



BULLETIN

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Window to the West: The Importance of the Czech Natural Gas Market for V4

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In comparison with other Visegrad countries, the Czech Republic's gas security is relatively high, especially following its connection to Nord Stream in January 2013. This move is the result of a resolute policy of diversification, which, coupled with good infrastructure and its accelerated adaptation to the regional gas market, will, in the mid-term, strengthen the country's position in Central Europe. This may also be beneficial for the V4 and Poland, and that is why better integration into the Czech transit system should become a strategic priority.

At first glance, the Czech Republic—a landlocked state with very low domestic output and high dependence on imports—may be seen as vulnerable in terms of gas security. However, thanks to an early and resolute policy of diversification, sound prospects for additional supplies, and a well-developed domestic market and infrastructure, the country should, in the mid-term, actually be considered as one of most secure in the region. This can also be beneficial for the other three Visegrad members. In the wake of the 2012 declaration on the integration of their gas systems, the Czech Republic may become for them a window to western markets, providing liquidity of supplies from Germany, Norway and the gas hub in Austrian Baumgarten.

Gas in the Czech Energy Mix. The Czech Republic and Slovakia have the lowest domestic natural gas output of all Visegrad countries. In the Czech Republic production is located primarily in south Moravia, which meets less than 2% of demand; the rest is ensured by imports. Although its primary source is Russia, which provides around three-quarters of its gas needs, the Czech Republic's import structure is still more diversified than that of any other V4 member, since the rest of the gas comes from a consortium of Norwegian producers (30–35%) and German gas exchange (5–7%). This is particularly important as demand for supplies in the country should only increase. Today in the Czech Republic there is relatively low demand for gas, which—unlike in Hungary and Slovakia—is not the most important component of the energy mix. It accounts for around 20% of the total mix, lagging behind coal (40%), ties with oil (20%) and “other” sources (20%), among which nuclear energy in particular is gaining in importance. However, it is very likely that the country's gas consumption will grow, and could reach more than 12 bcm in the coming decade, compared to 8.8 bcm in 2012, especially if the plan to build gas-fired power plants is implemented.

The Czech Republic on the Regional Gas Market. Unlike in Hungary and Slovakia, the 2006–2009 Russia–Ukraine gas crises were not the initial impulse for diversification of sources and supply routes in the Czech Republic. The country began the process of breaking its dependency on Russian supplies in the middle of 1990s, before Moscow had even noted the potency of energy as a foreign policy tool. A clear “back to the west” policy has informed energy issues, prompting an end to more than 50 years of complete dependence on supplies from the east, and leading to a change of policy notably in oil (Ingolstadt–Kralupy–Litvinov pipeline), and nuclear energy (Temelin power plant).

In the specific area of gas, the Czech Republic adopted a broad policy of integration with the German market, and in April 1997 took the important step of signing an agreement with Norway for the delivery of natural gas for 20 years. The Norwegian agreement usually supplies, in effect, “virtual” gas, swapped for Russian gas and delivered via German pipelines. During regional crises, however, this option remains feasible, as was proved in 2009, when “physical” Norwegian gas was imported directly, helping—together with the Czech Republic's large storage capacity—efficiently manage the risk of sudden cuts in imports.

The choices made in the initial period of political transition provided the country with greater energy security, and that policy continues, not least due to the high price of Russian gas arriving through the Brotherhood pipeline. In January 2013, after opening the Gazelle pipeline, which connects to Nord Stream via German OPAL, the Czech Republic not only limited its dependence on supplies coming through Ukraine, but also raised its strategic importance as a transit country, transferring gas to southern Germany and France, and opening the possibility of supplying neighbouring Slovakia and beyond. The Polish–Czech interconnector (Tranovice–Cieszyn–Skoczow), opened in 2011 and still in line to be upgraded, may in the long run give the Czech Republic access to Liquefied Natural Gas (LNG). Moreover, the Czech–Austrian interconnector (Lanzhot–Baumgarten or Ceske Budejovice–Oberkappel) should be constructed by 2017 at the earliest, which will connect the country directly to the regional gas hub and later maybe also to the Nabucco West as well as to Compressed Natural Gas (CNG) from seaports in Italy.

After Hungary, the Czech Republic also has the second largest underground gas-storage infrastructure of the V4, comprising ten storage units with a total capacity of 3.25 bcm. The government is working to better integrate these facilities, which are mostly located in the eastern part of the country, with the transmission system. The latter is best developed in the west and south, with three border delivery stations and five compressor stations, with the primary purpose of capturing supplies from Russia and Germany. Efforts to integrate the east—important also because of the location of the country’s industrial regions—include building the South-East Moravia pipeline (Tvrdonice–Libhost). Significantly, construction, scheduled for 2017, can also improve supply flows between Poland and Slovakia, acting as a link between the two.

EPH: a New Key Gas Player in the Region. In addition to gas diversification and infrastructure, a vital element of the gas market in the Czech Republic is the regional expansion of the conglomerate EPH (Energy and Industrial Holding), owned by the group headed by businessman Petr Kellner. EPH already possesses coal mining companies in Germany and Poland as well as Czech heating plants. Additionally, in January 2013, EPH struck a deal to buy the non-state shares of the Slovakian natural gas company SPP, an owner of Eustream—which supplies Slovakian customers with gas and transports Russian gas across the country—from Germany’s E.ON Ruhrgas and the French GDF Suez. The deal makes EPH an important gas player in the Czech Republic and Slovakia. This is part of a strategy by EPH, which, as a non-state company subject only to business calculations, openly expresses its aspiration for permanent growth; but it is also a reaction to the economic problems of western European utilities, which are generally withdrawing from the region. This withdrawal has recently allowed EPH to confirm its interest in the German-owned Net4Gas, which is an operator of the Czech gas transmission system. The transaction would allow better integration of Czech and Slovak systems, making EPH one of the most powerful energy companies in central Europe.

Recommendations for Poland. If the abovementioned Czech–Austrian interconnector and Moravia pipeline are implemented, they can both contribute to diversification in each of the V4 nations significantly. For Poland as well as for Slovakia, with which the Czech Republic has already strengthened the East–West reverse flow, and to a lesser degree for Hungary–Czech connections may become an important alternative to eastern supplies and routes, giving access to the gas hub in Baumgarten and—thanks to Czech-German gas interdependence—access to western markets. However, the sine qua non of achieving that is better consolidation with the Czech transit system. One solution is to upgrade the Polish–Czech interconnector, which has a current capacity of 0.5 bcm gas per year and simply cannot meet these demands. The second solution, also taken into consideration, is to build a new interconnector (probably Libhost–Hat–Kedzierzyn, with a maximum capacity of 10.5 bcm gas per year). Whichever option wins, it is recommended that Polish integration with the Czech Republic (also in the context of developing Poland’s interior gas system) is given high strategic priority.

What, though, may be quite disturbing for Poland, is EPH’s rapid expansion. Its recent transactions in Slovakia and planned purchase of Net4Gas raise concerns not just about the future of the Polish–Czech interconnector (co-constructed by Net4Gas), but also about the planned Polish–Slovak interconnector (co-constructed by Eustream). EPH has not yet declared its clear interest in continuing these two projects, and the Polish side should do its best to maintain the new owner’s attention—all the more so because it is still likely that, for the Czech Republic, development of its northern connections may come a distant second compared to linking with the gas hub in Baumgarten, especially if the necessity of connecting the LNG terminal in Swinoujscie with Poland’s southern border continues to be neglected.

Moreover, due to a gradual withdrawal of western energy investors from the central European markets, a tendency to create strong local monopolies is visible: apart from EPH, the other key player, Hungary’s MOL, is likely to become stronger, especially if the government in Budapest decides to merge it with the country’s other power company, MVM¹. Although the recent experiences of PKN Orlen in the Czech Republic may be discouraging, Polish companies would do well to become more active in the regional energy markets, which still offer trading opportunities as energy connections are being developed. Authorities in Warsaw should, in turn, increase their efforts to promote these companies abroad. Furthermore, although the Polish national gas monopoly (PGNiG) gives priority to gas exploration in Poland and is therefore unlikely to engage in central Europe in the mid-term, developing the company’s openness in the region, that could go together with the liberalisation of the country’s market, is recommended in the long run.

¹ D. Kałan, A. Sobják, “An Emerging Player in the Region: The Potential of Hungary on the EU Gas Market”, *PISM Bulletin*, no. 112 (445), 30 November 2012.