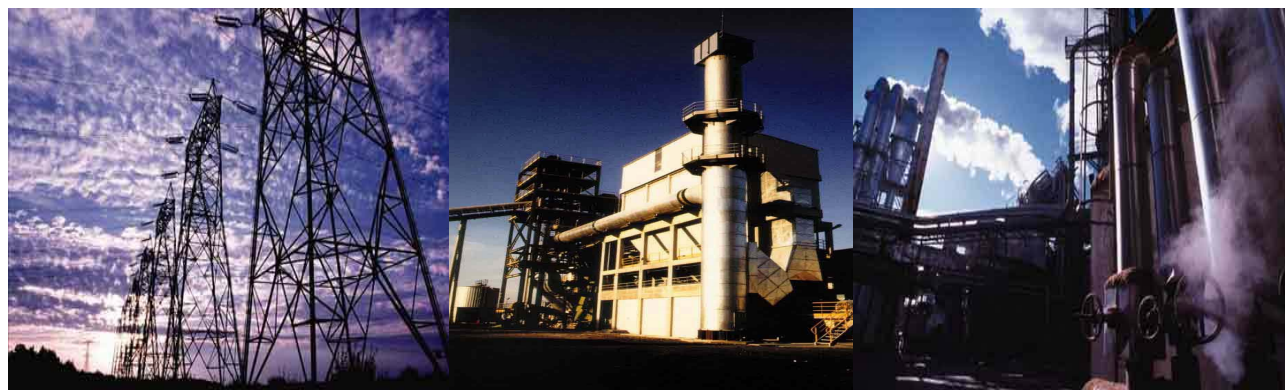




Energy Policy in South East Europe



Regional Approach to Energy Supply

1 Introduction

This memo outlines the strategy for the progressive creation of an integrated regional 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 in 2002 towards achieving these objectives in the electricity sector. The European Commission is now spearheading a similar initiative in the gas sector.

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

As President Prodi has outlined¹ and the Commission has set out in its Communication on a Wider Europe² and the Communication on the development of an energy policy for the

¹Romano Prodi President of the European Commission A Wider Europe - A Proximity Policy as the key to stability "Peace, Security and Stability; International Dialogue and the Role of the EU" Sixth ECSA-World Conference. Jean Monnet Project. Brussels, 5-6 December 2002

²Wider Europe - Neighbourhood: A New Framework for Relations with our Eastern and Southern Neighbours, Brussels, 11.3.2003 - COM(2003) 104 final

enlarged European Union, its neighbours and partner countries³, 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 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.

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 neighbours under more general international trade obligations. It involves the active creation of a real integrated market, free of any barriers.

3 The Athens Process⁴

The Commission brought forward proposals for the creation of a regional electricity market in South East Europe (SEE) in March 2002 with the aim of eventually creating a regional energy market. By November 2002, a Memorandum of Understanding ("The Athens Memorandum") was signed at the Athens Ministerial by all the countries⁵ with the Commission and the Stability Pact⁶ acting as sponsors. The Commission also agreed on a common strategy paper with all international donors active on a regional basis.

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

⁴ All of the documents relating to the Athens Process can be found in the Energy Section of www.seerecon.org

⁵ The present signatories (May 2003) are Albania, Bosnia and Herzegovina, Federal Republic of Yugoslavia, Bulgaria, FYR of Macedonia, Greece, Italy, Turkey, Croatia, Romania and Kosovo (signatory pursuant to UN Resolution 1244). Observers include Moldova, Slovenia, Austria, Hungary, and Italy.

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-ordinating donors and presenting plans to the countries of the region; it is headed by Dr. Erhard Busek.

Regional Electricity Market in South East Europe

All South East Europe countries agreed to adopt the European Union legislation based on principles set out in the Electricity Directive (96/92) and the new European Union proposals once adopted. Regarding the timetable, the countries of the region committed themselves to start to open their electricity markets by 2005, to create Regulatory Bodies and Transmission System Operators by June 2003 and Distribution System Operators by January 2005. All this is based on the rules currently in force and being developed by the European Union. Eventually the Regional Electricity Market will be integrated within the European Union's Internal Electricity Market. All these commitments are included in the 2002 Athens Memorandum.

The Athens Memorandum of Understanding provides for the following:

- to implement tariff reform 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, not later than June 2003;
- the establishment of National Transmission System Operators (TSOs): by June 2003; and
- Unbundling by 2003: the TSOs should be fully independent from all activities not relating to the transmission systems in terms of ownership. In addition, the system operator should be independent at least in terms of its legal form, organization and decision making from all activities not relating to transmission.

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

The following organs are collectively known as the 'Athens Process':

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 the 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 – the Athens Forum. The 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.

Two Task Forces have been set up:

- The South East Europe Energy Regulators Task Force, under the umbrella of CEER and co-chaired by the Greek and Italian Regulators, thus Professors P. Kapros and P. Ranci respectively.
- The South East Europe Transmission System Operators Task Force under the umbrella of ETSO, co-chaired by the Italian and Greek TSO, Mr. Serrani and Mr. Tassoulis.

Both Task Forces have been met several times over the last year and have advanced the work necessary towards establishing a Regional Electricity Market in South East Europe.

With respect to the **Regional Gas Market in South East Europe** issues, these will be dealt under the Athens Forum. It is expected to reach a political agreement at the Ministerial meeting scheduled for November 2003.

This regional plan will have the following objectives:

- to implement national gas market reform in all signatory countries
- to implement international best practice in the wholesale gas markets and to facilitate cross-border trade
- to create regional and national gas markets, in part to reduce the environmental impact of existing thermal plants and,
- to secure supplies for the region and the EU through the creation of a seamless integrated market between Vienna and Ankara.

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 the smooth operation of the Regional Energy Market Development. In addition, the Commission intends to:

- Undertake a benchmarking exercise annually to verify conformity to the Electricity Directive and its 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 Donors⁷

- **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)**
- **Italy, France, Germany, Switzerland and Greece. The UK is associated through the work of the EBRD.**

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. The Donors have agreed on a strategy paper on the regional electricity market in South East Europe and its integration into the European Union Internal Electricity Market⁸, on 15 November, 2002. It provides the road-map for developing the electricity market in South East Europe.

5 Infrastructure necessary for the creation of a fully integrated electricity and gas market in the region

For a wider European electricity and gas markets to function effectively it is equally necessary that adequate infrastructure exists in parallel to common rules and standards that link the Member Countries. In the 2001 European Energy Infrastructure Communication⁹, the Commission put forward a number of measures, including a 10% electricity interconnection target and the priority for Trans European Network Funding of certain projects identified as being Priority Projects of European interest. The construction of the new infrastructure necessary to permit such an enlarged European market to function effectively and to ensure the future supply of gas to the European Union requires close collaboration between the Community and supply countries, as well as those involved as transit regions. The commitment, in financial and political terms of the European Union to new development, reinforcing and diversifying Community gas supplies is vital. It is proposed that these same targets be adopted in South East Europe.

⁷ See also Annex 1 attached

⁸ Brussels, 11/11/2002, D(2002)

⁹ COM(2001)775, 20.12.2001

Electricity

In order to complete the reconnection of the electricity system of the countries of the region and these countries with the European Union, a number of strategic interconnections have been identified in the context of the Athens Forum Process: These are:

- the reconnection of the Ernestinovo and Mostar lines in Croatia /Serbia / Bosnia and Herzegovina;
- the completion of the Western North-South Connection through Elbasan in Albania;
- the strengthening of the Greece – Bulgaria links; and
- the strengthening of the Greece-Italy and the Greece-Turkey links (Ipiros – Puglia and Philippi-Hamidabad).

The Commission therefore believes that these interconnection projects should be declared Priority Projects of European Interest, and that they should benefit from possible support funding under the Trans-European Network Mechanism [TEN].

Gas

With respect to gas, the lines necessary for the completion of the regional gas market are presently under examination in the context of the proposed creation of the regional market itself. Any such lines necessary will be considered in the context of future revisions of the TEN guidelines. However, the following projects can be identified as being the most important that should attract Community political and possibly financial support.

- Turkey - Bulgaria - Romania - Hungary - Austria gas pipeline;
- Greece, Former Yugoslav Republic of Macedonia, Serbia, Bosnia, Croatia and Slovenia gas pipeline

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<http://www.seerecon.org/infrastructure/sectors/energy/>

Annex 1

Donors' activities in South East Europe

The role of co-ordinating the donors was given to the Commission by the Stability Pact (Istanbul, 2001). The Commission retains the overall co-ordination, setting political/technical goals and organising donors. Financial institutions as well as bilateral donors are part of the Donors Group for South East Europe, (particularly the World Bank, the European Bank for Reconstruction and Development-EBRD-, the European Investment Bank – EIB -, the German Development Bank –KfW-, the United States Agency for International Development –USAID-, the Canadian Agency for International Development –CIDA-, the European Commission, France, Greece, Italy, Switzerland. The Commission is the major donor in the region financing projects at national and regional level.

At regional level the Commission funding is being provided for the following projects:

- Secretariat Support to the Athens process
- "Regional Electricity Market (REM) Action Plan" which builds on the progress achieved so far at the Athens Forum and the work being done by the Regulators and Transmission System Operators Task Forces for South East Europe
- The Regional Gas Market project which replicates the Electricity Market for gas is to be launched in 2003
- The World Bank has put forward a study on the Optimisation of Regional Investment Planning that will enable investors in South East Europe to pursue optimal decision making and ensure, in the longer run, the proper operation of the REM. The proposal got the blessing of the donors' group.

EdF is to draft compatible grid codes for SEE.

USAID has funded a Regional Transmission Planning project, which identified 12 interconnection transit lines and 3 internal lines as priority on transmission investment to be covered by 2005. USAID also provides funds to benchmark in depth the Regulators capacity in South East Europe (complementary work to the benchmarking report carried out by the Commission).

CIDA funds projects aiming at improving the skills of the staff involved in the electricity market in South East Europe, but also does technical work of high value.

KfW provided funding to analyse the evolution of the demand and supply balance in the region and now address energy efficiency issues.

EBRD is carrying out a study on "Power Sector Affordability in South East Europe" to identify the extent to which *effective* prices reflect costs for each category of customers. Moreover, the Bank, may propose the setting up of a Clearing Bank Mechanism in South East Europe to assume a portion of non-market and political risks.

Switzerland funds a number of hydro projects at national level.

Italy along with ENEL working on the improvement of the electricity sector in Albania and ENEL itself invests in the Maritsa 3 power plant in Bulgaria.

Greece provides funding to South East Europe countries based on bilateral agreements.