



EU-Balkans Discussion Group – 4th Luncheon – Hungarian Embassy – London, 21 March 2011

Concept Note: Energy Security and Energy Infrastructure in the Western Balkans

Discussion Group Objectives:

- Mapping the political economy of energy production, trade and consumption in the region in order to identify policy and investment issues of concern for Western Balkans (WB) governments and current/potential investors.
- Strengthening the capacity of WB governments to address policy concerns relevant for investors.
- Identifying key sub-sectors with untapped potential for foreign investment. Identifying key multinational players in sub-sectors defined in order to draw preliminary list of potential exhibitors/participants at the Western Balkans Investment Promotion Conference.

Regional Energy Policy: General Objectives

- *Building consensus around a more multidimensional conception of energy security.*
Security of supply should be thought of in distributional terms as well, i.e. as entailing equitable access for all businesses and households (including SMEs and low-income groups). Further, investment in long-lasting energy infrastructure should tally up environmental costs and their possible repercussions on local economies.
- *Giving political impetus to the promotion of IFI-driven and private investment in energy infrastructure in all segments of the energy system.*
Particular attention should be paid to demand-side interventions (energy efficiency schemes, pricing systems, building insulation), as energy intensities in SEE remain much higher than their Western European counterparts¹. In this area, there is scope for stepping up engagement with technology companies and private equity firms looking to invest in or market new technologies in the region (e.g. efficient heating systems, insulation systems, small-scale wind and solar systems etc.).

Structure of the Energy System: Key Features and Policy Priorities

- As a legacy of socialist energy planning, coal dominates the Total Primary Energy Supply (38%), followed by oil, gas (mostly concentrated in Croatia and Serbia) and hydro (7%)².
→ Need to switch to less carbon-intensive fuel mix.
- Electricity accounts for 17% (Croatia) to 51% (Albania) of the structure of final consumption³ (average 28.5%).
→ Some countries (chiefly Albania and FYR Macedonia) face challenge to shift mode of consumption away from electricity, especially with regards to residential heating.

¹ EBRD (2006): *Energy Operations Policy*, approved by Board of Directors, 11 July 2006, p.85-86.

(<http://www.ebrd.com/pages/sector/powerenergy/energypolicy.shtml>). Energy intensity: energy consumption per unit of GDP (PPP or market exchange rates)

² IEA et al. (2008): *Energy in the Western Balkans. The Path to Reform and Reconstruction*, International Energy Agency and Organization for Economic Cooperation and Development: Paris, p. 16

³³ Buzar S. (2008): 'Energy, Environment and International Financial Institutions: the EBRD's activities in the Western Balkans', in *Geografiska Annaler: Series B, Human Geography*, 90(4), p.416

- Electricity mix is highly coal-dependent for Kosovo, FYR Macedonia, Serbia; highly hydro-dependent for Albania, Montenegro and Croatia⁴.
→ Poor diversification (apart from Croatia) means either high carbon-intensity of electricity production (e.g. Kosovo) or high dependency on hydrological cycles (e.g. Albania)

Political Economy of Energy in Western Balkans: Two Axes of Debate: Investment, Trade.

(1) Energy cooperation A: regionally coordinated investment in energy capital;

(2) Energy cooperation B: regionally facilitated trade in inputs and outputs along comparative-advantage lines.

(1) Investment

- The Energy Community Treaty (2005), which established a common market for electricity and natural gas networks⁵, provides a regulatory framework to eliminate protectionism, enlarge markets and thus attract investment in energy generation capital. Under the Treaty, the main instruments to liberalise markets are: 1. Unbundling of horizontally integrated utilities to establish competitive, non-discriminatory access to (transmission and distribution) networks, 2. Alignment of rules across countries, 3. Establishment of independent regulators⁶.
→ Opening up markets must be followed by financing of trade infrastructure (electricity transmission/oil and gas pipelines) – which will eliminate physical barriers to markets and attract private capital in energy generation (see also below in Trade section).
→ Arguably, presence of regulators managing pricing and licences in natural-monopoly sectors (e.g. transmission, oil coastal offloading) does not prevent the possibility that anti-trust regulators might use ‘abuse of dominant position’ legislation for rent-seeking (e.g. fining of operator of Vlore coastal terminal in Spring 2010⁷).
→ Treaty does not cover oil products – which remain subject to protectionist measures⁸.
- Apart from equity financing of SENCAP and Enercap – equity funds devoted to renewable energy investment in SE Europe – EBRD’s direct investment in renewable energy is less than 10% of portfolio (2008)⁹. How can this be stepped up?
- Further, what are the prospects of EBRD-driven demand-side energy-efficiency financing, perhaps streamlined through local commercial banks? The latter seems pressing as demand-side inefficiencies (such as poor building insulation and incentives to switch to artificially cheap electricity for residential heating) account for much of the region’s high energy intensity¹⁰. Further, urban and housing policies appear to have a significant causal role in determining patterns of energy poverty¹¹. Arguably, synergies should be leveraged with the property development supply chain to finance and market energy-saving technology.

⁴ IEA et al., 2008: p.17

⁵ Buzar, 2008: 423

⁶ Ibid.

⁷ Decision of the Competition Authority no. 140 of 10 March 2010.

⁸ IEA et al., 2008: 75. In some cases – the fiscal/customs regime favors import over domestic production – thus providing disincentives for investment in domestic process capacity; see IEA et al., 2008: 131.

⁹ Buzar, 2008: 426; SENCAP: <http://www.ifc.org/ifcext/spiwebsite1.nsf/0/E0594424EBFFE4B0852576C10080CD2A>; Enercap: <http://www.enercap.com/content/view/29/44/>

¹⁰ Buzar, 2008: 419

¹¹ Buzar (2007): ‘The ‘hidden’ geographies of energy poverty in post-socialism: Between institutions and households’, in *Geoforum*, 38, p.228

- Prospects of EBRD co-financing coal TPPs, e.g. the EFT Stagnari plant in Bosnia¹², or the planned ENEL Porto Romano plant near Durres, Albania?

(2) Trade

- Micro-economics of energy trade/industrialization: comparative advantages at the level of primary energy sources are static because they are set by geography (e.g. Kosovo is rich in lignite and has no gas). Yet when it comes to processed energy higher up the value chain, there is a clear case for import-substitution: imported oil products /electricity is less ecologically and cost- efficient due to losses, costs and risks of transportation; plus, since energy installations (electricity generation and refineries) are not labour-intensive or branded industries, learning effects are absent so that unit costs are low from the start.
- WB: Net dependence on hydrocarbon imports from outside the region (region is resource poor), including refined oil products (refineries on average operate at 40% of nameplate capacity due to outdated infrastructure). Overall, SEE is net exporter of electricity¹³, while it is likely that WB countries are net importers (from Romania, Bulgaria and Greece).
→Reducing costs to consumers (and improving environmental efficiency) requires moving import structure down the energy value chain – i.e. importing only primary energy products (crude oil, gas, etc.) and develop domestic refining and electricity-generation capacity.
- Given the focus of EBRD's lending portfolio in WB on domestic reconstruction and expansion of electricity generation/transmission¹⁴, what are the opportunities for financing cross-border electricity transmission projects, oil pipelines (e.g. AMBO) and natural-gas networks to facilitate the gasification of residential heating and industry? Civil society groups have vented objections regarding risk that, as a result of trade infrastructure projects, the region will become a transit zone bearing the environmental costs (and no benefits) of cheap energy generation and import from gas-rich Russia/Turkey¹⁵ for export and consumption in Western Europe. The EBRD seems alive to this line of criticism in having withdrawn financial support for the Vlore Coastal Terminal (2008) as a result of criticism from local and international civil society¹⁶. However, the critique ignores the fact that building high-tech transportation infrastructure is crucial to improving environmental and cost performance of imports of primary energy sources or processed products.
- Synergies between energy-trade-related projects in the EBRD portfolio should also be built along efficiency lines. Investment in refining capacity is crucial to absorb domestic crude production and cut expensive imports of oil products. Would the EBRD support financing of refinery construction or upgrade projects in the region, in the face of lack of support from domestic and international civil society?

¹² Bankwatch (2008a): *South-East Europe Development Watch position paper. South-east Europe Energy Policies*, 8 December 2008, SEEDW, p. 5

¹³ IEA et al., 2008: p.75, 38

¹⁴ Buzar, 2008: 426

¹⁵ Bankwatch, 2008a: 4

¹⁶ See Bankwatch (2008b): *Energy Matters: the Vlora Coastal Terminal. Fact Finding mission report on energy and industry developments in Vlora, Albania*, April 2008