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NEWSLETTER

German Economic Team

MOLDOVA

Gas crisis in Moldova: the times of cheap gas are over

The gas contract between Gazprom and Moldovagaz came to an end in Sep-21. Negotiations on a new contract were tough, also due to very high international gas prices, but finally an agreement was struck. The new price, which is linked to international oil and gas prices, is likely to be much higher than in the past: while Moldova paid 149 USD/tcm on average in 2020, the import price will amount to around 565 USD/tcm in the period until Sep-22.

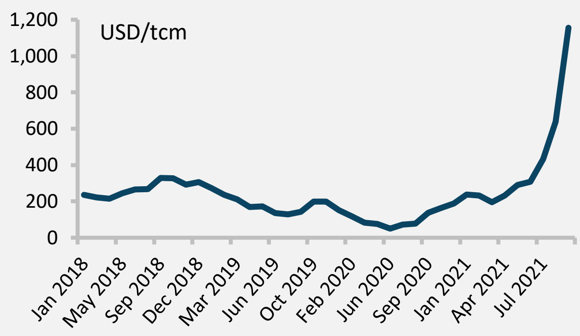
Thus, the country faces a severe gas price shock, which calls for government action. In our view, government should focus on households, not on business: energy intensity of industry is rather limited, given the lack of heavy industry. Furthermore, government should focus on vulnerable households. For this heating season, government was not able to introduce a targeted system of subsidies. However, work to establish a targeted system for the next heating period should start immediately.

Beyond the issue of subsides, the gas price shock calls for deep structural reforms in the energy sector. Moldova needs to diversify the supply of gas and electricity, introduce measures to increase energy efficiency, and attract investment into renewable energies. The times of cheap gas are over, and the country needs to adapt to the new reality.

Gas crisis in Moldova

The recent gas crisis has placed Moldova at the centre of international attention, while also putting the new government to a serious test. The gas contract between Gazprom and Moldovagaz, which had ensured relatively low and stable import prices for Moldova, expired at the end of September 2021; a temporary extension was agreed on for October. Negotiations for a new contract took place against the background of very high international gas prices.

Dutch TTF Natural Gas price



Source: Yahoo Finance

Unlike neighbouring Ukraine, Moldova has neither natural gas resources of its own nor any gas storage facilities, making the country fully dependent on imports. After several rounds of difficult negotiations, a new five-year-deal starting from November was finally agreed on. Under the new contract, the price for gas imports will be linked to international oil and gas spot rates. Thus, the future price of gas imports will depend on market developments. Considering current projections of future market prices, Moldova will likely be paying an import price around 565 USD/tcm for the period until September 2022, which is nearly four times higher than the 149 USD/tcm average of 2020.

This will have a significant effect on the country, as gas is a key energy resource for Moldova. Electricity production is almost exclusively based on gas. In addition, gas is the most important energy source for district heating. Households, the largest consumer group of natural gas in Moldova, also use gas for decentralized heating and cooking.

Impact of a gas price shock on businesses

While gas is also used by industry, it is to a much smaller extent. If we exclude electricity generation, metallurgy, and cement plants in the Transnistrian region, energy-intensive production in Moldova is limited. As such, industry only accounts for 14% of the final gas consumption of right-bank Moldova.

According to our analysis, higher gas prices would overall lead to rather manageable cost increases for most businesses. In a worst-case scenario (import at Oct-21 spot price of 1100 USD/tcm), costs for the non-metallic minerals and metallurgy industries – the most energy-intensive sectors in Moldova – would increase by ca. 13%. Moreover, these industries do not play a significant role in the economy, as they only account for 1.5% of GDP. For the food and drink industry, which is much larger (5.1% of GDP), costs would increase by only 3% in the worst-case scenario.

Since international competitors face similar increases in energy prices and domestic companies can pass most of the additional cost on to consumers, we do not see an immediate need for the government to act and mitigate the impact of the higher gas price on businesses.

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Compensation schemes for households

Households, on the other hand, will be hit much harder by the gas price shock. To protect the population, several compensation schemes for households can be considered. When deciding on a compensation scheme, it is important to take several factors into account: the extent to which the subsidy targets the most vulnerable groups, the scheme's effectiveness in incentivizing prudent resource use, and its fiscal cost.

The easiest option in terms of implementation is a direct subsidisation, which would allow to keep the tariffs for gas and heat unchanged for households (i.e. compensations of the gas/direct heating suppliers or the importer). While easy to implement, such a scheme would have considerable downsides. A constant tariff would not give households any incentive to use resources more efficiently. In addition, all households would receive the same subsidy regardless of vulnerability. Such a scheme would also entail the largest fiscal burden.

Based on direct subsidisation, block tariffs address some of the previously mentioned weaknesses. Here, subsidies are directly linked to consumption: higher tariff subsidisation for consumption below a certain threshold and accordingly lower for consumption above the threshold. As the Moldovan government was able to draw on previous own experience in implementing block tariffs, it is understandable that this option was chosen as the immediate policy response. First, tariffs were increased from 4.64 to 11.1 MDL/m^3 (including VAT). At the same time, households will receive a substantial subsidy for the first 50m^3 of gas consumed per month, a smaller subsidy for consumption between 50m^3 and 150 m^3 and pay the full tariff for consumption above 150 m^3.

While the subsidy system adopted by the Moldovan government is clearly superior to untargeted subsidies, certain risks remain: there still is no strong link between subsidy and vulnerability, no full incentives for consumers to efficiently use resources, and arbitrage opportunities/room for manipulation for gas suppliers.

Outlook

It is highly unlikely that Moldova will return to low gas prices comparable to those before the crisis anytime soon. We thus recommend to start taking steps towards an improved subsidies scheme for the heating season 2022/23. If properly implemented, a targeted housing and utility subsidy system would ensure a clear link between vulnerability and subsidy, while also incentivising efficient use of energy at significantly lower fiscal costs. In this regard, parallel investment in energy efficiency is necessary: residential buildings in Moldova on average consume almost twice as much energy as those in the EU. Furthermore, fuel switching is key to increase flexibility and reduce dependency on imports. Efforts should be made to reduce the role of gas in favour of renewable energy sources. Lastly, the high dependency on one gas supplier should be reduced. To achieve this, Moldova should invest in transport and storage infrastructure to diversify its options for importing large quantities of gas.

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