

Slovakia: looking for a new role on the natural gas map

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In mid-May the Slovak gas operator Eustream introduced a plan for Slovakia to integrate more closely with the gas markets in Austria and the Czech Republic. This plan includes the creation of a 'virtual pipeline' in the Slovak gas system which will facilitate gas trade between the Austrian, Czech and Slovak markets. This is not the first such initiative by Slovakia, which is working to maintain its status as an important transit state for the transport of gas, in response to Russia's strategy of bypassing Ukraine (and by extension Slovakia). Since the Nord Stream gas pipeline was activated, the amount of gas transferred via Slovakia fell by 37% in 2011-2014; moreover, as Gazprom has announced, Russia intends to cease gas transit through Ukraine completely after 2018. In a situation where Slovakia has no chance of maintaining its traditional role as a key route for Russian gas to Western Europe, Bratislava has been looking for ways to take on a role as a regional crossroads. Last year, Slovakia started a gas reverse on its border with Ukraine, allowing gas to be sent from Western Europe to the East. Bratislava has also taken steps for its infrastructure to be used to link the markets of central and south-eastern European countries by promoting the Eastring pipeline, among other measures. The Slovakian initiatives are also part of an ongoing process of building up the EU gas market, which inspire the countries in the region to mutual integration and deepen their links with Western gas markets.

The Slovak initiative for gas integration with Austria and the Czech Republic

The announcement by Eustream, a company belonging to the Slovak state and the Czech company EPH, concerning its concept for integrating the Austrian, Czech and Slovak gas markets, is only preliminary, and thus rather general in nature. It was announced that these three markets could be integrated thanks to a significant increase in the capacity to import gas from the Czech Republic at the Lanžhot point, from 67 to 140 million m³ per day (i.e. from 24.5 to 51 bcm per year). Eustream also proposes the creation by 2018 of a 'virtual pipeline' within the Slovak gas system, which would link the Czech market to the Austrian hub at Baumgarten (which since 2013 has been operating under the name of CEGH). Eustream's announcement refers to the application of the so-called market coupling mechanism, which closely ties the allocation of cross-border capacity to the trading process in coupled markets. This method is modelled on the integration of electricity markets and has never been tried on the gas market so far. Currently, planning is under way on possible uses of this mechanism in the planned integration of the gas markets of Spain and Portugal (the so-called Iberian project), as well as in three French gas zones operating independently of each other.

The Slovak idea for integration with the Czech Republic and Austria is a part of the process of finding a formula for integrating the gas markets of Central Europe, which is a part of the wider debate on establishing a final gas market model for the EU. One of the predominant ideas in this debate is the linkage of the region's smaller domestic gas markets. This should allow for greater liquidity, diversification and competition, and the lowering and levelling of gas prices. The most ambitious project in Central Europe which meets the ambitions for the wider gas market was the proposal (presented in 2012) to establish a Central European 'trading region' made up of Austria, the Czech Republic and Slovakia (CEETR). This idea is based on the fusion of three wholesale markets (while maintaining the autonomy of the end users balancing zones), and on establishing a common, virtual trading point. This would almost certainly be the Austrian CEGH hub, as it is the highest trade turnover point in the region. The idea of the trading region is strongly supported by the Austrian regulator E-Control and the Czech gas operator NET4GAS, but Slovakia's Eustream withdrew from the project in mid-2013, without giving clear reasons for doing so. It can be assumed that Eustream did not support the idea because its implementation would have led to the loss of revenues from the fees charged at the connectors with Austria and the Czech Republic. It is no accident that the concept which the Slovak operator is now proposing – although it does represent a step towards integration – still assumes that the three domestic markets will continue functioning with a high degree of autonomy. This shows that Eustream is interested in integration, but on a basis which ensures that it will make big profits, and will have the greatest possible influence on how the linked markets operate.

Infrastructure offensive

In parallel with its offer of closer integration of the gas markets in Central Europe, Slovakia has put forward new proposals for infrastructure solutions which would further strengthen its role as a transit country. In September 2014, Slovakia launched the biggest gas reverse to Ukraine in Central Europe. This currently allows a continuous supply at 14.6 bcm per year (for comparison, the gas reverse from Poland amounts to 1.4 bcm, and from Hungary 6.1 bcm, both of which operate on the interruptible basis, which *de facto* means lower supplies). As a result, since the beginning of this year, Ukraine has imported half of its gas from the West. A gas link between Slovakia and Hungary is also planned for launch in the middle of 2015. Work continues on constructing the first gas connector from Poland, which is scheduled to come online in late 2018. Eustream has presented a proposal to build a new pipeline, Eastring, which would connect Slovakia to Romania and Bulgaria via Ukraine or Hungary. It would have an initial capacity of 20 bcm (with a target of 40 bcm) and allow gas supplies both from Turkey to Central Europe, as well as from Western hubs to the countries of South-Eastern Europe. During the Eastern Partnership Summit in Riga, the governments of Slovakia, Hungary, Romania and Bulgaria gave their initial support to the idea of building this bus, although its name was not mentioned in the declaration they signed.

The Russian context

Since the 1970s Slovakia has played a key role in the transit of Russian gas to the West. This has brought considerable revenues to its budget (around €150 million per year). This favourable situation for Slovakia changed with the launch of the Nord Stream gas pipeline in

November 2011 (gas transmission fell from 74 bcm in 2011 to 46.5 bcm in 2014). The Slovak-Russian agreement on gas transit, which is binding until 2028, obliges Gazprom to use Slovakia's infrastructure under a 'ship or pay' clause, but Russia's announcement that it will cease gas transit via Ukraine after 2018 has been met with anxiety in Bratislava, and this topic will be discussed during Prime Minister Robert Fico's visit to Moscow in June. On one hand, Slovakia wants to continue reaping the benefits of the current configuration for as long as possible, but Russia's current export strategy, assuming that Ukraine will be bypassed, has forced Eustream to look for new business solutions.

The Slovak gas networks are designed to transfer nearly 90 bcm per annum (domestic demand is around 5 bcm per year). For this reason, the key objective of Slovak gas policy is to maintain the country's role as a transit state. The large amounts of gas flowing to the West over the years also guaranteed Slovakia security of supply. This situation has been changed by a series of Russian-Ukrainian gas conflicts, which has led Slovakia to expand its cross-border connections in order to ensure its energy security in the event of disruptions to supplies from the East. For Eustream and the Slovak government, diversifying transit routes is more important than diversifying gas sources. Both Prime Minister Fico and Eustream representatives have emphasised in their statements a desire to maintain close cooperation with Gazprom on the supply and transit of gas. Fico has emphasised that the Easting project can be reconciled with Russian plans for gas transit via Turkey. Nevertheless, Slovakia is clearly trying to create additional opportunities for the use of its infrastructure.

The Central European context

The process of Central European gas integration between Austria, the Czech Republic and Slovakia would not be possible without close infrastructural links between these countries. However, there are no large-capacity connections on other borders in the region (the Polish-Czech connector can take 0.5 bcm, the Hungarian-Slovak connector 4.4 bcm, and the Hungarian-Austrian connector 4 bcm, and the Polish-Slovak one is missing). The integration process is also being strengthened by capital ties between the companies. The Czech energy holding EPH has managerial control and 49% of the shares in the Slovak operator Eustream, which in turn has a 15% stake in the Austrian CEGH hub. At the same time, the CEGH hub is working closely with the rapidly growing Czech energy and gas exchange PXP (the Prague Stock Exchange, which belongs to the same financial group as the Vienna Stock Exchange, itself a shareholder in CEGH). Nevertheless, it is worth noting that the Czech Republic and Austria have so far opted for a much deeper formula for integration, and they may consider the Slovak project to be too unambitious.

If the integration of the gas markets of Austria, the Czech Republic and Slovakia is successful, it will be of great significance for the potential creation of a common gas market in the Visegrad Group. The process of building the V4 regional gas market was launched in mid-2013 (Road Map towards a Regional V4 Gas Market). Currently, this does not provide for any far-reaching integration mechanisms (such as market coupling, or a more advanced trading region). The focus so far has been on cooperation to improve the security of gas supplies, and on harmonising the implementation of EU network codes. In the longer term, the development of wholesale markets and the growing role of north-south flows (which will intensify thanks to the launch of the Polish LNG terminal and the construction of the

necessary cross-border gas pipelines, among other projects) will on the one hand create opportunities for the other countries in the region to join the integration processes which Austria, the Czech Republic and Slovakia are in the forefront of creating; and on the other hand, open up the way for Poland and Hungary to cooperate in other regional integration plans.