Interview – Anna Creti

Overcoming the barriers to gas market development

Anna Creti teaches economics at Università Bocconi in Milan. She is a Research Director at the Institute for Energy and Environmental Economics and Policy (IEFE). Prior to this position, she was a researcher at the Laboratoire d'Economie des Ressources Naturelles (LERNA) and the Institut d'Economie Industrielle (IDEI) in Toulouse. Her research focuses on economics of energy, theory of regulation and competition policy and industrial economics. She answered our questions regarding the future of gas markets in Europe.

With tight LNG supply expected from 2012 onwards, what strategy can ensure security of supply?
In the long term, investments in those critical infrastructures that allow supply diversification and a properly functioning gas spot market are the only way to ensure security of supply and solve the import dependency problem. New pipelines and regasification terminals are therefore very important. But in the short to medium run, we should not forget that storage will always play a key role in any predictable and unpredictable unbalance in gas demand and supply. However, at the EU policy level, some contradictions still affect the organization of storage services. The Green Paper on Energy Security of Supply and the Directive 2004/67/EC encouraged Member States to take specific measures against supply shocks. Yet the message delivered by the 2007 proposal for a new liberalization package is different: building up strategic gas stocks to deal with potential supply disruptions would be too expensive and technically difficult. But in November 2008, the Commission proposed a five-point EU Energy Security and Solidarity Action Plan that includes oil and gas stocks and crisis response mechanisms. A question arises naturally: which action should be taken and agreed upon? The European Commission should clarify once and for all the importance and regulation (if any) of precautionary gas reserves.

How does the Russia-Ukraine dispute impact EU consumers and should we fear disruption in the longer run?

The gas crisis that hit Europe at the beginning of 2009 has already faded in our minds. Officially, the problem ended on January 17, with resumed deliveries and higher gas prices for Ukraine. On January 20, supplies to Europe began to flow again. Commission President Barroso welcomed the resumption of deliveries, after a two-week standoff that left millions of Eastern Europeans without heating in the middle of winter. Why was the crisis not so severe for Europe's importing countries? Apart from (geo)political stress and diplomatic solutions, there is a poorly known player behind the scenes of the gas crisis: storage. Europe's storage operators delivered significant volumes of gas stocks as the main mitigation measure. The average European drawdown of gas stocks was around 15% from January 5 to 19, compared to 2.5% per week in the same period in 2008. Stored gas moved across borders, reinforcing the key role storage plays in both domestic and regional gas markets. All gas consumers were covered by gas stocks and no gas was drawn down from strategic reserves (in the countries where they exist, i.e. Italy and Hungary).
However, all systems are vulnerable to a "low probability-high impact" event, such as a gas supply disruption at the European level. We have to be prepared when this happens.

What are the main barriers to the development of liquid and interconnected markets in Europe? The first barrier of course is the highly concentrated gas supply structure. Incumbents retain a very high share of trading in OTC markets. Moreover, there is no excess capacity in the import infrastructure, for a liquid market to develop. But there are also other, less obvious barriers, including: excessive transaction costs, such as balancing fees that don't reflect the cost to the service provider; the so-called "destination clauses" that restrict the ability of a gas purchaser to re-trade purchased gas, yet require the purchaser to remain financially liable for gas it cannot utilize; the restriction of gas storage access solely to entities with end-use customers.

As these markets develop, will the gas pricing fundamentals change?

A well functioning market isn't enough to ensure gas competition and decoupling from oil prices. You have to consider the international dimension. The LNG trade helps integrate the previously segmented markets in North America, Europe and Asia. Spot prices on either side of the Atlantic may be converging. And demand should change too. As long as demand - both by industrial and residential consumers - remains price inelastic and gas interruptible contracts are not well developed, we should not see major changes in gas pricing.