COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

CONCERNING NATURAL GAS

COM(84) 583 final

I N D E X

1. Introduction

1.1. In a Communication from the Commission to the Council concerning natural gas (COM(84) 120) of April 1984, attention was focused on natural gas supply prospects to the year 2000 and the development of security measures.

1.2. The Communication was discussed by the Council (Energy) on 22 May. In order to facilitate discussion on policy guidelines for natural gas at the next meeting of the Council (Energy), the Commission was asked to study the role of natural gas in the total energy balance and to develop further the themes of supply diversification and security measures.

1.3. In carrying out this study, the Commission obtained valuable assistance from Member States' experts.

2. Recent Developments

2.1. Before discussing the main issues, it is necessary to update the picture by outlining some of the more important developments since last April.

2.2. The recovery of natural gas demand, first observed in 1983 after three years of decline, continued in 1984. In the first eight months an increase of 8.1% on the previous year was registered.

2.3. Imports from third countries during the same period increased by over 20%; and there was a rise of 2.5% in indigenous production.

2.4. Negotiations between the Governments of the United Kingdom and Norway on the purchase of Sleipner gas have continued but no agreement has been reached.

2.5. Negotiations between Ireland and the UK (Northern Ireland) on the sale of natural gas from the Kinsale field collapsed on the issue of a review, requested by the United Kingdom, of the purchase price initially comtemplated.

2.6. In May 1984, Italy completed a renegotiation of the outline agreement reached with the USSR in 1981. Under the revised terms, offtake obligations and price were reduced. The Federal Republic of Germany also renegotiated the volume and delivery conditions of its contract with the USSR with comparable results.

2.7. The USSR offered Belgium short-term deliveries of natural gas geared to supplying the Belgian fertilizer industry. Belgium finally did not take this gas as the Netherlands offered a special arrangement.

3. Place of Natural Gas in the Total Energy Balance

3.1. Earlier this year the Commission, in its review of progress towards attainment of the Community's 1990 energy objectives (1), presented the latest available projections by Member States of energy supply and demand up to the end of the decade. Underlying many of those projections was an assumption of a return to substantial and sustained levels of economic growth from the mid-1980's (an average of 2.4% a year) and a continuation of improvements in energy use per unit of output, although at a lower rate than in the past few years. The net result was an expectation that energy demand would increase by some 17% over 1982-1990, with natural gas growing at a slightly higher rate and therefore increasing somewhat its market share over the period. Similar projections underlay the figures and analysis given in the Commission's last report on natural gas supplies.

3.2. More recent information from Member States suggests that there is now greater uncertainty about the likely evolution of energy demand and about the prospects for individual fuels in the medium and long term. There is particularly uncertainty about trends in economic growth, about the likely evolution in the structure of industry and its impact on energy demand, and about energy prices, particularly in the medium term. The result is less consensus about future economic and energy conditions, complicating the framework within which policy development for particular sectors, including gas, must be pursued.

3.3. In preparation for Council discussions to identify energy objectives for a horizon going beyond 1990, the Commission services are undertaking a comprehensive analysis of future energy supply and demand relationships to 2000. This work will be discussed with experts from Member States.

3.4. At present, the share in total primary energy demand held by natural gas stands at 18%. It is possible, on the basis of unchanged conditions, to foresee natural gas sustaining this level of market share. However, conditions will not necessarily remain on the present course and important changes may occur.

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(1) Docs. COM(84) 87 final
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3.5. In contrast to the uncertainty concerning the future development of demand for natural gas in the Community, there does appear to be widespread agreement that, within the natural gas market, an increasing proportion of gas will be consumed in the public distribution sector. There is, however, more uncertainty regarding the development of natural gas consumption in the industrial and public power plant sectors.

3.6. In looking to future developments in demand for natural gas, it is helpful to distinguish between the medium and longer term prospects. There is at present a surplus availability of natural gas in the Community, which is expected to set the pattern for the short term. Since 1980 demand for natural gas has decreased, in line with demand for energy in general, without a corresponding reduction in supply. Many of today's supply contracts, concluded in the 1970's when optimism was high regarding future prospects for demand and end-use prices, have inflexible price and delivery conditions. This has led to a situation in which more gas is contractually available than is required. Member States are dealing with this situation in different ways. In countries such as Belgium, Denmark, Ireland, Italy and the Netherlands, some of the surplus is being sold to public power plants. In addition, import contracts are being renegotiated with a view to obtaining greater offtake flexibility and indigenous production is at lower levels than planned. The present situation of surplus availability may last for some years to come and each Member State will respond in its own way.

3.7. Prospects for natural gas demand in the longer term are more difficult to assess, but clearly the level of demand will depend upon the relationship of natural gas prices with those of competing fuels in end-use markets. A critical factor in the future will be the supply prices which Community gas companies pay to producers over the long term. The more Community importers can take advantage of the potential competition between gas producers, the greater the possibility of assuring present markets and indeed of growth in market share. On the other hand, however, if in the longer term import contracts remain inflexible, in terms of price and delivery conditions, natural gas will lose competitivity in the market place. This would result in the loss of markets, irretrievably in some cases, and a steady decline in market share.

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3.8. Although price is a key element influencing the share of the market held by natural gas, it is not the only determining factor. Natural gas enjoys certain inherent advantages over rival fuels. These include respect for the environment from the point of production to the point of end-use, easy control and high efficiency. The gas industry has recognized that it must exploit these inherent advantages. As a result, advances have been made in tne technical field, for example in the development of condensing boilers and gas-fuelled heat pumps. The quality of marketing employed by the gas industry will play an important part in influencing future sales of natural gas vis-à-vis competing fuels.

3.9. Given the potential availability of natural gas in the longer term, and the Community's continuing policy to diversify away from oil, it is in the Community's interests that natural gas should in the future continue to play an important part in satisfying the Community's energy requirements. To the extent that Community importers can take advantage of competition between gas producers as mentioned above, the Commission would favour further penetration of natural gas in the total energy market, provided that there is no overdependence on non-OECD sources.

4. Future Supplies and Security

4.1. The long-term supply situation of the Community was analysed in depth in the last Communication to the Council.

4.2. Despite the increased uncertainty regarding demand development discussed in the previous section, import dependence of the Community is expected to reach 40% in 1990 and at least 50% in 2000. Against this background the Council (Energy), at its meeting on 22 May, stressed the need for security measures including the diversification of supply sources and close cross-border co-operation.

4.3. The availability of gas based on indigenous production and contracted imports is such that the gas market is likely to remain in surplus for several years.

4.4. The outcome of the renegotiation of existing import contracts, which will take place in the coming years, especially those concerning Algeria and the USSR, will be of great importance to the development of demand in Member States' markets. As noted above, these contracts were concluded when expectations about achievable prices in the end-use markets, the growth of energy consumption and particularly the growth of natural gas consumption, were all high. This resulted in price and minimum take provisions which are not compatible with the realities in the end-use markets of today and tomorrow. It appears to be in the interest of both the Community and its suppliers to find solutions which will permit natural gas to get that share of the energy market which is in line with its potential availability.

4.5. Natural gas is increasingly facing inter-fuel competition and transmission companies need greater flexibility in price and delivery conditions vis-à-vis their suppliers. The Commission feels that the competitiveness of natural gas in the various end-markets in the years to come is a critical issue.

4.6. One of the risks inherent in the present surplus availability, in association with the uncertainty regarding the development of demand, is a negative impact on indigenous exploration activities, leading perhaps to lower indigenous production in the longer run. Against the background of the expected increase in gas import dependence, and in line with the Community's objective to reduce further its dependence on oil, it seems important that Member States should continue to stimulate and ensure a high level of exploration activities.

4.7. Imports of additional supplies of natural gas will be needed from the early or mid-1990's onwards. The traditional suppliers, i.e. Norway, Algeria and the USSR, appear to be in the strongest position to meet these import requirements. Nigeria, Cameroon and the Ivory Coast might also supply some gas before the turn of the century. Canada, Abu-Dhabi and Qatar appear as longer-term prospects, more likely to come on stream in the next century. For Canada, the recent deferment of the Arctic Pilot Project by its developers reinforces this view. All in all, potential supply from external sources far exceeds expected import needs.

4.8. From the point of view of supply security, imports should be diversified.

4.9. The outcome of current negotiations by the Netherlands to supply additional exports to continental customers and to the UK, of the negotiations between Norway and the UK regarding Sleipner, and of the expected negotiations on Troll between Norway and various European transmission companies, will have a significant impact on the Community's supply security in the 1990's and thereafter.

4.10. For Troll in particular, long lead times must be taken into account. Decisions will have to be taken before long if Troll is to contribute to the Community's supplies in the second part of the 1990's. Production from this field could eventually account for about 20% of the Community's total gas supply in the early years of the next century.

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4.11. Both the USSR and Algeria could, at relatively low incremental costs and at short notice, make large additional volumes available to the Community. The USSR will be able to export substantial additional volumes to Europe without the need for new transport capacity. With increased transport capacity, even greater volumes could be made available. Additional volumes could easily come from Algeria as LNG and/or through the Transmed pipeline in Italy on the basis of spare capacity in the existing infrastructure.

4.12. Therefore, if decisions on new import deals are delayed until such time as the demand evolution becomes clearer, the likely fallback suppliers who can supply quickly and at reasonably low additional expense will be the non-OECD suppliers, Algeria and the USSR.

4.13. On the other hand, the timely conclusion of a contract for the purchase of Troll will depend critically on the negotiation of an equitable gas price and other delivery conditions, sufficient to stimulate development of the reserves and yet competitive with other sources and with other fuels.

4.14. Although the dilemma described above has been recognized for some time, negotiations between the Norwegian and Community gas companies have not yet commenced.

4.15. The Commission has had bilateral discussions with the Norwegian Government on energy and natural gas questions. It plans to include in these talks a discussion on the reasons for lack of progress in the development of Troll. Clearly such discussions, the results of which would be reported to the Council, should not prejudice the negotiations of specific contracts between the gas companies concerned.

4.16. The Commission believes that it would be inadvisable for the Community to allow its degree of dependence on imports from non-OECD countries in the 1990's to exceed the level already envisaged for the period up to 1990, unless Member States concerned had first provided for specific additional arrangements to provide for back-up supplies in an emergency.

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4.17. In COM(84) 120 it was argued that the Community's supply security could be considered adequate until the early 1990's on the basis of imports from existing contracts on the one hand, and security measures already taken and/or planned by Member States' gas industries on the other. In view of the expectation of lower natural gas demand than forecast, the security situation for the immediate future has improved.

4.18. In addition to supply diversification, security measures foreseen in the earlier Communication include surge capacity from indigenous production, interruptible sales, storage and cross-border standby arrangements. The standard of security adopted was the capability of the gas industry to deal with a major interruption of supplies (at least 25% during a period of six consecutive months) with a minimum of repercussions for the final consumer.

4.19. To the extent that the import dependence of the Community, and more particularly the dependence on non-OECD sources, will further rise in the 1990's, this standard of security should then be adapted accordingly.

4.20. The expected increase in natural gas demand in the public distribution sector is a further reason to pay close attention to the standard of security. It is in this sector that customers would be more directly affected by an interruption as there is very limited possibility for them to switch to another fuel.

4.21. In order to maintain a watch on the Community's natural gas supply and its security, the Commission considers it desirable that certain key topics are regularly analysed and discussed between national gas experts and the Commission. Such topics would include the development of the natural gas supply situation as a whole, diversification of supply sources and security measures, and procedures to be adopted in the event of an emergency.