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## An Emerging Player in the Region: The Potential of Hungary on the EU Gas Market

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*With its rising prospects of supply diversification and accelerated integration with the regional gas market, Hungary stands a good chance of not only improving its energy security, but also emerging as a significant regional player. Such possibility should urge Poland to speed up its own efforts to liberalise the gas market if it wants to play a competitive role in regional gas trade. The European Union, in turn, while welcoming Hungary's infrastructure progress, should continue to observe the country's policy measures to ensure their compatibility with EU policies.*

In the mid term, Hungary's energy supply security will improve, and the same goes for the country's position on the regional gas market. A complex grid of interconnectors, the largest gas storage capacity in the region, prospects for additional supplies, a new natural gas exchange, and geographic proximity to both the Baumgarten hub and LNG terminals are all factors that contribute to this trend. This can bring Hungary a strategic position similar to that enjoyed by Ukraine in the context of the Brotherhood pipeline

**Hungary on the Regional Gas Market.** Natural gas is the most important component of Hungary's energy mix, accounting for almost 40% of the total. The country's natural gas consumption is expected to reach 12.6 billion cubic metres in 2012. The share of natural gas in Hungary's energy mix has more than doubled over the last 40 years, making the country fourth in the EU by percentage. Domestic output meets only a quarter of the demand; the rest is ensured by imports, which arrive through the Brotherhood pipeline in the east and the HAG pipeline via Austria. In both cases, however, the primary source is Russia. This means close to 80% dependence on gas from that country. Although some quantities of unconventional gas were found in the Makó area in south-eastern Hungary, extraction with currently known techniques is commercially unviable.

Following the 2006 Russia-Ukraine gas crisis, Hungary stepped up its efforts to become more integrated into the regional gas market. The country already has interconnectors joining its transmission system with five of its seven neighbours (Austria, Croatia, Romania, Serbia, and Ukraine). Another interconnector with Slovakia is due to be completed in 2015, while a connection with Slovenia is still at the planning stage. Developing cross-border connections contributes to supply source diversification in the long run; it also ensures alternative routes and access to gas at more competitive prices—especially if the interconnectors are upgraded with reverse flow capabilities and their capacity is expanded. By the end of the decade, Hungary may be able to receive LNG from the planned terminal in Croatia, while the lines with Romania and Slovakia would allow the country's infrastructure to integrate with the proposed Azerbaijan-Georgia-Romania Interconnector (AGRI) and the North-South Gas Corridor.

However, of all the Central European countries, Hungary has not only more interconnectors with its neighbours but also the largest underground gas storage infrastructure. It has five gas storage units with a total capacity of 6.1 bcm. Coupled with the interconnectors, these storage facilities can efficiently manage risk against regional crises—as in 2009 when Hungary made emergency supplies from its stockpiles to the Western Balkans.

Both the interconnectors and storage facilities will be put to a much better use with the launch of the Central Eastern European Gas Exchange (CEEGEX) in 2013, which will contribute to Hungary becoming a regional gas-trading hub. Moreover, the liquidity of gas trading via the new Hungarian gas trading platform could increase significantly with the arrival of competitive Caspian and Russian gas in the future.

**Multi-Track Pipeline Policy.** A vital element of the policy of supply diversification is seeking to be a party to all emerging transnational projects serving this purpose. This is made possible by the country's favourable geopolitical location. Apart from Bulgaria, Hungary is the only EU country that can play multiple cards by participating in all these projects, becoming a crucial transit country sooner or later.

As a result of this strategy, on 31 October 2012, Hungary's state-owned power company MVM signed the final investment decision with Gazprom on building the South Stream. The pipeline aims to transport Russian gas to Europe through the Black Sea. The country is also a member of the Nabucco West consortium, which is seen as a rival to South Stream and is designed to transport Caspian gas. After alleged plans to quit the project in the spring, surprisingly in August Hungary was the first country to submit environmental permits. Finally, Hungary is a signatory to AGRI, which is still at the phase of feasibility studies.

So far, the Hungarian government has been successfully balancing between Nabucco West and South Stream. But if both these projects are eventually carried out, Hungary may have to make the choice for economic reasons. Nabucco West would be a more advantageous option because it would provide access to a much desired alternative to gas from Russia. However, the need to negotiate a new long-term gas delivery contract with Gazprom starting from 2015 will give Russia an opportunity to pressure Hungary to focus primarily on South Stream.

**Increases in State Control of the Gas Market**. In addition to gas supply diversification, a further feature of the Orbán administration's energy policy is to increase state control over the country's energy and utilities sector. The goal is to negotiate lower long-term gas tariffs with Gazprom. But the ability to provide cheaper energy for consumers would also boost the Fidesz party's popularity ahead of the 2014 parliamentary elections.

To this end MVM is now negotiating the purchase of the Hungarian subsidiary of E.On Ruhrgas, which controls around 70% of the gas market. Moreover, the government is thinking of pre-emptively taking over natural gas reserves from MOL, another key player in the energy sector. The government has already increased its role in MOL by buying a 21.2% stake from Russia's Surgutnieftiegaz in June 2011. The final objective can be to merge MVM and MOL and turn the group into a national monopoly and a highly competitive regional player. This would fit well with the idea of Hungary as a major energy player in the region in the future.

**Recommendations for Poland and the EU.** Such a strengthening in Hungary's position should be beneficial for the Visegrad Group (V4), especially after an agreement on the integration of the gas systems in the region was signed on 31 October 2012 in Warsaw. Hungary's role is important since the country will provide access to new supply sources and routes. It is thus recommended for Poland to continue its efforts to timely complete its interconnector with Slovakia, which will eventually join it with Hungary as part of the North-South Gas Corridor after the opening of the Hungarian-Slovak connection.

However, while infrastructure cooperation is in the interest of both Hungary and Poland, both countries have ambitions to emerge as regional trade centres. Similarly to CEEGEX, Poland plans to set up a gas-trading hub in the future LNG port at Świnoujście, which would primarily serve northern, but also Central European markets. Bearing in mind the pace of developments in Hungary, Poland should speed up the completion of its Natural Gas Release Programme as part of the gas market liberalisation process. Poland should also accelerate legal preparations to enable the launch of exchange-based wholesale gas trading, a project scheduled to kick off at the end of this year, but probably not fully operational before 2013.

From the EU's point of view, Hungary's efforts to decrease its energy dependency and become better integrated with the regional gas market are welcome. However, the country's plans to increase the government's role in the sector are far less liberal than the EU policy line. In a communication released on 15 November, the European Commission expressed its concern over recent limitations in the independence of Hungary's national energy regulator as well as other measures that hinder equal access to markets. Therefore, the Commission should closely watch Hungary's energy policy to make sure it does not reduce competition.