

BALTIC COUNCIL OF MINISTERS'



BALTIC ENERGY STRATEGY

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INTRODUCTION

Common history, traditions for co-operation and coherent national policies of Estonia, Latvia and Lithuania create very favourable conditions for improved co-operation in the energy sector. Over the past few years, co-operation between the energy authorities of the Baltic countries has become more active and has developed under different principles than was previously the case. It is based on free will of three independent countries that join the forces for the benefit of their people.

Baltic Energy Strategy is a document which outlines a framework for the energy sector development in a long-term prospective with the overall aim to enhance the co-operation between the energy sectors both within the Baltic States and within a wider international arena. Co-operation within the energy sectors of the Baltic States is a tool in promoting the general economic development and in strengthening the efforts of the Baltic countries in accession to the European Union.

The Baltic Energy Strategy has three main objectives - competitiveness, security of supply, environmental protection and safety through achievement of which the national economies of the Baltic countries would improve their competitiveness and which will support the process of integration of the Baltic States into the European Union. These objectives are to be achieved by a set of measures comprising liberalisation of markets, price transparency, energy efficiency and interconnections.

Agreement on Co-operation in the Energy sector was signed in Riga on October 29th 1998 between the three Ministries of Economy that is considered as a first step in achieving the objectives stipulated by this Strategy. However, integration into European Union, expanding co-operation within the Baltic Sea region and with the Nordic Council, United Nations Framework Convention on Climate Change and other international treaties require that this co-operation is extended and developed. The Baltic Energy Strategy serves as a framework for these efforts.

The Strategy is considered as an act of free will of each of the states and it is based on equal rights, mutual benefits and reciprocal assistance. Any of the activities derived from this strategy will take into account principles of each country's policy as well as specific differences arising from economical, social structural and geopolitical factors. Given the numerous common elements in both - positions of the countries' as well as their legislative inheritance much can be gained from adapting a common approach to many of the problems that the Baltic countries face. However, co-operation may not be considered as a goal in itself, instead it is a vehicle in achieving increasing competitiveness of national economies, improved security of supply and integration of environment protection and safety into the energy sector policies.

Energy sectors in the Baltic States are to be adapted, both - structurally and technically, not only to face growing competition but also to take advantage of the opportunities arising from a competitive market. Future growth in the Baltic countries requires an affordable, reliable energy supply in appropriate quantity and quality. Security of supplies should be at the level to ensure that present and future energy needs are met at financially sustainable terms, which anticipates utilisation of diversified, stable and reliable energy sources. Since energy is a vital factor of the country's economy, the supply should be secured against disruption shortfalls and unexpected price rises. Energy policy objectives should integrate the environmental policies and ensure that expected future growth in energy consumption in the region does not lead to significant increase of emissions. Measures influencing the energy sectors at national level should be co-ordinated between the energy and environment authorities and introduced at regional and international level. Binding international treaties provide a framework for joint implementation of environmental policies and emission trading where relatively diverse structure of power generation in the Baltic states play an important factor.

The Baltic Council of Ministers' Committee of Energy invites energy sector representatives to take an active part in strengthening links of co-operation and common development in the Baltic region. The Committee of Energy is grateful for the co-operation to a wide range of organisations and people that have kindly contributed to this document.

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GENERAL OBJECTIVES

Competitiveness

It is likely that trends towards the globalisation of markets and the movement towards fewer restrictions on trade between different countries, including the Baltic countries, will also enhance competition. For this reason, the energy sector is to be adapted, structurally and technologically, to face the increased competition and take advantage of the opportunities resulting from competition. The economic growth forecast in the Baltic countries will require an affordable, stable and high quality energy supply. This means that the Baltic energy sectors must be in a position to serve the entire economic development, and to provide input to other economic sectors.

Today's level of energy sector competitiveness is determined by the heritage of the Soviet period, where energy prices were low compared with today's price level. Low energy prices lead to inefficient technology and buildings where energy efficiency was not considered the key issue. The change of technology requires time and significant investments. Wider application of new and efficient technologies should lead to an increase in the overall efficiency of the energy sector. Technology also contributes to achieving other strategy goals such as security of supply, by improving access to domestic energy resources, including renewable energy sources, and improving the environment and safety.

Security of Supply

Security of supply is considered as an essential objective of a regional co-operation. Security of supply means ensuring that present and future energy needs are sufficiently met, under acceptable economic conditions, and by making use of diversified, stable and reliable energy sources. Since energy is a vital factor of a country's economy, the supply of energy should be secured against disruptions, shortfalls and unexpected price rises. The acceptable quality of energy supplied is of a particular concern for Baltic countries, as the Baltic power system presently is unable to achieve the frequency regulation standards required for its deeper integration with European power systems.

Although Estonia has substantial resources of indigenous oil shale, Latvia and Lithuania hardly rely on imports of primary energy resources. This situation requires that particular emphasis be given to issues connected with the security of supplies. Risks associated with dependency on imports are to be minimised by diversifying the mix of energy carriers, technologies and diversification of suppliers.

Interconnections between the Baltic States and with neighbouring countries are considered as an important measure to improve the overall security of supply as well as a measure contributing to better integration of the energy systems.

Co-operation between the Baltic States in the field of joint utilisation of energy transmission and storage facilities as well as energy emergency planning is to be improved and expanded.

Environment and Safety

Environment and safety are major determinants and constraints in global, regional and national energy policies. Environmental protection at national and regional level should be achieved through measures that do not reduce the competitiveness of national economies in general, or of energy sectors. Improving the competitiveness of national economies and the energy industry whilst still protecting the environment requires competitive conditions in the Baltic region.

Due to the decline of economic activities and energy consumption in recent years, the emissions have also decreased significantly in the Baltic States. The main objective of the future energy and environmental policies will be to ensure that future growth in energy consumption in the region does not lead to significant increase of emissions. Measures that influence the energy sectors at national level should be co-ordinated between energy and environmental authorities, and introduced at regional and international level. The current international agreements, such as the Kyoto Protocol, will allow the implementation of joint environmental policies in the energy sector. This joint implementation and emission trading could be of interest to the Baltic states, particularly when taking the different primary energy sources for electricity generation in the different countries into account.

MAIN INSTRUMENTS

Liberalisation of Markets

Liberalisation of the energy market is an effective approach to improving economic efficiency by increasing competition. The prime instrument will be to liberalise the electricity and gas markets. The main reasons for liberalisation of the energy markets are to promote competition, improve efficiency and attract investments. Because monopoly firms in the energy sector have very few competitors, they lack the incentive to keep the costs at an appropriate and economically sustainable level.

Synergy effects resulting from a common Baltic power market would give definite benefits to the national economies of the Baltic States. This would improve the overall competitiveness of the national economies and, indeed, their energy sectors in particular. Varied primary energy sources and mixed power generation structure could be used more efficiently to develop the synergy potential by means of optimisation of power production, co-ordinated development strategies, reserve pooling, mutual electricity deliveries, peak load exchange, the minimisation of transmission losses, etc. The precondition of such a liberal market is the establishment of harmonised market conditions, such as electricity trading rules, regulations, common environmental policies, common technical standards and norms, etc.

Efforts to establish an effective market framework and trading rules, e.g. a harmonised electricity tariff system on a regional level of the Baltic states should be continued and extended. Ongoing activities relating to the Baltic electricity trading exchange (Baltic electricity pool) are to be continued and developed. The establishment of state-owned high-voltage electricity transmission companies (main grid or national grid) in each Baltic country should also be considered, as a neutral market place. In the medium- and long-term, closer co-operation between national transmission companies could lead to the possible strategic option of forming a joint state-owned Baltic electricity HV transmission company for the entire Baltic region.

Price Transparency

Energy prices should give the appropriate market signals to producers as well as consumers and should therefore cover the costs of the production, transportation and distribution of energy. Transparent pricing will create the necessary conditions for efficient regional energy markets.

Due to the relatively low income and other conditions (e.g. climate, economy, etc.) compared with developed EU countries, the share of energy cost in the Baltic states in terms of total average monthly income is higher than that in the EU. Subsidies to energy consumers by means of socially acceptable low tariffs present a market distortion, and reduce incentives for energy efficiency and structural changes towards better efficiency. The energy policies of the Baltic countries accept that the social policies should be implemented through social programmes, which are separate from the pricing of energy.

Co-operation in this field should ensure that a transparent pricing system based on the regulations adopted by the European Union is in place in all three Baltic countries. This could be done through the harmonisation of regulatory principles implemented by regulatory institutions, and by the harmonisation of energy tax rates (particularly excise tax rates and environmental taxes) and tax subsidies.

Energy Efficiency

Energy efficiency in end-use and energy supply chains will have substantial influence on the competitiveness of companies both inside and outside of the energy sector. Programmes to promote cost-effective energy efficiency improvements are useful instruments for avoiding decreases in competitiveness when markets open up. Also, security of supply and environmental objectives must benefit from energy efficiency improvements.

All three Baltic countries have developed their plans for energy efficiency, which are financed by private and budgetary resources. A number of projects are also financed through multilateral and bilateral loans, and assistance has been given since independence. Even when top priority has been attached to energy efficiency, at least in policy and strategy papers, it is a fundamental problem that very little state budget can be made available to implement the policies formulated.

One topic of special regional interest in this field of energy efficiency is development of a legal framework, norms and standards in compliance with directives of the European Union for implementing energy efficiency policies.

In addition joint efforts should be undertaken in promoting use of renewable energy sources and combined heat and power production.

Interconnections

Interconnections serve the security of supply objective, both by improving the efficiency and reliability of existing supplies, and by diversifying supply sources and routes, not only of individual countries, but of all Baltic countries and for the Baltic Sea region. Other reasons for carrying out interconnection projects include their contribution to the functioning of Baltic energy markets and economic cohesion. Interconnection projects will allow electricity produced in Baltic countries to be exported to neighbouring countries, thus improving the economic performance of the energy sector.

An essential measure in improving the long-term security of supply is interconnecting the Baltic Power System to the West and North European power systems. An undersea cable connection between Estonia and Finland and a connection between Lithuania and Poland have the highest priority. New high-voltage electricity lines between Latvia and Estonia, and between Lithuania and Latvia, may be necessary as well. Interconnection projects and transmission system improvements are necessary when considering the synchronisation of the Baltic States with CENTREL/UCPTE¹. When planning such interconnection projects, the mutual interests of each Baltic country should be taken into account.

The relatively low level of security of the natural gas supply systems based on only one supply source has brought forward the possibility of establishing a Baltic Gas Ring, which could connect the Baltic Sea countries in a common network supplied through pipelines from the Norwegian and Russian natural gas deposits, and from Latvia, where underground natural gas cavities are used for gas storage. The pipeline links would enable to offer gas storage capacities existing in the region to a wider range of European gas companies in need of such capacity on a regular basis. The three states will co-operate in common utilisation of natural gas underground storage facilities. Polish-Lithuanian link and planned gas storage in Lithuania are also essential in implementing integration with European gas systems.

Projects of common interest concerning electricity, natural gas and oil interconnections between the Baltic countries, and between Baltic countries and neighbouring countries, should be initiated, and joint investment initiatives should be developed. The cooperation between the Baltic countries should be strengthened in relation to the European Union's Trans-European Network Programme.

It is expected that most of the future projects, including interconnections, will be decided in the framework of a liberal energy market dominated by competition. However, the governments of the three Baltic countries will pave the way and provide possible support for the identification, preparation, planning, financing and implementation of interconnection projects.

¹ - Union for the Coordination of Production and Transmission of Electricity