How we can end Europe's energy squeeze

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This week's warning from the International Energy Agency about **soaring oil costs**, as prices edge towards $100 a barrel, is just one signal of Europe's fragile energy system. After the coldest December in decades, and with warnings of more bad weather to come across northern Europe, the chances of an even tighter energy squeeze in January or February – traditionally the period of highest demand – have increased. Natural gas prices have already doubled in less than a month.

Yet this potentially dangerous prospect comes despite plentiful supplies of both **oil** and gas on the world market. The IEA shows spare global oil production capacity of more than 5.5m barrels a day. Newly opened liquefied natural gas terminals should allow supplies to reach Europe, while Russian production is steady – with no sign of more conflicts between **Gazprom** and Ukraine to spook the market.

Why, then, are those same markets signalling a dramatic **supply problem**? The answer lies in the fragmentation of Europe's energy system, and the lack of a cushion against unpredicted events – such as **surges in demand** or the loss of particular sources of supply and infrastructure links. Put simply: poorly-linked national markets cannot cope when things go wrong.

With the development of renewable and new nuclear capacity still bogged down by uncertainties over pricing and regulation, Europe's reliance on gas will continue to grow over the next decade. But the supply system – the infrastructure which takes the primary fuels such as gas into power stations and then transmits electricity businesses and households – is a patchwork quilt with no central control. The lack of connectivity is most obvious between what used to be eastern and western Europe, but the problem stretches across the continent. Shortages in one country often cannot be made up from elsewhere. The natural gas grids are even more limited and less connected.

For most of the time these patchworks function only because national facilities have been built to meet local needs. Unfortunately a partially integrated system can actually make problems worse when events create a shortage in several different national markets at once – because the pull on supplies from those prepared to pay diverts resources from other areas. If Europe's market tightens further in the next few weeks, British politicians can only watch fearfully to see if cargoes of LNG destined for the UK will be (easily and perfectly legally) diverted to where prices are higher. And their concern will be well based: at times of peak demand LNG makes up 20 per cent of the UK's gas needs. Any shortfall will be felt within days.

The risks to this fragile system are not limited to adverse weather, however. Security can also be threatened by terrorism. Suppliers could turn the taps off in times of political conflict. With imports meeting more than half of Europe's gas needs, competition in world markets is intense too: Chinese demand for imported gas doubled over the year to November as demand for heating rose.

The consequences of a tighter squeeze start with higher prices, damaging growth as Europe struggles to emerge from recession. But as import dependence grows, we cannot even assume Europe will always be able to secure the supplies it needs. The possibility of a physical shortage, and the need for rationing, at some point within the next decade is real and growing. Anyone who considers this scaremongering should examine their own gas contract. Many, especially business customers, will find clauses saying supplies are interruptible in specific circumstances.

In recent years Europe's governments have focused energy policy on new competition and on the long-term shift to a lower carbon economy. Both are important. But while the energy business is predominantly a private sector activity, energy security is a public good and must be managed as such. Between the old model of centralised national control and a system of free markets lies a sensible approach in which private behaviour is shaped by careful regulation.

The answer to these varied risks lies in the development of new forms of resilience, to withstand shocks and allow the market to operate when things go wrong. Improved interconnectivity of electricity and gas supply systems across Europe would help – so a shortfall in one country could then be met by supplies from another True resilience, however, needs diverse sources of supply and more stocks to cover shortfalls. Most supply crises are temporary: 30 or 60 days of new gas storage capacity (with clear rules on its gradual use) would diffuse most surges in price. Infrastructure links, and avoiding complete dependence on single supply lines and facilities, can reduce terrorist threats too.

For as long as we choose to remain dependent on imported hydrocarbons for most of our energy, we must accept that dependence carries risks that must be managed. Yet northern Europe's worsening energy squeeze this winter will still be needlessly uncomfortable for those with sensitive businesses or household budgets – because it is a squeeze that is eminently avoidable. Of course, true resilience carries a cost that must in the end be borne by consumers. But such one-off investments now would be a modest and wise way to stop the very real threat of rationing in the future.

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