

ENERGY COOPERATION IN CENTRAL EUROPE:

INTERCONNECTING THE VISEGRAD REGION

OCCASIONAL PAPER

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Occasional Paper

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General context of global energy governance

“Global energy governance is a topic which has come under increasing levels of scrutiny at the moment. Debates about energy security have become more acute in recent years, as concerns which consumer nations once had over access to cheap oil flows during the 1970s have transformed into an even more alarming politicisation of present-day [energy] supplies.”¹

When talking about global energy governance, it is important to highlight the fact that this term encompasses the international relations on matters relating to energy, predominantly its production, transit and consumption.

However, the question remains whether what we are seeing now in energy international relations is indeed an attempt for a global governance, or rather a regional governance with global implications. Regional economic integration began in the 20th century with the aim of bringing together economic interests of like-minded states in different regions of the globe. This is why we may well look at some of the regional cooperation schemes and the way they have been influenced by global energy developments. The aim of this first part is to briefly outline the historical development of the Visegrad Group as a cooperation platform of four Central European states and its interconnection to global international relations, especially in the energy sector.

¹ M. Terterov, “Testing the Water for Global Energy Governance Reform: Can the Energy Charter Provide a New Benchmark?”, *Occasional Paper of the Energy Charter Secretariat Knowledge Centre*, 10 July 2013, p. 4.

How the Visegrad Group cooperation started²

The Visegrad Group was founded on 15 February 1991 in Visegrad, Hungary at a meeting of the then Czechoslovak President, Václav Havel, the President of the Republic of Poland, Lech Wałęsa, and the Prime Minister of the Republic of Hungary, József Antall. The symbolic meaning of the meeting stemmed from a historical link to a gathering of the three monarchs of Bohemia, Hungary and Poland in 1335. Motivations behind both meetings were linked to intentions to intensify mutual regional cooperation and friendship among the countries.

Cooperation has been established based on aspirations to: (1) eliminate the remnants of the communist bloc in Central Europe, (2) overcome the regional historical tensions between these countries, and (3) achieve common objectives (i. e. facilitate economic, political and social transformation and join the European and Transatlantic integration process) in a cooperative and mutually advantageous manner. Last but not least, the foundation of the Visegrad Group was also possible due to the like-mindedness of the then political elites in Central European countries.

Due to this ideological and political closeness in the early 1990s, the Visegrad cooperation was intense from the outset, mainly during negotiations on integration with the European Communities (Union) and the North Atlantic Treaty Organisation (NATO). However, after the split of Czechoslovakia 1993 and a change in political realities in the region (the infamous Slovak authoritarian regime under former Prime Minister Vladimír Mečiar, for example), cooperation began lagging behind and only resumed actively in the late 1990s. This new momentum resulted in the creation of the International Visegrad Fund in 2000 to “facilitate and promote the development of closer cooperation among citizens and institutions in the region as well as between the Visegrad region and other countries, especially the Western Balkans and countries of the Eastern Partnership.”³

Historical legacy and the Visegrad regional cooperation

As evidenced by the example of the most successful and integrated regional economic integration organisation, the European Union, as well as other regional cooperation and integration platforms, collective action on a regional level might be the best way to formulate common goals and objectives, achieve mutual efforts and cooperation as well as tackle challenges in a concerted manner. As such, the Visegrad Group aimed at establishing a functioning cooperation platform to coordinate efforts of the four Central European countries in all aspects of their politics, economics, social, security development, as well as energy sectors, thus providing them with a more salient and credible voice in international relations.

As energy is a basic component of all activities and is effectively a backbone of the economies, the Visegrad cooperation has been established in this sector in the spirit of the founding fathers of the Visegrad Group. However, one of the motivations behind the Visegrad cooperation has proven difficult to overcome, which is the legacy of a strong reliance on Soviet energy supplies, mainly oil and gas.

Due to the construction of the Soviet production, transit and distribution energy networks in an integrated economic space (Soviet Union including the countries in the Soviet sphere of influence) as well as the geographical location, the Visegrad region has always been in the so-called geographical “buffer zone” between the East and the West, and as such it had to deal with multiple political, economic, social and energy challenges stemming from such a position in international relations.

As a result, historical realities of the Soviet and post-Soviet era after the dissolution of the Soviet Union in the early 1990s in Visegrad countries shaped the whole region for years to come. The transit route had been built on the east – west axis, with gas flowing from the east to Visegrad countries. As there was no need of “Soviet friends” to diversify energy supplies and build interconnections, no north – south pipeline axis was established.

Thus, the cooperation and priorities of the Visegrad region, as evidenced for example by the priorities of the Polish presidency in the Visegrad Group, revolve around and remain aimed at developing key energy infrastructure in the region (internal gas networks and interconnections), working on an optimal market model for the region,

2 “History of the Visegrad Group”, Visegrad Group, 2000, retrieved 13 March 2014, www.visegradgroup.eu/about/history.

3 “International Visegrad Fund”, International Visegrad Fund, 2000, retrieved 13 March 2014, <http://visegradfund.org/about/>.

as well as establishing a Visegrad Forum on gas market integration to facilitate the cooperation between policy makers and gas sector stakeholders.⁴

Visegrad energy security – Russian (in)dependence

Based on historical legacies of the Soviet era, “[t]he Central Eastern European Region, including the Southeast of Europe, is heavily dependent on Russia’s energy resources. This includes gas, oil and nuclear technology.”⁵ Even after the region’s accession to the European Union (EU) in 2004, and continuous integration of Visegrad countries to an EU-wide internal energy market (that has been under construction for several years now) to allow for more energy security in the EU market (different suppliers, transit routes, energy sources and functioning market principles), Russian dependence remains present in energy mixes and strategies of the region’s countries.

As a result, all Visegrad countries are strong proponents of the diversification of energy supplies and transit routes, building mutual network interconnections in order to enhance the region’s energy security and mitigate the negative effects of one-sided dependency on Russian oil and gas supplies.

The Czech Republic is a strong advocate of supply diversification. As a result, it has been building additional capacities to supply oil from Western Europe (connection to Trans-Alpine Pipeline that brings crude oil from Italian Trieste) as well as storage facilities. In terms of gas, the Czech Republic “is importing 91% of total consumption with more than two thirds of imports from Russia. The rest of the Czech demand is covered by Norwegian gas”.⁶ Moreover, it has developed storage capacities that could cover six months of domestic consumption. Overall, the support goes to more reliable energy sources (renewables, nuclear) as well as new projects that diversify supplies of oil and gas. In terms of electricity, the Czech Republic is a net exporter, but is heavily influenced by Central Western market developments (predominantly in Germany) mainly stemming from intermittent imbalances in electricity networks generated by renewables.

Hungary is less dependent on Russian gas (80%) than its regional neighbours, however, it has also tried to further increase energy diversity by supporting the now defunct Nabucco Pipeline (bringing Azeri gas to the EU, now replaced in planning by the Trans-Adriatic Pipeline (TAP)) and alternate transit routes (South Stream bringing Russian gas to Europe via the Black Sea). As a result, Hungary had been engaged in so-called ‘double-pipeline politics’ (more on Nabucco below).⁷ However, at the same time, Hungary also needs to diversify its energy mix, develop more electricity generation capacities (potentially nuclear) as well as electricity networks.

Similarly to other Visegrad countries, Poland’s main policy objectives remain the security of supply and transit. Poland is also highly dependent on Russian gas (around 90%). In order to mitigate this dependency, Poland built an LNG terminal in the Baltic sea, which however did not bring anticipated results mainly due to the start of the economic crisis in 2008. Poland’s electricity generation mix is mainly coal, with a marginal share of renewables. In order to deliver on EU climate change targets, Poland would need to implement either new, cleaner technologies in its power generation sector or overhaul it in preference for cleaner sources (more renewables, shale gas, nuclear etc.).

Slovakia is the country most dependent on Russian energy supplies (mainly oil and gas), and thus supports the diversification of supply sources and transit routes, and the interconnecting of the Visegrad region. In terms of gas, Slovakia is almost 100% dependent on Russian imports for its domestic consumption, as well as for transit of gas supplies to Western Europe. A similar situation is in oil imports, where Slovakia imports all of its oil from Russia. The Slovak energy mix is complemented with nuclear-based electricity generation, and an increasing share of renewables-generated electricity in compliance with EU 2020 energy and climate change policy framework.

Energy security has become even more salient in national energy strategies since the Russia-Ukraine gas crises in 2006 and 2009. Ever since being hit the hardest by the 2009 crisis, Visegrad countries have been looking for

4 Visegrad Group, Polish Presidency of the Visegrad Group (V4) July 2012-June 2013, *Visegrad 4 Integration and Cohesion*, Executive summary, Warsaw, 2013, p. 2.

5 M. LaBelle, “The Russian rock: Re-landscaping CEE energy (in)dependence”, *The Energy SCEE*, 29 September 2013, retrieved 20 April 2014, <http://energyscee.com/tag/risk-governance/>.

6 “Energy security of Visegrad region”, *Visegrad.info*, 2010, retrieved 20 April 2014, www.visegrad.info/energy-security-infrastructure/factsheet/energy-security-of-visegrad-region.HTML.

7 Energy Security of Visegrad region, *ibid*.

alternative supply sources and transit routes and headline the EU's policy in this regard. First, the EU aimed to integrate its internal energy market even more via its Projects of Common Interest (PCIs). Second, it aimed to diversify supply sources and transit routes, initially advocating the construction of Nabucco Pipeline to bring Azeri gas to the EU, and now supporting the replacement plan of TAP. Third, it established an Early Warning Mechanism and emergency response protocols prescribing oil and gas storage capacities to temporarily cope with oil and gas supply disruptions.

As evidenced above, some Visegrad countries have been more successful in enhancing their energy security than others. Among the former we can count the Czech Republic, which managed to decrease its dependency on Russian gas to around 60% of its imports, whereas among the latter we can consider the Slovak Republic still being almost 100% dependent on Russian gas imports. "The region may have gotten democracy and removed overt economic and political control [of the former Soviet Union] but the energy infrastructure is a strong reminder that continues the previous political-economic relationship."⁸

Thus, the Visegrad region might have been integrated to a greater or lesser extent into the EU internal energy market, however, due to the historical legacy of the region and the still only partial functioning of the EU's internal energy market,⁹ all national, regional as well as global market complexities and developments need to be taken into consideration when energy strategies and policies are being drafted. Thus, we will continue seeing more and more national and regional policies being determined by global energy developments.

Global developments

"The Nabucco pipeline is out of the game. But Central Europe can reinforce its energy security through new ways to trade gas and access the integrated European market. Only then it can tackle both major challenges, Gazprom and the Asian demand."¹⁰ This is one such example of how a regional energy project had been influenced by developments on a global scale. The Trans Adriatic Pipeline (TAP) has been chosen over Nabucco to bring Azeri gas to the EU. While Nabucco was a political project symbolising EU's diversification efforts, TAP was more economically viable, and a logical choice prevailed. However, for the Visegrad region, the route of the Nabucco Pipeline would have been a preferred option to decrease Russian dependence.¹¹

While taking a closer look at the two proposed remaining options for the Visegrad region, LNG trade and the liquidity of the European market, we also need to take global developments into consideration.

First, LNG trade might be an option for the region, however after taking into account advantages (transportable over distances) and disadvantages (costs of LNG ports, unpredictable long-term take-or-pay contracts linked to oil prices), we also need to see the global picture. In particular, gas demand and LNG prices are the highest in Asia, thus most supply ships head in this direction and not Europe.

Second, liquidity on the European market may bring more leverage for gas buyers: the more gas is available on spot (short-term) markets and the more the market is interconnected, the easier is it for gas buyers to diversify and respond to new trends. As for the Visegrad region, the gas network remains highly East-West oriented, thus more diversification and interconnection is needed. However, two global factors stemming from the region's higher engagement in spot markets emerge: first, future infrastructure investment decisions will be difficult and unpredictable (due to the long return on investment ratio in the energy sector), and second, a smaller, highly open market like the Visegrad will be more volatile and susceptible to spot market price speculation (same as on any other spot price market).

Thus, the overarching factors to be taken into consideration in the future are not only national and regional factors that influence policies and strategies (such as the EU 2020 energy and climate change policy framework), but also global developments and challenges.

8 M. LaBelle, *ibid.*

9 This is mainly due to an overarching fact that the energy mix remains an exclusive competence of the EU's Member States, thus subject to national interests prevailing over a common EU approach to energy security and diplomacy.

10 P. Szalai, "Visegrad's energy security after Nabucco", *EurActiv.com*, 18 October 2013, retrieved 12 March 2014, www.euractiv.com/central-europe/visegrad-energy-security-nabucco-analysis-531129.

11 P. Szalai, *ibid.*

Visegrad region future challenges ahead

With the ongoing crisis in Ukraine, and continuing tensions between Russia and Ukraine *inter alia* in the energy sector, as well as new global energy developments such as the shale gas revolution, Visegrad countries are faced with the difficult challenge of adjusting their national and regional energy policies to mitigate potential risks to their energy security. Several options have emerged, however their potential feasibility remains largely unpredictable at this stage.

Firstly, the unprecedented boom in the extraction of shale gas in the United States, the so-called shale gas revolution,¹² is unlikely to be repeated on a similar scale in Europe. This is mainly due to “higher population density and different rules on land and resources ownership [as well as environmental concerns accompanying the process of shale gas fracking (extraction of gas from shale formations deep below the surface by pumping chemicals and water at high pressure)].”¹³ In terms of the Visegrad region, in 2012 Poland was termed the ‘Qatar of Central Europe’ for its endeavours in “giving out exploration concessions to companies with the production know-how and the means to invest [in shale gas fracking]”.¹⁴ The Slovak Republic and Hungary have cautiously followed Poland’s example: Slovakia has aimed to ascertain whether Polish shale gas reserves cross the mutual border, while Hungary has conducted drilling exploration to see whether it holds similar shale gas reserves as Romania and Bulgaria. Only the Czech Republic has remained sceptical on fracking, due to environmental concerns as well as high investment costs (which are three times higher in Poland than in the US).¹⁵ Thus, even though the Visegrad countries have explored this possibility to enhance their energy security, Europe and the Visegrad region in particular will likely remain largely dependent on conventional gas imports coming from established suppliers and/or potential upcoming ones.

In this regard, the four Visegrad countries addressed a letter to the Speaker of the US House of Representatives, John Boehner, in which they called for lifting the ban on US natural gas exports in order to mitigate the negative consequences on natural gas deliveries to the EU stemming from the tense situation between Russia and Ukraine.¹⁶ With this in mind, two questions arise immediately: first, would the high political support for lifting this ban be translated into practical reality?¹⁷ Second, if that would be the case, would this step make a difference for the energy security of Central European countries? An answer to the former remains to be seen, but the latter is yes: such a move could help to diversify gas supplies to the Visegrad countries (via LNG imports to the EU). However, due to high LNG prices in Asia, the US gas exporters may be prone to trade with this part of the world instead of Europe, where the prices are lower.

As outlined in the previous sections, the Central European region remains highly dependent on Russian oil and gas imports and this situation is unlikely to change in the foreseeable future. Looking at different options for the short-, medium- as well as long-term future, the Visegrad region’s most feasible possibility for addressing this dependence would be to make use of the internal energy market of the EU, mainly in terms of reversing gas flows and adding more supply by spot market trading and adding regional interconnections. At the same time, due to region’s geostrategic position and historical legacies, the Visegrad countries may need to keep balancing their position between the east and the west. Importantly, they also need to adjust their national energy mixes, both in terms of diversifying supply sources and supply routes. Hence, the already established cooperation and coordination will continue to be of crucial importance for the future energy security of the Visegrad region.

12 “Europe’s resistance to shale gas could boost renewables”, *EurActiv.com*, 24 August 2012, retrieved 20 April 2014, www.euractiv.com/climate-environment/eus-slow-take-shale-gas-boost-re-news-514421.

13 “Europe’s resistance to shale gas could boost renewables”, *Ibid.*

14 P. Szalai, “Gas in Central Europe: From Russia to Qatar And Back”, *V4 Revue*, 20 August 2012, retrieved 24 March 2014, <http://visegradrevue.eu/?p=1016>.

15 P. Szalai, *Ibid.*

16 “In Response to Russian Aggression, Key Central European Nations Plead for U.S. Natural Gas Exports”, *Speaker of the House John Boehner*, 8 March 2014, retrieved 8 May 2014, www.speaker.gov/press-release/response-russian-aggression-key-central-european-nations-plead-us-natural-gas-exports.

17 Upon receipt of this letter House Speaker John Boehner expressed his support for this initiative and called on the US President Barack Obama to approve pending natural gas export requests.



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