

Energy Policy in Estonia

A COMPARATIVE VIEW ON PARTY POSITIONS

In the light of the German *Energiewende*, i.e. phasing out of nuclear energy and the implementation of binding limitations on CO2 emissions, debates on resource sustainability is not limited to institutions of the *European Union (EU)*. In fact, resource sustainability is discussed all over Europe. Estonia is a small national economy with a certain limit of domestic energy resources. It is dependent on the import of energy fuels; thus, the realignment of the German energy policy and the surrounding debate on sustainability policies are significant for the Estonian government and their own energy policy agenda. In a way, the Estonian energy situation is quite comparable to the German one and the *Energiewende* might prove a valuable lesson on how to sustain one's energy system and decrease energy dependency. Despite tremendous political, economic and social progress, Estonia still is in transformation and has to catch-up. Therefore, the Estonian government attempts to provide a convenient framework for its businesses and reasonable energy prices for its citizens. One crucial issue for Estonia is to uphold these framework conditions for businesses and citizens while complying with international and European climate regime provisions.

Peripheral geographic location and historical implications link Estonia to Russia. In the energy sector those links are highly substantial. Regarding the diversification of its energy supply, Estonia seeks to add variety to its energy market regarding the overall energy mix as well as the range of suppliers. However, this proves difficulties when one is not located in the centre of a European energy and resource distribution system. Therefore, Estonia together with Finland, Latvia and Lithuania put forward several proposals for the further development of a trans-European power network. Estonia with 1.3 million residents is a small market. Here, the question of in-market competition remains crucial. Increasing electricity prices at the turn of the year once more intensified the debate on energy prices and the Estonian energy policy in general. Here the most important facts and issues of Estonian energy policy and the common and different positions on energy policy of political parties represented in the Estonian Parliament are shown.

Energy Debates and Policies

The Estonian energy policy agenda can best be outlined along two strategy papers adopted by the Estonian Parliament in 2009: The *DEVELOPMENT PLAN OF THE ESTONIAN ELECTRICITY SECTOR (DPE)* until 2018 and the *NATIONAL DEVELOPMENT PLAN OF THE ENERGY SECTOR (NDP)* until 2020. These papers define development directions of Estonian power production for the next 10 to 15 years. The strategic guidelines enjoy broad and almost consensual support within all political parties. But various opinions regarding

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propositional details exist. The overall objective is a considerable decrease in electrical energy production from oil shale and an increased production from other energy sources. Currently, 60 percentages of electric energy is produced from oil shale; in 15 years, this figure is supposed to be at 30 percentages. The Estonian energy diversification strategy wants to balance the overall energy mix: Each of the available energy sources such as wind and potential nuclear energy as well as timber, gas and liquefied fuels are supposed to have a share of about 20 percentages of energy production in the future.

The liberal-conservative government has made significant progress towards the diversification of the national energy mix. In 2006, parliament adopted generous legislation on renewable energy, resulting in an abundance of wind energy and heat producers in the market. In fact, renewable energy accounted for 11 percentages of the Estonian internal energy production in 2010. The objective set by the government is a renewable energy share of 25 percentages by 2020 - exceeding the 20/20/20 objectives set by the EU for 2020, for that matter - and experts are convinced that this objective is feasible with the current legal framework. The DPE provides different objectives for re-designing the electrical energy production within the next 10 to 15 years. To this end, the combined heat and power production is to be expanded from 200 to 300 megawatt by 2014.

The concept of energy security - especially in the context of current Estonian-Russian relations and energy dependency - is the main driver for most objectives within the Estonian energy agenda and policy decision-making. The projected amount of state expenditures for activities outlined in the NDP will approximately account for €2 billion, the projected amount for the DPE will approximately be €1.1 billion. The final implementation for both plans will approximately account for more than €6.4 billion within the next 15 years.

Reconstruction of Narva Oil Shale Plants

Based on EU carbon dioxide emission objectives the Narva oil shale based power plants – due to their insufficient technology – need to be closed by 2016. Even ten years ago *Eesti Energia (EE)*, an Estonian national power provider, started to lobby for the option of reconstruction and compliance with EU regulations. The decision to reconstruct EE Narva plants is a contentious issue in Estonian energy policy: In 2010, liberal-conservative *Union of Pro Patria and Res Publica (IRL)* pushed for the reconstruction and financial support for the two plants; eventually, it was adopted in the *Electricity Market Act 2010*. Liberal coalition partner *Reform Party (RE)* was reluctant towards the Narva support scheme due to the assumption that it might undermine the feasibility of a future *nuclear power plant (NPP)* capacity project in Estonia; furthermore, reconstruction is not necessary in order to secure energy supply, market-based supply models are more efficient. These reconstruction plans have been highly controversial and the *European Commission (EC)* initiated an in-depth investigation for the project under EU state aid rules provisions. The Ministry of Economic Affairs claimed financial support to be necessary in order to increase security of energy supply. Finally, EC rejected the government's application but allowed for the government to subsidize the reconstruction of the Narva plants via allocating free CO2 emission quotas to *Eesti Energia*.

Due to the controversial nature of the project, oppositional *Social Democratic Party (SDE)* launched a non-confidence vote against Minister of Economic Affairs Juhan Parts (IRL); in fact, SDE did not disagree with the reconstruction project in general but rather criticised the untransparent nature of the process regarding finance and decision-making. Indeed, Minister Parts almost exclusively finalized investment decisions and did not fully consider EE management and supervisory board concerns. The non-confidence vote against Parts failed; however, the media stays seized of the matter: French Alstom, which won the tender for

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Narva plant reconstruction, was recently engaged in a large-scale corruption scandal regarding Latvian national energy company Latvenergo. Oppositional *Centre Party (KE)* joined the non-confidence vote against Parts, but criticised the project less forceful than SDE.

Renewable Energy

Renewable energy subsidies have been a tense issue on the energy agenda of the government coalition in the past few years. Minister Juhan Parts promised to reduce subsidies in this area significantly, whereas coalition partner RE opposed these plans. In 2012, the government eventually decided to reduce subsidies and entered into negotiations regarding time frame and scope of those reductions with renewable energy investors and producers. Despite many interest groups such as windmill companies, the Estonian Bank Union, European Bank for Reconstruction and Development (EBRD) as well as the European Commissioner for Energy opposed those reduction plans, parliament adopted legislation reducing renewable energy subsidies by 20 percentages in late 2012.

In fact, Estonian renewable energy policy and investment figures have been quite sufficient in recent years: In 2012, a record number of new wind generators were put up with 86 megawatts of new capacity. The nation's total wind generating capacity of 269 megawatts produced 448 gigawatt hours of electric energy during the year. This 22.7 percentages increase mainly is due to EE completing new wind farms near Narva and Paldiski. In fact, €14.1 million of subsidies were spent, totalling investments to €122 million just in wind energy. Despite these impressive output and investment figures, the reduction of subsidies to €93 per gigawatt hour as well as the implemented 600 gigawatt hour support ceiling for renewable energy threatens to compromise necessary power supply infrastructure and future capacity investments.

IRL has been the main driver of reducing renewable energy subsidies by abolishing renewable energy subsidies legislation from 2006. The underlying idea is to reduce energy prices for home-owners. IRL described aforementioned legislation as driven by corruption and a punishment for home-owners. Furthermore, the party doubts on EU's carbon dioxide emission reduction based energy policy. RE and SDE oppose the IRL approach for rather practical reasons, for both parties seek to attract renewable energy companies as well as private investors as potential financial supporters as well as political allies. KE stayed out of the debate and noted that while subsidies are too generous, the recent increase in energy prices for private consumers is caused by other, more severe policy failures than those subsidies.

Energy Security

The concept of energy security is an important objective to Estonia - as to any other modern national economy, for that matter - and means that it seeks to meet its overall energy demand by balancing energy import and regional as well as domestic energy production. The political significance of energy security for Estonia mainly derives from its energy dependence on Russia which is undesirable due to the common history.

In the early 2000, there were substantial approaches towards the construction of NPP capacity in Estonia by 2023. But the debate has been of rather hypothetical nature. Currently, there are no significant initiatives towards NPP capacity in Estonia and the coalition agreement between RE and IRL remains vague on the issue. Frontrunners in the nuclear debate are within the RE; consequently, the party proxy NGO *Estonian Nuclear Association* has been established to organize public panels and campaigns promoting the establishment of NPP capacity in Estonia. In fact, public support for nuclear energy is

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relatively high. In April 2011, KPMG conducted a survey among entrepreneurs and nuclear power gained as much as 48 percentages support for being the most promising Estonian future energy source. Currently, Estonia is a shareholder in the Lithuanian Visaginas plant and despite political commitment it is rather questionable, if the project will ever be complete. IRL remains rather quiet on the issue and Minister Juhan Parts believes Estonian NPP capacity is rather unrealistic.

Furthermore, in the context of implementing an Estonian energy security strategy there are the issues of electricity and gas interconnections with a common European energy system. The Estonian government pushes for regional integrated markets as well as the further development of a trans-European energy system: In 2006, power cable *Estlink* between Estonia and Finland was completed; *Estlink 2* is currently under construction and supposed to be operational in 2013. In the gas sector, European interconnections and supplier diversification are crucial elements of Estonian energy policy; in fact, Estonia plans to build several natural liquefied gas (LNG) terminals in order to decrease dependency on Russian gas imports. Currently, *Gazprom* is Estonia's single gas supplier and Riigikogu has adopted necessary legislation on gas market liberalization in order to break *Gazprom* ultimate market power. Aforementioned legislation forces gas company *AS Eesti Gaas* to sell its pipeline units by 2015 or risk a fine and nationalization of business.

Russian gas monopolist *Gazprom* accounts for 37 percentages of *AS Eesti Gaas*, German *E.ON AG (EOAN)* for 33.7 percentages, Finnish *Fortum Oyj (FUM1V)* for 17.7 percentages and Latvian *Itera Latvija* owns 10 percentages. Liberalization and unbundling of the domestic gas market was driven by RE and supported by IRL. The plans for Estonian LNG terminals are to accomplish aforementioned objectives; however, higher gas prices might be the price for more energy independence vis-à-vis Russia and its gas monopoly. Oppositional SDE generally supports the government's liberalization and unbundling policy, whereas KE criticises the plans as economically unreasonable and politically motivated.

Liberalization of the Electricity Market

In 2007, the liberalization of the EU electricity market was complete; thus, Great Britain, Sweden, and Finland were among the first member states to transition their domestic markets towards a common European electricity market. The liberalization applied to large-scale consumers first and subsequently to all market participants. In 2003, Estonia signed its treaty of accession to the EU and agreed upon partially liberalizing its electricity market in 2009; full implementation of the EU liberalization provisions is to be achieved in 2013. In 2010, the electricity market was partly liberalized and opened for large-scale consumers - defined as consuming above 2 gigawatt hours of electricity a year - that account for approximately 35 percentages of the entire domestic electricity consumption. In 2013, the Estonian electricity market opened for small and household consumers.

The market liberalization for large-scale consumers went rather undisputed and smooth; yet, the market liberalization for small and household consumers remains a controversial issue. Oppositional KE made this their main political issue in 2012 and 2013; they literally blocked parliament by organizing night sessions for three consecutive weeks: In essence, KE demanded lowering electricity excises in order to mitigate price peaks for private consumers. Minister Juhan Parts (IRL) has a tough time with the prospective final liberalization in 2013, for the IRL election campaign was mainly about decreasing utility costs for private households. RE and oppositional SDE manage mostly avoid the on-going dispute. Yet, the political outcome of the Estonian electricity market liberalization remains to be seen.

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The current and future Estonian energy policy will have to live up to the triad of low energy prices, the interrelations of energy security and dependency as well as compliance with international climate regime regulations and the implementation of renewable energy: First of all, the government energy policy aims at low energy prices for both private and business consumers by utilizing new technologies, smart use of energy as well as fostering the saving of energy. It appears that economic growth, development and contestability are priorities of current energy policy due to their overall significance rather than low energy prices for private consumers.

Taking into account its specific geographic location, lack of domestic energy resources and its dependence on Russian oil and gas imports, Estonia seeks to establish future energy security while decreasing its energy dependence. The national electricity and gas markets have been liberalized, but Estonia's market is small. To this end, it plans a regional integrated gas market with the Baltic States and Finland in order to reach a critical market volume of 10 billion m³ and further develop their LNG plans. Moreover, the reconstruction of Narva oil shale plants might be vital for future energy production; oil shale examples from Canada and the United States indicate large-scale feasibility and huge potential in energy production. Besides the possible future potential of oil shale and LNG, Estonia promotes and subsidises the development and construction of renewable energy capacity, especially wind energy. In 2012, Estonia almost accomplished European as well as national objectives regarding reduction of carbon dioxide for 2020; therefore, subsidies for renewable energy have been reduced in order to keep prices at low levels and further foster the contestability of Estonian businesses.

In the last parliamentary election campaign in 2011, IRL declared low private consumer prices for electric energy and heating their priority in energy policy. In fact, many party members and especially Minister of Economic Affairs Juhan Parts have pushed for respective legislation in the current term. Regarding energy policy in general and low energy prices in particular, its liberal coalition partner RE did not push for major innovation and legislation in the energy sector, although they are chairing the Economic Affairs Committee. Both oppositional parties have criticised government energy policy. SDE was active and quite constructive at the same time, whereas KE has been less active but rather populist at times.

In conclusion, modernization, liberalization, regional integration as well as the promotion of renewable energy seems to prepare Estonia's energy system for current and future energy challenges. In fact, the new *Global Energy Architecture Performance Index Report 2013* by the *World Economic Forum* evaluates energy systems of 105 countries and ranks Estonia in place 30. This is remarkable and underlines the long-term focus of Estonian energy policy on economic growth, energy security and environmental sustainability.