

Future Integration of the Baltic Sea States Gas Supply

*Report on the 28-29 November 1996 Symposium in
Tallinn, Estonia*

This symposium was organized by the Estonian Academy of Sciences, the Finish Academies of Technology, the Estonian Association for Energy Economics, the European Foundation for Cooperation in Energy Economics and the Estonian Gas Association and held at the Estonian Academy of Science in Tallinn. The event was sponsored by the Estonian Gas Association, the EFCEE and the Estonian Academy of Sciences. Chairman was Mihkel Veiderma, Vice President of the Estonian Academy of Sciences.

The meeting focused on gas supply strategy in the Baltic Sea region, including gas policy and gas demand, gas pricing, gas transport, the security of gas supply and integration, infrastructures and much more.

Forty-five participants, including representatives of energy and gas companies, research and consulting institutions and universities, ministries and other public organizations from all ten Baltic Sea states took part in the symposium. Sixteen papers were presented including twelve by speakers from energy, gas and expert companies including Statoil, Gazprom, Ruhrgas, Gasum Oy/Neste Energy, Imatran Voima Oy, Vattenfall Naturgas AB, Mellansvenska Naturgaskonsortiet AB, Dansk Olie & Naturgas AS, Polish Oil & Gas Company, and gas companies of Lithuania, Latvia and Estonia. The research institutions, Norwegian School of Management, Latvian Institute of Physical Energetics and The Estonian Energy Research Institute also participated.

Peter G. Claus, Secretary General of Eurogas gave an overview of the present and future state of gas supply in the European countries and Jasper K. Jensen presented the results of the study of the Baltic gas market prepared by DONG and PLE.

Harry Anton of Gasum Oy/Neste Energy introduced the basis of the Nordic Gas Grid project and the representatives of Statoil and Gazprom presented their action plans for gas production and export expansion and discussed the main points concerning gas supply in the Baltic Sea region. They support the building of a gas pipeline linking Finland, Sweden and Denmark or Norway which can be fed from the east by Russian gas as well as by North Sea gas from the west.

The representatives of national gas companies of the Baltic states concentrated on the expansion, modernization and restructuring of the domestic gas supply system, including the potential for interconnections to international gas supply systems. Professor Zeltinsh from the Latvian Institute of Physical Energetics described the facilities for the underground storage of gas in Latvia noting that capacity could reach 20 BCM in the future. For utilizing this potential, it is expedient to anticipate building a gas link from the Nordic Gas Grid (via Finland and Estonia or straight from Sweden) in the development plans for the Baltic Sea region gas supply. The direct link between Poland and Lithuania, suggested in the study of the Baltic gas market, produced contradictory opinions. According to the representative of Gazprom the two supply systems could be linked via the Yamal-Europe gas pipeline.

The most heated discussion was prompted by the proposal to develop a Baltic Gas Ring, as presented by Harry

Kaar, Director of the Estonian Energy Research Institute. The proposal would connect all the Baltic Sea countries in a ring, the ring integrated with the trans-European gas grid, thus insuring security of gas supply and competition in the gas market. Several participants in the symposium felt that the near-term priority should be access to the Nordic Gas Grid and the linking of the Latvian underground storage with the Estonian and Lithuanian gas network.

In reports on the uses of LNG in the Baltic Sea region, more rational use of gas for regional heating and for household heating, building of electricity and heat cogeneration plants and price formation with the liberalization of the gas market were discussed.

Most participants agreed that gas demand in the Baltic Sea countries will increase two-fold during the next fifteen to twenty years, reaching almost 40 BCM (Denmark and Germany, excluded). Therefore, it was felt that more development work was needed, particularly from the standpoint of supply security, cooperation, pricing and market liberalization.

*Mihkel Veiderma
Estonian Association for Energy Economics*

Is Competition in Electricity Markets Compatible with Security of Supply?

*Notes from the Second BIEE Seminar on Competition and
Regulation of Energy Utilities, 19 June 1996*

The discussion was opened by Tony Cooper, General Secretary of the Engineers and Managers' Association making the following points:

- Originally, the fear was that competition would inhibit investment in generation, but the special circumstances since privatization (surrounding the "dash for gas") provides little evidence as to whether this will be a problem in the longer term.
- At present, the more important issue arises from regulation of the monopoly activities (the "wires businesses"). What is the acceptable level of risk? No satisfactory market mechanisms exist to provide the answer, so should the regulators decide?
- The "optimum" balance between costs and benefits may not be publicly acceptable. Public aversion to risk of supply interruption appears to have increased since privatization. This suggests that security standards should be "political" decisions. But would this mean merely substituting civil servants for the regulator?
- There is a problem of lags. Increased short-term pressure from the capital markets may increase the temptation for managements to divert funds to shareholders at the expense of capital and maintenance expenditures on the infrastructure; but if the cuts were too great, it would take time for the effects to show, and when they did, additional expenditure to rectify these problems could be recouped through the next price review.
- To overcome these difficulties by regulation would involve detailed and intensive intervention by the regulator. An alternative approach could have the following elements:

1. Security standards for the "wires business," and the mandatory (much higher) fines that could apply in the event of failure, would be set by the political process, after public consultation and discussion.
2. Companies would be obliged to insure against the risk of failure. Once the standards had been set, the market decisions would be made in the insurance market.

In the ensuing discussion, the points made included the following:

- It should not be assumed too readily that the insurance market could deal satisfactorily with this issue.
- At present, there was only one product – electricity in continuous supply. But value of lost load (VOLL) varied greatly between customers. Demand-side management and interruptible tariffs needed to be considered. A single value for VOLL for the whole system might be quite inappropriate.
- The "disaggregation" of the supply security issue could raise difficult political issues, particularly if seen as a means of reducing security in the domestic market.
- If there were a range of VOLL's, should there not also be a range of penalties for failure of supply? How could the numbers be determined and how would the system be policed?
- Fully competitive supply markets will make it very difficult to impose social obligations on individual suppliers. Similar considerations apply to security of supply failures (other than those arising from defects in the infrastructure).

M.J. Parker

Saudi Oil Power (continued from page 19)

Press for the IISS, 1996), p. 66.

³ *New York Times*, 13 September 1993, pp. D1-D2.

⁴ *Financial Times*, 27 June 1995, p. 3.

⁵ *New York Times*, 20 November 1994, "Iran: An Economy in Disarray;" also Chris Kutschera, "Iran's Peeling Veneer," *The Middle East*, Sept. 1994, p.20.

⁶ Ahmed Hashim, "The Crisis of the Iranian State," pp. 13-14.

⁷ Comments by Iran's Oil Minister, Gholamreza Aghazadeh, 5 July 1995.

⁸ Fawaz A. Gerges, "Washington's Misguided Iran Policy," *Survival*, Volume 38, No. 4, Winter 1996-97, p. 6.

⁹ *Energy Compass*, Weekend Review, pp. 21-23.

¹⁰ Mamdouh G. Salameh, "The Price of Oil & the Future of the Saudi Monarchy," *IAEE Newsletter*, Spring 1996, p. 11.

¹¹ Rosemary Hollis, "Dual Containment & The Oil Market," Briefing Paper No. 24 (The Royal Institute of International Affairs, August, 1995), p. 1.

¹² *International Herald Tribune*, 30 September 1993, pp. 1 & 17.

¹³ Shahrar Chubin & Charles Tripp, "Iran-Saudi Arabia Relations," p. 69.

¹⁴ *Tehran Times*, 23 February 1994.

¹⁵ Saudi Oil Ministry Statement, 18 March 1994.

¹⁶ Shahrar Chubin & Charles Tripp, "Iran-Saudi Arabia Relations," p. 71.

Swiss Association Holds Conference on Opening the Electricity Market

In May of 1996, the Swiss Association for Energy Economics held a conference to consider the differing views on the opening of the Swiss electricity market.

The meeting was based on the report of the *Cattin Committee* which consisted largely of the representatives of the electricity industry and large industrial users.

Jean Cattin, president of the committee and Head of Section in the Federal Department of Energy Economics summarized the committee's recommendations:

- Introduction of Third Party Access.
- Unbundling and privatization of power plants, of which about 75 percent are owned by the state.

Cattin emphasized that liberalization was not a goal in itself but that it served both the purpose of increasing efficiency in the electricity market and the revitalization of the economy through low electricity prices.

Max Breu, Managing Director of the Swiss Association of Power Plants, agreed, putting additional stress on the necessity of reducing taxes and obstructive regulations.

Adalbert Huber, of steel company, Von Roll Stahl, AG, noted that progressive deindustrialization was responsible for the increase in unemployment. A considerable number of jobs, he said, are threatened by Swiss electricity rates which are higher than abroad.

Whether liberalization leads to more efficiency without a loss of supply reliability is ultimately an empirical question which Professor Peter Zweifel of the University of Zurich answered positively on the basis of the experience of Great Britain and Norway. He considered the grid the only natural monopoly that must be regulated by the state. As far as production and trade are concerned, he suggested the introduction of competition. Together with unbundling, third party access leads to more transparent electricity prices that increasingly take into account the cost limits of the firms.

Zweifel does not consider privatization of the British kind as absolutely necessary. The latter statement must have pleased Daniel Brelaz of Industrial Services of the City of Lausanne, who expressed great skepticism regarding the privatization of power plants and distribution systems as well as its effects on consumers. Brelaz even opined that the privatization would lead to a squandering of state property.

What the opening up of the Swiss electricity market will look like, once it has been realized, remains an open question in the face of the conflicting interests at the time. The fruits of a liberalization could, however, be harvested, at least partly, if there was a unilateral opening of Switzerland. At this point, however, Mr. Breu and Mr. Cattin's readiness for reform obviously stops: Mr. Breu didn't want a Swiss solo run and Mr. Cattin referred to reciprocity. Plainly and simply, the discussion could be summarized as follows: We will do something when the EC has done something.

Jurg E. Bartlome

**IA
EE**