Europe needs a single market for natural gas

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There is a broad consensus in Brussels on the need for an external energy policy to diversify suppliers and routes and loosen Russia's grip on the European natural gas market.

Writing recently about the emerging European energy diplomacy, Benita Ferrero-Waldner, commissioner for external relations, said the European Union had signed or was negotiating agreements with Azerbaijan, Ukraine, Kazakhstan, Turkmenistan, Algeria, Egypt, Morocco, Jordan, Iraq, the countries of the Gulf Co-operation Council and, "when the political situation will allow it", it would negotiate with Iran.

The list looks impressive but, in fact, the scheme makes little sense. Almost everything in this vision - the availability of gas resources, the possibility to develop them, the political and commercial feasibility of the transport infrastructure - is hypothetical at best.

The recent announcements about Turkmen and Iraqi gas exports to Europe illustrate the virtual nature of the EU's foreign energy policy. It is not clear whether Turkmenistan, given existing contractual commitments, has 10bn cubic metres of gas available for the EU. But it will not be tested as the proposed options to ship Turkmen gas to the western shore of the Caspian Sea are nowhere near credible. In any case no commercial contract has been signed. The Iraqi announcement (of 5bn cu m annually starting "in the next 3-4 years") has even less commercial reality behind it.

The common denominator in these two announcements is the Nabucco project, a new "gas corridor" to Europe through Turkey that is the centrepiece of the European plan to diversify away from Russia. Yet there is no earmarked gas to feed Nabucco, either in central Asia or the Middle East. The pipeline is conceived as an enabling project that, once built, will gather gas from various sources.

But financing a multibillion euro international gas pipeline requires a long-term contract between buyers and an upstream company controlling a large resource base. Diplomatic involvement can help reduce noncommercial risk, but cannot substitute for commercial logic. EU officials are desperate to show there is potentially a lot of gas that could flow through Nabucco, but even if that is true it does not make it more likely to be built.

This is not necessarily worrying. The idea that Europe lacks, or will soon lack, access to a diversified and secure (read: non-Russian) natural gas supply is not backed by the data. Even as Russia expanded exports to Europe, its share of European imports (for the 27 current member states) has roughly been halved since 1980, from 80 per cent to about 40 per cent. Since 1990, 80 per cent of the rise in EU gas imports has been from non-Russian sources. Europe already enjoys a diversified natural gas supply. Russia's failure (or unwillingness) to develop its resource base and expand exports to Europe is bound to make the European market all the more attractive for other exporters in the coming years - though it will also mean higher prices.

Europe faces three main gas security challenges. The first is to export gas supply diversity from western Europe to eastern Europe, where the rate of dependence on Russia is much higher but gas markets are much smaller. Market integration is the only way to do that. A single European gas market would create de facto solidarity between all consumers and the bilateral dependencies would become largely irrelevant.

The second challenge is to increase the ability of Europe as a whole to cope with supply disruptions, whatever their causes. Here again, market integration and competition is the way to go. A well-functioning market transforms any localised physical shortage into a universal price increase. Additional measures such as interruptible contracts and emergency inventories would help reduce the economic impact of supply shocks.

The third challenge is to remove the debilitating effect of the EU-Russia gas relationship on EU foreign policy towards Russia. A European integrated and flexible gas market would make eastern Europe more secure, just as it would make the relationship between Gazprom and large utility importers in Germany, Italy or France less cosy. This is a better position from which to speak with one voice to Moscow.

Building a well-functioning internal gas market is less grandiose than developing a foreign energy policy, but also more promising. This is what the Commission should concentrate on.