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The political significance of LNG terminals

The Russia-Ukraine conflict has once again become a catalyst for action concerning Europe's energy independence. Previous conflicts in 2006 and 2009 prompted the European Union to take decisions related to the development of energy infrastructure, where LNG terminals are playing a strategic role. The current conflict between Russia and Ukraine justifies the need for further efforts to enable the diversification of gas supplies to Europe, and to create instruments of EU energy solidarity.

In the current issue of the "Pulaski Policy Papers" Reseach Fellow at the Casimir Pulaski Foundation Dr. Mariusz Ruszel analyses the political significance of LNG terminals. "From the point of view of the strategic objectives of national energy policy, possession of an LNG terminal is essential. In the case of exporting countries, the construction of an installation for liquefied natural gas exports increases substantially the possibilities of diversification of supply and independence from natural gas consumers, compared to the gas pipeline transport. Terminals provide a similar benefit to recipients in relation to suppliers, particularly in view of the growing importance of the LNG spot market."

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The Russia-Ukraine conflict has once again become a catalyst for action concerning Europe's energy independence. Previous conflicts in 2006 and 2009 prompted the European Union to take decisions related to the development of energy infrastructure, where LNG terminals are playing a strategic role. The current conflict between Russia and Ukraine justifies the need for further efforts to enable the diversification of gas supplies to Europe, and to create instruments of EU energy solidarity.

LNG Terminals

LNG terminals, depending on their type, enable natural gas to be received (import terminal) and sent (export terminal) by sea in liquefied form. The terminals for receiving and re-gasifying LNG dominate among the existing facilities of this type of energy infrastructure. They transform LNG into gas, which then can be transported by transmission and distribution pipelines to consumers. In some cases, the gas in liquefied form received by a terminal is distributed in this form by railway or cryogenic tanks. There is significant additional investment connected with the construction and launch of an LNG terminal, particularly with regards to the development of the necessary port infrastructure, the terminal's connection to the gas network, as well as the usual need to rebuild the transmission network of a country, which is the case in Poland. Globally, there are currently more than 80 LNG terminals operating, more than 20 of which are located in Europe (6 in Spain with the possibility of receiving a total of 60 billion cubic meters of natural gas per year). Currently, Japan is the biggest importer of liquefied natural gas, which in 2012 was responsible for consuming 37% of the world's LNG. At the moment, there are plans to build dozens of additional LNG terminals in the world, and in Europe alone there are 7 which are currently in various stages of construction (France - with the possibility of receiving 13 billion cubic meters of natural gas annually, Lithuania - 4 billion cubic meters of natural gas annually, Poland - 5 billion, Italy - 3.75 billion, and 3 billion in Spain - a total of 9.6 billion cubic meters of natural gas per year). If the investments are completed on time, in 2018 EU countries will gain an additional opportunity to receive natural gas via LNG terminals at the level of 35 billion cubic meters of natural gas annually. Liquefied gas goes to the EU by sea from Algeria through export terminals near Arzew and Skikda and from Norway through the installation in Snøhvit. Significant quantities of liquefied natural gas also come to Europe from Qatar, Egypt and Nigeria.

LNG imports within the EU go mainly to the UK, Spain, Italy, France and the Benelux countries. Although Russia, as the largest supplier of natural gas to Europe, sends it through pipelines, the importance of LNG terminals will continue to grow. They allow greater flexibility of supply, and thus enhance the ability to select the most advantageous offer. It is worth noting that the U.S. is considering lifting the ban on the export of natural gas and plans to build more LNG export terminals. Similar investments are planned by Russia's Gazprom and Novatek, as well as some African countries. It is true that the LNG transactions market is still dominated by long-term contracts with "take or pay" clauses, but it is possible that it will develop into more flexible short-term transactions. It is important that it takes the shape of the current oil market, which is considered to be diversified and flexible.

The impact of an LNG terminal on energy security

From the point of view of the strategic objectives of national energy policy, possession of an LNG terminal is essential. In the case of exporting countries, the construction of an

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installation for liquefied natural gas exports increases substantially the possibilities of diversification of supply and independence from natural gas consumers, compared to the gas pipeline transport. Terminals provide a similar benefit to recipients in relation to suppliers, particularly in view of the growing importance of the LNG spot market. Each country endeavours to ensure energy security. It is achieved through a well-coordinated energy policy. The foundation of this security is to ensure the continuity of energy supplies. As far as the natural gas market is concerned, it must be emphasized that the supply of this material may become a tool of exerting political and economic pressure on consumers. In particular the price of gas for a specific recipient in a country is often not based solely on market data (e.g. stock exchange prices of crude oil and petroleum products), but it is adjusted plus/minus according to political relations between countries. To a large extent, the import of natural gas is based on transit pipelines and long-term contracts that provide stability of supply to customers and long-term financial guarantees to those investing in natural resources and transmission infrastructure. However, this tends to lead to an unhealthy dependence on a given supplier, which compares unfavourably with the more competitive and integrated EU common energy market.

Europe is dependent on Russian gas imports, which poses a risk of uncertainty and from the point of view of energy security may create certain concerns. On the one hand, there are political risks arising from the growing imperialism of the Russian Federation, which is one of the main suppliers of natural gas to Europe, whose demand for this raw material is increasing. On the other hand, it should be stressed that many Russian resources are neglected, and the system of Russian gas transmission pipelines is heavily exploited. In many places there is a real risk of technical failure of either land or sea transit infrastructure. This means that Russia needs both technology and equipment as well as the capital of the western energy companies. Without them it is not able to maintain the current state of natural gas extraction. Russia will remain a major exporter of natural gas, but the expansion of LNG terminals will increase the sense of energy security of the European states, as well as enabling EU market saturation and a reduction in price, which will consequently translate into the ability to create a flexible source of its origin. At the same time this situation will create the foundation for the commercialization of existing contracts signed between Gazprom and the EU energy companies. And increasing the number of LNG terminals in the EU will contribute to strengthening their negotiating position with respect to the existing natural gas exporters that deliver it by pipeline under long-term contracts. It is important to remember that these agreements generally allow the renegotiation of the terms of supply of natural gas every 2-3 years, and can be adapted to the current market situation. The more LNG terminals EU countries build, the stronger the negotiating position will be in relation to the exporting countries. This is because alternative delivery routes, along with the possibility of market saturation with gas delivered on short-term transactions, may contribute to the pressure on the existing exporter in terms of reduction in the price of natural gas, or even a change to the pricing formula or supply conditions. In a country that builds LNG terminals, where extension of this type of energy infrastructure is expected, the activity of foreign energy companies that have a strong position as existing natural gas suppliers will increase. They will attempt to gain a position in the LNG market, by reaching final customers or by cooperating with some domestic firms, and propose a business model designed to achieve the strongest possible position in the market. This in turn will allow them to establish cooperation with selected equipment manufacturers who use LNG fuel. The kind of product that may emerge could be, for example, buses powered by liquefied gas, which will be offered at competitive prices, in exchange for signing a long-term contract for the supply of LNG fuel. From the point of view of national energy companies, it is important to continually strengthen its competitiveness and to take appropriate action which will not only prevent the loss of position on the home market, but also in Europe.

The role of LNG in the common EU energy market

The idea of creating a common EU energy market assumes the expansion of the energy infrastructure in such a way that the various gas systems in the member states are combined into a single competitive gas market. Analysing the process of shaping a common energy market, it can be assumed that in the first place regional markets will appear, which will eventually integrate into one. Therefore, LNG terminals will increase the energy security of individual regions in Europe. First, they will increase the possibility of diversification of gas supply, which is particularly important in a crisis situation and in the case of deterioration of political relations with existing suppliers of raw material by pipeline. Second, increasing the number of natural gas import "points" in various regions of Europe will contribute to a more efficient use of underground gas storage facilities. Thirdly, the possibility of the purchase of liquefied natural gas by sea will facilitate the purchase of certain quantities of fuel at a reasonable price, if there is a surplus at the time of this fuel on the market (e.g. due to a warm winter or excess gas on the market). Fourth, the construction of new LNG terminals will have a positive impact on the competitiveness of the energy market, as well as contributing to increasing the number of comprehensive offers, i.e. the offer of supplies of natural gas and electricity from one energy company at a better price. As a result, this will create new opportunities for the use of liquefied natural gas in the industry.

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Recommendations for the European Union

1. It is in the interest of the EU to expand LNG terminals that will enable the delivery of liquefied gas from different geographical directions, and thus contribute to the growth in elasticity of supply and improve energy security.

2. The EU should coordinate the development of energy infrastructure in the context of a common energy market. It is important to further support the construction of new LNG terminals, gas interconnectors, gas transmission pipelines and underground gas storage facilities through EU funds.

3. It is in the interest of Europe to support politically and financially the gas corridors including the North-South corridor, which will reduce the possibility of political pressure of gas supplies to Central and Eastern Europe.

4. It is important to develop instruments for energy solidarity (including the regulatory environment, crisis response mechanisms in the event of an interruption of gas supplies, joint energy purchasing, transparent market mechanisms) that will enhance the negotiating position of member states with respect to gas suppliers.

5. Europe should take advantage of the potential of conventional and unconventional natural gas resources, which, mined in an environmentally friendly way, can help to increase energy self-sufficiency and develop the competitiveness of the EU economy.

Recommendations for Poland

1. It is in Poland's interest to develop the capacity of transmission pipelines connecting the LNG terminal in Świnoujście with the planned LNG terminal on the island of Krk, within the North-South gas corridor, as well as connecting to the gas hub in Baumgarten.

2. Poland should expand its energy infrastructure, including underground gas storage facilities to the level of at least 25% of annual demand (about 4 billion cubic meters), as well as increasing the maximum daily quantity of gas consumption from underground storage facilities to a level of about 55 million cubic meters.

3. It is important that Polish energy companies continue to work on the exploration of conventional and unconventional gas in Poland and abroad

4. Poland should strengthen its political activity in the EU in the context of co-creating EU's energy policy. The divergence of interests of member states resulting from different structure of power generation will hinder the construction of the coalition, which may take a different form with respect to various aspects of energy policy. It is important that Poland seeks to strengthen cooperation between the Weimar Triangle and the Visegrad Group.

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The Casimir Pulaski Foundation was founded due to political changes that took place in Poland after 1989. The principal values of Casimir Pulaski (freedom, justice and democracy) are an inspiration for every initiative undertaken by the Foundation. A few of the Foundations activities include: conducting scientific research, preparing publications and analyses, organizing seminaries and conferences, providing education and support for leaders (www.instytutprzywodztwa.pl).

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