

## EFMA'S POSITION ON COMPETITIVE AND FAIR MARKET CONDITIONS FOR GAS

*This paper addresses the Internal Market dimensions of the Commission's Green Paper on Energy, as well as some broader and external contemporary gas issues facing the European nitrogen fertilizer industry.*

### A Truly Competitive Single European Gas Market - Internal Dimensions of the Commission's Green Paper

1. The West European fertilizer industry, which represents the single largest gas-consuming sector in the European Economic Area, welcomes a number of the strategic thrusts developed in the Commission's Green Paper. This industry attaches special importance to the following reforms and developments addressed in the Green Paper, which it considers to be critical for a single gas market.
  - 1.1 First and foremost, the development of a truly competitive Single European Gas Market (based upon the EEA structures), characterised by **open, unrestricted and unsubsidised gas production, transportation and supply**, is considered to be an imperative by this industry.

Central to the achievement of this Single European Gas Market is economic and corporate structural reform involving the **definite reduction of monopoly** and near monopoly positions.

It should be noted that the fundamental turning point in the liberalisation of the UK gas market was in 1991 when restrictions were placed on the then British Gas' monopoly supply position and British Gas was obliged to "release" contracted gas to its competitors.

Significantly, third party access was not enough to promote gas to gas competition in the U.K. The latter required an explicit and definite removal of the monopoly or near monopoly supply side situation. EFMA's members support the regulation of gas supply by means of "limiting market share" and/or the purchasing ability of the suppliers of gas. Given that monopoly creation is conventionally not permitted, the continued existence of monopolies should also not be permitted.

- 1.2 **Gas to gas competition** where spot (reference page 45, Green Paper) and forward prices are readily available is a goal that the fertilizer industry shares and aspires to.
- 1.3 **A free and efficient supply scene must remove** – as a matter of urgency - **all constraints upon supply**. This requires freeing up supply constraints at the key source areas within the European Economic Area, i.e. primarily from the North Sea gas fields. Equally, it requires that all the member states promote a 100% "opening" of their gas markets to competition. This will, of course, require a second EU Gas Directive aimed at the total liberalisation of the EEA gas market. EFMA welcomes the Commission's intention to address the "second" gas liberalisation effort within the forthcoming proposal for a new energy directive.
- 1.4 **Concerns over the security of supply** for gas such as those commended by the Commission concerning Dutch gas (reference page 30, Green Paper) should not be used as an excuse to slow or prevent the necessary promotion of true competition within the Single Gas Market (based on EEA structures).
- 1.5 **Freeing up the supply side** of gas will invariably require the **following concrete steps** over the short-term:
  - 1.5.1 National regulators and a European regulator to enforce and force liberalisation. A primary function of such national and/or European regulator(s) must be to ensure that transmission and storage capacity is made available to consumers or independent gas suppliers. There is an equally important role for regulators to oversee the operation of Transmission Network Operators (TNOs) and the promotion and guarantee of the interoperability of EU gas networks.

- 1.5.2 Structural legal unbundling.
  - 1.5.3 Coherent, transparent and minimal cross border tariff systems.
  - 1.5.4 Phasing out of contractual terms such as "side letters" that restrict the resale of gas. It is imperative that the unrestricted resale of gas is totally assured as a key tenet of gas market liberalisation.
  - 1.5.5 Removal of "hourly balancing" where applied in certain member states.
  - 1.5.6 Information disclosure to customers as well as suppliers and transporters/shippers is vital to the transparency required in an open competitive marketplace. This is particularly important with regard to economic circumstances such as capacity, storage, transmission capabilities, demands etc.
  - 1.5.7 Competitively priced short-term transportation costs need to be promoted and developed in order to guarantee real and practical access to existing gas networks.
  - 1.5.8 Harmonisation of gas supply specifications (sometimes referred to as "quality") is an important feature for the promotion of competition. No artificial restrictions should be allowed to arise from suppliers' "quality" or technical specifications.
- 1.6 The nitrogen fertilizer industry maintains that a functioning competitive Single European Gas market will be greatly supported by the above reforms and that those reforms will actually promote security of supply as gas suppliers seek **access to a healthy marketplace.**
- 1.7 Major customers for gas such as the nitrogen fertilizer industry wish to have total **freedom of choice** with regard to available price mechanisms or indices for agreeing gas supply deals.

## **Free and Fair Market Economy Conditions for Gas and Fertilizers - Strategic External Dimension, in particular Russia**

2. The EU's intention to promote the development of strategic and deeper relations with the major external suppliers of gas to the EEA is essential.

Fortuitously surrounded by a “sea of gas” from established sources such as North Africa and the Former Soviet Union, EFMA considers it essential that the Commission is pro-active in developing strategic gas/energy relations with other suppliers on the Eurasian continental scene.

- 2.1 Sourcing from the Middle East is another option, which could be explored and developed. Ultimately the best decisions upon new infrastructure will be based upon the **true costing of projects and true market pricing of gas** according to internationally recognised financial standards.
- 2.2 The promotion of the structural **development of LNG facilities** in Europe should also feature in an EU gas strategy. Such supplies especially from North and West Africa and Trinidad could play a significant part in the liberalisation process and the promotion of international gas competition on the EU market.

As pipeline owners are obliged to make “capacity available”, it is somewhat logical that owners of LNG facilities should also be obliged to make “capacity available”.

- 2.3 The Western European industry supports the understandable urge of the Commission and the Union toward the “development of a **long term energy partnership** with key suppliers such as Russia” (reference pages 44 and 46, Green Paper).

Russia and Gazprom’s involvement in the Western European market has been a positive force for liberalisation and further supply assisted by new infrastructure, e.g. the Yamal pipeline, should promote price competitiveness as well as security.

- 2.4 However, the Single European Gas Market and its expansion to the East should be based upon the removal of state fixed pricing; promoting market economy conditions and practices; and **fair and equal pricing treatment** between suppliers and their local and international customers. In particular, double pricing arrangements whereby local customers receive subsidised low prices and the EU customers pay substantially higher prices is a feature that should be totally and immediately removed.

- 2.5 This **double pricing feature** of Russian gas represents the most serious threat to the health and viability of the Western European fertilizer industry. EFMA, on behalf of the industry and in the context of Russia's application for membership of the World Trade Organisation, has been an active partner with the Commission in securing the removal of a gas export subsidy/discount scheme designed to assist the local nitrogen industry's export capabilities.
- 2.6 While the export subsidy scheme has been removed there still remains the well-established practice of periodically **fixing gas prices in Russia** by the Russian Federal Energy Commission in concertation with Gazprom – the monopoly supplier of gas. This state fixing exercise is an overhang from the Soviet system. In de jure and de facto terms, these state fixed prices continue to represent a considerable subsidy to local manufacturing operations – and especially the nitrogen fertilizer industry.
- 2.7 Another potentially damaging feature against free and fair competition in the gas and fertilizer markets of the Former Soviet Union is the emergence of subsidiaries of Gazprom which “**toll**” **low cost dumped gas** into Russian, Ukrainian and other FSU operations. The primary motivation for these schemes is to gain hard currency from abnormally priced gas-nitrogen fertilizer sales, but an increasing and significant second feature is to gain control of manufacturing assets in the FSU and Eastern Europe.

Free and fair competition is also threatened in this context by “grey” gas operations such as Itera, whose rapid and unconventional arrival on the scene is difficult to explain in any rational business or economic terms.

- 2.8 Having suffered a monumental collapse in local Russian fertilizer demand from 41.7 kg/Ha in 1992 to 8.6 kg/Ha in 1998, the response of Gazprom and the local nitrogen industry has been to conduct **aggressive export dumping campaigns**.

Reform of Russian land property rights and the overall introduction of market economy reforms onto the Russian agriculture scene is a major challenge. A start should be made now, when the EU's negotiation of WTO entry and a PCA provide for unique leveraging opportunities. The same applies to the Ukraine and other countries in the region seeking such treaty relationships.

From this artificial distorted gas cost base, the local Russian nitrogen industry practices massive dumping into hard currency, high-income areas such as the European Union. The Union has considered it necessary over two decades to apply anti-dumping duties on Russian ammonium nitrate, urea ammonium nitrate solutions and urea – thereby covering nearly all nitrogen products from Russia.

Owing to massive dumping surges associated with the rouble devaluation in 1998 and in part due to the near closure of the Chinese nitrogen market in April 1997, to-day the Union applies anti-dumping measures on Russia: a minimum import price of Euro 115/mt on urea, a specific duty of Euro 26.3/mt on ammonium nitrate, and a specific duty of Euro 20.11/mt on urea ammonium nitrate solutions.

- 2.9 These EU measures are vital to the defence of the world class assets of the Western European industry - **the world's most energy efficient nitrogen fertilizer manufacturer**. It would be ridiculous to allow such world class performing assets to be shut down because of massive dumping or subsidisation of product from inefficient, environmentally unsound production plants in Russia or indeed elsewhere.

EFMA's best available assessment of public sources identifies the relative energy efficiencies of a major Russian ammonia plant (49GJ/t N), a comparable Central and Eastern European plant (45GJ/t N) and a similar operation in Western European (35GJ/t N). The Western European performance represents one of the best world-wide.

Again, it would be illogical to allow the inefficient Eastern plants to damage the financial viability of such energy and environmentally efficient Western European operations.

- 2.10 Of course, the whole **health, safety and environmental performance** of the EEA industry is of the first order and complies with the *acquis communautaire*. EFMA's members believe that the EU and EEA should insist upon the full adoption of the HSE *acquis communautaire* by all accession countries and all countries enjoying bi-lateral Association or Partnership and Co-operation treaty arrangements.
- 2.11 While the defence of the EU industry has been (partially) secured at the EU frontiers with the EU/WTO anti-dumping instrument, the ultimate solution is the establishment of **market economy mechanisms in the Russian gas market**.

Gas prices in Russia have recently been set well below actual production cost levels when Western cost accounting standards are applied to fully evaluate costs. Moreover, the allocation of gas is mostly conducted without reference to price, depending as it still does on the submission of “zayavki” (supply requests, or allocation orders) inherited from Soviet times.

The problem of the overhang from the Soviet system on gas price/cost relationships are considerable. The introduction of market economy pricing and costing with audits based on internationally recognised accounting standards is the key and necessary challenge facing Russia and Gazprom. Selling below cost – especially to manufacturing industries engaged in international markets - is a totally unacceptable norm.

- 2.12 The strategic challenge for the **EU-Russia energy partnership** – which is monumental given Russia’s non-payment crisis which hits Gazprom especially hard – is to establish a Russian gas economy which is market economy orientated and which can supply gas at highly competitive prices to Western Europe.

## **Concluding Remarks**

The Western European fertilizer industry congratulates the Commission upon its efforts to promote a true and efficient Single European Gas market with strong political and practical relationships to the “sea of gas” surrounding Europe. It is vital that the supply of gas be subject to full competition, that consumers and new gas suppliers are allowed access to the gas networks and that a total freedom of choice with regard to price mechanisms or indices be established in the Single European Gas Market.

It is also imperative, in our view, that the accession countries and those countries with Association and Partnership and Co-operation Agreements in North Africa and the former Soviet Union remove state fixing and subsidy arrangements on gas and thus become truly equal partners on the gas market. The need for resolutions on these situations is especially acute with respect to Russia, the Ukraine and other former Soviet Union countries which have persistently engaged in extremely injurious dumping campaigns over the past decade.

We hope that this paper will open a dialogue with the Commission, with the member states and the gas industry that will not only secure the sustainable health of our industry, but rather promote its gas cost competitiveness so that its leading world class performance can be even further improved.

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