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Security of energy supply in Hungary

Today, energy-security is a chief concern for the international agenda. This is largely due to the New Year's crisis when Russia cut energy supplies to the Ukraine. Leaving half of Europe with energy shortages, the Ukrainian Crisis definitely had a positive effect: it alerted European and American leaders to Russia's energy leverage and its associated risks. Indeed, the bitter political statements traversing the Atlantic hint at the possibility of a new type of cold war in which super powers threaten each other with 'energy weapons,' i.e. curtailing energy supplies or providing them from elsewhere.

Situated between predominant world economies, the question for Hungary is whether it can pursue its domestic energy-security interests or must it implement decisions made elsewhere (mainly in Moscow, Brussels and Washington). This also leads us to ask whether Hungary has any distinguished national energy policy at all. Has Hungary already adapted to the extent that it has not developed an energy policy?

This article seeks to answer the above questions by examining the current energy-security situation from Hungary's perspective.

Conceptual clarification

Energy-security is usually understood as the securing of a continuous supply of energy and tends to encompass two issues: alternate energy sources and physical protection. Alternative sources of energy require that states diversify their energy sources to guarantee an uninterrupted supply. This acts a precaution against an energy supplier that decides

to uphold or terminate the energy provision. As demonstrated by the Ukrainian crisis, this is a necessary precaution.

Energy-security also requires the physical protection of energy infrastructure against terrorist attacks and natural disasters. This became an objective following the September 11 attacks on the US, but the objective has yet to become a reality. In other words, we do not know how to protect pipelines and power plants from an actual terrorist attack. Responding to this void, the European Commission is currently developing a European Programme for Critical Infrastructure Protection (EPCIP), published a Green Paper regarding this issue in 2005, and initiated a consultation with the Member States and stakeholders.¹ In addition to the EU, NATO has also expressed an interest in extending its activities to energy infrastructure protection.

However, when it comes to the Russian definition of energy-security, the picture is somewhat different. For Russia, primarily means greater guarantees of access to the European market.² No wonder that as Russia is holding the G8 meeting in St. Petersburg July 2006, energy security is primary item on the agenda. At the conference, President Putin is expected to present Russia as a major energy producer and player on the international economic scene as well as to forward Russian plans to invest into Western European and US energy facilities.³

Mutual EU-Russian interdependence

Here are some figures to clarify the statistical background of the set-up of the EU-Russian relations in the context of energy: The EU imports about 50% of its energy consumption. This figure is expected to rise to 90% in regards to oil and 80% in regards to gas by 2030.⁴ Russia

¹ Green Paper on a European Programme for Critical Infrastructure Protection of 17 November 2005. The 'Green Paper' is a type of legally non-binding document of the European Commission which sets the directions of policy-development in new fields and may in the future lead to a formal legislative proposal.

² Russia plays energy card vs. Western investment. *The New York Times*, 11 June 2006.

³ Russia bargains bigger stake in West's energy. *The New York Times*, 12 June 2006.

⁴ Doing more with less – Green Paper on Energy Efficiency. European Commission, COM (2005) 265 final of 22 June 2005. See also 'Green Paper – A European Strategy for Sustainable, Competitive and Secure Energy', COM (2006) 105 final of 8 March 2006.

has one of the world's largest fuel reserves, housing approximately 34% and 13% of the world's gas and oil supplies respectively.⁵ Russia currently provides 30% of the EU's oil and 50% of its gas imports. On the basis of these figures, one thing is clearly evident: the EU is heavily dependent on Russian supplies. However, this dependence is not one-sided: Russia also relies on the EU since as much as 25% of Russian GDP comes from its trade in energy.⁶ The fact that Russia recently agreed to repay its entire \$21.3bn debt to the Paris Club of creditor nations by the end of August 2006 – mainly from energy revenues⁷ – indicates how much energy trading yields for Russia. According to these figures, then, the EU and Russia are greatly interdependent.

This interdependence between the EU-Russian also means that both sides should be careful when discussing strategies to reduce their interdependence. On the one hand, even if plans work out to construct pipelines that enable the EU to receive energy from countries other than Russia, they will still remain dependent upon Russia in the immediate future. On the other hand, Russia certainly cannot afford to lose Europe as its major energy trading partner because this loss would harmfully impact its GDP.

Is there an EU energy security policy as such?

The sudden realisation of overdependence on Russian energy has prompted the prioritisation of energy-security in the past six months. Beyond the thrust to secure supplies, Brussels's anxiety is compounded by a series of other energy-related problems such as high prices, lack of competition in the electricity and gas sectors, and friction between Member States as regards nuclear energy and environmental concerns to name a few. Additionally, some Member States also view energy as an issue of national sovereignty and are more resistant to Brussels's initiatives. Larger Member States like Germany and France feel that securing energy supplies is a national priority and should not be left to the slow and bureaucratic processes of the EU – which many believe has also failed to rectify many problems that it has identified. Take the Lisbon Agenda, which set the objective for the EU to become the world's most

⁵ Official website of the G8 presidency of the Russian Federation in 2006.

⁶ Source: European Commission, Directorate General External Relations.

⁷ Russia to repay \$21bn Paris Club debt. *Financial Times*, 23 June 2006.

competitive economy by 2010, as an example. Judging by the recent gloomy European economic outlook, especially in some larger Member States, Lisbon appears to be an ongoing failure. Apart from proposals and heated discussions, not much has been actually achieved to make this proposition a reality.

Most importantly, little strategy seems to be developing in regards to how the EU should respond to domestic developments in Russia's energy sector. Specifically, no strategies have been explored to deal with the increasing public-private overlap, which has made the Russian energy sector less transparent and predictable.⁸ One solution would be to convince Russia to abide by relevant international trade rules, namely that of the Energy Charter Treaty. This Charter aims to internationally liberalise the sector and provide a minimal operational-conduct code. Not surprisingly, Russia is reluctant. While it has already signed the Charter, it is refusing to ratify it because it would provide Western investors access to the Russian energy market. Russia's forthcoming adherence to the WTO provides no solution either because there is no separate WTO agreement on energy trade. For the time being, therefore, the present situation will prevail: energy trade will continue to be regulated by inter-company agreements.

Russia is eyeing Hungary?

Hungary is probably the EU Member State most dependent on Russian gas. It receives approximately 80% of its supplies from Gazprom, the state-owned Russian energy giant; it is also being pressured to consent to plans that would further increase this rate. When President Putin visited Budapest on 6 March 2006, an important item on his agenda was the possibility of Gazprom buying the wholesale division of MOL, the Hungarian oil-and-gas company. There are also proposals to extend the Blue Stream Pipeline, which currently connects Russia and Turkey, by linking Russia to Southern Europe via Hungary. Finally, there is the idea of establishing a natural gas hub that would be capable of storing 1.2 bcm of gas in Hungary. Should Hungary agree with these plans, it would greatly undermine European plans to construct the Nabucco pipeline,

⁸ Andrew Monaghan and Lucia Montanaro-Jankovski: EU-Russia energy relations: the need for active engagement. *European Policy Centre*, March 2006.

which would be capable of supplying alternative gas supply from Iran, Turkmenistan, Azerbaijan and Kazakhstan.⁹ As Nabucco would connect Turkey with Austria, similar to the Russian proposal to prolong the Blue Stream, it would also pass through Hungary.

These recent visits send a clear message: Hungary seems to be a target for Russia more than a possible partner and is left with a quite limited amount of political maneuverability. Indeed, Hungary's situation in this political matrix is more clearly portrayed in the various international, rather than domestic media.

The Polish way

Contrary to Hungarians, the Polish have certainly not kept a low profile. Following a series of bitter incidents last year, in an interview with the BBC this May, Polish Defense Minister Radek Sikorski has openly accused Russia of using its energy reserves as a means of blackmailing its Western neighbours. He stated that Poland desires a commercial relationship with Russian energy suppliers that are free of monopolies, price-fixing or blackmail.¹⁰ His words seem to echo Dick Cheney, US vice-president, warning Russia against "intimidation or blackmail, either by supply manipulation or attempts to monopolise transportation."¹¹

However, voicing one's opinion can cost dearly: Last September, Russia signed a deal with Germany to build a gas pipeline under the Baltic Sea, bypassing Poland. Gazprom will own 51% of the pipeline, with German EON and BASF taking 24.5% each.¹² Warsaw is now worried that the new pipeline – which would also bypass EU members Lithuania, Latvia and Estonia – could be used to cut off energy from Poland for political purposes, without affecting supplies to Germany. It might not be that far from the truth as few in Russia doubt that gas supplies via a seabed pipeline will ultimately be more expensive than one across the land, i.e. through Poland. However, in exchange for the higher construction price, Ukraine, Belarus and Poland will no longer be the exclusive operators of gas transit and, consequently, will not be able to 'transit

⁹ Putin pushes energy expansion into Central Europe. *Radio Free Europe/Radio Liberty*, 6 March 2006.

¹⁰ Poland slams Russian fuel policy. *BBC Online News*, 19 May 2006.

¹¹ Who is afraid of Gazprom? *The Economist*, 4 May 2006.

¹² Germany and Russia sign gas deal. *BBC Online News*, 8 September 2005.

blackmail' Russia.¹³ The Polish Defense Minister compared this deal to the pre-World War II Nazi-Soviet pact which carved up Poland. He also accused Germany of halting plans for more integrated EU cooperation on foreign and security affairs, including energy security.¹⁴

Increasing US involvement in Central European energy policy

With the strategic decision about whether Hungary will agree to Russian or EU pipeline construction proposals pending, it is no wonder that Budapest and other neighbouring capitals have recently become frequented hot spots by Russian and US envoys, including both President Putin and Bush. In the face of Russia's repeated demonstrations of its powers over energy politics, US Secretary of Energy Samuel W. Bodman, only ten days following Mr. Putin's March 6 visit to Budapest was quick to point out that "[t]he US and Central Europe share many of the same energy goals including greater energy efficiency, use of clean and reliable energy supplies, and expanded infrastructure...This meeting provided a unique opportunity to discuss strategies to enhance Central Europe's regional strategy."¹⁵

NATO has also started to increase its involvement in European energy security issues. At a major NATO Forum on Energy Security Technology in Prague in February, Kevin Rosner, co-director of the conference stated that "the trans-Atlantic Alliance must get involved in trying to help stabilize future energy supplies and believes it could play a critical role in doing so." One of the subjects discussed was a proposal to create a new alliance in which NATO and EU members would act in concert "in the face of any threat provoked by either a cut or a diminution of supply sources that may occur because of natural disasters, disruption of wide distribution and supply systems or political decision by suppliers." Not surprisingly, the proposal was put forward by Poland,¹⁶ which now regards the US as the primary guarantor of its energy security.

¹³ Baltic deal worries Polish press. *BBC Online News*, 8 September 2005.

¹⁴ Russo-German deal irks Poland. *BBC Online News*, 30 April 2006.

¹⁵ Secretary Bodman meets with regional energy ministers in Hungary, emphasizes US support for Central European Energy Security. *US Department of Energy News Release*, 17 March 2006.

¹⁶ NATO considers role in increasing energy security. *Radio Free Europe/Radio Liberty*, 24 February 2006.

Besides direct US and NATO involvement in the European energy concerns, at the EU-US Summit – the official trans-Atlantic political forum – cooperation in energy security was also identified as a priority. In a statement after the EU-US Summit in Vienna on June 21, 2006, US President George Bush and European Union leaders jointly listed their concerns about some recent developments in Russia. Also, the European Council Declarations of the Summit¹⁷ devoted a separate chapter to the subject. Entitled ‘Promoting Strategic Cooperation on Energy and Energy Security, Climate Change and Sustainable Development,’ this chapter identified the areas in which EU-US strategic cooperation should be increased: diversification of energy sources and supplies, securing energy infrastructure, and improving energy security by enhancing the dialogue with the main transit, producer and consumer countries – to name a few. They have also agreed to jointly analyze geopolitical implications of the worldwide energy situation and develop policies in the framework of an annual review of the EU-US energy cooperation. This means that something substantial has finally happened in the trans-Atlantic dialogue, which has been widely criticized for lacking any meaningful political will.

German separatism

While Putin and Bush are certainly attracting the most attention when security is at stake, German energy interests should not be overlooked. In fact, it seems that the Germans are playing their own game. Critics within the EU have already complained that Germany is guilty of putting its own interests above those of other Member States.¹⁸ Definitely, the joint construction of the Baltic pipeline by Gazprom and German companies EON and BASF will increase the Russian foothold in Europe – exactly what the EU is aiming to reduce. Moreover, EON is anxious to acquire a piece of Russia’s wealth, a 25% stake in the Russian Yuzhno-Russoye natural gas field.¹⁹ As no foreign investment has previously been allowed in the Russian energy sector, the deal is historic. However, what the German companies are offering in return for such

¹⁷ 10783/06 (Presse 189), 21 June 2006.

¹⁸ Germany and Russia sign gas deal. *BBC Online News*, 8 September 2005.

¹⁹ Germany and Russia maneuver for gas deal. *International Herald Tribune*, 18 May 2006.

a stake is exactly what many in Hungary fear: EON energy assets in Hungary and Central Europe.

In recent years, EON has acquired strategic stakes in Central Europe,²⁰ and more importantly, in Hungary.²¹ It has considerable market shares: 2,401,454 Hungarian customers in electricity and 564,673 in gas markets.²² Gazprom has expressed its interest in buying the wholesale division of MOL, and in the case of refusal, EON could potentially offer just what Russia wants. As EON has recently acquired the gas division of MOL as well, this could also easily become part of the exchange price for access to the Russian market. A piece of the MOL Group – which is the leading oil group in Central and Eastern Europe, currently being publicly traded on the Budapest, Warsaw, and Luxembourg stock exchanges and has retail units in 10 countries – certainly sounds attractive. Indeed, it is assumed that EON-owned assets in MOL have already been offered.²³ While there is no official answer as of yet, should EON sell off its Hungarian and possibly other Central European equities to Gazprom, Russia would undoubtedly secure its energy leverage in Europe.

Lack of a visible and coherent Hungarian energy policy

In the midst of this complex political situation, it is difficult to identify the pursuit of a strategy to secure domestic energy supplies by the Hungarian Government. While this is probably somewhat due to the recent elections that led politicians to focus their attention elsewhere, it is disconcerting that no policy seems to be developing.

It might be expected that the newly elected government's 2006 National Program would contain some indications, but as it stands, the

²⁰ See E.ON Annual Report 2005.

²¹ EON equity stakes in Hungary: E.ON Dél-dunántúli Áramszolgáltató Zrt. (100%); E.ON Tiszántúli Áramszolgáltató Zrt. (100%); E.ON Észak-Dunántúli Áramszolgáltató Zrt. (100%); KÖGÁZ Rt. (98.1142 %); DDGÁZ Rt. (50.01%); E.ON Energiakereskedő Kft. (100%); E.ON EÜT Kft. (51%); DKCE Kft. (10%); E.ON IS (49%); EMSZET (74.7%); EH-SZER Kft (51%); ENERGO-HOLDING Kft. (74%); Dunatújváros Sewage Treatment Plant Ltd. (49%).

²² Website of EON Hungária Zrt, http://www.eon-hungaria.com/eng/hung_ceg-tort.php

²³ The German E.ON refuses to let Gazprom into its network. *Kommersant*, 18 May 2006. See also: EON offers Hungarian assets to Gazprom in exchange for Russian gas field. 14 March 2006, *Expats Hungary*, <http://www.expatshungary.com/news/item/1037>

National Programs is too broad and too vague in regards to energy security. While the policy document that should have elaborated the subject in more detail, entitled the New Hungarian Energy Policy Strategy for 2006–2030²⁴ certainly has some good ideas, it is definitely lacking in vision for the near future. Although the Strategy is meant to determine the energy-policy trajectory for the next 25 years, it does not answer the most important question: What stance should Hungary take with respect to Russia and supply diversification in the international context? Besides stating that it is only feasible in the context of EU external energy policy, the Strategy does not generally contain any external energy relations' policy at all. Only semi-official, short press releases by the Minister for Energy and Transport on the Ministry's website²⁵ resemble a policy vision and tackle some of the crucial pending issues. They discuss the importance of Central European cooperation, the alignment of energy security policies by the new Member States at EU forums, and Hungary's interest in building the Nabucco pipeline. Nevertheless, they do not change the fact that there is an obvious vacuum in official policy development, which reveals that the government's "energy strategy" is keeping a low profile and reacting to emergency situations.

Having only recently become an EU member, Hungary's is still new to decision-influencing techniques and is of limited economic weight. Because of this, Hungary's primary role in the EU seems to be mechanically implementing Brussels's decisions. One wonders, though, what would Hungary's role be now, should Mr. László Kovács have become the European Commissioner for Energy instead of Tax and Customs, the latter being one of the more marginal positions.

The only initiative the Hungarian Government has managed to successfully advance among EU Member States is the location of the proposed European Energy Supply Observatory in Budapest. This initiative definitely has a chance, provided the unwritten rule that all Member States should have at least one EU agency located in their country, stands. Since the Polish lobbied much better for the location of the Border

²⁴ Az új Magyar energiapolitika tézisei a 2006– 2030 évek közötti időszakra. [The principles of the new Hungarian energy policy for the period between 2006 and 2030] Ministry of Economy and Transport, 13 January 2006.

²⁵ Nyolc állam képviselői tárgyaltak az energia biztonságáról [Representatives of 8 countries discussed energy security] – press release on the website of the Hungarian Ministry of Economy and Transport, 22 March 2006.

Monitoring Agency, Hungary still has no such EU agency. Because of this, Hungary is currently at the top of the waiting list. However, the agency is mostly a question of prestige and will, therefore, probably have little or no impact in the formulation of EU energy policy.

Internal solution to external dependence?

The debate over how best to secure our energy supplies has also drawn attention to renewable energy, i.e. reduction of consumption and increasing the energy efficiency. However, prospects in Hungary are far from bright.

Concerning renewable energy, Hungary is at the bottom of the EU. It has made the lowest offer of national target-percentage of domestic renewable energy production: 3.6% until 2010, compared to Slovakia's target of 31% and Slovenia's target of 33.6% by 2010.²⁶ While the 2006 National Program indicates that the Hungarian target will be increased – and has already effectively been surpassed, presently standing around 4.17%²⁷ – it is still rather low. The National Energy Strategy for 2006–2030 predicts that renewable energy production could be increased to maximum of only 7% by 2010 and 9% by 2025. It is important to note, though, that this increase is mostly for efforts related to biomass rather than wind, solar or thermo energy. According to some renewable energy experts, old power plants can be technically transformed and enabled for biomass production, i.e. by environment-related supports, so that old industries can be revived and restructured. While this transformation is a supportable objective, it should not be made to the disadvantage of wind and the other renewables.

The Hungarian Energy Office has declared that the electricity network is technically not prepared to take in more capacity generated by wind farms and that this situation will not change in the foreseeable future. This, in practice, prevented any further network infrastruc-

²⁶ 'The share of renewable energy in the EU – Country Profiles – Overview of renewable energy resources in the Enlarged European Union', *European Commission Staff Working Document*, SEC(2004) 547 of 26 May 2004.

²⁷ 'A megújuló energiaforrásokból termelt villamos energia mennyisége és a támogatási rendszer pénzügyi mutatói Magyarországon 2005-ben' [The amount of electricity generated from renewable energy sources and its financing system] website of the Hungarian Energy Office.

ture-development for an undefined period of time. This statement is in spite of the fact that only last year renewable energy investors submitted requests for approximately four times as much electrical-generation capacity than the Energy Office's current set-maximum of 330 KW. Still, when compared with the conclusions for Hungary in a 2004 Commission Staff Working Document on renewable energy sources in the enlarged EU, this increased investment interest in wind energy production is definitely an improvement. The study found that "[T]here would be good opportunities for biomass, solar, geothermal and some wind energy development, although the investment climate was not favourable until now and only very few investment has taken place with different multilateral funding."²⁸ Sadly, while investment interests backed by collateral have appeared, they are not overwhelmingly welcomed.

In terms of energy efficiency, Hungary is even below half of the EU average, which was also confirmed by János Kóka, Minister for Economy and Transport.²⁹ This result comes in spite of the fact that problems were already acknowledged a while ago. For instance, the 1999 Government Decision regarding the national strategy for energy efficiency³⁰ already provided for various measures, institutions and monetary allocations. Apparently, there have been no results. A recent positive development, though, is that the New Energy Policy Strategy for 2006–2030 revives or propels many of the initiatives. However, beyond the development of objectives, any results will boil down to the amount of money devoted to the issue. In the country's current gloomy financial state, it is fairly unlikely that the government will devote resources to long-term economic objectives, such as increasing the efficiency of energy utilisation by 2030.

Conclusion

Hungary is, indeed, small and stuck between powerful energy economies that drive international energy-security politics. More than likely, it will be unable to set the agenda. However, it has not been as active as

²⁸ 'The share of renewable energy in the EU ...' *op. cit.*

²⁹ 'Energiahatékonyság – pályázatok' [Energy efficiency – grants] 16 March 2006, news website of the Hungarian Ministry of Economy and Transport.

³⁰ Government Decision No. 1107/1999 (X. 8.) on the national energy efficiency strategy.

it could be. As there is no visible indication of a coherent national energy security strategy, it is not surprising that the country is not taken into account when decisions are made, neither to the extent it should.

It should be a priority to take pending political decisions and form a real national strategy. Not even energy experts can come up with magic solutions if their hands are tied by a lack of principal political tenets. Hungary's EU lobbying techniques should also be considerably enhanced. But again, this does not only depend on the administrators who actually negotiate. Without clear political intentions and decisions, it is difficult to lobby for anything.

Technically and financially, Hungary is not prepared to provide a substantial portion of national energy production from renewable energy sources. Since increasing energy efficiency and capacity utilisation are highly dependent on costly government investments, it is very unlikely that such long-term objectives will be integrated into effective government actions, beyond political rhetoric. And amongst the continuous international criticism over the huge budget deficit, the EU is also probably putting the requirement of sound economic management over saving energy.