



Energy Policy in South East Europe



1 Introduction

This memo outlines the strategy for the progressive creation of an integrated European Union standard market for energy supply and demand in South Eastern Europe. Improving the balance between energy supply and demand is crucial to improve and sustain economic development in South Eastern Europe. This requires a strong commitment by the countries of the region towards market oriented reforms, regional integration and sustainable development. This will offer significant advantages both in terms of improved utilisation of existing supply and production capacities, but also in fostering more cooperation and integration in the region, which would result in economic growth, stability and investment. Major steps have already been taken towards achieving these objectives in the electricity and gas sector.

2 The development of a wider European Union integrated electricity and gas market based on common rules and principles

As the Commission has set out in its Communication on a Wider Europe¹ and the Communication on the development of an energy policy for the enlarged European Union, its neighbours and partner countries², the European Union has to act as a force for stability and sustainable development in the European Continent. Extending the benefits of the Internal Market is part of that projection of stability to the ring of countries that surround the Community. This is a central role for the Union. A well implemented wider internal energy

¹ Wider Europe - Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours, Brussels, 11.3.2003 - COM(2003) 104 final

² Development of Energy Policy for the Enlarged European Union, its neighbours and partner countries, 13.5.2003 - COM(2003) 262 final

market will lead to increased competition and lower prices, allow increased environmental protection and safety over a wider area and enhance security of supply throughout Europe. It will also foster economic growth, and, hence, jobs.

The European Union is in the process of rapidly completing the internal electricity and gas markets. There are strong arguments for extending the internal electricity and gas markets outside the borders of the Community, but the creation of a level playing field and equivalent environmental and safety standards is a central element for a wider European electricity and gas market to function effectively. The process of inclusion of such countries goes considerably beyond simple questions of open trade between the European Union and its neighbors under more general international trade obligations. It involves the active creation of a real integrated market, free of any barriers but also free of regulatory authorities.

3 The Legal Creation of the Regional Market in South East Europe

A regional market in the area is envisaged as there needs to be a common regional perspective of investment which must be optimized across the states of the region. The region itself faces common problems, such as the lack of money in the energy system and the major need for investment. Individual markets are too small to support major new investments, and without the regional perspective the alternative could be stagnation. The regulatory frameworks in the region are still young but can progress rapidly to the type of regional cooperation needed. Another element in favor of this initiative is the wealth of technical talent in the region.

In 2002, the Commission put forward a strategy outlining the principles and the institutional necessities on which the development of the regional electricity market should be based³. This is being updated⁴. All South East European countries agreed to adopt European Union legislation and to set up a structure to monitor the operation of the market. These commitments were included in the Memorandum of Understanding on the Regional Electricity Market in South East Europe, signed in Athens in 2002 by all the countries⁵ with the Commission and the Stability Pact⁶ acting as sponsors.

Primary sources of energy in the region

Primary sources of energy in the countries of the region are quite limited. Although many countries produce low-quality lignite coal (eg, Bulgaria, The Republic of Serbia and Montenegro, FYR Macedonia and Romania), other sources are less common. Only Croatia and Romania have limited production of oil and gas, which is insufficient to meet the countries' demand, and there is hydroelectrical power generation in Albania, Bosnia-Herzegovina, Bulgaria and Croatia. The only nuclear power generation facilities are in Romania, Bulgaria and Croatia/Slovenia. As a result, the countries of the region are highly dependent upon the import of primary energy, particularly of oil and gas. Any increase in natural gas demand, however, will depend on the rate of expansion and interconnection of the natural gas system in the region.

³ The Strategy paper endorsed by donors and published at http://www.seerecon.org/infrastructure/sectors/energy/documents/see_electricity_market_strategy_paper.pdf

⁴ Discussion and Consultation Note "The Regional Energy Market in South East Europe and It's Integration into the European Community's Internal Energy Market" – June 2004, redrafted in October 2004 as "Electricity Transition strategy". A Gas Transition Strategy will follow

⁵ The present signatories (July 2004) are Albania, Bosnia and Herzegovina, State Union of Serbia and Montenegro, Bulgaria, FYR of Macedonia, Turkey, Croatia, Romania and Kosovo (signatory pursuant to UN Resolution 1244). Greece, Italy and Austria have the status of political participants to the process. Observers include Moldova, Slovenia, and Hungary.

⁶ The Stability Pact for South East Europe is an institution set up to create the political conditions for effective international assistance to the region by co-coordinating donors and presenting plans to the countries of the region; it is headed by Dr. Erhard Busek.

In March 2003, it was decided to extend the approach to gas. The Commission then prepared the Athens 2003 Memorandum of Understanding which takes into account both the extension to gas and the new electricity directives that were adopted within the European Union in June 2003. The European Union signed this document.

The Athens Memoranda of Understanding provide for the following:

- to implement tariff comprehensive plans;
- to implement all necessary technical standards, such as grid codes, accounting systems and information exchange for the operation of the grid;
- to implement effective third party access to infrastructure;
- the establishment of National Regulatory Authorities which are completely independent of the interests of the electricity industry;
- the establishment of Transmission System Operators (TSOs) and Distribution System Operator (DSOs) and their unbundling;
- to develop tariff schemes to allow smooth transition from the existing market structure to an open market;
- to consider all the approaches in order to ease the impact of reforms on vulnerable customers;
- to reduce the non-technical losses;
- to increase energy efficiency in order to abate demand;
- to facilitate the sensible energy substitution by e.g. the renewable energy resources, whilst maintaining a free market framework;
- to ensure EU levels of diversity in supply in fuel mix and approximate to the EU average;
- to co-ordinate anti corruption measures and anti-corruption monitoring mechanism;
- to establish compatible state and regional electricity and natural gas market action plans

To guide this process, the following market development coordination and validation structure has been put in place:

The Ministerial Council, which takes place annually with the participation of the Ministers of Energy of the member countries and the Commissioner for Energy and Transport, in order to take strategic decisions and give directions to the Forum or to formally adopt or endorse conclusions of the Forum. The Presidency of this Council rotates on a six monthly basis.

The Permanent High Level Group, which is composed of representatives of the Ministers of Energy of the Member Countries and the Commission. The group shall be convened, when necessary, on the initiative of either the Commission or the country holding the Presidency at the time, in order to prepare the Ministerial Council and to ensure the follow – up of its decisions. The Commission co-chairs this group along with the President in Office.

The Athens Energy Regulation Forum comprises representatives of the Commission, governments, regulators and transmission system operators of the countries of Southeast Europe, the Council of European Energy Regulators (CEER), the European Transmission System Operators (ETSO), the Union for the Co-ordination of Transmission for Electricity (UCTE), representatives of donors, electricity producing companies, and consumers. The Forum is co-chaired by the European Commission and a representative of the president in office.

The South East European Regulators Board for Electricity and Gas has been set up by the Ministerial Council according to the Tirana Declaration (June 2004), as an independent advisory Board which is composed of the heads of the competent regulatory authorities or their representatives. The role of the Regulatory Board is to facilitate consultation, co-ordination and co-operation between the regulatory bodies in Signatories of the Athens Memoranda, and between these bodies and the Commission with the aim to consolidating the regional energy market. The European Commission will be present at the meetings of the Board.

Energy Community in South East Europe

The South East Europe Regional Energy Market was renamed the Energy Community in South East Europe in June 2004.

The 2003 Memorandum of Understanding is limited to politically commitments. The states of the region stressed the need to move towards a legally binding framework, strong institutions and an oversight body to monitor the operation of the market. The European Union now proposes to conclude a legally binding document based on European Community Directives on energy and having the provisions and institutions anticipated under the political agreements of the Athens Memoranda.

The European Commission, in conformity with the legal constraints of Article 300 of the EC Treaty (Treaty of Nice) – obtained a negotiating directive from the Council of the European Union to conclude the legally binding agreement.

The Commission's initiative to re-integrate South East Europe into the mainstream European energy markets will create a single market established under the same regulatory rules from Sweden to Turkey, from Bulgaria to Portugal. This imaginative projection of the European Union's internal energy market will bring benefits to the countries of South East Europe before they enter the Union as full members. The Commission's initiative will create a market focused on gas and electricity first.

The benefits for the region include a stable and predictable regulatory framework with regional oversight and independent dispute settlement. This will assist international investors who are discouraged by the small markets and the often capricious investment climate. Moreover, the Commission seeks to highlight the need for reform to address the number one concern of the Union, namely energy poverty. Such an approach will also feed into economic growth, stabilization and eventually recovery.

Next steps

In order to achieve the objective of creating the Energy Community in South East Europe some issues still have to be solved and several transitional measures should be taken.

For achieving the aim of having an operational regional market in 2007, the Commission laid out⁷ the *main issues* to be addressed:

- The status and reform of distribution companies;
- Payments reform and transparent pricing policies;
- Compatibility of national market designs; and
- Phasing and reform sequence.

Special emphasis needs to be put on the social aspects of reform.

The Commission's Strategy identifies the *steps* that have to be taken, in two stages; a first stage will introduce state-level wholesale markets and then regional integrated wholesale markets will be investigated.

Two necessary preconditions are:

- that all parties stamp out trading abuses, corruption and non-commercial arrangements, as the parties have committed to do under the Athens 2003 Memorandum; and
- Develop energy statistics on a state basis and within states that allow for effective policy development.

The priorities to be addressed during the different envisaged phases are the following:

- During the first phase, to December 31, 2005, the priorities refer to the necessity for payments reform, starting of the process of distribution companies' consolidation in order to assure a stable and transparent framework for attracting investment, and putting in place incentives to develop reasonable levels of reserve generation capacity.
- For the second phase, December 31, 2005, to December 31, 2007, the measures to be taken regard the regionalization of investment, pre- and post – investment guarantees, the implementation of a single market design in the region, contracts exchange, license harmonization and mutual recognition, and energy distribution expansion.
- In the post-transition phase, the day-ahead markets and regional markets should be operational and, depending on feasibility, the issue of regional scheduling and dispatch can be looked at. The environmental situation in relation to energy and energy efficiency has to be improved by environmental commitments and national energy efficiency policies.

As the energy market develops, there is a need for *bodies* to oversee and monitor the operation of the market.

In this respect, the Regulatory Board, already established through the Tirana Declaration, could play an important role in setting the detailed statutory, technical and regulatory rules in the region and monitor implementation. The Board might have executive powers in certain limited areas consistent with the situation in South East Europe and limited adjudicatory powers for certain types of market disputes.

A Technical Committee is called to offer technical co-operation support for all signatories of the Athens Memoranda excluding EU states and having as objectives the energy market demand and supply data collection, analysis, publication and ongoing provision of information services.

The Secretariat will monitor implementation of the commitments and prepare adjudications and also have a strong role in overseeing governance issues and anti-corruption policies.

⁷ Discussion and Consultation Note, see supra footnote 4

The Regional Energy Information and Technical Centre could systematically collect data from across the region and make it accessible to all.

European Commission's role

In support of the process, the Commission will be providing impartial secretariat support and will help to build the mechanisms necessary for a smooth operation for the Energy Community Development. In addition, the Commission intends to:

- Undertake a benchmarking exercise annually to verify conformity to the Electricity Directives and their derivative legislation, norms and standards, and will also consult relevant bodies with regard to technical standards;
- Undertake an infrastructure prioritization exercise (in cooperation with World Bank). The identification and prioritization of projects will have a regional focus and will be conducted by the Commission in conjunction with the High Level Group and the donors; and
- Promote dialogue between donors and recipients, in its role as coordinator of donors (as mandated by the Istanbul Conclusions of the Stability Pact 2001).

4 International Donors Group

Supporting this process are the regional level donors. The Athens Donors are chaired by the European Commission following the Istanbul Conference of the Stability Pact in 2001, and the present members are:

International Donors

European Commission
The World Bank
The European Bank for Reconstruction and Development (EBRD)
The European Investment Bank (EIB)
USA – The United States Agency for International Development (USAID)
Canada – The Canadian Agency for International Development (CIDA)
International Energy Agency (IEA)
France – DREE
Switzerland – SECO
Italy – MPA
Germany – Kreditanstalt für Wiederaufbau (KfW)
UK - associated through the work of the EBRD. Energy Charter Secretariat

The Commission co-ordinates its own state and regional initiatives at the multinational and bilateral level. Amongst the European Union Member States, Germany, France, Italy and Greece are actively working with the Commission. The adhering countries and the donor community work together with responsible organisations such as the Council of European Energy Regulators (CEER), the European Transmission System Operators (ETSO), the Union for the Co-ordination of Transmission for Electricity (UCTE), and the Energy Regulators Regional Association (ERRA) to achieve our common objective.