THE ENERGY CRISIS AND ITS IMPACT FOR CENTRAL & EASTERN EUROPE

Searching for a way out from the energy crisis in CEE

12 October 2022

Europe is bracing itself for what is expected to be an extremely challenging winter as the countries of the continent struggle to secure energy supplies from various sources, reduce residential and/or industrial consumption levels, and subsequently mitigate the fallout from high prices in a Europe-turned-global energy crisis that continues to shape the continent's political and economic climate.

Triggered by rapidly increasing demand for gas under the post-pandemic economic recovery in 2021, the scarcity of gas supplies and skyrocketing energy costs on European markets, the current crisis has been exacerbated by Russia's war against Ukraine, the ensuing economic fallout and the Kremlin's move to halt most Russian gas supplies in retaliation to sanctions imposed by Western governments.

The crisis has put an enormous burden on Central and Eastern European countries, many of which have been relying on cheap Russian energy for years. Governments across CEE are now placing enormous efforts to shore up supplies, find long-term alternatives, as well as to mitigate the economic and social impact of the price hikes.

As Central and Eastern European EU member states gear up for the challenges lying ahead, Aretera takes a look at the fallout from the energy crisis in the region.

This memo will cover:

- the energy diversification efforts of CEE economies,
- key new energy policy measures introduced by CEE governments,
- the role of various power sources in the region's energy transition,
- an outlook on political stability in CEE in relation to the current crisis.

IN SEARCH OF ALTERNATIVES TO RUSSIAN FOSSIL FUEL IMPORTS

The energy crisis has been posing an enormous challenge to all European governments, not least to the countries of Central and Eastern Europe, which have been among the European nations most reliant on Russian fossil fuel imports and, therefore, those most exposed to the common European efforts to cut dependence on Russian imports in response to the war in Ukraine.

This crippling dependence particularly holds for the Czech Republic, Slovakia and Hungary, which remain the most vulnerable regional countries to a potential Russian gas cut-off. The dependence of these CEE countries was also evidenced by an EU decision in May to exempt them from the bloc's Russian oil embargo, allowing the governments in Bratislava, Budapest and Prague to temporarily continue importing Russian pipeline oil under the sixth EU sanctions package. In response to Russia's invasion of Ukraine and Moscow's decision to halt gas supplies, CEE governments have nevertheless started searching for solutions to replace Russian imports for good.

POLAND, BALTIC COUNTRIES LOOK TO LNG & SUBSTITUTE PIPELINES

Poland and the Baltic states have led CEE's diversification drive, with all four countries expressing strong interest in liquified natural gas (LNG) from the United States and other sources. According to Poland's state energy regulatory office URE, LNG has a key a played role in substituting Russian gas after Moscow cut off gas supplies in April. As gas imports from outside the EU have fallen by an astonishing 91.5% year-on-year by the second half of 2022, the overall volume of gas supplies has remained stable, largely due to the 171.5% year-on-year increase in imports from European countries and the 33.2% y-o-y increase of LNG deliveries.

Similarly to Poland, which was planning to get rid of Russian gas well before Ukraine's invasion by not renewing its long-term gas contract with Gazprom that was due to expire this year, the Baltic countries are also heavily investing in LNG infrastructure to substitute Russian imports. Most recently, under the so-called Marienborg Declaration, all four countries agreed with Germany, Denmark, Finland and Sweden to cooperate in further developing LNG capabilities and offshore wind projects, with the aim of securing energy independence. This effort could be centered around Klaipéda, a key Lithuanian port city aiming to become a hub for offshore wind energy production.

The recent inauguration of the Baltic Pipe on 28th September, which pumps Norwegian gas to Denmark and via the Baltic Sea to Poland, is another key element in the Polish diversification effort, with the new pipeline expected to cover 15% of Poland's natural gas demand.

BOOSTING DOMESTIC GAS PRODUCTION

As the Baltics and Poland are embracing LNG, Romania is looking to bolster its own natural gas production capabilities. Following years of stalling in May, the Romanian parliament approved new legislation to reduce taxes on future income from offshore natural gas projects, in a bid to unlock energy investments in the Black Sea and extract reserves for domestic use. In June, the government started extracting gas from Midia and delivering it into the gas network. Operated by Black Sea Oil and Gas (BSOG), a company owned by US-based Carlyle, this is the first natural gas development project completed in the Black Sea in 30 years. This was recently followed by the government's pledge to speed up two natural gas projects: the onshore deep Caragele field and the Neptun Deep project. Combined, the two projects would be able to cover the country's gas consumption for up to 10 years and could also turn the country into a net exporter.

SHORT-TERM RELUCTANCE TO CUT ENERGY TIES WITH MOSCOW

While the vast majority of CEE governments are searching for ways out of energy dependence on Moscow, Hungary remains an exception to this rule, at least for the short term. One of the most dependent countries on Russian gas, Hungary signed a new long-term gas contract with Moscow in late 2021 and an additional contract in August this year to make up for the losses of gas supplies that have occurred after the Kremlin decided to halt transfers to various EU countries in response to sanctions. Hungary also remains committed to complete the extensions of its sole nuclear power plant at Paks with support from Russian energy giant Rosatom.

Although differences on energy policy between most CEE countries and Hungary remain, Budapest also aims to phase out Russian gas (by 2050) and plans to do so by a large-scale electrification drive. The government has set out plans to review the country's energy strategy in early 2023, a review which could include curbing gas reliance and boosting electricity production with nuclear and solar energy.

Similarly to Hungary, Bulgaria has almost entirely relied on Russian gas for decades, however Bulgaria's Russian supplies were cut in August. The country's interim government[1] also looked to Moscow to renegotiate energy ties but this attempt proved unsuccessful, pushing Bulgarian state energy firm Bulgargaz to launch tenders for LNG shipments to avoid shortages in the winter.

On 1st October, however, Greece and Bulgaria started the commercial operations of the IGB, an interconnector pipeline that will provide major relief to Sofia by pumping 1 billion cubic metres of Azeri gas to the country. In the long run, the IGB could provide non-Russian gas to Serbia, North Macedonia, Romania and further to Moldova and Ukraine.

NEW ENERGY POLICY MEASURES IN SELECTED CEE COUNTRIES

Country	National Measures
Bulgaria	• call for tenders to secure LNG and pipeline gas • construction of interconnector pipelines
Czech Republic	• investing in small modular nuclear energy production • development of pipeline interconnectors with Germany
Hungary	• long-term and additional gas contracts with Gazprom • accelerating the construction of new nuclear capabilities • boosting renewable (solar) and storage capacities
Poland	• speeding up LNG imports • lifting ban on lignite for heating purposes • developing natural gas pipelines
Romania	• accelerating offshore gas production • investing in small modular nuclear energy production
Slovakia	• expanding nuclear energy production

[1] See here for Aretera's overview of Bulgaria's latest snap elections and here for its interim government

NUCLEAR POWER GAINS NEW MOMENTUM

While the EU's joint energy crisis package does not include measures related to nuclear energy, several CEE governments are embracing nuclear power as one of the possible solutions. This comes after the European Parliament – largely due to the efforts of the Czech Presidency of the EU – designated nuclear power as compatible with the bloc's goals to achieve climate neutrality under the European Green Deal by 2050.

Poland will soon see a key moment in this regard as the government of Prime Minister Mateusz Morawiecki is expected to announce an international partner for constructing the country's first-ever nuclear power plant, set to be operational in 2023. US nuclear energy firm Westinghouse, French utility firm EDF and South Korea's state nuclear giant KHNP are all competing for the job.

With Russian and Chinese companies restricted from bidding for security reasons, these three energy giants are also the bidders for completing new extensions to the Dukovány plant, one of the two NPPs operating in the Czech Republic. Bidders are expected to submit their project plans by November, with the Czech government aiming to approve the final plans by 2024 and start operating the new reactor blocks in 2036. In addition, Prague also aims to build a small modular reactor (SMR) at the country's other nuclear power plant in Temelín, as part of the South Bohemia Energy Park business project.

Neighbouring Slovakia maintains four operational nuclear reactors and is just about to inaugurate its fifth, the long-delayed Mohovce 3 NPP which is expected to produce electricity in early November for the first time, with full production scheduled for early 2023. Once the planned Mohovce 4 plant becomes operational, approximately two years after the installation of the third unit, Slovakia will become a net electricity exporter.

SMRs are deemed similarly favourable and a potential route out of the energy crisis in Romania, the second largest CEE market. In late September, Romania's state-owned Nuclearelectrica teamed up with Nova Power & Gas and US energy firm NuScale to deploy the first SMR to be built in the country, which is expected to be operational by 2030. However, this reactor would be part of a "hybrid plant" that would combine nuclear energy production capacities with renewables.

In the long run, Hungary is also looking to nuclear energy to ensure domestically produced electricity for industrial and residential consumption, as well as to achieve energy independence. Unlike other regional countries, Budapest is relying on Russia's Rosatom to build two new reactor blocks to the country's sole NPP at Paks. Although the project is already running late by six years, the Hungarian government has vowed to accelerate the process and complete the construction of the extension blocks by 2030. However, with EU-Russia relations deteriorating, it is yet to see whether the project will eventually be completed.

LOOMING CONCERNS ABOUT THE FUTURE OF THE GREEN TRANSITION

While EU countries naturally look to increasing the share of renewables in Europe's energy mix as an alternative to Russian fossil fuels, there are growing fears that the current crisis will negatively impact the green transition, which has so far been one of the highest priorities of the European bloc. Such concerns have multiplied in Poland, in particular, after the country's government lifted a ban on the use of lignite for heating households and introduced one-time allowances to buy more coal.

Critics argue that this governmental approach risks reversing a more than decade-long progress towards cleaner heating options. By far, Poland remains the most coal-dependent country in the European bloc, with coal's share in the country's energy mix estimated at 70.8% in 2021, down from 86.6% in 2010. Simultaneously, the share of renewables-generated electricity has more than doubled during the same period – from 6.9% to 16.9%.

At the same time, the energy crisis will likely accelerate the European green transition as home-grown energy investments are well-equipped to support the EU's current energy goals. The green transition in CEE member states is driven by the bloc's REpowerEU scheme, a plan aiming to make the continent fully independent from Moscow "well before 2030" by increased energy savings, speeding up clean energy production and diversifying supplies and the European Green Deal that is aimed to make Europe the first fully carbon neutral continent, among other EU-wide plans and regulations.

However, the EU's first joint emergency package to mitigate the fallout from prices, which includes mandatory electricity savings, as well as a cap on excess market revenues (from non-gas-fired power plants) and a levy to capture surplus profits of energy firms, has left the renewables industry sceptical about the future. Solar and wind energy industry associations and advocates remain concerned, arguing that the EU's first joint response to the price hikes could hit revenues rather than profits, and thus discourage renewables investors from doing business in European countries. At the time of writing, the European bloc is discussing further joint action, including the possibility of joint gas purchases, caps on gas prices, boosting the deployment of renewables and reducing demand.

KEY SUPPORT MEASURES BY CEE GOVERNMENTS

Country	Key Support Measures for Households & Businesses
Bulgaria	• temporary compensation for gas price hikes for businesses • discounts on retail fuel prices for households • reduced excise duties on gas, electricity and methane
Czech Republic	• caps on energy prices for households and small business consumers • preparations for windfall taxes on energy firms and banks
Hungary	• caps on household energy and fuel prices below average consumption • sectoral windfall taxes on energy and other companies • mandatory gas savings plan in the public sector • financial support to SMEs and energy-intensive companies
Poland	• freezing electricity prices for households from 2023 • support for energy-intensive companies • sectoral windfall taxes on state energy companies • mandatory electricity savings plan in the public sector
Romania	• caps on household energy prices, compensation and windfall taxes • taxing the entire energy chain ("solidarity tax") • plans to reduce energy consumption in public institutions
Slovakia	• established legal framework for future energy price caps

LOOKING AHEAD – IMPACT ON POLITICAL INSTABILITY

While the EU has managed to achieve its gas storage targets for the heating season (with above 91% of all EU storage facilities filled) and pushed the share of its gas imports from Russia to 9% of its total gas imports from 40% in 2021, CEE countries will continue to experience major political, economic and social challenges – including a potential recession – as Russia's war in Ukraine will go into 2023, and pose risks for the CEE region.

Poland is gearing up for legislative elections to be held during the second half of 2023. The country's ruling Law and Justice Party has been actively responding to both the war in Ukraine and the economic fallout, however continues to be locked in disputes with the European Commission, with the fate of much-needed post-pandemic EU recovery funds still undecided. The government's response to the current crisis could very well decide the outcome of the next elections.

In comparison with other countries of the region, critics say Slovakia lags behind in crisis mitigation, which is at least partially due to the recent coalition crisis that left Bratislava with a minority government[2] constantly relying on ad hoc parliamentary support and trying to avoid snap parliamentary elections.

Rising energy prices have severely impacted public support for the country's five-party ruling coalition in the Czech Republic, with protests against the government in Prague set to continue. However, the country's opposition – led by populist former PM Andrej Babiš – has performed poorly in the recent Czech Senate elections.

Locked into an electoral cycle that has left the country lacking a democratically elected government, Bulgaria's current caretaker cabinet will have to reach beyond its original function and ensure that Sofia will have sufficient energy supplies, at least for the short term.

While standing relatively stable compared to other CEE governments, Hungary's ruling Fidesz party is also poised to experience a severe drop in public support as households fear manifold increases in energy prices. However, given the lack of a credible opposition alternative, Prime Minister Viktor Orbán's rule will remain unchallenged. Budgetary and inflation pressure will be similarly high in Romania, however, the country's grand coalition government remains stable, at least, for now.

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[2] See here for our overview of the recent coalition crisis in Slovakia