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ENERGY

THE CHALLENGES EUROPE MUST FACE



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COVER PHOTO

EC1 power station in Łódź, Poland, by Robert Zapędowski (DARK FRAME)

PHOTOS

In this issue you may find photos of the revalorized building complex of 100-year-old EC1 power station (photos by Robert Zapędowski, DARK FRAME), an abandoned Ustronna power station and the industrial landscape of Łódź (photos by Tomasz Piwocha and Radosław Stępień, Urban Explorers Łódź). All photos were taken in Łódź, Poland.

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EU Needs Energising

The recent events in France showed that even the French cannot feel safe. Our European code of conduct seems to pose an increasing threat to those who do not share our values. The tragic events at *Charlie Hebdo* inevitably contribute to the long-standing discussion on freedom of speech and, by extension, freedom of the press. And it seems that the line between exercising those rights and balancing on the verge of hate speech is much thinner than we thought.

In the meantime, Vladimir Putin's ambitions continue to feed on Ukraine – as the President of Ukraine, Petro Poroshenko, has recently reported during World Economic Forum in Davos, the Russian involvement in eastern Ukraine has escalated and now amounts to 9,000 troops. But hasn't Russia always been trying to build its power on external expansion? Not that it's any excuse. The problem is that we seem to be constantly surprised by the further moves of Mr Putin and it's high time we all acknowledged the situation and power them down.

Power seems to be the key word in the relations between the EU and Russia. As the sanctions imposed by the EU appear to have slightly backfired, Europe must secure its energy supplies so we won't end up as *powerless* energy players. There is, however, one substantial problem. In the light of the 20-20-20 targets, the European task to secure its energy capacity gets quite complicated.

Europe is trying hard to save the world when it is failing in its own backyard. The strong, unanimous, unified front of the EU with regard to energy policy – which may eventually take the form of an Energy Union – and the EU that would protect our own interests is a must. We should try to be less dependent on external suppliers, to make use of our own energy potential – may it be renewables, shale gas or even coal. We need to charge our European batteries, exercise our potential and stop being submissive. As – as you may read in this issue of *4liberty.eu Review* – “weakness always emboldens”, and the EU may end up having no staying power.

Enjoy your reading,

Olga Łabendowicz
Coordinator of 4liberty.eu network

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Justice and Inequality



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PETAR
GANEV

Inequality is one of the predominant topics in public discourse. It is an unavoidable part of every economic debate not only because of its inherent social significance, but also because it sets the framework for a more general comprehension of economic development. The lines of separation between present-day economists on questions like: "Why some nations succeed and others fail?", "What caused the most recent global crisis?", "What should be the role of the state in the process of economic recovery?", "Are markets self-governed or are they inevitably distorted?", among others, can almost always be attributed to a certain understanding of inequality in society.

The success of the recently published books by the Nobel Prize-winning economist Joseph Stiglitz "The Price of Inequality" and Thomas Piketty's "Capital in the Twenty-First Century" proved once again the importance of the issue in the contemporary society. Those books present in a very absorbing way the popular understanding of the somehow unfair and huge differences between the elite (the one percent) and all the others (the 99 percent). This article explores the topic of inequality, focusing not on inequality by itself, but on its foundations and the perception of unfairness. It may also be perceived as a discussion on the morality of capitalism and a critique of some of the conclusions put forward by the abovementioned authors.

INEQUALITY BEFORE THE LAW OR WEALTH INEQUALITY

When we discuss inequality we should always distinguish between inequality before the law and inequality in wealth or distribution of income. The subject of inequality suggests a certain attitude towards (in)justice and that is why such a differentiation is particularly important. Inequality before the law in practice is always undue. If we

proceed from the presumption that all people have unalienable or unconditional rights (meaning life, liberty and property), a different legal treatment would make people unjustifiably unequal by definition. Throughout most of the human history people haven't been equal before the law (the right to vote is a sufficiently good example) and they have lived in societies of the privileged. However, the attitude towards this kind of inequality shouldn't be transferred automatically to the inequality of wealth in contemporary societies.

Inequality in wealth or income is an issue which doesn't suggest any inherent injustice. This is the big difference. Simply put, if two people are a part of a society and one of them has the right to work and earn his living, while the other one is prohibited to do so (i.e. they are unequal before the law), we can safely say that this is an unjust society. On the other hand, if they are a part of a society that provides them with the same opportunities, and one of them earns twice as much as the other, we would hardly be in a position to make a judgment about justice and injustice. This doesn't mean that we should neglect the data or not look for the causes of inequality in income, but rather that we cannot work with the presumption of injustice just because wealth and income are different. If there is injustice indeed, it lies somewhere deeper than the straightforward interpretation of raw data.

Although the distinction between inequality before the law and wealth inequality is widely accepted and understood, those two continue to be mixed-up in the popular perceptions of modern society. Stiglitz to some extent does it, too. From its very beginning, his book subjects the reader to the author's perception of the inherent injustice of inequality, pointing out the "Arab Spring" as a society's answer to inequality



YES, HISTORICALLY, IN SOCIALIST SOCIETIES MOST PEOPLE WORKED IN SIMILAR FACTORIES, INHABITED SIMILAR DWELLINGS, DROVE 3-4 BRANDS OF CARS (ALL BEING THE SAME CLASS) AND SEEMED QUITE "EQUAL" OVERALL, BUT THE DIFFERENCE BETWEEN THEM AND THE ELITE WAS SIGNIFICANT AT ALL TIMES

and quickly applying this argument to the American society, the wealth of the so-called "one percent" and market failures. However, the events in some Arab countries weren't brought about by any market deficiencies, but by the disregard for the rule of law and the limitation of free initiative.

Mohamed Bouazizi set himself on fire at the end of 2010 in Tunisia and unleashed a wave of protests in the region after being prohibited to sell his goods on the street and his means of subsistence being taken away from him forcefully. The "Arab Spring" then spread to societies where injustice was present, but injustice that was enforced by the state and not by the market. The inequality before the law caused the uprising in the Arab world. While the Arab case is highly important for the inequality debate in the so-called developed world, the argument should not be automatically transferred as a pure critique of wealth and capitalism.

THE ARTIFICIAL DEBATE: "CAPITALISM VS. EQUALITY"

By focusing on the allocation of wealth and income, the debate on inequality tends to be presented as an opposition between capitalism (and free markets) and some imaginary alternative which ensures equality. This approach is extremely manipulative as it disregards reality. There are no examples of human societies which have been at least to a certain extent developed and have had pure equality i.e. did not have members with more wealth/privileges and material advantages. If we could travel back in time we would come across societies with gods and shamans, pharaohs, emperors, noblemen, aristocrats, totalitarian leaders, bankers and merchants and so on. In each case we have inequality – there has always been a difference between the majority of people ("the 99 percent" in Stiglitz's terms) and the "elite".



THE MODERN WESTERN SOCIETY IS THE WEALTHIEST ONE THAT MEN HAVE EVER KNOWN, TRYING TO CREATE THE PERFECT WELFARE STATE FOR ITS CITIZENS, AND NEVERTHELESS, IT IS ALSO ONE THAT IS IN BOTH AN ECONOMIC AND A MORAL CRISIS

The argument “capitalism or equality” in the general sense supposes that the alternative is a form of socialism or state intervention (welfare state) which would lead to equality in terms of wealth and income. That is a fiction. Socialist societies also have privileged people and that is evident not only in history, but also in many examples around the world today. In a socialist society the division is between the elite or the so called “nomenclature” (those involved in government) and all the others that are subject to their power.

Yes, historically in socialist societies most people worked in similar factories, inhabited similar dwellings, drove 3-4 brands of

cars (all being the same class) and seemed quite “equal” overall, but the difference between them and the elite was significant at all times. Leaving aside the debate whether it is possible for such a society to prosper, we can safely state that in every society, including totalitarian and socialist ones, there is material inequality – it is inherent to every social order.

What is significant is not inequality itself, but the reasons for its existence and every person’s chances to “bypass” it naturally – therein resides the feeling of injustice. Note that in most societies, inequality has historically been imposed by force – not by some market-based process, but by the use of power. Here we should investigate if the free market can cause such an unjust inequality that in effect destroys the society as in the case with the arbitrary rule of the absolute power. The debate in its essence is not about the opposition “capitalism vs. equality”, but rather on the morality of capitalism and the form of capitalism that is present in modern societies.

FREE SOCIETY AND THE PERCEPTION OF JUSTICE

The belief in a free society should in no way be used for any kind of a simplified view of inequality. The idea that we can build a perfectly free society in which everyone has equal rights and just disregard the question of inequality often neglects the very organic beginning of this society. What makes a society free or fair is not the way its fundamentals and institutions are put on paper, but the people’s belief in it and their desire to live in it. Such a society, even being a democratic one, cannot exist if the majority believes that something is not right and the result is inherently unfair – in most cases this gives strength to populists and is the first step on the “road to serfdom”, if we use Hayek’s phrase.



THE DEBATE IN ITS ESSENCE IS NOT ABOUT THE OPPOSITION “CAPITALISM VS. EQUALITY”, BUT RATHER ON THE MORALITY OF CAPITALISM AND THE FORM OF CAPITALISM THAT IS PRESENT IN MODERN SOCIETIES

The contemporary Western society presents us with exactly such a conflict between the general idea of a “free society” and the wide-spread perception of injustice. The most recent global financial and economic crisis – called the Great Recession, contributed to this conflict a great deal. The present times are unique with the fact that it is precisely the wealthy part of the world or the so-called developed countries that are in a crisis – with unprecedented levels of debt and unfunded social liabilities. The modern Western society is the wealthiest one that men have ever known, trying to create the perfect welfare state for its citizens, and nevertheless, it is also one that is in both an economic and a moral crisis.

Does this moral crisis mean that modern-day capitalism brings injustice? It somehow seems that the classic discussion about the economic inequalities neglects that question – it observes what we call here “justified differences” and is not going any further. We will present here the classical discussion, but also build upon it and investigate the unfair inequality that is a product of either a market failure or a state failure in the form of clientelism or the so-called “crony capitalism”.

THE JUSTIFIED INEQUALITY AND DEVELOPMENT

On the one hand, the classic discussion about inequality and capitalism covers income redistribution and the concentration of wealth in the elite, and on the other, it focuses on poverty. The popular thesis is that differences are too big and ergo we have unfairness, while the obviously opposite thesis is that this is normal and actually represents the driving force of development.

Some may say “the rich are getting richer and the poor – poorer”, and others may say “all people are better off, including the



IF AN INDIVIDUAL
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poor". In other words, it's not the differences that matter, but the overall improvement of everyone's welfare. Here we come across the well-known thesis about the pie – even if you receive a smaller piece (share), if the whole pie got bigger, your chunk would get bigger, too. These are the arguments which we can see in the famous debate¹, involving Margaret Thatcher in her last stand in the House of Commons (1990). It is exactly this discussion where from Thatcher's famous quote that some people would prefer the poor to be poorer as long as the rich would be poorer as well.

In the classic version of this debate, other factors put aside, Thatcher's thesis meets significant rational support. Most people undoubtedly realize that a free society cannot be equal (in wealth) and there is nothing wrong with that. People are different, they work in various spheres, exert differ-

ent effort, have different values – some want more money, while others want more leisure. The development of an easily accessible global market leads naturally to more and bigger opportunities for success. Nevertheless, if an individual wants to be free, he or she will surely accept that freedom makes life diverse and less certain, including in terms of income and wealth.

The same goes for the rational attitude towards poverty and inequality. If we are to choose between a world without poverty and a world without inequality we would most probably choose the first option. The argument that capitalism is "bad" due to the significant inequality in income and wealth which it entails doesn't withstand the thesis that capitalism makes societies richer and limits poverty. It is true that this generation is facing unprecedented technological advancement and lives in a world with more opportunities than ever before. If you could choose an era to live in and wanted to have a better life without knowing in which part of the world you will end up or in what occupation, your best choice would be today's generation. The work of Hans Rosling² presents the big picture of the world in different dimensions and clearly shows that it is getting healthier and richer, and that the developing world is actually catching up in recent decades.

The discussion which contrasts the arguments of inequality to those of poverty and development, which we labeled as "classic", has taken over public attention and has set compelling barriers between leftist and rightist intellectuals and economists. However, the dividing line doesn't come from the logic of the market, but rather from

² See here: gapminder.org

In practice the world data shows that the statement "the rich are getting richer and the poor are getting poorer" is false, which, however, far from settles the debate about just and unjust inequality.

¹ <https://www.youtube.com/watch?v=rV5t6rC6yvg>



LET US IMAGINE MR STEVE JOBS AND MR MARK ZUCKERBERG. BOTH CAN SAFELY SAY THAT CAPITALISM HAS ALLOWED THEM TO EARN “OUTRAGEOUS” AMOUNTS OF MONEY AND EVEN TO POSSESS MORE MONEY THAN ENTIRE NATIONS. WHY AREN'T YOU ANGRY ALREADY?

the focus on simplified theoretical settings and a wrong interpretation of the feeling of injustice, trying to explain it through the prism of a given ideology or popular deceptions, and not searching for a rational basis. In this simplified debate there is not enough space for a critique of the modern-day capitalism and the feeling of injustice.

UNFAIR INEQUALITY – MARKET FAILURE VS. CLIENTELISM

Wealth inequality is inherent to capitalism – there is no doubt about that. There is also no doubt that a widespread feeling of injustice is present in the contemporary world, which has been additionally intensified by the “Big Recession”. But what does provoke this feeling – the success that is deserved, or the success of the privileged? We do not question the feeling of injustice, but ask if we do not rush to conclusions by accusing free markets for this perception?

Let's do a mental experiment. The popular view is that capitalism is unfair, as it leads to incredibly large distortions in wealth. Each symbol of this distortion should provoke negative emotions in us, i.e. activate a sense of injustice. Let us imagine Mr Steve Jobs and Mr Mark Zuckerberg. Both can safely say that capitalism has allowed them to earn “outrageous” amounts of money and even to possess more money than entire nations. Why aren't you angry already? How come the most emblematic examples of wealth accumulation in a capitalist society do not evoke immediate widespread negative emotions? Apparently, the feeling of injustice is not provoked by significant wealth, but by something else: how has this wealth been acquired?

Let us now imagine two anonymous bankers who handed out loans without proper risk assessment of the borrowers, harvested huge bonuses and in the end the state bailed them out. There it is, the



1.0 MPa

10.0 MPa

1.0 MPa

sense of injustice. A whole movement even arose from it – referred to as “Occupy Wall Street”. The privileged position of the banker in this case is not caused by a market failure, but by a gift from the state. Money supply in contemporary Western “capitalist” societies is entirely controlled by the state and has nothing to do with the market. Note that the only thing that the market did during the wake of the “Great Recession” was to try to destroy these very bankers - to kick them out on the street. The state saved them through the instruments of monetary and fiscal policy, which could easily be described as the money of the “99 percent”. Both the “left” and the “right” realize that bankers have been privileged. But are they aware that the market was about to destroy them, while the state was on their side?

We can give similar examples from post-communist Bulgaria too. Imagine a successful entrepreneur who has started from scratch, sells his goods worldwide, creates jobs and as a result of that has grown very rich. This hardly causes negative emotions in someone. Now imagine someone who has never created anything, but being close to power, has benefited during the transition period and the privatization of state owned enterprises. Here it is again - an overwhelming sense of injustice. Realizing the difference between these two examples, we can answer many questions about inequality being fair and unfair.

These examples – both domestic and foreign, show that the feeling of injustice is not a result of the accumulation of wealth by itself, but of something else – the privileged position of some members of society. Unjust inequalities in modern “capitalist” societies are a fact, but they are not caused by the markets, but by the so-called crony capitalism or clientelism. The latter phenomenon is often realized in its micro form

– getting an enterprise as a gift from the state, “winning” public procurement tenders, or receiving favorable regulation that basically “kills” your competitors or directly provides legal monopoly in a particular area. This form of micro clientelism is widely known, but the macro form of crony capitalism is almost always overlooked, namely monopolistic monetary policy and deficit spending by the government. These two are actually the main factors enriching the “crony” one percent, disguised as “social” policies and welfare.

FAIR SOCIETY

Let’s use John Rawls’s idea about the “veil of ignorance” – while behind the veil of ignorance, we can imagine a just society in which we want to live, without knowing in what role we’ll find ourselves there. The logical experiment would inevitably lead us to a free society where everyone is equal before the law, but not necessarily equal in income or wealth. A society without privileged people and artificial inequality. This society sounds very close to the notion of capitalist society but seems to be far from what we have in the modern Western world.

Interestingly enough, Stiglitz, while attacking capitalism in his book³, acknowledges the guilt of crony capitalism, but the decisions that he proposes lead to more government that would inevitably create more clientelism. Moreover, his proposals to combat inequality by using monetary and fiscal policies to achieve that goal (e.g. monetary policy that would rather focus on jobs than on price stability) would virtually transfer even more power to what we call here crony capitalism. These are just the kind of policies that attempt to engi-

³ Accusing capitalism of creating: *“inequality, pollution, unemployment and... degradation of values to the point where everything is acceptable and no one is accountable”*; Joseph Stiglitz, “The Price of Inequality”.

neer the “desired” society, but that brought about the “Great Recession” and fueled the sense of injustice in the first place.

If the main argument against wealth is that it is earned on the back of ordinary people, meaning at their expense, it can only be done in several ways – by force, that is by plundering and violation of the law; by rules that favor some at the expense of others; through monetary policy which channels cash flows in one direction and takes away a bit (or sometimes a lot) of everybody’s money (by depreciating their value along the way); and through fiscal policy that redistributes taxpayers’ money in someone’s favor. The rich earn at the expense of the poor when there is no rule of law, or when there is a form of crony capitalism. Free markets do not allow this to happen.

CONCLUSIONS

The modern debate on inequality is, in practice, a discussion about the morality of capitalism. To simplify this debate by presenting two opposing worlds – a capitalist society where skills and effort lead to inequality, and a socialist society where the state can secure equality, may be a good learning experience, but leaves aside the challenges that we face in the modern world. Such a framework is inadequate to tackle the unfair inequality that we face in present-day capitalist society where the state plays a huge role – usually called the welfare state.

In this article we try to show that if we investigate in depth the modern-world inequalities and the widespread notion of unfairness, we can dig down to the foundations of unfairness that seems to be at the heart of the issue. The anger roaming throughout the modern world is not rooted in the material differences (if that was so, the sole idea of capitalism would have never been put into practice), but in

the very process of their formation. If that is true, the perception of unfairness cannot be countered with redistribution, as it has nothing to do with the process of creating. The welfare state is no answer to the widespread perception of injustice. An in-depth discussion of unfairness is in reality a critique of modern-day crony capitalism.

The article is based upon several public discussions, among them one held at the University of National and World Economy in Sofia on March 19, 2014 and organized by the Institute for Market Economics and the Friedrich Naumann Foundation. The text, however, reflects the views of the author and should not be considered a summary of these discussions. •



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Hate speech: European Union – Central Europe – Poland



*

MIŁOSZ
HODUN

The spectrum of hate speech is very broad, varying from hatred to extremely abusive forms of prejudice. *Oxford English Dictionary* defines hate as “an emotion of extreme dislike or aversion; detestation, abhorrence, hatred”. And often the qualification of an action as “extreme” is treated as a decisive parameter in defining hate speech.

From a legal perspective, the hate speech spectrum stretches from types of expression that are not entitled to protection under international human rights law, to types of expression that may or may not be entitled to protection, depending on the existence and weight of a number of “contextual variables” (e.g. extremely offensive expression), to other types of expression that presumptively would be entitled to protection despite their morally objectionable character (e.g. negative stereotyping of minorities).¹

One of the definitions of hate speech can be found in Recommendation No. (97) 20 of the Committee of Ministers of the Council of Europe:

(...) the term “hate speech” shall be understood as covering all forms of expression which is used to spread, incite, promote or justify racial hatred, xenophobia, anti-Semitism or other forms of hatred based on intolerance, including: intolerance expressed by aggressive nationalism and ethnocentrism, discrimination and hostility against minorities, migrants and people of immigrant origin.

One more definition that does not come from a legal text is as follows:

Hate speech is any speech, gesture or conduct, writing, or display which is forbidden because it may incite violence or prejudicial

”

HATE SPEECH IS GROWING IN EUROPE. THE YEARS AFTER ECONOMIC CRISIS BROUGHT NEW ANTAGONISMS IN THE EUROPEAN UNION. THE RICH AGAINST THE POOR, THE LOCALS AGAINST THE NEWCOMERS, THE SOUTH AGAINST THE NORTH... ANTAGONISMS BRING CONFLICTS AND CONFLICTS BRING HATE SPEECH

action against, or by a protected individual or group, or because it disparages or intimidates a protected individual or group. The law may identify a protected individual or a protected group by certain characteristics.

This understanding of hate speech includes publications, symbols, graffiti, songs, movies and radio broadcasting. This definition

¹ The Council of Europe against online hate speech: Co-nundrums and challenges.

will be accepted as the official one in this report. It is broad and implies that hate speech cannot be left alone, and action must be taken against it.

Hate speech is growing in Europe. The years after economic crisis brought new antagonisms in the European Union. The rich against the poor, the locals against the new-comers, the South against the North... Antagonisms bring conflicts and conflicts bring hate speech. New surveys and researches show that the extremists are on the wave. Especially those from the far right who build their identity and programme on hatred, xenophobia, anti-Semitism and many other phobias. They introduce hate speech to mainstream discourse, both in politics and media. And the latter ones influence a lot the speech of regular people.

The ultimate confirmation of the trend was remarked during the elections to the European Parliament in May 2014. Eurosceptic right-populist parties increased their vote share from 11% to 15%, with some countries receiving even more support. Lega Nord in Italy, Austrian Freedom Party, Jobbik in Hungary, Party of Freedom in the Netherlands, True Finns, and Congress of the New Right in Poland have now marked their representation in Strasbourg and Brussels. Danish People's Party, National Front in France and the United Kingdom Independence Party won the elections in their states, scoring respectively 26%, 25% and 27% of votes. The National Democratic Party of Germany and the Golden Dawn of Greece, two parties considered neo-nazi also won seats for their MEPs. The last case is especially alarming because the Greek party (associated with a swastika-like symbol) promotes political violence, being under investigation for brutal crimes, and their leaders facing incarceration. This proves that the radical right present in the European Parliament is thus not only the so called "far right 2.0", the

one with more aesthetic look and rhetoric traits, but also includes the traditional far right that bases its support on racism, anti-Semitism, skinheads, etc.

Hate speech is one of the aftermaths of the development of extreme right movements in Europe. It is organically connected with nationalistic demagoguery, with both phenomena feeding on each other. Hate speech reflects a negative attitude represented by nationalists towards different groups, and, on the other hand, hate speech becomes the nutrient for far right movements that institutionalize aggressive discourse. This is the classic knock-on effect, which can also be observed in the relationship between hate speech and hate crime. Therefore the fight against hate speech contributes to the fight against nationalism, which implies that focus on the topic is required from the liberal front.

Hate speech has become a typical behavior among politicians. More than 40% of respondents in a research dealing with this issue said that the use of offensive language towards LGBT people by politicians is widespread in their country. In some countries it went up to above 90%. On an average, 44% of respondents across the eight countries surveyed said that anti-Semitism in political life is a big problem. In some countries, this figure rises to well over 50%.

Political hate speech is connected with hate speech in media. The same survey shows that in those countries in which the respondents reported a high degree of anti-Jewish sentiment, there is also a heavy presence of anti-Semitic reporting in the media. This research appears to have identified an interaction between the media and the politics, that requires further investigating.²

² http://fra.europa.eu/sites/default/files/hate_speech_warsaw_slide.pdf



HATE SPEECH IN CENTRAL EUROPE

Hate speech in the Eastern Europe has some specific features, especially when compared with the Western Europe. It is of course connected with the specific socio-economic situation that was determined by the common historical experience, built on the trauma of World War II and the communist era, with a strong role of the Christian religion in its more ludic and conservative version. The countries that were closed and partly isolated from the outside world developed different societies, that were more homogeneous, with specific national, ethnic and religious tensions.

As Andras Sajo observed:

After all, racism and incitement to hatred against ethnic (national) groups (primarily but not exclusively minorities) present a major social and regulatory problem in the post-communist period. Extremist nationalist propaganda has often been part of the self-assertion of nationalist political movements and become part of official government ideology. Extremist nationalist speech played a major role in the escalation of the Yugoslav conflict, contributing ultimately to genocide. Given the strong endorsement of nationalism by many political actors, including some governments, in many countries extremist speech, irrespective of the legal provisions, became, to some extent, socially normalized.³

It can be noted that hate speech in Eastern Europe targets some specific groups. Roma people, LGBT and Jews can be pointed out here. However, the reasons for that are very complex and explaining them lies beyond the scope of this article.

High level of discrimination against Roma people has been reported in many studies.⁴ Hate speech against Roma is permanently present in public discourse of Hungary, the Czech Republic, Slovakia or Romania. The media build a negative image of the Roma. Also the politicians do not avoid spreading hatred. An example of a Hungarian mayor can be quoted here. He once said "The Roma have no place among human beings. Just as in the animal world parricides must be expelled."⁵ It is difficult not to see the connection between hate speech and other hate crimes here. For example, in Hungary between 2008 and 2009 six Roma people were killed with "Molotov cocktails" thrown at their houses, and they were shot as attempted to flee.⁶

Central and Eastern Europe is also deeply homophobic⁷ and it is reflected in the hate speech. 23% of Croatians, 22% of Bulgarians and 21% of Romanians believe that homophobic harassment and assault are very widespread in their countries. Slovakia, Poland, Hungary, Latvia, Lithuania, Estonia come next.⁸ Countries of the region "won" also when their citizens were asked about how widespread offensive language about lesbian, gay, bisexual and/or transgender people by politicians is in the country where they live (Lithuania 58%, Bulgaria 42%, Poland 33%), hatred jokes in everyday life (Bulgaria 68%), aversion towards transgender people in public (Bulgaria 47%, Croatia 42 %, Lithuania 41 %).⁹

⁴ Stewart 2012, European Union Minorities and Discrimination Survey.

⁵ Goldstone 2002, p. 156.

⁶ Daroczi 2012.

⁷ More <http://ecpr.eu/Filestore/PaperProposal/c6f365c3-025d-41e3-809d-172390f5ba9e.pdf>

⁸ It is important to note that the Czech Republic comes last in the whole survey (only 2%).

⁹ <http://fra.europa.eu/en/publications-and-resources/data-and-maps/survey-data-explorer-lgbt-survey-2012>

³ András Sajó, *Freedom of Expression* (Institute of Public Affairs, Warsaw 2004), p. 128.



EVERYONE HAS THE RIGHT TO FREEDOM OF OPINION AND EXPRESSION; THIS RIGHT INCLUDES FREEDOM TO HOLD OPINIONS WITHOUT INTERFERENCE AND TO SEEK, RECEIVE AND IMPART INFORMATION AND IDEAS THROUGH ANY MEDIA AND REGARDLESS OF FRONTIERS

The International Network Against Cyber Hate and the Paris-based International League Against Racism and Anti-Semitism released a report documenting the explosion of online anti-Semitic hate speech. It is a trend observed in all of European Union, but while in the West it is connected with the war between Israel and Hamas, in the East it is still an aftermath of the stereotypes and experience of the war and communism. In a poll conducted by the Warsaw University Center for Research on Prejudice, researchers concluded that more than half of Polish youth visit anti-Semitic websites that glorify Hitler and Nazism. In Hungary, Marton Gyongyosi, an MP for the far-right Jobbik, who is the vice-chairman of the Parliament's Foreign Affairs Committee, had called for the authorities to compile a national list of Hungarian Jews, especially those in parliament and government, who represent what he described as a "national-security risk", allegedly slanting Hungarian foreign policy in Israel's interest.

In general, it should be noted that hate speech against the abovementioned groups, but also others, is very common in Central Europe and it seems more tolerated by the members of Central European societies. Therefore, it must be combated. Most former communist states in Central Europe regulated hate speech on the basis of its content. Some of the post-Soviet states, like Lithuania or Estonia, the post-Yugoslav republics and Romania, incorporated the anti-hate speech provisions into their constitutions. It is important to notice that the constitutional regulations of hate speech emerged in the region in states with big national minorities and heavy tensions between the groups of citizens (or non-citizens).

The scope of laws in different countries varies. Some states regulated hate speech with very general terms, giving their law enforcement bodies more freedom, while some have detailed regulations.

COMBATING HATE SPEECH

Hate speech can interfere with human rights and also with so-called operative values, such as dignity, non-discrimination, equality, freedom of expression, religion, association or effective participation in public life. Additionally, hate speech harms individuals and causes damages in individuals such as psychological damages, fear, inhibited self-fulfillment or disintegrated self-esteem. And this is the reason why it should be fought with legal instruments.

Such fight is as at least as old as the Universal Declaration of Human Rights, that reads: "Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless of frontiers". Also in the European Charter of Human Rights we read in Art. 11: "Everyone has the right to freedom of expression. This right shall include freedom to hold opinions, and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This article shall not prevent States from requiring the licensing of broadcasting, television or cinema enterprises."

The first hate speech legislation in European nations in the 20th century was aimed at stopping political racism associated with fascism and the experiences of the World War II. After the war, the United Nations, through various declarations and treaties, sought to fight racist regimes. In its International Convention on the Elimination of All Forms of Racial Discrimination (ICERD) the UN linked racial discrimination with racism, in an effort to outlaw not only discriminatory treatment but also hate speech and other elements of racism that might not fall under the definition of racial discrimination.

There is already quite a long list of legal instruments that are supposed to restrict hate speech from the public space. A very special place in that system of protection hold the Council of Europe (CoE) and the European Court of Human Rights (ECtHR). Both were created to guard legal standards, human rights and democracy. Among those international legal instruments are:

1. The Convention on the Prevention and Punishment of the Crime of Genocide (e.g.. Article III(c) – direct and public incitement to commit genocide);
2. The International Convention on the Elimination of all Forms of Racial Discrimination (ICERD) (esp. articles 4 and 5 – all dissemination of ideas based on racial superiority or racial hatred, incitement to racial discrimination, with due regard to the right to freedom of expression);
3. The International Convention on Civil and Political Right (ICCPR) (esp. Articles 19 and 20 – respectively, freedom of expression and advocacy of national, racial or religious hatred that constitutes incitement to discrimination, hostility or violence).

Many of the treaty provisions have been clarified by General Comments or Recommendations, eg. Human Rights Committee's General Comment No. 34 on the right to freedom of expression and the Committee on the Elimination of Racial Discrimination's General Recommendation No. 35, entitled "Combating racist hate speech". ICERD is of special interest because it contains provisions on the relationship between freedom of expression and hate speech. Article 4 thereof requires states to render several types of expression punishable by law. This makes ICERD a special tool that creates more far-reaching obligations for states than other treaties.





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WHAT IS DEFINITELY
WORRYING

States Parties condemn all propaganda and all organizations which are based on ideas or theories of superiority of one race or group of persons of one colour or ethnic origin, or which attempt to justify or promote racial hatred and discrimination in any form, and undertake to adopt immediate and positive measures designed to eradicate all incitement to, or acts of, such discrimination.

In Europe, Article 10 of the European Convention of Human Rights (ECtHR) is the centerpiece for the right of freedom expression. It reads as follows:

1. Everyone has the right to freedom of expression. This right shall include freedom to hold opinions, and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This article shall not prevent States from requiring the licensing of broadcasting, television or cinema enterprises.
2. The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation or rights of others, for preventing the disclosure of information received in confidence, or for maintaining the authority and impartiality of the judiciary.

In 1996 the European Union also adopted a Joint Action that encouraged action from Member States to prevent perpetrators of racist acts from moving to States with more lenient laws by either criminalizing certain behaviors, or by agreeing to remove the requirement for double criminality. On 28 November 2008, the Council

of the EU adopted the Framework Decision on combating certain forms and expressions of racism and xenophobia by means of criminal law. As regards hate speech, Member States must ensure that the following intentional conduct is punishable when directed against a group of persons or a member of such a group defined by reference to race, color, religion, descent or national or ethnic origin:

- public incitation to violence or hatred, including by public dissemination or distribution of tracts, pictures or other material;
- public condoning, denying or grossly trivializing
- crimes of genocide, crimes against humanity and war crimes as defined in Articles 6, 7 and 8 of the Statute of the International Criminal Court (hereinafter 'ICC'); or
- the crimes defined in Article 6 of the Charter of the International Military Tribunal appended to the London Agreement of 8 August 1945, when the conduct is carried out in a manner likely to incite violence, or hatred against such a group or one or more of its members.

POLAND

Hate speech in Poland is, of course, very often connected with the most radical organized groups. The extremist nationalist groups are: Narodowe Odrodzenie Polski (National Rebirth of Poland), Obóz Narodowo-Radykalny (ONR; National-Radical Camp) and Stowarzyszenie Narodowe Zadruga (National Association Zadruga). They have all organized different kinds of events, like marches, concerts, happenings, where they chant and shout radical, nationalistic, xenophobic slogans, e.g. "Our sacred Res – Jews from Poland go away", "Whole Poland – only white", "Free Poland – no niggers". What

is more, the ONR delegates "greeted" the memorial of Silesian insurgent with Nazi gesture.

However, it would be naive to think that hate speech in Poland is produced only by the marginalized extremists. It is also used by others, especially by the politicians, what is definitely worrying. Otwarta Rzeczpospolita (Open Republic), an association that, among others, monitors hate speech activities in Poland, gives an example of Maciej Giertych, a member of the European Parliament and the father of the deputy-prime minister in the Kaczynski government, who published a brochure "The War of Civilizations in Europe". The publication referred to the works of a conservative historian Feliks Koneczny and presented Jews in a way that could lead to aggression and dislike as a "worse" nation. It is important to underline that Hans-Gert Pöttering called the brochure "the substantial violation of the fundamental individual rights, especially the right to dignity of a human being"¹⁰

Polish political scene has been sharply divided between the ruling Platforma Obywatelska (PO; Civic Platform) and the conservative Prawo i Sprawiedliwość (PiS; Law and Justice). This conflict is not really about the political agenda but it is personal and powered by the attitude towards the Smolensk tragedy (when Lech Kaczyński died in the plane crash in Russia). Both sides of the camp speak about the other side without any respect, using words that can often be recognized as hate speech. Political aggression has been growing in years. Escalation of hate speech in Polish political discourse was noted after last elections when the first openly gay deputy and first trans-gender deputy won seats in the Polish parliament. This negative at-

¹⁰ <http://www.aedh.eu/plugins/fckeditor/userfiles/file/Discriminations%20et%20droits%20des%20minorit%C3%A9s/Hate%20speech.pdf>



POLITICAL AGGRESSION HAS BEEN GROWING IN YEARS. ESCALATION OF HATE SPEECH IN POLISH POLITICAL DISCOURSE WAS NOTED AFTER LAST ELECTIONS WHEN THE FIRST OPENLY GAY DEPUTY AND FIRST TRANS-GENDER DEPUTY WON SEATS IN THE POLISH PARLIAMENT. THIS NEGATIVE ATTITUDE TOWARDS SEXUAL MINORITIES HAS BEEN STRENGTHENED BY THE CATHOLIC CHURCH AND ITS CRUSADE AGAINST "GENDER IDEOLOGY"

itude towards sexual minorities has been strengthened by the Catholic Church and its crusade against "gender ideology".

The example is set by the people at the top. An average Joe Bloggs speaks the way elites do. Hate speech is more and more acceptable in everyday situations. It is used in private conversations, written on walls, can be read in media and is omnipresent in the Internet. To sum up, hate speech in Poland is not a marginalized matter of the extreme right, it is observed in all groups, from the football hooligans to members of academia.

In the 2014 report on hate speech in Poland we read:

„I detest fags - they are degenerate human beings, they should be treated” - every fifth Pole thinks that such a statement is admissible in the public discourse. Almost two thirds of young Poles encountered examples of anti-Semitic hate speech on the Internet. About the same percentage of Polish young people heard hate speech towards Romani people from their friends. Every third adult Pole has read racist statements on the Internet, and as much as 70 percent of young Poles declare that they encountered such statements on the Internet. Surprisingly high percentage of Poles accept hate speech - in particular towards Jews, Romani people, and non-heterosexual persons - and see nothing offensive in it. But the representatives of the minorities are affirmative that such statements are offensive and should be forbidden. These are the results of the latest study performed by the Warsaw University Centre for Research on Prejudice and the Stefan Batory Foundation¹¹.

¹¹ Michał Bilewicz, Marta Marchlewska, Wiktor Soral, Mikołaj Winiewski Warsaw, 2014.

The survey showed that hate speech against non-heterosexual people receives the highest acceptance in Poland. 35% of adult and 38% of young Poles perceive it as acceptable. The most offensive statements were seen as acceptable by 22% of adult Poles and 20% of young people. Only 59% of adults said that such statements should be forbidden. Homophobic hate speech is encountered by young people mainly on the Internet (77%), when talking with friends (65%), and on the TV (33%). The level of acceptance for anti-Muslim hate speech is also relatively high – 15% of adult Poles and 19% of young people think that the statement: “Muslims are stinky cowards, they can only murder women, children and innocent people” is admissible.

Surveyed Poles (both adults and young people) believe hate speech towards Ukrainians and Africans/black people to be forbidden, but they are willing to accept hate speech against LGBT people, Romani people and Jews. The acceptance of hate speech, especially among young people, is strongly related to their right-wing, hierarchical attitudes. People with right-wing views were in particular tolerant of hate speech towards non-heterosexual people¹².

ANTI-HATE SPEECH LAWS IN POLAND

Hate speech laws in Poland are regulated at the constitutional level. Article 54 of the Constitution protects freedom of speech. By its Article 13, the Constitution prohibits political parties and other organizations which have programs based upon totalitarian methods and the modes of activity of Nazism, fascism and communism. Article 13 further prohibits any programs or activities which promote racial or national hatred. Article 35 gives national and ethnic

minorities the right to establish educational and cultural institutions and institutions designed to protect religious identity.

Additionally, hate speech is regulated in criminal code: Article 196 makes anyone found guilty of intentionally offending religious feelings through public calumny of an object or place of worship liable to a fine, a restriction of liberty, or to imprisonment for a maximum of two years. Article 256 makes anyone found guilty of promoting a fascist or other totalitarian system of state or of inciting hatred based on national, ethnic, racial, or religious differences, or for reason of the lack of any religious denomination, liable to a fine, a restriction of liberty, or to imprisonment for a maximum of two years. Article 257 makes anyone found guilty of publicly insulting a group or a particular person because of national, ethnic, racial, or religious affiliation or because of the lack of any religious denomination liable to a fine, a restriction of liberty, or to imprisonment for a maximum of three years.

Additionally, Article 119 makes anyone found guilty of using violence or threats against a person or group of persons due to their nationality, ethnicity, race, political convictions, and religion up to 5 years of imprisonment.

Article	Number of cases
Art. 256 § 1	461 / 26 bill of indictment
Art. 256 § 2	28 / 4 bill of indictment
Art. 257 § 1	332 / 68 bill of indictment
Art. 119	102 / 28 bill of indictment

¹² Ibid.

Nevertheless, the statistics showing the number of people punished for committing hate crimes are very low.

There are many reasons why these articles are not used frequently by the police and the prosecution, among them:

- Considered as low priority by prosecution authorities
- No specialists to combat internet-related issues
- Social acceptance of discriminatory speech (language issue)
- Limited scope of legal regulations (sexual orientation, political convictions)
- At local level prosecutors friends with perpetrators
- No reaction from society
- Little engagement of Internet Intermediaries/Internet Service Providers

All these reasons are intertwined. The society continues to be passive and does not see hate speech and hate crimes as important issues to be combated by the state authorities. This is transplanted onto the state organs. The definition of hate speech is not broad enough. The law-givers have not covered some important parts of hate speech, like gender-based hate speech, since there is not much public support for penalizing this kind of speech.

Moreover, the police and the prosecution do not treat these kinds of crimes with priority and victims are often convinced about the insignificance of their case. Another issue is connected with the fact that lots of hate speech crimes “take place” online and the police is not trained

properly and does not have enough man power to take account of all the online hate speech cases.

On the other hand, some hate speech cases become very famous since they bring lots of media attention. It is connected with the fact that hate speech is a very delicate part of the legal system, and this involves regulating sensitive matters that interfere in the sphere of private feelings and sentiments. What is more, it often happens that they involve famous people or celebrities who are infamous for their controversial behavior. For example in 2010, the police charged the Polish singer Doda (Dorota Rabczewska) with violating the Criminal Code for saying in 2009 that the Bible was “unbelievable” and written by people “drunk on wine and smoking some kind of herbs”. The same year, the police charged the lead singer and guitarist of the Polish death metal band Behemoth, Adam Darski, with violating the Criminal Code. The charge dated back to a performance by Behemoth in September 2007 during which Darski allegedly called the Catholic Church “the most murderous cult on the planet”, and he tore up a copy of the Bible on stage. In 2006, the Jan Karski Association complained that a broadcast on a catholic radio station defamed the Jewish people and violated Article 257 of the Criminal Code. Prosecutors refused to pursue the matter.

HOW TO CHANGE THE CURRENT SITUATION

Projekt: Polska and the European Liberal Forum prepared a policy paper entitled “Liberal Agenda Against Online Hate Speech”.¹³ It focuses mainly on hate speech in the Internet, but contains also

¹³ Available here: <http://www.liberalforum.eu/en/publications.html>

more general recommendations. Among others, these policy recommendations are:

- Broadening the scope of the definition of hate speech;
- Ratification of the Additional Protocol of the Convention on Cybercrime;
- Better monitoring of implementation of Framework Decision on combating certain forms and expressions of racism and xenophobia by means of criminal law;
- Fast implementation of the Victims' Directive;
- Introducing online filtering capacities;
- Online filtering capacities situated in the region.

These recommendations can improve the situation in Central Europe. Of course, because of the specific situation in the region some of them must be tailored to the needs of the particular countries. Education and integration is also a milestone to be achieved in combating hate speech in the region. Groups that are targeted by haters are very often alienated from big parts of the society. The hatred is connected with stereotypes and lack of knowledge about the groups. Therefore, campaigns that will bring closer Romanis, LGBT people or Jewish communities to other citizens can help more than any legislation. Educational campaigns for the youngest audience are of the utmost importance.

Projekt: Polska has been fighting hate speech for many years with its HejtStop project. HejtStop project aims at removing hate speech from the public space in Polish cities. A special web site was cre-

ated, wherein everyone could send a picture of an offensive graffiti, and the coordinators together with local authorities, owners of the walls, and with the support of private companies, removed them. Some were covered with beautiful murals. The project received large success initially and developed further. A special application and HejtStop remove hate speech from social media. The campaign is a perfect example of a good practice that shows how we can fight hate speech successfully. We hope that similar campaigns will spread across Central Europe soon, with the help of other liberal organizations. ●



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MIŁOSZ
HODUN

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War Propaganda and Free Press



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KRYŠTOF
KRULIŠ

At Christmas 2014 we could commemorate the one hundred years anniversary of the Christmas Truce 1914.

The truce events were described by Robert Naiman as “the most morally compelling acts of spontaneous mass civil disobedience in recorded human history”.¹ The events occurred at the Western Front in late December and early January in the first year of the Great War. Nowadays, these events receive broad public attention also thanks to the 2005 movie “Joyeux Noel”, nominated for an Academy Award for best foreign-language film in 2006. They also surfaced the year 2014, for instance in the Sainsbury’s Christmas advert created in cooperation with The Royal British Legion, and started to gain increased access even to school curricula as a means of explaining various aspects of the Great War.²

This one hundred years anniversary was not only an opportunity to commemorate the tragedy of a conflict that killed more than 15 million people but also to learn about the war propaganda and the role of free press in conflicts as well as to draw a parallel to the current conflicts, including the situation in eastern Ukraine.

THE CHRISTMAS TRUCE 1914

In 1914 after the First Battle of the Marne in Northeast France both sides dug in trenches stretching from the North Sea to Switzerland.³ The horrors of the trench

¹ NAIMAN, Robert. The Christmas Truce of 1914: “Threat to National Security”? *Catholic New Times*, 07010788, 1/24/2011.

² See for instance Teaching the 1914 Christmas Truces: Resource pack by Martin Luther King Peace Committee, Northumbria University and Newcastle University, available at: <http://research.ncl.ac.uk/martinlutherking/activities/world-waronechristmastrucecommemorations/> [2014-12-12].

³ See also WOODWARD, David R. Christmas Truce of 1914: Empathy under Fire. *Phi Kappa Phi Forum* [online]. 2011, vol. 91, issue 1, s. 18-19 [2014-12-02].

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THIS ONE HUNDRED YEARS ANNIVERSARY WAS NOT ONLY AN OPPORTUNITY TO COMMEMORATE THE TRAGEDY OF A CONFLICT THAT KILLED MORE THAN 15 MILLION PEOPLE BUT ALSO TO LEARN ABOUT THE WAR PROPAGANDA AND THE ROLE OF FREE PRESS IN CONFLICTS AS WELL AS TO DRAW A PARALLEL TO THE CURRENT CONFLICTS, INCLUDING THE SITUATION IN EASTERN UKRAINE

war repealed any remaining beliefs that the war could be finished swiftly. The appeal by Pope Benedict XV to cease fire during Christmas was sharply repudiated by the war governments and army leadership of all sides. Despite direct orders to shoot at

enemy even with a white flag, spontaneous truces occurred at various parts of the Western front on the holy day. Those who initiated truces were soldiers from the front lines. They did it under an immense danger of being shot from the enemy side and at the same time risked punishment from own army command for disobeying orders. German and British soldiers were more ready to get involved in the truces and even made larger scale agreements. French and Belgian soldiers, whose homeland was partly occupied at that time, also participated in several instances. However, in some locations fights continued. Soldiers who took part in truces met in no-men's land and were chatting, buried their dead, were singing Christmas songs and even exchanged gifts or were playing football. Some sources estimate that about 100,000 men took part in such events.⁴

The events offer an opportunity for scrutiny of war propaganda. It was an opportunity to learn about human nature of war enemies and even question own war propaganda that depicted the other side as pure evil.⁵ Soldiers who witnessed human nature of enemy soldier were no longer that easily convinced that the causes voiced by the war propaganda could really legitimize the whole process of killing ordinary people in the opposite trenches and risk own lives in inhumane conditions of the trench war. Acts of amity continued until early January 1915 when the phenomena had to cease under strict orders from the high-commands, threats of *court-martials* and series

of replacements of units that participated in the Christmas Truce with new-coming units.⁶

FREE PRESS AND WAR PROPAGANDA DURING THE GREAT WAR

The events of Christmas truces revealed also the different ways of possible coexistence of war propaganda with free press and the legitimate democratic discussion. The political and army leadership initially tried to prevent press coverage of these spontaneous events. However, it was hard for war propaganda to get along with such a large scale evidence of fraternity between soldiers. A breakthrough came with the *New York Times* coverage of the Christmas Truce on December 31, 1914.⁷ After this also British media offered extensive coverage of the events, including photographs and quotations from letters of participating soldiers. British newspapers mostly embraced the Christmas truce events and, instead of using army jargon of mutinous acts, largely praised humane character of the events. Sir Arthur Conan Doyle described Christmas Truce as "one human episode amid the atrocities which have stained the memory of war".⁸ Coverage on a significantly smaller scale was provided by German press – here, voices condemning the events occurred in some newspapers. French press featured these events largely by printing the official stances and suffered severe censorship.

⁴ VINCIGUERRA, Thomas. The Truce of Christmas, 1914. *The New York Times*, December 25, 2005, available at: http://www.nytimes.com/2005/12/25/weekinreview/25word.ready.html?pagewanted=all&_r=0 [2014-12-09].

⁵ See for instance SHORTELL, Catherine K. a Troy R. E. PADDOCK. Teaching the Great War through Peace. *History Teacher* [online]. 2011, vol. 45, issue 1, s. 9-24 [2014-12-02], p. 11.

⁶ TSUCHIYAMA, Jitsuo. *Fostering Peace through Cultural Initiatives*. Aoyama Gakuin University. The Japan Foundation, London, March 2010, p. 27.

⁷ NAIMAN, Robert. The Christmas Truce of 1914: "Threat to National Security"? *Catholic New Times*, 07010788, January 24, 2011.

⁸ See for instance THOMPSON, Jonathan. The Christmas truce of 1914. *The Telegraph*, July 4, 2014, available at: <http://www.telegraph.co.uk/sponsored/travel/first-world-war-centenary/10942667/christmas-truce-1914.html> [2014-12-09]

The diverse reaction of press can be attributed partly to different level of press freedom and in part to position of each individual country during the war. As indices monitoring the level of press freedom do not date back to before the 1980s, basic orientation for the level of freedom in individual countries could be drawn from Polity IV: Regime Authority Characteristics and Transitions Datasets by Center for Systemic Peace.⁹ While freedom of press is not examined separately, it is considered as a specific manifestation of general principles observed under a Democracy indicator of this dataset.¹⁰ The Democracy indicator is presented on a scale from 0 to 10 (10 being the highest level of institutionalized democracy). Moreover, the Autocracy indicator is also presented under Polity IV project and it can be understood as being able to counter the Democracy indicator. It is shown also on a scale from 0 to 10 (10 being the highest level of institutionalized autocracy). While both United Kingdom and France possessed during the whole period of the Great War the Democratic indicator of 8 and zero level on the Autocracy scale, Germany has only 5 points on the Democracy scale and at the same time the Autocracy indicator of 3. This suggests significantly lower freedom of press in Germany during the Great War and is a possible explanation of the restricted press coverage of the Christmas Truce in Germany in contrast to the British press.

The second factor of a different position of individual states in the war may be used to explain different level of freedom in coverage of the Christmas truces in France and

United Kingdom. France was invaded and some of its northeastern regions on border with Belgium were occupied. Paris was around 150 kilometers from the battlefields. There was no natural barrier to protect it as in case of the English Channel that provided, together with the British navy, relative safety for the United Kingdom during the war. With a similar level of democracy in France and United Kingdom in 1914 and 1915, the different position of each country in the war and fear of more imminent collapse is a possible explanation of the processes that resulted in coverage of the 1914 Christmas truces in France on a smaller scale. The situation of democratic institutions and free press was thus more complicated in France and war propaganda could easily claim its priority with appeals on threatened state security. This mobilizing factor of uneasy French position in the war may be a relevant explanation of why war propaganda gained upper hand. However, events such as the Christmas truces and more broadly the "live and let live" philosophy of the soldiers in trenches (when followed by both sides) could be in fact considered as less threatening to French national security than the strategy of reckless offensives with high casualties.

WAR PROPAGANDA AND FREE PRESS

The main reason for war propaganda is to unify people behind a particular cause and persuade them to sacrifice ordinary comfort and even own lives to that cause. For that war propaganda tends to concentrate on one sided arguments, exaggerates issues that may support the cause and suppress anything that may threaten it. War propaganda prefers to work with simplified facts and emphasize them to the extent that still could be believable by the audience. It may also slide to deliberate inaccuracy and even create artificial pretexts supporting the cause.¹¹ The main objective of

⁹ Center for Systemic Peace: <http://www.systemicpeace.org/inscrdata.html> [2014-12-09].

¹⁰ MARSHALL, Monty. GURR, Ted. JAGGERS, Keith. *POLITY IV PROJECT: Dataset Users' Manual*. Center for Systemic Peace, May 6, 2014, available at: <http://www.systemicpeace.org/inscr/p4manualv2013.pdf> [2014-12-09], p. 14.

¹¹ For a good compilation of quotations on the nature



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war propaganda is to boost morale. Not to stick to objectivity or keep facts in their real proportions. It doesn't work merely with the reason but also with emotions. It may not be in opposition only to the external enemy but also to the internal "enemies", such as pacifists.

The role of free press in the face of war propaganda is quite complicated. War propaganda may claim certain issues to be a taboo, setting them aside from available free discussion. Any attempt to enter such space may be labeled as defeatism or support for the enemy. Nevertheless, in liberal democracy, truly free press and media in general should question these entrenched positions and put them under dutiful scrutiny. This may even be considered as an advantage of liberal democracies. War propaganda that refused to prove itself in an open discussion can quickly rally support but this support may as well rapidly fall apart. Dutiful scrutiny of the cause could thus strongly add to its longer-term sustainability.

Free press as a means of setting boundaries to war propaganda has also an essential role in conflict prevention. An unrestricted propaganda would naturally tend to respond to a propaganda of the enemy side. This may lead to further exaggerations and end into a spiral of sworn hatred on both sides. An escalation of a conflict would be only a natural result of this process.

With regard to conflicts, free press should objectively report on all relevant issues including such things as the misfortune of soldiers and civilians on both sides. Free press should offer insights and even empathy to the suffering people and question

of war propaganda see for instance SHAH, Anup. "War, Propaganda and the Media." *Global Issues*. 31 March, 2005. Available at: <http://www.globalissues.org/article/157/war-propaganda-and-the-media> [2014-12-11].

legitimacy of the propaganda causes that brought such situation into existence. It does not mean that the free press must always disregard patriotism, but a real scrutiny of whether patriotism is not invoked in ill way or used to cover other hidden interests should be considered as essential aspects of free journalism.

Limitations of the free press in the face of the war propaganda may be therefore a key indicator of truthfulness of the propaganda and relevance of its cause. Only well established cause with deep foundations in the value system of general public can withstand open criticism of free press. At the same time free press and pluralistic discussion regarding all aspects of the cause can set borders to excessive propaganda and cultivate it. Low level of freedom of press at any side of a conflict can thus serve as a key indicator of potentially artificial propaganda. Level of press freedom can be also used as the basic and initial means to determine level of truthfulness of any propaganda and its rallying cause.

FREEDOM OF THE PRESS INDEX BY FREEDOM HOUSE

A useful tool for determination of the level of press freedom in a specific country is provided by the Freedom House in its annual reports *Freedom of the Press* that has been monitoring media independence around the world since 1980.¹² *Freedom of the Press* reports provide insights into media independence in 197 countries and territories and assign each country a numerical index as well as a simplified ranking as "Free", "Partly Free" or "Not Free".¹³

¹² Freedom House. Freedom of the Press. Available at: <https://freedomhouse.org/report-types/freedom-press#:vImx7XvPt7Y> [2014-12-11].

¹³ According to the data for 2013, only 14% of the world's population lived in countries with press ranked as "Free", Freedom House. Freedom of the Press. Available at: <https://freedomhouse.org/report-types/freedom-press#>.

The numerical *Freedom of the Press* index is on the scale from 0 to 100. Lower score indicates free press, high score the opposite. The index for every country is derived from its score in 23 methodology questions and 132 indicators that are divided into three main subcategories.

The subcategory (A) focuses on the legal environment for operation of free press, including guarantees for press freedom. It also covers potentially harmful laws and regulations. The subcategory (B) is devoted to the political environment in which press functions. This includes evaluation of the degree of control over media content that can be exerted from the political sphere and reflects even such aspects as self-censorship and intimidation of journalists. The last subcategory, ©, represents the economic environment in which press operates. This subcategory covers such aspects as the structure and transparency of the press ownership, or impact of bribery and corruption on the content of the press. The index recognizes cultural differences and uneven distribution of wealth in the world, but its data is based on the Article 19 of the Universal Declaration of Human Rights, which guarantees that "everyone has the right to freedom of opinion and expression".¹⁴

The whole process of score assessment is conducted on several levels. They include: pluralistic data gathering by individual analysts, reviews in regional groups, a deep scrutiny of any major numerical changes from the previous year and, in particular, the final layer of cross-regional assessments, which allows to compare the scores across all regions and parts of the world.¹⁵

[vImx7XvPt7Y](https://freedomhouse.org/sites/default/files/FOTP2014_Methodology.pdf) [2014-12-11].

¹⁴ Freedom House. Freedom of the Press 2014. Methodology. Available at: https://freedomhouse.org/sites/default/files/FOTP2014_Methodology.pdf [2014-12-11].

¹⁵ Freedom House. Freedom of the Press 2014. Meth-

As it was suggested above, the level of press freedom can serve as an indicator of the relevance of the different propaganda in conflicts. For that purpose, it can be underlined that *Freedom of the Press* index, under its legal environment subcategory, reflects also the legislative provisions that may hamper free and pluralistic coverage of propaganda-related events. The second methodology question of this subcategory includes the following indicators:

“Do laws restrict reporting on ethnic or religious issues, national security, or other sensitive topics? Do the authorities restrict or otherwise impede legitimate press coverage in the name of national security interests?”¹⁶

Positive answers to these questions may result in a higher score, which would indicate less free environment for operation of press in a given country.

At the end of 2014 the last available Freedom House report was *Freedom of the Press 2014*, the results of which are based on the events of the previous year (i.e. only events between 1 January 2013 and 31 December 2013 are reflected).¹⁷

WORLD PRESS FREEDOM INDEX BY REPORTERS WITHOUT BORDERS

An alternative to the abovementioned *Freedom of the Press* index by Freedom House is the *World Press Freedom Index* created

by Reporters Without Borders.¹⁸ *World Press Freedom Index 2014* focuses on the level of freedom of information in 180 countries. The limited number of countries (in comparison to the index by Freedom House) reflects the different way in which Reporters Without Borders create their index. The non-profit organization bases its findings on questionnaires dispatched to its partner organizations as well as to a network of its correspondents and cooperating human rights activists. Some countries thus have to be omitted due to a lack of confirmed data or incomplete questionnaires. Most of the relevant countries are, however, covered. Besides the questionnaires, additional data for the index is gathered through research of external researchers and includes such aspects as self-censorship (which might be biased in the questionnaires) or relevant legislation and governmental intrusions. The index is composed of six general criteria of different weight. These criteria include: pluralism, media independence from the authorities, environment in which journalists function, quality of legislative framework for media, transparency of institutions affecting news production and quality of infrastructure. The score of each country is between 0 and 100 (0 representing the highest freedom of press achievable and 100 the least free environment for press).¹⁹

The same scale (0-100) used in the *Freedom of the Press* (Freedom House) and *World Press Freedom Index* (Reporters Without Borders) simplifies the parallel use of both indexes. Nevertheless, the methodology and accentuated aspects are for

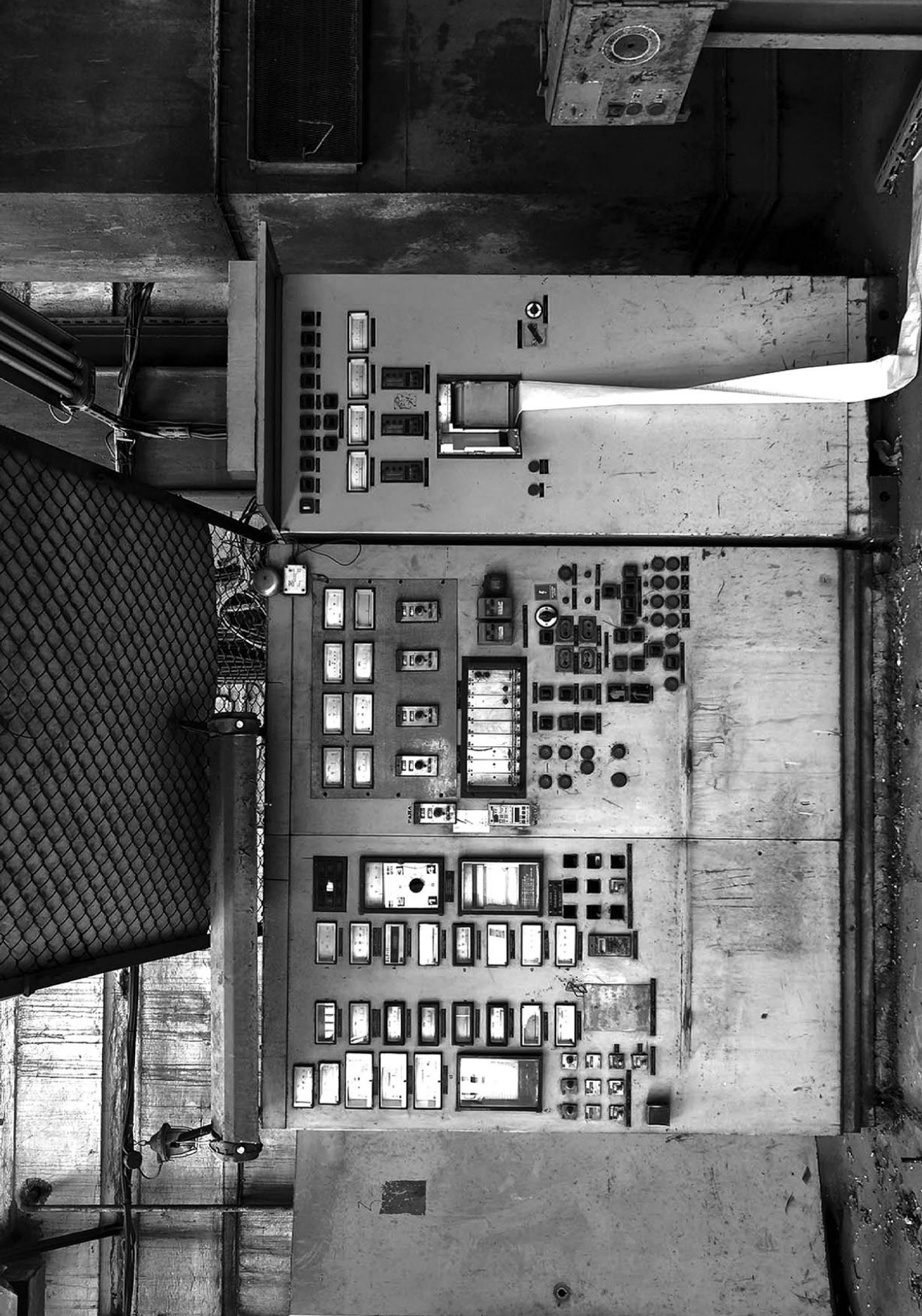
odology. Available at: https://freedomhouse.org/sites/default/files/FOTP2014_Methodology.pdf [2014-12-11], p. 1 and 2.

¹⁶ Freedom House. *Freedom of the Press 2014. Methodology*. Available at: https://freedomhouse.org/sites/default/files/FOTP2014_Methodology.pdf [2014-12-11], p. 3.

¹⁷ Freedom House. *Freedom of the Press 2014. Methodology*. Available at: https://freedomhouse.org/sites/default/files/FOTP2014_Methodology.pdf [2014-12-11], p. 1.

¹⁸ Reporters Without Borders. *World Press Freedom Index 2014*. Available at: <http://rsf.org/index2014/en-index2014.php> [2014-12-11].

¹⁹ Reporters Without Borders. *World Press Freedom Index – Methodology*. Available at: http://rsf.org/index2014/data/2014_wpfi_methodology.pdf [2014-12-11].



each index different. Violence against journalists is particularly stressed under *World Press Freedom Index* and results in significant score penalization. The last available reports (both covering events of the year 2013) thus reveal several noteworthy differences. For instance, in *Freedom of the Press 2014* the overall score for the United States (21) and Canada (19) is quite comparable and both countries are safely ranked as "Free". However, under *World Press Freedom Index 2014* the Canadian overall score of (10.99) is significantly lower than the overall score of the United States (23.49), to which Reporters Without Borders add a comment that since 9/11 the United States have been "torn by the conflict between national security imperatives and respect for the principles of the First Amendment."²⁰ This also ranks situation in Canada as "Good" and in the United States as only "Satisfactory". Combination of the two indexes can thus help us obtain a better picture of the freedom of press and may serve for mutual corrections.

PRESS INDEXES SCORES OF RUSSIA IN CONTRAST TO OTHER STATES (2013)

In 2014 one of the most intense clashes of different propagandas can be seen in the conflict between Russia and Ukraine. There are many issues that are interpreted by each side in an utterly different way. Both sides accuse the other of using groundless propaganda. For instance, Russian media showed pictures of pro-Russian demonstrations at various places in Ukraine. Media in Ukraine countered with identification of several persons on Russian photographs from demonstrations at various places in Ukraine claiming that they are always the same people. As the Ukrainian evidence concerned only several people from the bigger crowd and the Russian side can

always claim that the people were part of discrediting arrangement created by the Ukrainian side, uncovering the true story seems almost impossible.

For this purpose, a comparison of the level of the press freedom in the respective countries may be a helpful tool for better understanding of the labyrinthine spectrum of information that encompass the conflict. Therefore the Russian level of press freedom is further put under scrutiny and contrasted with the last available data for Ukraine (still only for the year 2013). As the conflict is also covered by media in the European Union, its countries are also analyzed in order to put the data on Russia and Ukraine in the context and reveal the level of press freedom in the countries that observe the conflict from a distance.

According to *Freedom of the Press 2014 (Freedom House)*²¹ Russia gained the **total score** of (81) and was ranked as "Not Free" for events during 2013. This score is comparable to the overall score of China (84) or Saudi Arabia (83). Russia has incurred a similar unfavourable total score for the last 6 years. It scored under 80 for the last time, in reports covering the year 2007, when it gained score of 78. Last score under 70 is even older and dates back to the years before 2005. In contrast to a Russian total score for events during 2013, even Ukraine scored considerably better and gained a total score of 63. It was still ranked as "Not Free" and its score was comparable to the score of such states as Mexico (61). The worst total score for a member states of the European Union was (46) for Greece, followed by Romania (41), Croatia (40) and Bulgaria (39). On the other hand the best-ranking states of the

²⁰ Reporters Without Borders. *World Press Freedom Index 2014*. Available at: <http://rsf.org/index2014/en-index2014.php> [2014-12-11].

²¹ Freedom House. *Freedom of the Press 2014*. Available at: <https://freedomhouse.org/report-types/freedom-press#.VImx7XvPt7Y> [2014-12-11].



EVENTS OF THE YEAR 2014 SUGGEST THAT THE POSITION OF FREE PRESS IN RUSSIA FURTHER DETERIORATED AS SEVERAL NEW MECHANISMS INTRUDING INTO PLURALISM OF THE INFORMATION LANDSCAPE HAVE BEEN INTRODUCED

European Union were Sweden (10) and Netherlands (10), followed by Finland (11), Belgium (11) and Denmark (12).

A closer look at individual Russian scores in the subcategories of *Freedom of the Press 2014* show the following results. The score for **legal** environment for the press in case of Russia is 25 on a scale from 0 to 30 (the same score had such countries as Oman or United Arab Emirates – it is one point worst even than the score of Zimbabwe: 24). For events during 2013 Ukraine scored 19. The worst scoring states of the European Union are Greece (14), Italy and Romania (both 12). In the European Union the best ranking is Netherlands (1), followed by Sweden, Luxemburg, Denmark and Belgium (all 2).

The score for **political** environment for the press in case of Russia is 32 on a scale from 0 to 40 (the same score was given to such countries as Central African Republic – it is only one point better than in China: 33, and considerably worst than in Zimbabwe: 25). For events during 2013 Ukraine incurred a score of 24. The worst ranking states of the European Union are Greece (20), Bulgaria and Croatia (both 16), followed by Romania (15). In the European Union the best ranking state is Finland (3), followed by Sweden, Luxemburg, Estonia and Belgium (all 4).

Finally, the score for **economic** environment for the press in case of Russia is 24 on a scale from 0 to 30. The same score was given to such countries as Iran, Zimbabwe or Burma (Myanmar). It is two points worst even than the score for China (22). For events during 2013 Ukraine incurred a score of 20. The worst ranking states of the European Union are Croatia (15), Romania (14), Greece and Bulgaria (both 12). In the European Union the best ranking states are Germany, Finland, Netherlands and Sweden (all 4).

Considering all aspects analyzed by the Freedom House, Russia is among the worst countries globally. Ukraine under President Yanukovich in 2013 scored considerably better in all subcategories than Russia, but still within the ranks of “Nor Free”. This is in contrast to the situation in European Union, where most of the states are placed in the “Free” category, sometimes even gaining the best results globally. Only Greece, Romania, Croatia, Bulgaria and Italy slipped into the “Partly Free” category .

The *World Press Freedom Index (Reporters Without Borders)*²² assigns Russia the **total score** of 41.78 (number 148 from the 180 covered countries) and ranked it as “Difficult situation”. Similar position occupy in this index Burma (41.43), Bangladesh (42.01) and Malaysia (42.73). Reporters Without Borders adds to the Russian score a comment that it “might have been lower in the index had it not been for the stubbornness and resistance shown by its civil society.”²³ Even in this case the numbers reflect the events of the 2013. For events of the 2013 Ukraine gained slightly better score (36.93) and ended up as the 127th worldwide. The worst ranking states of the European Union are Bulgaria (31.42) and Greece (31.33) at the positions number 100 and 99, respectively. The best ranking state of the European Union is Finland with the lowest score of 6.4, granting it the first position worldwide. Netherlands, Luxemburg, Denmark, Sweden, Estonia, Austria, the Czech Republic and Germany scored among the 15 best performing countries globally, with Germany at the position number 14 of the index (10.23).

²² Reporters Without Borders. *World Press Freedom Index 2014*. Available at: <http://rsf.org/index2014/en-index2014.php> [2014-12-11].

²³ Reporters Without Borders. *World Press Freedom Index 2014*. Available at: <http://rsf.org/index2014/en-index2014.php> [2014-12-11].



IT MAKES SENSE
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CONCLUDING REMARKS

The contrasted data shows a significant gap in the freedom of press between Russia and countries of the European Union in all the abovementioned aspects. The position of Ukraine in 2013 was somewhere halfway between the situation in Russia and in the worst ranking states of the European Union. Moreover, events of the year 2014 suggest that the position of free press in Russia further deteriorated as several new mechanisms intruding into pluralism of the information landscape have been introduced.²⁴ In case Ukraine follows the path of transformation towards a well-functioning liberal democratic state, for

²⁴ For more information see for instance AGHEKYAN, Elen. *Russia's Information Controls Reach Far Beyond the News Media*. November 25, 2014. Available at: <https://www.freedomhouse.org/blog/russia-s-information-controls-reach-far-beyond-news-media#.Vlq8KnvPult> [2014-12-12].

which the free press is one of the essential elements, and the 2015 press freedom indexes reflecting the events of the year 2014 confirm the positive trends in this direction, it makes sense to consider Ukrainian information coverage of the conflict as significantly more trustworthy than the Russian reports. At the same time, until Ukraine transforms itself into fully liberal democratic regime, it is still necessary to adopt its informational coverage with adequate caution.

Both Russian and Ukrainian positions are already deeply entrenched and it is very

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OVERCOMING THE EXAGGERATED PROPAGANDA AT BOTH SIDES IS AN ESSENTIAL ASPECT FOR THE “DE-ESCALATION” OF THE CONFLICT

difficult to identify any example of propaganda without invoking a stubborn defensive reaction and a long list of already existing arguments. It is, however, clear that certain aspects of the standpoints of both sides should be opened for pluralistic discussion and questioned by free press. Without understanding and empathy the conflict may only escalate further.

In Russia, the negative interpretation of the Euromaidan movement or the role of Russian citizens in the conflict should be questioned in an open pluralistic discussion and broader publicity should be given to perspectives alternative to the official propaganda. Similarly, in Ukraine the necessity of labelling of the campaign against the pro-Russian separatists as the “anti-terrorist operation” and possibilities of decentralization should be also put under free scrutiny and opened to public pluralistic discussion. Ukraine may be tempted to respond to Russian propaganda with a similar one-sided propaganda, but this would be contrary to its transition goals. It should rather support media plurality and open discussion even on the matters that may be considered as sensitive.

Overcoming the exaggerated propaganda at both sides is an essential aspect for the “de-escalation” of the conflict. Both Russian and Ukrainian Orthodox Christians celebrate Christmas Day on January 7 in the Gregorian calendar. Hopefully, this day would be an opportunity to strengthen the official truce with gestures of mutual respect for humanity and possibly emulate the bottom-up events of the Great War’s 1914 Christmas Truce in the eastern Ukraine. ●



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KRYŠTOF
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The Pressing Need for Energy Union



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BŁAŻEJ
LENKOWSKI

Creating efficient tools of Energy Union, which would secure the safety of the European Community, is one of the key challenges Europe must face in 2015. We need to be aware that only unanimity on this matter may protect European member states from being blackmailed by Russia and other exporters of energy resources. The task is indeed almost like cutting a Gordian knot, not only in the economic sense, but also geopolitically. European Union must be able to use its great potential that it was granted with and act as an entity. And it must be able to negotiate with other geopolitical agents as such.

If the newly appointed President of the European Council, Donald Tusk, intends to be remembered as the first leader of Europe who – despite his limited qualifications – became successful, he should employ all his diplomatic skills in order to make the dream of the European Energy Union come true during his term of office. Another point in his agenda should be devoted to establishing a mechanism of a 2nd, much wider in its scope, Eastern Partnership, which would serve as a kind of European Marshall Plan for Ukraine.

Tusk has already presented his main objectives with regard to Energy Union already as a Prime Minister of Poland, in April 2014. Let's remind the most crucial ones: joint negotiations of gas contracts, energy infrastructure investments – especially the construction of inter-containers connecting the gas networks between the particular EU countries; better management of our indigenous European energy resources (eg. natural or shale gas); a significant strengthening of the solidarity mechanisms – should there be put an embargo on energy supply; and an intense search for alternative energy suppliers (other than Russia and Gazprom).

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RUSSIA IS DETERMINED TO USE ITS ENERGY RESOURCES NOT AS ANY OTHER COMMODITY IN ECONOMIC EXCHANGE BUT AS A WEAPON FOR EXERTING PRESSURE ON THE STATES WHICH MAY BE OF VITAL IMPORTANCE FOR GEOPOLITICAL INTERESTS OF MOSCOW

The events in Ukraine in a ruthless way show that – despite the high hopes of our various Western partners – Russia is determined to use its energy resources not as any other commodity in economic exchange but as a weapon for exerting pressure on the states which may be of vital importance for geopolitical interests of Moscow. Poland has pointed out to this danger repeatedly but only the case of Nord Stream gas pipeline has proved that the Western Europe should have listened to Poles more closely. Of



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course, there were many different reasons for such a state of affairs. Nevertheless, the current position of Germany's former chancellor Gerhard Schröder in Gazprom proves that Russians have no problem with even corrupting the leading politicians of the West.

The recent decline in the prices of fuel may lead to a conclusion that the danger has been reduced, compared to the previous year. However, European leaders should be equipped with the ability to think strategically hence they should anticipate the fluctuations of the fuel prices in the future. As there is a strong chance that Russia will yet again try to lead Europe by the nose in the future.

Europe should also take into serious consideration employing various types of energy sources, including those currently discriminated due to the ecological aspect. Europe cannot save the world (in the ecological sense) on its own. It may, however, become eternally dependent on its enemies thus becoming an extremely non-competitive player. Therefore, Europe should not discriminate its indigenous, European energy sources – coal, conventional or not-so-conventional gas. Shale gas extraction should be thus regarded as one of the most advantageous energy sources – the method viciously opposed by pro-Russian lobbyists.

The disaster in Fukushima Daiichi Nuclear Power Plant raised endless questions on the safety of nuclear energy and brought many investments to a halt at the same time causing a gradual closing down of nuclear power stations in Germany. The questions that are still open are whether Europe did not forget about the need to keep its energy efficiency standards high and whether closing down fully operational power stations is a reasonable decision?

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IT IS CRUCIAL FOR MANY EUROPEAN COUNTRIES, POLAND INCLUDED, TO RETAIN POWER INDUSTRY BASED ON COAL. HOWEVER, REPLACING THE OBSOLETE, NOT VERY ECO-FRIENDLY POWER STATIONS WITH THE NEW, ECOLOGICAL AND HIGHLY EFFICIENT ONES, IS, OBVIOUSLY, A MUST

It is crucial for many European countries, Poland included, to retain power industry based on coal. However, replacing the obsolete, not very eco-friendly power stations with the new, ecological and highly efficient ones, is, obviously, a must. If we stop our own investments in the energy sector, we will become even more dependent on import of energy and resources, what will, undoubtedly, have a detrimental effect on the entire EU economy.

While creating the Energy Union, the EU should do its best to employ such mechanisms that would limit the regulatory power over the prices of sources and energy of individual states on the national level as much as possible. Such a solution applied to this specific market would – at least to some extent – secure a proper space for market principles and energy prices reflecting incomes of the citizens of a respective state.

I really hope that the year 2015 will bring a milestone in creating long-lasting mechanisms of Energy Union. It is, indeed, in the best interest of every EU country, even though some states do not yet have an overwhelming sense of presence of energy crisis. That's why it is absolutely vital that this new EU tool would apply to the whole European Community (if possible), and not just to some exclusive group of countries. This is also a huge opportunity for Europe. A chance to understand that only by acting together we may become a real world power. A geopolitical player that needs to be held in high esteem. ●



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Control or Market: Dilemmas of European Energy Policy



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Energy industry is par excellence a major industry. Power plants, fuel flows, networks, are one of the largest investment objects of any country. Take Three Gorges Dam in China, nuclear power in France or oil and gas in Norway. Few businesses have larger money flows than energy. Thus, it is not unnatural that it draws attention of powerful people, public and politics.

Common European energy policy had right roots to create unified market for coal and develop nuclear energy through Euratom. The starting point was in the post-war Europe of the state-run coal-based power industry. Famously, it was Margaret Thatcher, who started to fight the marxist mining labor unions and privatize the power generation industry. Many European nations followed suit in 1980s with privatization of energy companies.

However, with the rise of leftist environmental movements things have started to go well, to the left. Indeed, it was important to clean the air from excessive sulfides and microparticles, but since late 1990s one can undoubtedly claim that the European air is one of the cleanest of any densely populated areas on the Earth. However, the struggle of environmentalists with fossil fuels before the climate change in 1980s and fighting nuclear power even before Chernobyl accident proves two points. Firstly, they were ideologically driven as a protest against market economy and economic progress as such. Secondly, they were separated from the real-world practices, the economics and technical reality.

In 2000s, Europe experienced major policy craze with renewable energy that is still riding the waves of popularity, albeit with first subtle hints of realism. There was certain utopian idealism that all energy could be replaced with renewables such as wind,

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IN 2000s, EUROPE EXPERIENCED MAJOR POLICY CRAZE WITH RENEWABLE ENERGY THAT IS STILL RIDING THE WAVES OF POPULARITY, ALBEIT WITH FIRST SUBTLE HINTS OF REALISM

solar, biomass or wave energy. On top of that came emotional emphasis on efficiency and CO₂ abatement.

Grandiose targets for renewables were set at 20% CO₂ emission cuts by 2020 (compared to the year 1990), 20% higher efficiency, 20% renewable fuels and 10% fuels from biofuels by 2020. However, these goals are already somewhat contradictory. Renewable energy target with subsidies has substantially undermined European Emissions Trading Scheme, that was supposed to be key driver of CO₂ reductions. European power generation industry has been facing major problems due to renewable energy priority which reduced to nil profits from conventional power production. European power companies are unprofitable, their ability to invest has decreased significantly.

With the emotional focus on efficiency, some key ideas of economics were lost. First of all, by reducing the consumption of



UNFORTUNATELY, FIGHTING CLIMATE CHANGE ALONE MAKES LITTLE SENSE. 10% OF THE EU CO₂ EMISSIONS REDUCTIONS, AT COST OF BILLIONS OF EUROS AND THOUSANDS OF JOBS IN EUROPE, BALANCED JUST TWO WEEKS OF EMISSIONS IN CHINA

some product, the capital costs will remain the same. For example in district heating, by having 30% lower heat consumption of buildings, pipelines and power-plants still need to be paid for thus the prices have to be increased, what leads to far lower-cost saving than 30%. Secondly, by pushing consumers towards most efficient solutions, the effective cost of a certain product is driven much higher. Let's take the lighting – indeed, LED and halogen lamps are more efficient, but at the same time they are many times more expensive what means also invariably higher energy input for production. Hence the actual cost reduction of 1 light unit is debatable. Or let's assume that the house energy efficiency target for a year for new housing by 2020 shall be established at the level of 60 kWh/m². The current EU average for a house is somewhere around 150-250 kWh/m². Certainly, there is a lot to gain if primary retrofitting of houses (replacing windows, doors, roofs or ventilation system) is being done, but low or marginal utility implies that by investing in additional retrofitting (such as exterior walls or basement) makes the cost of the saved kWh way too high. [See: Figure 1]

Unfortunately, fighting climate change alone makes little sense. 10% of the EU CO₂ emissions reductions, at cost of billions of euros and thousands of jobs in Europe, balanced just two weeks of emissions in China. While the EU has cut its emissions over 2000-2013 years by 7-8%, mostly due to natural replacement of older technology with more efficient solutions and reduced industrial production, the CO₂ emissions in China have increased by approximately 250%, effectively making the European effort meaningless (see Figure 1). What caused it? Well, the production has been increasingly shifted to Asia, but Europeans still purchase toys, electronics, clothing, chemicals etc. So the studies show that,

Figure 1. Top four CO₂ emitters in the world.

The top four emitters in 2013 covered 58% of global emissions
 China (28%), United States (14%), EU28 (10%), India (7%)

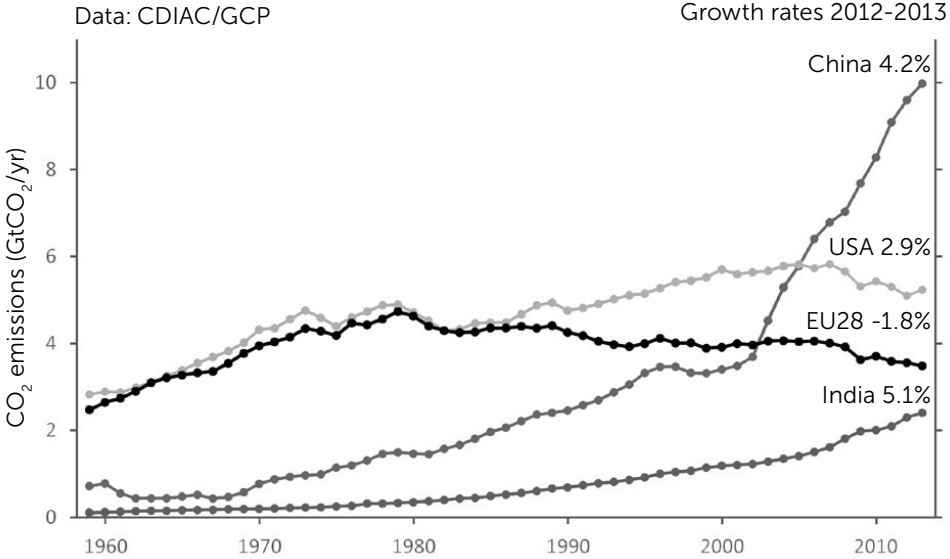
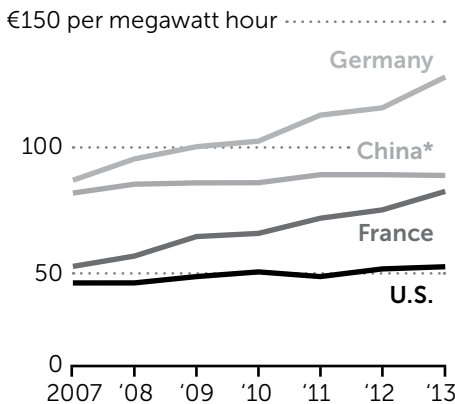


Figure 2. Power prices to industrial consumers.

Price Shock

Electricity prices paid by industry



Note: €1=\$1.32
 Source: IHS

*Guangdong Province
 The Wall Street Journal

due to Asian production, actually more carbon emissions are produced because of two reasons: less clean energy production and extra energy input needed for thousands of kilometers of transportation.

Based on the 20 years of experience, there is very little real likelihood that India, China, Japan, Brazil or even USA would cap their CO₂ emissions in any comparable way to the EU measures. Indeed, they may promise introducing some schemes but, in fact, they will not sacrifice their economic development to protect the environment. It does not mean that EU should abandon its policies completely, but it should consider CO₂ tariffs on imports from countries where there are no CO₂ caps to level the playing field for the EU producers and workers.

Of course, what matters to politicians are electoral votes. And, unfortunately, even politicians as astute as German Chancellor



THE NEW MEANS OF GENERATING NUCLEAR POWER SEEM MORE LIKE THE PINNACLE OF THE CIVILIZATION'S DEVELOPMENT THAN DOES THE HARVESTING OF THE SAME MODES OF POWER GENERATION THAT ONCE PROPELLED THE SHIPS OF COLUMBUS FORWARD. IF IT DOES NOT MAKE SENSE TO RETURN TO WIND-POWERED COMMERCIAL SHIPS, WHY SHOULD WE GO BACK TO THE WIND-POWER AGE?

Angela Merkel have bowed to the environmental populism and closed perfectly safe German nuclear power plants and made of the German subsidized renewable electricity one of the most expensive for end consumers (see Figure 2). European liberals shall therefore oppose the environmental populism with the ability to calculate and reason. [See: Figure 2]

Indeed, in the long run, nuclear power gives much longer-lasting chance than renewable energy. The bulk of the EU renewables comes from hydropower (thanks to mountains). Wind is both expensive and intermittent. There is also little chance that solar energy will ever constitute more than just a niche energy source with up to 10% of supply (in comparison to the current 3% in Italy and Germany). At the same time, 59 nuclear power plants have been supplying 80% of French power for decades without any serious accident. France is the EU's largest power exporter to Belgium, Germany and Italy with 45TWh. It is also reputable for one of the lowest power prices for consumers.

Nuclear power generation is quickly developing and its future lies in small, uranium-free, low-waste, passively-safe thorium reactors. These molten salt reactors will be tested in USA and are already developed in India, China, US, Canada and UK. There is three times more thorium than uranium on the planet – in a reactor there would be used 99% of thorium instead of 5% of uranium. There are also many more advantages (eg. unlike the uranium reactor, no plutonium is produced in the thorium reactor). And there are also plans of constructing a fusion reactor, albeit not in the ITER configuration but created by smaller, innovative designs developed by Lockheed Martin. Indeed, the new means of generating nuclear

power seem more like the pinnacle of the civilization's development than does the harvesting of the same modes of power generation that once propelled the ships of Columbus forward. If it does not make sense to return to wind-powered commercial ships, why should we go back to the wind-power age?

Economics is much better regulator of efficiency and energy than any politics. Industrial production has moved from Europe to Asia, Middle-East and both Americas due to lower labor and energy costs, lower regulation and thus reduced energy demand. However, because goods produced in Asia, Middle-East and Americas are still being consumed in Europe, the amount of energy that is actually consumed in end products is the same or even greater. Higher energy prices have prompted consumers to purchase more efficient technologies and cars. A breakthrough visible on the example of electric cars (Nissan Leaf or Tesla) has not happened thanks to government, but because of innovators and entrepreneurs. Just like smartphones and tablets are the breakthrough products not because of government, but entrepreneurs and innovators. Thus governments and politicians should meddle less with the energy sector and rather stand aside – except for the matters related to safety and reliability, when more economically innovative solutions come to the fore.

There should be no subsidies for any kind of energy production, nor should it be additionally taxed (as it is happening with nuclear power in Germany and Belgium). We should neither discriminate nor subsidize any energy source in Europe. We should create a level playing field.

In terms of strategic energy supply, Europe must realize that Russia is not a reliable energy provider and that the depend-

ence on Russia raises serious political problems – by threatening the European security and undermining European integrity by funding of the Jobbiks and Le Pens. Europe may and must depend on its own energy resources – be it Polish coal, French nuclear power, Norwegian hydro, British oil, Estonian oil shale, East-Mediterranean gas fields or Danish wind. Excessive regulation and emotions should no longer intrude on energy policy. Reason, technical know-how and fair competition should prevail. ●



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The Current Energy Options in Europe: Principles of Economic Liberty and the Situation in Ukraine



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MARTIN
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current crisis in Ukraine and the rounds of sanctions directed against Russia in the aftermath of the aggressions in Crimea and eastern Ukraine have once again led to the escalation of the debate about the energy independence of European countries. More specifically, the discussion focused on the options we have to create a comprehensive set of energy options that would leave us less vulnerable in the face of the power escalation with any potential adversary in control of a considerable energy resource.

This issue became a crucial one mainly due to the fact that some of the Central and Eastern European countries have found themselves fully dependent on the imports of oil and gas from Russia, which have been threatened by the current escalation of conflicts in Ukraine and the rounds of sanctions that were passed on both sides of the conflict. The 2009 gas dispute between Russia and Ukraine was the first example of such an escalation and the impacts of this crisis were felt mainly in Slovakia and Bulgaria which had 100% (Slovakia) and 96% (Bulgaria) of their gas imports from Russia with no diversification ready at the time that could help them in the case of such crisis¹.

Thus, a plan of energy diversification became one of the hot issues in the face of this new conflict, which reached the level of a military aggression and the annexation of the Ukrainian territory. However, it

is yet very unclear as to what the best options in context of this political and economic drama really are.

The list of energy options can vary from a simple diversification of imports to the countries of Central and Eastern Europe, through support of energy efficient transportation and production, to financial support for the renewable energy resources, and numerous others. However, due to the fact that the EU favours creating either financial disincentives against the production of CO₂ – as illustrated by the proposals for the carbon tax – or direct subsidies for other energy resources – as in case of the renewable resources – it is necessary to ask a number of questions. Namely, it is crucial to investigate how do these policies affect the economic freedom of businesses and consumers within the EU, illustrate their impact and briefly discuss the alternative approaches that might have a smaller effect.

Due to the current military aggression in Ukraine, it is usually taken for granted that the EU must act as a protector of the energy independence and assure that the energy needs of the countries are met. However, it needs to be questioned how the EU should tackle this task and what this mandate should allow the EU to do. If we leave the issue of freedom aside for the sake of emergency situation we are now facing, we might find that this will lead to unintended consequences distorting the energy market and affecting the energy prices for the citizens and companies in Europe.

ENERGY STRATEGY OF THE EU

So what have been the responses of the EU in the energy field so far? The current framework of the debate in the European Union about the establishment of a common energy policy has been properly kicked off in 2006 by the Green Paper entitled *A European Strategy for Sustainable, Competitive and*

¹ Bilgin, M. (2009) "Geopolitics of European natural gas demand: Supplies from Russia, Caspian and the Middle East", *Energy Policy*, Volume 37, Issue 11, November 2009, pp. 4482–4492.



IN THE YEAR 2011,
THE EU COUNTRIES
IMPORTED MORE
THAN 54% OF THE
ENERGY THEY
CONSUMED

Secure Energy. This green paper included possible founding principles for the common energy policy going forward.

The first set of proposals, *Energy for a Changing World*, was published by the European Commission in March 2007. These proposals were supposed to lead to a post-industrial revolution and a low-carbon economy, which would be accompanied by an increased competition in the energy markets, more secure and diversified energy supply, smaller impact on the environment and also improved employment situation in the European countries. The key proposals that were included:

1. a decrease of at least 20% in the emissions of the greenhouse gasses from the primary energy sources by 2020 in comparison to the 1990 levels together with continued support for Kyoto Protocol, which would aim for a 30% cut by all developed nations;
2. a cut up to 95% in CO₂ emissions from primary energy sources by 2050;
3. a minimum target of 10% for the use of biofuels by 2020 in the European Union;
4. improving energy relations with the main neighbours of the EU, including Russia and the bordering regions to the South and East, with the example of the Africa-Europe Partnership, to help Africa adopt low-carbon technologies and become a sustainable energy provider and supplier².

Moreover, besides the basic targets with regard to renewable energy and the emissions of greenhouse gasses, another key aspect of

² Europa.eu (2006) "Green Paper: A European strategy for sustainable, competitive and secure energy", *Europa.eu*, 5th July 2006, at http://europa.eu/legislation_summaries/energy/european_energy_policy/l27062_en.htm

Europa.eu (2014) "The 2020 climate and energy package", *Europa.eu*, 11th November 2014, at http://ec.europa.eu/clima/policies/package/index_en.htm





WITH THE UKRAINE CRISIS AND THE ROUNDS OF SANCTIONS THAT WERE EXCHANGED BETWEEN THE EU AND RUSSIA, THE POLITICAL DIMENSION OF THE ENERGY DEBATE IS LIKELY TO TAKE THE UPPER HAND AS THE FOCUS WILL INCREASINGLY BE DIRECTED TOWARDS SERVING THE POLITICAL INTERESTS THAT THE EU CURRENTLY PREFERS

the EU's energy strategy is the aspect of energy independence and the diversification of its energy resources. According to European Commission, in the year 2011, the EU

countries imported more than 54% of the energy they consumed. More importantly, however, the EU countries imported more than 80% of its oil needs and 60% of the gas they used. Over the last ten years this aspect was one of the driving factors behind the EU's push for a greater self-reliance of the EU in terms of use of renewable energy resources, building of the new energy networks and the increase in the energy efficiency, which is also one of the key aspects driving the current initiatives of the EU.

There is a definitely positive tone to this aspect, particularly due to the fact that diversification of imports should bring more competition to the energy markets of the EU countries, and thus lower the prices for the consumers. However, with support for the domestic alternatives in the form of renewable energy policies through the policy of subsidies casts a doubt on the economic rationality even if the aspect of greenhouse gas emissions is included. This is mostly due to the fact that the unintended economic consequences create such negative effects that the potential positive effects can be more efficiently gained through other means. In addition, with the Ukraine crisis and the abovementioned rounds of sanctions that were exchanged between the EU and Russia, the political dimension of the energy debate is likely to take the upper hand as the focus will increasingly be directed towards serving the political interests that the EU currently prefers³.

These proposals clearly indicate that the main direction of the European energy policy was designed to be heavily focused on centrally creating targets that would have to be met by the countries through policies that would drive companies from the use of traditional sources of energy. This means two main things for the future success of these initiatives.

³ Eurostat (2013) "EnergyConsumptionEurostatNewsrelease STAT/13/23." *Press Release*.

Firstly, the goals of the European Union were set in terms of a declarative tone of future levels, which are completely outside the power of the EU, which makes them unachievable and unrealistic given the competing interests of all the 28 member states of the European Union. Secondly, if the EU was to actively pursue these goals, it would have to encourage a set of subsidies and forms of regulation to ensure compliance with these plans, which (as it is shown later in the article) often leads to different results than those anticipated by the EU. Therefore, from the outset it is possible to say that the EU energy agenda is based on pursuing goals which will lead to series of limitations on economic freedom for the companies and the consumers themselves, and which will be mostly funded by the tax money. Therefore, it is necessary to investigate what the results of these policies have been in some countries up to this point.

CURRENT POLICIES AND THEIR IMPACTS

So what did these strategies and goals amount to in terms of actual policies and what were their outcomes as regards achieving their goals and impacting economic freedoms? As it was mentioned above, the 2007 targets led to an adoption of the set of goals which were approved by the European Council and became known as the “20-20-20” targets, which meant that every country was given a specific target for the proportion of energy to come from the renewable energy resources. These targets took into consideration the local climatic capacities and other circumstances specific for a given country. For example, Slovakia was given a target of 14% and the Czech Republic 13%. Moreover, each of the countries was required to ensure that by 2020 the proportion of energy from renewable energy sources in all forms of transportation will be at least 10%.

CO₂ EMISSIONS

To achieve this target the EU countries adopted numerous initiatives including the EU ETS (European Union Emission Trading Scheme) system, which set the limits for the CO₂ emissions and enabled the trading with the allowances of the CO₂ emissions. In theory, this should allow for the supply and demand with these allowances to result in a creation of a balanced price for the pollution and offer a good disincentive to factories and producers to scale down their emission levels. The problem with this approach is, however, that the level of the total number of allowances which was set up arbitrarily did not create a short supply of them, so the effect of the incentive was relatively low. The key to the success of this strand of energy policy is an optimal level of the allowances, which in practice is extremely hard to achieve, and which in past always proved unsuccessful⁴.

RENEWABLE ENERGY

Renewable resources are also on the priority list of the European Union and this was represented by the number of initiatives undertaken in this field in the member states of the EU. The main tool on this front in the EU member states was the Feed in Tariffs (FIT), which supports the renewable energy through guaranteed prices, and this approach is typically complemented by fiscal stimuli, numerous investment grants, Tradable Green Certificates (TGCs) and various support programmes based on the EU’s structural funds. So it can be seen that all of these programmes in support of the renewable energy were based on the interference in the market on numerous levels. This means that they were from their very outset prone to create imbalances in the

⁴ Carbon Trust (2013) “EU Emissions Trading Scheme (EU ETS)”, *Carbon Trust*, November 2013, at <http://www.carbontrust.com/resources/reports/advice/eu-ets-the-european-emissions-trading-scheme>

energy market resulting in the unintended consequences to be borne by clients in the member states.

To begin with, the implementation of the renewable energy sources is expensive with respect to the initial investment costs as well as the energy demands at the time of installation. For example, the energy returns for the coal plants are approximately 3.2–3.6 months, for nuclear plants approximately 2.9–3.4 months and for gas 0.8 months. The renewable energy resources fare in this comparison is much worse, with energy returns for water plants being around 4.6–13.7 months and photovoltaics in the scope of 71–141 months⁵.

Another problem associated with the renewable energy sources is their irregular and unpredictable electricity production, since it is dependent on natural factors. In case of positive circumstances there is an overproduction of electricity and a considerable congestion of the transmission system. Conversely, in case of bad weather circumstances might cause insufficient energy supplies, which have to be compensated by the backup, which increases the costs. The problems of this system are aggravated by the increasing integration of the European energy network. This means that the member states will have to invest increasingly large sums of money to maintain and reconstruct their own networks.

One of the complementing arguments in favour of the renewable energy approach from the proponents was that it would help create new jobs and increase the competitiveness of the sector in comparison with the rest of the world. The total turnover of



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the energy sector in the EU was estimated to be 137 billion Euros. The number of new jobs was estimated to exceed 1.1 million. A bulk of them was associated with installation and the service of the new plants. However, despite the expectations, the European producers of renewable energy are gradually losing their competitiveness to the rest of the world. While Europe is still dominating the global market in the area of wind energy, in case of the solar energy, the top 10 producers of solar panels contain eight from China and none from Europe.

Moreover, even the argument about the jobs is based on a very limited perspective. The subsidies directed at the renewable energy are crowding out the investment and consequently jobs from the unsub-

⁵ Drábová, D. (2007) "Rizika a Přínosy Jaderné Energetiky." *Pro-Energy Magazin*.

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WHEN LOOKING AT THE CHARTS OF THE EU ENERGY IMPORTS, IT'S NOT HARD TO NOTICE THAT MANY OF THE TOP FUELS, OIL AND GAS TRADING PARTNERS (INCLUDING COUNTRIES SUCH AS COLOMBIA, NORWAY, SOUTH AFRICA, INDONESIA, CANADA, UKRAINE, SAUDI ARABIA, QATAR, AZERBAIJAN, ALGERIA OR PERU) EITHER ALREADY HAVE SIGNED OR ARE IN THE PROCESS OF NEGOTIATING THE FREE-TRADE AGREEMENTS WITH THE EUROPEAN UNION

sidised and cheaper energy sectors. Furthermore, the resources spent on subsidies could be directed to other purposes, and thus have a more positive effects on the employment, or alternatively, given back to the taxpayers for their own use⁶.

Finally, the most hotly debated aspect of the support for the renewable energy is the impact it has on the energy prices in the European countries. This impact is perhaps best illustrated by the example of the Czech Republic, which committed itself to 13% share of renewable energy sources on the final energy consumption for 2020. It opted for a number of measures in support of the renewable energy producers, including income tax exemption for the first five years of production (later abolished), property tax exemption and investment support from subsidy programmes. The key element was the law no. 180/2005, which guaranteed returns on units of electricity for 15 years and capped maximum per-year decline in purchase price of renewable energy at 5%. These measures collided with a decrease in the costs of the solar panels due to cheap exports from China, which caused a boom in the solar energy sector that then resulted in a boom in the energy prices. These were covered from two sources: the former from the subsidies provided from the national budget, and the latter from the increased energy prices for the households and companies. Just in the Czech Republic the subsidies reached 11.7 billion euros both in 2012 and 2013 and grew to 14.7 billion in 2014. However, these subsidies covered only some portion of the total amount of the increased costs associated with the renewable energy. The part that is passed on the consumer has reached 38.4 billion in 2012 and 44.4 billion euros in

⁶ EurObserv'ER. 2012. "The State of Renewable Energies in Europe, 12th EurObserv'ER Report", 12th EurObserv'ER Report.

2013. This proves that the politically motivated approach to decrease the dependency on the foreign sources of energy can cause negative outcomes if it is based on the policy of subsidies⁷.

FOREIGN IMPORTS

The last key aspect of the current energy policy of the European Union and its member states reflects the fact that the EU is a net importer of energy, as stated above, notably in the areas of oil and gas. Thus, it has been crucial for the EU to develop good energy relations with its neighbouring countries and regions, which could act as potential partners with respect to the energy exchange. The main regions that are in the interest of the European Union are the Eastern Europe (including Russia and Ukraine), South Eastern region (starting from Balkan countries, through Turkey up to the Caucasus region in the North) and Mediterranean region (including North Africa and the Middle Eastern countries in the East). These countries have been approached through various multilateral partnerships, such as the Union for the Mediterranean, Energy Charter Treaty, and Energy Community, which altogether cover all mentioned areas.

These partnerships focus mostly on energy market, efficiency, transit and investment, dispute settlement and increased use of renewable energy. The importance of the neighbouring regions for the EU was strengthened through offers for economic partnerships in form of the EU neighbourhood policy and later association agreements, which should act as a carrot that would encourage economic, social and political reforms. This explains how the EU has currently

such a rich network of agreements, including the currently signed Association Agreements with Ukraine, Moldova and Georgia and the negotiations of the Agreements with Armenia and Azerbaijan. At the same time, the Free Trade Agreements reach even farther and to include countries such as Egypt, Tunisia, Algeria and Morocco.

When looking at the charts of the EU energy imports, it's not hard to notice that many of the top fuels, oil and gas trading partners (including countries such as Colombia, Norway, South Africa, Indonesia, Canada, Ukraine, Saudi Arabia, Qatar, Azerbaijan, Algeria or Peru) either already have signed or are in the process of negotiating the Free-Trade Agreements with the European Union. This generally shows a good direction of the EU policy towards ensuring the security of its energy exports through expanding the options of the imports in case that there will be an escalation of the political crisis such as can be seen now. This approach even extended to the approach adopted by the Visegrad Group (Czech Republic, Hungary, Poland and Slovakia) to address the US House Speaker John Boehner to help fast-track the LNG (Liquefied Natural Gas) exports from the United States to the countries of the EU as a measure against their dependence on the imports from Russia. However, this is currently very difficult and costly mainly due to the regulatory processes that have to precede the exports to the countries, with which the United States have not signed the Free-Trade Agreement. Since this currently applies also to the countries of the European Union, these countries will have to either push towards a change of the approach in the USA or try to speed up the signing of the Transatlantic Trade and Investment Partnership, which would allow for a faster

⁷ Konoplyanik, A. and Walde, T. (2006) "Energy Charter Treaty and Its Role in International Energy", *J. Energy Nat. Resources L.*, 24 (2006): 523.





THE IDEA OF SOLIDARITY THAT TUSK REFERS TO, MIGHT BE JUST A MORE ELOQUENT NAME FOR SOMETHING COMMONLY KNOWN AS FREE-RIDING, WHICH PRESUMES THAT WHILE SOME MEMBER STATES WOULD PAY THE BILL, OTHERS WOULD BENEFIT, EITHER IN HEIGHTENED ENERGY SECURITY, LOWER PRICES OR THE COST OF INFRASTRUCTURE

adoption of such measures. This proposal would be generally in lines with the principles of the free market⁸.

COMMON EUROPEAN GAS PURCHASING VEHICLE

A different proposal, however, coming from the Polish Prime Minister Donald Tusk is directed towards the idea of an 'energy union'. The idea behind this proposal is that the European Commission should negotiate gas contracts on behalf of the entire EU as a bloc, which would help unite its purchasing power, and thus ensure through its better bargaining position that the security of the imports would not be jeopardised.

According to Donald Tusk, this, together with the solidarity clause, would help weaken the position of Russia and help end its stranglehold on Europe. It may look good on paper. In reality, though, it would mean that Europe would bring the European Union back to the model of public utility of the 1970s or 1980s, where it would adopt the role of the end-to-end coverage of energy services and price setting, which would counter the entire set of reform packages currently aiming at the liberalisation of the energy markets.

Furthermore, the idea of solidarity that Tusk refers to, might be just a more eloquent name for something commonly known as free-riding, which presumes that while some member states would pay the bill, others would benefit, either in heightened energy security, lower prices or the cost of infrastructure. In this particular case, the Polish prime minister argued mostly for the European orchestration and the financing of a dense energy infrastructure, which would greatly benefit the Central and East-

⁸ Horn, H. & Mavroidis, P. C. (2010) "Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements", *The World Economy*, Volume 33, Issue 11, pp. 1565–1588, November 2010.

ern European countries, including Poland, but would be provided from the budgets of all the countries in the European Union.

Fortunately, it looks like this proposal will not be adopted at the European level as the liberal principles that are taking roots in the European energy market combined with the particular national interests of the individual countries seem to be too great a hurdle for such policy to be passed⁹.

SANCTIONS AGAINST RUSSIA'S OIL SECTOR

Unfortunately, the outbreak of Ukraine crisis led to another unfortunate development that will undoubtedly affect the future of the European energy policy, namely in the form of the sanctions targeting Russian energy sector. The main rationale behind this policy is the effort to punish Russia for its military annexation of Crimean peninsula and discipline it into cooperative behaviour with respect to the ongoing fighting that the Eastern parts of the Ukraine are still facing.

The main reason why the energy sector was picked as a suitable one for the sanctions was the scope of the energy sector in Russia and the effects the sanctions could have on Russian budget and the economy. It was due to this aspect, that it was expected that such an approach would leave Russia without the option of turning the taps off for the European consumers. Whether or not we agree with the approach for political reasons and regardless of the actual efficiency, it is necessary to investigate a number of particularities of the energy market that could have a serious impact on the energy security and prices in Europe.

One thing that needs to be remembered about the global oil market is its size with roughly ninety million barrels of oil consumed each day. With such number in mind, it is almost impossible to place aside one of the largest oil producers out of the energy market without causing significant repercussions within the European Union. The primary consequences could be in terms of price shocks, inevitably hurting customers on both sides of the importing and exporting nations. The price vulnerability would be, however, felt mostly in the European economies. This cost is all the more questionable given the fact the outcome of the sanctions – the proponents of sanctions often refer to the sanctions that were placed on Iran due to its nuclear programme in 2012.

The problem with this analogy is that with respect to Russia we are dealing with a very different historical, political and economic background that preceded the application of sanctions in the country. As Iran has faced political and economic isolation by the Western countries for a period of decades prior to the oil sanctions in 2012, the investment in the country in form of capital and technology dropped to a minimum. This resulted in the productive capacities of Iran being much lower at the time of sanctions, and thus the impact on the global oil system was much smaller. This allowed for the tough financial sanctions to have much more influence on disciplining the Iranian regime. Given the prominent place of Russia in the global oil market it is less likely that such an approach can have similar effects on Russia, particularly, as it has already gone into military involvement in Ukraine and currently supports the actions of rebels in the eastern parts of the country. This shows that the stakes on

⁹ Goldthau, A. & Boersma, T. (2014) "The 2014 Ukraine-Russia crisis: Implications for energy markets and scholarship", *Energy Research & Social Science*, Vol. 3 (2014), pp. 13–15.

the Russian side are much higher and it may not be easily deterred from taking this sacrifice¹⁰.

EVALUATION

All these proposals coming from the European Union and its member states with the efforts to achieve energy security with regards to Russia and green development with respect to the renewable energy greatly simplify the global oil and energy markets and the resulting interdependencies stemming from the current power imbalances. It is therefore vital for the EU to revisit its basic goals in order to define the energy goals in a different way that would be more conducive to the free market principles and respecting the past developments as the key interest of the policy-makers should be to ensure the most economically beneficial outcomes for the citizens and businesses in their country. So far, this has not been achieved.

Furthermore, the EU and other global players – notably the United States and Russia – are currently facing more dynamic challenges in terms of the global energy governance. This includes a crucial element of growing importance of other energy actors, such as India or China, and also change in the main themes of the energy debates shifting more to soft issues of climate change and energy poverty. This means that the world is currently moving towards a more global governance system in the area of energy debate. As a result, the global energy governance is likely to become more multilateral and involving numerous non-state institutions and agents. If the current crisis will escalate into a full-scale energy conflict, this development might be severely threatened.

¹⁰ Goldthau, A. & Boersma, T. (2014) "The 2014 Ukraine-Russia crisis: Implications for energy markets and scholarship", *Energy Research & Social Science*, Vol. 3 (2014), pp. 13–15.

CONCLUSIONS

So all in all, it can be seen that there are some important lessons to be learned from the current approaches of the European Union towards the energy sector. First of all, over the past decades the EU has moved towards embracing the market principles in the area of energy and experiences positive effects of this approach. The main facet of this approach could be seen in the liberalisation of the energy markets and the overall diversification of its energy imports.

However, it wasn't the crisis involving Russia and Ukraine that created the pressure for the EU to propose or directly enact measures conflicting the market principles. These have appeared firstly in the areas of CO₂ emissions and also the support for the renewable energy, which was based on the political goals defined by the European Commission. The attempts to put these goals in practice had numerous unintended consequences that were mostly felt by the people and businesses in the respective countries.

These means of the politics-based approach to the basically economic issue of energy have been thus merely accelerated by the crisis involving Russia's military involvement in Ukraine. It is up to the EU to revisit these policies based on the findings from their own policies and past examples from other countries to better tailor its steps with the interests of the EU businesses and citizens in mind. ●



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Steam Coal Crisis in Ukraine: A Pressing Need to Diversify Fuel Imports



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Over the past several months Ukraine experienced severe shortages of certain types of coal at its thermal power plants which eventually led to electric power outages and power blackouts all over Ukraine. Where should we seek the roots of the problem and what are the possible ways solving it?

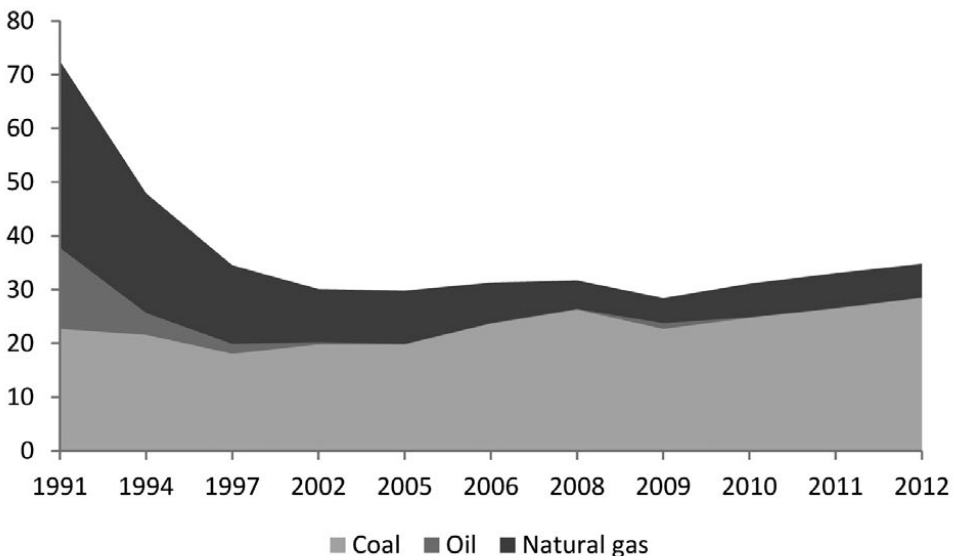
ELECTRICITY PRODUCTION IN UKRAINE

All electricity generating facilities in Ukraine work as a United Energy System (UES). They have a joint production, transmission and distribution regime of electric and steam energy, which is managed from a single operation centre. UES consists of eight regional electric systems: Dniprovskaya, Donbaska, Zakhidna, Krymska, Pivdenna, Pivdenno-Zakhidna, Pivnichna and Tsentralna (see Annex A).

The basis of Ukrainian UES is thermal power generation, as it accounts for over 60% of installed capacity and for about 50% of electricity generation. It includes thermal power plants (TPPs), combined heat and power plants (CHPs), energy units at enterprises and municipal CHPs. Nuclear energy accounts for 25.8% of the total installed capacity and generates about 46% of electricity. The share of hydro power plants (HPPs) and hydro accumulating power plants (HAPPs) in the total installed capacity is 10.2% (approximately 6% of the total electricity generation).

The capacity of HPPs and HAPPs is not enough to regulate the energy consumption. Thus, the structure of Ukrainian electricity generation is overloaded with basic facilities (NPPs and the majority of TPPs) and is characterized by an acute shortage of shunting capacity. Consequently, the units designed to work in a basic mode are

Figure 1. Share of fuel in electricity generation at TPPs and CHPs in Ukraine, in tons of standard fuel.



Source: Ministry of Energy and Coal Industry of Ukraine.



THERE ARE FOURTEEN THERMAL POWER STATIONS (TPPS) IN UKRAINE. HALF OF THEM USE GAS COAL, WHILE THE OTHER HALF USES ANTHRACITE COAL. FOR THE NORMAL WORK ELECTRICITY GENERATION SECTOR NEEDS ABOUT 1.6 M TONS OF EACH GROUP OF COAL MONTHLY

used as shunting capacity, which is an additional factor of accelerated depreciation of equipment. Much of the TPPs work in peak and semi-peak modes.

Coal power plants play an important role in Ukrainian energy system as coal is the main local source of energy. According to the Ministry of Energy and Coal Industry, installed capacity of TPPs is 27.2 m Kwt including 21.8 m Kwt of coal power units, or around 41% of the total UES capacity (see Figure 1)

Since 2002, due to a rapid increase in the price of imported natural gas, TPPs started to displace natural gas with other fuel. At a time when nuclear power plants produce almost half of all electricity in UES of Ukraine at base load, thermal power plants have to cover the daily and weekly fluctuations in electricity consumption working longer at partial load. Such work is possible only with improving the quality of coal supplied to the power station. The quality of solid fuel burned at thermal power plants changed significantly. During the period between 1980-2002, coal quality has significantly deteriorated and its ash content increased to 35-38%. The share of coal in electricity generation at thermal power plants in Ukraine had been increasing since 2002, and starting with 2003 its quality also began to increase.

There are fourteen thermal power stations (TPPs) in Ukraine. Half of them use gas coal (grade DG gas flame coal and grade G gas coal), while the other half uses anthracite coal (grade T lean non-banking coal and grade A anthracite). For the normal work electricity generation sector needs about 1.6 m tons of each group of coal monthly.¹ [See: Table 1]

¹ <http://uaenergy.com.ua/post/20855>

Table 1. Grades of coal used by TPPs.

TPP	Type of coal	Heat content $Q_{r,iv}$ Kcal/kg	Ash content A_r , %	Water content W_r , %
Prydnistrovska	Anthracite	6010	16.7	7
Kryvorizka	Nonbaking coal	5900-6550	15.2-21.6	4.5-6
Zaporizka	Gas coal	5000	22.3	11
Ladyzhynska	Gas coal	5000	22.3	11
Dobrotvirska	Gas coal	4950	22.4	10.5
Burshtynska	Gas coal	5380	22.4	7.4
Starobeshivska	Anthracite	6010	16.7	7
Slovyanska	Anthracite	5800	18.8	7.4
Trypilska	Anthracite	5790	19	7.5
Trypilska	Nonbaking coal	6550	15.2	5
Zmiivska	Anthracite	6010	16.7	7
Zmiivska	Nonbaking coal	6550	15.2	5
Vuglegirska	Gas coal	5000	22.3	11
Zuivska	Gas coal	4730	26.7	11
Luhanska	Anthracite	5800	18.7	7.5
Kurakhivska	Gas coal	4100		

Source: Prospects for the implementation of clean coal technologies in the energy sector of Ukraine. GNOZIS 2013.

Since the beginning of the military operation in Donbas the Luhansk TPP has been working as an energy island, which puts electricity supply of the nearest territory at risk. The rest of TPPs are part of the UES. A decrease in the power capacity of any of the energy units will affect the rest of the country including Donbas and Crimea.

Coal reserves at power plants are about 1.4 m tons of coal including 1 m tons of steam coal and more than 250 thousand tons of anthracite (see Figure 2). The main difficulty is that some stations with minimum stocks cannot operate at required capacity. As of December 5, the biggest difficulties with fuel shortages had Prydniprovsk and Kryvorizka TPPs in Dnipropetrovsk region and Zmi-

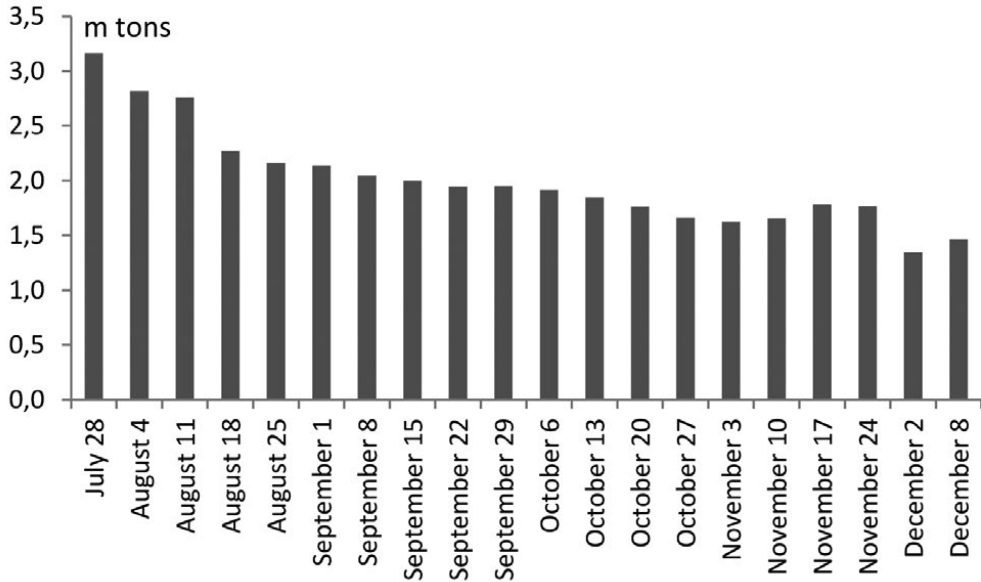
ivska TPP in Kharkiv region.² All of them use anthracite. Overall, coal deficit of the anthracite group amounts to about 1 m tons a month³. [See: Figure 2]

Daily consumption of coal at TPPs is around 105 thousand tons.⁴ The share of coal was gradually decreasing since spring, when Russia cut gas supplies and Ukraine started to substitute expensive gas with coal. Later this trend reversed as Ukraine experienced sharp shortage of steam coal after supplies from Donbas region were cut.

² http://mpe.kmu.gov.ua/minugol/control/uk/publish/article?jsessionid=77A5A412E97C3CA29A0F0ACD475D5FD6.app2?art_id=244971463&cat_id=35109

³ <http://www.epravda.com.ua/news/2014/10/15/498150/>

⁴ Own estimation on the basis of the Ukrenergo data.

Figure 2. Coal reserves at thermal power plants of Ukraine.

Source: Ukrenergo.

Daily electricity consumption in Ukraine is 25-26 GWh of electric energy, 36-42% of which is covered by TPPs, depending on the season. As of December 2, 22 units of TPPs and NPPs were under emergency repair with the total capacity of 5930 MWt (30% of the actual capacity). Electricity consumption reached 25200 MWt and the existing generating capacities could not cover it. The electricity deficit was 3000-3500 MWt. The same electricity deficit continued to exist throughout the first two weeks of December and Ukrenergo, the national operator of UES of Ukraine, introduced emergency switching off of the main consumers.

COAL PRODUCTION IN UKRAINE

Coal sector is traditionally considered as a guarantee of energy security in Ukraine because coal is the largest indigenous source of fossil fuel energy. In 2013, domestic coal production covered about 35% of the total primary energy supply⁵. How-

ever, military conflict in the east of Ukraine has questioned the reliability of even this source of energy and further weakened energy security of the country.

Ukraine is endowed with abundant coal deposits including a range of coal types from anthracite to lignite, which account for about 90% of the fossil fuel resources of the country. According to the IEA (2012)⁶, anthracite and bituminous coal reserves are estimated at 32 Gt⁷ and sub-bituminous coal and lignite – at 2 Gt⁸. Ukrainian government estimates total hard coal reserves at about 118 Gt and proven reserves at about 57 Gt⁹. Most coal seams are located in the Donetsk, Lviv-Volyn anthracite basins

⁵ Ukraine 2012: Energy Policies Beyond IEA Countries.

⁶ Ukraine is sixth in the world ranking for hard coal reserves, after the United States, China, Russia, Australia and South Africa.

⁷ Fifteenth place in the world ranking of lignite reserves.

⁸ <http://mpe.kmu.gov.ua/minugol/control/uk/doccatat-log/list?currDir=50358>

⁹ Energy balance of Ukraine, <http://www.ukrstat.gov.ua/>



and lignite Dnieper Basin. Largest deposits are concentrated in Donetsk, Luhansk and Dnipropetrovsk regions of Ukraine.

During the period from 1945 to 1970s, coal production in Ukraine was among the largest in the world. Since then, coal seams were gradually depleted what moved coal extraction deeper in the ground resulting in increased production costs. Hence, extraction levels decreased considerably (IEA, 2006). In about 20 years, coal production declined from 135.6 m tons in 1991¹⁰ to 84.3 m tons in 2013. The number of mines decreased from 283 to 135, respectively.

As of 2013, 53 mines were in private ownership producing 60.2 m tons of coal (71.4% of total) and 82 mines were in public ownership without taking into an account small and often unauthorized mines (so-called "kopanki"¹¹). Considering that the majority of mines with better geological conditions were already privatised, unprofitable shallow mines with complicated geological conditions were left in state ownership. Thus, state mines are heavily reliant on state subsidies, which were growing every year irrespective of the amount of coal produced. In 2013, about UAH 13.3 bn were allocated to compensate for the losses because of the difference between the coal price and production costs¹² and UAH 1.6 bn were allocated for technical moderni-

¹⁰ Data for 1991 are taken from the Energy strategy, data for 2013 were obtained from http://www.niss.gov.ua/articles/1495/#_ftn1

¹¹ According to various sources, "kopanki" could contribute to about 6-9 m tons of coal annually (mainly of the steam variety), which is equivalent to 7-10% of the total steam coal production. Source: Baker Tilly. 2013. Industry report: Ukraine Coal.

¹² In 2013, average production cost per 1 t of coal was about three time higher (1352 UAH) than the market price of coal (493 UAH). <http://www.niss.gov.ua/articles/1495/>



DURING THE PERIOD FROM 1945 TO 1970s, COAL PRODUCTION IN UKRAINE WAS AMONG THE LARGEST IN THE WORLD. SINCE THEN, COAL SEAMS WERE GRADUALLY DEPLETED WHAT MOVED COAL EXTRACTION DEEPER IN THE GROUND RESULTING IN INCREASED PRODUCTION COSTS

sation and restructuring, which in total equalled to 4.4% of state expenditures in 2013.

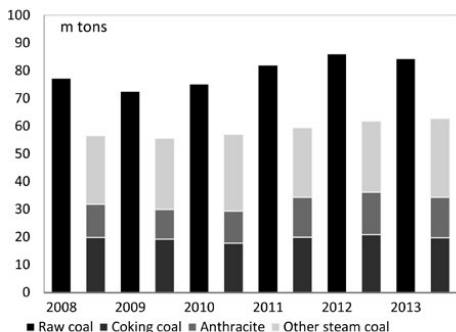
On the contrary, private mines are profitable – exploit about 90% of production capacities, have labour productivity and salaries about 20-25% higher than the state

mines. The majority of private coal mines are part of vertically integrated metallurgy or power companies (LLC Metinvest Holding has seven mines, Donbas Fuel and Energy Company (DTEK) has 28 mines, JSC Donetsk Metallurgical Plant has one mine), or horizontally integrated structures like Scientific-Production Organisation "The Mechanic" (six mines). Additionally, there are about ten independent coal mining enterprises of different legal forms.

The program of economic reforms in 2010-2014 envisioned privatisation of the potentially profitable mines and closure of unprofitable ones. The Laws of Ukraine "On the peculiarities of coal mines privatisation" and "On the peculiarities of renting or concession of the state-owned objects of the fuel and energy complex" were approved and lists of mining enterprises which could be privatised subject to corporatisation or may be granted in concession, were prepared. [See: Figure 3]

Figure 3 shows that raw coal output increased by about 11% from 2008 to 2012 and then slightly dropped. At the same time, marketable coal production increased from 56.5 m tons in 2008 to 62.7 m tons in 2013. Coking coal extraction remained largely unchanged while production of the steam coal group expanded by

Figure 3. Coal production in Ukraine.



Source: State Statistical Service of Ukraine

about 17.2%. According to the operational data of the Ministry of Energy and Coal Industry, about 61.4 m tons of coal were extracted in Ukraine in the period from January to November, which is 5.9% less than was planned and 43.7% less than for the same period in 2013¹³.

The quality of Ukrainian coal is rather poor and is getting worse with increased depth of coal seams¹⁴. Particularly, the ash content of domestically consumed coal¹⁵ increased from 29.8% in 1991 to 37.9% in 2005. At the same time, sulphur content is very high, about 2.5% on the average. Thus, preprocessing of coal should be conducted to improve its quality, what would affect the competitiveness of the Ukrainian coal at the international market.

Since the beginning of the 1990's, Ukraine gradually turned from a net exporter to a net importer of coal, which is largely explained by deteriorated quality of coal. However, Figure 4 illustrates that coal export is gradually growing (reached 6 m tons of oil equivalent in 2013) while import stayed almost at the same level at 9 m toe in the last six years. [See: Figure 4]

Ukraine is currently importing coal due to the deficit of lean non-baking coals (grade T) required by the power plants and also to the deficit and low quality of coking coal (high sulphur content) demanded by metallurgy industry.

Key suppliers of coal to Ukraine are Russia with 73% and USA with 20% (see Figure 5). The demand for coking coal from Russia

¹³ Energy Business N49/887 as of 9.12.2014.

¹⁴ OECD/IEA. 2006. Ukraine: an overview of energy policy.

¹⁵ The quality of exported coal is higher. Its ash content was at the level of 18.3% in 1991 and increased to 25.5% in 2005.

Figure 4. Production, import and export of coal and peat in Ukraine.

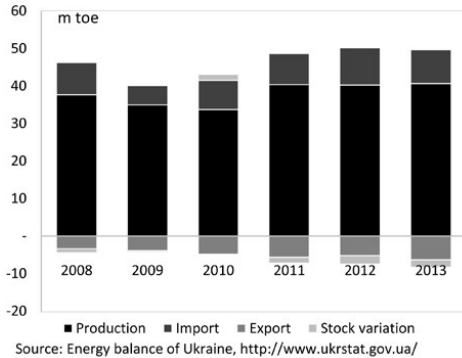
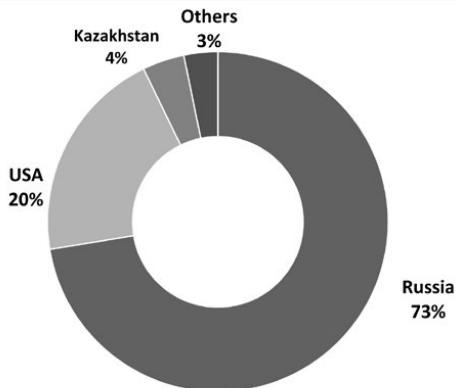


Figure 5. Breakdown of coal imports by countries in 2013.



especially increased during 2010–2013 because metallurgical enterprises started to use pulverised coal injection technology which requires high quality coke for cast iron production. In comparison, Russian coking coal contains about 0.5% of sulphur while Ukrainian coal contains about 1.4–3% which makes it less competitive¹⁶. [See: Figure 5]

Key export destinations of Ukrainian coal are Turkey (14%), Bulgaria (11%), Morocco (10%) and Russia (9%) (see Figure 5). During Janu-

ary–August, coal exports reached 6.2 m tons¹⁷ which is an increase of 26% (by 1.3 m tons) yoy. It should be noted that Ukraine did not experience coal deficit by the end of July 2014. However, escalated military confrontation in the Donbas region impeded coal extraction as the majority of state mines are located in the area of military conflict. Most of the anthracite mining enterprises have either fully or partially flooded mines or non-working equipment and are unable to dispatch coal due to the damage of railway infrastructure. According to the Ministry of Energy and Coal Industry¹⁸, about 2 m tons of coal had been accumulated at the storages of Donetsk and Luhansk regions and cannot be transported.

In this situation Ukraine had to start imports of steam coal for the needs of TPPs for the first time in a long period of time. In September 2014, the contract was signed between the State Foreign Trade Company Ukrinterenergo and Steel Mont Trading Ltd (UK) on supply of 1 m tons of anthracite from South Africa¹⁹. Despite the verification of price and quality of coal in the contract by the Ministry of Energy and Coal Industry of Ukraine the quality of coal in the first batch delivered was below the technical requirements of Ukrainian TPPs. Such coal could only be used by TPPs in combination with the Russian coal. Moreover, due to multiple revisions of the contract the actual price of purchased coal increased from USD 86 to USD 134 per ton. This spurred a scandal in the media and Prosecutor General's Office of Ukraine started investigation of this case. As a result, Steel Mont Trading refused to deliver the rest of the

¹⁷ <http://www.epravda.com.ua/news/2014/10/15/498150/>

¹⁸ http://mpe.kmu.gov.ua/minugol/control/uk/publish/article?jsessionid=77A5A412E97C3CA29A0F0ACD475D5FD6.app2?art_id=244971463&cat_id=35109

¹⁹ Energy Business N49/887 as of 9.12.2014.

¹⁶ <http://www.niss.gov.ua/articles/1495/>



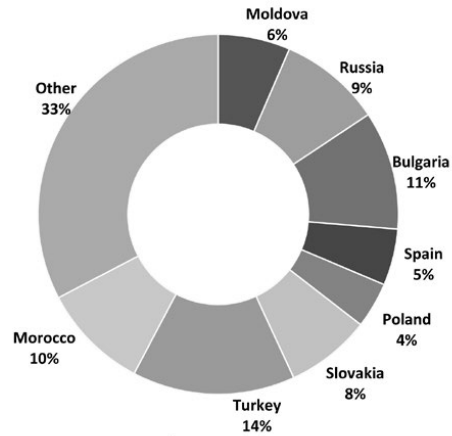


ESCALATED MILITARY CONFRONTATION IN THE DONBAS REGION IMPEDED COAL EXTRACTION AS THE MAJORITY OF STATE MINES ARE LOCATED IN THE AREA OF MILITARY CONFLICT. MOST OF THE ANTHRACITE MINING ENTERPRISES HAVE EITHER FULLY OR PARTIALLY FLOODED MINES OR NON-WORKING EQUIPMENT AND ARE UNABLE TO DISPATCH COAL DUE TO THE DAMAGE OF RAILWAY INFRASTRUCTURE

contracted coal (about 510 m tons) due to risks of non-payment or shipment blocking. [See: Figure 6]

According to the prime minister²⁰, Australian and USA coal prices are unacceptably high and imports from South Africa are not possible at the moment due to on-going investigation of previously signed contracts. Hence, Ukraine has to import coal from Russia. Two Ukrainian companies, Tsentren-ergo (3 TPPs) and DTEK (9 TPPs), planned to purchase about 3.1 m tons of coal from Russia by the end of 2014. Tsentrenerg

Figure 6. Breakdown of coal exports by countries in 2013.



Source: State Statistical Service of Ukraine

contracted 509 thousand tons of A and T grades coal at the price of USD 80 per ton. DTEK plans to import 2.6 m tons of coal and 1.3 m tons has been already delivered²¹.

Negotiations with Poland on potential coal supplies also take place. However, there are no large contracts at the moment as Poland does

²⁰ <http://ua-energy.org/post/48755>

²¹ <http://ua-energy.org/post/48755>

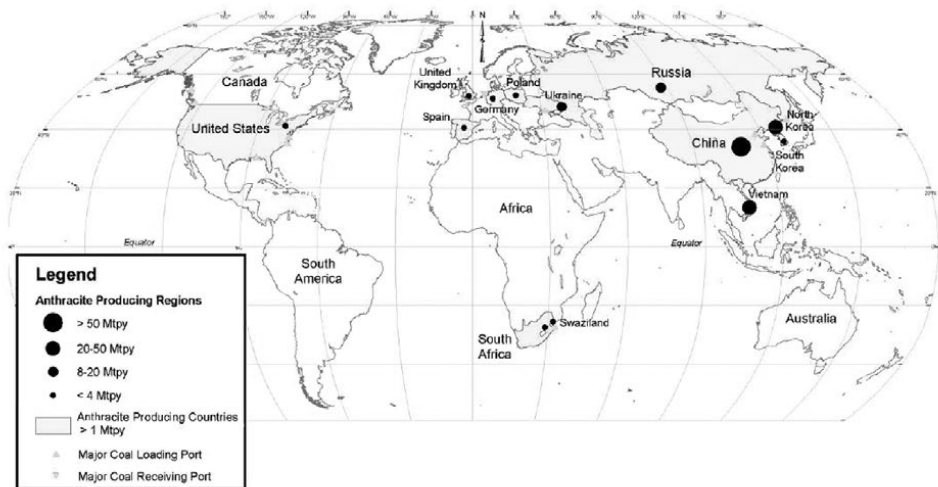
not have coal of a required grade for Ukrainian TPPs. Nevertheless, regional consumers are importing coal from Poland in smaller quantities²².

ANTHRACITE WORLD MARKET

Let's look at the anthracite world market more closely. In 2007, Ukraine was the third largest anthracite extracting country in the

American analysts note that Ukrainian and Russian anthracite exports influence the price of anthracite at the American market. Historically, Ukraine exported 160,000–170,000 tons of anthracite to the US each year. "So far in 2014 up to July, Ukraine had shipped 83,466 tons of anthracite and astonish-

Figure 7. World anthracite production.



Source: Marston.

world. The first two were China and Russia. The Top-10 also included Vietnam, North Korea, South Africa, South Korea, Spain, USA and Poland. The main anthracite exporter in 2007 was Vietnam with 32.5 m tons. Next comes Russia with 8.6 m tons and China with 5.3 m tons. [See: Figure 7]

Unlike for other types of coal, anthracite prices are not quoted on a recognised price exchange and so pricing is not transparent. Some public listed anthracite mining companies – like UK AIM Listed Atlantic Coal – report on anthracite prices due to its requirements as a public company. Pricing is often negotiated based on market feel, rather than on a quoted index.

ingly even with trade sanctions the Russians had managed to land 25,000 tons into the US. We know for certain that these shipments have now stopped. The price of Ukraine anthracite in the US has typically been priced at around USD 85 per ton and had a pretty significant impact on driving and dampening prices of anthracite in the US market. Now that these shipments have stopped, which have accounted for approximately 9% of the total US production, it is fair to say that US anthracite prices should head north by 10%.²³

²³ Andre Morrall, analyst at Christian & Small LLP, <http://secretlyfriedcollective.tumblr.com/post/104250690509/atlantic-coal-atc-expects-us-domestic-anthracite>

²² <http://ua-energy.org/post/49300>

The price of anthracite widely varies by country and depends on the shipment distance and the volume of anthracite traded. [See: Table 2]

In Ukraine, the average price of coal sold to TPPs in January–October 2014 for different types of coal was the following: gas coal 793.3-842.2 UAH/t, gas flame coal 816.54-821.34 UAH/t, flame coal 814.97 UAH/t, fat coal 801.79 UAH/t, non-bank-

ing coal 681.31-767.28 UAH/t, anthracite 629.51-845.16 UAH/t depending on coal characteristics. During this period state coal mines delivered to power stations 6 m tons of steam coal. The total supply was 17.6 m tons.

According to the Ministry of Energy and Coal Industry, in the period of August–November 2014 Ukraine imported 1.8 m tons of anthracite coal: 1.5 m tons from Rus-

Table 2. Prices of non-agglomerated anthracite by major anthracite producers.

	From	To	Average price, USD/t
June 2014	China	France	415
	China	Germany	462
	China	Italy	416
	China	Netherlands	318
	China	Spain	403
	Viet Nam	Switzerland	519
	United States	Belgium	151
July 2014	China	France	381
		Germany	471
		Italy	418
		Netherlands	588
		Spain	464
	United States	Iceland	209
		Norway	191
		Spain	523
August 2014	China	France	472
		Italy	452
		Latvia	560
		Spain	389
		United Kingdom	494
	South Africa	Ireland	268
	United States	Iceland	218
		Latvia	783
September 2014	Vietnam	Switzerland	529

Note: Prices in the range 400-800 USD/t are for low volumes of anthracite traded.

Source: Comtrade.

Table 3. Ukraine's trade volumes in anthracite in January–September 2014.

	Country	Net weight, tons	Trade value, m USD	Average price, USD/ton
Exports	Belarus	33875	2.9	86.3
	Moldova	74434	6.2	82.8
	Russia	449564	24.9	55.4
	Belgium	174378	14.2	81.5
	Bulgaria	571276	37.9	66.4
	Bosnia Herzegovina	43632	4.4	101.7
	United Kingdom	28161	2.4	86.4
	Greece	11133	0.6	50.6
	Spain	324558	25.1	77.3
	Italy	111555	6.3	56.2
	Germany	9817	1.5	149.1
	Poland	233452	19.6	84.1
	Portugal	6798	0.2	36.6
	Romania	129818	9	69.4
	Serbia	20569	1.5	74.9
	Slovakia	209805	15.3	72.9
	France	46766	3.2	68.3
	Croatia	44099	2.7	62.1
	Switzerland	3307	0.3	83
	Georgia	3159	0.3	100.4
	India	259648	22.5	86.5
	Cyprus	3946	0.2	56.4
	Rep. of Korea	22878	1.9	81.2
	Lebanon	23139	1.3	55.4
	Saudi Arabia	11134	1.1	94.6
	Turkey	798370	63.6	79.6
	Philippines	1133	0.1	98.2
	Algeria	22303	1.1	50.7
	Egypt	170732	12.6	73.8
	Morocco	146905	8.8	60.2
	Brazil	38898	5	129.7
	Canada	110256	7.4	67.3
Mexico	8347	0.8	91.3	
USA	49086	3.9	78.6	
Imports	Russia	353587	36.7	103.7

Note: trade is shown for trade volumes greater than 1000 tons.

Source: State Statistical Service of Ukraine.

sia, 0.2 m tons from South Africa and 0.1 m tons from Australia. In November alone Ukraine imported 0.7 m tons of steam coal from Russia, 0.2 m tons from South Africa and 0.1 m tons from Australia. The share of domestic coal in the total coal volumes supplied to power plants was only 17.8%. [See: Table 3]

As the Table 3 shows, Ukraine was actively trading in anthracite in 2014, fulfilling the existing contracts. At the same time, the shortage of anthracite domestically was already evident in summer and Ukrainian companies started importing anthracite from Russia at a relatively high price.

Overall, it should be noted that shortage of steam coal took Ukrainian government and extraction companies by surprise and they appeared unprepared to deal with the crisis in short period of time.

CONCLUSIONS

1. Ukrainian electricity generation lacks shunting power capacities.
2. Ukrainian electricity generation is highly dependent on one type of fuel/coal.
3. Ukrainian anthracite reserves are concentrated in one region – Donbas—which is currently not controlled by the Ukrainian government. This makes it impossible to mine and transport anthracite from there.
4. Anthracite market is very limited with the largest producers situated far from Ukraine. The biggest producer of anthracite closest to Ukraine is Russia. However, purchases from Russia are undesirable for political and energy security reasons.
5. Due to the market size, anthracite is traded mainly under long-term contracts. Its availability in the short-term is very limited and the price is very high. Therefore, in

the short-term Ukraine has to use all possibilities to buy the anthracite coal, including the Russian market. But in the long run, the country needs to prepare itself and sign long-term contracts with big producers at more favourable prices.

6. In the long-term, on the demand side, energy consumption should be reduced through reconstruction of old production capacities, modernisation of infrastructure and energy-efficiency incentives for the final consumers. On the supply side, reform of the coal sector should be completed to eliminate producer subsidies for unprofitable mines, attract investments for development of private coal mining and diversify imports of high quality coal. ●



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Annex A.

Electric system	Power stations	Capacity, MWt
Dniprovska	Prydniprovska TPP	1765
	Kryvorizka TPP	2820
	Zaporizka TPP	3600
	Zaporizka NPP	6000
	Dniprodzerzhynska TPP	61.6
	Kremenchutska HPP	632.9
	Dniprodzerzhynska HPP	369.6
	Dniprovska HPP	1513.1
	Kakhovska HPP	329
	Krasnokhutorska HPP	3.3
	Ternovska HPP	1.95
	Novoarkhangelska HPP	1.3
	Gayvoronska HPP	5.7
	Berezivska HPP	0.3
	Power units at enterprises (CHPs)	746.4
	Botievska WPP	90
	Tokmak Solar Energy SPP	1.5
Gril Company SPP	0.075	
Turbo expander PP	4	
Donbaska	Starobeshivska TPP	1975
	Slovyanska TPP	880
	Kurakhivska TPP	1487
	Zuyivska TPP	1245
	Luhanska TPP	1425
	Vuhlegirska TPP	3600

	Myronivska TPP	275
Zakhidna	Rivnenska NPP	2835
	Dobrotvirska TPP	500
	Teplotransservis CHP	5
	Novoyavorivska CHP	25
	Lvivska CHP	41.3
	Energy-Novy Rozdil CHP	36
	Drohobyska CHP	17
	Zhydachivska CHP	18
	Burshtynska TPP	2300
	Kaluska CHP	200
	Tereblya-Ryvska HPP	27
	Probynivska HPP	1.77
	Uzhgorodska HPP	1.9
	Onokivska HPP	2.65
	Nadvirnyansky Oil Processing Plant CHP	30.5
	Ivanofrankivskteplokomunenergo CHP	3.5
	Lokachi CHP	8.8
	Rivneazot CHP	24
Krymska	Simferopolska CHP	68
	Sevastopolska CHP	34.5
	Kamysh-Burunska CHP	30
	Sakski teplovi merezhi CHP	12
	Perove SPP	105.58
	Okhotnikove SPP	80
	Owl Solar SPP	31.55
	Sakska WPP	20.8

	Tarkhankutska WPP	20.11
	Donuzlavskaya WPP	11.6
	Chornomorska WPP	1.2
	Myronivska WPP	18.4
	Rodnikove SPP	7.5
	Aktashka WPP	2.81
	Prisnovodnenska WPP	5.6
Pivdenna	Pivdenoukrainska NPP	3000
	Tashlytska HAPP	302
	Khersonska CHP	80
	Odeska CHP	68
	Mykolaivska CHP	40
	Kotovskiy Concrete Plant CHP	6
	Zaplazky Concrete Plant CHP	6
	Krasnokutska HPP	3.3
	Gileya CHP	12
	Oleksandrivska HPP	11.5
	Vozko cogeneration station	2
	Odesa Krokmal CHP	6
	Teplodarenergo CHP	2.5
	Lukoil Energy and Gas of Ukraine CHP	17.848
	Starokozache SPP	44.5
	Artsyuz SPP	43
	Reni SPP	40
	Zorya-Mashproekt CHP	186
	Mykolaiv Alumina Plant CHP	18
	Mykolaivoblteploenergo CHP	1.26

	Ukrainian Sugar Company CHP	12
	Pershotravneva HPP	2.14
	Khersonnaftopererobka CHP	6
	Kakhovska HPP	329
Pivdenno-Zakhidna	Khmelnyska NPP	2000
	Ladyzhynska TPP	1800
	Ladyzhynska HPP	7.5
	Dnistrovska HPP	702
	Dnistrovska-2 HPP	40.8
	Dnistrovska HAPP	324
	Vinnytske PTM CHP	10
	CHP-4	2.5
	Sabarivska HPP	1.05
	Chornyatynska HPP	1.4
	Sutyska HPP	1.4
	Kasperivska HPP	5.1
	Kamyanets-Podilska CHP	18
	Chernivetska CHP	8
	Hlybochanska HPP	6.13
Pivnichna	Shostkinska CHP	115
	Shostka Plant Zvezda CHP	18
	Frunze Plant CHP	38
	Sumska CHP	40
	Okhtyrska CHP	12.75
	Pervukhinsky Concrete Plant CHP	5
	CHP-5	470
	KhCHP-3	86
	CHP-2	74

	Kupyansky Conrete Plant CHP	12
	Poltava Locomotive Repair Plant CHP	10.5
	Zmiivska TPP	2200
	Shebelinska CHP	6
	Pervomaysky Energokhymprom CHP	50
	Kremenchutska CHP	255
	Krasnooskolska HPP	3.68
	Kremenchutska HPP	632.9
	Krukivsky Wagon Repair Plant CHP	12
Tsentralna	Trypil'ska TPP	1800
	CHP-5	700
	CHP-6	500
	Cherkaska CHP	200
	Chernigiv'ska CHP	210
	Darnytska CHP	160
	Bilotserkiv'ska CHP	120
	Kyiv'ska HPP	436.5
	Kaniv'ska HPP	472
	Kyiv'ska HAPP	235.5
	Slavenergoinvest CHP	2.026
	Chornobyl'ska NPP	0
	Bohuslav'ska HPP	1.1
	Korsun-Shevchenkiv'ska HPP	1.71
	Stebliv'ska HPP	2.85
	Gazoporshneva CHP	1.48
	Smilaenergopromtrans CHP	2.6
	Umansky Greenhouse Plant CHP	6

State Governance in the electrical power industry in Slovakia



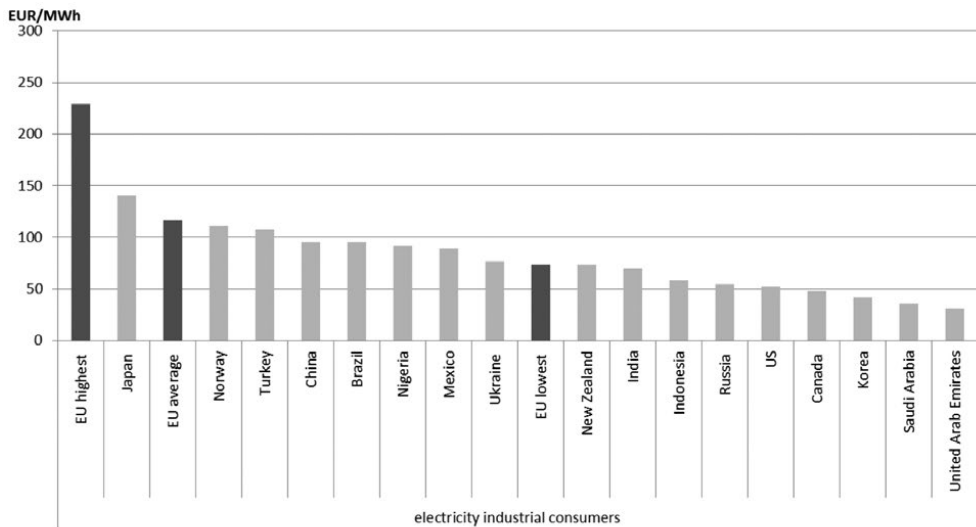
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MARTIN
VLACHYNSKÝ

High prices of energy in Europe are pushing down its competitiveness in global perspective. While the “green” targets are the usual suspect, the problem has roots in political involvement in the energy sector. Slovakia is experiencing one

one was opened¹. While the gas industry is thrown into insecurity mainly due to the endangered commodity flow from Russia, problems of the electrical power industry are more complex. They stem from governance of various aspects of this industry, both on national and European level.

Figure 1. Electricity prices for residential consumers.



of the highest electricity prices for industry in the Eastern Europe. There are three main reasons behind the high prices: high cost of transmission, domestic coal support, and renewables support. Costs of nuclear power plants decommissioning are the fourth, minor reason. Solution is twofold: reduce political influence in the sector and shift the costs from electricity bills to state budget.

Energy becomes one of the great economic pains in the EU. Both gas and electricity prices are reducing European industry competitiveness. The pressure is especially high on energy-intensive industries. For example, 11 of the EU’s 26 large aluminum smelters have closed since 2003 – and not a single new

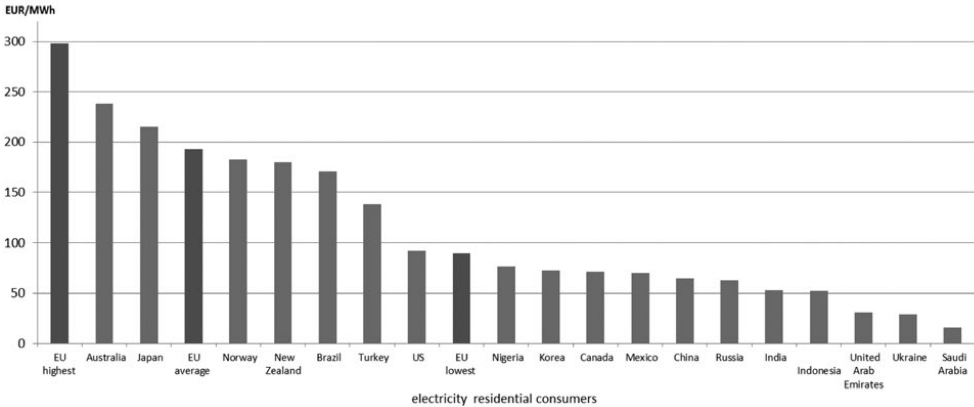
Electricity prices in Europe are higher than in the United States and already higher than in most Asian countries. Of the major industrial countries, more expensive² are Japan, Korea and Australia. [See: Figure 1] [See: Figure 2]

Moreover, the prices are growing in an unprecedented pace. While prices in other countries have been stable (with certain

¹“Energy costs, regulations threaten EU aluminium industry”, 11/06/2014, Enterprise & Industry Magazine http://ec.europa.eu/enterprise/magazine/articles/sustainable-industry-innovation/article_11117_en.htm

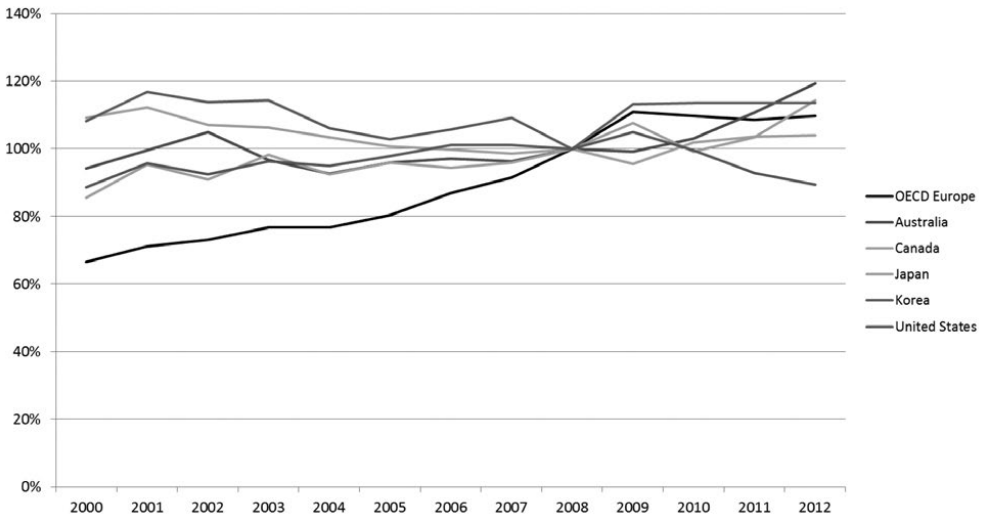
² Electricity for final consumption is a complex product and average prices may vary, depending on the methodology used for their calculation.

Figure 2. Electricity prices for industrial consumers.



Source: Commission Staff Working Document: Energy prices and costs report.

Figure 3. Index of real electricity prices for industrial end-users (2008=100).



Source: Commission Staff Working Document: Energy prices and costs report.

degree of variability of course), average price in Europe has grown more than 50% in the last decade and half. [See: Figure 3] The 20-20-20 targets diverted investments into low-productive and expensive sources of energy and thus become the obvious suspect to blame for the rising price. But the root of the problem goes deeper.

Politicians love to have firm control over the energy sector. In most countries, including those officially recognizing the principles and advantages of market economy, energy sectors come among the most regulated ones. There are four main reasons, why government intervention in energy industry is dangerous for market economy:



1. The sector is heavily regulated. Be it by various public regulatory bodies (The Regulatory Office for Network Industries plays this role in Slovakia, but it also includes number of EU bodies, starting with the Commission) or by direct involvement of the state in the ownership structure. Entrepreneurs in the energy sector have extremely narrowed field of actions and they often can't follow the optimal strategy, be it in the field of price, diversification or innovation strategy.

2. There are some of the biggest projects in the economy (nuclear power plants, dams, grid improvements...) with procurement going often to billions of Euro. This makes it an interesting target, with politicians and regulators often pressing for participation of national, or other related contractors.

3. Energy is an important item in the consumption basket of all voters. Not only financially, but also psychologically. For example, a voter more readily recognizes small change in his electricity bill, than a steep rise of his employer's labor cost due to higher income tax or social contributions. Ability to control the market price of energy is a powerful political tool.

4. Companies in the energy sector are economic giants with revenues often going to tens of billions. They are able to withstand number of large economic blows. Politicians can use their balance sheets to correct government's mistakes, to function as a proxy for social policies, or just to buy votes. Currently, it is excellently demonstrated by Orban's government in Hungary³. However, nothing lasts forever and even giant companies have to subdue

to the reality of economics and the mistakes have to be paid for. Great example is the situation in Spain utility sector⁴.

This pattern of political influence over energy sector can be found in various degrees in any country. This work explores the situation in Slovak electrical power industry.

CURRENT SITUATION IN SLOVAKIA

The electrical power industry sector has many similarities with sectors in other post-communist European countries. Centrally planned economy dominated by heavy industry required extensive resources, including electricity. This was delivered by a backbone of four nuclear reactors, two large thermal power plants and a number of hydropower plants.

Since 1989, the industry had to face several problems. Due to the economic transformation, it was hit by steep decline of consumption. Before the demand was able to recover, it was hit by another decline during the 2009 crisis, which has not been offset yet, despite GDP recovery. As a result, the consumption of electricity in Slovakia has never reached the maximum level of 1989 again. [See: Figure 4]

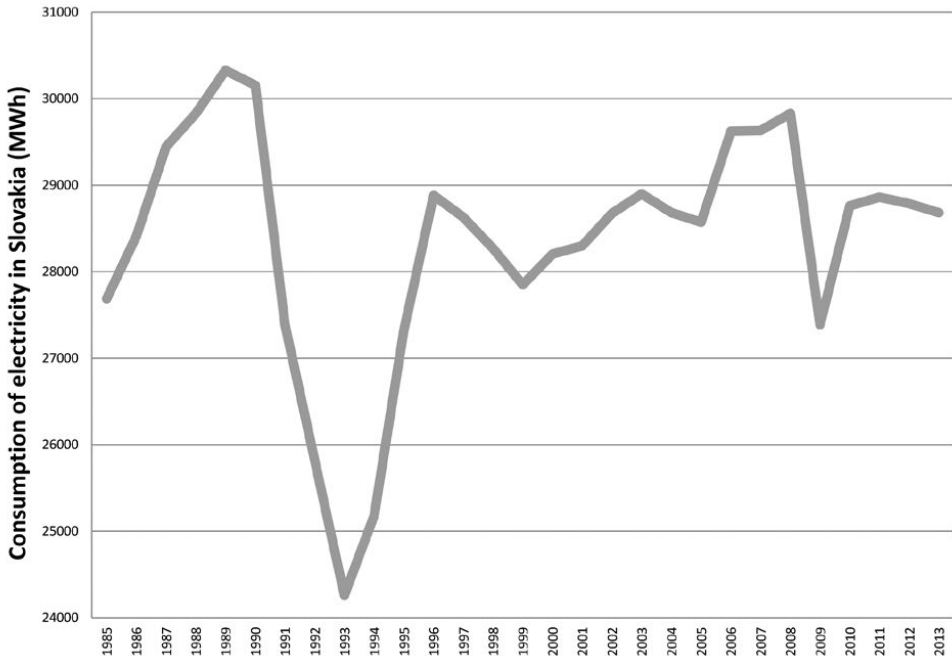
The second problem was the need for capital for modernization and the mismanagement in the early 1990s. This was countered by privatization, which saw foreign investors enter the sectors of production, distribution and sale of electricity. The state retained 100% stake in the national transmission grid (highest voltage) and keeps stakes also in the major generation company and all three distribution companies. As majority of European power markets, also Power Exchange Central Europe⁵

³ See: "Hungary's ruling Fidesz party plans more energy price cuts –paper", Jan 24, 2014, Reuters <http://www.reuters.com/article/2014/01/24/hungary-fidesz-idUSL5N0KY07V20140124>

⁴ See: "Rajoy Targets Utility Revenue to Curb Spanish Debt Loan", Jun 21, 2013, Bloomberg <http://www.bloomberg.com/news/2013-06-20/rajoy-targets-utility-revenue-to-curb-spanish-debt-loan.html>

⁵ Connects Czech, Slovak, Polish, Hungarian and Romanian markets

Figure 4. Consumption of electricity in Slovakia.



Source: Compiled by INESS from various sources.

experienced steady decline of electricity (commodity) price in the recent years. [See: Figure 5]

In Slovakia, final consumption price of electricity is regulated on the household and SME level⁶. However, many price segments are regulated for all subjects (see below).

POPULAR TOPICS

While electrical power industry has been providing steady flow of news to Slovak media, the number of events grew in the last two years. The key events in the sector:

- **Plans to build a third nuclear power plant. The incumbent government⁷** pushes for construction of another nuclear power plant. Lacking the funds in public coffers, it searches for a potential investor.

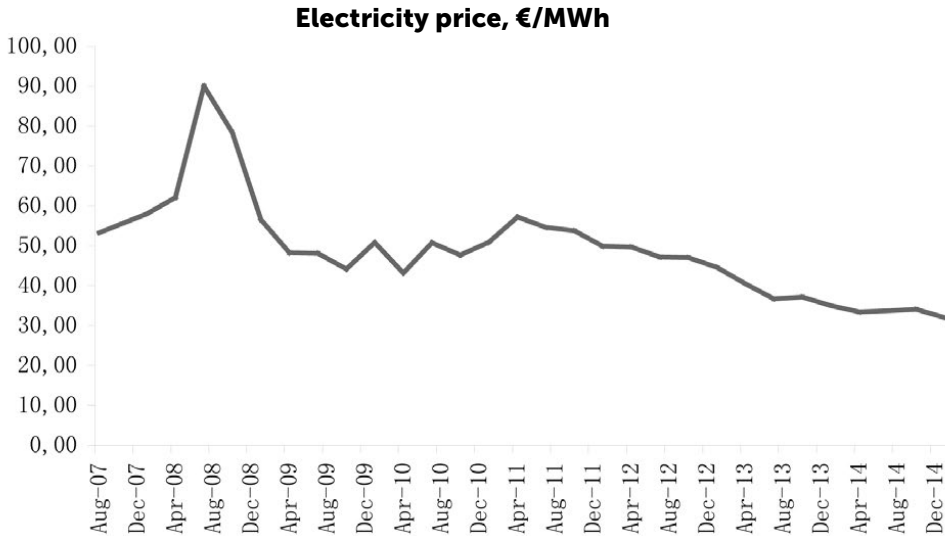
⁶ Price regulation for SME was reintroduced in 2012

⁷ The idea was supported also by the previous two governments

- **Slovenské elektrárne (SE) offered for sale.** Current owner ENEL offers (as of middle of December 2014) major Slovak power generating company SE (produces 80% of Slovak electricity) for sale. The state (currently owning 34%) considers buying part or all remaining shares to acquire higher share in the company.

- **Continuous legal disputes between government and ENEL.** The disputes head back to the privatization in 2004 and the price paid.

- **Completion of the two remaining reactors of the Mochovce power plant by SE.** The construction prolongs and the budget had to be hiked up several times already, to great annoyance of the government (the state has 34% stake in SE and forgoes dividend payments to fund the construction).

Figure 5. Consumption of electricity in Slovakia.

Source: Kurzy.cz

- **Dispute between distributors, renewables owners and the state.** Three regional electricity distributors are halting entry of new renewables to the grid, quoting technical reasons and stability of the grid. Ongoing financial problems with renewables subsidy mechanism are suspected to be one of the reasons.

- **G-tariff⁸ controversy.** Introduced in 2014, the tariff, which was broadly opposed by renewables producers, was supposed to bring down consumer prices on producers expense.

- **Continuous subsidization of lignite mines in central Slovakia.** Every electricity bill contains also a part, which is used to subsidize the mines and nearby thermal power plant, where majority of mines production is burnt.

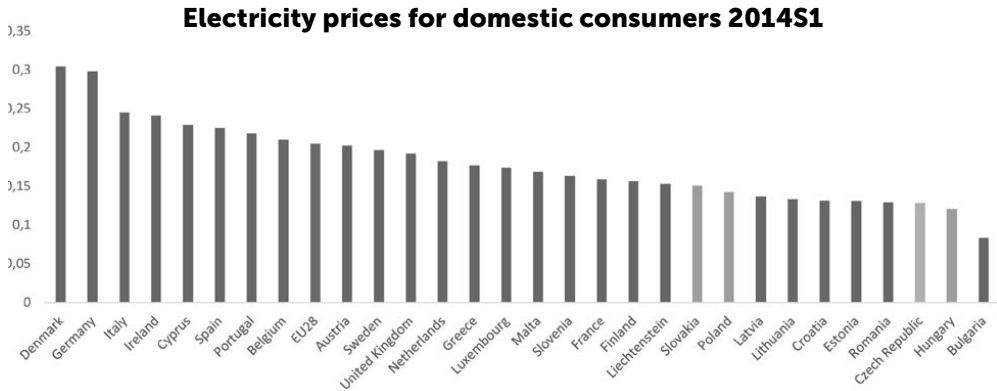
- **High relative final consumption price of electricity.** Despite falling price of the commodity, the price of electricity is relatively high in Slovakia compared to other East European countries (and other regions in the world, especially the US), notably for industrial consumers. Most notable cases involve aluminum works in central Slovakia, which were given special exemption⁹ by the government to survive and steelworks in eastern Slovakia, which got special deal¹⁰ on electricity.

Since price is a major issue, which is caused by some of the abovementioned characteristics of Slovak electric power industry, we will devote the following sections to it.

⁸ Generation tariff, or generation fees. Unlike L(load)-tariff, which is paid by consumers for using the grid capacity to consume, G-tariff is paid by producers (power plants) for using the grid to feed the product into it. See "G-tariff sparks objections", 14 Oct 2013, Slovak Spectator http://spectator.sme.sk/articles/view/51660/22/g_tariff_sparks_objections.html

⁹ A universal cap on payments to National Nuclear Fund was introduced. However, the cap is set so high, that only this single company (which is by far the biggest consumer of electric energy in Slovakia) reaches it.

¹⁰ The law setting support for renewables was changed, so metallurgy gases became eligible for support as a fuel.

Picture 6. Electricity prices for domestic consumers, first half of 2014, € per kWh.

Source: Eurostat.

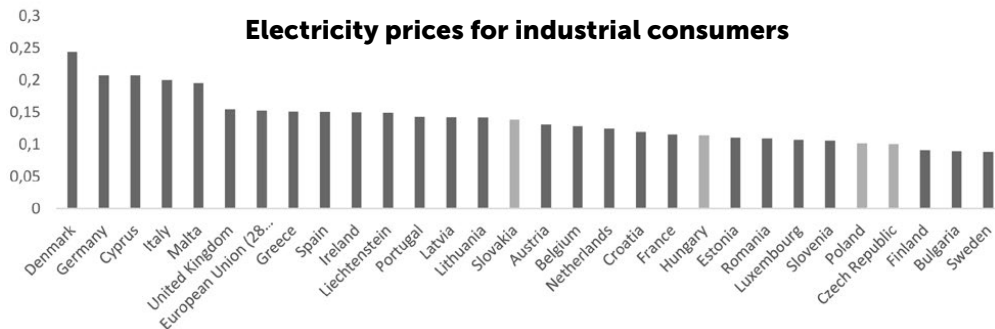
PRICE

According to Eurostat, Slovak households pay below-average price for electricity. Still, the price is higher when compared to V4 countries (green) and second highest to Slovenia of all post-communist EU-members. [See: Figure 6]

The segment of industrial consumers is more complicated in terms of possible volume of consumption and also required qualitative aspects of the supplies. Therefore it is difficult to construct a universal price ranking. Using Eurostat, Slovakia again places among the most expensive of ex-communist countries. [See: Figure 7]

Electricity bill for industrial consumer consists of 10 segments:

1. Commodity price – paid for the volume of delivered electricity;
2. Fixed payment for each distribution place;
3. Fixed tariff for distribution;
4. Variable tariff for distribution;
5. Tariff for technical losses in the grid;
6. Tariff for system services (fee for the quality of supply – voltage and frequency);

Figure 7. Electricity prices for industrial consumers, first half of 2014, € per kWh.

Source: Eurostat.

7. Tariff for system operation;
8. Contribution to National Nuclear Fund (collects funds to cover costs of the current decommissioning of V1 nuclear power plant and any future decommissioning);
9. VAT (recoverable for VAT payers);
10. Excise duty (industrial consumers only).

[See: Figure 8]

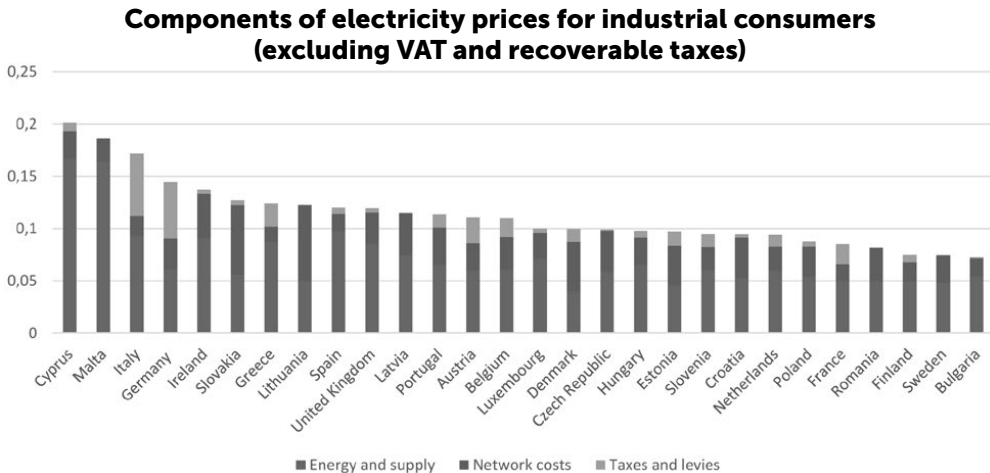
There are five different kinds of players in the market, creating the final supply for consumers. There is the grid

state, represented by (formally independent) the Regulatory Office for Network Industries, which directly sets the prices for electricity produced by renewables, cogeneration and from domestic coal. The Office also sets price ceiling or price ceiling calculation mechanisms for number of segments. It directly sets the tariffs #6 and #7.

RELATED PROBLEMS

There are several sources of relatively high electricity price in Slovakia – and number of reasons, why the price may continue to rise in the near future and endanger competitiveness of Slovak economy.

Figure 8. Components of electricity prices for industrial consumers (excluding VAT and recoverable taxes), 2013, € per kWh.



Source: Eurostat.

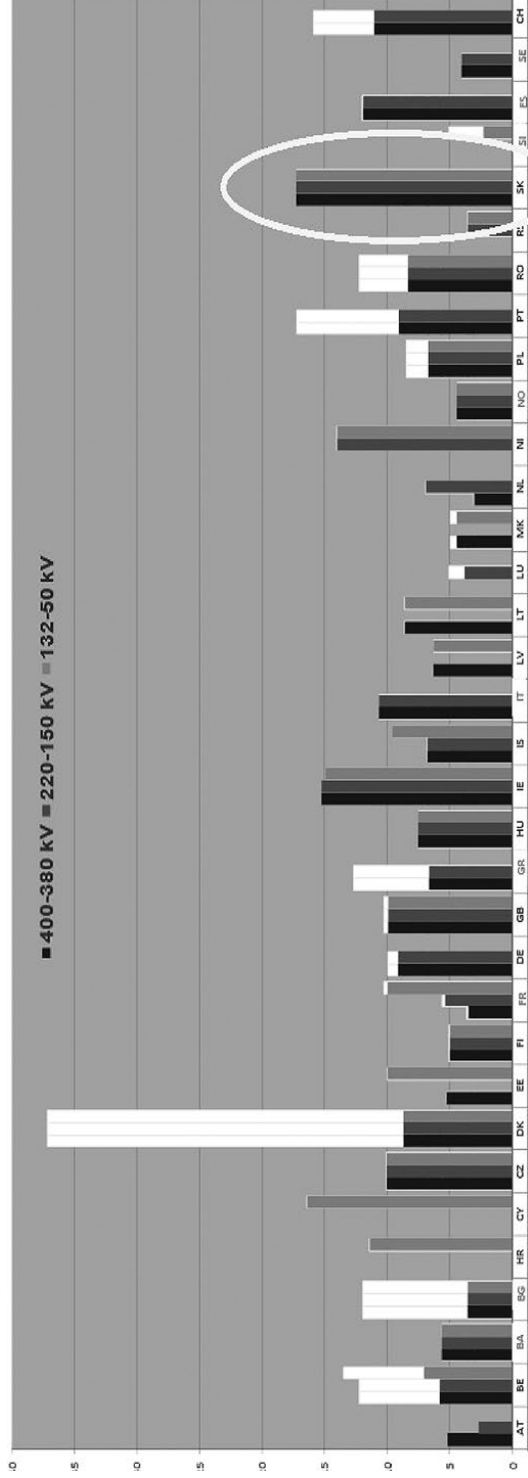
operator (in Slovakia represented by a state owned monopoly company), who charges power plants, distributors, and huge consumers connected to the top-level national grid. Power plants sell the commodity wholesale to suppliers, who resell it to the final consumers. The commodity reaches final consumers (except the biggest ones) via regional networks of three distributors. Finally, there is the

TRANSMISSION TARIFFS

Cost of using the national high voltage grid are the highest in Europe, both according to Eurostat and European Network of Transmission System Operators for Electricity (ENTSO-E).¹¹ [See: Figure 9]

¹¹ Available at https://www.entsoe.eu/publications/market-reports/Documents/SYNTHESIS_2014_Final_140703.pdf

Figure 9. Split of the unit transmission tariffs between components related to TSO activities and other regulatory charges, 2014, € per MWh. White column represents other regulatory charges not directly related to TSO activities.



Source: ENTSO - E Overview of transmission tariffs in Europe: Synthesis 2014

Besides well-described inefficiencies connected with publicly managed organizations, public stakes in energy companies serve the government as a welcomed source of revenues for the state budget. SEPS, the grid operator, plays one of the leading roles. Companies from the energy sector should contribute around EUR

NATIONAL NUCLEAR FUND CONTRIBUTIONS

National Nuclear Fund was created to cope with the decommissioning costs of A1 nuclear power plant (closed after major accident in 1977) and V1 power plant (closed as a condition of accession into the European Union in 2004) and

SEPS (thousands €)	2012	2013	2014 (expected)	2015 (planned)	2016 (planned)	2017 (planned)
Dividends	21 374	0	67 913	14 925	16 070	11 210
Superdividends	0	0	78 177	0	0	0
Total	21 374	0	146 090	14 925	16 070	11 210

850 million to the state budget in the year 2014 alone. That accounts for around 5% of the state budget revenues. Around EUR 500 million comes from electrical power industry¹². Income from SEPS is almost EUR 150 million. The dividend income was artificially boosted this year, and also so-called "superdividend" (extra dividend besides the standard payment) was added to it.

Grid fees thus serve also as an invisible "electricity tax" with revenues feeding the public coffers¹³.

Solution: Grid should be operated privately (either by a private company, holding, or publicly traded company¹⁴).

for potential future decommissioning. It is funded by surcharge to every electricity bill and by fee paid by every nuclear power plant operator (currently only SE). The electricity bill fee¹⁵ is set over EUR 3 per MWh and thus rises the electricity bill by 2-4%.

Solution: While the related costs are obvious and can be hardly avoided, the closing of fully operational V1 power plant was a political decision. As such, it should be covered by the state budget, not transferred to the consumers¹⁶. Therefore, the part of fund's revenues coming from the bill surcharge should be funded by the state.

¹² And that excludes dividends from the SE, which are used to cofund the nuclear power plant Mochovce construction

¹³ The company also heavily invests in the infrastructure improvements.

¹⁴ As National Grid plc in UK for example.

¹⁵ Nuclear power plant owners pay 13 400 EUR per MW of installed capacity.

¹⁶ Obviously, consumers and tax payers are to the large extent the same persons. However, using state budget is much more transparent and matches responsible politicians with the cost of their actions more readily and thus makes running and defending such support schemes politically more difficult.

DOMESTIC COAL SUBSIDY

Lignite mines in central Slovakia directly employ almost 4000 miners. The company (and the thermal power plant which consumes majority of their production) is kept afloat by regular subsidies of around EUR 50 million annually (2013). The subsidies is funded by the tariff for system operation charge on bills. The subsidy covers mainly miners' wages. The thermal power plant is the second biggest CO₂ polluter in Slovakia, responsible for around 7% of Slovak CO₂ emissions.

Solution: *Quick phase out of subsidies. Redundant miners can be given special social support if needed. Any future support should be funded by the state budget, not consumers. As a side effect, closing the thermal power plant would drastically cut Slovak CO₂ emissions¹⁷ and thus reduce the need to fund other solutions to meet the 2020 and 2030 EU goals.*

RENEWABLES SUBSIDY

As in a number of other EU countries, renewables (including cogeneration) became one of the major problems for healthy development of Slovak electrical power industry. Subsidization started in 2010 and new power plants (mainly photovoltaic, 56% of subsidies in 2013 went to solar power plants) were granted sale prices exceeding 10 times market price of electricity for period of 15 years. While in the granted prices for new installations fell, the cumulative effect has been large. Total subsidies reached EUR 343 million in 2013 and were supposed to reach EUR 400 million in 2014. The

subsidies are funded by the tariff for system operation¹⁸, which has been rising steeply.

Despite the rise, distributors¹⁹ claim there is a financing gap worth around EUR 150 million. Another factor affecting the costs related to renewables is high fluctuation of production. Its management increases requirements on the grid quality and need for infrastructural investments.[See: Figure 10]

The forced introduction of renewables on European level requires deeper discussion, which is out of the scope of this article. However, Slovak politicians made several mistakes when creating local strategy:

Front-loading instead of back-loading. Costs and effectiveness of renewables technology, especially solar, has been rapidly falling. The last is the winner in this race. Slovakia would be now able to build the existing capacities for a fragment of its price paid few years ago.

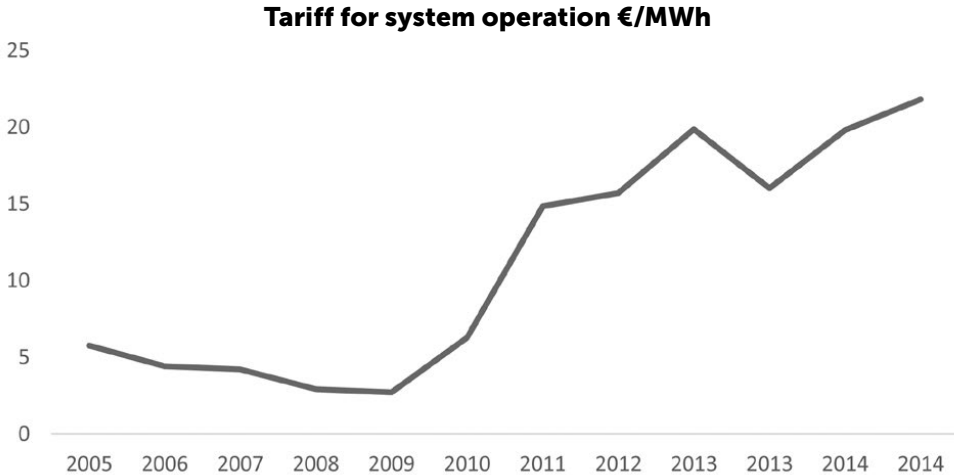
Price setting instead of auctions. The initial granted prices were set extremely high and explicitly set for each different source. Instead, desired volume of electricity from renewables could have been bought in an auction from any producer (solar, hydro, biomass, wind) who would offer the best price.

¹⁸ Used also to subsidize domestic coal, see above, and small portion of the funds collected via this tariff is used to fund the Short-term electricity Market Operator - OKTE.

¹⁹ Distributors serve as intermediaries in the financial flow between consumers and renewables producers. The renewables production is estimated for a given year and the tariff value is set according to this estimate. However, the real volume of production may differ (more or less sunshine, unplanned maintenance etc.). The subsidies are paid by distributors immediately to the producers, but the payments to distributors run according to the estimate and are corrected only two years after.

¹⁷ 32-times more than would result from implanting Slovak Strategy of electro mobility and actually more than introduction of all electric vehicles in the world so far! (author's calculations).

Figure 10. Tariff for system operation, € per MWh. Sometimes the tariff was reset more than once during a year.



Source: Regulatory Office for Network Industries (URSO)

Subsidies funded by consumers, instead of taxpayers. Current system of the tariff for system operation creates hidden tax, which is difficult to account. Certain burden of the political decision was transferred to distributors and conventional power generators.

Solution: *Any future power from renewables should be acquired via auctions. Introduction of renewables should be postponed as long as possible. Facing proceedings from the EU may be even a cheaper solution. Current costs of subsidies should be transferred to the state budget, funded by privatization of public shares in energy companies, or alternatively by using the dividend revenues from these companies.*

STATE AS AN ENTREPRENEUR

The representatives of state often act as entrepreneurs in the electric power sector. However, they lack the capabilities (different way of decision-making), motivation (based on the length of political

cycle) and most importantly – responsibility (not investing their own funds) of entrepreneurs. Large projects like power plants temporarily boost employment and domestic consumption, leaving the consequences (higher prices of electricity, market distortions and bankruptcies of competitors) to much later stage.

This potentially can create large mal-investments, especially in the energy sector. Good example of this is the proposed construction of a third nuclear power plant in Slovakia. This project became focal point of official long-term energetic strategy. While not having the funds, the incumbent government actively encourages potential investors. Even guaranteed sale price for production of this power plant was seriously considered.

This comes in a moment when electricity consumption in Slovakia has been stagnant for two decades, country is bound to reduce primary energy

consumption by the EU, and is already completely self-sufficient in installed capacity²⁰.

After finishing remaining two reactors in Mochovce power plant²¹ (planned in 2016 and 2017), Slovakia will become net exporter. If the third nuclear power plant was built, there would be domestic production surplus of around 40%. In a region, where potential for export is limited. According to our calculations²², this project, supposing the subsidies, could rise electricity price in Slovakia by around EUR 8.6 per MWh.

CONCLUSION

Electric power generation industry is a common playground for politicians in every country, including Slovakia. Typically, burden of various policies (social, environmental, regulatory) is shifted on consumers as a hidden tax. The consequences of such policies are revealed often only after substantial time. This time in Europe and Slovakia comes now. High electricity prices are lowering Slovak competitiveness both in global and European scope.

Solution is always two-fold. First of all, abandoning the current direction. That does not have to mean abandoning the political goals (social or environmental) altogether, if it's not feasible. Many of these goals can be reached with lower

cost, if market is left to find the optimal way. For example, using auctions to buy energy from renewables, instead of administratively setting granted prices.

Secondly, any cost of the policies should be transferred to the public finance accounting. This would make hiding the real costs of energy policies more difficult. Slovak budget has large revenues from dividends, or alternatively potential revenues from privatization of the public share in energy companies, which can be used to fund energy policies. ●

²⁰ There is miniscule net import of electricity in Slovakia. Potentially, the country would be able to produce more electricity than it consumes, but some power plants are mothballed or running at reduced capacity due to economic inefficiency under current market circumstances.

²¹ Even in this case, it is very dubious, if the majority owner of SE would decide to finish the two reactors without the constant significant pressure from the government, which has a minority stake.

²² Details in INESS Policy note 3/2013 *Atómová hrozba*. English excerpt can be found at <http://4liberty.eu/nuclear-threat/>



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Electroenergy Sector in the Czech Republic – Present Situation, Opportunities and Threats



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ALEŠ
ROD

The energy issue is one of the most important, i.e. most frequently discussed topics in every country in the world. And so it is in the Czech Republic.

The energy industry in the Czech Republic covers both production and distribution of all forms of energy, including mining and the use of energy sources such as coal, oil, natural gas, uranium, etc. The discussion among politicians, businessmen and other decision-makers related to the energy sector covers especially topics such as sustainability, energy mix, self-sufficiency, regulation, efficiency or renewables. The Czech Republic is one of the largest electricity exporters in the European Union, so the energy sector – especially the market of electricity – plays a vital role in the Czech economy as well as in the energy security of the Central Europe.

Due to several factors (e.g. the EU regulation, a specific shape of the national regulation, the Czech energy mix, an effort to maximize the use of indigenous resources, comprising coal, uranium and renewable energy, the expansion of renewable energy supported from the public finance, the position of the Energy Regulatory Office of the Czech Republic or the Czech political and economic institutional environment), the Czech energy market is undoubtedly an interesting topic to analyze. So both, description and analysis of the recent situation on the electricity sector in the Czech Republic and its opportunities and threats, are the main focus of this article.

REGULATION

In the Czech Republic, the energy market is – as well as in other countries – subject to immense regulation. There is a regulated access to the transmission system, to the distribution systems, to the potential construction of power plants and also to the

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THE CZECH REPUBLIC IS ONE OF THE LARGEST ELECTRICITY EXPORTERS IN THE EUROPEAN UNION, SO THE ENERGY SECTOR – ESPECIALLY THE MARKET OF ELECTRICITY – PLAYS A VITAL ROLE IN THE CZECH ECONOMY AS WELL AS IN THE ENERGY SECURITY OF THE CENTRAL EUROPE

construction and running of utilities necessary for transferring electricity. The regulation is provided via several main channels – the government and the parliament (legislation), the Energy Regulatory Office of the Czech Republic¹ (production control) and, last but not least, the Czech Transmission System Operator² (transfer network). As the

¹ Known as český energetický úřad (ERÚ).

² Known as ČEPS – Česká energetická přenosová

government and the parliament (Chamber of Deputies and the Senate) participate in a standard legislative process, which does not differ when compared to other countries, let us briefly discuss the Energy Regulatory Office (ERO) and the Czech Transmission System Operator (ČEPS).

The ERO was established on January 1, 2001 (Act No. 458/2000, passed on November 28, 2000) as an administrative authority responsible for regulation of the energy sector in the Czech Republic³. Among the ERO's main competences, we may find mainly price control, supporting the use of renewable and secondary energy sources, support for heat and power generation, consumers' protection, granting licensing permissions and market administration, support for a fair competition in the energy industries, co-operation with the Office for the Protection of Competition and supervision of the energy market.⁴

The ČEPS, with its license under the Energy Act granted by the ERO, is responsible for the electricity transmission operating through the ownership unbundling (TPA – Third Party Access). The ČEPS was established in 1998, when the General Meeting of ČEZ⁵ separated the Transmission system division from the ČEZ activities and formed this brand new institution. The ČEPS has an exclusive license for a long-distance transmission of electricity at high voltage. It implements a supervisory control of the transmission system on the Czech territory in real time and is also responsible for the stability of the power and frequency, voltage control

soustava, a.s.

³ The ERO is managed by the Chairperson appointed for a term of six years by the President of the Czech Republic upon the government proposal.

⁴ Source: ERO.

⁵ ČEZ, a.s., is the largest Czech energy company, partly owned by the state. The Czech Republic, represented by the Ministry of Finance, holds 69.78% shares of the company.

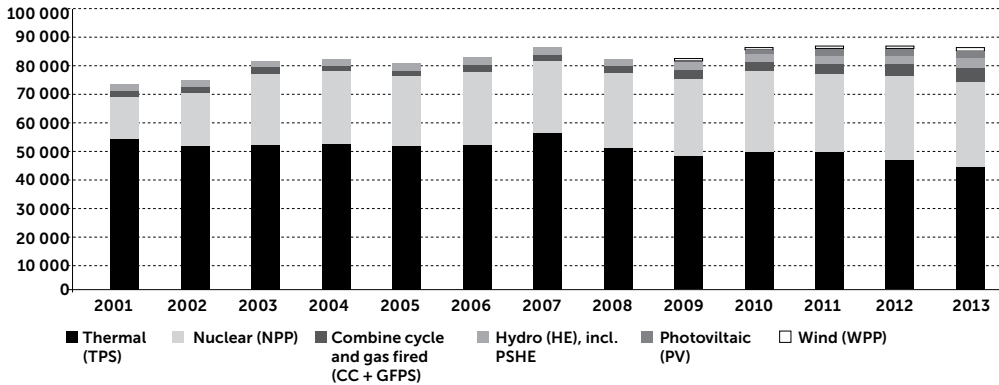
and reactive power. The ČEPS is allowed to trade the energy on its own account to ensure stability parameters and required power reserves. Hand in hand with the extension of an unpredictable energy production from renewables (especially solar systems and wind power plants), the ČEPS processes and tests a plan of defense against the spread of the system failures transmission and a recovery plan for the electrification system after system disorder.

ELECTRICITY GENERATION

In the Czech Republic, the generation of electricity is provided by several sources:

- **Thermal power stations:** Thermal power stations are the largest energy producers in the Czech Republic. They are located in regions with large deposits of coal (especially lignite, i.e. brown coal) and the proximity to rivers. The largest ones are situated near the cities of Sokolov, Most, Ostrava, Mělník, Chvaletice or Opatovice.
- **Nuclear power plants:** Nuclear power plants are the second largest producer of electricity. Two power plants (Dukovany and Temelín) are the subjects of a heated discussion about completion or extension, which should increase the installed capacity in the Czech Republic.
- **Hydroelectric power stations** (including pumped-storage hydroelectric power stations): Traditionally, hydroelectric power stations are a stable part of the Czech energy sector, because the Czech countryside is very rich in water sources. The largest hydroelectric power stations are located by the cascade of dams on the Vltava river (Lipno, Kamýk, Slapy, Orlik, Vrané).
- **Combined cycle and gas-fired power stations:** In the past ten years, this source of electricity production had doubled its share in the Czech energy mix. A combined

Figure 2. Electricity consumption by sectors in the Czech economy (2001 – 2013). Development of electricity consumption in the national economy by sector [GWh]



cycle in the production process improves efficiency of energy sources processing. That is why several large projects of this kind of power stations are completed or forthcoming (esp. Počerady and Mochov).

- **Photovoltaic power plants:** A boom of photovoltaic power plants is related to the government intervention to the energy production (subsidized prices), i.e. to the effort to diversify energy production towards the renewable energy. Among almost 30 thousands power plants, the largest ones are situated in the Northern Bohemia (Ralsko), the Central Bohemia (Vepřek) and the Southern Bohemia (Ševětín).

- **Wind power plants:** The energy produced from wind power plants covers a negligible share of the Czech energy consumption. The most of wind power plants are located in mountain ranges in the northern part of our area, such as Jeseníky, Krušné hory or Orlické hory.

Considering the share of production, thermal power stations and nuclear power plants significantly dominate. In 2013, the gross electricity production reached the total of 87,065 GWh, whereas 51.4% of that was produced by thermal power stations and 35.3% by nuclear

power plants. The remaining sources covered just about 13% of the energy production. For further details about the Czech energy mix and its development in time, see the Figure 1.

As observable in the Table 1, the share covered by the thermal power stations is decreasing (especially during the last six years). Nevertheless, it still exceeds a half of the annual gross electricity production. A stable (or slightly increasing) energy production by the nuclear power plants presents an important stability anchor of the Czech energy self-sufficiency. The table also captures the boom of photovoltaic power plants, which expanded under the governmental support especially between 2009 and 2010 (it increases app. 7x) and moreover the next year (when it increases app. 3.4x). Combined cycle power stations, gas-fired power stations and hydro power plants do not constitute a key energy source, but they could be marked as efficient sources of diversification, especially with a regional importance. [See: Table 1]

PRODUCTION, CONSUMPTION, ENERGY BALANCE

The Czech Republic regularly reports that the annual electro-energy production is higher than the annual electro-energy

consumption. The Table 2 provides a significant data about net electricity production (gross electricity production adjusted for house load for electricity production), gross consumption and net consumption between years 2000 and 2013. The presented in the fourth row "net balance" shows annual cross-border exchanges of electrical energy (flow), which can be calculated as total electricity imports (+) adjusted for total electricity exports (-) in a given period. When resulting positive, the country is a net electricity importer; a negative value denotes that electricity exports of the country are exceeding its imports. The data indicates the Czech Republic exported 195,403 GWh of electricity between 2000 and 2013.

It is noticeable that the Czech electricity grid is not free of energy losses. These losses oscillated between 4,000 and 5,000 GWh per year (compare with the Table 1). The most efficient performance was recorded last year. Moreover, one could consider as interesting the increasing trend of electricity consumption at pumped-storage hydroelectric power stations. [See: Table 2]

Let's have a brief look at the electricity consumption by sectors. The Czech Republic is an export-oriented economy with an important share of manufacturing (especially automotive), construction and engineering. This fact significantly influences the sector consumption. In the past ten years, the industry sector consumed about a third of the annual electricity consumption (2013: 34.3% of the total consumption). Households used up about 20% of annual consumption (2013: 20.1%). The third largest consumer of electricity is the sector of energy generation itself, which needs slightly less than a fifth of the total electricity consumption (2013: 18.2%). The overview of all sectors and their electricity consumption is pictured in the Figure 2.

GRID

A grid provides a transfer function at the Czech electro-energy sector, so the information about it simply must be featured in this article. A so-called installed capacity belongs among the most important characteristics of each energy sector. In the Czech Republic, the recent installed capacity reaches 21,079 MW. The largest part of it is provided by thermal power stations (more than 51%) and nuclear energy (20.4%). A state intervention into the market with renewable energy supports surfaces in the share of photovoltaics. It has already exceeded 10%. The wind energy covers the smallest share (270 MW, i.e. 1.3% in total).

The development of the installed capacity of individual energy sources in time is shown in the Figure 3. Thermal power generation is a quite stable component in time, so is the hydro source. Nuclear energy hasn't changed since 2003 and 2004, when Temelin Nuclear Power Plant has been completely joined to the grid. Together with Dukovany Nuclear Power Plant, those are the only two nuclear power plants in the Czech Republic. Looking at increasing trends, combined cycle and gas-fired power stations could be also mentioned, but the number one is undoubtedly the photovoltaics. There was no photovoltaic installed capacity before 2008. However, after 2009 and further, the photovoltaic energy boom has caused enormous increases of the installed capacity – as of January 1st, 2014, there were 28 thousands⁶ of photovoltaic power plants. The largest one, FVE Ralsko RA 1, operates with the installed capacity of 38.3 MW. [See: Figure 3]

For the energy security in the Czech Republic, a regional distribution of the electricity generation really matters.

⁶ 1. 1. 2014: 27,956 power plants. Source: ERO.

Table 1. Production mix in the Czech Republic (2001 – 2013).

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Gross electricity production	73 486	74 647	76 259	83 205	84 333	82 579	84 361	88 198	83 518	82 250	85 910	87 561	87 574	87 065
House load for electricity production	5 725	5 868	5 955	6 572	6 414	6 387	6 477	6 796	6 433	6 260	6 446	6 533	6 485	6 207
Net electricity production [GWh]	67 741	68 780	70 304	76 633	77 919	76 192	77 884	81 413	77 085	75 990	79 465	81 028	81 088	80 858
Net balance	-10 017	-9 539	-11 387	-16 213	-15 717	-12 634	-12 631	-16 153	-11 469	-13 644	-14 948	-17 044	-17 120	-16 887
Total capacities [GWh]	57 724	59 241	59 917	60 420	62 202	63 558	65 253	65 260	65 616	62 346	64 516	63 984	63 968	63 971
HD C	22 062	23 387	30 036	30 724	32 183	33 435	34 595	35 710	35 768	32 510	34 162	34 823	34 614	34 146
LD C	20 917	21 572	21 573	22 207	22 452	22 618	23 260	22 564	23 173	23 088	23 506	22 251	22 681	22 888
Other	20 471	20 149	13 263	14 061	13 980	13 892	13 875	13 771	13 108	13 008	13 294	13 443	13 158	13 143
Gross consumption [GWh]	63 450	65 108	64 872	66 992	68 616	69 945	71 730	72 045	72 049	68 606	70 962	70 517	70 453	70 177
Pumping at PSHE	749	556	479	552	730	867	946	592	477	747	795	944	982	1 217
Network losses	4 683	4 910	4 858	5 087	5 084	5 087	4 885	4 915	4 662	4 487	4 467	4 405	4 187	4 098
Net consumption [GWh]	52 282	53 775	53 581	54 781	56 388	57 664	59 421	59 753	60 478	57 112	59 255	58 634	58 799	58 656

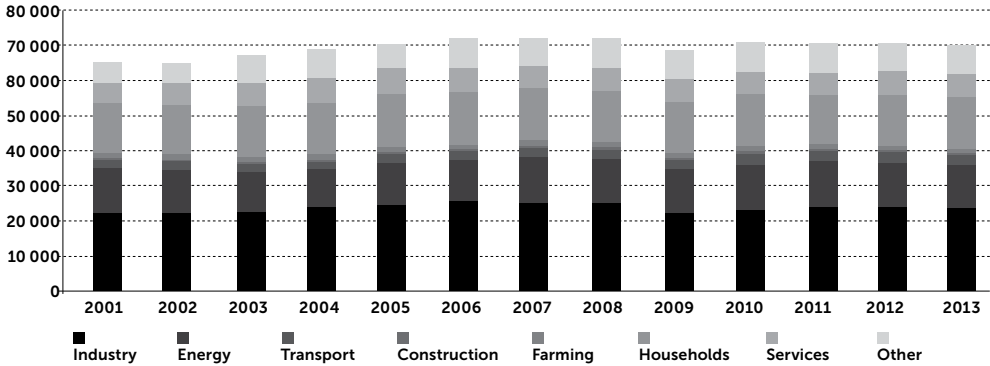
Source: Energy Regulatory Office.

Table 2. Electrical energy balances in the Czech Republic (2000 – 2013).

Type of power station	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Thermal (TPS)	55 114,3	52 409,8	53 045,6	52 811,0	52 137,2	52 395,4	56 728,2	51 218,8	48 457,4	49 979,7	49 973,0	47 261,0	44 737,0
Nuclear (NPP)	14 749,3	18 738,2	25 871,9	26 324,7	24 727,6	26 046,5	26 172,1	26 551,0	27 207,8	27 988,2	28 282,6	30 324,2	30 745,3
Combined cycle and gas fired (CC + GFFS)	2 316,0	2 352,9	2 511,0	2 524,8	2 685,4	2 612,1	2 472,9	3 112,7	3 225,2	3 600,4	3 955,1	4 435,1	5 272,4
Hydro (HE), incl. PSHE	2 467,4	2 845,5	1 794,2	2 562,8	3 027,0	3 257,3	2 523,7	2 376,3	2 982,7	3 380,6	2 835,0	2 963,0	3 761,7
Photovoltaic (PV)	0,0	0,0	0,0	0,1	0,1	0,2	1,8	12,9	88,8	615,7	2 118,0	2 173,1	2 070,2
Wind (WPP)	0,2	1,6	3,9	9,9	21,3	49,4	125,1	244,7	288,1	335,5	396,8	417,3	478,3
Total [GWh]	74 647,2	76 348,0	83 226,6	84 333,1	82 578,6	84 360,9	88 023,8	83 516,4	82 250,0	85 900,1	87 560,6	87 573,7	87 064,9

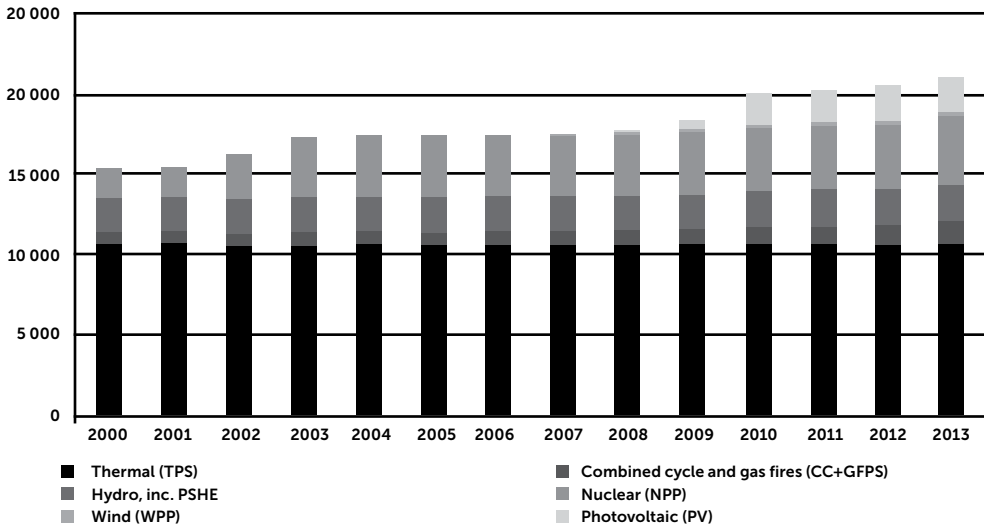
Source: Energy Regulatory Office.

Figure 2. Electricity consumption by sectors in the Czech economy (2001 – 2013).
Development of electricity consumption in the national economy by sector [GWh]



Source: Energy Regulatory Office.

Figure 3. Installed capacity in the Czech electricity grid (2001 – 2013).
Installed capacity in the Czech electricity grid [MW]



Source: Energy Regulatory Office.

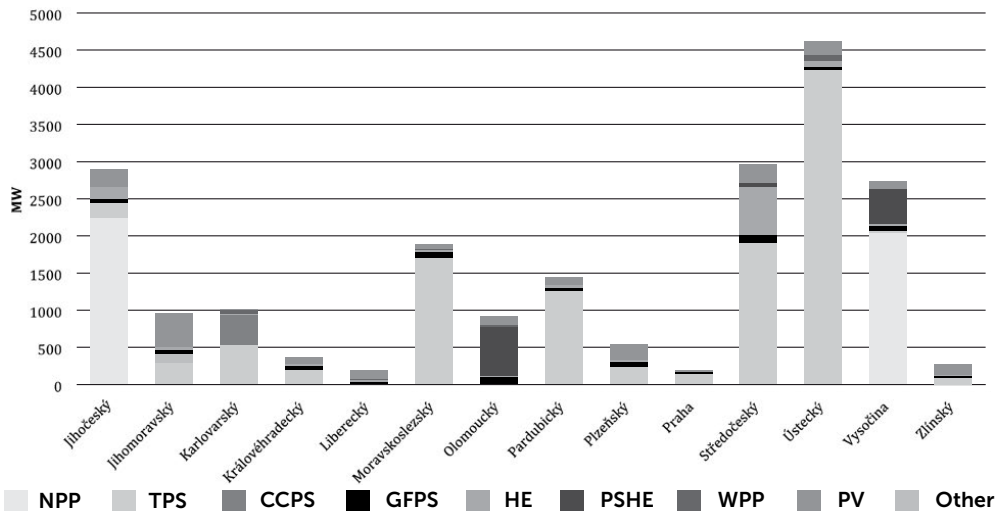
Differences generate special requirements on the Czech electricity grid as surpluses or deficits of the available energy are necessary to transfer among regions of the Czech Republic. From this point of view, there are major differences among individual regions, what is in consequence one of the reasons of the abovementioned big network losses. The largest installed capacity is located in

As visible in the Figure 4, the Jihočeský region and the Vysočina region constitute a major part of the installed capacity of nuclear energy. Temelín Nuclear Power Plant (the Jihočeský region) has the capacity of 2,110 MW (2 x 1,055 MW), Dukovany (the Vysočina region) generates the capacity of 2,040 MW (4 x 510 MW).

[See: Figure 4]

Figure 4. Installed capacity in individual regions (as of August 2014).

Installed capacity in regions of the Czech Republic (NUTS 3 - August 2014)



Source: Energy Regulatory Office.

the Ústecký region (4,621 MW, especially because of thermal power stations burning coal⁷), then in the Středočeský region (2,956 MW, mainly thermal power stations + hydro power stations) and in the Jihočeský region (2,896 MW, the result of the Temelín Nuclear Power Plant). On the other hand, the lowest installed capacity may be found in the Liberecký region (186 MW), Praha (198 MW) and in the Zlínský region (280 MW).

RENEWABLE ENERGY

When travelling around the Czech countryside, it is almost impossible not to notice the typical photovoltaic panels covering fields, farmlands and meadows. The actual capacity of photovoltaic power plants exceeds the projected six years ago reality. Several times. Undoubtedly, that's the result of the state regulation.

The renewable energy support program was originally based on a legislation proposed in 2003 by the government of the PM Vladimír

⁷ The key power stations are owned by the ČEZ Group – Tušimice, Ledvice, Počerady and Prunéřov.



WHEN TRAVELLING AROUND THE CZECH COUNTRYSIDE, IT IS ALMOST IMPOSSIBLE NOT TO NOTICE THE TYPICAL PHOTOVOLTAIC PANELS COVERING FIELDS, FARMLANDS AND MEADOWS. THE ACTUAL CAPACITY OF PHOTOVOLTAIC POWER PLANTS EXCEEDS THE PROJECTED SIX YEARS AGO REALITY. SEVERAL TIMES. UNDOUBTEDLY, THAT'S THE RESULT OF THE STATE REGULATION

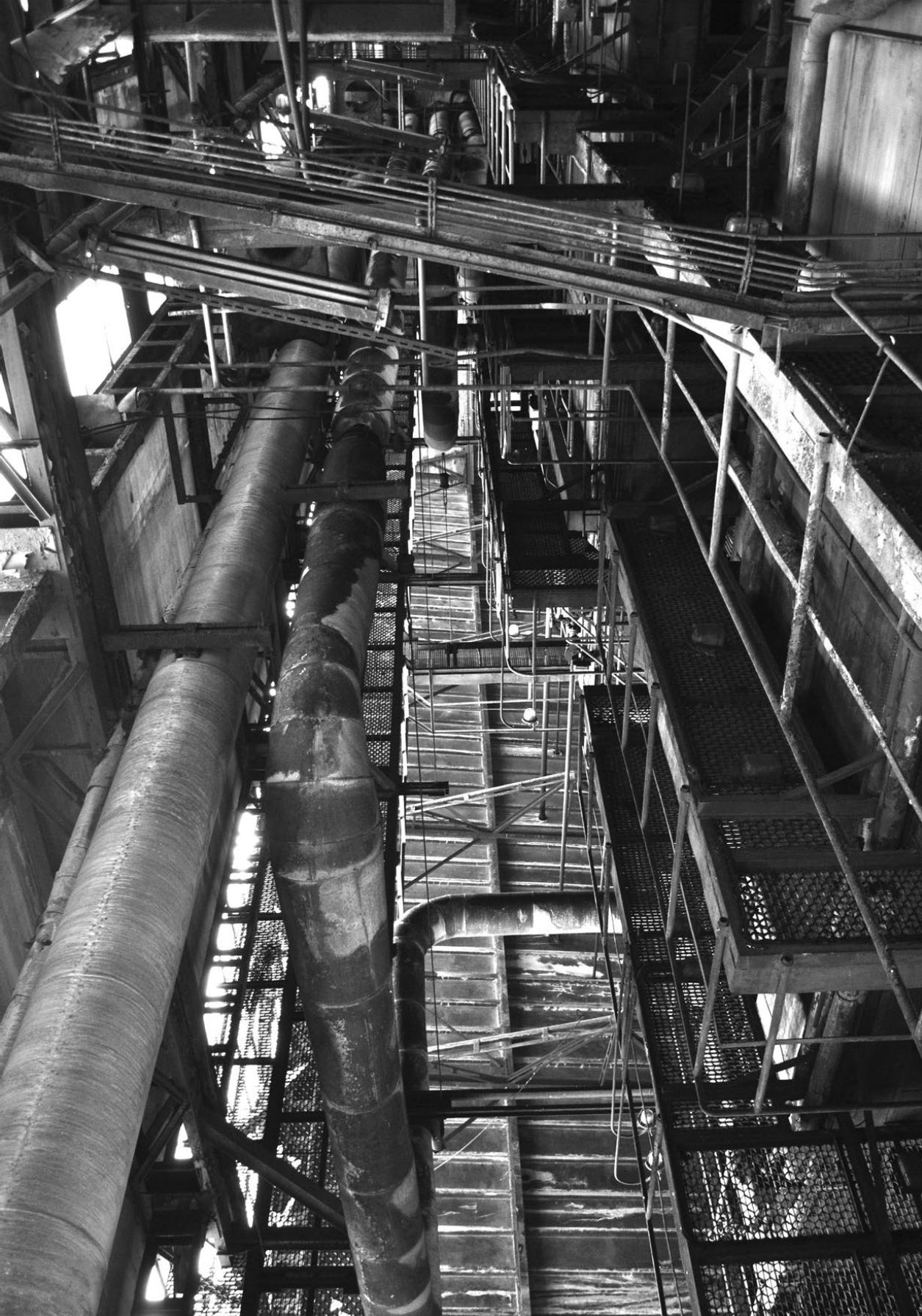
Špidla. The state support to the electricity produced from renewable energy sources in the Czech Republic was proclaimed by a special Act no. 180/2005 Coll. (and the promotion of renewable energy sources), a guarantee of the financial support to wind energy, solar energy, geothermal energy, water energy, soil, biomass, landfill gas and biogas. The provisions have announced significant subsidies especially in 2009 and 2010, what prompted the construction of thousands of power plants and caused the threat of higher prices for electricity customers in the state by tens of percent.

Between 2008 and 2010, the sharp decline in the prices of photovoltaic panels (return on investments with included support dropped from legislatively calculated 15 years to 6 or 7 years) caused the dramatic increase in the construction of photovoltaic power plants, i.e. dramatic pressure on public finance expenditures.

The critical situation has led to the effort to limit the support under the emergency legislation process. In September 2010, an amendment to the Act⁸ has been passed. It approved the limitation of the state support for newly constructed solar power plants, while the plants built by the end of 2010 still had the guarantee of extremely discounted purchase price of electricity for other 20 years with the regular annual increase by 2%.

So, the aim of rent-seekers (owners of photovoltaic power plants) was to finish the construction and connect it to the network by the end of 2010. In the second half of 2010, applications and requests for connection to the grid flooded the regulatory offices. This generated a high capacity for corruption and clientelism in

⁸ This Act has been replaced later on by the Act no 165/2012 Coll. (on supported energy sources).



those days. Courts in the Czech Republic are still dealing with serious cases of corruption of officials, deception and frauds, as well as litigations related to high-priority connections of new companies with anonymous property structure to the electro-energy network, which are often rumored to be covertly co-owned by politicians, officials and other decision-makers. [See: Figure 5]

The Figure 5 provides the information about a share of renewable energy sources on the annual gross consumption in the Czech Republic (right axis) and the electricity generation in TWh (left axis).

In total, the share of renewable energy sources increased up to 13.17% in the end of 2013. Especially the boom of photovoltaic along with biogas and landfill gas stations could be marked as the main driven factor. Concerning the renewable electricity generation, it produced over 9.243 TWh in 2013. The essential part of that is covered by hydro energy (almost 30% on RES production), biogas and landfill gas (over 24%), photovoltaics (over 22%) and biomass (app. 18%).

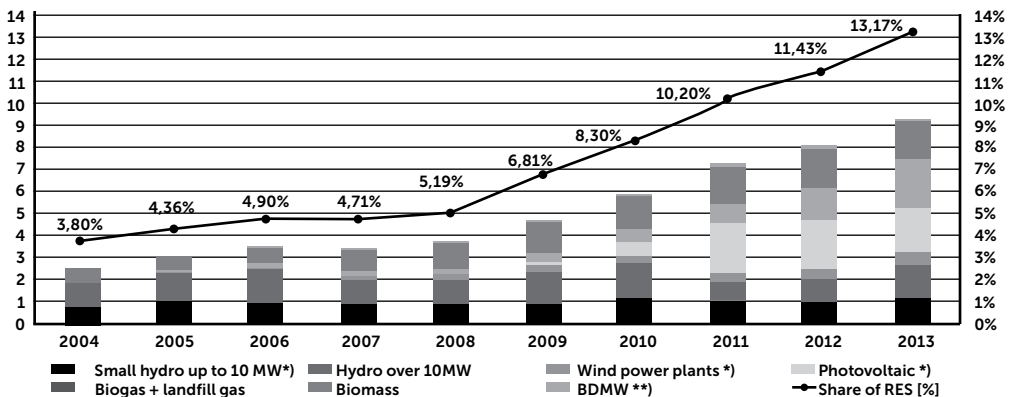
CONCLUSIONS

The Czech electricity sector has many particularities. Some of them could be definitely labeled as opportunities and threats.

The Czech Republic produces a higher volume of electricity than it is consumed in the country. Installed capacity and ability to produce stable volume of electricity provides good conditions for electricity export, which can cover power cuts related to a high installed capacity of renewable energy sources in neighboring countries. The "Go Green" way in energy politics, which has been already accepted in several states in the Western Europe, will need a stabilizing factor, an anchor. And that is a good opportunity for the Czech electro-energy producers.

The boom of renewable energy sources, which creates problems in energy sectors across Europe as it delivers an unforeseeable amount of the produced electricity, has been scaled down in the Czech Republic. Although the Czech taxpayers (as consumers) still feel the significant impact of the renewables on their wallets, the recent shape of legislative framework doesn't

Figure 5. Renewable energy sources in the Czech Republic (2004–2013). Electricity production form RES and its share of gross consumption in CR [TWh]



really create a desirable conditions for any notable enlargement of the renewable energy sector.

On the other hand, the Czech Republic is not energy self-sufficient in terms of resources used for electro-energy production. The extensive resource depletion before 1989 reaps its harvest now, especially when talking about coal mining. The net import of resources used for electricity and heat production left the country dependent on suppliers, so any problem on the international market (including international political) could cause a cost-shock in the economy and threaten the energy consumption.

As mentioned above, the boom of the renewables was suppressed in the Czech Republic. Nevertheless, that doesn't mean it is over for good. In the matrix composed of very strong rent-seekers, very weak and corruptive politicians and a very bad institutional background, one cannot be sure that the regulation of the renewable energy sources will not go bad and that as a result, the market won't be distorted again.

The problem, which is settled in many other states, is also related to the obsolescence of traditional sources of electricity. And, it is like a vicious circle leading to the catastrophic end. Planning and construction of new power plants, no matter whether the thermal or the nuclear ones, takes years and years of preparation and billions of euros, on the costs side. The current situation in the Czech Republic (and in the European Union as well) together with decreasing prices of the electricity does not provide good conditions for these long-term investments. The renewable energy sector is not strong enough to cover all the consumption of electricity 24/7/365. The energy sector needs traditional sources, but those are neither in the plans nor under

construction. The business *unisono* says the recent situation is unsustainable and there is no way to cover the future power cuts without a traditional sources, i.e. without a state guarantee of the purchase price of energy needed for lowering the risk related to projecting a new power plant.

In the following years, the Czech government should definitely focus on the energy policy improvements. The energy efficiency should be enhanced, ideally by the means of the low-carbon technologies implementation. The presence of renewable energy in the European grid needs significant improvements of the energy infrastructure as well. ●

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Paks II: Investment of the 21st Century – But at What Price?



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ZSUZSANNA
KORITÁR



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ANDRÁS
PERGER

On January 14, 2014, Hungary and Russia concluded an agreement on atomic energy cooperation, in which the countries agreed, *inter alia*, to construct two new nuclear reactors of at least 1,000MW capacity each. The signatory from the Hungarian side was Mrs Lászlóné Németh, the minister of national development, and Rosatom from the Russian side.

The agreement perplexed the public. The intention has always been to select the investor in a tender procedure. To understand why the Hungarian-Russian agreements were such a shock, we should take into account the historical overview.

FROM THE BEGINNING TO THE PRESENT DAY

The extension of the Paks Nuclear Power Plant from four to six reactors was already planned during the construction of the plant in the 1980s. For this reason space for two reactors of 1,000MW capacity each at the Paks site was left. In the 1990s only one unsuccessful invitation to tender was organized regarding this matter, however, by the end of the 2000s a serious governmental intention was formulated to make the original plans come true.

Paks Nuclear Power Plant started to work on this issue in 2007: the so-called Teller project was launched then, which aimed at preparing the analyses underlying the necessary resolution of parliament. As a result of the project, on March 30, 2009 the Parliament in its resolution approved the "*commencement of preparatory activities for the development of new nuclear block(s) at the Paks site.*"

Various legal and substantive concerns arose in relation to the resolution: it was not clear what was actually approved by

the means of it. It was not explained who was authorised to perform the activity and the concept of preparatory activities was left unclear. The second Orbán government referred to this resolution in January 2014, following the conclusion of the agreement, by stating that they prepared the establishment of the new Paks blocks with the agreement.

Following the parliamentary resolution, MVM and Paks Nuclear Power Plant launched the so-called Lévai project, which was specifically directed at preparing the investment, in particular the preparation of the invitation to tender, the completion of technical and economic analyses, the implementation of licence-related activities, performance of PR activities, and finally invitation to tender and its evaluation by the end of 2014. The project was given a total funding of HUF 12.74 billion.

The transparency of the Teller and Lévai projects was low, the public disclosure of the project data – plans, costs, data accumulated during the projects, such as contracts, results – could only be enforced via judicial and official proceedings. This situation, as we will see later, has not changed since then either.

In the summer of 2012, the government adopted resolutions in which it designated the planned investment a priority, decided to set up a government committee, and determined tasks related to this case for the government (June 18, 2012, government resolutions Nos 1194/2012, 1195/2012 and 1196/2012). A project company was founded in July under the name of MVM Paks II Atomerőmű Fejlesztő Zrt. (MVM Paks II Nuclear Power Plant Development Ltd.) within MVM to continue the Lévai project.

With this action it became non-transparent as to what role these organisations play in the preparation of the investment. To those

watching from the outside, an appropriate interpretation could have been that the government, for some reason, took the initiative on this issue from MVM. From then on it has become clearer that the earlier communication, according to which the Paks project would be a market-based investment executed by MVM, had seized to be valid.

Centralisation, characteristic of other areas, has arrived for the new nuclear power plant as well. Up until the summer of 2013, the position that the constructor will be selected in an invitation to tender still prevailed. However, by the end of 2013 it became more and more clear – on the basis of the government¹ statements², that a decision could be expected soon and that the government would wish to conclude an agreement with Russia without organising a public procurement procedure.

Note here that the tasks determined on the basis of the abovementioned government resolutions relating to, amongst others, the financing and technical content of the construction, the funds of the investor, the possible role taken up by the state (so-called financial contribution, state guarantee, warranty) and radioactive waste handling strategy, have never been performed.³

Despite all this, on January 14, 2014 the agreement on the construction of two new reactors was concluded, and on March 31 the two countries signed another agreement on a loan which was supposed to be provided by the Russian party for construc-

tion funding, which states that Russia provides EUR 10 billion interstate loan for Hungary to implement the investment at Paks.

The Parliament of Hungary adopted the interstate agreements (in February and May of 2014). In July 2014, dr. Attila Aszódi, the head of the Institute of Nuclear Techniques of the Budapest University of Technology and Economics was appointed the government commissioner to control the investment by the government. Negotiations between the representative of Hungary and Russia opened under the supervision of the government commissioner to discuss the issues related to the investment and to prepare the three agreements (on construction, on fuel supply and handling of spent fuels, and on cooperation in the operation and maintenance of the power plant) necessary for its implementation. The agreements were signed on December 9, 2014, therefore, the investment is now ready to start.

The state gained direct ownership over the MVM Paks II Nuclear Power Plant Development Ltd. project company in October 2014. The extension is supervised by the Prime Minister's Office within the government, where the office of the government commissioner also belongs. The Paks investment has therefore become fully centralised.

In the meantime, the licensing procedure has also started. The first step of nuclear safety licensing, the licensing of the test programme necessary for the nuclear site licence was initiated in April 2014. The Hungarian Atomic Energy Authority issued the resolution in November 2014, but actual analyses had already started back in August. Environmental licensing will be continued with the environmental impact assessment procedure following the preliminary consultation completed already in 2012, but its date is not known yet (pursuant to the resolution

¹ <http://www.dehir.hu/belfold/orban-viktor-magyarorszagon-lehet-a-legalacsonyabb-az-aramar-az-eu-ban/2013/10/18/>

² http://hvg.hu/gazdasag/20131218_Az_oroszok_vihetik_a_paksi_bovistest/

³ <http://energiakontrollprogram.hu/hir/paks-2-a-ko-rmany-sajat-szabalyait-sem-tartja-be>



of the Southern Trans-Danubian Inspectorate for Environment, Nature Protection and Water on the preliminary consultation, MVM Paks II Nuclear Power Plant Development Ltd. may request the commencement of the environmental impact assessment procedure until December 21, 2014 by submitting the environmental impact assessment).

Although the European Commission investigates the Paks extension from several aspects, it is still not sure whether the investment and its funding is EU-compatible in its current form; in the 2015 draft budget of Hungary there is already HUF 28.116 billion allocated for this purpose. Recent press releases state that this will cover the expenses of the project company, the costs of licensing and the planning costs which have not been determined yet.

On the basis of the historical overview it can clearly be seen that the project is actually ill-prepared. A lot of questions and problems arise in relation to the investment. And this is what shall be pointed out in this article.

DO WE NEED A NEW PAKS?

When discussing the topic of Paks, the zeroth question is whether we need such a huge capacity to be built in the Hungarian electricity system at all, and if yes, should it really be solved by constructing nuclear blocks?

In 2008, a parliamentary resolution required the government to commence the preparatory work related to the new nuclear power plant capacity and to examine, *inter alia*, the necessity of such investment. This work has not been carried out ever since. In 2011, the Parliamentary Commissioner for Future Generations declared that besides the fact that the necessity of surplus nuclear energy had not been actually examined, no impact assessments and no strategic environmental assessment had been carried out.

Assessments of the necessity, alternatives, and the energy/economic/environmental/social impacts of the new nuclear power plant capacity have still not been prepared. The majority of information on the investment is confidential: Energiaklub has been requesting data on the Paks investment since 2009, but their disclosure to the public could mostly be enforced via legal proceedings only. The possibility of participation of citizens in the procedure was not guaranteed either. The abovementioned Ombudsman position stated that their inclusion must be ensured: this provides the guarantee for revealing and discussing major social risks in all aspects with civil and expert organisations as well as individuals, who/which have no professional or economic interest in the construction of the power plant. However, this has never been organised.

What are the possible risks and consequences of the investment? We must discuss, on the one hand, the impact of building a new capacity on the current system, and, on the other hand, the problems arising from the framework and loan agreement concluded with Russia, as well as their influence.

Although Hungary has still not taken a clear position on when it is planning to put the two blocks into operation, we may conclude on the basis of a few conditions (e.g. the condition of the loan agreement on that the loan repayment must be commenced before 2026) that the designated target date may be in the mid-2020s. However, Hungary will not need the power produced by a new nuclear power plant around that time. The replacement of the four operating blocks is due only in the mid-2030s, and in case six blocks are to operate from the mid-2020s simultaneously, electricity production from the surplus nuclear source would only mean that the investment will have created

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BY EXPRESSING SUPPORT FOR THE NEW NUCLEAR POWER PLANT CAPACITIES TOO EARLY AND IN A PRECIPITATED AND HASTY MANNER, WE HAVE CEMENTED THE ENERGY SUPPLY OF HUNGARY FOR DECADES AND PRESERVED AN ENERGY SYSTEM WHICH IS LIKELY TO BE LESS AND LESS ABLE TO COOPERATE WITH THE EUROPEAN NETWORKS

unjustified additional costs, caused potential environmental risks, and would place a restricting impact on the electricity market.

Serious developments would be needed both at the site and within the electricity network, and this would only be necessary to fulfil the cooling demand that will be more than doubled compared to the current value, and to transport the more than doubled amount of electricity produced. These investments are needed only for the 6-8 years when the six blocks shall operate together.

Nuclear capacities will become so huge in the system that, based on the current electricity demand, it will require the constant pressure to export on the one hand (even with the restriction or shut-down of non-nuclear generators during night hours) and on the other hand, it will hinder further technology development. Inflexible nuclear capacities compete for access to the network with wind and solar energy having very low variable costs. This competition (generated by the renewable developments in Germany) on the European electricity market may become so excessive that would pose a challenge also to the two new blocks themselves without the older ones.

By expressing support for the new nuclear power plant capacities too early and in a precipitated and hasty manner, we have cemented the energy supply of Hungary for decades and preserved an energy system which is likely to be less and less able to cooperate with the European networks developed in other directions in both technical and market aspects.

ECONOMIC CONSEQUENCES

The construction of the new Paks Nuclear Power Plant together with associated investments would mean spending HUF 4000 to 5000 billion of public money. Russia provided EUR 10 billion in loans and the rest is to be covered by Hungary. The

new reactors of the Paks Nuclear Power Plant are expected to produce electricity for at least HUF 30 per kWh, hence not the cheap kind. This means that the price of electricity in general would be one and a half times higher than now. A recent example of the Hinkley Point C nuclear power plant planned to be constructed in Great Britain shows that the currently calculated price of electricity produced by the nuclear power plant is approximately the double of the wholesale price of electricity nowadays, and it is more expensive than the electricity produced by most renewable energy technologies. Therefore, it is doubtful whether the electricity to be produced by the new blocks can be sold at all.

If the costs of the loans are borne by the state, this will mean at least HUF 400 billion additional burden to the budget annually. So, either more taxes need to be collected from taxpayers to make up for this amount, or other expenses need to be reduced (e.g. less will be allocated for health care or education). Either way, the competitiveness of Hungary may decline due to the giga-investment, because it is ultimately the Hungarian economy that needs to produce this amount of money.

Besides the Paks site, further investments are needed on top of the above due to the size of the blocks supplied by Russia (1,200MW). The current 500MW reserve capacity (which has to be proportional in size to the biggest generator unit in the electricity system, which in Hungary means the Paks blocks of 500MW each) must be increased by 700MW, what means that many new nuclear power plants must be built in the country. These investments would raise total project costs by several HUF hundred billion investment demand, which – together with the power plant maintenance costs – would be paid by the population in the form of electricity price

and/or taxes, thus further decreasing the return on the investment at the national economy level.

When it comes to investments of such a size we always have to consider the risk of corruption. In relation to the construction of the Paks Nuclear Power Plant it was already clear during the publication that from among the few possible actors the Russian Rosatom State Nuclear Energy Corporation would be selected for construction. The selection process and criteria were not open, which gave a greater possibility to abuses and corruption from both sides compared to organising all the proceedings in a regulated and open procedure. Based on international empirical analyses, at least 5% of the investment is at risk of corruption in similar projects. However, the Hungarian data set the ratio of bribery fee to three times this amount at 13 to 16% of the value of investment. However, the social loss related to corruption can be several times higher than this percentage. This means several HUF hundred billion loss of taxpayers' money in such a great investment item.

LENDING SCHEME AND ITS RISKS

Under the abovementioned agreement Russia provides a HUF 10 billion loan to Hungary for the construction of two new Russian blocks in the Paks Nuclear Power Plant between 2014 and 2025. 80% of the project's cost is financed by Russia, the rest is covered by Hungary. The loan is to be paid back in 21 years – the first instalment will be due when the two blocks are finished, but this cannot be later than March 15, 2026. Annually, two instalments are to be paid (on March 15 and September 15). The interest of the loan is between 3.95% and 4.95% - it is the lowest during construction and increases gradually, thereby reaching the highest amount in the last seven years of repayment.

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SINCE THE PAKS INVESTMENT AMOUNTING TO 10% OF THE GDP WILL APPEAR IN THE MEANTIME IN THE GOVERNMENT BALANCE-SHEET, THE DEBT RATIO MUST BE DECREASED BY THE SAME AMOUNT DURING THE INVESTMENT, I.E. NOT 10%, BUT 20% DECREASE MUST BE REALISED

While the interest conditions can be said to be favourable, some other conditions of the loan and unclarified circumstances raise serious doubts. Thus, it is unclear what happens if the blocks are not finished by March 15, 2026 – the agreement provides only 15 days to assess the invoices issued by the Russian party; it does not specify the law governing the handling of any disputes, and does not determine an adequate mechanism to handle such situations. If Hungary is 15 days late with the transfer of the instalment due, the agreement foresees a penalty interest that is 1.5 times higher than the original interest, and, in case the Hungarian party is 180 days late with an instalment, the agreement threatens with the possibility that Russia withdraws from the agreement and the loan can be claimed back in a lump sum. Due to all these strict and unilateral conditions the agreement may become unfavourable for Hungary in the future.

Since the state takes up the loan to finance the construction, the obvious question of what consequences this will entail on the public finances and the budget arises. On the basis of the currently effective statistical accounting rules of the European Union, the project is most likely to be accounted for in the government sector.

The investment will mean a huge burden to the country during construction. This is because Hungary currently has an approximately 80% debt-to-GDP ratio, and this must be reduced to around 70% by 2024 in any case pursuant to relevant regulations. Since the Paks investment amounting to 10% of the GDP will appear in the meantime in the government balance-sheet, the debt ratio must be decreased by the same amount during the investment, i.e. not 10%, but 20% decrease must be realised. In practice this means that taxes need to be raised during the investment or ex-



ALTHOUGH THE REPAYMENT DOESN'T START UNTIL 2026, THE FINANCIAL BURDEN CAUSED BY THE PAKS INVESTMENT CANNOT BE LEVIED ON THE FUTURE GENERATIONS, BUT IT MUST PRIMARILY BE BORNE BY THOSE WHO PAY TAXES OR RECEIVE SUPPORT FROM PUBLIC FINANCES DURING THE INVESTMENT

penses need to be reduced in the amount of HUF 400 to 450 billion annually (e.g. value-added tax should be raised to 35% or social expenses and other government investments or the support given to enterprises need to be reduced). Although the repayment doesn't start until 2026, the financial burden caused by the Paks investment cannot be levied on the future generations, but it must primarily be borne by those who pay taxes or re-

ceive support from public finances during the investment. Therefore, in compliance with the constitutional requirement of a sustainable and transparent budgetary policy, the Hungarian government should publicly reveal its assumptions, calculations and other ideas related to the budgetary consolidation measures. If they do not plan to postpone the project, these ideas should be presented in the convergence programme of spring 2015 (providing a prospective to 2018) at the latest.

WHAT IS THE OPINION OF THE EU?

A serious question arises as to whether the planned financing scheme should be considered state aid. The reason for this is because state aid is normally prohibited pursuant to EU law, therefore consultations must be held on this issue. The plan voiced during the conclusion of the agreements, according to which construction costs would not be integrated into electricity prices, but they would fully be covered by the central budget, would possibly not be accepted by the Directorate-General for Competition of the European Commission (it investigates the cases related to prohibited state aids). The financing in its present form would satisfy all criteria of prohibited state aid: the investment is realised from state resources; support is selective, because it does not cover the other economic actors; the aid causes distortion of competition, because Paks II could not be implemented on a commercial basis; it has an effect on trade between Member States, because state-supported electricity – which can therefore remain below the market price – may have competitive advantage in the export market. Probably due to that, the Hungarian position is likely to change: the Paks government commissioner recently speaks about the fact that all costs will be integrated into the electricity price. However, this raises the very





IN THEORY, IT IS POSSIBLE FOR HUNGARY TO OBTAIN FUEL FROM A SOURCE OTHER THAN RUSSIA, BUT THE PRACTICAL REALISATION MAY BE SOMEWHAT PROBLEMATIC

important question of competitiveness: is such an investment economical and recoverable today on the energy market?

Similarly, it must also be examined whether it has been lawful to conclude the agreement without an international tendering procedure. According to government communication, the European Commission agreed to conclude the agreement without a tender, but this has not been confirmed by official European sources yet, and the Directorate-General for Internal Market and Services has already commenced the related procedure.

We have already mentioned the issues relating to public finances. A third controversial matter that arises in the EU-context is the modifying effect of the loan on the debt path and the sustainment of the debt ratio, the examination of which may be performed by the Directorate-General for Economic and Financial Affairs.

ENERGY DEPENDENCY, SECURITY OF SUPPLY

The construction of two new blocks would switch the main part of domestic electricity production to one energy source and technology, physically concentrated to one site. This poses several threats to the security of supply.

If electricity production becomes impossible at this site for any (e.g. technical or environmental) reason, it will threaten the supply of the country both in case of short-term and long-term failure. Due to this, the country would heavily depend on technology and the fuel supplier, even if it has a fuel stock enough for two years provided for by law. Since Russia would supply the fuel to the two new reactors as well as supplying also the current four reactors of Paks, the possible failure of Russia to provide fuel would place decision-makers in





EXTERNAL OBSERVERS MAY SEE THAT IN PAKS A MUCH GREATER AND COMPLEX COOPERATION IS BEING ESTABLISHED WITH RUSSIA, WHICH EXTENDS TO OTHER AREAS AS WELL. IT FURTHER DISCREDITS HUNGARY THAT ALL THIS HAPPENS SIMULTANEOUSLY TO THE CRISIS IN UKRAINE, DURING WHICH HUNGARY HAS FOR INSTANCE ARGUED AGAINST THE RUSSIAN SANCTIONS SEVERAL TIMES

a grave situation. In theory, it is possible for Hungary to obtain fuel from a source other than Russia, but the practical realisation may be somewhat problematic. There is no guarantee that during the time of need the potential manufacturers can supply fuel in the appropriate quality and quantity. The time necessary for licensing of the new fuel type also increases the potential risks.

The framework agreement of January 2014 is not clear with regard to the issue of spent fuel. Pursuant to its text, the Parties conclude an agreement on the transport of spent fuels up until we obtain the fuel from Russia. Waste from the spent fuel processed in Russia is then transported back to Hungary. It is unclear whether this agreement is mandatory or not. It is also unclear whether we must expect to bury the spent fuels in the territory of Hungary or not, i.e. whether we will become dependent on Russians as regards nuclear waste as well, or not.

Above all this, the planned investment has further dependency risks: the Russian loan to be taken up for the construction, with regard to its unfavourable conditions, will tie Hungary to Russia for several decades. This situation may further distort the existing energy dependency relation to the disadvantage of Hungary.

GEOPOLITICAL RISKS

Hungarian government tries in vain to handle the agreement as a sole energy issue but there will definitely be a high foreign policy price to pay for that. On the one hand, the Hungarian government completely ignored the concerns of the EU related to the competitive market, financing and increase of sovereign debt, which may have consequences in the future. On the other hand, external observers may see that in Paks a much greater and complex cooperation is being established with Russia, which extends to other areas as well. It further discredits Hun-

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HUNGARIAN GOVERNMENT TRIES IN VAIN TO HANDLE THE AGREEMENT AS A SOLE ENERGY ISSUE BUT THERE WILL DEFINITELY BE A HIGH FOREIGN POLICY PRICE TO PAY FOR THAT

gary that all this happens simultaneously to the crisis in Ukraine, during which Hungary has for instance argued against the Russian sanctions several times.

This close link may cause disturbances in the system of alliances of Hungary, the consequences of which can already be seen: the United States expressed its concern with the behaviour of Hungary on several occasions and in various forms in autumn 2014 in relation to the agreements concluded with Russia on the Paks extension and the South Stream pipeline. The EU institutions and the bigger Member States have not expressed their disapproval publicly with such clarity as the United States, but this does not exclude the possibility that Hungary will be treated as a helper of the enforcement of interests of Russia within the European Union, which might push Hungary into vacuum. The collaboration may cause the collapse of the cooperation between the Visegrad, and the

only alternative to this for Hungary will be isolation. None of these can be treated as a potential objective.

It is questionable whether we can withdraw from the nuclear agreement. Hungary had the chance for this prior to the conclusion of the detailed agreements (as previously mentioned, on construction, fuel supply and maintenance), because the agreement of January can be terminated without justification

However, the loan arrangement does not make it possible – these agreements were needed to fill it with content. Following the signing, it has most probably become way more difficult to withdraw from the agreement, the price of which is most likely to be paid by Hungary. •



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Anti-Capitalism in Hungary: The Energy Reforms



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MÁTÉ
HAJBA

Hungary is currently in a unique position within the European Union. The country is carefully balancing between the EU and Russia, relying on the former for financial support, yet looking for the friendship of the

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SOCIETY IS DISAPPOINTED WITH THE FREE ECONOMIC CHANGES WHICH TOOK PLACE IN THE COUNTRY AFTER THE FALL OF THE SOCIALIST REGIME. AND THIS DISILLUSIONMENT RESURFACED AFTER HUNGARY JOINED THE EUROPEAN UNION. BECAUSE THE ECONOMIC SITUATION DID NOT CHANGE OVERNIGHT

latter. As Russia substantially defines energy policy in the region, it is an important aspect of the decision making process. Whereas in many of the post-Eastern Bloc countries some sort of impersonal distancing from the previous overlord may be observed, in Hungary not only has the government declared the so-called “Eastern Opening” of its foreign policy, but also followed that declaration in the wake of the previous regime’s briefly discontinued anti-capitalistic measures. Thus when researching the Hungarian energy reform, three main factors must be taken into account: the general anti-capitalistic sentiment among people; the government’s regulatory and restrictive measures (in many cases regardless of the public attitude) and Hungary’s relations with Russia and the EU.

Recent energy reforms in Hungary made the country dependent upon Russia what in the midst of the current EU-Russia relations strongly affected by the escalating tensions makes the situation of Hungary more difficult. The general anti-capitalist tendencies of the public intertwined with the populist measures of the government, such as aggressive price reductions, nationalization and over-regulation, further weaken the already volatile economy of Hungary, making the country even more dependent on foreign aid.

ANTI-FREE MARKET TENDENCIES IN HUNGARY¹

Although Hungary was in a relatively fortunate position even during the communist era, what enabled the country to regain a well-functioning economy, starting from the early 1990s the trend of progress has been reversing mainly due to the interventionist government policies augmented

¹ <http://szabadpiacalapitvany.hu/article/studies/19>

by the anti-capitalist position of the general public. These anti-free market notions have in turn been capitalized on by populist parties, further increasing the distrust of free economy.

Society is disappointed with the free economic changes which took place in the country after the fall of the socialist regime. And this disillusionment resurfaced after Hungary joined the European Union. Because the economic situation did not change overnight.

The economic regression of the late 2000s caused the rise of historically anti-capitalist far-right ideologies. Conspiracy theories became more and more popular putting the blame on others, rather than claiming responsibilities. Nationalist tendencies that highly oppose a globalized, free market and progress struck the economy hard.

Nowadays, the government fulfills the need of a strongly paternalistic state that saves the people from international corporations, foreign investors, banks and the globalized market. With an absolute majority, the government went into a rampage of nationalizations and regulations, making the situation in Hungary highly unpredictable, dissuading foreign investors from

enterprising in the country. The rise of ultra-nationalistic groups also damages the economy, halting progress and thus stopping substantial economic growth.

Anti-free market tendencies in society

After the democratic changes of the early 1990s, the free market aspirations turned into a state capitalist system. The transparency of the privatizations was not sufficient and many institutions got into the hand of cronies. As a result, the political echelons and the private sector became entangled and many policies started to be aimed at making certain companies richer. This naturally caused a deep distrust in both public and private sector and made the word "free market" synonymous with state capitalism.

A dichotomy ensued in the society – people required a stronger intervention from the state, while at the same time wanting the state to interfere less in their private affairs. A study conducted by the European Values Study (EVS) shows that the Hungarian population is divided between the line of individualism and egalitarianism. [See: Table 1.]

Society as a whole, paradoxically, wants more state intervention at the same time hankering after more personal freedom.

Table 1. Individual freedom versus social inequalities (% , 2008).

I find that both freedom and equality are important. But if I were to choose one or the other, I would consider personal freedom more important, that is, everyone can live in freedom and develop without hindrance	47.1
Certainly both freedom and equality are important. But if I were to choose one or the other, I would consider equality more important, that is, that nobody is underprivileged and that social class differences are not so strong	50.0
Neither/don't know/no answer	2.9



The results of the study do not differ significantly if the question of state versus individual is asked of each party's voters.

One of the reasons for this controversial perception of the state can be the high degree of distrust amongst the citizens towards each other, as shown by many studies. Since individuals do not think much of other people, they are turning towards the state to improve their situation. In the Eastern-European countries, despite of the officially collectivist ideologies, the decades-long state socialism did not result in greater social cohesion. Insane individualism, greater distrust, lesser cohesion are more inherent in these countries than in Western Europe. The majority of the Eastern-European voters, Hungarians included, do not trust the state but they trust other people even less and this paradoxical set of mind makes them paternalists.

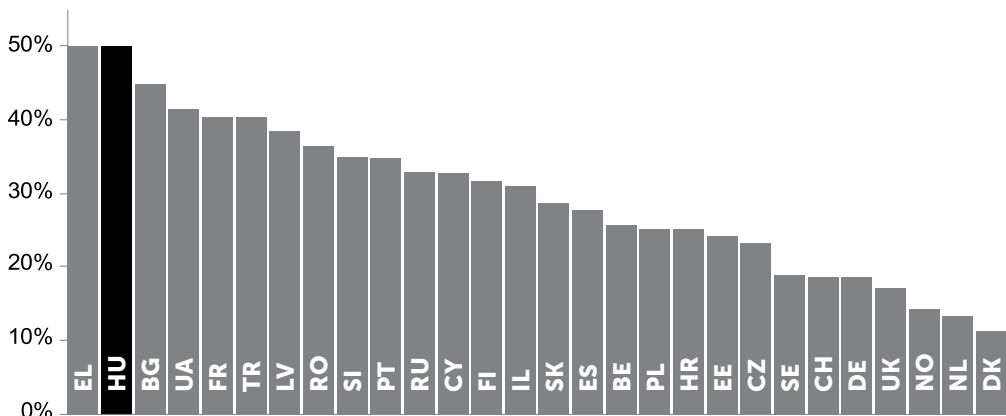
The word "paternalist" usually describes those who require a more intensive intervention and regulations from the state but at the same time they are aware that this entails sacrifices and limitations of freedom on the level of the individual, which are accepted for the beneficial results of

the state intervention. In Hungary, however, paternalists want the benefits of state intervention, for example greater security, smaller social inequalities, but they don't accept the individual consequences, such as higher taxes or limited personal freedom.

In 2010, a flat tax system was implemented, what made the issue of taxation and redistribution relevant. Opposing this measure, studies show that in 2009 half of the population in Hungary strongly agreed that the state should narrow the differences between incomes, putting Hungary at second place, right after Greece, in the ranking of EU countries. Similarly, nearly half of the population supported a progressive taxation. [See: Figure 1.]

People don't accept wide income gaps even if when they reward talent and hard work. In relation to meritocracy, Hungary is lagging far behind other countries. There is a huge confusion regarding income inequalities and redistribution in the country and people think that it is the responsibility of the state to lower the inequalities – but on the other hand, taxes should be lowered as well.

Figure 1. The state should narrow income inequalities (rate of those who completely agree).



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MANY FOREIGN INVESTORS PERCEIVE THE SITUATION IN HUNGARY AS UNSTABLE AND UNPREDICTABLE BECAUSE THE GOVERNMENT, WITH AN ABSOLUTE MAJORITY, IS PASSING LAWS TOO QUICKLY. AND MANY OF THOSE LAWS ARE NOT IN FAVOR OF THE FREE MARKET BUT OF A STRONG STATE INTERVENTION AND HEAVY TAXATION

It should be noted that there are no significant differences between those who deem themselves right or left wing sympathizers with regard to paternalism, distrust of free market or competition. This shows a confusion as to the ideological spectrum, because traditionally the right wing was more pro-capitalist while the left wing – more for state intervention. In Hungary, the dichotomy of political polarities is based rather on how much emphasis one puts on the importance of national values. In this regard, the self-proclaimed right-wing parties are usually more nationalistic, whereas the left wing is less so.

Studies show four main contradictory views of the Hungarian citizens:

1. The state should have more responsibilities in securing the welfare of the individuals and the control of society, but this should not limit individual freedom and independence, the state should not interfere in their lives (omnipotent 'night-watch' state);
2. The state should satisfy the needs of its citizens but should also lower social benefits and subsidies;
3. The state should lower income inequalities, but should also lower taxes and social spending;
4. The amounts of social benefits and subsidies are both too high and too low.

Government policies

In the early 1990s, when the socialist regime failed, Hungary had a relative economic advantage as compared to the other post-communist countries. Hungary joined the EU in 2004. At first there was a rapid growth but it gradually slowed down and the economic regression of the late 2000s hit hard. The mismanagement

Table 2. Comparison of the set of values of capitalism and the far-right.

Main components	Capitalist ideology	Far-right ideology
What is in focus?	the individual	the nation
What is the perception of people?	people are predominantly good	people are predominantly bad
What is the primary value?	liberty	order
What is an ideal society like?	accepting	discriminative
What is an ideal state like?	minimalistic	totalitarian
What makes a community better?	competition	unity

of the situation by the then ruling socialist party led to a landslide victory of the self-proclaimed central-right party Fidesz at the next elections in 2010. They managed to gain an absolute majority, meaning that they acquired two thirds of the seats in the general assembly, which was enough to implement a new constitution. It came into effect in 2012. Fidesz, which has been in power ever since with absolute majority, fell under heavy criticism for weakening the system of checks and balances and interfering with civil rights, eg. free press.

Although claiming to be a conservative, right-wing party, their economic measures have been predominantly left wing. For example, the government nationalized the private pension funds, set up an agency to exercise a certain amount of censorship over the media, forcefully reduced utility fees causing huge losses in the private sector and now the government is investigating civil organizations for being founded from abroad.

Although the government implemented flat tax, there are many new side-taxes, so even this measure cannot be regarded as

purely capitalistic. There is a strong anti-multinational company sentiment, a lot of inventors are complaining about an unjust taxation system which favors national investors to foreign money. A lot of sectors are heavily taxed, eg. the financial and communication sectors.

There is also a strong anti-EU sentiment in Hungary, although the rate of euro-skeptics is close to the average within the EU. Despite the fact that the country is heavily subsidized by the European Union, because of the lack of transparency and possible embezzlements the beneficial effects are not immediately apparent to the public. The government is currently opposing Brussels on issues like the EU's concern with new legislations and regulations the EU wants to implement.

Many foreign investors perceive the situation in Hungary as unstable and unpredictable because the government, with an absolute majority, is passing laws too quickly. And many of those laws are not in favor of the free market but of a strong state intervention and heavy taxation.



THE ANTI-FREE MARKET TENDENCIES IN HUNGARY PROVED TO BE A HOTBED OF THE POPULIST FAR-RIGHT IDEOLOGIES. IT IS A COMMON PHENOMENON THAT POLITICAL EXTREMITIES RESURFACE AT THE TIME OF ECONOMIC REGRESSIONS, WHEN PEOPLE FEEL THE NEED TO FIND A SCAPEGOAT

The far right and anti-capitalism

The far right historically opposed liberal values. It has always been against individual freedom, free market and globalization. Its collectivist views are in stark contrast to the capitalist set of values which emphasizes the importance of an individual rather than a nation or an ethnic group. [See: Table 2.]

The anti-free market tendencies in Hungary proved to be a hotbed of the populist far-right ideologies. It is a common phenomenon that political extremities resurface at the time of economic regressions, when people feel the need to find a scapegoat.

The far right of Hungary, mainly embodied by the Jobbik party, which has 20% of the popularity rate, opposes both individual and economic freedom, but its views also contain the same controversies as those of the general public.

In the program of the party appear the following elements of the far-right ideology:

- The idolization of the state, thus expanding its powers and its influence on the economy;
- Ethnocentric views, resulting in the rejection of foreign investors;
- A xenophobic attitude towards foreign capital, fear of clandestine interest groups;
- Aversion to big businesses;
- Limitation of free competition based on national values and human weaknesses such as selfishness and avarice;
- Prioritizing the duties rather than the rights, the supremacy, the establishment and the maintenance of order;



GOING AGAINST THE EUROPEAN TREND OF LIBERALIZING THE ENERGY SECTOR, HUNGARY IS WORKING TOWARDS MORE STATE CONTROL

- Strong aversion to the elite, discrimination of certain economic groups.

The agenda of Jobbik includes some more paradoxes as well: exercising a strong and wealthy government is an impossible task when at the same time it wants to reduce public charges. Jobbik also opposes foreign capital, except for investments from the East.

The far-right's aversion to free markets is also strengthened by a set of anti-Semitic conspiracy theories. Many people believe that Jewish interest groups are trying to weaken Hungary, buy (and thus, using their discourse, steal the lands), and they control the market and the trend for globalization. A staggering 42% of the Hungarian population thinks that a shadow organization is controlling the government.

The Hungarian Free Market Foundation created a damage calculator which provides a monthly calculated index, denominated in the Hungarian currency (forint), which gives an estimate of the quantified, indirect damage to Hungary, caused by

the internationally published pessimistic articles on the activities of the Hungarian extreme right. By calculating the damage, the PR values of the articles, the decreasing touristic incomes due to the negative reports and the decrease of business investments are being taken into consideration. Every second about 30-forint (approximately 0.132 USD) damage is caused.²

Populism and paradoxes

In Hungary, most of the people favour the individual liberty aspect of capitalism as long as they are the individuals in question, but they don't care about others. On the other hand, people find inequalities unjust and they think it is government's responsibility to reduce the gaps.

The increasing number of supporters of the far right is against every aspect of free market values, both economically and on the levels of civil liberties. They believe in strong nation-states and collectivism.

Paranoia and distrust are a major problem and contributing factors of the socio-economic views of the people. They think that the state should provide greater security by exercising greater powers over others. The society's economic and social perception is paradoxical in nature and its priorities contradict each other.

The populist parties are capitalizing on the paranoid anti-capitalism of the people and are seeking to implement interventionist measures.

ENERGY POLICIES

It is a commonly understood that direct government interventions into the economic processes, although in the short term may lead to successes, in the long term are

² <http://szabadpiacalapitvany.hu/about/method>





THE NEW HUNGARIAN FOREIGN POLICY DIRECTIVE, CALLED THE "EASTERN OPENING", CLEARLY SETS THE TONE FOR THE COUNTRY'S RELATIONS

unsustainable and cause more harm than bring benefits. Going against the European trend of liberalizing the energy sector, Hungary is working towards more state control. There are three main measures in which anti-free market tendencies manifest within the energy sector. These are: price reduction, nationalization and foreign policy.

Price Reduction

In general, the European Union endeavours to limit price regulations in the field of production since the liberalizations of the 2000s. The European Commission requested Hungary to end long term power purchase agreements in 2008 on the grounds that free market will provide better opportunities.³ This trend to deregulate prices is present in the policies of all the member states, except for Hungary, where every household, every small business up to a limit of consumption and every public institution is entitled to gas and electricity on a regulated price. Such extent of centralization is unique in the European Union.

International Practices

A review⁴ of the Council of European Energy Regulators (CEER) revealed that about half of the member countries still regulate prices, however, most of them plan to abandon this practice. This will happen faster in the electricity sector, although only a few countries have precise strategies on doing so.

As for the gas sector, changes will be slower but the overall trend within the EU is moving towards transferring prices to the hands of the free market, as regulations in the long

³ http://europa.eu/rapid/press-release_IP-08-850_en.htm

⁴ http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Customers/Tab3/C12-CEM-55-04_SR-3rd-Pack-customers_7-Nov-2012.pdf

term do more damage than good. Unfortunately, however, while the most countries intend to abandon price regulations, they mostly lack a roadmap on how to proceed.

Hungarian Practices

In the mid 1990s, Hungary privatized most of the electricity and gas services, but the real opening of the markets started in 2003. This period, which lasted until 2008, is called the “dual market”, because whereas the industrial consumers enjoyed the benefits of a relatively open market, the private consumers were provided for by service providers enjoying monopolies and under strict regulations. In 2008, when the market truly opened, this duality seized to exist. State intervention concerning industrial consumers was limited to setting tariffs and taxes. This was still a significant portion of the full price (more than 50%) so the market was still not exempt for state intervention.

In 2010, a new trend started to bloom opposing the liberalization efforts with the change of political parties in power. The National Energy Strategy 2030⁵ clearly sets a new direction: *“The presence of the government is currently rather moderate on a market-oriented, liberalised and highly privatised energy economy. The government is primarily able to assert its priorities through regulatory instruments, in accordance with the rules of the European Union. In itself, the ensuring of the coherence of legal and economic conditions is insufficient in order to efficiently vindicate public good and national interests. While in the electric power sector, the government continues to have a substantial direct potential to influence the market through the state-owned MVM Zrt. (Hungarian Power Companies Ltd.) and the Paksi Atomerőmű*

Zrt. (Paks Nuclear Power Plant Ltd.), a similar potential should be established in the natural gas and oil sectors, with particular regard to the expiry in 2015 of the long-term natural gas contract between Hungary and Russia. This may include the granting of new authorizations to the MVM Zrt., creating a new state-owned natural gas trading company or acquiring a controlling interest in a company with a high market share.”

One of the manifestations of this new direction are the price reductions in the prices of utilities. In 2013 there was a 20% energy price cut, and in 2014 – as per the third wave of regulations – the price of gas was reduced by a further 6.5%, electricity by 5.7% and district heating by 3.3%⁶.

Energy service providers not owned by the Hungarian state, which were hit hard by the reductions, took matter to court, and they won, but in the meantime the Hungarian Energy and Public Utility Regulatory Authority (MEKH) was given powers to issue decrees which couldn't be pursued in court. The government plans to extend the forced price cuts to the industrial sector as well.

The Impact of Price Reductions

The new set of economic measures of the Hungarian government project a paternalistic, protectionist image, which many voters found appealing. The price reduction was more of a populist political move than a well considered economic measure, all the more so, because the Hungarian electricity and gas prices were not – as the government propaganda led people believe, extremely high compared to other EU member states. True, they were high compared to the wealth of the people, but, even so, the sound solu-

⁵ <http://2010-2014.kormany.hu/download/7/d7/70000/Hungarian%20Energy%20Strategy%202030.pdf>

⁶ <http://www.mekh.hu/kozerdeku-adatok-2/a-magyar-energia-hivatal-kozlemenyei/626-10-szazalekkal-csokken-a-lakossagi-villamos-energia-a-foldgaz-es-atavho-ara-januartol.html>

tion is not lowering the prices, but raising the welfare of the people by opening and liberating the market. Price reductions only generated losses for the companies⁷, so in the long term they will either go bankrupt (which will soon be the case in small businesses in the utility sector) or they will have to cut wages and reduce employment.

The rate of investments fell in the energy sector and elsewhere as well after the price reductions were implemented, and this, in turn, lead to a decrease in the rate of economic growth. According to the statistics of the Hungarian Central Statistical Office (KSH), since 2010 investors find Hungary less and less favourable. The OECD projects that in 2015 the growth of GDP will only be 1.7% compared to the 2% of 2014⁸.

Nationalizations

The governing party is leading a nationalistic policy, favouring Hungarian ownership over foreign companies. Multinational businesses are directly targeted, and banks with foreign ownership are being bought up. Moreover, due to the reluctance of foreign investors to continue operating in Hungary in such an atmosphere, it is easier for the state-owned providers to acquire businesses. The government has outlined a plan (although the details are constantly being changed) to establish one great, non-profit, public service provider which would incorporate the energy sector as well.

Foreign Policies

The new Hungarian foreign policy directive, called the "Eastern Opening", clearly sets the tone for the country's relations. In

2014, the Prime Minister Viktor Orbán put forth his idea to establish an illiberal democracy based on the model by Vladimir Putin, which he also started to implement. Euro-scepticism is growing in Hungary not only amongst citizens but on the government level as well. The speaker of the national assembly stated, that if the EU continues along the same line, it is time to back out of it. The EU flag was taken down from the building of the Hungarian parliament.

Since Hungary enjoys the benefits from Brussels a lot – with 6.3% of the Gross National Income coming from EU funding in 2013 and with 95% of all public investments being at least partially financed from Brussels⁹, the country is highly dependent on the EU.

In order to give credibility to the anti-EU and anti-US sentiments Hungary had to find other supporting partners. It turned its glance towards Russia, with its plans to form a Eurasian Union as an alternative to the European Union. Thus Hungary liaised with Russia, increasing its energy dependency on the Eastern country, at the same time endangering the EU's efforts for energy security in the midst of the currently volatile international relations.

Paks

In 2014 Hungary has signed a deal with Russia to build new nuclear power plants beside the already existing and operating plants in Paks. The deal involved a substantial loan which Hungarians will be paying off for decades to come. The lack of transparency accompanying the agreement raises concerns – the details were said to be revealed 1 year after the planned completion. Hence it is not certain what

⁷ <http://index.hu/gazdasag/2013/04/02/rezsicsokkentest/#>

⁸ <http://www.oecd.org/economy/economic-survey-hungary.htm>

⁹ http://ec.europa.eu/budget/mycountry/HU/index_en.cfm

this deal actually involves, except for the obvious fact that the country's dependency on Moscow will increase because of it. Allegedly, the new plants will not be owned by Russians¹⁰. The new blow to the Russian economy, however, gives leeway for either Russia or Hungary to back out of the deal, as the former couldn't afford any more and the latter might find it beneficial for political reason to back out, as the deal came under heavy attacks. However the Hungarian government wants to push forward with the deal nonetheless.

Southern Stream

The other main deal with Russia involves the Southern Stream pipeline, which would transport gas from Russia. The pipeline was against EU laws, because the pipeline as well as and the gas flowing through it would be owned by the same company, Gazprom. However, Hungary created a new law that enables construction of the pipeline despite the concerns of Brussels.

Russia had backed out of the deal because Bulgaria – one of the countries the pipeline would have crossed, abiding by the EU regulations didn't give the project the green light. This situation, however, has changed since and the future of the pipeline is debated.

Nevertheless, Hungary should limit its dependency on Russia and rather explore its shale gas reserves, which the EU would support as well¹¹. Hungary gains 76% of its gas from abroad, so it is high time to look for alternatives. Such a move would, obviously, benefit Europe.

CONCLUSIONS

Hungarians support anti-free market tendencies as long as their own individual interests are not affected in the process. This, the already protectionist and anti-capitalistic populist government, is more than happy to feed.

The domestic energy policy of Hungary goes against the EU trend, and not without a reason. Since it stands on the populist political and ideological pillars rather than on sound economic reason, it is not certain whether it will endure, and may in the meantime cause great losses for businesses and the Hungarian economy.

As for the foreign policy, Hungary plays a dangerous game with its warming to Putin under the "Eastern Opening" directive. The growing tensions between the EU and Russia put Hungary in a delicate position. Instead of going towards the East, Hungary should give precedence to its loyalty to the West, which represents the values Hungarian citizens hold dear. For this reason, Hungary should break ties of its energy dependency with Russia and explore other ways of sustaining itself. •



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¹⁰ http://hvg.hu/gazdasag/20141204_Kormanybiztos_nem_kerul_orosz_tulajdonba

¹¹ http://ec.europa.eu/energy/doc/20140528_energy_security_study.pdf

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Shale Gas: The Untapped Potential



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ŽILVINAS
ŠILĖNAS

Less than a decade ago many people were talking how we will be running out of oil soon. Many politicians and experts were constantly spouting “Peak Oil”. Solemn faces during reputable conferences were asserting that it is obvious that the world production of oil has peaked, and will now be decreasing. Few dissenters were called naive or nicknamed “market fundamentalists”. In fact, claims about “peak oil” were popular since the 19th century. Even in the 1970s many serious people were convinced (and some of them still are), that we are running out of oil. Like in most cases regarding the future of humanity, the pessimists were wrong.

The shale gas (and oil) revolution is a perfect example of how human ingenuity and freedom to act can solve any problem. Hydraulic fracturing has been around since 1950s. However, only recently a couple of key technologies come together, namely horizontal drilling (i.e. drilling one kilometer down and then two to the right) and development of proppants (i.e. sand and similar particles that keep fractures open and allow for gas to be collected) made shale gas a massive success. This allowed the US to become the new energy superpower.

This revolution is happening so fast many still do not grasp it. Five years ago many companies in the US planned to build new LNG import terminals. Now, however, there are around 30 applications to build export terminals (even though experts think that, in the end, only four or five will actually be built). USA already outproduces everyone in oil. Natural gas is three times cheaper than in Europe and four times cheaper than in Asia. Energy intensive industries – chemical industries – are relocating back to the US. If 5-6 years ago there were no new plans for chemical plants, now there are around 150 such plants planned.

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WHILE EUROPEANS ARE PREOCCUPIED WITH “GASLAND” AND YOUTUBE VIDEOS ABOUT BURNING TAP WATER, THE US IS EXPERIENCING A REAL REVOLUTION IN ENERGY AND AN INDUSTRIAL RENAISSANCE

While Europeans are preoccupied with “Gasland” and Youtube videos about burning tap water, the US is experiencing a real revolution in energy and an industrial renaissance. What can be done to remove unfounded obstacles to shale gas in Europe?

ENVIRONMENT

First, we need a simple, clear non-discriminatory environmental impact assessment procedure. Shale gas should be treated as any other source of energy. The method of extraction of a natural resource should not play a major (if any) role in assessing its benefits. We should be concerned with the final product, its price and availability, not with how it was extracted. If the EU has not banned the extraction or use of natural gas, there is no sound reason not to allow the extraction of shale gas.



IF ENVIRONMENTAL PROTECTION IS THE MAIN OBJECTIVE OF ANY REGULATION WE NEED TO GET RID OF DOUBLE STANDARDS WHEN IT COMES TO SHALE GAS EXTRACTION

Criteria on what constitutes “harmfulness” must be clear, quantifiable and not discriminate the industry of shale gas when compared to other industries. In other words, no special or unique restrictions should be developed specifically for the industry of shale gas. Impact assessment should concentrate on final and quantifiable harmfulness (if such harmfulness can be foreseen), not on the technological process or the technological details (e.g. composition of chemicals used or methods of extraction etc.)

There seems to be no objective quantitative method of measuring the harmfulness of shale gas extraction, especially one that could be also related to other economic endeavors. It is simply not fair to juxtapose shale gas extraction with the pristine, untouched environment and treat the difference as a quantitative assessment of environmental harm. We need to compare fracking to other human activities, which usually do not take into account any detailed impact assessment.

This type of thinking can help solve many potential problems. Does shale gas use a lot of water? Well yes, that’s true. But if we are talking water usage we should not forget that large amounts of water are used in the *initial* stage of shale gas production, i.e. the hydraulic fracturing. Once the fracking is done (which takes a couple of months), the water can be reused or recycled. At the same time, the gas well is producing gas for at least a decade. Now, let’s compare this to the water used by the average farm or plantation. Especially if we consider the projections for the next 10 or 20 years. What do you think, what is less harmful?

What about noise made by trucks transporting water to the fracking site? Indeed, there is that. But any construction project



AN ANTI-FRACKING AMERICAN INDIVIDUAL HAS ALL THE RIGHTS TO FORBID FRACKING (OR ANY OTHER EXTRACTION OF MINERALS) ON HIS PROPERTY. A LAND-OWNING EUROPEAN USUALLY DOES NOT HAVE SUCH A CHANCE

is noisy. Roads, buildings, shopping malls, stadiums. Many construction projects (especially public ones) usually cause noise and inconvenience. But somehow a proposal to impose moratorium on, say, new stadiums, would seem silly, while proposals to halt extraction of shale gas do not. If environmental protection is the main objective of any regulation we need to get rid of double standards when it comes to shale gas extraction.

What about pollution? Especially the widely discussed pollution of ground water. Let's leave aside the scientific and engineering technicalities. Let's assume that there even is a probability of some degree of pollution from fracking. Would this probability

and magnitude of pollution be significantly higher than that of other industrial activities? If we are so concerned with run-off of some chemical substances, what about run-off of fuel, engine oil and other things that are washed away from our streets and parking lots every time it rains?

Someone might think it is necessary to raise the bar of protection of environment to near-impossible level. To require companies to ensure that no pollution would ever occur. Some might even think it is a noble effort. But the sheer impossibility of this is obvious if we imagine imposing the same standard on other human activities. This would translate into something like "the car that would never crash", "the ship that would never sink" or "the pipeline that would never leak", "the factory that would never produce any pollution". Clearly these are unreasonable demands. But why do then so many people feel good about trying to impose these unachievable benchmarks on one specific industry – shale gas?

LAND USE, ROYALTIES AND REVENUES

How to decide what to do with revenues from gas wealth is another issue that is hotly contested. This discussion is already riddled with certain misconceptions, misunderstandings and myths.

It is true that in the US, people who own land usually own the so-called mineral rights as well. This means that the minerals (or as in this case – gas) belongs to the owner of the land. The actual situation is a tangle of federal and state regulations – there are cases where land owners actually own the surface, but not the mineral rights and so on. It is also true, that in many of European cases people own the surface but not the mineral rights. This difference between the two property regimes is interesting but it does not prove



IF WE ARE SERIOUS ABOUT THE IDEA THAT TAXES ARE IMPOSED TO DEAL WITH NEGATIVE EXTERNALITIES (E.G. NOISE), WE SHOULD AWARD THE TAX REVENUE TO THE COMMUNITIES THAT ARE EXPERIENCING THE ACTUAL NOISE AND OTHER SUCH SIDE-EFFECTS. THIS WAY IS MUCH MORE FAIR AND DOES NOT SOUND LIKE AN EXCUSE TO HIKE TAXES JUST TO FILL THE STATE COFFERS

in any way that shale gas extraction in Europe is impossible. If anything, there is actually more risk in the US, not in Europe. An anti-fracking American individual has all the rights to forbid fracking (or any other extraction of minerals) on his property. A land-owning European usually does not have such a chance.

At the same time, in the US many fracking operations are done on federally owned land (e.g. in the state of Colorado). In those cases the situation is quite similar in Europe – e.g. the government owns the mineral rights and benefits directly from the extraction of shale gas. If it can be done in the US, why not try it in Europe?

What Europeans could learn from the Americans is how to spread the wealth. In the case of Colorado, even if shale gas is extracted on federal land, half of revenues goes to the specific county in which the extraction took place. This sharply contrasts with the situation in, say, Lithuania, where the district gets 10% of the taxes from extraction of natural resources. If we are serious about the idea that taxes are imposed to deal with negative externalities (e.g. noise), we should award the tax revenue to the communities that are experiencing the actual noise and other such side-effects. This way is much more fair and does not sound like an excuse to hike taxes just to fill the state coffers.

WHAT IS THE OPTIMAL TAX LEVEL?

Finally, what type of taxes should we impose on fracking? Clearly, taxes should not be used as a measure of ensuring that fracking does not happen. In other words, if you impose 50% royalty on every cubic meter of gas extracted, most likely you will not find any investors willing to develop a project. Such taxes are discriminatory and should not be tolerated. They are



tantamount to imposing an arbitrary tariff on, say, black sofas. And if this comparison sounds ridiculous, that's because it is. In a world, in which natural gas is widely used, it is ridiculous to impose discriminatory taxes on natural gas extracted by a specific technology.

More serious discussion about optimum levels of taxation of extractive industry largely centers on how to get more revenue (see the table below). This brings several insights into the matter.

First of all, royalty (or tax on actual extracted quantities of gas) is not the only tax the companies pay. Besides the private sector taxes companies pay also corporate income tax, taxes and social security benefits on their employees, etc. Therefore royalties should be seen in a wider context. A 10% royalty does not mean that company only pays 10% tax. Usually it pays much more. Lithuanian example indicates that companies engaged in extraction of oil struggle with tax burden amounting to around 27% of their turnover.

Secondly, if the royalty is set too high ("overshooting"), then one of the two scenarios might occur. Scenario "A": companies do not engage in extraction of gas, there is no economic activity, and the state gets nothing. Scenario "B": companies do engage in productive activity, but high royalties eat all the profit margins. In that case, state gets no corporate income tax, whereas high royalty stifles growth and investment of the industry.

However, if the government sets a low level of royalty ("undershoots"), and companies earn large profits, the state budget receives extra income from corporate income tax. In addition, growth and investment of sector are stimulated.

Therefore it is better to "undershoot" than "overshoot", when it comes to setting royalties.

STATE-OWNED OR PRIVATE COMPANIES?

Another side-argument is sometimes construed. It goes along the lines that shale-gas extraction should be done by government-owned companies. This argument is supported with a factoid that some companies in the business of extracting oil are state-owned. But the fact that some countries give monopoly rights for extraction of hydrocarbons to government-owned companies is not an example worth following. Is there any proof that government-owned companies are better at fracking or environmental protection? Undoubtedly, Europe should not be allured by the state-owned energy companies, especially given what kinds of governments usually practice the nationalization of energy-extraction sector.

Extraction of shale gas or other unconventional fuels should be ran by private enterprises. The EU should clearly defend freedom of establishment and criticize national governments if those choose to award rights of extraction – openly or tacitly – only to state-owned companies, but not to private ones.

PEN, PAPER, POLITICAL WILL

Obstacles to successful extraction of shale gas in Europe are artificial. They stem neither from technological complexity (even though hydraulic fracturing is technologically complex), nor from economics (even though probably not all technologically viable gas wells make economic sense). The major obstacles have legal basis. A pen, paper and political will. That's what we lack and what actually reminds me of a sad episode, back in 2002, when famine-stricken

Table 4. Primary Government Objective and Relevant Mechanism

	Signature Bonus	Flat Royalty	Sliding-scale Royalty	Resource Rent Tax (and ACE)	CIT/VIT	State Participation
Maximizing government share over project life				X	X	
Securing early revenue	X	X				
Ensuring adequate incentives for exploration				X	X	
Visible share of commodity price increases			X			
Strategic ownership interest						X
Maximize resource utilization				X	X	
Minimize administrative burden and risks	X	X				

Fiscal Regimes for Extractive Industries: Design and Implementation, IMF, 2012, p.28.

Zambia refused to accept food aid because the government was convinced by the Western green NGOs that the food aid contained GMOs. Similarly, green NGOs employ scare tactics and even overt anti-Americanism in the debate on shale gas in Europe.

The world is experiencing a real energy revolution of shale gas and shale oil. It is driven by real sources of energy, affordable prices and solid business sense. Shale wells are being drilled with profits, not subsidies. The outcome of shale gas revolution is more energy and lower prices

for consumers. It is time for European politicians to get their pens, paper, gather political will, and allow this revolution in Europe. •



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Slovenia's Privatisation Failure and Failure to Privatisise¹



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JURE
STOJAN

On May 1, 1998, privatisation in Slovenia was declared officially over – an occasion marked by the coming into force of a new law. Passed only weeks earlier, it was aptly titled the ‘Act Concluding Ownership Transformation and Privatisation of Legal Entities Owned by the Development Corporation of Slovenia’. Fifteen years later, independent observers still report that the State holds an excessive ownership stake in the Slovene economy. International institutions indeed admonish Slovenia for not having privatised enough, even though a massive privatisation had taken place. In 1990, there were 3,709 ‘socially owned’ companies operating in Slovenia². Approximately 1,500 were at least partly privatised, the rest ended in insolvency or liquidation³. By 2010, the State had retained significant shareholdings in 79 companies in 7 industrial sectors⁴. However, this official figure understates the true involvement of the State with the Slovene economy. It accounts neither for investments held by State-owned enterprises (SOE), nor for collateral on non-performing loans seized by State-owned banks during the recent economic crisis⁵.

¹ An earlier version of this article was published as: “Privatisation Failure and Failure to Privatised: The Slovene Example,” in *Economic Affairs* (June 2014), Vol. 34, Issue 2, pp. 270-281.

² Smith, S. C., B.-C. Cin and M. Vodopivec (1997). “Privatization incidence, ownership forms, and firm performance: evidence from Slovenia.” *Journal of Comparative Economics* 25 (2): 158-179.

³ Simoneti, M., A. Bohm, M. Rojcek, J. Damijan and B. Majcen (2001). “Secondary privatization in Slovenia: Evolution of ownership structure and company performance following mass privatization.” *CASE Network Reports* (46).

⁴ AUKN. (2011). “Strategija upravljanja kapitalskih naložb Republike Slovenije.” Retrieved: December 29, 2014, from http://www.auknrs.si/f/docs/Obvestila_zajavnost/Strategija_upravljanja_november_2011_1.pdf.

⁵ No consolidated list of State holdings exists even in 2013. The complex network of SOE cross-holdings can

As lately as in April 2013, the OECD complained over the ‘already large state ownership in the economy’. The organisation also noted that ‘privatisation of non-financial corporations supported by the definition of a clear asset management strategy, underpinned by a well-defined distinction between strategic and non-strategic holdings, could attract valuable equity’⁶. Only a month earlier, an IMF mission to Slovenia had concluded: ‘Misconceived defence of “national interests,” including the reluctance to sell assets to foreigners, burdens the budget and unduly prolongs the corporate and financial sector distress. A prominent privatization could convey a powerful signal to international investors’⁷.

This article argues that the Slovenian experience with privatisation has been marked by two phenomena. First, the Slovenian State did not exit enough business – there was widespread failure to privatise. Second, the privatisation campaigns that were undertaken suffered from several severe problems – there was widespread privatisation failure.

be illustrated with the ownership structure of Triglav, the largest Slovene insurance company by market share – 34.47% of its shares are controlled by the State Pension Fund, 28.97% by the State-owned Compensation Fund (Slovenska odškodninska družba, SOD, which in late 2013 is being restructured into the Slovene Sovereign Wealth Fund), and 3.06% by NLB (the State-owned bank with the largest market share in the country). The remainder is held by the private sector, mainly by institutional investors. Now Triglav controls, through its wholly-owned investment vehicle Triglav Naložbe, a diversified portfolio of firms, ranging from a 39.07%-stake in Nama, a Ljubljana department store, to 80.10% of Golf Arboretum, a 18-hole golf course (Triglav Group (2013). Annual Report 2012. Ljubljana). None of such investments by State-controlled holdings appear in the official list of State-owned enterprises (SOD. (2013). “Letno poročilo upravljavca neposrednih kapitalskih naložb RS 2012 [Annual Report by the manager of sovereign investments].” Retrieved December 29, 2014, from <http://www.so-druzba.si/files/1371817044LETNOPOROIL0ZA2012.pdf>).

⁶ OECD (2013). *OECD Economic Surveys: Slovenia 2013*, OECD Publishing, p.65.

⁷ IMF. (2013). “Slovenia 2013 Staff Visit—Concluding Statement of the Mission.” Retrieved December 29, 2014, from <http://www.imf.org/external/np/ms/2013/031813d.htm>.



IRONICALLY, THE LARGE EXTENT OF STATE OWNERSHIP IN THE SLOVENE ECONOMY IS AN OUTCOME OF THE PRIVATISATION PROCESS ITSELF

Both phenomena were related, even though the precise relationship can be modelled in several ways. For instance behaviourally – privatisation failures could have been common knowledge and were reflected in non-negligible ‘failure expectations’ that inflated the expected costs of privatisation (thereby contributing towards failure to privatise). The article assesses several ways of defining and modelling privatisation failure and the failure to privatise.

A BRIEF CHRONOLOGY OF SLOVENE PRIVATISATION

Ironically, the large extent of state ownership in the Slovene economy is an outcome of the privatisation process itself. The latter can be broken down into several stages. Stage 0 refers to the starting point, a socialist economy of the Yugoslav type. Capital was socialised and companies subjected to soft budget constraints, but from the late 1960s onwards, there was no central planning (unlike elsewhere in Eastern Europe). ‘Ownership was deemed to be “social” rather than “state,” on the ostensible grounds that enterprises were managed by workers’

councils rather than through centralized branch ministries⁸. Moreover, Slovene companies traded heavily with Western European markets.

In the late 1980s, the reformist (and final) Yugoslav federal government of Ante Marković laid legal groundwork for a spontaneous ‘proto-privatisation’ (often disparagingly referred to as ‘wild privatisation’ by contemporaries). After Independence of 1991, the new Slovene government began preparing a new legal framework for privatisation but was slowed down by intense political disagreements over privatisation method.

Thus Stage 1 only began in late 1992, with the passing of privatisation legislation. It enabled the transfer of ‘social capital’ to new private owners but also, more importantly, to the State. State ownership thus arose at the same time as private ownership – previously, all companies had been owned by the notional society. Despite some test cases there were initial delays in privatisation, partly due to legal uncertainty created by on-going revisions of the legislation. Therefore, ‘mass privatisation’ is usually dated from 1995–1999⁹.

Phase 2, the subsequent period of ownership consolidation, is usually referred to as ‘secondary privatisation’. Owners from mass privatization started selling their stock – they were ‘largely transition-

⁸ Pleskovič, B. and J. D. Sachs (1994). Political independence and economic reform in Slovenia. *The Transition in Eastern Europe*. Chicago, University of Chicago Press. 1: 191–220.

⁹ ‘Mass privatization was formally completed at the end of 1998 but has actually remained uncompleted on both the demand and supply sides’ (Simoneti, M., A. Bohm, M. Rojec, J. Damijan and B. Majcen (2001). ‘Secondary privatization in Slovenia: Evolution of ownership structure and company performance following mass privatization.’ CASE Network Reports (46)).



Figure 1. Four types of privatisation failure.

Phase in privatisation	Type of privatisation failure	Agency behind failure
Phase 0 privatisation planning	Failure in method	Committed by policy makers
	↓	
Phase 1 on-going privatisation	Failure in regulation	Committed by policy makers
	↓	
Phase 2 privatisation completed	Failure in process	Committed by economic actors; facilitated by policy makers
	↓	
	Failure in outcomes	Aggregate responsibility for failure

al owners, playing a role of privatization agents in search of strategic investors¹⁰. Stage 3 was only announced in the aftermath of the financial crisis of 2008–2013, within a framework of fiscal consolidation¹¹.

Any discussion of privatisation failure is prone to three types of pitfalls. The 'muckraking syndrome' manifests itself in long catalogues of various crimes and

misdeeds. Since it is essentially lacking in theory, it provided few valid policy lessons.

The other extreme is the theoretical high ground, dismissing the whole topic as insignificant because it is already predicted by even the simplest of models. For instance, since it is the government that manages privatisation, privatisation failure can be expected as a simple consequence of all-common government failure. But privatisation itself is a policy designed to prevent government failure. It is therefore useful to understand how the problem ends up corrupting the proposed solution.

The third pitfall is the checklist approach. How does it decide when to call privatisation a failure or a non-failure (or outright success)? The analyst counts the indicators for failure and deduces the number of indicators for non-failure. However, this approach is sensitive to the total number of indicators used and on top of that, national governments are expert at playing such evaluation forms.

¹⁰ Simoneti, M., A. Bohm, M. Rojec, J. Damijan and B. Majcen (2001). "Secondary privatization in Slovenia: Evolution of ownership structure and company performance following mass privatization." *CASE Network Reports* (46), p.7.

¹¹ In May 2013, the Slovene government announced 15 SOE targets for imminent privatisation, in fulfilment of its commitments given to the European Commission in the course of the Excessive Deficit Procedure. The shortlist includes Adria Airways (the national airline), Ljubljana Airport, Telekom Slovenije (the former telecommunications monopoly), NKBM (Slovenia's second largest bank), Terme Olimia Bazenji (a spa resort), as well as two chemical companies, Helios and Cinkarna Celje. UKOM. (2013). "8. redna seja vlade [press release after the 8th meeting of the government]." Retrieved December 29, 2014, from http://www.vlada.si/fileadmin/dokumenti/si/Sporocila_za_javnost/sev13-8.doc.



IN THE CASE OF SLOVENIA, FAILURE IN PRIVATISATION METHOD CAN BE OBSERVED WITHOUT RECOURSE TO OUTCOME OPTIMALITY. FAILURE WAS INHERENT IN THE PARTICULAR LEGISLATIVE SET-UP OF PRIVATISATION

A TYPOLOGY OF FAILURE

In economic literature, a focus on privatisation outcomes often means that privatisation itself is treated as a black box. But privatisation failure can also be defined independent of outcomes: as failure in privatisation method, failure in regulation and failures in privatisation process. As illustrated in Figure 1, these different types of failure arise at different points in time – before, during, and after privatisation¹². [See: Figure 1]

Failure in outcomes

In economics, policy failure is typically defined against the outcomes. If a policy (say, privatisation) appears to raise a given set of criteria, it is deemed successful, otherwise it is a failure (strictly speaking, there is also a zone of indeterminacy but it is outside the scope of this argument). From a microeconomic perspective, privatisation failure is measured against performance criteria for individual companies. Despite the predominance of financial variables (e.g. return on capital, value added), equitable considerations are also common (e.g. labour shed or added, firm-level income inequality).

Taking a broader view, privatisation is itself one of the main indicators of success and failure of economic transition. Successful privatisation is behind two of Janos Kornai's three criteria for accomplished transition¹³. The first one states that 'the Communist Party must lose its

¹² Introducing Phase 0 and 1 into analysis could also be thought of as the opening up of the 'black box' of the privatisation process. It also implies that some types of failure can be identified even while privatisation is ongoing, whereas failure in outcomes is only observable after privatisation had been completed, i.e. with a significant time lag.

¹³ Kornai, J. (1999). Reforming the Welfare State in Post-socialist Economies. *When is Transition Over?* A. N. Brown. Kalamazoo, MI, W.E. Upjohn Institute for Employment Research: 99–113.

monopoly power in politics'. But already the next one refers to disposal of State assets: 'the dominant part of the means of production must be held privately, and the private sector must account for the larger part of the gross domestic product (GDP). This private sector does not have to be created exclusively through privatization: it can become dominant through the entry of more and more new firms.' The third criterion requires the market to be the dominant coordinator of economic activities, alongside various other mechanisms.

Failure in method

Failure in method means that of the several possible techniques of privatisation, a sub-optimal one was chosen. And there is a lot to choose from; according to a World Bank report, 'the most commonly used methods of privatisation are: public offering of shares, private sale of shares, new private investment in an SOE, sale of government or SOE assets, reorganisation (or break-up) into component parts, management/employee buyout, and lease and management contract'¹⁴.

Unfortunately, most applications of the 'failure-in-method' approach rely on further assumptions regarding the optimality of outcome. In consequence, this approach to privatisation failure offers nothing more than a particular hypothesis for explaining general failure in outcome (which has to be demonstrated prior to analysis along some other dimension, i.e. without using data on the privatisation method). Nevertheless, such approaches to evaluating privatisation enjoy a long-standing tradition in economics. For example, Ferguson¹⁵ compares four

methods (sale to foreign company; auction sale to nationals; voucher sale or give-aways to nationals, also with intermediaries) based on seven criteria (ownership pressures; competitive pressures; entry possible; static efficiency; dynamic efficiency; know-how transfer; and equitable transfer), depending on market power of the privatisation targets.

There is another drawback of tying privatisation method to privatisation outcomes. The method is only one among many factors that can determine the outcome – and these variables need to be controlled for. Zinnes, Eilat et al.¹⁶ find 'that as a result of different initial conditions the economic performance responses of countries to the same policies are different'.

In the case of Slovenia, failure in privatisation method can be observed without recourse to outcome optimality. Failure was inherent in the particular legislative set-up of privatisation. The Ownership Transformation of Companies Act (1992) introduced the following model: 10% of a company's socially-owned capital was to be transferred to the State-owned pension fund, 10% to the State-owned Compensation fund, and 20% was to be exchanged for privatisation vouchers managed by special investment funds (vouchers were allocated for free according to age; the amounts ranged from 100,000 tolar – for all citizens under the age of 18 – to 400,000 – for citizens over 48). Alternatively, vouchers could be exchanged for shares by citizens acting on their own account, but only within the remaining 40% of capital earmarked for 'internal distribution,' i.e. for insiders (workers and management) as well as their close family members¹⁷.

¹⁴ Vuytsteke, C. (1988). *Techniques of Privatization of State-owned Enterprises: Methods and implementation*, World Bank, p.8.

¹⁵ Ferguson, P. R. (1992). "Privatisation options for Eastern Europe: the irrelevance of Western experience."

World Economy 15 (4): 487-504.

¹⁶ Zinnes, C., Y. Eilat and J. Sachs (2001). "The gains from privatization in transition economies: Is "change of ownership" enough?" *IMF Staff papers*: 146-170.

¹⁷ [Ownership Transformation of Companies Act] (1992).

Slovene privatisation was therefore set up in a way that increased State holdings. Privatisation transferred the socially-owned capital into private – and into State hands. This was not lost on contemporary observers; the CEO of a major pharmaceutical company was quoted as saying: 'It is completely clear that privatisation needs to be an acceptable political compromise. [...] The political goal was to distribute among citizens a certain amount of property based on the criterion of equity. But let us be completely clear. Now, the fundamental principle of the law is nationalisation, which cannot be efficient in the long run'¹⁸.

Failure in regulation

Privatisation can also fail because of internal inconsistency in the legal framework. In Slovenia, these inconsistencies arose because privatisation was based on several foundational acts. The Denationalization Act (1991) provided for the restitution – in kind, in bonds backed by the Compensation fund, or in other State-owned securities¹⁹. The Housing Act (1991) enabled the sale of socially-owned apartments to their occupants at heavily discounted prices (citizens living in private accommodation, either as owners-occupants or as tenants, were excluded)²⁰. The Ownership Transformation of Companies Act (1992) created the legal framework for privatising socially-owned enterprises. The National Farm Land and Forest Fund Act (1993) transferred all socially-owned land that had not been claimed by previous owners to the State²¹.

Zakon o lastninskem preoblikovanju podjetij, Uradni list. 55/1992: 3117.

¹⁸ Čeh, S. (1993). Kako se privatizirajo podjetja [How companies privatise themselves]. *Delo*. Ljubljana.

¹⁹ [Denationalization Act] (1991). Zakon o denacionalizaciji, Uradni list. 27/1991: 1093.

²⁰ [Housing Act] (1991). Stanovanjski zakon, Uradni list. 18/1991: 589.

²¹ [National Farm Land and Forest Fund Act] (1993). Zakon o Skladu kmetijskih zemljišč in gozdov Republike

These acts created competing claims to the same assets even though legislation addressed almost the most egregious examples. If, for instance, an apartment had been confiscated after the Second World War, claims of the initial owners or their heirs took precedence over the tenants. In other cases, precedence was less clear. Companies that had acquired plots of agricultural land found all this property confiscated by the State. They also had to create capital reserves to offset denationalisation claims²².

Failure in process

Failure in process is related to failure in regulation, which is a consequence of incomplete contracting or incompetent drafting. In short, most actors involved in privatisation have to take failure in regulation as a fact of life. Failure in process implies activity – privatisation was carried out against the law. However, even though privatisation process failure involves white-collar crime, Slovene criminal law offers little help to elucidate the concepts. What follows is an argument against using a legalistic definition of failure in process in the case of Slovenia.

The State criminalised mainly the spontaneous proto-privatisation that was based on either Yugoslavia-era laws or on a blatant disregard for law. To quote an official report, 'from 1990 until the adoption of the [Slovene privatisation legislation] many companies have restructured, recapitalised or reorganized on the basis of the then Federal Enterprises Act and the Traffic and Disposal of Social Capital Act (the so-called "Markovič Act")'²³. This self-emergent, cov-

Slovenije, Uradni list. 10/1993: 454.

²² Čeh, S. (1993). Kako se privatizirajo podjetja [How companies privatise themselves]. *Delo*. Ljubljana.

²³ [Ministry of Interior] (1995). Poročilo o delu na

ert privatisation was run by company insiders – only to be partially undone by the passing of the Ownership Transformation of Companies Act, which went into force on December 5, 1992. But it took a second amendment Act in June 1993 to criminalise previous privatisations²⁴.

The amended law introduced ten new offences of 'injury of socially-owned property' ('oškodovanje družbenega premoženja'): approving loans and other credit facilities with an annual real interest rate below inflation plus 8% (s. 1 and 2); leasing out premises below the regulated rent (s. 3); paying out dividends without making prior capital reserves of at least 6% of socially-owned capital (s. 4); preferred shares issuance (s. 5); cost reimbursement without the necessary proof of payment (s. 6); unjustified or undocumented write-offs (s. 7); unpaid transfers outside the company holding structure if socially-owned capital was thereby reduced (s. 8); taking out loans from employees or employee-owned firms at higher rates than offered by the company's main bank (s. 9); and 'all the other cases' with the interest rate below inflation plus 8% or with socially-owned capital not being revaluated prior to recapitalisations (s. 10).

The list codified in the law was, nevertheless, open-ended: it also mentioned 'the other cases of socially-owned capital being reduced through privatisation' (s. 10)²⁵.

področju lastninskega preoblikovanja podjetij [Report on the work in the field of privatisation of enterprises]. Ljubljana, p.4.

²⁴ Therefore, the law acted retroactively. The first Privatisation Act of 1992 merely provided for retrospective audits of a limited number of transactions that resulted in a change of ownership structure. The amended text of 1993, however, not only expanded this list of suspicious business activities but also defined them as 'injuries of socially-owned property', as well as introduced legal sanctions.

²⁵ [Ownership Transformation of Companies Amendment Act] (1993). Zakon o spremembah in dopolnitvah Zakona o lastninskem preoblikovanju podjetij, Uradni

Sections 1, 2, 3 and 10 thus effectively created an offence against central planning (even though it had been mostly abandoned already under Yugoslav socialist self-management). The law explicitly presumed that any deviation from regulated prices was wealth destroying.

A total of 17 companies (some of them represented by the Slovene Chamber of Commerce) appealed against the new amendments. They were joined by the Ljubljana branch office of the State Accounting Agency ('Služba družbenega knjigovodstva', a now defunct socialist-era organisation responsible for tracking financial transactions, auditing and keeping the company register) as well as the Slovene State Council ('Državni svet', the unelected upper chamber of parliament representing various interest groups). The constitutional judges, however, stroke down a single provision, the one that declared all unpaid transfers of socially-owned assets between companies illegal²⁶.

A new government body was set up to investigate privatisation-related offences, the Privatisation Audit Agency ('Agencija Republike Slovenije za revidiranje lastninskega preoblikovanja podjetij', operating from August 1996 to July 2004). The agency conducted 1,106 audits into privatisation undertaken between January 1, 1990 and December 31, 1992, that is, before the Ownership Transformation of Companies Act was operational. The investigation valued the total damage to socially-owned capital at 86,174 million in 1992 tolar, the Slovene currency at the time (equal to 873 million 1992 US dollars). Investigation was dropped in only 77 cases;

list. 31/1993: 1699.

²⁶ Ustavno sodišče (1994). Odločba o razveljavitvi tretjega odstavka 51. člena in o ugotovitvi, da določbe 48. a, 48. b in 48. c člena zakona o lastninskem preoblikovanju podjetij niso v neskladju z ustavo, Uradni list. 32/1994: 2102.





ANY SYSTEM WOULD
BE CONSIDERED
ROTTEN IF IT
CONTAINED TOO
MANY ROTTEN
AGENTS

524 firms (60%) 'voluntarily' restituted socially-owned capital valued at 52,215 million tolar (529 million 1992 dollars). The agency also had authority to reopen audits as long as privatisation had not been formally concluded (through registration with the court). There were 246 such audits that uncovered additional damages of 8,820 million 2004 tolar (44 million 2004 dollars)²⁷.

Even though some of the privatisation offences were only created in 1993 – and systematically investigated since 1996 – previous investigation had taken place. An official report explains that Slovene authorities 'began preparing for a period of privatisation at the end of 1989.' From 1990 to 1992, 58 privatisation-related criminal charges were pressed, most commonly for exceeding the bounds of discretion, signing detrimental contracts, abuse of office and falsification or destruction of business documents. But even the authorities admitted that 'deviant phenomena in ownership transformation are also due to vague and unclear property laws, which the executives in socially-owned companies abused for a speculative undertaking of privatisation, hoping that a lack of regulations would preclude prosecution. We have also found that the process of privatisation cannot be effectively guided solely by repressive measures, since these measures are meaningful only in specific cases where there is suspicion of criminal activity'²⁸.

The economic performance of the firms involved points to further weakness of the criminal law perspective on privatisation

²⁷ Žušt, R. and A. Kovač Arh. (2004). "Zadnje poročilo o delu Agencije za revidiranje na dan 31. 7. 2004 [Closing report by the Privatisation Audit Agency]." Retrieved December 29, 2014, from http://www.arlpp.gov.si/porocilo_o_delu_2004.doc.

²⁸ [Ministry of Interior] (1995). Poročilo o delu na področju lastninskega preoblikovanja podjetij [Report on the work in the field of privatisation of enterprises]. Ljubljana.

failure. Smith, Cin, and Vodopivec²⁹ analyse data for all the companies operating in Slovenia from 1989–1992 in a period of ‘spontaneous privatization’ (note that this time frame is a year longer than the one used by the Slovene Privatisation Audit Agency when investigating suspicious transactions). They use income statements and balance sheets to determine the degree to which insiders had already privatised the company’s capital (ingeniously, the old Yugoslav accounting standards provided the category of ‘domestic ownership’ – i.e. the amount of capital owned by private citizens as opposed to ‘society’ – as a proxy for employee ownership). In 1989, 24 companies out of a country-wide total of 2,795 exhibited ‘some employee ownership’. This proportion increased from 74/3,709 in 1990, 180/6,538 in 1991 and finally, to 134/9,693 in 1992³⁰ – or in percentages, 0.86%, 2.00%, 2.75%, 1.38% (for 1989, 1990, 1991 and 1992, respectively).

The authors find that a percentage point increase in employee ownership was associated with a 1.4% increase in value added (only 208 observations of partly privatised companies are actually used for productivity analysis). All data pooled together, companies that were more likely to privatise also tended to be export-orientated, with higher revenues and profits³¹.

If Smith, Cin and Vodopivec are correct, then proto-privatisation was associated with efficiency gains. Since one of the stated objectives for system-wide privatisation were already accomplished, the subsequent State-enforced undoing of much of the previous self-emergent privatisation must have been

motivated by factors other than economic efficiency, especially since self-emergent privatisation was mostly to be found among a small number of successful companies³².

The public, however, approached the matter with remarkable detachment, often observing that the ‘proverbial Slovene envy’ could have been one of the reasons for the spontaneous privatisation being contested. Jože Mencinger, the former Minister of Economy who had resigned over privatisation disagreements, was quoted saying that ‘The numerous requests for audits of privatisation proceedings are an expression of envy and the desire to redistribute an ever smaller loaf of bread, instead of ensuring it would grow’³³.

Once privatisation began in earnest (that is, once it was restarted based on new laws), it was set up in such a manner that it benefited both company insiders and the State itself (hidden behind a veil of special-purpose vehicles and investment funds). Additionally, the renewed privatisation created a lucrative market for legal advice.

WHOM TO BLAME?

So far, the discussion has largely avoided the topic of agency (the third column in Figure 2) – who is to blame, the rotten system or the rotten individual. Both levels clearly interact,

²⁹ Smith, S. C., B.-C. Cin and M. Vodopivec (1997). ‘Privatization incidence, ownership forms, and firm performance: evidence from Slovenia.’ *Journal of Comparative Economics* 25(2): 158-179.

³⁰ Ibid.

³¹ Ibid.

³² Was proto-privatisation criminalised in order to cut short (and attempt to reverse) on-going looting, or merely ex-post abuse of power? Further research is needed to uncover conclusive evidence in favour of either hypothesis. Writing during Stage 1 privatisation, the Slovene sociologist Veljko Rus (Rus, V. (1993). ‘Socialna evalvacija privatizacije [The social evaluation of privatisation].’ *Teorija in praksa* 30(7/8), p. 610) observed: ‘the asserted dominance of external owners (State funds and citizen shareholders) over internal owners (workers and managers) [...] was of course entirely politically motivated, since it wanted to take away the property as well as capital from “red” managers and workers, and to transfer it to State funds as well as to citizens, over which greater control could be held by parties of the then ruling coalition’.

³³ Lekše, M. (1993). Vsi kapitalizmi niso enaki [Interview with Dr Jože Mencinger]. *Dnevnik*. Ljubljana.

since any system would be considered rotten if it contained too many rotten agents. Therefore, it might be useful to rephrase the question: How could a system not be rotten even though it employed rotten elements? Ideally, a system should be robust enough to maximise given objectives under given constraints. If the system under consideration is a State which is about to launch a privatisation campaign, its stated long-term objectives can range from GDP growth to the equally abstract utilitarian principle 'the greatest happiness for the greatest number'. Among the major constraints are, of course, the corrupted elements inside the system.

In an ever-changing world, constraints rarely stay as given. An ideal system would also minimise the obstacles to its objectives, for instance by reducing the incentives and the opportunities for graft, cronyism and corruption among its agents. It is useful to distinguish between temptation and the opportunities for acting out on it. Even if a legislator could squash every single opportunity for corruption existing at a given moment in time, new ones would soon arise since we are living in a world of uncertainty, incomplete contracts and information.

If the state is unwilling or unable to monitor its agents, is the civil society going to perform this role? On the brink of independence, privatisation enjoyed great public support which should have made implementation easier. It hints at what beliefs Slovene economic actors had at the time, i.e. untainted or unconditioned by the tough, rough and messy experience of economic transition.

A survey conducted between May and June 1991 showed that only 14.9% of respondents opposed privatising socially-owned enterprises while a significant 16.8% declared to be without any opinion on the matter. 33.4% advocated a privatisation method that would transfer the ownership of the company to its

employees, 18.4% were in favour of selling the enterprises to the highest bidder ('even if the buyers were foreign') and 16.6% advocated restitution to original owners if the company in question had existed and been nationalised after the World War II³⁴.

A previous survey conducted in November and December 1990 offered further insight into privatisation preferences held by the Slovene public. 9.6% intended to apply for damages or for restitution in kind for family property confiscated in the 1940s. Another 4.6% had no intention of pursuing the matter while a majority of 80.7% declared to have no claims to such property. As for denationalisation itself, 59.3% were against the restitution of the property seized to foreign owners (especially German or Austrian), while the rest of respondents split almost evenly between the proponents of the policy and the undecided³⁵. It was less a reflection of an underlying Slovene economic nationalism – rather, it reflected fears that the aggregate stock of capital about to become privatised would diminish.

The Slovenes expressed the greatest support for those aspects of privatisation that were most likely to benefit them personally – in other words, when the expected individual pay-off was easily evaluated and accrued already in the short term. Consequently, the privatisation of former socially-owned housing was met with a 63.4% approval rating, tenable and short-term benefits to a majority of citizens³⁶. As for the pace of transition, 54.1% felt 'things were moving too slow', 16.3% felt they were going 'fast enough' and 16.0% 'too fast'³⁷.

³⁴ Toš, N. (1991). Slovensko javno mnenje 1991/1. Ljubljana, FSPN, CJMMK.

³⁵ Toš, N. (1990). Slovensko javno mnenje 1990/2 [Slovene public opinion]. Ljubljana, FSPN, CJMMK.

³⁶ Toš, N. (1990). Slovensko javno mnenje 1990/2 [Slovene public opinion]. Ljubljana, FSPN, CJMMK.

³⁷ Toš, N. (1991). Slovensko javno mnenje 1991/1. Ljubljana, FSPN, CJMMK.

Figure 2. Economic role of the state during transition (Frye and Shleifer 1997).

Model	Legal environment	Regulatory environment
Invisible-hand	Government is not above law and uses power to supply minimal public goods. Courts enforce contracts.	Government follows rules. Regulation is minimal. Little corruption.
Helping-hand	Government is above law but uses power to help business. State officials enforce contracts.	Government aggressively regulates to promote some business. Organized corruption.
Grabbing-hand	Government is above law and uses power to extract rents. The legal system does not work. Mafia replaces state as enforcer.	Predatory regulations. Disorganized corruption.

The economic crisis concentrated Slovene minds on economic topics, albeit not necessarily on privatisation. In a survey conducted in February 1992, only 5.1% of respondents named privatisation as 'the most pressing problem' and 6.2% as the 'second most pressing problem'. Instead, they chose inflation (38.7%), unemployment (35.7%) and social security (14.4%) as the most burning issues of the day³⁸.

Therefore even in crucial early stages of privatisation, there was not enough wide-spread interest for screening and monitoring the process – this opened up opportunities for graft. Unfortunately, the privatisation process was not robust enough to contain this type of privatisation failure.

Note that the system is assumed to be closed – working independent of the forces in its environment and, more importantly, having assigned the role of an active principal. So the system is employ-

ing agents in order to fulfil its objectives. A more radical position would hold that the system is itself an agent, serving the interests of ruling elites. The rulers may change, but they pass on the ropes and pulleys they use to rule with – in other words, the State survives in spite of regime change.

Unsurprisingly, the State itself relies on the 'rogue individual' explanation. Thereby, it eschews responsibility for having created the incentives for graft in the first place, and for not having closed down opportunities for corruption. For this reason, privatisation-related white-collar crime should not count as an exogenous shock to privatisation. Rather, it should be considered as endogenous to privatisation – another version of the argument against the legalistic definition of privatisation failure.

So far, the State has been implicitly assumed to be a system set up by a benevolent if incompetent designer – in other words, the State's responsibility for privatisation failure lies in its oversight and its inactivity. This assumption is habitually relaxed in econom-

³⁸ Toš, N. (1992). Slovensko javno mnenje 1992/2. Ljubljana, FSPN, CJMMK.

ics. Frye and Shleifer (1997), for instance, define three basic views (Weberian 'ideal types') of how 'bureaucrats and entrepreneurs interact during transition, as well as more generally'³⁹. Privatisation outcomes



SUCCESSFUL NATIONS TAKE ADVANTAGE OF FOREIGN CAPITAL, BUT ARE CAREFUL TO REMAIN OWNERS TO A SUFFICIENT EXTENT. THIS WAY, THEY RETAIN A DECISIVE OPTION TO INFLUENCE THEIR OWN FUTURE

can be thus related to the type of State itself; indeed, they can be used as an indicator. The three 'models of government' are summarised in Figure 2.

Frye and Shleifer define each model of the State in terms of its legal and regulatory environment. But the chain of causa-

tion is by no means clear – is the dire state of the legal system a consequence of the grabbing-hand State or is it the other way round? Or are both influenced by a third, hidden factor?

TOWARDS FORMALISING FAILURE

'It doesn't follow that in order to attract foreign capital or to send a "positive signal," we should rush into selling – below the long-term potential valuation – profitable Slovene businesses and strategic infrastructure companies. Without analysing the broader consequences and without considering the long-term consequences, you just don't do that. Successful nations take advantage of foreign capital, but are careful to remain owners to a sufficient extent. This way, they retain a decisive option to influence their own future'⁴⁰.

Opponents often refer to 'the State's heirlooms,' 'the national patrimony' or to its 'family silver'. These buzzwords imply the speaker is not against privatisation as such, merely against a particular privatisation target (often by evoking the 'national interest' and the company's 'strategic importance'), or against a particular privatisation timing. But behind ideology and opportunism there lies a valid point: privatisation is indeed irreversible (the State's ability to renationalised assets at some later time is severely constrained by its membership international organisations) and privatisation is indeed affected by several types of uncertainty (political, macroeconomic or financial).

Politicians and activists who insist on postponing or even cancelling privatisation appear to be intuitively using the 'options' con-

³⁹ Frye, T. and A. Shleifer (1997). "The invisible hand and the grabbing hand." *American Economic Review* 87 (2): 354-358.

⁴⁰ Golob, M. (2013). Ko enkrat prodaš [Once you sell]. *Večer*. Maribor: 9.

cept originating from finance. In order to criticise such positions validly, one should take their authors by their words and assess how they measure up against a framework they themselves are accidentally proposing. What follows is by no means a formal exposition of the underlying theory but a short summary of the main implications for privatisation theory.

Option is a contract that gives its owner the right – but not the obligation – to buy or sell an asset at a future date of his or her choosing⁴¹. Similarly, a privatisation program gives the State the opportunity but no obligation to dispose of a company (unless required by international lenders). This optionality is further reflected in persistent rumours that place certain companies among privatisation targets (e.g. Triglav, the leading Slovene insurance company, and Telekom, the former telecommunications monopolist). But the State still has not exercised the option (since it is open-ended, it can be modelled as a perpetual American put option).

This waiting also raised the cost of privatisation – but only if compared to a now-or-never privatisation campaign. Are the talks earnest or is it just a manoeuvre to postpone privatisation, perhaps indefinitely? And why postpone it in any case? Leaving aside ideological arguments about the merits and demerits of privatisation, financial economics has developed methods to determine the optimal timing of privatisation (now, later, or perhaps never). Note that by adding some extra assumptions and complexity, real option models can be calibrated with real-life data to generate valuation ranges for State-owned enterprises and to determine the optimal (i.e.

the State's wealth-maximising) privatisation timing at the level of individual privatisation targets.

A real option framework presumes that Slovene politicians are indeed rationally maximising the state coffers (no assumption is being made about the potential for graft and how it influences the decision to privatise or not). Finally, valuation models churn out fair valuations of the option to privatise, which a rational decision-maker would use in order to decide whether to privatise a given firm ('to exercise the option') or keep it.

The decisions he or she actually takes (or postpones) may turn out to be 'irrational' in this very limited, model-based sense. Significant deviations from the theoretically-derived 'rational policy' point to privatisation failure or even to sheer corruption (keeping the assumption that policy makers are rational). Deviations from these theoretically determined values can be taken as a measure of privatisation failure. Similarly, the failure to privatise can be defined as the failure to exercise the privatisation option at the optimal time. •



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⁴¹ Schulmerich, M. (2010). *Real Options Valuation: The Importance of Interest Rate Modelling in Theory and Practice*, Springer.

A Survey of the Lithuanian Economy 2014/2015



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LFMI

We present to you the 34th edition of the *Survey of the Lithuanian Economy* which was launched more than 15 years ago. This survey covers estimates of economic indicators for 2014 and forecasts for 2015. In the first part we offer a special topic of this edition – why it is important to use accurate forecasts in planning public finance. The Parliament is currently debating Lithuania's 2015 budget bill. In this article we analyse whether the budget proposal has been grounded on accurate projections. We take a closer look at public sector's abilities to adjust to economic changes. We also discuss why it is important to draw on accurate forecasts and how to plan public finance realistically.

In the second part of this survey we provide estimates of the main economic indicators for 2014 and forecasts for 2015 that are based on a poll of market participants. In addition, we give an overview of the factors that might have influenced the opinions and expectations of the survey respondents.

The estimates and forecasts of economic indicators are based on the expert consensus paradigm originating from the theory of rational expectations.¹ This theory states that economic variables can be related to observable processes in the economy, and market participants use all available information to form estimates and forecasts concerning these processes. The more information market participants possess, the more credible their estimates and forecasts are. It is assumed that individuals who are engaged in day-to-day business activities have the most information about

the economy, and their successful performance reflects their ability to process this information.

Fifty-eight experts participated in this survey² which was carried out in September 2014. This survey is not representative. We do not aim to have a representation of specific sectors of the economy or regions or enterprises. Rather, we interview specialists who represent prospering companies. The respondents were asked not to provide information about their own companies or industries but to estimate indicators reflecting the country's general economic situation on the basis of all available information. Survey participants were requested to focus only on variables that they think they are competent enough to appraise. Most of the respondents in the latest survey took part in the previous stages of this survey.

LFMI expresses its gratitude to the survey participants, donors and everybody who have provided comments and remarks on this survey.

The importance of accurate forecasts in planning public finances

In today's economy, market actors have access to an ample supply of forecasts of macroeconomic indicators. Public, non-government and private organisations all produce their own projections of economic growth, inflation or unemployment for the next year.

As often as not, a single prognosis turns into a piece of news but this does not mean that economic forecasting is an end in itself. Forecasts of economic indicators serve as preconditions for better activity planning. Equipped with reliable macroeconomic

¹ One of the most familiar surveys based on the expert consensus paradigm is the Livingston survey conducted in the United States since 1946. Its results are regularly published on the Philadelphia's Federal Reserve Bank's website (<http://www.philadelphiafed.org>).

² The list of participants is available at the end of the complete survey (http://files.lrinka.lt/LET34/LET2014-15-1_EN.pdf).



POLITICIANS CANNOT BE CERTAIN THAT THE NEXT TIME THEY CUT THE PUBLIC SECTOR'S WAGE BILL, PENSIONS OR OTHER WELFARE PAYMENTS, THEIR DECISION IS NOT RULED, IN PROCESS OF TIME, TO BE VIOLATING THE CONSTITUTION, AND THEY ARE NOT BOUND LEGALLY TO COMPENSATE FOR THE ANTI-CONSTITUTIONAL REDUCTIONS

projections, companies can adopt critical decisions, such as whether it's the right time to expand their business and to what extent they should do so, or, on the contrary, whether it's time to start shaping up for impending economic calamities.

Normally, the private sector has the ability to adjust to changing economic circumstances. For instance, when economic growth ceases, businesses react expeditiously to the altered situation: they freeze plans of development, cut down on wages and employees, and take other urgent measures. However, the swift and timely response of the business community can be stunted by a strict Labour Code and other government regulations that are applied in Lithuania.

In the public sector, the situation is much more complex. In the following section we will look at several important issues. Firstly, we will examine the forecasts that have been used in drafting Lithuania's 2015 budget proposal. Secondly, we will determine what difficulties the legislators typically confront in cutting public spending when the forecasts they employed prove to be incorrect. And thirdly, we will assess what dangers there are if the budget law appears to have been based on inaccurate projections.

The 2015 budget bill is dangerously optimistic

Drafted by the Ministry of Finance, Lithuania's 2015 budget bill rests on the assumption that the country's real and nominal GDP will grow by 3.4% and 5.5% respectively, annual inflation will stand at 1.2%, and personal earnings will rise by 5.8%.

When we compare the 2015 budget proposal with the 2014 budget's revenue plan, we can clearly observe an expected increase in revenue collections from several taxes, namely, value added tax (VAT) (8.1%), profit tax (8.3%), personal income tax (PIT) (7.6%), and excise duties (4.9%).

Compared to other institutions' forecasts, the Ministry's projections of economic growth seem relatively bold. The Interna-

Min.-Temp.

Max.-Temp.



tional Monetary Fund (IMF) predicts that Lithuania's GDP will grow by 3.3% in 2015, and the European Commission gives the figure of 3.1%. Respondents to the LFMI survey expect the country's economy to rise by 2.8%.

The National Audit Office has also voiced its opinion about the budget's revenue plan as being much too optimistic. According to this institution, the growth of income from VAT, PIT, excise duties and profit tax has been planned with scant caution.

Another important fact is that Lithuania's growth projections for 2015 have been lowered over the last six months. The IMF shaved its forecast down from 3.5% to 3.3%, the European Commission slashed it from 3.7% to 3.1%, and the LFMI survey participants marked it down from 3.4% to 2.8%.

The worsened economic outlook reflects rising concern over a new economic crisis in the eurozone and worldwide. According to the IMF, the probability of the eurozone's economy falling into decline in the offing has doubled over the last six months, from 20% to 40%.

As we can see, the 2015 Lithuanian budget proposal has been predicated on optimistic figures of growth, with no notice of the deteriorating economic scenario for the country. In the section below, we will discuss why employing optimistic forecasts is particularly dangerous when planning a state budget.

The inflexible public sector adapts to worsening economic conditions with great difficulty

The use of optimistic projections would pose no problems if budget expenditure were trimmed, automatically, in lockstep

with shrinking budget revenue. Sadly, this is not the case. The public sector finds it difficult to adjust to a deteriorating economic situation for a number of reasons:

- When politicians curtail spending – namely, public-sector pay, pensions and various social benefits – this invariably dwarfs their popularity among the ranks of public-sector employees and the recipients of social benefits involved. In 2014, Lithuania paid old-age pensions to 600,000 retirees (from the “Sodra” budget), work incapacity pensions to about 210,000 citizens, and various other social allowances to hundreds of thousands of Lithuanians.³ At the same time, the country's public sector was employing 362,000 civil servants,⁴ comprising 31.6% of the total hired labour force in Lithuania. Because cuts in public sector salaries and entitlements affect more than a half of the country's electorate, such moves are always highly unpopular, meaning politicians usually attempt to give them a wide berth or at least to postpone them.

- The Constitutional Court has ruled that salaries and pensions that were reduced during the latest economic crisis must be restored. Consequently, there is always some likelihood that the Court may issue similar unfavourable decisions in the future, too. This uncertainty is diminishing politicians' abilities to make an adequate response to the economic situation and trim the budget. The Constitutional Court's ruling also states that the decreased old-age pensions must be compensated for when the extreme economic conditions are over. But, when such time comes, the national budget may lack a source of funds for this purpose. Thus, a fraction of politicians might be reluctant to enact cuts in

³ Source: “Sodra”.

⁴ Source: Statistics Lithuania.



TRIMMING THE
STATE BUDGET
WITHOUT HAVING
SPENDING
PRIORITIES AT HAND
TURNS INTO AN
UNPREDICTABLE,
CHAOTIC PROCESS

the “Sodra” budget entirely because they will be obligated to offset them, one way or another, at some time in the future. As mentioned previously, the probability of similar decisions by the Constitutional Court in the future lessens politicians’ abilities to react flexibly to changes in the economic situation. As the Constitutional Court has ruled, salaries and pensions may be reduced temporarily at times of economic-financial hardship. But the problem is that decision makers do not know in advance whether a specific method of these reductions will not be acknowledged as running counter to the Constitution. For example, in the year 2009 salaries of civil servants were cut progressively, i.e. the most sizeable reductions of salary rates were applied to the highest-paid servants. At that time it was believed that this was the most appropriate way for cutting down public-sector pay. But in 2013 the Constitutional Court issued a ruling, establishing that the uneven reduction of civil servants’ salaries conflicted with the Constitution. The upshot of this ruling is the following: politicians cannot be certain that the next time they cut the public sector’s wage bill, pensions or other welfare payments, their decision is not ruled, in process of time, to be violating the Constitution, and they are not bound legally to compensate for the anti-constitutional reductions.

- Budget expenditure is never prioritized, so there is no way of knowing beforehand which areas of spending are more/less important than others. As a result, when the need for budget cuts arises, it invariably becomes a difficult task to trim spending according to priorities. As already stated, when revenue collection misses the planned target, spending is not slimmed down, automatically and accordingly. The country’s budget bill does not contain a ‘Plan B’ which would specify smaller budget allocations and be followed when

budget revenue sinks. As Lithuania's experience indicates, trimming the state budget without having spending priorities at hand turns into an unpredictable, chaotic process. This problem could be resolved by means of instituting the principle of conditional budgeting. This means that at the stage of endorsing budgetary programmes, specific levels of priority must be attached to each programme, indicating, say, 'highly important,' 'important,' 'less important,' or numbers from 1 to 3 (or higher). When the state budget fails to collect the planned income, the 'less important' programmes should be automatically frozen.

It must be admitted that if the economy contracts, the public sector is much less prepared for cutting spending at present than it was in 2008 and 2009. Like in the year 2009, spending programmes have not been prioritized but, unlike in 2009, the costs of interest on state debt have more than doubled in size. Moreover, the budget is now under pressure to reimburse the earlier cuts in the public-sector pay and old-age pensions. And on top of that, politicians are likely to be less willing to shave off spending, fearing the new cuts might be ruled as being out of tune with the Constitution.

Relying on inaccurate prognoses in budget planning is dangerous

Using inaccurate economic forecasts in the private sector takes its toll on the owners, employees and suppliers of specific companies. But when such forecasts are employed in the public sector, they exert far wider effects.

When budget revenues miss the planned target and, at the same time, spending is not cut, there is always more probability of tax hikes. This is precisely what happened in Lithuania in the period between

2008 and 2011. At that time quite a number of taxes were raised, including VAT (along with the removal of VAT exemptions), profit tax, excise duties, and social insurance contributions on income from individual activity and authorship contracts. Political talks in Lithuania often revolve around the necessity to levy a car tax, a tax on all real estate, progressive taxation and other measures. Evidently, failure to execute the budget revenue plan would constitute a bigger threat of tax increases in the country.

Yet, raising taxes may not suffice to retain the set budget deficit target (especially if tax increases were found to be boosting the shadow economy and decreasing budget revenues). That is why such a situation automatically leads to an inevitable growth of the budget deficit and, accordingly, state debt. At present Lithuania's state debt totals LTL 50 billion, while interest on state debt will amount to LTL 2.2 billion in 2015.

For reasons outlined above, it is essential that the state budget and budgets of municipalities and non-budgetary funds are all grounded on the most accurate growth forecasts available to budget planners.

How the 2015 budget must be planned?

As discussed earlier, the 2015 budget proposal has been built following an overly optimistic scenario. Seeking to prepare for potential risks and unexpected developments that may come along, the existing 2015 budget bill should be revised to include the following recommendations:

1. To plan budget revenue with more caution. As highlighted previously, income expected from certain taxes has been estimated too generously, and the National



ECONOMIC GROWTH IN LITHUANIA WILL DECELERATE IN 2014, MAINLY DUE TO TRADE RESTRICTIONS BETWEEN THE EUROPEAN UNION (EU) AND RUSSIA, AND THE CONTINUED STAGNATION OF THE EU ECONOMY

Audit Office has evaluated these projections as overly incautious. For this reason, the budget bill must be streamlined according to a more realistic projection of income growth. Budget expenditure must also be adjusted accordingly.

2. To prepare for potential budget cuts through fixing the principle of conditional budgeting: when endorsing budgetary programmes, specific levels of priority must be attached to each programme, indicating, for instance, 'highly important,' 'important,' 'less important,' or numbers from 1 to 3 (or higher). When the state budget fails to collect the planned income, the 'less important' programmes should be automatically scrapped.

THE LITHUANIAN ECONOMY

GDP, price growth and unemployment: stable prices and moderately falling unemployment are advancing economic growth

In the survey of the Lithuanian Free Market Institute (LFMI), gross domestic product is understood as the total value of goods and services produced for final consumption within the country, including the shadow economy, during a given period.

In the LFMI survey changes in consumer prices are defined as changes in the average prices of goods and services intended for household consumption by comparing price levels at the end of a given period.

Unemployment is understood as the ratio of the unemployed – persons of working age who are seeking jobs but are not necessarily registered at the Labour Exchange – to the total labour force. The "labour force" then refers to all people of working age. The LFMI sur-

vey respondents were asked to evaluate the rate of unemployment at the end of the year.

According to the Survey of the Lithuanian Economy, the country's economy will grow at a slightly lower rate in 2014 compared to 2013 but unemployment will continue to fall. The experts polled by LFMI also expect a somewhat less marked rise in prices.

The LFMI survey participants believe that economic growth in Lithuania will decelerate in 2014, mainly due to trade restrictions between the European Union (EU) and Russia, and the continued stagnation of the EU economy. The 2014 forecast of economic growth has been marked down to 2.8% compared to the prognosis of 3.5% reported early this year. But even with the diminishing expectations, Lithuania will still be among the fastest growing economies in the EU.

It is worth noting that the Ministry of Finance plans an optimistic GDP growth, 3.4%, in 2015, while market participants are more conservative about the economic development next year. They predict that the country's economy will rise by the same amount as in the current year, by 2.8%. Such moods can be explained by the risks that market participants perceive for the near future.

According to the vast majority of the LFMI respondents (93%), the geopolitical situation resulting from the Russia-Ukraine conflict is the main risk source for Lithuanian businesses. The worsening economic situation in Europe is a second largest source of threat (35%), and 48% of respondents reported the latter to be only a medium-level risk. Unfavourable, hardly predictable changes in Lithuanian legislation were rated as a medium-level risk. Among the exam-

ples of such changes is an increase in the monthly minimum wage from October 2014, talk about raising taxes and plans to increase the minimum wage further. The lack of qualified labour and meagre business investments were mentioned to be among other threats to the country's companies.

The LFMI survey participants were also asked to evaluate how the Ukrainian conflict and its after-effects will change the investment climate in Lithuania. The bulk of the LFMI respondents (63%) share the opinion that this conflict will work to deteriorate the country's investment environment. This is yet another cue that the Ministry's forecast of growth might not be realised.

Unemployment is set to decline further in spite of the lowered projection of GDP growth. According to the experts polled by LFMI, the rate of unemployment will stand at 10.7% and 10.1% at the end of 2014 and 2015 respectively. These predictions are more optimistic than the figures released by the Ministry of Finance. But looking at dynamics in the unemployment rate over the last two decades, the current rate seems still too high – double the unemployment rate, say, in 2005. On the other hand, Lithuania's rates of unemployment look better when set side by side with the EU average (11.5%).

The current situation – a sluggish decline in unemployment during a spell of brisk economic growth – highlights the problem of structural unemployment that is underlying the Lithuanian labour market. One of the most popular ways to help solve it is staff training and vocational training courses. However, as the experience of EU countries demonstrates, it is a costly and ineffective tool.⁵ Considerably greater benefits

⁵ Source: "Faktai ir analizė. FLEXICURITY principų įgyvendinimas darbo rinkos politikoje" (LLRI, 2014).





LOWERING TAXES
ON LABOUR AND
STREAMLINING THE
LABOUR CODE TO
INCLUDE MORE
FLEXIBILITY CAN
HELP BRING DOWN
THE SHADOW
ECONOMY

would be brought by a more up-to-date, less regulated Labour Code – the instrument which would ease the recruitment of jobless and young individuals in particular.

As the LFMI survey respondents reported, the feeble economic situation (33%) is the main reason that a large portion of individuals are still failing in finding jobs. Nearly a quarter (23%) of market participants thinks that recruitment is being inhibited by the excessively high minimum wage. Evidently, the latest increase in the minimum wage (from October 2014) and plans to raise it further are typical examples of decisions that are rushed with no consideration for their effects. The lumping minimum wage is now among the most considerable barriers to labour market entry for young or unskilled people.

Roughly a half of those polled (44%) indicated more problems – the lack of qualifications and motivation to work – that are hindering people to get employed. Lavish welfare payments can be listed among the factors behind low work motivation.

As the LFMI survey demonstrates, consumer prices will mount by 2.1% in 2014 (a lower forecast compared to that provided in the previous survey). But in 2015 prices are expected to rise more significantly, by 2.6% percent. The latter forecast differs markedly from the information released by the Ministry of Finance which projects that prices will go up by barely 0.3% in 2014 and 1.2% in 2015.

Imports and exports: international turmoil is strongly affecting Lithuania's foreign trade

The LFMI survey analyses changes in the value of exported and imported goods and services, both reported and unreported, during a given period as compared to the preceding period.

According to the LFMI survey participants, Lithuanian exports will only undergo a 4-percent growth in 2014 compared to an 8-percent increase projected in February of this year. Such a sizeable change in the export forecast can be attributed mainly to trade sanctions applied by Russia and the EU. The imposed trade barriers are having particularly negative repercussions for Lithuania which is one of major re-exporters to Russia. Flabby economies of most EU countries are not helping Lithuania to improve its economic *status quo* either, while finding new markets for national products is quite a lengthy process. Despite that, market participants are awaiting a pick-up already in 2015, expecting a 6-percent export growth, plus a change in the export structure.

The LFMI survey participants believe that exports to the countries of the Customs Union will see a decline by 8 percentage points, which will spread out fairly evenly across all other markets. The largest export growth is predicted to take place in the EU and other countries. However, some fraction of export-oriented production, such as dairy products, may well be sold at home. In line with the skidding exports, the LFMI respondents have also slashed their forecast of import growth, from 9% to 6%.

The shadow economy will contract modestly, the tax burden will remain the same

The shadow economy is defined as a share in total GDP of goods produced and services rendered for final consumption within the country and unreported for the purpose of avoiding taxes and/or regulations.

In the LFMI survey the relative tax burden is understood as the ratio of total tax revenues of state and municipal budgets and funds to gross domestic product (GDP).

According to the LFMI survey, the share of the shadow economy is expected to shrink in line with the rising economy. Sadly, the pace of this reduction will remain still sluggish, with as much as a fifth (24%) of the 2015 GDP being generated in the underground economy. The pre-crisis level when the share of the shadow economy in GDP averaged 20% percent (in 2011 through 2008) will not be reached.

Lowering taxes on labour and streamlining the Labour Code to include more flexibility can help bring down the shadow economy. These two measures would simplify recruitment, rendering it cheaper and more flexible. As a result of the existing employment restrictions and high labour costs – both financial and time costs – companies are hesitant about creating new jobs. Meanwhile, the tremendous gap between total employer-borne labour costs and employees' take-home pay is also goading into concealing at least an element of income from labour.

The LFMI survey participants were asked to evaluate the structure of the shadow economy. They believe that smuggling of and illegal trade in cigarettes, alcohol, fuel and other goods represent the largest share of the shadow economy. Compared to the results of the previous survey done early in 2014, the share of this type of illicit activity has increased from 32.9% to 34.4%. If the excise duties remain high, especially if they are raised further, people may easily resort to consuming more of smuggled goods in response to this move.

According to the LFMI survey participants, unofficial wages paid in 'envelopes' and unreported employment constitute the second largest share in the shadow econ-



WHEN FORMULATING
A BUDGET
PROPOSAL, ITS
AUTHORS MUST
PLAN ECONOMIC
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REALISTICALLY,
PROJECT BUDGET
REVENUE WITH
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AND PREPARE FOR
PROBABLE BUDGET
CUTS BY MEANS
OF INTRODUCING
THE PRINCIPLE
OF CONDITIONAL
BUDGETING, I.E.
ESTABLISHING
PRIORITIES
FOR SPENDING
PROGRAMMES

omy, 25.7%. The underlying cause here is high taxation of labour. The experts polled think that roughly a fourth of job-seeking individuals could not find employment

due to strict labour market regulations and the high minimum wage. Therefore, further increases in the minimum wage may swell the ranks of those working under the table.

The remaining share of the shadow economy is comprised of the following activities: product distribution/service provision without paying taxes and hiding of business activity (20.5%), trade in illegal goods and services (11.2%), and other types of illicit activity (8.1%).

As the LFMI survey shows, the relative tax burden in Lithuania will remain heavy. Market participants project that the tax burden will make up 35% percent of GDP in 2014 and 36% of GDP in 2015. The 2015 forecast was slightly lowered in the current survey compared to February 2014 when the LFMI respondents expected the tax burden to increase to 37% of GDP.

Personal earnings will continue to grow

Average personal earnings refer to the average monthly reported or unreported monetary remuneration for work after tax.

According to the LFMI survey, average net earnings will continue to grow steadily both in 2014 and 2015, with the growth being faster in the coming year. General economic growth in the country is an essential factor behind rising earnings. Foreign investors also play an important role in this respect. In most cases, they pay higher-than-average salaries, thus pushing the average wage level upwards. It should be noted that as the LFMI survey participants reduced the forecast of economic growth, they also lowered their 2014 forecast of average net earnings growth, from LTL 1,958 per month (reported in February) to LTL 1,888 per month.

To sum up this survey of the Lithuanian economy, even amid the Russian conflict, the prospects for economic growth in Lithuania look bright, *albeit* somewhat conservative. Lithuania is expected to stand as one of the fastest growing economies in the EU. Led by the rising economy, unemployment and the shadow economy are set to decrease gradually. But the two indicators will still remain high, whereas economic growth alone will not be able to amend the situation. To that end, Lithuania needs to embark on structural reforms. However, they are currently delayed.

CONCLUSIONS

1. According to the Survey of the Lithuanian Economy, the country's economy will rise by 2.8% both in 2014 and 2015. Compared to the forecast reported early in 2014 (3.5%, market participants' expectations have diminished.
2. Lithuania's 2015 budget bill, drafted by the Ministry of Finance, has been grounded on more optimistic growth forecasts than those released by other institutions. Evidently, the drafters did not take into consideration a handful of potential risks for the Lithuanian economy arising from the Ukrainian conflict and the likely economic decline in the eurozone.
3. When formulating a budget proposal, its authors must plan economic growth realistically, project budget revenue with more caution, and prepare for probable budget cuts by means of introducing the principle of conditional budgeting, i.e. establishing priorities for spending programmes.
4. According to the absolute majority of the LFMI respondents (93%), the geopolitical situation resulting from the Russia-Ukraine conflict is the main risk source for Lithuanian businesses. The worsening economic situation in Europe has been reported to be a high- or medium-level risk by 83% of those polled.
5. Market participants project that average net earnings will continue to grow steadily, amounting to LTL 2,002 (EUR 580) per month in 2015. General economic growth in the country is the key factor augmenting earnings.
6. Unemployment is expected to decline further. However, its rate will still remain twice as high as in the pre-crisis period. According to the experts polled by LFMI, the rate of unemployment will stand at 10.7% and 10.1% at the end of 2014 and 2015 respectively.
7. According to a third of the LFMI survey respondents (33%, the feeble economic situation is the main reason that a large portion of individuals are still failing in finding jobs. Nearly a quarter (23%) of market participants polled think that recruitment is being inhibited by an overly high minimum wage and tight employment regulations.
8. Lithuanian exports will only undergo a 4-percent growth in 2014 compared to an 8-percent increase projected at the beginning of this year.
9. As the LFMI survey demonstrates, consumer prices will rise by 2.6% in 2015.
10. Market participants project that 24% of GDP will be generated in the underground economy in 2015. •



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LFMI

The Lithuanian Free Market Institute is a private, non-profit, non-partisan organization established in 1990 to promote the ideas of individual freedom and responsibility, free market, and limited government intervention. The team conducts research on key economic and policy issues, develops conceptual reform packages, drafts and evaluates legislative proposals and aids government institutions by advising how to better implement the principles of the free market in Lithuania.

25 Years of Market Economy in Poland



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ALEKSANDER
ŁASZEK



*

SONJA
WAP

In the last 25 years Polish economy experienced high economic growth. Quarter of a century after the beginning of transition from socialism to capitalism GDP per capita has more than doubled. It is the best result among post socialist countries in Central and Eastern Europe. [See: Chart 1]

Among regional peers only Slovakia and Estonia achieved similar economic growth over the last 25 years. Other economies in the region have increased their volume by 20-50%. There are several theories explaining differences in economic growth in these countries. Most of them suggest that economic growth rate is positively correlated with rapidity of structural reforms (Krueger, 2004). Aslund (2012) observes that most successful countries were those which *pursued all major reforms together in a comprehensive, early and radical package*¹. These findings support the “shock therapy” economic transformation pattern. Reforms that had to be conducted include macroeconomic stabilization, deregulation, privatization and democratization.

“ISLAND OF GROWTH: 2008-2013”

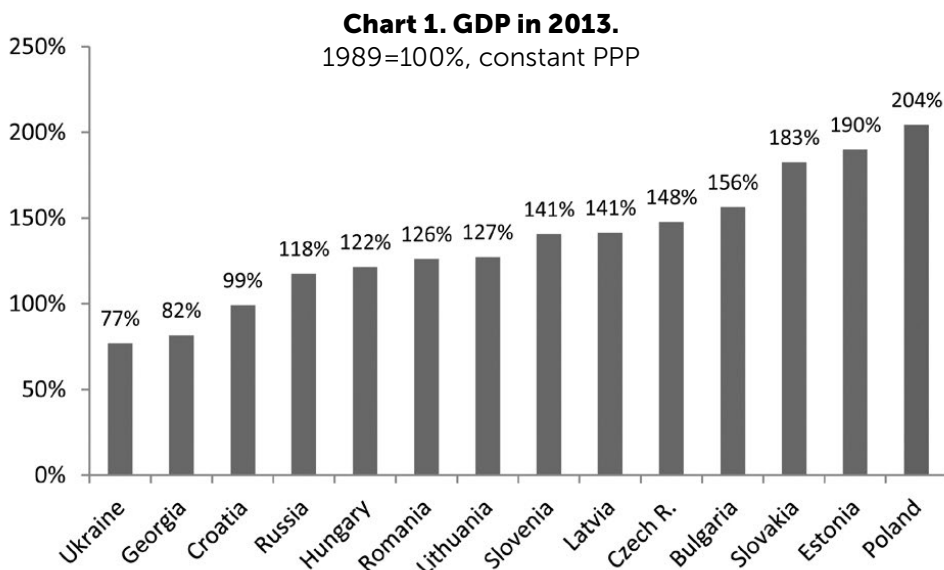
After the outburst of global financial crisis in 2008 Poland has been best performing economy in the EU. In 2009 all European countries, except Poland, experienced recession, while Polish economy grew at a positive rate of 1,7%. For that reason it has been nicknamed the “green island of growth”. It should be noted that during this time our regional peers experienced drops in GDP even deeper than old EU member states. Behind Polish resilience stood mixture of good policies (more prudent financial supervision and tighter monetary policy) and good luck (large domestic market). [See: Chart 2]

¹ Aslund A., (2010), “How Capitalism Was Built”, New York: Cambridge University Press.

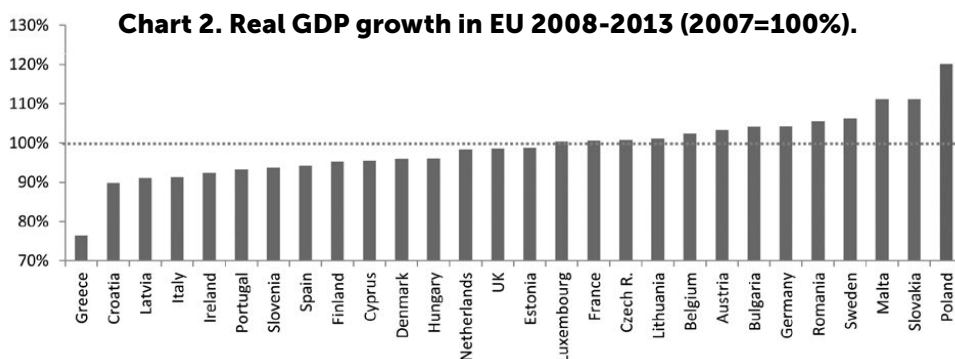
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IN THE LAST 25 YEARS POLISH ECONOMY EXPERIENCED HIGH ECONOMIC GROWTH. QUARTER OF A CENTURY AFTER THE BEGINNING OF TRANSITION FROM SOCIALISM TO CAPITALISM GDP PER CAPITA HAS MORE THAN DOUBLED. IT IS THE BEST RESULT AMONG POST SOCIALIST COUNTRIES IN CENTRAL AND EASTERN EUROPE

Before the crisis CEE countries, similarly to Euro-zone periphery, enjoyed huge capital inflows, fuelling cheap credit boosting investment (particularly in real estate, where bubbles formed) and consumption. Booming domestic demand made non-tradable



Source: Total Economy Database.



Source: Eurostat.

sectors (such as construction, financial services) more attractive for workers and capital than tradable sectors exposed to international competition (e.g. manufacturing), soon eroding competitiveness². In Poland the boom was smaller due to stricter financial supervision (which limited the growth of FX-denominated loans) and

tighter monetary policy. Also there was an element of luck – in Poland rapid growth of credit started a little bit later than in neighboring countries and did not reach the full scale before the outburst of the crisis.

The boom's masked eroding competitiveness and structural deficits were hidden by windfall gains. However, after the outburst of the crisis such weaknesses were exposed. As it might be expected the most heavily affected were countries that experienced big-

² For details see: Bakker B.B., Gulde A.-M., (2010), "The Credit Boom in the EU New Member States: Bad Luck or Bad Policies?", International Monetary Fund, IMF Working Paper WP/10/130.



AMONG ALL FACTORS INFLUENCING ECONOMIC GROWTH IN POLAND, ONE OF THE MOST DETRIMENTAL IS DEMOGRAPHICS. TOTAL FERTILITY RATE HAS BEEN DECREASING OVER THE YEARS TO REACH THE LEVEL OF 1,4 IN 2013

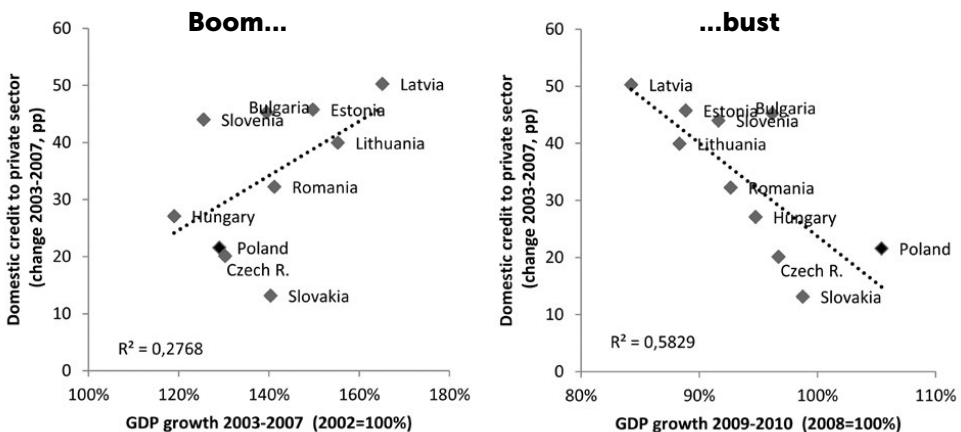
gest booms in previous period. (see Chart 3). The fall in GDP in Poland was further dampened by relative size of its domestic market and its floating FX rate. Lastly, there was some lucky timing of policy changes – tax cuts enacted in 2007 came into force at the beginning of 2009, boosting demand in crucial moment. [See: Chart 3]

OUTLOOK FOR THE FUTURE

Although Poland has been successful in sustaining economic growth throughout the last 25 years, due to low starting point we are still the 6th poorest country in the EU (in terms of GDP per capita). As Summers and Pritchett show³, past grow rates are poor predictor of the future, so we should not take future successes for granted, but rather think what more can we improve in our economy, especially now, that the available long term forecasts are rather worrying. According to economic projections of various institutions displayed in Chart 4, economic growth in Poland is considerably to slow between 2018 and 2040. Average growth

³ Pritchett L.H., Summers L., (2014), "Asiaphoria Meets Regression to the Mean", National Bureau of Economic Research, Working Paper 20573, <http://www.nber.org/papers/w20573>

Chart 3. Correlation between credit and GDP during...





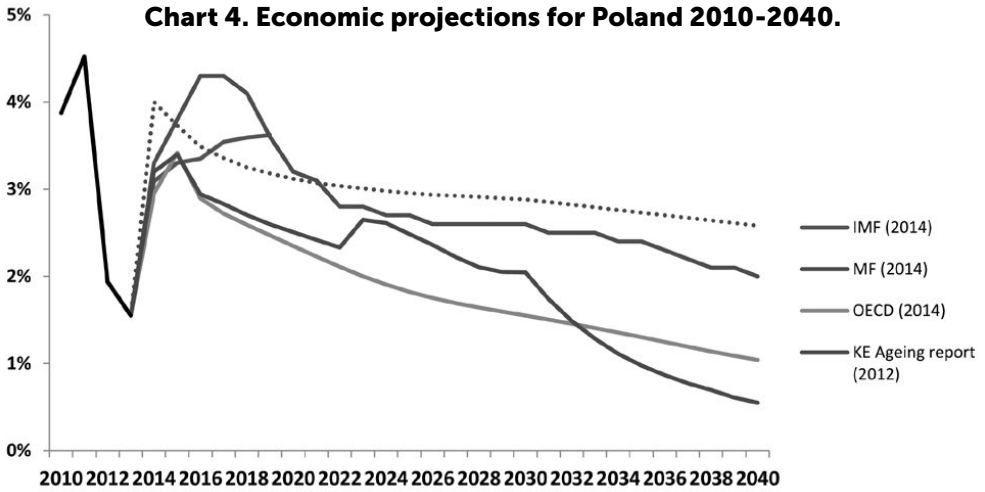
ALTHOUGH
POLAND IS AMONG
COUNTRIES
THAT SPEND THE
LARGEST SHARE
OF LABOR MARKET
EXPENDITURES ON
ACTIVE POLICIES
(OVER 50% - OECD),
IT IS STILL ONE
WITH THE LARGEST
INACTIVITY AND
UNEMPLOYMENT
RATES

rate will evolve around 2% (compared to over 4% during the last 20 years), according to OECD and EU projections. Such forecasts are well grounded in already visible trends – unfavorable demography, low investment rate and falling rate of productivity growth. [See: Chart 4]

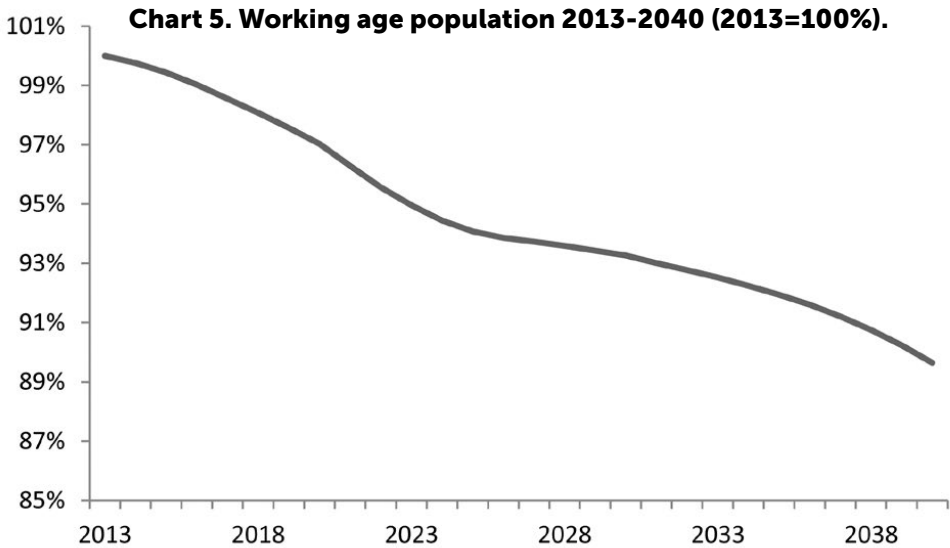
Among all factors influencing economic growth in Poland, one of the most detrimental is demographics. Total fertility rate has been decreasing over the years to reach the level of 1,4 in 2013. Poland is already facing the problem of ageing society caused by decrease in working age population (see Chart 5) and increasing old-age dependency ratio. Working age population will decrease by 2,5 mn by 2040 (without the increase in retirement age⁴ it would have been 5 mln and, worryingly, there are populists in Poland who want to reverse that reform). This will affect not only Polish pension system, but also the labor market as a whole. [See: Chart 5]

Consequences of ageing can be partially eliminated by increasing labor force participation, which should be the main goal for Polish economy. In 2013 only 65% of working age population was in the labor market, that is 5 percentage points less than the European average, which shows that comprehensive reforms of labor market could increase labor force participation. Those inactive in the labor market are mostly older people who decide to go on an early retirement, which they acquire through special pension privileges granted by Polish law, eradicated only partially during last few years. In order to help young people Poland should make the labor market more flexible through differentiating minimum wage and reforming labor law.

⁴ Reform from 2012 introduced new retirement age. Female retirement age is increased consecutively from 60 to 67, so as to reach 67 by 2040. For men retirement age is increased from 65 to 67, which will be effective since 2020.



Source: IMF, OECD, European Commission, Polish Ministry of Finance.



Source: Central Statistical Office of Poland.

Low labor market participation is only one side of problems with Polish labor market. Another one is unemployment, which remains at a relatively high levels (around 10%, reaching even 20% in 2002) since 1990. Unemployed or inactive are mostly young (age below 24), elderly people (55+) or women. Additionally, labor market policies, introduced by the government, often prove ineffective. Minimal targeting of acting labor market policies contributes to the fact that such policies are applied to those who could find a job even without the government help or to those who are long-term unemployed and need a more sophisticated aid. Although Poland is among countries that spend the largest share of labor market expenditures on active policies (over 50% - OECD), it is still one with the largest inactivity and unemployment rates.

There are numerous reforms that need to be undertaken to increase labour market participation of older Poles. First of all, reducing or eliminating privileged pension schemes for miners, soldiers and farmers would have two important and self-reinforcing effects. To start with, it would limit the possibilities for early retirement that allow the abovementioned professions to leave the labour market before official retirement age, thus increasing activity rates for these particular groups. Secondly, such changes would constitute a large saving for public finance – special pension schemes are generous for participants at the expense of an average taxpayer. It would allow to lower the tax burden and consequently the effective tax rates on labor, raising activity rates across all the professions. Some additional programs such as pre-retirement pensions or survivors benefits for relatively young spouses should also be redesigned and limited. We already have a good example in this field – in 2008 government significantly limited availability of early retirement for the ma-

majority of workers. As a result, between 2008 and 2013 the employment rate in the age group 55-64 increased from 32% to 41%, closing the remaining exemptions should be the next step. Another issue are further increases of retirement age. Act from 2012 raises the retirement age up to 67 years for men starting with 2020 (currently it is 65) and for women in 2040 (currently it is 60). However, in our opinion, the target retirement age for women should be reached earlier than 2040. Another idea would be to later on automatically raise further the retirement age proportionally to growing life-expectancy.

Increasing employment among young people and women also requires reforms. In case of young, inexperienced workers this should include: introducing lower minimum wages and loosening employment protection legislation, which would encourage employers to take the risk and hire them. Female labor force participation can be increased by further development of more institutional care for children and the elderly. As far as nurseries and kindergartens are concerned – the issue is hardly new – some progress has already been made, but still, more should be done. The less recognized problem is the lack of institutional care for the elderly. With ageing society such issue will become more urgent, since many women quit labor market in order to take care not only for their offspring but also for their elderly parents.

Another problem of Polish economy is low investment rate, resulting mainly from low business investment (see Charts 6 And 7). Although many factors affect investment decisions, the most plausible explanation of poor performance of Poland in this area is rate is overregulation and increased uncertainty. Although the problem needs further research, we can point to at least two major sources of unnecessary uncertainty

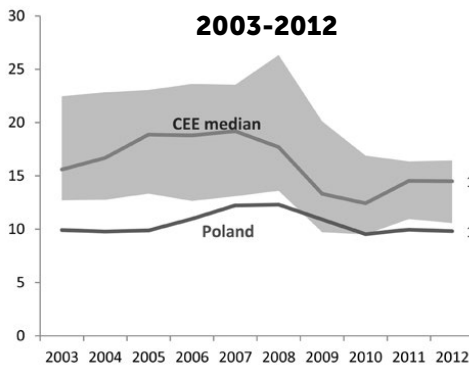
originating in governmental actions (or inactions): complicated tax system and inefficient judiciary, hampering enforcement of contracts. [See: Charts 6 and 7]

Polish tax system is incoherent and complicated. Due to its complexity it is expensive for both enterprises and government administration. About half of administrative costs incurred by companies in Poland that are mandated by the law is connected with tax administration.⁵ Polish Ministry of the Economy estimates that corporate expenses attributable to time spend on filling

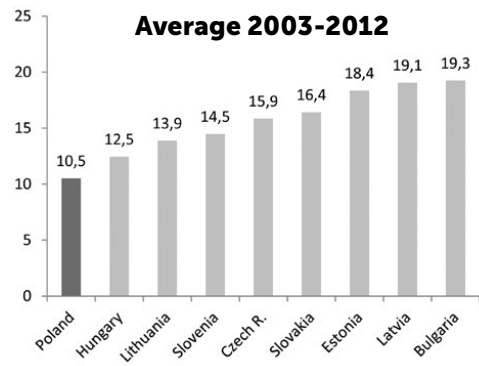
uncertainty. Frequent changes, unclear and sometimes even contradictory regulations mean that entrepreneurs are never sure how much taxes they would have to pay.⁶

The Tax Ordinance Act (main act concerning the relations between a taxpayer and tax administration) has been changed over 100 times during last 20 years and currently is incoherent and outdated. The acts concerning particular taxes are not much better. In the most recent paper on taxes, EY estimates that regulations concerning VAT have been changed 36 times over the last 8 years⁷ and the whole regulations on VAT

Charts 6 and 7. Business Investment (% GDP).



Source: Eurostat.



tax forms concerning PIT, CIT, VAT and social security payments accounts for around 3% of GDP. As for government expenses, OECD estimates that relation of government administrative costs to tax government incomes equals 2,73% – that is almost 1,7 percentage point more than the OECD average, which shows how expensive and ineffective is raising taxes in Poland. However, more harmful effect of poorly functioning tax system is the already mentioned

taxes are about 12 thousand pages long.

The way the products are assigned to different tax rates is also very arbitrary. For example, frozen and chilled dumplings are subject to different rates. The rate on massages and plastic surgery also depends on whether they are done for medical or other purposes. The same event can be a subject of different tax rates depending whether it

⁵ Administrative costs were estimated in 2008 by Deloitte at 6% of GDP; according to our estimations, despite the subsequent changes the amount remains significant, well above 5% GDP.

⁶ In the category of "paying taxes" Poland ranks out of 31 OECD high income economies in Doing Business 2014 ranking.

⁷ EY, (2014), *System stworzony od podstaw, czyli prawdziwa historia 25-letniej polskiej podatków*, Warsaw.



POLES SHOULD BEAR IN MIND THAT FUTURE SUCCESS SHOULD NOT BE TAKEN FOR GRANTED AND REQUIRES MORE REFORMS, AND NOT NECESSARILY MORE EUROPEAN UNION FUNDS

is organized by artist himself or specialized agency. Income taxes also require changes. The same activity can often be taxed as either personal or corporate income if performed by owner of sole proprietorship. Furthermore, there are substantial differences in social contributions due on different types of contracts (some contracts are exempt from them). As a result, too many companies build their comparative advantage on the more creative use of tax loopholes and not innovative business models.

Enforcement of contracts in Polish courts is a very protracted process – in the category of “enforcing contracts” it’s 23rd out of 31 OECD high income economies in Doing Business 2014 ranking. According to Doing Business, average time needed to complete the procedure in Poland is 685 days, substantially longer than the OECD

average of 540. When it comes to more complicated cases it often takes many years before issuing the final verdict. Anecdotal evidence indicates that some Polish companies prefer to sign deals or even move their headquarters abroad in order to settle their disputes, for example, in English courts in order to avoid interactions with Polish judiciary.

Apart from the protracted settling of disputes between viable companies, another faulty side of Polish legal system is bankruptcy law. Poor design of procedures grants unsecured creditors little control of the process and more generally makes outcomes of bankruptcy unpredictable. As a result, both debtors and creditors avoid bankruptcies, often at the cost of keeping unviable companies afloat, thus blocking the flow of employees and capital to more productive uses.

Rational response of entrepreneurs to uncertainty is being much more cautious in starting new projects or expanding the existing ones. Unfortunately, both in case of tax system and judiciary, no deeper reforms have been done in recent years. One should note, however, some positive changes in other areas, improving business environment. Such developments can be seen i.a. in decreasing corruption levels or better infrastructure (Global Competitiveness Report, 2014).

Domestic saving in Poland is too low to finance investment even at a current, limited rate. As a result, investment must be funded by foreign sources. Recent crisis showed that overreliance on foreign funding can make economy much more vulnerable during the periods of stress in global financial market. Furthermore, foreign financing means that part of gains from the investment will go to foreign investors. Higher national saving rate would



make Polish economy more resistant and would allow to finance higher investment rate. Unfortunately, recent changes in pension system reform, eliminating mandatory private (capital) pension pillar, limited mandatory household savings rate. Simultaneously, such changes allowed the government to postpone reforms limiting general government deficit. As a consequence, overall saving rate is lower than it would be in case of upholding capital pillar of pension system and deeper reforms reducing public deficit.

Third major concern for Polish economy is decreasing productivity. It is natural that with the gradual closing of the gap in productivity levels between Poland and Western Europe potential for rapid growth in productivity is decreasing. At the beginning of transition in the 1990s, simple import and implementation of Western technologies and managerial practices coupled with slashing waste generated by previous system was a low hanging fruit allowing for high productivity growth. Now, further progress requires much more effort. It should be also noted that the empirical data⁸ shows that for the countries that are nearer to the technological frontier regulatory barriers matter more. It is a critical warning for Poland, because as OECD PMR index (see Chart 7) illustrates, Poland is among most overregulated economies among OECD members.⁹ Si-

multaneously, however, such overregulation is also a chance – OECD indicates that due to its starting position Poland is among countries that can reap biggest gains from deregulation. [See: Chart 8]

Low productivity in Polish economy is also a result of government support for low-productivity sectors, such as mining and agriculture. There are numerous incentives for workers to stay in those sectors, including the already mentioned privileged pension schemes. Warsaw Institute for Economic Studies estimates public contributions to coal mining at around 34 bln euro over the years 1990-2012. Agriculture is highly subsidized by the European Union, but Polish government also adds some perks. Together with pension subsidies from Polish government and tax expenditures of all sorts, agriculture in Poland receives around 10 bln euro annually¹⁰. To put this number in perspective, value added generated in agriculture in 2013 was around 13 bln euro. The low productivity of agriculture is most visible when we compare its share in total employment (around 12%) with its share in total value added (below 4%). It can be argued that Polish government spends a lot in order to keep as many people as possible in the least productive sector of the economy.

Apart from the direct support, also anti-competitive regulations and widespread public ownership hamper productivity in some sectors. One of the examples may be network industries, with gas industry dominated by state-owned semi-monop-

⁸ Wölfel, A. et al. (2010), "Product Market Regulation: Extending the Analysis Beyond OECD Countries", OECD Economics Department Working Papers, No. 799, OECD Publishing, <http://dx.doi.org/10.1787/5km68g3d1xzn-ent>

⁹ Bourlès, G. Cette, J. Lopez, J. Mairesse, G. Nicoletti, (2010) "The impact on growth of easing regulations in upstream sectors", Journal of International Comparisons, 8, p. 3

⁹ PMR index measures the degree to which policies promote or inhibit competition in areas of the product market where competition is viable. (OECD stats, 2013) The higher the index, the more regulations constraining competitiveness.

¹⁰ This figure should be considered a rough approximation. Firstly, farmers are not required to keep accounts; their taxes are related to the area of land owned and to the income, so we don't really know their real income, which makes for example estimating tax expenses problematic. Secondly, some governmental programs support not only agriculture but also other economic activity in rural areas, blurring the distinction between support to agriculture and support to other activities.

Chart 8. Product market regulation in OECD 2013.



0 - the least strict regulations, 3 - the most strict regulations;
Source: OECD.

oly as a prime example. In other network sectors (except airlines) Poland is closer to the OECD average, but still is far away from OECD best practices. Substantial regulatory barriers to competition exists also in professional services (like accountants, lawyers, engineers). Despite some progress in this area, still much more should be done. One should remember that anticompetitive regulation in the mentioned sectors (called "upstream sectors" by OECD) not only hinder productivity growth there, but also have negative trickle-down effect on productivity growth of their consumers.

In conclusion, over the last 25 years Poland performed impressively well. Foundations for high economic growth were laid by comprehensive reforms undertaken by Polish government after the fall of communism in the country. Poland has also done very well during the crisis of 2008, being the only country in the EU to sustain economic growth. However, Poles should bear in mind that future success should not be taken for granted and requires more reforms, and not necessarily more European Union funds. Without reforms, the economic growth in Poland will slow down before reaching the level of development of Western Europe. ●



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‘Weakness Always Emboldens’:

An Interview with
Adam Michnik



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ADAM
MICHNIK

“Nations, just like women, experience brief moments of intoxication. But those moments pass soon enough.” Adam Michnik talks to Leszek Jażdżewski, editor-in-chief of Polish liberal quarterly magazine *Liberté!*, about how a brief moment of European weakness will affect Russia in the end and what can go wrong in the meantime.

Is Russia becoming, just like in the 19th century, the “gendarme of Europe”?

Well, it definitely wants to become the gendarme of the so-called *near abroad*. Russia has switched gears when it comes to its foreign policy. Putin is no longer predictable, he is driven mostly by the fear of triggering a Russian Maidan. After the annexation of Crimea, the Russian president became extremely popular but at the same time he was already trapped by the tendencies he awoke. It’s just like a Russian rebellion of black-hundredists in the 20th century. And Russian rebellions – as once wrote Pushkin – can be horrifying, senseless, brutal and ruthless.

Many reasonable – or so would one think – Russians started to support Putin after the annexation of Crimea. Isn’t the fact that the Kremlin’s aggressive foreign policy is designed to suit its internal needs one of its most dangerous aspects?

Yes, indeed, it is dangerous. However, I think this will not last long. Nations, just like women, experience brief moments of intoxication. But those moments pass soon enough. It seems that we are facing something that during the perestroika was called “altering the flow of the river”. The only way to survive the current commotions is for Russia the restoration of Stalin’s terror – what now isn’t very likely.

”PUTIN IS NO LONGER PREDICTABLE, HE IS DRIVEN MOSTLY BY THE FEAR OF TRIGGERING A RUSSIAN MAIDAN. AFTER THE ANNEXATION OF CRIMEA, THE RUSSIAN PRESIDENT BECAME EXTREMELY POPULAR BUT AT THE SAME TIME HE WAS ALREADY TRAPPED BY THE TENDENCIES HE AWOKE

Ivan Krastev once wrote that the simple democracy-authoritarianism dichotomy doesn’t explain much. Despite the current situation, in Russia still operate some free media – at least on the internet. Russian authoritarianism – although it may seem *passé* – is still extremely flexible. It may change according to current economic situation. Sometimes it takes the form of



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Medvedev's modernisation, some other time of the aggressive neo-imperialism. What makes Russian authoritarianism so easily adaptable? Some personal qualities of Mr Putin?

Initially, Putin's Russia was standing at the crossroads. There was no classical authoritarianism then, it evolved later on. Just as Bolshevik Russia wasn't a country of Stalin's terror from the very start, also this evolution took some time and it wasn't so certain what route will it take. After all, many people took the fact that Medvedev, with his modernisation project and liberal gestures, became president very seriously. There have always been different options among Russian elites but in the end Putin without hesitation placed his bet on imperialistic-authoritarian option. He assumed that, after the Arab Spring and Maidan, the only way to keep his power is doing exactly what he has been doing and a constant activation of the masses. I have no doubts that adopting such a route must end badly. Nobody knows, however, how long this journey will last and what will it entail.

So only weak and non-imperial Russia can be, in your opinion, democratic?

Russia doesn't have to be weak or non-imperial. It has always had a tendency to build its power on external expansion. It seemed that the age of Gorbachev and Yeltsin will put an end to it. But Putin tries to reinstate this tendency, to rebuild the post-Soviet empire, which he calls the Eurasian Union.

Why did the Russian experiments with democracy fail?

From a historical point of view we may perceive it as a movement of a pendulum. Even Great Britain didn't have a perfect parliamentary system from the very start, the same applies to France. The entire 19th century was a time of alternate periods of

progress and regression. Russia is therefore not an exception. It is simply going through the period of regression.

So what can we expect after this stage? What will the Russia after Putin look like?

I'm not a prophet so I don't know what will happen. But there is one thing I'm sure of – nobody expected that after Chernenko some politician from Stavropol Krai will change Russia to such an extent. That the communist party will be dissolved and that the Soviet Union will fall. Russia has a strong democratic potential. Democracy seems inconceivable in Afghanistan, where there are no democrats. There are, however, democrats in Russia.

So in your opinion the Russian political culture is not in contrast with liberal democracy?

Russia's predicament regards the problematic existence of democratic circumstances. 19th century wasn't only the age of autocracy but also the age of change. Then the hardships of Bolshevism came, what ended tragically, although it could have been averted. The same applies to Putin's policy. Obviously, the problems of Russia will not get solved easily, but didn't any other country (let's look at Hungary, Slovakia, Romania or Poland) have to face such difficulties? Polish Catholic Church – even including Polish Pope and "Tygodnik Powszechny" – experiences regression. The response to the German economic crisis was Hitler.

Czesław Miłosz in an interesting way wrote about how certain national personality traits were developing long before the modern nations were formed. In this sense, the main characteristic features of Russians are manicheism and some kind of fatalism: pursuing some ideal but only in some distant future or in the afterlife, complete separation of the

Earthly life from the ideal world, disbelief in the purpose of trying to influence reality as it is already doomed, strong belief that the world is Satan's creation.

Does this cultural gene really has such a great influence?

Such elements are indeed rooted in Russian culture. However, they do not determine it once and for all. If they did, extensive historical studies showing that Hitler was in fact the result of the values already encoded in German culture would have arisen. But Hitler was defeated and his country has changed eventually.

Russian identity and collective memory are based on the victory in the Great Patriotic War. Is it possible that Russian memory would acknowledge the victims of communism? Or maybe first they would have to lose a war, just like the Germans and the Japanese?

Russians are still divided. Every nation prefers to remember the good moments and in Russia the cult of the victory in World War II is still alive. But there are also Russian businessmen who want to modernize. There are people who maintain relations with the West and sympathize with Western values. There is, of course, the issue of brainwashing people, especially in the countryside. I don't agree, however, that Russians have such a servile gene, it's nonsense. We could apply a theory that the historical course of events of a state depends on the genome of its nation to every country possible. Tradition matters but it does not determine the future once and for all and it is definitely not the only aspect that this future influences.

Is it possible that a change of the policy to a more pro-democratic will come from the anti-Kremlin opposition? Or will it originate in the ruling camp?

Both solutions are possible. But changes initiated by the pragmatic wing of the ruling camp seem more probable.



IF EUROPEAN UNION INTENDS TO ACT AS A SOVEREIGN AGENT, EUROPEAN ARMY MUST BE CREATED. WE COULD OBSERVE THAT IN CASE OF THE BALKAN CONFLICT – EUROPE WOULD NOT BE CAPABLE OF DEALING WITH THE SITUATION IF IT WASN'T FOR THE AMERICANS

Why in your opinion Russia still tries to keep up the appearances? Is it just the masquerade for the sake of the West? Or maybe Russia would like to have a strong position and be respected but it is simply capable of causing only fear?

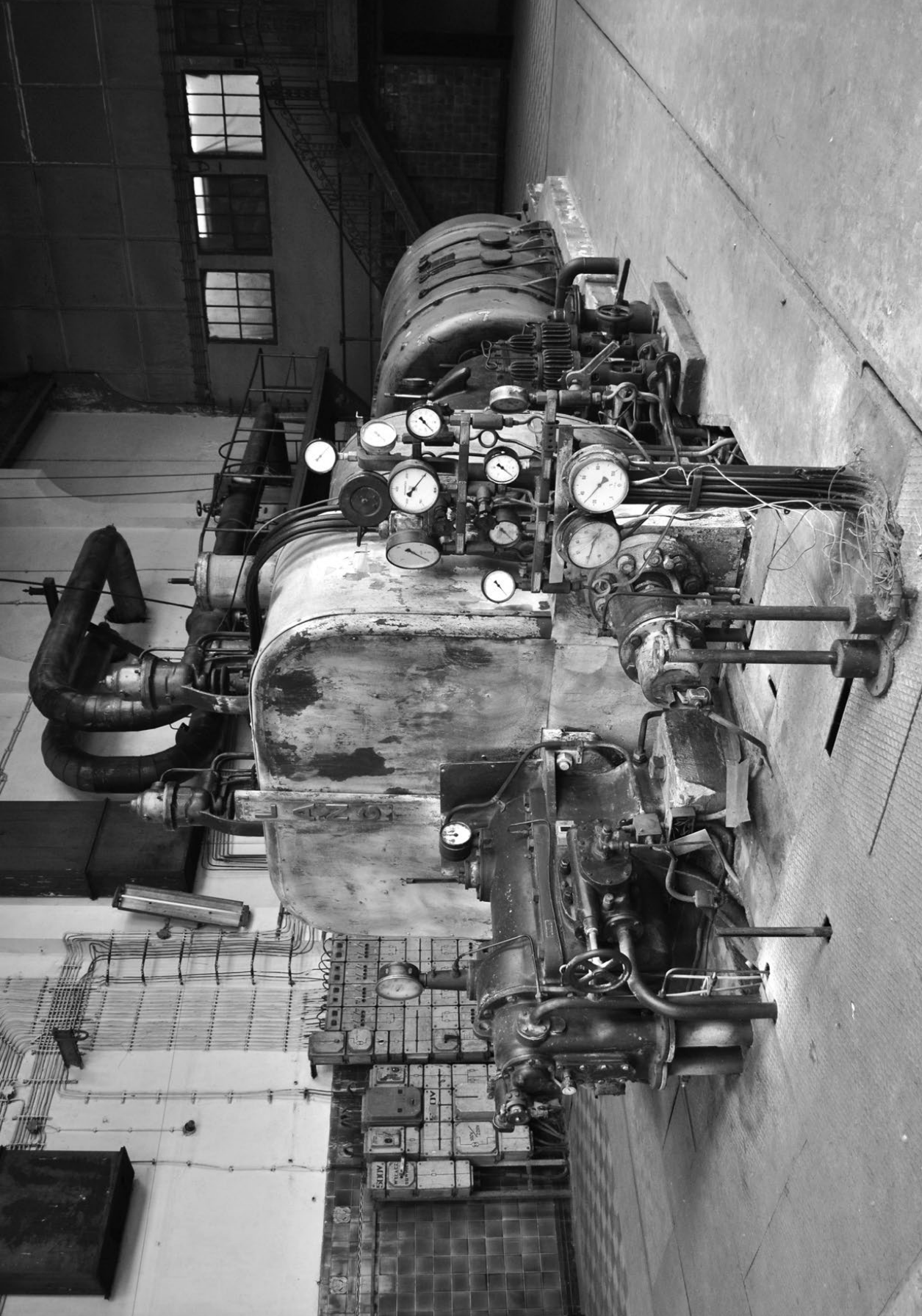
I wouldn't say that about Russia itself, rather about Putin. Many different people live in Russia, there are many different voices, which at the moment have been silenced. Now, an atmosphere of pessimism and depression prevails. Those people feel that authoritarian-imperial-nationalistic discourse have dominated the public sphere.

You wrote in "We, the Traitors" that you object to modern pacifists. Do you see now among the Western advocates of Russia only useful idiots or maybe also people who are simply not able to open their eyes and see the things as they really are?

Both. The theories that we should not support Ukraine are now absurd. Russia keeps sending there regular army troops. Putin keeps repeating that separatists have bought armoured carriers and tanks at the shop. It's pure nonsense. There seems to be some Munich-like logic behind these actions – this is how people were yielding to Hitler and there was some logic behind it as well, or so it would seem. Remembering all that and the consequences that followed, we can no longer surrender in such cases.

Isn't European culture pacifistic in manner? Incapable of self-defence? We seem to be so accustomed to living under the umbrella of the USA and NATO that we are not able to deal with a real danger.

It looks like that's really the case. However, it is also not the result of some genes. If European Union intends to act as a sovereign agent, European army must be cre-



ated. We could observe that in case of the Balkan conflict – Europe would not be capable of dealing with the situation if it wasn't for the Americans.

But do you think that it's possible that the French would be willing to die for, let's say, Białystok¹?

If it isn't possible, the North Atlantic Treaty is pointless.

It is said that when asked how many soldiers are needed to protect Europe, Churchill replied that only one, preferably the dead one. At this point the United States are withdrawing their troops from Europe. Can we really count on American involvement in our continent? I can't see the involvement as in the times of the Cold War. America is not ready for a global confrontation with Russia.

One thing we know for sure. American politics was filled with confidence that there is peace in Europe, that there are no dangers here. That's why the US turned its eyes towards Asia. It seems, however, that now the US' way of thinking is undergoing reorientation.

From this point of view the fact that confrontation with Russia is not as open as in case of Soviet Union still remains a problem. Now the front line is getting more blurry.

Before Maidan I would agree with such a statement. Now I don't. We should not make predictions for the future on the basis of last year's situation because it has already changed.

But do you think that we should make the discourse more explicit? Strive for standards that were present during

the Cold War? After all, Putin's actions didn't indicate any global ambitions until recently.

Neither did Hitler! No one has ever said so many beautiful words about peace as the dictator of the Third Reich. Peace for generations...

The problem with Putin is that he poses a non-symmetrical threat. He is far more dangerous for Poland and other Baltic states than for the Western Europe. At the same time our mobilisation capacity is relatively small. The only consolation is in the fact that we are on the right side of the Iron Curtain.

Let's do what we have to do and we'll see how it goes.

Mitosz wrote that Poles have the complex of an unheard Cassandra. Do you think that we are going through that again?

I agree with Czesław Miłosz when it comes to the critique of some elements of Polish collective mentality. However, the fact that it is often degenerated and leads to nonsense doesn't imply that it is absurd. Of course, Poles were often right when they tried to warn the West. But at the same time they were also as often wrong. In their claims towards the West, Poles did never bit off more than they could chew but they believed every word they heard, what was obviously naïve. Nonetheless, suggesting a certain code of conduct as regards Ukraine, we try to protect also European interests. Nobody knows what can be expected from Putin or the next person who takes over the reign after him if Europe employs a submissive attitude and shows its helplessness now. Weakness always emboldens.

Do you think that Europe is not ready to treat Putin seriously because of its interests? After all, he announced his plans the day before the Munich Conference. So he actually did warn us.

¹ The largest city in northeastern Poland and the capital of the Podlaskie Voivodeship.

We regarded his remarks as pure rhetoric and that was our mistake. It was, however, the mistake of all of us, not of just one individual politician. Except for Russophobes, we all believed that it is possible to reason with Putin. Now it is obvious that it is not and so we must defend ourselves.

You've mentioned that when Poles were trying to warn the West they were often right in doing so. The thing is that that's often not enough in politics. Warnings should be supported by power. Do you think that from this point of view it would be better if Poles had strongly criticised Russia or rather sought a wider European consensus and stay in line so we wouldn't be labelled as Russophobes?

The latter.

So more like the politics of Radosław Sikorski rather than of Jarosław Kaczyński?

Sikorski is right. But I'm not him. Different things are expected from me than from him. He is expected to be a successful politician. And he is. I'm expected to always tell the truth.

Taking into consideration current dangers, should we aim at creating pan-European media and thus a European public opinion?

This is not going to happen overnight. Of course, we should go in this direction but such process will take a long time. Moreover, it's neither organic, nor administrative in manner.

Do you think that launching a European "Gazeta Wyborcza", a popular European web portal or a successful European institution would be impossible? Our European magazine is a variation of *The New York Times*.

I see your point and you're right. Europe should follow this direction and it is bound to do so if we want the European framework to continue in its form. Although we must remember that it is a process and such changes are often introduced gradually, and sometimes they even go unnoticed. I see how in Poland the degree of awareness of European dilemmas changes in comparison to how it was shaped twenty-something years ago. We have different people with different mindset.

What tools do Poles now possess that could change Russia – as Giedroych has advised us before?

We are influencing Russia via cultural, academic, intellectual proximity. Undoubtedly, Russia needs change but that doesn't mean employing a submissive policy towards the aggressive, imperialistic, feeding on the spirit of annexation policy of Putin. Some aspects of Russian mentality are already changing. Russians are slowly becoming aware of the fact that for some actions there is a high price to be paid. ●

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Membership Developments in Political Parties in Estonia, Moldova and Ukraine



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PRIIT
KALLAKAS

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decline of the party memberships over the last decades is a widely recognized trend in Western democracies¹. Decrease of members has mostly been related to the changes in party organizations, especially to the emergence of cartel parties. Richard Katz and Peter Mair² noted that parties have turned to centrally managed political organizations, which – disregarding ideological differences – cooperate with each other for mutual benefits. Katz and Mair claim, that modern parties do not need mass-membership any more. Membership fees compose marginal share from parties' budgets, decision making process is centralized, and campaigns are organized by PR specialists. Therefore the benefit from the single member for the party has been diminished. However, the political parties in post-soviet countries are still interested in widening their memberships, regardless of cartel party theories, which claim that modern cartel parties do not need members to be successful.

Let us focus on two aspects of party systems in post-soviet countries, which have not received the required attention in Western European political studies, but are decisive elements in post-communist countries in which political consolidation is still on-going. Firstly, the minimum membership criteria for establishing a political party will be compared and then the membership growth trends in post-communist area shall be analysed. I will focus on three post-soviet states – Estonia, Moldova and Ukraine. Estonia has been a member of the European Union already for a decade, and Ukraine and

¹ Biezen, Mair & Poguntke. 2012. Going, going, . . . gone? The decline of party membership in contemporary Europe. *European Journal of Political Research* 51, 24-56.

² Katz, S.R & Mair, P. 1995. Emergence of the cartel Party, *Party Politics* 1995; 1; 5.

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VOTERS IN POST-SOVIET COUNTRIES DO NOT HAVE MUCH TRUST AND CONFIDENCE IN THEIR NEW RULERS AND THEY MAY RATHER NEED STABILITY IN THEIR POLITICAL SYSTEM THAN POLITICAL PARTIES THAT COME AND GO AS RAIN CLOUDS IN MONSOON SEASON

Moldova represent post-soviet states which are included in the Eastern Partnership program and are still on their way towards European Union. In 2002 the CIS countries (Ukraine and Moldova) had the least participatory civil societies in the world and their civil societies were regarded as weak and passive³. At the same time Estonia has one of the fastest party membership growth in Europe and is an example of a country with already consolidated political system.

³ Melnykovska & Schweickert. 2008. Who you gonna call? – Oligarchic Clans as a Bottom-up Force of Neighborhood Europeanization in Ukraine.

MEMBERSHIP REQUIREMENTS TO ESTABLISH A PARTY

Threshold to register a political party may be one of the most significant hurdles for political participation. High threshold cements the positions of existing parties and limits the political competitiveness which results in cartelization of politics. At the same time, in developing democracies a certain threshold to establish a party may be crucial. Lack of threshold or relatively low bar to enter the political playground may induce populists and project parties to try their luck and therefore destabilize the whole political system. Voters in post-soviet countries do not have much trust and confidence in their new rulers and they may rather need stability in their political system than political parties that come and go as rain clouds in monsoon season.

Estonia, Moldova and Ukraine are good examples of countries with different levels of membership thresholds. Ukraine has the lowest bar to establish a party. There is no minimum membership criteria, but it has to be officially represented in at least 14 administrative divisions (oblast) out of 24 and the initiative group of the party has to collect 10 000 signatures of eligible voters, and those signatures have to be taken from 2/3rds of administrative divisions⁴. Even though the demand to collect the 10 000 signatures and to be represented in 2/3rds of the territorial units may seem harsh, it is not a difficult task in a country with more than 37 million voters. Ironically, there are even law firms which offer the signature collecting service⁵. Due to the simplicity of establishing a political party,

there are 218 political parties registered in Ukraine at the moment⁶ and this figure is growing annually.

Moldova represents a country with one of the highest membership thresholds in post-communist area, lagging behind only from neighbouring Romania (Figure 1). Pursuant to the Law, a minimum of 4000 members is required to establish a political party in Moldova⁷. Half of those members must be residents of second level administrative territorial units, with no less than 120 in each of those units and all the members have to be citizens of Moldova.

Despite the high threshold for establishing a party, there are 22 active parties in Moldova. The official registry of political parties controlled by the Ministry of Justice reports to have 40 political parties registered⁸, but 18 of them haven't been active for years⁹.

Estonian threshold for party membership has changed throughout the development of the country. After regaining the independence, the required number of members to create a party was 200. As the Estonian political landscape was extremely variegated, the bar was raised to 1000 members and this criterion was enforced in October 1998. The amendment turned to be extremely efficient as at the beginning of 1998 there were 31 parties active in Estonia, but a year later only 19. The Estonian political system continued its consolidation process and in 2013 there were only nine parties left in Estonia. Due to noteworthy public demand and social pressure to reduce the criteria, the lawmakers made an

⁴ Law of Ukraine on Political Parties in Ukraine 2001.

⁵ http://accents.com.ua/Registracija_nekom-mercheskih_organizacij/Politicheskie_partii.php

⁶ <http://www.drso.gov.ua/party>

⁷ Law on Political Parties of Moldova, 2007.

⁸ <http://justice.gov.md/pageview.php?l=ro&idc=212&id=780>

⁹ <http://www.e-democracy.md/parties>



Figure 1. Membership threshold for establishing political parties in post-soviet countries.

Country	Members/signatures to establish a party	Country	Members/signatures to establish a party
Romania	25,000 members ¹¹	Moldova	4000 members ¹²
Lithuania	1000 members ¹³	Bosnia and Herzegovina	500 members ¹⁴
Estonia	500 members ¹⁵	Bulgaria	500 members ¹⁶
Slovenia	200 members ¹⁷	Ukraine	10 000 signatures ¹⁸
Latvia	200 members ¹⁹	Croatia	100 members ²⁰
Czech Republic	1000 signatures ²¹	Slovakia	10000 signatures ²²

amendment to the Political Parties Act and stipulated that 500 founding members are needed to establish a political party¹⁰.

Since lowering the party establishing bar to 500 members in April, one party has already emerged and several other groups are planning to do the same ahead of parliamentary elections in March 2015. The emergence of single political party may not sound noteworthy in most of the Western democracies, but in Estonia the last birth of a political party happened in 2005. As there are parliamentary elections held within few month, we can forecast small "baby-boom" of the political parties in Estonian near future. [See: Figure 1]

MEMBERSHIP/ELECTORATE RATIO

Membership/Electorate Ratio represents a percentage of voters belonging to a political party. The higher ratio figure shows that parties are natural and integral part of civil

societies and people see them as a chance to influence politics. Low membership/electorate ratio level is a warning sign to political elite, as they stand far from their voters and people do not have enough confidence in them.

Mair, Biezen and Poguntke show in their study, that the average level of party membership in post-communist countries is 3.5%, in contrast to the average of 5.7%

¹¹ Law on Political Parties of Romania, 2003.

¹² Law on Political Parties of Moldova, 2007.

¹³ Law on Political Parties of Lithuania, 2010.

¹⁴ Election Law of Bosnia and Herzegovina, 2001.

¹⁵ Act of Political Parties of Estonia, 2014.

¹⁶ <http://www.legislationline.org/documents/id/15811>

¹⁷ Act Amending the Political Parties Act of Slovenia, 2007.

¹⁸ Law of Ukraine on Political Parties in Ukraine 2001.

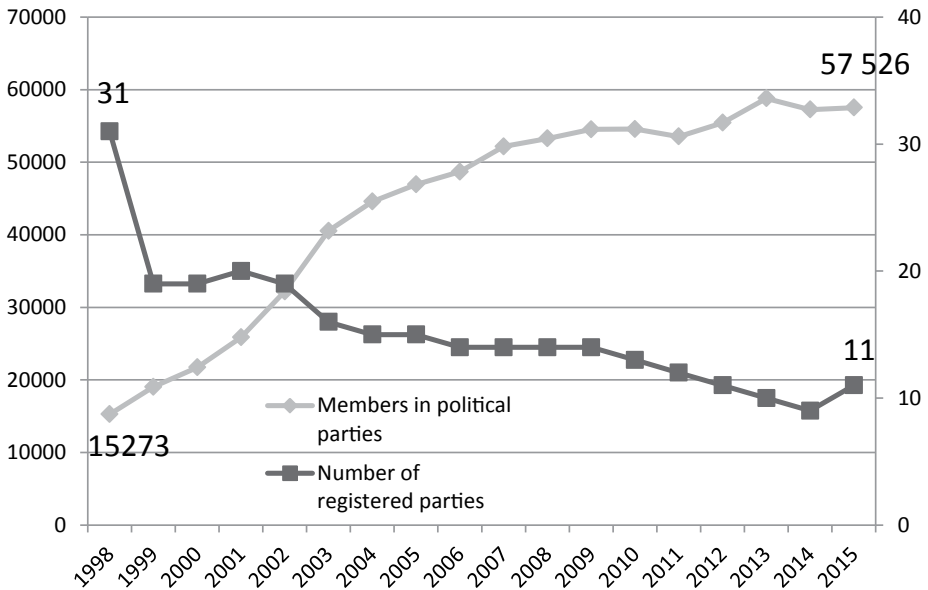
¹⁹ Law on Political Parties of Latvia, 2006.

²⁰ Political Party Act of Croatia, 1993.

²¹ Act of Law on association in political parties and political movements of Czech Republic, 2006.

²² Law on Political Parties of Slovakia, 2005.

¹⁰ Political Parties Act of Estonia 2014: <https://www.riigiteataja.ee/en/eli/508072014003/consolide>

Figure 2. Membership developments in Estonian parties 1998-2014.

Source: Author calculation based on data by Estonian Centre of Registers and Information Systems.

Figure 3. Membership/Electorate ratio in Estonia 1995 - 2014.

Year	Eligible voters	Party Members	Membership/ Electorate Ratio
1995	791 957	5 959	0,75%
1999	857 270	20 584	2,40%
2003	859 714	47 519	5,53%
2012	913 346	55 434	6,07%
2014	913 346	57 526	6,28%

Source: Author's calculations based on the data by Estonian Centre of Registers and Information Systems and Estonian Election Committee.

for the longer-established democracies²³. The European average, according to this study, was 4.65%. The selection of the study did not include European Union Eastern Partners, but it is useful to bring out some figures from observed Eastern-European countries: Latvia (0.74%, 2004y), Poland (0.99%, 2009y), Hungary (1.54%, 2008y), Romania (3.66%, 2007y), Bulgaria (5.6%, 2008y), Slovenia (6.28%, 2008y)²⁴.

Party membership in Estonia

Estonia has had one of the highest party membership growth rates in Europe. In 1997 Estonia had 31 political parties, but only 12,472 party members. In January 2013 Estonia had nine parties and 58,803 party members (Figure 2). The membership growth has therefore been more than 470 per cent in 15 years. The increase of members of the political parties has been decelerating in past two years and in 2013 Estonia faced the first time in re-independence period the downfall of absolute membership numbers. The wave of members secession from political parties in 2012-2014 was mainly caused by the several political scandals and voter disappointment in general politics. [See: Figure 2]

It is too early to conclude whether the Estonian parties have reached their membership peak or is it only temporary back-lash, but it is definitely a sign to Estonian political leaders. Despite of the small decrease of the absolute membership numbers in political parties, Estonia is still a country with one of the highest membership-electorate ratio in Europe. In September 2014 6.28% of the Estonian voters belonged to political organizations. [See: Figure 3]

²³ Biezen, Mair & Poguntke. 2012. *Going, Going, ... Gone? The Decline of Party Membership in Contemporary Europe*, *European Journal of Political Research* 51, 24-56.

²⁴ Ibid.



PEOPLE OFTEN SEE POLITICAL PARTIES AS THE ONLY MEANS OF HAVING SOME INFLUENCE AND HAVING A CHANCE TO PARTICIPATE

The high rates of party membership in Estonia could be explained by the institutionalization of former national movements after Estonia regained its independence, as well as the newly opened opportunity to participate in social processes after fifty years of occupation. Probably even more important aspect of membership increase in Estonian political parties is the relative weakness of non-political civic associations. People often see political parties as the only means of having some influence and having a chance to participate.

Other noteworthy feature of Estonian parties is their club-like behaviour and wide range of offered services. Political parties provide people with an opportunity to spend time together and take part in educational, sports and entertainment activities. Smaller municipalities are not financially competitive with state-funded political parties and therefore political organizations might be the only chance for social interactions²⁵ at the municipal level.

²⁵ Kallakas, Priit. 2010. *Development of political party membership in Estonia in 1995-2009*.

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UKRAINIAN PARTIES ARE NOT MODERN CARTEL-PARTIES WITH CATCH-ALL STRATEGIES LIKE PARTIES IN ESTONIA OR IN MOLDOVA. UKRAINIAN PARTY MODEL IS UNIQUE AS IT ORGANIZATIONALLY RESEMBLES MOSTLY ELITE PARTIES, CAMPAIGNING STRATEGIES LOOK LIKE THOSE OF CATCH-ALL PARTIES AND AT THE SAME TIME THEY ACT AS CARTEL PARTIES

The largest parties in Estonia are the main opposition party, Centre Party, and the governing, liberal Reform Party. Both parties have around 13,000 members. Other parties have already less than ten thousand members.

The enlargement of political parties is not only the result of people's interest in parties, but parties deliberately seek opportunities to widen their membership. Party leaders in Estonia believe that a single member can bring two extra voters for the party regardless of the level of activeness of the member. Party leaders calculate that the members discuss political issues during family gatherings and at social events and thus spread the party's message. It is therefore believed to be extremely beneficial to have as many party members as possible.

Party membership in Moldova

Party leaders in Moldova are also keen to enlarge their parties' memberships and – like their Estonian colleagues – parties organize street campaigns to recruit new members and also induce party members to invite their acquaintances and relatives to join the party.

Unfortunately, only in Estonia – among other post-soviet countries – the entire list of party members is regarded as public information and controlled by the state. In Moldova the parties are also obliged to deliver their membership information to the Ministry of Justice, but neither the state nor the parties reveal the full list of their members. Therefore the following figures are based on parties' own declarations and – as party leaders also compete for the "largest party" title – they tend to exaggerate the numbers of their membership.

What we know about Moldovan parties is that there are 40 parties registered, but 18 of those are not active anymore. Therefore

Figure 4. Membership in political parties in Estonia, Ukraine and Moldova.

	Political parties	Eligible voters	Members of political parties	Membership/Electorate ratio %	Minimum members/signatures
Estonia	10	913346	57526	6,28	500
Ukraine	218	36163839	~2,100,000	5,8	10,000 signatures
Moldova	40	2734700	~290,000	10,9	4000

I have calculated the membership/electorate ratio based on the memberships of active parties.

The parties with the largest membership are long-term parliamentary parties. More than 60% of the party members in Moldova belong to six parties represented in parliament²⁶. The biggest party, ideologically centre-left Democratic Party of Moldova (PDM), claims to have 60,000 members²⁷. PDM is followed by the Communist Party and the Liberal Democratic Party in Moldova which reported to have around 40,000 members. Other parties have significantly fewer members, but as it is prescribed by law, all the parties have to have at least 4000 members.

The rough estimation suggests that 290,000 individuals belong to political parties in Moldova. At the parliamentary elections in 2010 there were 2.73 million registered voters. This means that 10.6% of the eligible voters already are members of political parties and with this figure Moldova would have one of the highest membership/electorate ratios²⁸ in Europe, but as mentioned above those figures must be taken with reservations.

Party membership in Ukraine

In Ukraine parties are not under obligation to present their membership lists to state agencies and they do not publish them on their own. Because of this the size numbers of the Ukrainian parties analysed in this article are similar to Moldovan figures based on rough estimations and parties' own declarations.

Ukrainian parties are not modern cartel parties with catch-all strategies like parties in Estonia or in Moldova. Ukrainian party model is unique as it organizationally resembles mostly elite parties, campaigning strategies look like those of catch-all parties and at the same time they act as cartel parties. Elite parties are organizations built around charismatic leaders, they are not based on ideology. Elite parties derive much of their resources, whether financial or not, from among personal contacts²⁹. In Ukraine elites are the only domestic agents capable of building institutions. Among the various elite groups, the oligarchic clans are the most powerful bottom-up forces, "capturing" the state authorities and controlling the enforcement and implementation of institutional reforms³⁰.

²⁶ <http://www.e-democracy.md/parties>

²⁷ Ibid.

²⁸ Biezen, Mair ja Poguntke . Going, Going, ... Gone? The Decline of Party Membership in Contemporary Europe, 2012.

²⁹ Katz, S.R & Mair, P. 1995. Emergence of the cartel Party, *Party Politics* 1995; 1; 5.

³⁰ Melnykovska & Schweickert. 2008. Who you gonna call? – Oligarchic Clans as a Bottom-up Force of Neighborhood Europeanization in Ukraine.





THE WEAKNESS OF STATE AGENCIES, LACK OF STRONG CIVIL SOCIETY AND THE RISE OF MASS MEDIA CREATED A FRUITFUL SOIL FOR THE EMERGENCE OF CARTEL PARTIES AND PLAYED ALL THE CARDS INTO THE HANDS OF THE CHARISMATIC LEADERS OF POLITICAL PARTIES ENABLING THEM TO DESIGN THE COUNTRY FOR THEIR OWN BENEFIT

Due to the oligarchs-based party system there are not many parties with clear left-right scale. Therefore people interested in politics rather gather around a charismatic political leader and do not make their party choice based on their ideological beliefs. But as the success or failure of the parties

depends mostly on the decisions of single leaders and the responsibility is not shared with the board or the wider organization, the parties in Ukraine tend not to operate long, with few exceptions, and do not gather a lot of members.

There are five main parliamentary parties in Ukraine. The added-up membership of those parties amounts to app. two million. The Party of Regions declared on the peak of the former head of cabinet Viktor Yanukovich's era to have 1, 4 million members³¹ (700,000 of those were supposed to be from Donbas region hence the epicentre of the on-going conflict). The second largest party was Yulia Tymoshenko's and present prime minister's Arseny Yatsenyuk's party Pro Patria, which claimed to unite 600,000 members³² – but this party has recently been divided into many smaller parties and at the moment the membership number is definitely smaller. Other parties represented in Ukrainian parliament have already significantly fewer members. Vladimir Klitschko's party "Udar", which has main stronghold in Kyiv, has around 10,000 members³³. The coalition party Svoboda reported to have 15,000 members³⁴.

Taking the previous figures into consideration and presuming that there are gradually fewer members in the rest of the political parties, we can make an assumption that there are around 2.1 million party members in Ukraine. This means that around 5.8% of eligible voters are members of Ukrainian political parties (Figure 4), which would be

³¹ <https://www.kyivpost.com/content/politics/regions-party-members-flee-faction-amid-growing-unrest-332864.html?flavour=mobile>

³² http://www.ukrinform.ua/eng/news/batkivshchyna_cleans_ranks_party_expels_1500_people_324793

³³ <http://klichko.org/about/history/>

³⁴ Olszański, A, T. 2011. Svoboda Party – the New Phenomenon on the Ukrainian Right-Wing Scene.

in European context above average result. Of course I have to remind that the calculation was based on the declarations of the largest parties about their membership size, which means that the precise membership/electorate ratio might be smaller, but still it gives some sort of estimation of memberships of the Ukrainian parties. [See: Figure 4]

CONCLUSIONS

This article gives an overview of membership developments in political parties in three post-soviet countries: Estonia, Moldova and Ukraine. Article focused on two aspects of political parties. Firstly, it analysed the membership criteria for establishing a political party, and secondly, it outlines party membership sizes and membership/electorate ratios in the three abovementioned countries.

Political parties in post-communist countries did not undergo the same development paths as the parties in Western democracies over the last century. The weakness of state agencies, lack of strong civil society and the rise of mass media created a fruitful soil for the emergence of cartel parties and played all the cards into the hands of the charismatic leaders of political parties enabling them to design the country for their own benefit.

One of the characteristic features of cartel party systems is that parties try to make the entrance of the newcomers to political arena as difficult as possible. One of the options is to set the high membership criteria for establishing a political party. In Moldova to establish a party, 4000 founding members are required. This threshold is one of the highest in post-communist countries lagging behind only the neighbouring Romania. On the other side stands Ukraine, where no concrete limit has been set but a group has to collect 10,000 sig-

natures (not members) to form a party. The ease of establishing political parties in Ukraine has resulted in 218 registered parties, which are built around charismatic leaders not on ideology. In Estonia public demand caused the lowering the membership criteria to 500 members. Before the amendment, for 16 years the limit to establish a party was 1000 members.

The weakness of civil society was conducive to the increase of membership in mainstream political parties in Estonia, Moldova and Ukraine. In all of the three countries the percentage of voters in political parties is relatively high and clearly above the European average. In Moldova 10.9% of the eligible voters are members of political parties. In Estonia it is 6.3% and in Ukraine 5.8%.

Membership developments in political parties in post-soviet countries need definitely further attention and analysis. The abovementioned two aspects of membership developments are only two pieces of a larger and much more complicated puzzle. •



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4liberty.eu

Network Meeting in Tbilisi

On October 16-18, 2014 the 4liberty.eu team participated in a joint meeting of all member organizations held in Tbilisi, Georgia. This was also the perfect opportunity to welcome the three new cooperating partners of our network: New Economic School – Georgia, The Institute of Economic Research and policy Consulting – Kiev and Center for Civil Liberties.

Economic School – Georgia and University of Georgia about creation of Institute of Economic Freedom. The members of the network were also invited as panellists into discussion entitled “Economic Freedom after the EU accession: Lessons from CEE Region” (Richard Durana – the President of INESS, Slovakia; Leszek Jażdżewski – Editor-in-Chief of Libertel, Poland; Tanja Porcnik – the President of Svetilnik, Slovenia; Gia Jandieri – vice-president of New Economic School of Georgia).

During our stay in the capital of Georgia we had also a chance to take part in a ceremony of signing agreement between New

The meeting was organised thanks to the support of Friedrich Naumann Foundation for Freedom and Visegrad Fund. ●

MEMBERS OF 4LIBERTY.EU NETWORK

Free Market Foundation (Hungary) is a think tank dedicated to promoting classical liberal values and ideas. The organization's projects focus on advocating a free market economy and fighting racism. The Foundation's activities involve education, activism and academic research alike, thus reaching out to different people.

Liberální Institut (Prague, Czech Republic) is a non-governmental, non-partisan, non-profit think tank for the development, dissemination and application of classical liberal ideas and programs based on the principles of classical liberalism. It focuses on three types of activities: education, research, and publication.

Svetilnik (Ljubljana, Slovenia) is a non-profit, non-governmental and non-political association. Its mission is to enlighten Slovenia with ideas of freedom. The goal of the association is a society where individuals are free to pursue their own interests, and are responsible for their actions.

The Lithuanian Free Market Institute (Vilnius, Lithuania) is a private, non-profit, non-partisan organisation established in 1990 to promote the ideas of individual freedom and responsibility, free market, and limited government. The LFMI's team conducts research on key economic and economic policy issues, develops conceptual reform packages, drafts and evaluates legislative proposals and aids government institutions by advising how to better implement the principles of free market in Lithuania.

The F. A. Hayek Foundation (Bratislava, Slovakia) – is an independent and non-political, non-profit organization, founded in 1991, by a group of free-market oriented Slovak economists. The core mission of the F. A. Hayek Foundation is to establish a tradition of market-oriented thinking in Slovakia – an approach that had not existed before the 1990's in our region.

IME (Sofia, Bulgaria) is the first and oldest independent economic policy think tank in Bulgaria. Its mission is to elaborate and advocate market-based solutions to challenges citizens of Bulgaria and the region face in reforms. This mission has been pursued since early 1993 when the Institute was formally registered a non-profit legal entity.

The Academy of Liberalism (Tallinn, Estonia) was established in the late 1990s. Its aim is to promote liberal world view to oppose the emergence of socialist ideas in society.

INESS (Bratislava, Slovakia), the Institute of Economic and Social Studies, began its activities in January 2006. As an independent think tank, INESS monitors the functioning and financing of the public sector, evaluates the effects of legislative changes on the economy and society and comments on current economic and social issues.

Projekt: Polska (Warsaw, Poland) Projekt: Polska are people who are dreaming of a modern, open, and liberal Poland. Those, to whom a democratic, effective and citizen-friendly government is a key goal, and who help accomplish this goal while enjoying themselves, forming new friendships, and furthering their own interests.

Liberales Institut (Potsdam, Germany) is the think tank of the Friedrich Naumann Foundation for Freedom dedicated to political issues such as how liberalism can respond to challenges of contemporary world and how the liberal ideas can contribute to shaping the future.

Fundacja Industrial (Lodz, Poland) is a think tank created in Łódź in 2007. Its mission is to promote an open society, liberal economic ideas and liberal culture and to organize a social movement around these ideas. Among Foundation's most recognizable projects are: Liberté!, Freedom Games, 6. District. Foundation is coordinating 4liberty.eu project on behalf of Friedrich Naumann Foundation.

Republikon Institute (Budapest, Hungary) is a liberal think tank organisation based in Budapest, focusing on analysing Hungarian and international politics, formulating policy recommendations and initiating projects that contribute to a more open, democratic and free society.

Civil Development Forum (FOR) (Warsaw, Poland) was founded in March 2007 in Warsaw by Professor Leszek Balcerowicz as a non-profit organization. Its aim is to participate in public debate on economic issues, present reliable ideas and promote active behaviour. FOR's research activity focuses on four areas: less fiscalism and more employment, more market competition, stronger rule of law and impact of the EU regulations on the economic growth in Poland. FOR presents its finding in the forms of reports, policy briefs and educational papers. Other projects and activities of FOR include among others Public Debt Clock, social campaigns, public debates, lectures, spring and autumn economic schools.

COOPERATING PARTNERS FROM EASTERN PARTNERSHIP COUNTRIES

The Institute for Economic Research and Policy Consulting (Kiev, Ukraine) is a well-known Ukrainian independent think tank, focusing on economic research and policy consulting. IER was founded in October 1999 by top-ranking Ukrainian politicians and scientists and German Advisory Group on economic reforms in Ukraine, which has been a part of Germany's TRANSFORM programme. Its mission is to provide an alternative position on key problems of social and economic development of Ukraine.

New Economic School – Georgia (Tbilisi, Georgia) is a free market think-tank, non-profit organisation, NGO. Its main mission is education of young people in free market ideas. It organizes seminars, workshops and conferences for education and exchanges of ideas. NESG was founded by Georgian individuals to fill the gap of the market economy knowledge in the country and the deficit of good teachers and economics textbooks.

BŁAŻEJ LENKOWSKI
THE PRESSING NEED FOR ENERGY UNION

PAGE 040

Europe cannot save the world (in the ecological sense) on its own. It may, however, become eternally dependent on its enemies thus becoming an extremely non-competitive player. Therefore, Europe should not discriminate its indigenous, European energy sources.

KALLEV KALLEMETS
CONTROL OR MARKET: DILEMMAS OF EUROPEAN ENERGY POLICY

PAGE 044

The new means of generating nuclear power seem more like the pinnacle of the civilization's development than does the harvesting of the same modes of power generation that once propelled the ships of Columbus forward. If it does not make sense to return to wind-powered commercial ships, why should we go back to the wind-power age?

MARTIN REGULI
THE CURRENT ENERGY OPTIONS IN EUROPE: PRINCIPLES OF ECONOMIC LIBERTY AND THE SITUATION IN UKRAINE

PAGE 050

Due to the current military aggression in Ukraine, it is usually taken for granted that the EU must act as a protector of the energy independence and assure that the energy needs of the countries are met. However, it needs to be questioned how the EU should tackle this task and what this mandate should allow the EU to do.

ALEŠ ROD
ELECTROENERGY SECTOR IN THE CZECH REPUBLIC: PRESENT SITUATION, OPPORTUNITIES AND THREATS

PAGE 098

The Czech Republic is not energy self-sufficient in terms of resources used for electro-energy production. The extensive resource depletion before 1989 reaps its harvest now, especially when talking about coal mining. The net import of resources used for electricity and heat production left the country dependent on suppliers, so any problem on the international market (including international political) could cause a cost-shock in the economy and threaten the energy consumption.

ŽILVINAS ŠILĖNAS
SHALE GAS: THE UNTAPPED POTENTIAL

PAGE 138

Obstacles to successful extraction of shale gas in Europe are artificial. They stem neither from technological complexity (even though hydraulic fracturing is technologically complex), nor from economics (even though probably not all technologically viable gas wells make economic sense). The major obstacles have legal basis. A pen, paper and political will. That's what we lack.

'WEAKNESS ALWAYS EMBOLDENS': AN INTERVIEW WITH ADAM MICHNIK

PAGE 188

Russia doesn't have to be weak or non-imperial. It has always had a tendency to build its power on external expansion. It seemed that the age of Gorbachev and Yeltsin will put an end to it. But Putin tries to reinstate this tendency, to rebuild the post-Soviet empire, which he calls the Eurasian Union.