

HUNGARY



# A Hungarian power play

Inside Budapest's 10 billion euro nuclear deal with Moscow, and why some see it as the Kremlin trying to buy influence in Europe

BY KRISZTINA THAN

## HUNGARY A NUCLEAR DEAL WITH RUSSIA

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Its currency is wounded and its economy besieged by sanctions, yet Russia still has money to spare for potential allies overseas. Even as it scrabbles for foreign funds, Moscow is poised to make a 10 billion euro loan to Hungary, one of the European Union members most sympathetic to it.

Budapest plans to draw on the first tranche of the loan this year, a Hungarian government commissioner told Reuters.

Officially the loan is to finance the expansion of the Paks nuclear power plant, Hungary's only atomic power station, which supplies about 40 percent of the country's electricity. But critics say there is another motive as well: Russia buying favour with a European Union (EU) government.

"This Paks deal is camouflage," said Zoltan Illes, a former lawmaker in the ruling Fidesz party who was a state secretary for the environment until 2014. "This is a financial transaction, and for the Russians this is buying influence."

Illes, who opposes the use of nuclear energy, believes the deal is more about pumping money into the economy of Hungary, where Prime Minister Viktor Orban faces re-election in 2018, than providing electricity.

For years, Moscow has used commercial relationships – in particular gas sales – to exert influence across Europe. Now those methods are coming under closer scrutiny after the United States and EU imposed tough economic sanctions on Russia for annexing Crimea and supporting separatist fighters in the east of Ukraine.

In return, Russia is striving to retain ties, commercially and diplomatically, from the Baltic states to Europe's southern rim. The loan to Hungary, agreed last year, is seen by some as part of that undeclared struggle for influence.

Government spokesman Zoltan Kovacs rejected such claims. "The rationale of the Paks investment is not about election campaigns and chances. It serves the country's



NUCLEAR MISSION: Inside the turbine hall and, below, operations centre of reactor four at the Paks atomic power station in Hungary. Russia is to help expand the plant. Cover: Prime Minister Viktor Orban of Hungary, right, with Russian President Vladimir Putin at a news conference in Budapest in February. **REUTERS/LASZLO BALOGH (3)**



long term energy security," he said. He added that Russia was helping to build reactors in other countries and that Russia had less economic influence in Hungary than in other Western European states.

Officials in Moscow and Budapest say the nuclear deal was concluded purely on commercial and energy grounds and was good for both countries.

Hungarian Foreign Minister Peter Szijjarto told Reuters the deal was "the business (transaction) of the century." Rosatom, the Russian state nuclear firm,

and the Russian finance ministry responsible for the loan to Hungary did not respond to requests for comment.

Hungary had initially planned to put the contract to expand Paks out to tender, and some Western firms showed interest, along with Rosatom. But Reuters found that Hungary abruptly dropped the idea of a tender. Specialists in the Development Ministry who had worked on plans to expand the Paks plant were sidelined, said two people familiar with Hungary's energy sector. Instead, a small group close to Prime



TURNING POINT: In November 2013, protesters gathered in Kiev after Ukraine signed an aid deal with Russia. A month later Hungary was in advanced talks with Russia over expanding the Paks power station. **REUTERS/GLEB GARANICH**

Minister Orban chose to award the contract to Rosatom. Russia offered a loan as part of the deal.

Kovacs, the government spokesman, said: "The whole project is being carried out with very serious professional preparations. Decisions of a political nature are naturally made by politicians."

Since the agreement was struck, Orban has appeared much more friendly towards the Kremlin than his EU peers have done. He has said Europe was shooting itself in the foot by imposing sanctions on Russia, though he did not go so far as blocking sanctions. Orban is also leading a push for a new pipeline to take Russian gas to south-east Europe, bypassing Ukraine.

Last month, Orban hosted Putin in Budapest. He is the only EU leader to invite the Russian president on an official bilateral visit since Malaysian airliner MH17 was shot down over Ukraine in July 2014. Western officials say the plane was most likely brought down by a Russian missile; Russia denies any responsibility.

Standing alongside Putin in the

Hungarian parliament, Orban adopted a conciliatory approach to Moscow. He said EU governments were "chasing ghosts" if they believed they could get by without co-operating with Russia.

Asked whether Hungary was being more friendly towards Russia because of the Paks loan, Kovacs said: "Russia is important from an energy aspect, what's more it is a strategic partner ... But this is not a question of 'friendship.'"

**PRAGMATIC PARTNER**

Orban regularly flouts EU rules with policies that critics label populist. Since he was elected with a two-thirds parliamentary majority in 2010, Orban has imposed windfall taxes on banks, telecoms companies and retail firms to keep the budget deficit in check. He's clashed with Brussels over curbs on the media. And he has consolidated his power with measures that critics say weakened democratic checks and balances - an allegation the government denies.

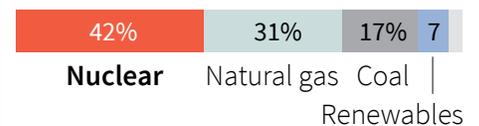
At the same time, he is not a natural Kremlin ally. As a young student in 1989,

**Hungary's reliance on Russia**



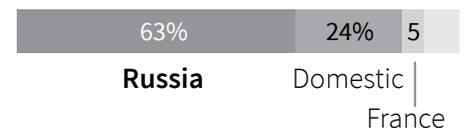
**Electricity generation**

The Paks nuclear plant, built with the help of the former Soviet Union, is the country's single biggest source of electricity.



**Gas supplies**

63 percent of the natural gas used in Hungary comes from Russia, mostly imported via Ukraine.



Sources: IEA; OECD

he burst onto the political scene with an impassioned speech demanding the withdrawal of Soviet forces from Hungary. He and Putin appear to have little personal affinity; at their Feb. 17 meeting in Budapest, their body language was stiff.

However, people who know Orban say he is a pragmatist. "I think power is incredibly important to him per se," said John Alderdice, who was a leading member along with Orban of an organisation called Liberal International, a global network promoting liberalism. "The issue (for him) is: 'How can I get into power, and hold onto power.'"

In November 2010, soon after he was elected, Orban met Putin in Moscow for talks on economic issues, including further cooperation at the Paks plant. The plant is a huge concrete structure built in the 1970s by Soviet technicians on a floodplain next to the Danube River. Orban was looking to spur growth in Hungary's economy, and Russia could help him achieve that.

The two men talked for hours, including over lunch, said a source familiar with the discussions. But no decision was taken on the Paks project.

Instead, a team of energy specialists at the Development Ministry in Budapest prepared for an open tender for a contract to expand the plant, according to a former energy official. In addition to Rosatom, French company Areva expressed interest in bidding, as did U.S. firm Westinghouse, according to three people with knowledge of the preparations.

In early 2013, the plans for a tender were still on track, according to comments by the chief executive of MVM, a Hungarian state-owned energy group, published in the journal of the Paks power station. Bidders were told then that a tender would go ahead, according to a diplomatic source in Hungary.

### SUDDEN CHANGE

Late that year the international context changed. In November 2013, then Ukrainian



INFLUENTIAL: Janos Lazar, chief of staff to the Hungarian prime minister, pictured here in 2013. Lazar addressed a parliamentary committee summoned at short notice to discuss the Russian nuclear deal. **REUTERS/LASZLO BALOGH**

President Viktor Yanukovich rejected an association agreement with the EU and instead signed an aid deal with Moscow. Thousands of pro-Western protesters camped out in Kiev's central square, determined to make Yanukovich stick with the EU agreement or give up power. The stage was set for the biggest standoff between Russia and the West since the Cold War.

In Budapest, too, there was a change of tack. On Dec. 17, the parliament's economy committee was convened at one day's notice. Antal Rogan, a lawmaker with the ruling Fidesz party and head of the committee, called the meeting.

Orban's chief of staff, Janos Lazar, told the committee that the government was in advanced talks with Russia on extending the life of the Paks plant. "It was sudden," said Bernadett Szel, an opposition lawmaker.

Pal Kovacs, who at the time was state secretary for energy and had a leading role in preparations for the Paks tender, had not been told the tender was being scrapped, according to a person with links to Hungary's state energy sector. The source

## Under EU scrutiny

European officials are examining whether the Paks project meets EU rules on state aid and the supply of nuclear material from Russia. The EU sets limits on state subsidies, and has rules designed to prevent EU countries becoming over-dependent on Russia for nuclear fuel.

The Euratom Supply Agency (ESA) has sought changes to the Paks supply deal asking that non-Russian organisations be allowed to ship fuel to the plant, the Hungarian government said earlier this month. The government said talks with the EU about fuel supply were not blocking the project.

A Commission spokeswoman has also confirmed that the EU was looking into the fuel supply deal, but was not blocking the Paks construction. The EU has not yet commented on the state aid aspects of the project. On March 24, Janos Lazar, chief of staff to the Hungarian prime minister, said all hurdles to a fuel supply deal had been removed.

### Talks with the EU about fuel supply are not blocking the project.

#### Hungarian government

"There are very strict rules governing state aid and the single market, and I think this project as we know it now goes against them," said Andras Perger, an energy analyst at independent think tank Energia Klub in Budapest.

Attila Aszodi, the Hungarian commissioner in charge of the Paks project, said the project did not contravene state aid rules because the rate of return is high enough that, theoretically, private investors would get involved if they had the chance.

Since Hungary and Russia agreed the original deal to develop the Paks plant, the two countries have signed three further agreements setting out details of the project. Despite the EU Commission's concerns and Moscow's financial difficulties, Hungarian officials say the deals are not in jeopardy.

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said the deal with Russia was concluded by members of the prime minister's inner circle.

Government spokesman Zoltan Kovacs said parliament's approval of the deal showed it had broad political support.

Asked about the decision to scrap the tender and award the contract to Rosatom, Westinghouse said the decision was "abrupt." Areva declined to comment. Government spokesman Kovacs said: "Of course, the agreement on concrete conditions was made at a given point of time, but it would be a mistake to say it was 'abrupt.'"

Attila Aszodi, the state commissioner in charge of the Paks expansion, said the Rosatom deal stood out because the Russians had offered long-term financing for the entire construction project, something he said the other prospective bidders would not provide. He told Reuters in a December interview that a tender is "a good tool; however, it is not the silver bullet."

The Hungarian government has also pointed out that the existing reactors at Paks were built with Soviet nuclear expertise.

Critics say the deal's terms are generous. Hungary will begin repayments on the loan only once the new reactors are up and running in 2026 and will repay the loan over 21 years. Until 2026 the interest rate will be just under 4 percent, rising to 4.5 percent afterwards and 4.8 to 4.95 percent in the final 14 years.

The terms compare well to market rates for financing, although conditions in every debt deal are different. The Russian loan finally agreed will cover 80 percent of the construction costs, and Hungary will put up the rest. Hungary plans to start drawing on the loan this year to finance planning work for the new reactors, Aszodi told Reuters.

### HUNGARIAN RHAPSODY

Moscow has voiced its happiness with Hungary's recent support for Russia. In November last year, Russian Foreign



DEPENDENT ON MOSCOW: Most of Hungary's gas comes from Russia. Hungary's pipeline system, including the Kiskundorozsma distribution centre above, also transmits gas to Serbia and other countries. **REUTERS/LASZLO BALOGH**

Minister Sergei Lavrov said that Hungary - unlike other ex-Communist states in the EU - conducts itself "responsibly" and does not succumb to "Russophobic approaches." At a Kremlin ceremony, Putin called Hungary one of Russia's most important partners.

Orban's invitation last month added to the mutual appreciation. During the visit, Putin and Orban agreed that Russia would give Hungary several years' grace to pay for gas that Budapest had committed to buy but never used.

For Orban, though, the cost of staying close to Russia has gone up as the Ukraine crisis has deepened. Some EU governments are uncomfortable with what they see as a drift by Hungary into the Kremlin's orbit. The United States has also criticised some of Orban's policies towards Russia, and one U.S. diplomat said there had been a lack of transparency in granting the Paks contract.

Illes, the former environment secretary, said the Paks deal was typical of Orban's

pragmatic style of governing. In the short term he reaped domestic political benefits against opponents, and in the medium term the project will generate jobs.

But for Orban, he said, "long-term considerations, they don't exist."

*Additional reporting by Christian Lowe in Warsaw, Karolin Schaps and Nina Chestney in London, Barbara Lewis in Brussels, Geert de Clercq in Paris, and Vladimir Soldatkin and Maria Tsvetkova in Moscow. Editing By Richard Woods, Philippa Fletcher and Simon Robinson*

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