



2017

ENERGY SECTOR IN
BALKAN COUNTRIES
AND
REGIONAL COOPERATION

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1. Executive summary

Regional cooperation in the energy sector is politically, and to a lesser extent, financially incentivized through numerous initiatives backed by the European Union or its member states (Energy Community Treaty, CESEC¹, Berlin Process). It is also important that initiatives from other players also aim at regional cooperation, but are not necessarily in line with the EU priorities. Gas connectivity projects are supported and promoted by various actors primarily Russia, while Chinese investments in regional infrastructure are coming in the framework of the “one belt one road” initiative. In addition, EU led initiatives do not seem to be fully harmonized. The initiatives, taken together, promote state investment and commercial actors may be completely crowded out with possible detrimental effects on the outcome in terms of quantity, quality, effectiveness and efficiency of future investments. In Serbia for example, in the month of November 2017, a construction of the new 350 MW lignite fired power plant commenced. The financing has been secured through the loan of a more than \$ 600 million from the Chinese export support state owned bank to the Republic of Serbia. The loan has been on-landed to the state owned utility. In the same month in the same country, KfW signed an agreement to lend 80 million Euros and grant 1 million Euros for a 66 MW wind project with the same state utility. Private developers have to compete with such subsidies to state utilities which is extremely difficult.

Investments are required to drive energy transition if the region is to improve its competitiveness, and if the reduction of the damage to the environment both local (air and water pollution) and global (contribution to the climate change) is to be achieved. The goals of the EU 2030 climate and energy framework will be mandatory for the entire region either through the membership of the EU or through the accession process and participation in EU backed initiatives.

Affordability of energy is one of the most sensitive questions that needs to be addressed in the process of energy transition. Mere transposition of directives from the EU and replication of the protection schemes developed there, will not serve this purpose. The region is home to an extremely large number of energy poor (and others) who rely on domestic biomass for the provision of energy services. This specificity is rarely taken into account when developing national and regional policies. Regional cooperation on this topic is non-existent. If energy poverty is not addressed, consumers, tax payers and industry will not be able to bear the investment costs needed for the energy transition. If transition is further delayed, the region is exposed to severe risk of additional economic deprivation and will lag further behind the more developed parts of the EU. Such developments may pose a threat to the stability and even peace in the region. If the EU decides, for example, to enforce the implementation of the obligations regarding the reduction of the emissions of Sulphur oxides, nitrogen oxides and dust from combustion plants, almost all lignite plants in the region may be closed by 2023. Such a situation could give rise to social unrest.

Lignite based domestic energy supply cannot survive unchanged if the region seeks to reduce poverty and increase its competitiveness. The EU 2030 climate and energy framework with its goals, will be too narrow for the region if energy supply remains unchanged. Regional cooperation enabling better interconnectivity, single legal, regulatory and investment framework is essential.

Security of energy supply, in particular natural gas supply, and different possible transit routes, spur vivid discussions and may cause tensions. It seems that regional mechanisms for the settlement of disputes are emerging with CESEC having important role in the process. However, the risk of conflict or individual action remains high as numerous stakeholders with possibly diverging interests are involved. Also for this reason, it is important to understand that natural gas is currently not vital for energy supply in the region. Such understanding may provide for the creation of a framework which enables longer term planning around cooperation that should bring sustainable and secure natural gas supply.

Improved quality of governance is required if better quality regional cooperation is sought. National ownership of regional processes (going well beyond government ownership) is mandatory and the role of civil society in these processes should not be overlooked.

1 Central and South-Eastern European Gas Connectivity.

	Albania	Bosnia and Herzegovina	Croatia	Greece	Kosovo	Macedonia	Montenegro	Serbia
Property rights	111	130	102	98	N/A	N/A	93	126
Diversion of public funds	93	113	105	79	N/A	N/A	60	89
Judicial independence	123	117	114	71	N/A	N/A	85	118
Favoritism in decisions of government officials	73	113	122	93	N/A	N/A	59	104
Efficiency of government spending	38	112	114	132	N/A	N/A	39	44
Efficiency of legal framework in settling disputes	100	124	135	133	N/A	N/A	75	117
Efficiency of legal framework in challenging regs	97	130	135	114	N/A	N/A	71	119
Transparency of government policymaking	32	131	128	122	N/A	N/A	58	78

Table 1: Rank of the countries in the region (out of 137) based on the selected competitiveness indicators. Source: World Economic Forum², 2017.

² Kosovo and Macedonia were not covered by the last survey.

2. INTRODUCTION

2.1. METHODOLOGY:

Our literature review focuses on the situation in the energy sector, with a geographic focus in Albania, Bosnia and Herzegovina, Croatia, Greece, Kosovo, Macedonia, Montenegro, Serbia. Croatia and Greece are members of the EU while Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro and Serbia are parties to the Energy Community Treaty. The energy sector in these countries has been viewed based on the prospects for the achievement of the goals of the EU agenda for 2030 and the role of regional cooperation in this respect.

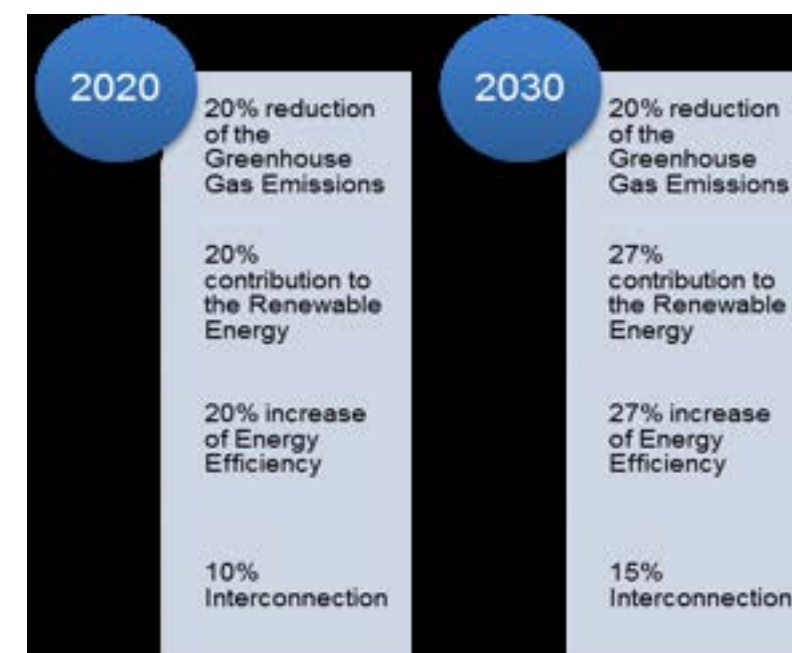


Figure 1: 2030 EU framework for climate and energy in figures. Source: <http://bit.ly/2iq9zuS>

2.2. EU MEMBERSHIP AND THE ACCESSION PROCESS

Croatia and Greece are members of the European Union. They are, as opposed to other parties in the region, in a position to influence the development of the EU energy policy.

Albania, Macedonia, Montenegro and Serbia are candidate countries. The last two have started negotiations with the EU. Montenegro has opened Chapter 15- energy, for negotiations.

Kosovo and Bosnia and Herzegovina are considered as potential candidates.³

Members of the EU are obliged to cooperate in different aspects related to their energy policies while through the accession process countries that wish to accede are also obliged to harmonize their legislation to that of the EU. In the particular case of energy, it is the membership of the Energy Community Treaty that sets the pace of the legislation harmonization and the creation of the single market in energy. Moreover, it is possible that countries use the negotiation process to slow down the harmonization process initiated in the Energy Community framework.

2.3. ENERGY COMMUNITY TREATY

The Energy Community is an international organization which brings together the European Union and its neighbors to create an integrated pan-European energy market. The organization was founded by the Treaty establishing the Energy Community signed in October 2005 in Athens, Greece, in force since July 2006. The key objective of the Energy Community is to extend the EU internal energy market rules and principles to countries in South East Europe, the Black Sea region, and beyond, on the basis of a legally binding framework.⁴ As of July 2017, the Energy Community has ten members: the European Union and nine Contracting Parties - Albania, Bosnia and Herzegovina, Georgia, Kosovo, Macedonia, Moldova, Montenegro, Serbia and Ukraine. Armenia, Norway and Turkey participate

³ https://ec.europa.eu/neighbourhood-enlargement/countries/check-current-status_en

⁴ <https://www.energy-community.org/aboutus/howweare.html>

as Observers.

The mission of the Energy Community Treaty is to:

- Establish a stable regulatory and market framework capable of attracting investment in power generation and networks;
- Create an integrated energy market allowing for cross-border energy trade and integration with the EU market;
- Enhance the security of supply to ensure stable and continuous energy supply that is essential for economic development and social stability;
- Improve the environmental situation in relation with energy supply in the region and foster the use of renewable energy and energy efficiency; and
- Develop competition at regional level and exploit economies of scale.

The Energy Community comprises the following areas: electricity, environment, gas, competition, renewable energy, statistics, energy efficiency, infrastructure and oil.

The Energy Community also serves as the mechanism for streamlining financing of large infrastructure projects. Priority projects of the Energy Community refers to infrastructure projects that comply with the general and specific criteria, as defined in the adapted Regulation 347/2013 on guidelines for trans-European energy infrastructure; most importantly its long term benefits outweigh its costs and has a cross-border dimension.

The Regulation, as adapted for the Energy Community, establishes rules for identifying projects of Energy Community significance, called Projects of Energy Community Interest (PECI) and Projects of Mutual Interest (PMI). These projects would benefit from:

- streamlined permitting procedures within Contracting Parties – if the Competent Authorities are put in place,
- where applicable, cross-border cost allocation.
- Currently the list of PEICs consists of six electricity interconnection projects, three gas inter-connection projects and one oil pipeline⁵.

2.4. CONNECTIVITY AGENDA AND THE WESTERN BALKANS SIX

The Prime Ministers, Foreign Ministers and Economy Ministers of Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Montenegro, Serbia, Slovenia, Austria, France, as well as representatives of the European Commission, met on 28 August 2014 in Berlin, on the initiative of German Chancellor Angela Merkel. The aim of the Summit, i.e. the highest level meeting, dedicated to the Western Balkans, was to achieve a common agreement on the strengthening of regional cooperation in the Western Balkans and establish a four-year framework (2014-2018) for resolving the remaining open issues in the region.⁶

The summit hosted by Italy in Trieste in 2017 was the fourth in the series, after Vienna in 2015 and Paris in 2016⁷.

The summit discussions have given priority to economic cooperation within the region, in particular connectivity in the energy, transport and digital sectors, including the pan-European corridors. Establishment of the Transport Community between the European Union and the Western Balkans is one of the more visible outcomes of this process.⁸

Connectivity agenda

Electricity trading across borders is a key element of EU energy policy. Three regulatory packages⁹ have opened up formerly isolated EU markets and introduced cross-border trading through liquid spot markets, with a view to removing the barriers to an internal electricity market covering the entire EU. As Contracting Parties to the Energy Community Treaty, the six Western Balkan countries ('WB6 countries')¹⁰ have followed this development. Since the WB6 region is physically closely linked with neighbouring EU Member States, it is crucial to develop an

5 <https://www.energy-community.org/regionalinitiatives/infrastructure/selection.html>

6 <http://www.mfa.gov.rs/en/foreign-policy/eu/regional-initiatives/berlin-process>

7 https://ec.europa.eu/transport/themes/international/news/2017-07-12-western-balkans-summit-2017-delivering-region_en

8 <https://ec.europa.eu/transport/sites/transport/files/2017-factsheet-communitytreaty-wb.pdf>

9 http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_5.7.2.html

10 Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, Serbia

integrated SEE trading region, including WB6 and EU countries in order to overcome the limits of the small size of isolated national markets. The WB6 countries will support integration with the neighbouring EU Member States (MSs). National market reforms will also have to be executed in EU MSs neighbouring the WB6 countries to allow for successful implementation of market coupling in the SEE Region (to be followed up by EC). In order to achieve all these goals a Roadmap for a Regional Electricity Market for the Western Balkan 6 has been developed. The following conditions that WB6 parties need to fulfil are key for the implementation of the roadmap:

1. Adhere to a power exchange
2. Develop trading/market coupling with one or more neighbors
3. Participate in MoU and SEE Coupling Initiatives and implement agreed measures
4. Ensure, and if necessary increase liquidity and monitor the progress on indicators

Sustainability charter

At the 2016 Western Balkan 6 Summit in Paris, the WB6 Contracting Parties endorsed a Sustainability Charter to support them in the transition towards low-carbon and climate-resilient energy sectors. The Sustainability Charter has three main priority areas: improving the governance for energy efficiency; implementing smart support measures that improve the sustainability of energy systems; and fostering climate action and transparency of sustainable energy markets.¹¹

The progress in achieving the goals of the sustainability charter is measured by the Secretariat of the Energy Community. In the last progress report Secretariat notes that: "progress in a number of measures has been achieved by the Western Balkan 6 countries, although higher quality of legislation and continued investment in the energy sector, in particular in renewable energy deployment, low-carbon technologies and energy efficiency, remain critically important for ensuring sustainable economic development in the region."¹²

2.5. CESEC

To accelerate the integration of central and south eastern European gas markets and to diversify gas supplies, Austria, Bulgaria, Croatia, Greece, Hungary, Italy, Romania, Slovakia and Slovenia and the EU set up a High Level Working Group in February 2015. They were joined later by Ukraine, the Republic of Moldova, Serbia, Macedonia, Albania, and Bosnia and Herzegovina.

The aim of the group was initially to coordinate efforts to facilitate cross-border and trans-European projects that diversify gas supplies to the region, as well as to implement harmonized rules.¹³ The signatory countries expressed their commitment to jointly resolve challenges related to the security of gas supply and promote source diversification by implementing coordinated measures that should enable regionally optimal results. They expressed their readiness to sustain the necessary political commitment to oversee the full and timely implementation of the CESEC Action Plan 2.0, which includes the following elements:

Selecting a limited number of key projects benefitting the CESEC region (map below);

- Identifying and addressing project-specific challenges;
- Financing aspects, including the role of the EIB and the EBRD;
- Addressing market integration challenges.

Action Plan 2.0 essentially consists of a list of specific regulatory actions that are linked primarily to fully and effectively implementing harmonized EU rules in the natural gas sector as well as the over-arching Third Energy Package provisions. Whilst the list for the EU Member States is displayed in appendix 1, there is a separate list (appendix 2) for the Contracting Parties aiming at full and effective implementation of the CESEC MoU and Energy Community gas acquis.¹⁴ At the fourth meeting of the CESEC, high level group in Bucharest in September 2017 the Memorandum of Understanding was signed complementing the Central and South-Eastern European Connectivity (CESEC) initiative with a Joint approach on electricity market, energy efficiency and renewable development.

11 <https://www.energy-community.org/regionalinitiatives/WB6.html>

12 <http://heyzine.com/files/uploaded/c73f08f4e8fa6b800d91b1c41fa80b808af2edeb.pdf>

13 <https://ec.europa.eu/inea/en/news-events/events/4th-meeting-central-and-south-eastern-european-connectivity-cesec-high-level-group>

14 <https://www.energy-community.org/regionalinitiatives/CESEC.html>

3. FACTS AND FIGURES

Albania	2.89	13.13	2190
Bosnia and Herzegovina	3.81	18.3	8032
Croatia	4.2	58.33	8397
Greece	10.86	244.31	23185
Kosovo	1.8	6.82	2516
Macedonia	2.08	10.59	2678
Montenegro	0.62	4.52	1010
Serbia	7.1	40.18	14756

Table 2: Population, GDP and the total primary energy supply of the countries in the region (IEA, 2017)
 Population (million) GDP (billion 2010 USD) TPES (thousands tonnes oil equivalent)

The region is not rich with good quality energy resources. Due to the extensive use of poor quality lignite, regions overall import dependency is below EU28 average with only Greece, Macedonia and Croatia having import dependency equal or larger than 50%.

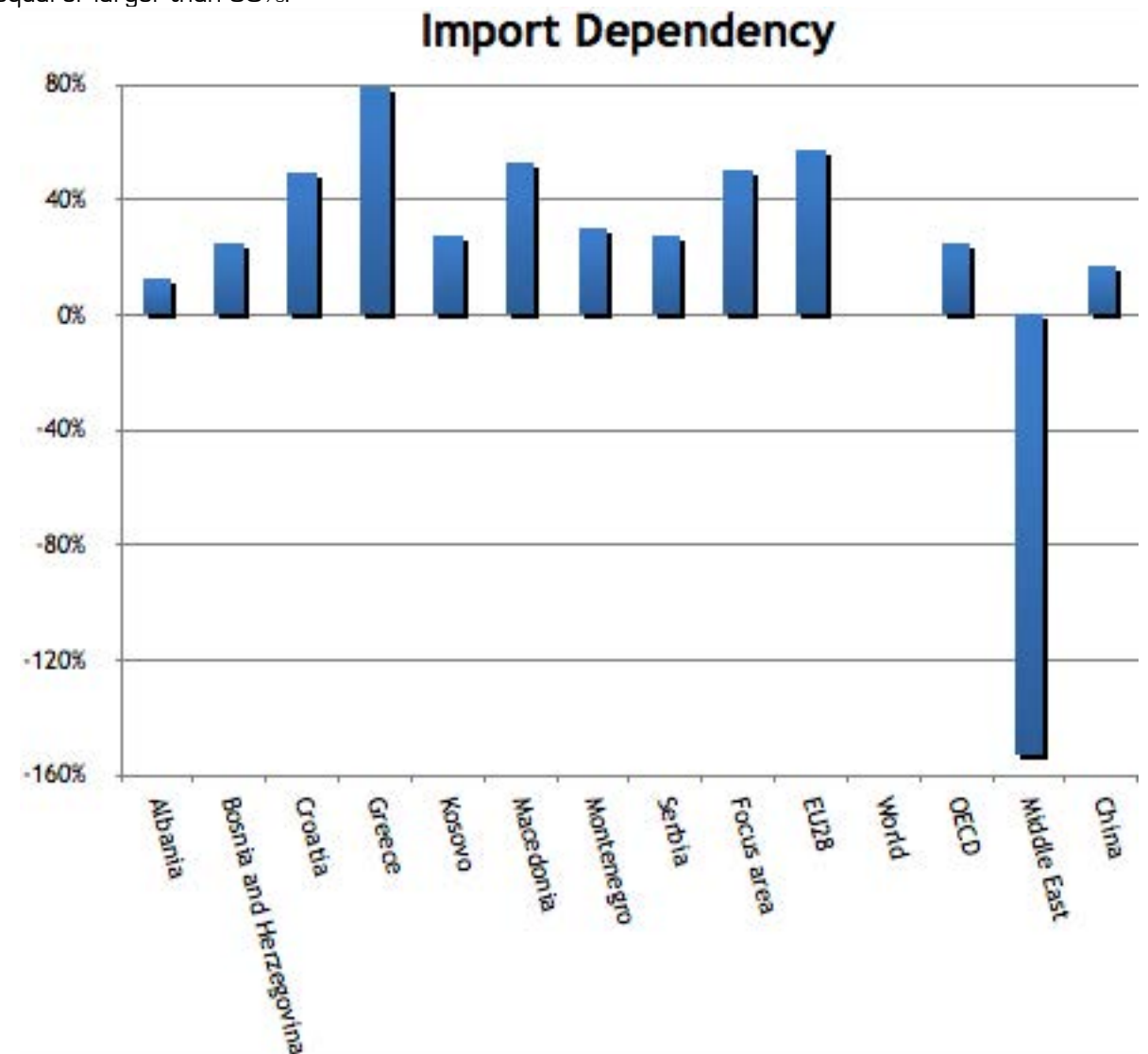


Figure 2: Energy import dependency of economies in focus areas and selected countries and regions in 2015.
 Source: IEA

Four countries in the focus area (Albania, Croatia, Greece and Montenegro) have access to the sea which enables the possibility of more favourable trade terms in all aspects, including in energy. Landlocked territories are tied to pipeline transport for the provision of good quality fossil fuels: oil and gas. These four countries are at the same time jurisdictions with the lowest carbon and energy intensities of the economy, expressed in absolute terms as ra-

ratio of total primary energy supply and total CO2 emissions, and GDP expressed in absolute terms in USD constant 2010 prices.

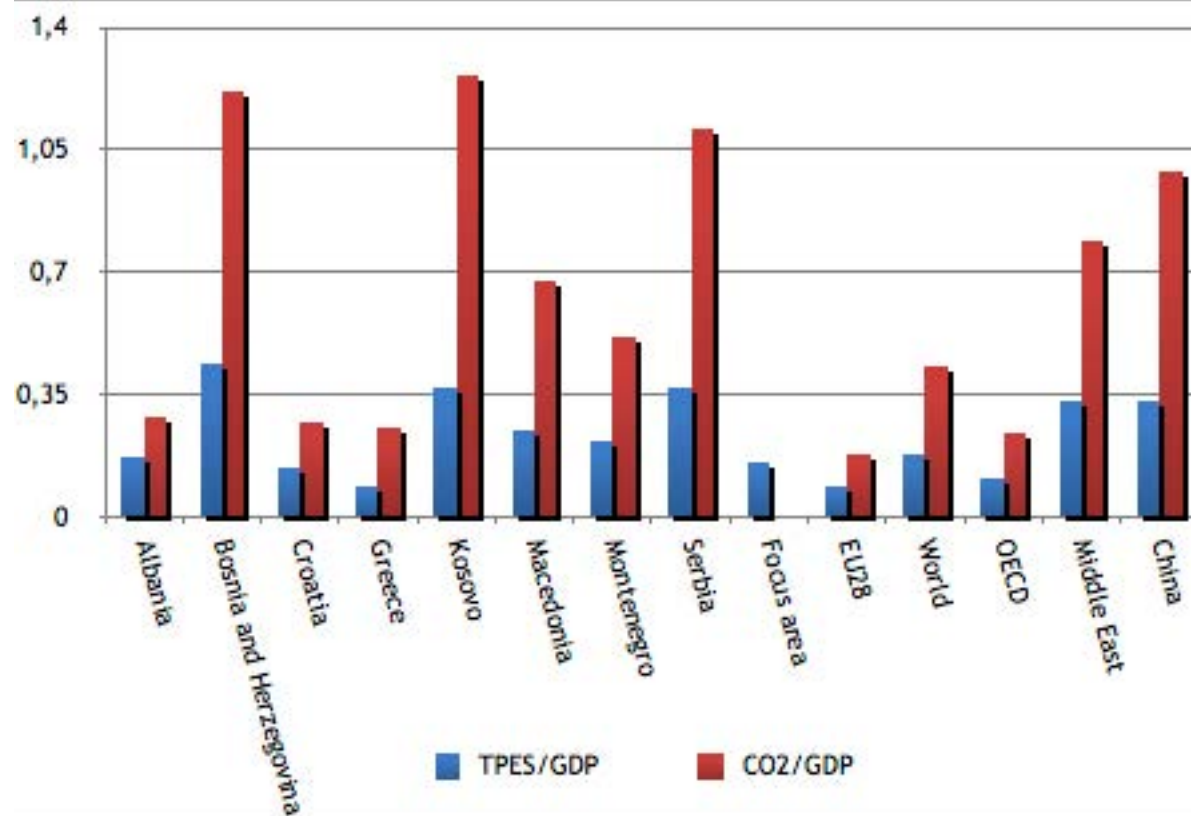


Figure 3: Carbon and energy intensity of economies in focus areas and selected countries and regions in 2015. Source: IEA

All parties in the region are obliged to reach certain targets regarding renewable energy. The current situation, indicative targets and final targets as well as comments are provided in the table below.

	Albania	Bosnia and Herzegovina	Croatia	Greece	Kosovo	Macedonia	Montenegro	Serbia
RES share last available year	36.10	N/A	29	15.4	19	19.9	31.7	21
2020 target	38	40	20	18	25	28	33	27

Table 3: RES shares and targets in the focus area as per Directive 2009/28 EC and Ministerial Council Decision 2012/04/MC-EnC Sources: EU, EnCT Secretariat

Viewing at the EU2030 framework targets and overall goals of every energy policy (security of supply, competitiveness and sustainability) and having in mind the real situation in the region we see the following challenges for the most of the region:

- Share of coal in total primary energy supply TPES
- Security of gas supply
- Energy poverty and the role of energy efficiency and renewable energy in combating energy poverty

3.1. Phasing out coal?

If the Paris goals and EU2030 goals related to GHG emissions are to be met the challenge of coal - more specifically, lignite consumption - needs to be resolved. In six counties this share is higher than the EU28 average while in

five it is higher than the world average. In three jurisdictions, coal accounts for more than 50% of all energy supplied. These three economies are at the same time more energy and more carbon intensive in absolute terms than China for example. This is probably the single most difficult challenge for the entire region when energy transition is concerned.

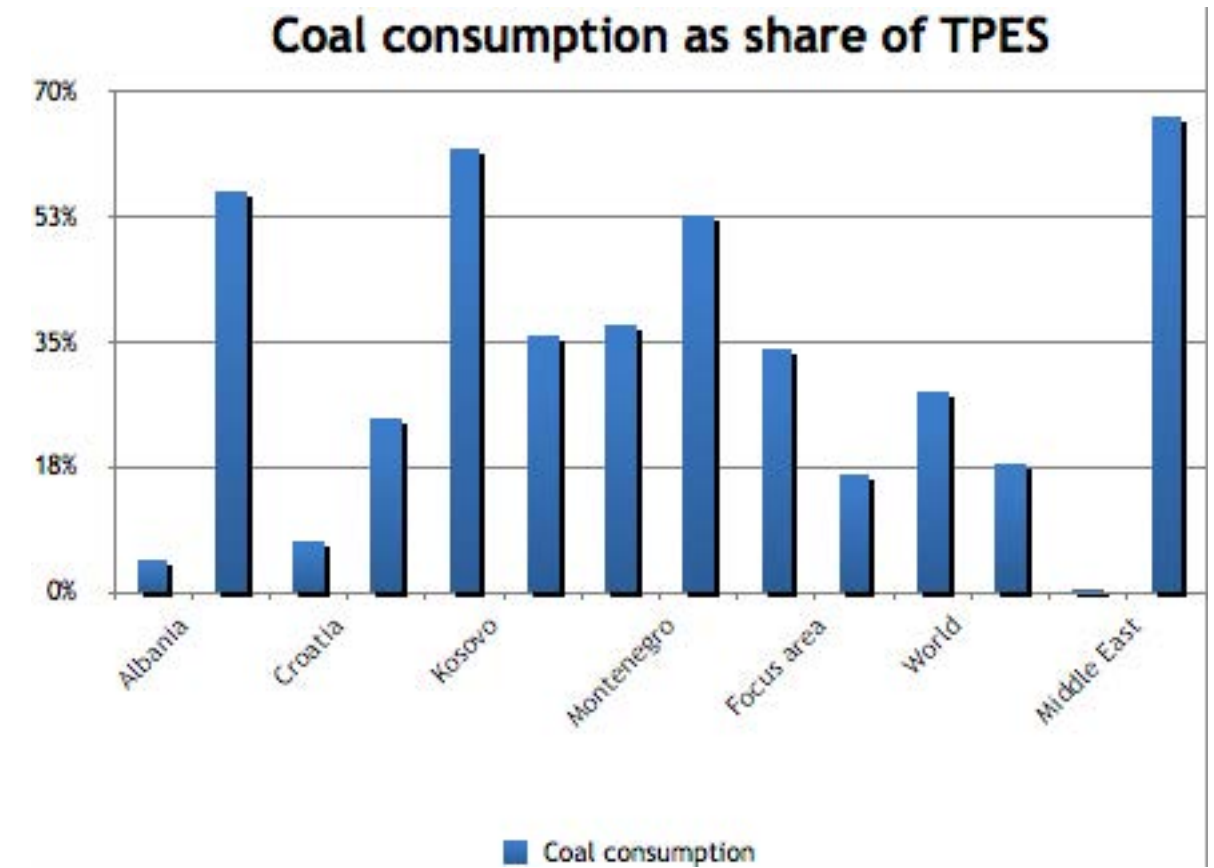


Figure 4: Share of coal in TPES in economies in focus areas and in selected countries and regions in 2015. Source: IEA own calculations

3.2. How much gas and how?

A lot of political focus is placed on the issue of the gas supply to the region. Regional cooperation in this area is incentivized by numerous actors. Geopolitics, rent-seeking, proper security of supply issues and commercial difficulties are combining to create numerous attempts to resolve the diversity of gas supply to the region. Having in mind the fact that only four countries out of 8 in the region have access to the sea, regional cooperation is of vital importance both for the pipeline transport of natural gas and for all forms of transport of liquefied natural gas LNG. Gas supply in the focus area does not significantly affect the total energy mix in the vast majority of jurisdictions.

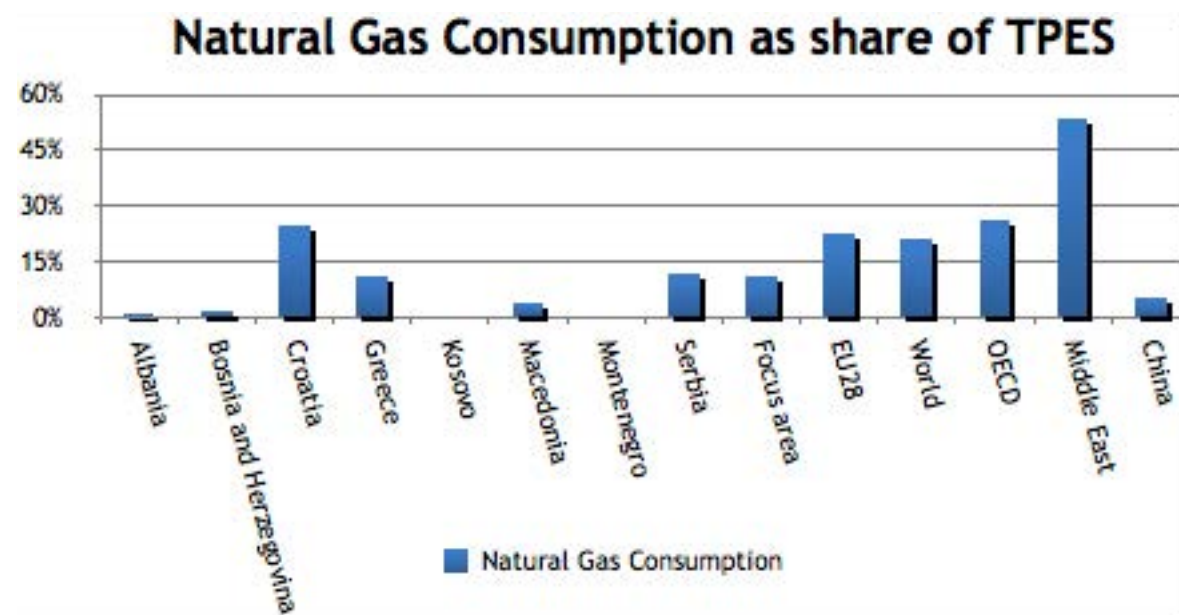


Figure 5: Share of natural gas in TPES in economies in focus areas and in selected countries and regions in 2015. Source: IEA own calculations

3.3. Energy poverty

Energy transition requires technology change. Financial resources are also required for the implementation of this change. Economies of the focus region are still weak and purchasing power of consumers is very low. Energy prices are seen as a factor that may increase the number of people living in poverty (currently standing between 10% in Montenegro and 33% in Macedonia¹⁵) beyond the socially acceptable level. This may endanger not only the prospects for the transition, but also basic social stability. Even at current prices, large numbers of citizens are struggling to pay their energy bills and to maintain a sufficiently warm home, good nutrition and adequate resources for education, sport recreation or culture. Energy poverty is common in all the jurisdictions in the region. In absence of a common definition and robust data we rely on publicly available information on this topic. The implementation of EU directives drives the focus to vulnerable customers of electricity and gas. In reality households in the region, in particular poor households are relying heavily on biomass. The frequency of different heating modalities is differently covered in national statistics which makes it challenging to compile this data for a regional presentation.

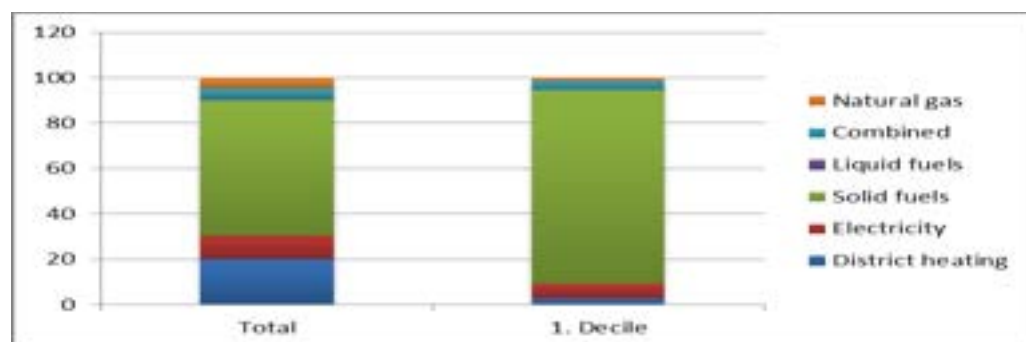


Figure 6: Percentage shares of heating modalities in Serbia in 2015. Overall population and first decile of consumption. Source: Household budgetary consumption survey. Statistical office of Serbia.

4. CONCLUSIONS

Membership of the EU, accession, the Energy community and the Berlin processes, and CESEC are all frameworks in which cooperation in the region in the energy sector is taking place. Russia is also interested in promoting some connectivity projects in particular in the gas sector, while the “one belt one road” agenda promoted by China more and more strongly influences regional cooperation. Processes promoted by the EU or its larger member states seem to continue to have in mind a reconciliation perspective. Ownership of those initiatives by the countries in the region does not seem to be strong, despite seemingly obvious need for strong regional cooperation in energy. All parties in the focus area, with the exception of Greece and Albania used to be members of the same energy market, yet the benefits of regional integration still do not seem to drive the connectivity agendas.

If the EU 2030 goals set in the climate and energy framework are to be met, and in so doing delivering on the development agenda, energy transition needs to take place in the region. Increased connectivity, and a single regulatory and investment framework are the tools to achieve this transition. The main challenges remain the reliance on the domestic low quality lignite, security of gas supply and energy poverty. Relations between overall quality of governance or the human rights agenda with the development sector is missing from all the processes. The accession process, organized by chapters is failing to identify the relations between the good governance framework, human rights, and energy; while other processes do not have sufficient political strength to address these issues and are focused on the infrastructure and connectivity aspects.

In governance frameworks remain unchanged, transit infrastructure may be seen as the source of monopoly rents rather than as elements enabling trade and security of supply. In almost all countries, focus on self-sufficiency, energy exports and the status of the transit hub is visible in rare public discussions on energy issues. More emphasis in all the processes needs to be put on good governance in and outside the energy sector.

Energy processes need to be rapidly opened up for participation. The entire process of the streamlining infrastructure projects suffers from lack of transparency and quality assurance.

There seems to be a strong role for the civil society organizations including professional associations, and Academia in these processes yielding in true national ownership that may secure better and smoother implementation of regional cooperation.

Energy poverty is present as a topic in almost all these processes but remains poorly understood by the main players.

Energy poverty eradication may happen only as a genuine, fit to context, bottom up policy.

Managing large infrastructure agendas and the process of energy poverty eradication using the same tools does not seem to be feasible.

Actors in energy poverty are numerous and are not sufficiently represented in the design and implementation of the current regional cooperation mechanisms.

Civil society needs to be mandated to lead on this agenda as it is best suited to initiate and lead on such complex, multi-stakeholder local level policy at the current level of the developments in the societies in the region.

5. RECOMMENDATIONS

NATIONAL GOVERNMENTS

- Develop frameworks for public goods accounting enabling assessments of benefits from regional cooperation.
- Design and adopt long term development strategies enabling regional cooperation, connectivity agendas and EU accession to be used as the tools for the achievements of the targeted development benefits.
- Develop in cooperation with civil society, national frameworks for the monitoring of energy poverty and design national strategies to combat energy poverty.

EU/EXTERNAL ACTORS

- Deploy a human rights based approach when assessing the progress of countries in the region that are in the accession process.
- Use cross references between the negotiation chapters.
- Firmly support the implementation of the Energy Community Treaty.
- Associate the countries of the Western Balkans with the Energy Union and mandate it to implement integrated climate and energy policies.
- Understand the differences between energy poverty profiles in the region to those in the EU.
- Incentivize and support regional cooperation on the energy poverty issue.

BUSINESSES

- Advocate with national governments and the EU for the longer term predictability of the energy and climate policies.
- Cooperate with civil society to understand the energy poverty profiles in the region and access the bottom of the pyramid market, providing goods and services that increase energy efficiency yielding high marginal benefits.

CIVIL SOCIETY

- Advocate with the EU and the regional processes for human rights based approach to regional cooperation related to energy.
- Lead on the design of energy poverty eradication policies and on regional cooperation around this topic.
- Advocate with the EU for the association of the Western Balkans with the Energy Union and implementation of integrated climate and energy policies.
- Advocate for the full implementation of the Energy Community Treaty provisions.

About THE BALKAN FORUM

The Balkan Forum is a regional, cross-sectoral platform that aims to create a new vision for the Balkans through border dialogue on economic development, democratic values and the rule of law.

Our positive vision is built on the common values of hospitality, solidarity, and generosity. We commit to celebrating ethnic, religious, and cultural diversity, aiming to regenerate interaction and catalyze stronger relationships among the Balkan countries; and to create a stable platform of regular communication and cooperation.

Our geographic focus is Albania, Bosnia and Herzegovina, Croatia, Greece, Kosovo, Macedonia, Montenegro and Serbia.

The following four broad thematic areas, which have been identified as having a special dynamic in the Balkan region; thus, presenting great opportunities for cooperation and joint development - form the framework of The Balkan Forum initiative:

- (1) Education,
- (2) Energy and Environment,
- (3) Tourism and Infrastructure Development,
- (4) Human Capital and Labor Market.