From privatization to nationalization – the Hungarian case

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1. Milestones of Hungary's energy development

Three major periods, four major topics

1. Privatization and modernization of the system (1994-2000)
2. European harmonization and establishing interconnectivity (1999-2009)
3. The comeback of the State and renationalization (2010-)

The first sectoral privatization in the V4

Distribution (gas and electricity) and major power plants were privatized to Western strategic investors en masse between 1994-96.

The leading motivation was fiscal debt management, raising revenues and smoothening social austerity.

Sectoral regulation (including the establisment of the Regulator in 1995) formed due to investors' request with the mission to safeguard profitability.

No political consensus regarding the process: young conservatives, Orbán criticised the privatization.

Massive flow of investments into the sector due to booming demand, guaranteed (8%) profitability and positive expectations.

Harmonizing and interconnecting Europe

European regulations were implemented relatively easy. Unbundling was esp. smooth in the gas sector due to already existing OU after 2006.
In the electricity field state-owned MVM provided an ITO.

Gas interconnectivity was rather corporate, not policy driven: MOL (TSO-owner) pushed for expanding the network since the mid-2000s.

Consequently projects were prepared prior to 2009, national interconnectivity programme was finished by 2013.

In the electricity field imports and harmonization with EU is beneficial due to growing imports from the West (market coupling in 2012). Some exports to the Balkans.

The comeback of the State

Since Viktor Orbán’s return to power in 2010 social affordability and ownership issues took the centerstage in sectoral policies.

Utilitiy price cuts have been used as important political instruments in electoral campaigns (during 2013-14 a cut above 25% was given for residential consumers). Regulatory squeeze on tariffs and prices.

The takeover of the sector from Western investors primarily by the state has been publicly announced among others in utilities.

Consequently, since 2013 Western companies have been selling their assets to the government. Sectoral investments have fallen by 60-80% due to low tarrifs and losses.

2. The National Energy Regulator

The Hungarian Energy Office was established relatively early, in 1995, in the context of the Western corporate-Hungarian state relations.

In 2013 the Office was reshuffled and renamed as Hungarian Energy and Public Utility Regulatory Authority (HEPURA).

HEPURA is headed by the President, nominated for seven years by the Prime Minister (Lajos Dorkota, close affiliate of Viktor Orbán).
Relatively big instituiton (321 people with a 22.72 million EUR budget).

The Parliament oversees its activity, annual reporting and close budgetary scrutiny exerted. Strict (informal and formal) political controll from the Executive, the vehicle of the state’s influence in the sector.

Activity and responsibilities

<u>Extremely extensive sphere of responsibilities</u>:

Electricity (generation, distribution, and trading); Natural gas (transmission, distribution, commercial and strategic storage, trading); District heating (generation and distribution); Water utilities (distribution); Public waste management (oversees tariffs); Other: price preparation (universal service) and tariff setting; consumer protection; licensing and inspection; coordination of transposition of EU regulatory measures.

Tariff and price preparation and setting is the most important regulatory activity in the sector. Preparation belongs to the HEPURA, while final decisions are taken by the Minister of National Development.

Organization of HEPURA

Cabinet and four deputies as major pillars of the organization:

To the President's cabinet: communications, press and public relations, internal auditing, IT and security departments.

Four deputy Presidents are in charge of:

(1) energy sector - gas, electricity and heat
(2) public utilities - water and public waste
(3) international cooperation
(4) general affairs - legal, HR departments, financial issues, consumer protection and the statistical department.

3. Energy Efficiency Funds/Programmes

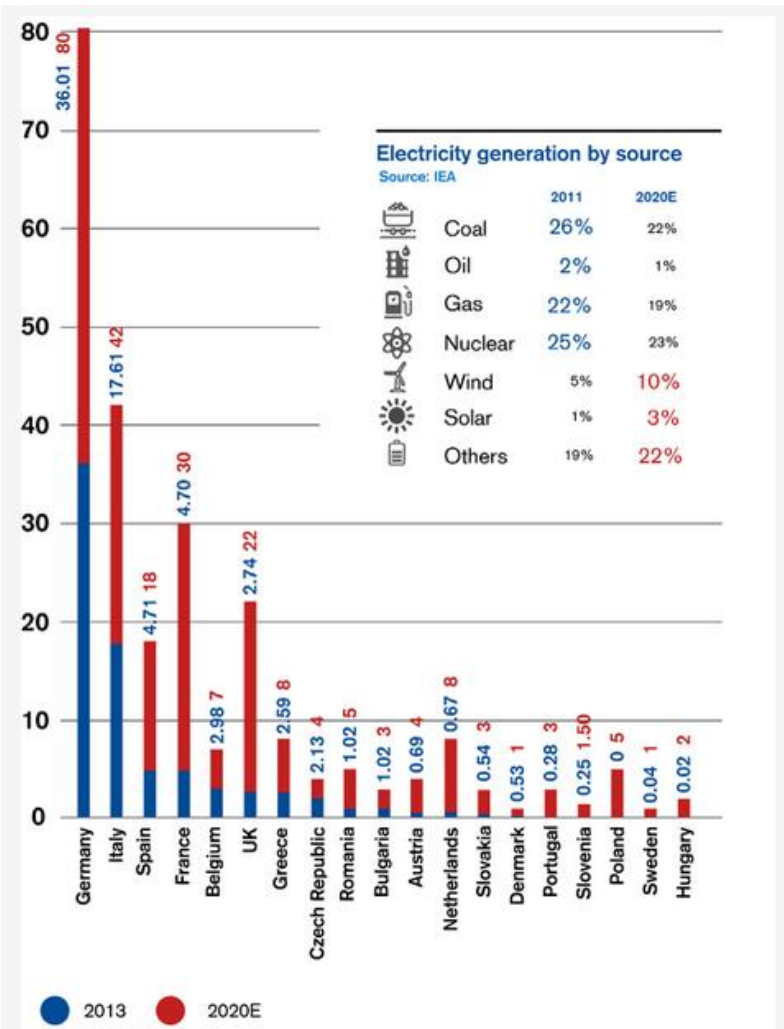
1. Neutral attitude towards energy efficiency, hostile relations towards renewables.

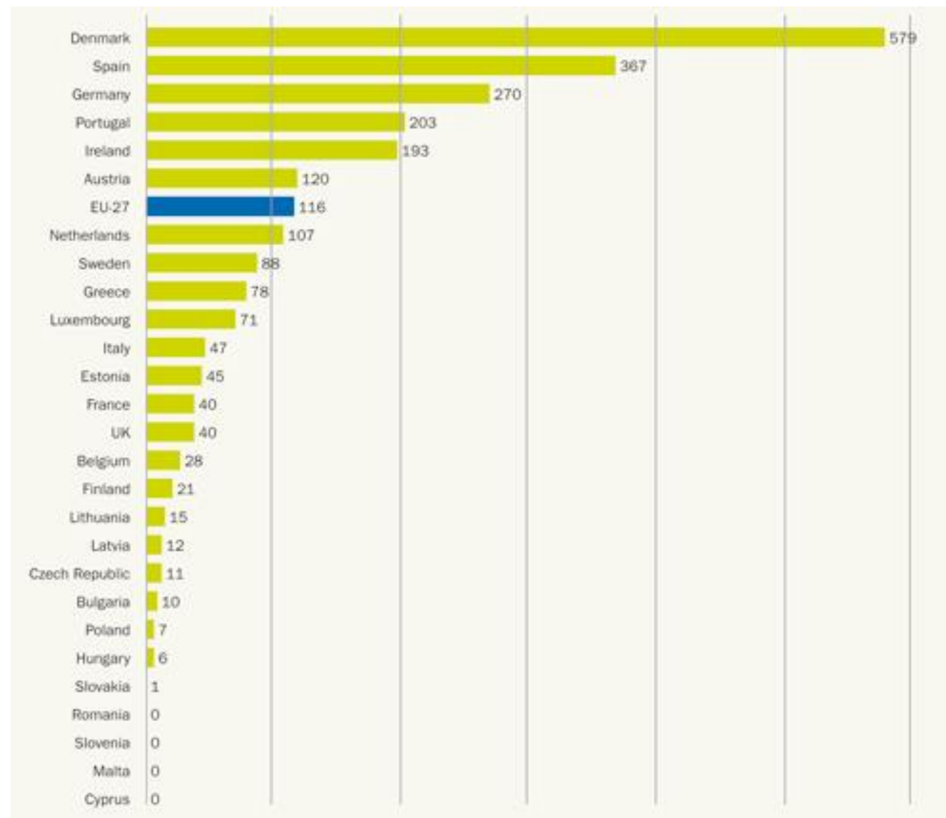
2. On paper funds mainly come from EU and are significant (around 700 million EUR between 2007-13). In reality these funds are only partly used accordingly and often channeled for other purposes.

3. Hungary has abolished its Renewables Financing Scheme in 2010 and failed to introduce a new system yet. Solar, wind and other subsidies are provided through asset-financing mainly from EU funds exclusively.

4. Hungary has its targets both for EE (non-mandatory) and RES. These shares are growing primarily because of shrinking consumption and non-supported biomass.

Hungary has a poor record in RES capacities





Potential reasons for the lack of activity

1. Social affordability considerations, utility rate cuts do not leave room for any subsidies in tariffs.

2. Strong supply side attitude combined with low prices in the residential sectors. Profitability of these investments are low, while demand is needed for the Paks extension project.

3. Very conservative attitude regarding network balancing.

4. Lack of domestic industrial base and synergies with industrial policies. Political elites perceive these efforts as expensive and driven by foreign interests.

4. Lessons learned and recommendations

Energy reform and transition is a two-way street.

Policy sustainability is a key asset of the reform, do not aim too much too fast if it endangers long-term sustainability too much.

Quasi political consensus on major issues is an important factor.

Ownership issues, development priorities, questions related to social affordability shall be brought on the same political/policy fundament. The policy shall search for these solutions, regulation cannot be fully apolitical.

Lessons learned and recommendations - 2

Administrative and human resources are key and scarce assets.

HEO/HEPURA policy outcomes often depended on some personalities, expert contributions. Performance varied heavily between the departments due to the staff's activity. Long-term HR policies, smart recruitment and stability are crucial at the beginning.

Do not overstretch in regulation.

Both in terms of regulated fields and in-depth of it, regulation shall keep its limits. The decision makers shall withstand the temptation to go too far in these regards. It fragments the scarce HR capacities and regulation will lose its focus.

Lessons learned and recommendations - 3

Do not be afraid of policy trade-offs.

„Second and third best policies” shall be aimed, rather than copying other solutions.

„Fight for sectoral minds” is a major challenge.

Regulation shall explain its efforts and make them as much popular as they can in the policy and corporate circles. Hostile perceiptional and ideological setups may handicap regulation in the long run. „Educate, communicate, make friends”, rather than simply regulate.

Thank You for Your attention!