

Croatia's Approach to Russian War

in Ukraine:

How the EU Was
Suddenly Forced
to Deal with Its
Decades-Long
Dependence
on Russian Energy
and to Look
for a Way Out



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In February 2022, Russian troops invaded the sovereign territory of Ukraine in an attempt to overthrow the regime of President Volodymyr Zelensky and install a compliant one which will take their orders from Moscow and Russian president Vladimir Putin. Russia made an identical move almost eight years ago, when it invaded the Crimean Peninsula in February 2014 and illegally annexed it. Later that year, Russian-backed armed forces seized government buildings in the Donetsk and Luhansk regions – now self-proclaimed independent republics. While the sanctions on Russia were already imposed by the international community, they clearly did not deter further escalations of Russia's actions, eight years later.

Russia weaponized its energy resources and used them as a countermeasure against European sanctions, cutting down the energy supply, and forcing the EU to take multiple measures in order to preserve its economy and to step up its efforts in becoming green, sustainable, and no longer dependent on Russia.

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RUSSIA
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AS A COUNTERMEASURE
AGAINST EUROPEAN
SANCTIONS

Unlike the events that have taken place in 2014, a full-scale invasion in 2022 brought forth a much stronger international reaction and accompanying sanctions, as well as unity, most likely surprising the Russian leader. However, this time the world experienced a much different scenario in the form of the first major global energy crisis. The crisis itself prompted the European Union in particular to double down on its green agenda, reducing the dependency on the imports of Russian fossil fuels. Still, decades of dependency on Russian energy made such a transition impossible, at least in the short run. So, for the last 18 months, EU member states had to help the economy and its citizens deal with rising energy prices, and consequently rising costs of everyday items.

While it would be wrong to say that the Russian invasion of Ukraine is the sole culprit for the current economic environment, it did contribute to it. The world just recently declared the end to the COVID-19 pandemic, which severely damaged international supply chains, and before that, a worldwide increase in inflation began in mid-2021, which is still plaguing global economies, creating instability before February 2022¹. CEE states were among many to introduce aid packages worth billions of euros in order to prevent more severe economic consequences in the form of price regulations, further business support, and money transfers to vulnerable groups in the society².

¹ Attinasi, M. et.al. (2021) "Supply Chain Disruptions and the Effects on the Global Economy", [in]: *ECB Economic Bulletin*, Issue 8/2021. Available [online]: https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202108_01-e8cceebe51f.en.html

² <https://www.bruegel.org/dataset/national-policies-shield-consumers-rising-energy-prices>

Europe's golden hour has finally arrived, a perfect storm of need and opportunity. Firstly, following the COVID-19 pandemic, and the economic hit it took, the European Union has decided to double down on its commitment to rebuilding the continent's economy to be more green, circular, and sustainable. EU funding across the continent is conditioned on implementing green, more efficient technology, and sustainability of its natural resources.

The EU's economy will need to be fueled to a greater extent by green sources which include wind, solar, hydrogen, and nuclear energy. Secondly, Russian aggression has added further impetus to the speed of a green transition and to invest even more heavily into the development of innovative infrastructure, which will serve to transport hydrogen.

EUROPEAN DEPENDENCE ON RUSSIAN ENERGY

For decades, the European continent was becoming increasingly reliant on Russian energy sources. In 2021, EU countries imported 155 billion cubic meters (bcm) of Russian gas, which accounted for about 45 percent of total gas imports³. Before the Russian aggression in Ukraine, Russia was also one of the largest suppliers of crude oil to the European Union (108 million tons), and the largest supplier of petroleum (91 million tons)⁴. Furthermore, the EU also imported a little over 50 million tons of coal, whereas 18 of its nuclear power blocks were fueled by Russia (six in the Czech Republic, four each in Hungary and Slovakia, and two each in Finland and Bulgaria)⁵.

³ <https://ecfr.eu/article/conscious-uncoupling-europe-ans-russian-gas-challenge-in-2023/>

⁴ Ibid.

⁵ Ibid.



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The rationale for such policies is beyond the scope of this article, but whatever policies there were in place to support such a system, they are gone as of February 24, 2022. On that day, the narrative according to which Europe and Russia are equal trading partners in this deal (and that Europeans need Russia as a supplier as much as Russia needs Europeans as customers) fell apart. Warnings from foreign partners to the EU that such a strong dependence in this strategic sector is something to be taken seriously, went largely unnoticed⁶. Cooperating with a nation whose fundamental values are so different from those of the EU, turned out to be impossible.

⁶ <https://www.marshallcenter.org/en/publications/occasional-papers/europes-dependence-russian-natural-gas-perspectives-and-recommendations-long-term-strategy-0>

Table 1: Dependence Upon Russian Natural Gas by Selected Former Soviet and Former Soviet Satellite Countries (2004)

Country	"Quantity (in billion m ³ /year):"	o/o of Domestic Consumption
Estonia	13	100
Latvia	14	100
Lithuania	28	100
Moldova	28	100
Belarus	198	99
Bulgaria	28	99
Slovakia	64	99
Finland	46	98
Greece	22	82
Czech Republic	72	77
Austria	60	69
Turkey	143	65
Hungary	90	64
Slovenia	056	52
Poland	60	43
Germany	365	42
Ukraine	240	35
Italy	242	31
France	115	28
Romania	39	22
Netherlands	27	6

Source: Gelb, B. A. (2007) *CRS Report to Congress: Russian Natural Gas: Regional Dependence*, p. 3. Available [online]: <https://sgp.fas.org/crs/misc/RS22562.pdf>

NOTE: Table 1 includes almost every CEE nation, with data collected almost 20 years ago. It is, however, likely that such numbers have gone up in many of those countries.

A relatively cheap (compared to today's situation) and steady supply of Russian fossil fuels, predominantly LNG, was the main benefit from this partnership. LNG, being a much cleaner resource than oil and coal, also fits in nicely with the EU's Green Deal. There is no question that in terms of renewable energy policy, the EU is ahead of many nations across the globe, trying to develop a sustainable and circular economy that will support economic growth, while at the same time preserving the environment.

However, it failed to recognize the risk that comes with dependence on Russian energy – predominantly gas. According to the papers by the European Commission, in the next few decades, the EU would end up importing 80% of its natural gas, with 60% of those imports would be supplied by Russia⁷. Meanwhile, in 2007, the report⁸ handed to the U.S. Congress (using data from 2004) presented a concerning piece of evidence, showing an almost total dependence by some countries on Russian natural gas [See: Table 1].

Following its invasion of Ukraine, Russia has weaponized its natural gas and oil supply in order to strike back against the sanctions implemented by the EU and the U.S. It would be difficult to say that there were not certain warning sounds. In 2006, the European Union experienced a brief energy crisis when Russia threatened to cut off energy supplies to Belarus, Georgia, Moldova, and Ukraine. It should have been clear then that Russia was ready to use its energy supply as a weapon against those who do not act the way Russia wants them to.

⁷ The European Union (2006) Green Paper: "A European Strategy for Sustainable, Competitive and Secure Energy", p. 3. Available [online]: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52006DC0105>

⁸ Gelb, B. A. (2007) *CRS Report to Congress: Russian Natural Gas: Regional Dependence*, p. 3. Available [online]: <https://sgp.fas.org/crs/misc/RS22562.pdf>



BEFORE THE RUSSIAN AGGRESSION IN UKRAINE, RUSSIA WAS ALSO ONE OF THE LARGEST SUPPLIERS OF CRUDE OIL TO THE EUROPEAN UNION

The International Monetary Fund⁹ estimated that some of the most affected countries facing the biggest economic difficulties ahead are countries in Central and Eastern Europe – Hungary, the Slovak Republic, and the Czech Republic. In those states, there is a risk of shortages of as much as 40% of gas consumption and of gross domestic product shrinking by up to 6%. The impacts, however, could be mitigated by securing alternative supplies and energy sources, easing infrastructure bottlenecks, encouraging energy savings, all while protecting vulnerable households and expanding solidarity agreements to share gas across countries.

Even though the analysis was done in 2022, and the worst (so far) has been avoided, it speaks of the fragile grounds that CEE economies are now standing on. The EU's own data showed only moderate GDP

⁹ <https://www.imf.org/en/Blogs/Articles/2022/07/19/blog-how-a-russias-natural-gas-cutoff-could-weigh-on-european-economies>

growth in the spring of 2023 (1%) and 2024 (1.7%), with inflation at 6.7% in 2023, and 3.1% in 2024¹⁰. The European Union must now find a way to reduce its dependency on the Russian energy supply by forming partnerships with like-minded countries, which share its values. While the ultimate objective is clear, in the short run, the EU is forced to mitigate risks immediately.

SO, WHAT HAS THE EU DONE TO ADDRESS THE ENERGY CRISIS?

On March 8, 2023, the European Union published its *REPowerEU* plan, outlining measures to become completely independent from Russian fossil fuels well before the end of the decade. The key elements in this plan are “*diversifying supplies, reducing demand, and ramping up the production of green energy in the EU*”¹¹. In accordance with the plan, the EU has opened to working with international energy partners such as Norway, Japan, South Korea, and Qatar to develop their cooperation on LNG.

Since the beginning of the energy crisis, the European Union has also undertaken several steps to ensure the stability of the market by diversifying its supply. These steps, while useful, have not completely annulled the negative effects – and no one should have been surprised by that. Decades of reliance cannot be undone in a single year. Nonetheless, the Russian supply of gas has gone down – between January and November 2022, Russia (pipeline gas + LNG import) stood for less than a quarter of EU gas imports. Another quarter came

¹⁰ European Commission (2023) *Spring 2023 Economic Forecast: An Improved Outlook Amid Persistent Challenges*. Available [online]: https://economy-finance.ec.europa.eu/economic-forecast-and-surveys/economic-forecasts/spring-2023-economic-forecast-improved-outlook-amid-persistent-challenges_en

¹¹ https://commission.europa.eu/news/focus-reducing-eus-dependence-imported-fossil-fuels-2022-04-20_en



COOPERATING WITH A NATION WHOSE FUNDAMENTAL VALUES ARE SO DIFFERENT FROM THOSE OF THE EU, TURNED OUT TO BE IMPOSSIBLE

from Norway, and 11.6% from Algeria. LNG imports (excluding Russia – mainly from the United States, Qatar, and Nigeria) stood for 25.7%¹².

In October 2022, the European Commission proposed joint gas purchases, along with a price limiting mechanism, and called on solidarity between member states in order to prepare for the upcoming winter. Along with that, it imposed a 5% obligation to reduce electricity demand during peak price hours, set a 15% gas demand reduction target, and mandated minimum underground gas storage levels in the EU by November 1, 2022, as of June 2022. The EU reached those levels two months before the deadline. The 2022/2023 winter was mild with above-average temperatures, leading to relatively calm markets without major problems.

¹² European Commission (2023) *Where Does the EU's Gas Come From?*. Available [online]: <https://www.consilium.europa.eu/en/infographics/eu-gas-supply/>

However, replenishing storage for the 2023/2024 winter will be harder if Russian gas flows cease completely. The estimated import of Russian gas at the moment amounts to only 10 bcm, compared to 62 in 2022 and 146 in 2021¹³. This year, the EU faces several different problems. While the demand side is growing and becoming more competitive, no significant growth in LNG supply is expected on the world market this year¹⁴. The ECFR also reports that despite a drop in Russian exports, Russia remains the second largest exporter to the EU after the U.S. Finally, the report points out that major gas suppliers will not be able to significantly increase their supply this year¹⁵.

Lastly, EU member states have presented measures (including price caps, financial transfers to consumers, VAT interventions, etc.) to mitigate the impact of high prices on households and businesses. Nonetheless, in the long run, the EU must develop additional energy infrastructure.

LNG TERMINAL IN CROATIA: A STEP FORWARD TO SECURING A MORE STABLE ENERGY SUPPLY FOR EUROPE

After decades of dependence on Russian oil and gas, Europe must diversify its energy supply, and Croatia has the potential to provide some relief in terms of secure and safe energy supply. While the capacity of the floating liquified natural gas (FLNG) has been increased from 2.9 billion cubic meters (bcm) to 6.1 bcm annually¹⁶, it is still

¹³ <https://ecfr.eu/article/own-goal-how-russias-gas-war-has-backfired/>

¹⁴ <https://ecfr.eu/article/conscious-uncoupling-europeans-russian-gas-challenge-in-2023/>

¹⁵ Ibid.

¹⁶ The Croatian government (2023) *Povećanje kapaciteta LNG terminala; Filipović: Nastavlja se jačanje energetske sigurnosti Hrvatske*. Available [online]: <https://vlada.gov.hr/vijesti/povecanje-kapaciteta-lng-terminala-filipovic-nastavlja-se-jacanje-energetske-sigurnosti-hrvatske/38133> [in Croatian]



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far from the capacity of the onshore LNG facility capable of securing larger quantities of liquified natural gas to Europe, which would be considered significant.

The successful establishment of the LNG terminal in Croatia will open up significant opportunities for the country's economy. It will further position Croatia as a gateway for LNG shipments to Central and Eastern Europe, attracting investments and fostering regional energy cooperation. Finally, Croatia has a place on the energy map of Europe, and the potential to become an even bigger player in it. However, a myriad of problems surrounding the construction of an onshore facility prevents it to take over a more significant piece of the burden that is safe, reliable, and plentiful energy supply after the Russian invasion of Ukraine.

WHY DOES IT MAKE SENSE?

Croatia, located in the heart of Europe, has emerged as a significant player in the global liquified natural gas (LNG) market. The country has established itself as a hub for energy diversification and security by constructing a state-of-the-art LNG terminal. The development of this terminal repre-



DECADES OF RELIANCE CANNOT BE UNDONE IN A SINGLE YEAR

sents a major milestone for Croatia's energy infrastructure, opening up new possibilities for both domestic consumption and international trade.

The LNG terminal in Croatia offers numerous benefits to the country and the broader region. It provides an alternative source of natural gas, reducing dependence on traditional pipelines and enhancing energy diversification. The terminal also has the potential to increase competition in the natural gas market, leading to improved pricing and supply options for consumers. Furthermore, the terminal's operations align with Croatia's commitment to environmental sustainability, as LNG is a cleaner fuel compared to other fossil fuels.

Prime Minister Andrej Plenković said: *"This terminal in Croatia, combined with those in Lithuania and Poland, forms a new point on the north-south corridor for the diversification of gas supply and competition in Central and Eastern Europe"*¹⁷. However, the LNG terminal on the island of Krk has been marked as a project of strategic importance for the country, the wider region,

¹⁷ The Croatian government (2021) *Otvaranje LNG terminala na Krku je povijesni trenutak kojim se mijenja položaj Hrvatske na energetske karti Europe*. Available [online]: <https://vlada.gov.hr/vijesti/otvaranje-lng-terminala-na-krku-je-povijesni-trenutak-kojim-se-mijenja-polo-zaj-hrvatske-na-energetske-karti-eu-ropce/31404> [in Croatian]

as well as the whole of Europe for the last 28 years.

According to the information provided in the Croatian Chamber of Economy's document on the LNG terminal¹⁸, the first feasibility study and technical documentation for the LNG project dates back to 1995. In 2006 the ADRIA LNG consortium is founded (the founders of ONV, German EON, French TOTAL, Czech-German RWE Transgas, and the Slovenian GEOPLIN), which takes over the documentation for construction of an onshore LNG terminal.

In 2015, the Ministry of Construction and Spatial Planning arrangements issues a location permit. However, because of the opposition from the local community, lack of funding, numerous legal problems, bureaucracy and administration, the project for an onshore full-fledged LNG terminal was postponed, and in 2021 the floating LNG (FLNG) facility in the form of a carrier ship was set-up. The plans for the onshore terminal are still there, mainly because the FLNG terminals have a lifespan of about 10 years.

ADAPTIVE MEASURES BY CEE STATES

Ever since Russia invaded Ukraine, the European Union has implemented measures to mitigate the historic rise in energy prices. The EU was forced to diversify its supply of energy. A *Trilateral Memorandum of Understanding* was signed between the EU, Egypt, and Israel for the export of natural gas to Europe, a *Memorandum of Understanding* with Azerbaijan on a Strategic partnership in the field of energy, whereas the United States committed to provide the EU with an additional 15 billion cubic meters of LNG in 2022. As a result, in

¹⁸ Croatian Chamber of Commerce (2018) *Hrvatski UPP (LNG) terminal*. Available [online]: <https://www.hgk.hr/documents/hrvatski-upp-lng-terminal5a9e3b8dccb7e.pdf> [in Croatian]



THE SUCCESSFUL ESTABLISHMENT OF THE LNG TERMINAL IN CROATIA WILL OPEN UP SIGNIFICANT OPPORTUNITIES FOR THE COUNTRY'S ECONOMY

the first half of 2022, non-Russian LNG imports rose by 19 billion cubic meters (bcm) as compared to the same period last year¹⁹.

The EU has also introduced the *European Gas Demand Reduction Plan* to help member states reduce gas demand by 15%²⁰. In May, the EU adopted the *REPowerEU* plan to end its dependence on Russian fossil fuels as soon as possible. On October 18, 2022, the European Commission proposed new measures on joint gas purchasing, price limiting mechanisms, and transparent infrastructure use, as well as on solidarity between member states and demand management, and finally began mandating 15% minimum gas storage obligations for all EU countries.

The entire European community has implemented some form of measures designed to shield consumers from rising prices, and most of them were aimed at the prices of energy and, naturally, the impact they had on the rise on the cost of living. Let us take a brief look at a couple of CEE countries and what measures they implemented since energy prices started rising. These were selected primarily because their example shows to what extent various states went to protect their economies, as well as their different approaches.

CROATIA: SUPPORTING CITIZENS AND BUSINESSES WITH FOUR EXTENSIVE SETS OF MEASURES

The first package²¹ of measures was announced on February 16, 2022. The package was worth HRK 4.8 billion (app. EUR 636 million) and aimed at mitigating the growth of energy prices, which will limit the electricity prices. The package limited the price rise in electrical power to 9.6%, and gas to 20%. The amount of support directly on the account is 10 Lipa (app. 1.3 eurocent) per kWh, which is about 20% of the projected price of EUR 66 per MWh.

The government added that the cost of this measure is HRK 600 million, and financing will be provided by auctioning greenhouse gas emission units. Further government measures included a permanent reduction of VAT on gas and heat (pellets, briquettes, wood chips, and firewood) from 25% to 13% starting on April 1, 2022, until March 31, 2023.

Furthermore, the Croatian government in its first move also reduced the VAT on food. VAT rates were, therefore, reduced

¹⁹ https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/eu-action-address-energy-crisis_en

²⁰ Ibid.

²¹ The Government of the Republic of Croatia (2022) *Predstavljen paket mjera za ublažavanje rasta cijena energenata vrijedan 4,8 milijardi kuna*. Available [online]: <https://vlada.gov.hr/vijesti/predstavljen-paket-mjera-za-ublazavanje-rasta-cijena-energenata-vrijedan-4-8-milijardi-kuna/33907> [in Croatian]

from 13% to only 5% on items such as fresh meat, fish, eggs, butter, fruit, vegetables, edible oils and fats, baby food, and costs in agriculture (seedlings, fertilizer, and pesticides), and a 13% VAT rate on hygiene products. A 5% VAT rate was adopted on various tickets for sports, cultural and other events.

Measures also included HRK 400 (EUR 53) vouchers for social categories, roughly 51,000 individuals, including 5,700 pensioners. Further support for pensioners included a special one-time compensation, the so-called 'energy supplement', which is provided for 721,000 pensioners with a pension of up to HRK 4,000 (EUR 530).

The business sector was also taken into account in this first package. Support for entrepreneurs refers to micro, small, and medium-sized enterprises with an average annual consumption of up to 10 GWh. The amount of support was 15 Lipa per kWh via voucher. Finally, PM Plenković added that *"without these measures, from April 1, 2022, electricity bills would have gone up by 23%, and gas bills by 79%"*²².

On September 8, 2022, the government presented the second set of measures²³ worth over HRK 21 billion (app. EUR 2.8 billion), during the six months period, of which HRK 6 billion (EUR 800 million) will be directed to the state-owned company HEP, while the rest will be used to help the consumers.

The decision on direct measures to control the prices of certain food products was adopted, limiting the prices of nine

²² Ibid.

²³ The Government of the Republic of Croatia (2022) *Snažan, pravedan i sveobuhvatan paket mjera vrijedan 21 milijardu kuna zaštitit će sve i omogućiti mirnu jesen i zimu*. Available [online]: <https://vlada.gov.hr/vijesti/snazan-pravedan-i-sveobuhvatan-paket-mjera-vrijedan-21-milijardu-kuna-zastitit-ce-sve-i-omoguciti-mirnu-jesen-i-zimu/36021> [in Croatian]



THE EU WAS FORCED TO DIVERSIFY ITS SUPPLY OF ENERGY

food products (including oil, flour, sugar, pork, chicken, and mixed minced meat) by more than 30 %, in order to *"preserve the purchasing power of citizens"*²⁴. While most of the measures were extended, the government introduced grades for the consumers²⁵.

On December 22, 2022, the government introduced a third set of measures²⁶ worth HRK 700 million (EUR 93 million) aimed at

²⁴ The Government of the Republic of Croatia (2022) *Vladin paket uključuje mjere pomoći za sve segmente društva*. Available [online]: <https://vlada.gov.hr/vijesti/vladin-paket-ukljucuje-mjere-pomoci-za-sve-segmente-drustva/36022> [in Croatian]

²⁵ For half-yearly consumption of up to 250,000 kWh, a cheaper price of electricity is paid at a single tariff of HRK 0.5295 per kWh, which is essentially the same initial price that applies to the category of the public and non-profit sector. For half-yearly consumption above 250,000 kWh, the prices are as follows: for customers with a single tariff, the price is HRK 1.6176 per kWh, and for customers with a lower and higher tariff, it is HRK 1.7215 per kWh in the higher tariff and HRK 0.8447 per kWh in a lower tariff. The average price after someone consumes those 250,000 kWh is EUR 180 = per MWh. In the third category, for large consumers, that is, for half-yearly consumption over 2.5 GWh, the average price will be EUR 230 per MWh.

²⁶ The Government of the Republic of Croatia (2022), *Novim paketom mjera, vrijednim više od 700 milijuna kuna, osigurana pomoć za gotovo milijun građana*. Available [online]: <https://vlada.gov.hr/vijesti/novim-paketom-mjera-vrijednim-vise-od-700-milijuna-kuna-osigurana-pomoc-za-gotovo-milijun-gradjana/37559> [in Croatian]

giving away one-time financial aid to vulnerable groups of citizens including pensioners, the unemployed, individuals with disabilities, and those of lower socio-economic status.

The final, fourth set²⁷ was presented on March 30, 2023, worth EUR 6.4 billion, and PM Plenković reminded that the price of gas will remain regulated for the next year, the price of electricity will remain the same until September 30, and the regulation of oil derivatives prices (introduced in the Q4 of 2022) will continue. EUR 900 million was to be given to state-owned utility company HEP in order to enable normal functioning, but also to fund necessary investments in the context of the energy transition.

THE CZECH REPUBLIC

According to the data gathered by the European Bruegel think-tank²⁸, in June of 2022, the Czech government introduced a series of measures worth EUR 2.7 billion to assist both households and the business sector with the rising energy costs. Similar to Croatia, the Czech government then provided discounts and financial aid for the households reliant on electricity and gas for heating, lighting, and cooking.

Later that year, the government drafted a law that allocated CZK 100 billion (EUR 4 billion) to cap the prices of electricity and gas. Following those actions in 2022, in 2023, the government agreed on a compensation mechanism for energy traders incurring losses due to the capped electricity and gas prices. The actions undertaken

²⁷ The Government of the Republic of Croatia (2023), *Predstavljen 4. paket mjera pomoći Vlade RH za ublažavanje inflatornih učinaka i porasta cijena energenata*. Available [online]: <https://mrosp.gov.hr/vijesti/predstavljen-4-paket-mjera-pomoci-vlade-rh-za-ublazavanje-inflatornih-ucinkaka-i-porasta-cijena-energenata/13032> [In Croatian]

²⁸ <https://www.bruegel.org/dataset/national-policies-shield-consumers-rising-energy-prices>



THE ENTIRE EUROPEAN COMMUNITY HAS IMPLEMENTED SOME FORM OF MEASURES DESIGNED TO SHIELD CONSUMERS FROM RISING PRICES

by the Czech government largely followed the same pattern as in Croatia, but also in other CEE countries.

ESTONIA

In Estonia, much like in the Czech Republic, prices were already in focus before the Russian aggression on Ukraine. At the beginning of 2021, the Estonian government²⁹ approved a cap on electricity (EUR 0.12/KWh) and gas prices (EUR 65/MWh) for households, while for businesses it had completely removed the electricity distribution charges (previously only halved)³⁰ in an effort to mitigate the negative effects of rising energy prices. In September 2022, the government announced further financial aid (so-called 'allowances') for children to EUR 80, and large family allowances by 50%.

Among other measures, in the 2023 state budget, the Estonian government introduced subsidies in the amount of EUR 50

²⁹ Ibid.

³⁰ Ibid.

per megawatt-hour of electricity for domestic consumers, and 80% compensation for price increases that go above EUR 80 per megawatt-hour. In the case of gas and central heating, the government will compensate 80% of the price increases. As a final measure, universal service³¹ was adopted and made available to home consumers from October 1.

Similar measures were introduced all across the CEE region. They included reducing VAT rates (either permanently or temporarily), retail price regulation, transfers to vulnerable groups, different mandates to state-owned firms, and support to the business sector, among others.

CHALLENGES AHEAD

The world entered the energy crisis almost immediately after exiting the COVID-19 pandemic. A once-in-a-lifetime global pandemic similarly called for incredible state interference into the private sector and markets in general. For two years, the government subsidized the private and public sectors to unprecedented levels, and the energy crisis simply took over with those same demands for intervention. For three years now, the global economy has not operated under the conditions of a free market, and the question is how long it is going to stay like that. Pumping huge amounts of cash into the global economy significantly contributed to the rise in inflation, which then caused consumer prices to go up, which in turn warranted further actions from the governments, thus creating a vicious circle.

With the huge amount of financial resources going into the national economies to support them, some action taken

³¹ Universal service is essentially an electricity package that all household consumers and apartment associations can voluntarily use. See: <https://www.energia.ee/en/universaalteenus>.



SIMILAR
TO CROATIA,
THE CZECH
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THEN PROVIDED
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AND GAS
FOR HEAT-
ING, LIGHTING,
AND COOKING

by the states was deemed unwelcome by the private sector. Part of the criticism was directed toward the windfall taxes many countries introduced.

However, a windfall profits tax was introduced because of the sudden and unexpected spike in earnings by the energy companies, in this particular case caused by the Russian invasion. Here, the case of Croatia serves as a rather telling example, as it was one of the first countries to introduce such a tax.



ALREADY BACK IN MARCH 2022, THE EUROPEAN COMMISSION ALLOWED ALL MEM- BER STATES TO TEM- PORARILY IMPOSE WINDFALL TAXES ON ALL ENERGY PROVIDERS

Already back in March 2022, the European Commission allowed³² all member states to temporarily impose windfall taxes on all energy providers. This new taxation would not be retroactive, but rather technologically neutral. As part of the *REPowerEU* plan, it was meant to be designed in a way not to affect the wholesale electricity prices and trends. On September 30, the Council of the European Union agreed to impose an EU-wide windfall profits tax on fossil fuel companies, as a solidarity measure for those who have been hit the hardest by this energy crisis. According to the EU, such a tax rate would raise about EUR 140 billion³³, which would later be used to offset households' high energy bills.

³² European Commission (2022) *REPowerEU: Joint European Action for more affordable, secure, and sustainable energy*, p. 3. Available [online]: https://eur-lex.europa.eu/resource.html?uri=cellar:71767319-9f0a-11ec-83e1-01aa75ed71a1.0001.02/DOC_1&format=PDF

³³ <https://taxfoundation.org/windfall-tax-europe-2023/>

Following the EU Council's endorsement of the EU-wide windfall tax, 25 European nations have taken steps towards adopting it (or a modified version of it) within a span of nine months. Among these, nineteen countries have successfully implemented the windfall tax, while Ireland, Luxembourg, the Netherlands, and Poland have made public their intentions to introduce similar measures. Latvia and Norway have declared their official intent, while the Czech Republic, Hungary, Slovakia, Spain, and the United Kingdom are contemplating the continuation of windfall tax utilization beyond the year 2023³⁴.

As of June 12, 2023, the majority of countries implemented the tax with five countries that have proposed it, and two which have announced it, according to the Tax Foundation. In their publication, they stated that *"the flawed design of these windfall profit taxes has already created problems in countries that implemented them"*³⁵. Since there was no unified approach when it comes to the implementation of this tax, the report published by the European Commission found that *"diverging implementation strategies across [m]ember [s]tates have reportedly led to significant investor uncertainty"*³⁶. EU countries, therefore, approached the implementation of such a tax in significantly different ways. The Czech Republic and Lithuania, for instance, extended the scope to the banking sector. When it comes to the specific tax

³⁴ Enache, C. (2023) *What European Countries Are Doing about Windfall Profit Taxes*, Tax Foundation. Available [online]: <https://taxfoundation.org/data/all/global/windfall-tax-europe-2023/>

³⁵ Ibid.

³⁶ The European Commission (2023) *Report from the Commission to the European Parliament and the Council on the Review of Emergency Interventions to Address High Energy Prices in Accordance*, p.17. Available [online]: https://energy.ec.europa.eu/system/files/2023-06/COM_2023_302_1_EN_ACT_part1_v2.pdf



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rates, Croatia implemented a 33% tax rate on all profits companies made past a certain threshold (the threshold being set at the average profit over the last four years increased by additional 20%)³⁷. For com-

³⁷ The Government of the Republic of Croatia (2022), *Primorac: Tvrtkama s više od 300 milijuna kuna prihoda porez od 33 posto na dobit veću od 20 posto*. Available [online]: <https://vlada.gov.hr/vijesti/primorac-tvrtkama-s-vise-od-300-milijuna-kuna-prihoda-porez-od-33-posto-na-dobit-vecu-od-20-posto/36371> [in Croatian]

parison, the United Kingdom implemented a 25% tax rate on oil and gas companies operating in the UK and the UK Continental Shelf; Slovakia introduced a 90% windfall tax for electricity producers and a 70% tax rate for the rest of businesses; Ireland started taxing electricity producers with a 75% tax rate; Lithuania started taxing 60% of profits; and Slovenia implemented a 90% windfall tax for electricity producers, and 33% for other businesses³⁸.

Croatia implemented the windfall tax on December 23, 2022, starting on January 1, 2022. According to the government's proposal, those liable for this windfall tax will be those with increased profits, regardless of the activity they perform. It will be paid by companies with revenues in 2022 of more than HRK 300 million (app. EUR 40 million), at a rate of 33%, but only on profits greater than 20% compared to the four-year average, already previously mentioned³⁹. Such a broad implementation of this tax was justified by the Croatian government by saying that there were no energy companies in Croatia of such size which would fall under the initial EU proposition and was, therefore, 'adjusted' for local economy.

This kind of interpretation of the EU recommendation caused a major backlash among Croatian employers, with Croatian Employers Association (HUP)⁴⁰ pointing out to the government a number of unwanted consequences of such action. Most

³⁸ Enache, C. (2023) *What European Countries Are Doing about Windfall Profit Taxes*, Tax Foundation. Available [online]: <https://taxfoundation.org/data/all/global/windfall-tax-europe-2023/>

³⁹ Zakon.hr (2022) *Zakon o dodatnom porezu na dobit*. Available [online]: <https://www.zakon.hr/z/3397/Zakon-o-dodatnom-porezu-na-dobit> [in Croatian]

⁴⁰ Croatian Employers' Association (2022) *Prijedlog novog poreza na dobit diskriminira i kažnjava najuspješnije tvrtke*. Available [online]: <https://www.hup.hr/prijedlog-novog-poreza-na-dobit-diskriminira-i-kaznjava-najuspjesnije-tvrtke.aspx> [in Croatian]

important being the reduction of competition amongst Croatian companies on the European and global markets compared to their counterparts who do not have to pay for this additional new tax, as they stated throughout their public campaign⁴¹.

The introduction of such a tax would have further added to the uncertainty factor in the local economy and would damage the investors' trust in the government to maintain a calm and predictable environment for them. Additional taxation would also damage companies' capabilities to reinvest their financial gains in order to expand their businesses or to simply have a cash reserve which would be welcomed in times of future crises. Finally, the new tax would add to the already overly taxed private sector, further hindering its potential, and making them more uncompetitive.

The government's estimates said that it could generate budget revenues of HRK 1.5 billion (app. EUR 200 million). On May 11, 2023, the government announced EUR 236 million had been collected through additional profit tax⁴².

CONCLUSIONS: EUROPE MUST LEARN FROM ITS MISTAKES

Europe is currently facing the consequences of its misguided policy decisions, which first took place decades ago. Doing business with a country whose values are fundamentally different than those of the European nations turned out to be as dangerous and reckless as ever before. Even if

⁴¹ Croatian Employers' Association (2022) Uvođenje novog poreza na dobit zaustavit će investicije i rast plaća. Available [online]: <https://www.hup.hr/uvodjenje-novog-poreza-na-dobit-zaustavit-ce-investicije-i-rast-placa.aspx> [in Croatian]

⁴² The Government of the Republic of Croatia (2023), *Sjednica Vlade: Dodatnim porezom na dobit prikupljeno 236 milijuna eura* Available [online]: <https://vlada.gov.hr/vijesti/sjednica-vlade-dodatnim-porezom-na-dobit-prikupljeno-236-milijuna-eura/38295> [in Croatian]



EUROPE WILL ALWAYS BE FORCED TO IMPORT ENERGY FROM OTHER COUNTRIES, BECAUSE OF THE OBVIOUS LACK OF ITS OWN SUPPLIES ON THE CONTINENT

the warnings that the allied nations provided throughout the years before kept falling on deaf ears, it should have been clear in the beginning that being dependent on energy imports from Russia was never going to end well. Especially when it became clear that Russia was ready to use its gas as an economic weapon back in 2006. Recently, Europe has faced a rude awakening to a brand new economic and geopolitical reality.

So far, the European Union has managed to mitigate the dangers of a reduced energy supply from Russia by pouring large sums of money into the member states' economies, capping the price of gas, reducing consumption, providing financial aid to vulnerable groups, and VAT rates interventions, among other steps taken. A mild winter, continued imports of Russian energy (albeit significantly reduced), and a spike in U.S. LNG exports were also helpful. But de-

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Russian aggression in Ukraine is eventually going to end, and when that happens, the EU must continue to pursue its own goals established in 2022. It will be tempting to let the Russian gas and oil flow yet again through existing infrastructure, but Europe simply must resist it. It is standing on the brink of a unique opportunity to completely detach itself from Russia in this vital sector and turn itself toward the United States and countries alike. Russia cannot ever again hold such enormous leverage over the lives of European citizens.

spite that, the EU did slip into a mild technical recession in the first three months of this year. However, the biggest challenges lie ahead.

Europe will always be forced to import energy from other countries, because of the obvious lack of its own supplies on the continent. However, if we talk about importing such a vital resource, the European Union should turn to its traditional allies – such as the United States. The LNG terminal in Croatia is just one positive example of how the EU can find a way out of this situation.

The Russian war in Ukraine made it painfully clear that building further infrastructure (ports, pipelines, and storage) is the only thing that will provide long-term security in gas supply and stability of its economy. On the other hand, what could slow this progress down (or even completely stop it) is the European disunity and lack of vision.



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