulnerability to Gazprom Supply Cuts" developed by ECIPE confirms what many an analysis has found, which is that the more the domestic national markets are closed and monopolized, the more they are exposed to supply cuts from Gazprom, and the less able they are to respond to delivery disruptions.

National Scores - Vulnerability to Gazprom Supply Cut Index



A quick glance at the scores of EU member states is revealing. Bulgaria scores first, and Slovakia third. These are the two countries that have suffered most during the January 2009 gas crisis: they were utterly unprepared, and the fact that they had not invested in interconnecting infrastructure with their neighbours meant they couldn't be helped out.

Indicators used to build ECIPE's "Index of vulnerability to gas supply cuts from Gazprom" in EU member states

- 1) Share of gas in primary energy consumption of an individual member state
- 2) The level of a member state's import dependency on Russian gas
- 3) A country's adoption or exemption from existing EU Directives aimed at improving competition in the gas markets
- 4) Actual levels of retail and wholesale gas market concentration
- 5) A country's World Economic Forum rank in "Effectiveness of Antimonopoly Policy"
- 6) Whether and how a country has suffered from gas supply disruptions so far
- 7) The presence of Gazprom in the domestic market as investor
- 8) Whether a country used to be part of the Soviet Union or the former Soviet bloc (extra an incentive for Moscow to decide in favour of gas cuts).

A quick glance at their market structure speaks volumes. Bulgaria has a state-controlled gas sector that is fully dependent on imports from Russia. The intermediary in the market (ie. between Gazprom and the local gas monopoly) is Topenergo, which is a subsidiary of Gazprom. Slovakia is also 100% dependent on imports of Russian gas. The Slovakian market is dominated by the monopoly distributor and network company SPP, a joint venture between the Slovak government and Slovak Gas Holding. The latter is a Netherlands-based consortium co-owned by E.On Ruhrgas (in which Gazprom has a 6.4% share) and Gaz de France. Both local players are locked into long-term supply contracts with Gazprom.

The Baltic States, which score very high in the Index (#2 for Latvia and #3, along with Slovakia, for Estonia), have also been victims of gas supply disruptions in the past. Here too, the incentive structure in their small isolated markets is biased in favour of Gazprom. In Estonia, Gazprom holds a 37% stake in Estonia's national gas monopoly Eesti Gaas. Other shareholders include Gazprom-partner E.On Ruhrgas (33.66%), Itera (9.85%), which also has links to Gazprom, and Finland's Fortum Oy. A similar pattern can be found in Latvia: 34% of the national gas monopoly Latvijas Gaze is owned by Gazprom, whilst the rest of the company is co-owned by the same E.On Ruhrgas and Itera. Obviously the local governments don't act themselves to roll back the excessive grip of such a

dominant player. And EU regulations have proven useless. So what can be done?

An answer would be to look at the existing Single Market competition toolkit in the EU and at what has recently happened further west. The powerful competition authorities in Brussels have launched widely publicized antitrust cases for abuse of market dominance against the big gas players in Germany, France and Italy. The cases reveal that these companies foreclose their markets to other European players and by extension endanger security of gas supplies. GDF Suez stands accused of denying competitors access to gas import capacity into France. ENI is suspected of capacity hoarding in Italy and strategic underinvestment in its international pipeline system. It is very likely that similar behaviour can be found in CEE. Brussels would be well advised to act in the same way there too.

There, an ENI- or GDF-style case would discourage a company like Gazprom from using the gas tap as a means to further its interests. It must bear in mind that even when it's not targeting directly an EU member, but say, Ukraine or Belarus, cutting off the gas would have implications further down the pipeline road and so couldn't be justified to its clients, thus making it costly. Such cases would ultimately force the local national monopolies to grant competitors access to import pipelines or national distribution grids. This would help increase supply in the local markets and diversify sources of imports via interconnecting pipelines with the other EU member states. This would provide a country with more alternatives to Gazprom as gas supplier, and therefore force it to improve customer service. Furthermore, in many cases, the threat of fines on local players is likely to affect Gazprom itself, given that it holds shares in many of the companies. This too will force it to think twice before shutting off the gas tap again.

Brussels so far has been timid in launching antitrust cases in the new member states. Whilst it has started acting in some areas, such as telecommunications and even in the electricity sector, there has been a taboo as to the gas markets, although these are among the least integrated of all. This taboo must now go. None of the new foreign policy powers granted to Lady Ashton under the Lisbon Treaty will be of any use in the EU's dealings with Russia if its gas markets continue to be as vulnerable as they are to such an outdated monopolist as Gazprom.

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