

Supporting the Western Balkans' Energy Transition: An Imperative Task for the German EU Council Presidency

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Much is at stake for the European Union in the Western Balkans Six

(WB6: Albania, Bosnia and Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia)

The WB6 form a region bordering the EU on all sides, and the EU's stability and prosperity over the long term are only possible if they also prevail in the Western Balkans. Solely for this reason, the Western Balkans' positive development and maintenance of good relations with the EU are in the EU's strategic interest.

Geopolitical interests continue to compete where neighbourly disputes and fragile solidarities strain international relations. In the WB6, long a sphere of competing Russian, US, and EU interests, a growing Chinese influence is now challenging the EU over questions of sustainable development and rivaling notions of international solidarity and co-operation.

The COVID-19 pandemic's impact further exacerbates vulnerabilities and dependencies felt in the WB6. The

European Commission identified a total of €700 million in EU crisis aid in April, followed by another €3.3 billion announced before the Western Balkans Summit on May 6 as part of the EU's global response to the ensuing crisis.

Sizable financial support is coupled with credible conditions as part of the long-term recovery plan, which allocates another €16.5 billion for external support.¹ Some of this is likely to benefit the WB6, which can position the EU as a reliable partner for sustainable development, reform, and helping mitigate conflicts. With a strong emphasis on energy transition, the EU and the German Council presidency could effectively point the development trajectories and diplomatic relations in the WB6 towards sustainable recovery.

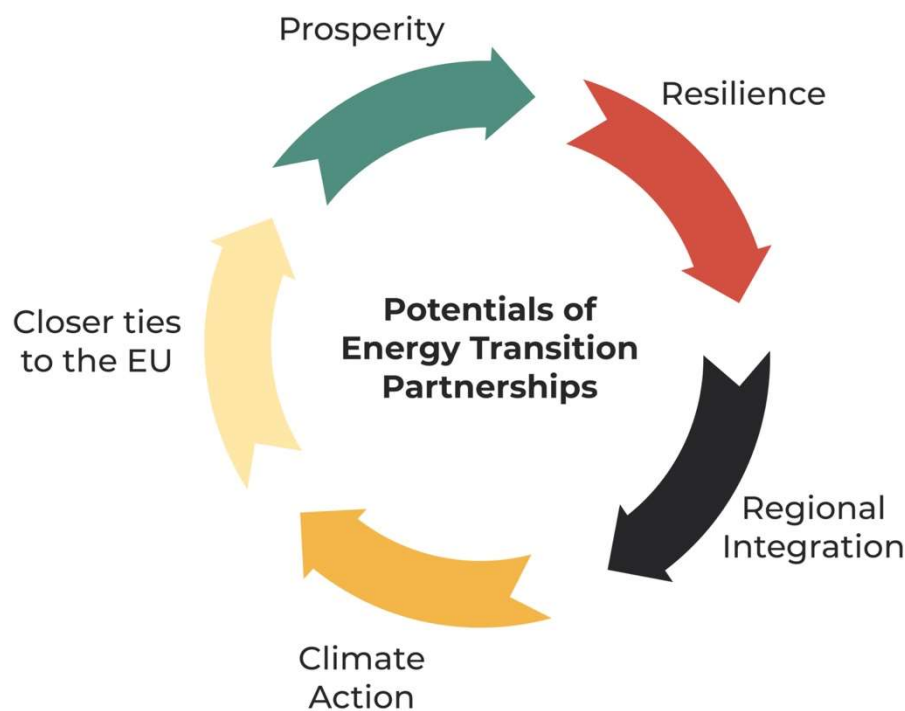
Potentials of Promoting WB6 Energy Transition

Energy systems play a key role for economic prosperity and could be a driver for more co-operation and security in the region. Collaboration towards a clean energy transition should be a centrepiece of the European strategy there. Partnerships between the EU and WB6 countries aimed at improving energy efficiency and increasing the share of sustainable renewable energy offer numerous

benefits to both sides. This could stimulate progress in the following domains:

- **Prosperity:** Investments in renewable energies create added value locally and future-proof jobs. Energy efficiency improvements also boost the entire economy's efficiency. Moreover, investments in future technologies enhance the long-term position of the Western Balkan countries'

¹https://ec.europa.eu/commission/presscorner/detail/en/ip_20_940



economies. The International Renewable Energy Agency (IRENA) estimates a successful energy transition in South-Eastern Europe could lead to increased cumulative economic output of around €430 billion by 2050.²

- **Resilience:** Modern energy systems with decentralised power generation from renewable energy sources, which are linked in efficient networks, have greater resistance to external shocks. Dependency on fossil fuel imports subsequently decreases. Stranded assets (energy infrastructure that must be decommissioned before it is written off) are avoided. Decreasing air pollution improves the population's health.
- **Regional integration and conflict prevention:** Energy transition in the WB6 will work better if electricity grids are interconnected across national borders, cross-border fluctuations in wind/sun availability are balanced, and storage capacities are used. This is a substantive

incentive for closer co-operation in the region, which could help to prevent conflicts.

- **Closer ties with the EU:** There are already well-established political and economic ties between the EU and WB6. Ties with the EU will expand further if the EU successfully positions itself as the partner to provide the Western Balkans with credible and substantial resources to help them move towards a sustainable economy. The clean energy transition offers many material opportunities for closer co-operation between companies, research institutions, and governments from each side. Integrating the energy system beyond the EU's borders, while promoting energy efficiency, innovation, and market reforms to consolidate this cornerstone of EU energy policy, could function as an ease-in process for candidate countries' accession.
- **Climate action:** The European Green Deal (EGD) envisages Europe as the first climate-neutral continent by 2050, and aims to build a circular economy. It would create a new model of prosperity that is socially just and

² <https://www.irena.org/publications/2019/Dec/RE-Market-Analysis-Southeast-Europe>

respects planetary boundaries. However, the EGD can only have its full impact on achieving global climate and sustainability goals if the EU succeeds in bringing other countries along on this path. As EU Energy Commissioner Kadri Simson stressed in January, the EGD and its geopolitical ambition would require the

EU's external actions to fully align with its domestic climate ambition, especially in the Western Balkans³. Yet if the EU and WB6 countries are unsuccessful in aligning their climate ambitions, new tensions could result; for instance, with the EU's introduction of a Carbon Border Adjustment Mechanism.

WB6 in Transition

The transition towards sustainable, renewable energy is a major worldwide trend. It is becoming a crucial part of most countries' considerations of economic development and energy security amidst decarbonisation. For decades, the WB6 countries have been advancing their *first* energy transition – from state-controlled energy sectors to open and regionally integrated markets. While that transition is not yet completed, a second trend is spreading through energy markets around the world, posing new challenges for the WB6. Countries are modernising their energy sectors and investing heavily in renewable energy sources, an important part of the efforts to decarbonise entire economies. This is also the case in the EU, where the pace of the clean energy transition is likely to accelerate with the EGD.

"It is crucial that we **fully align** our external action with our domestic **climate ambition**. Therefore, I will fully support the development of a **green agenda** for the Western Balkans."

-EU Energy Commissioner Ms Simson-

The Western Balkans should join this trend or they risk being left behind.

Despite significant economic risks, some WB6 countries continue plans to invest in coal-fired power generation. The International Energy Agency (IEA) indicates, WB6 countries use lignite coal as a source for roughly 60% of their electricity generation.⁴ Sixteen power plants are operating in the region with another 12 projects planned and awaiting construction or seeking financing. With the COVID-19-induced economic downturn depressing energy consumption, the business case for new plants has suffered further.

Not only does coal-fired electricity generation seriously harm ecosystems, human health, and well-being, it also increasingly risks becoming stranded assets (energy infrastructure that must be decommissioned before being written off) within the next decade. Instances of stranding assets are also very likely to lead to job loss, in the power sector and its value chain, including lignite coal mining.

This scenario is growing increasingly probable considering the expected introduction of a carbon price (e.g., the European Emissions Trading Scheme) and renewable energy sources steadily growing more competitive. Adoption of the

³https://ec.europa.eu/commission/commissioners/2019-2024/simson/announcements/opening-remarks-commissioner-simson-itre-committee-energy-related-elements-european-green-deal-2020_en

⁴ [https://www.iea.org/data-and-statistics?country=WORLD&fuel=Energy%20supply&indicator=Total%20primary%20energy%20supply%20\(TPES\)%20by%20source](https://www.iea.org/data-and-statistics?country=WORLD&fuel=Energy%20supply&indicator=Total%20primary%20energy%20supply%20(TPES)%20by%20source)

carbon border adjustment mechanism proposed by the European Commission, thus putting a carbon price on imported goods from outside the EU, could expedite this reality.

Electricity may in fact be among the first sectors to implement such a mechanism.⁵ Nonetheless, new thermal power plants meant to secure energy self-sufficiency are still an integral component of many national policies. This often leads to shunning of regional solutions and maintenance of market-distorting subsidies, which cost national budgets millions of euros each year.⁶

There is great potential for renewable energy and energy efficiency in the WB6:

- The entire region is endowed with good wind resources and its solar irradiance is on par with or better than in European countries with high deployment of photovoltaic systems (PV), such as Germany. In 2017, an International Renewable Energy Agency (IRENA) study showed renewable **energy sources such as wind and solar could be cost-competitive** if capital costs could be reduced.⁷
- Costs continue to fall for solar and wind technologies. Additionally, the capacity factor of utility-scale solar PV and onshore wind projects in the wider region of South-Eastern Europe (SEE) is developing in line with values

achieved elsewhere in Europe. Recent estimates by IRENA suggest the **levelised cost of electricity was only 5% higher than the weighted average for the European market outside SEE**.⁸

- The Institute for Energy Economics and Financial Analysis (IEEFA) showed that established integration technologies and policy measures to adapt to **high wind and solar power shares** could thus diversify domestic generation **without compromising reliability or supply**.⁹

The current state and future development of energy infrastructure are key factors for sustainability of WB6 countries' long-term energy mixes and their alignment with both national and EU decarbonisation goals. The political momentum of the EGD and German EU presidency present a window of opportunity to support the WB6 on a path to affordable and clean energy.

Germany has the experiences of transitioning towards renewable energy sources in the energy sector, successfully employing policy mechanisms such as feed-in-tariffs, and actively managing a coal phase-out. These position it as a credible partner to assume the lead on energy co-operation between the EU and WB6.

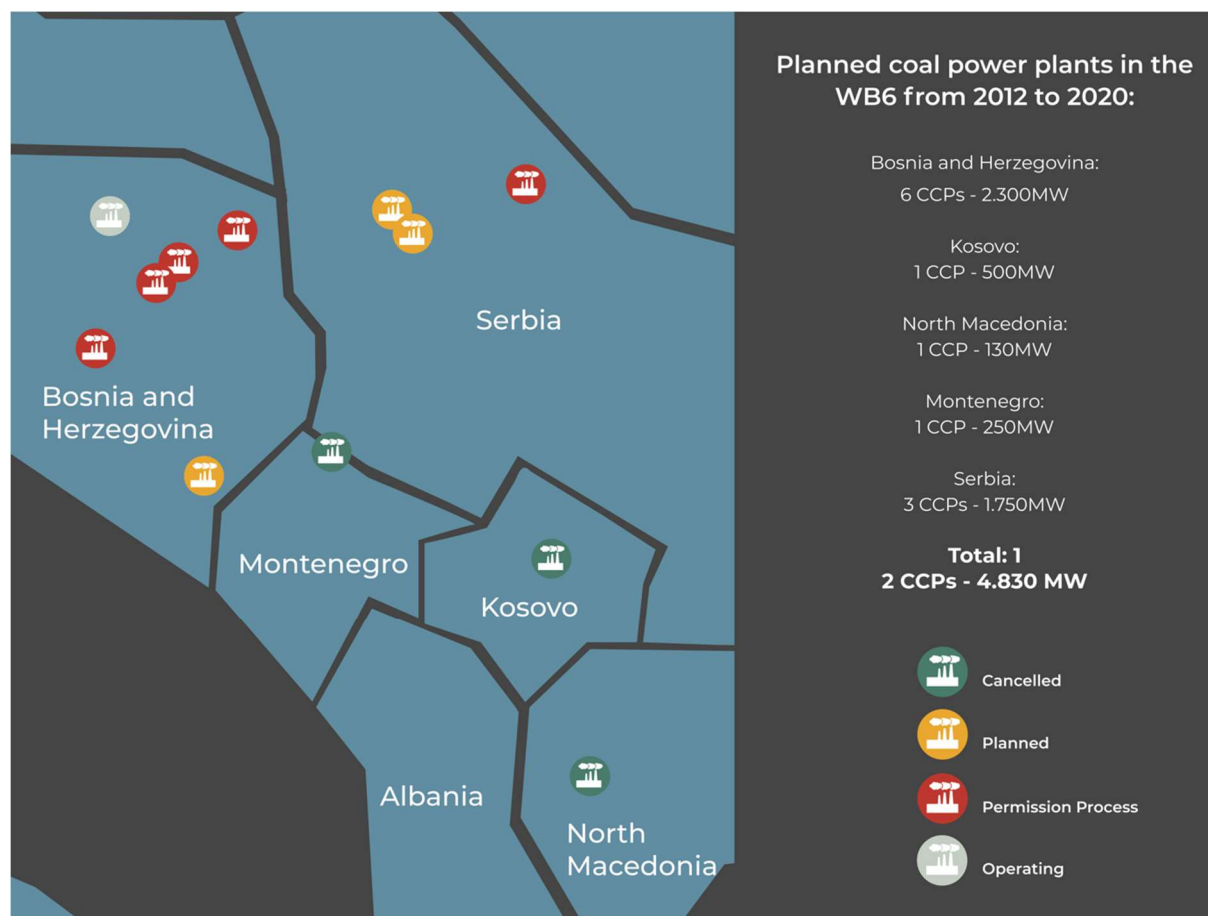
⁵ <https://www.spglobal.com/platts/en/market-insights/latest-news/metals/030520-ec-to-include-power-in-eu-power-in-eu-carbon-border-import-tax-plans>

⁶ <https://www.euractiv.com/section/energy/news/western-balkans-pump-subsidies-worth-e1-2-billion-into-coal/>

⁷ <https://www.irena.org/publications/2017/Jan/Cost-competitive-renewable-power-generation-Potential-across-South-East-Europe>

⁸ <https://www.irena.org/publications/2019/Dec/RE-Market-Analysis-Southeast-Europe>

⁹ <https://ieefa.org/ieefa-report-now-nine-case-studies-electricity-markets-leading-transition-wind-solar/>



Source: CEE Bankwatch Network

Opportunities for the EU and Germany to Support the WB6 Energy Transition

Numerous channels exist for the EU and Germany to engage with the Western Balkans and support a clean energy transition. The EU recently revived its enlargement process by opening accession negotiations with Albania and North Macedonia and announcing an overall revision of the enlargement methodology. Statements at the EU-WB Summit in May 2020 made clear that offering a European perspective to the WB6 is an EU priority.

Since the early 2000s, the EU and WB6 have steadily intensified their co-operation on energy

issues. The aim of establishing a pan-European energy market – based on the EU's *acquis communautaire* on energy – led to establishment of the Energy Community (EnC) and its treaty. This was signed by all WB6 countries and the EU, and entered into force in 2006.

The EnC meanwhile has developed from a group of countries focused only on market reforms to an intergovernmental organisation promoting the integrated energy and climate policy of the EU and its neighbours. Numerous other existing processes also aim to build closer ties and could

be used to advance the clean energy transition (see Box I). Additionally, the EU and Germany are using several channels to provide financial and

technical support for the WB6 energy sector (see Box II).

Box I – Relevant Processes for WB6-EU Integration

Several processes, forums, and initiatives are working towards integration of the WB6 and the EU with implications for the energy transition:

- The **EU accession process** serves as a geostrategic investment in peace, stability, security, and prosperity in Europe. Candidate countries must implement complex reforms in many areas, including the energy sector and climate policy. In February 2020, the European Commission published a reform plan with explicit reference to the Western Balkans' European perspective.¹⁰
- In May 2018, the **EU Western Balkan Summit** participants concluded in the Sofia Declaration their ambition to heighten regional co-operation for a peaceful future. A core means to this end is to enhance all types of connectivity: transport, energy, digital, economic, and cultural.
- The **Energy Community** (EnC) is an important institutional advocate for a sustainable energy transition in the Western Balkans. It was established to extend the EU internal energy market to South-eastern and Eastern Europe. The EU body of energy law and obligations are incorporated with the EnC's acquis to which all of the WB6 must harmonise their legislation. In 2019, alignment with the EU climate policy was added to the EnC's agenda, thus mandating development of National Energy and Climate Plans (NECPs). The **Transport Community** follows a similar logic and structure, aiming to integrate transport markets in the region since 2017.
- The European Commission proposed a **Green Agenda for the Western Balkans** as part of its EGD. The specific inclusion of the WB6 in the EU's central policy to achieve carbon emission neutrality by 2050 aims to strengthen climate diplomacy in the region. It does so while linking national energy and climate policies with those of the EU (NECPs) and under the Paris Agreement (NDCs).
- The **Berlin Process** was launched in Berlin under the Merkel cabinet in 2014. Its purpose was to consolidate and maintain the dynamics of the EU accession of the WB6 by promoting regional co-operation and revitalising multilateral ties with selected EU member states. A yearly summit is held, hosted by a rotating presidency.
- The **Regional Cooperation Council** is a framework for countries in South Eastern Europe. Its South East Europe 2020 strategy, developed in consultation with governments of the region, the European Commission, and international financial institutions aims to improve the region's living conditions and overall economic development.

¹⁰ https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/enlargement-methodology_en.pdf

The WB6 countries, as part of their obligations under the EnC treaty, are currently developing national energy and climate plans (NECPs) that formulate targets for 2030 and 2050. This brings the simultaneous needs for support in the region to achieve the Paris Agreement commitments, transpose the reform obligations under the EnC

treaty, and progress with the EU's accession process. All three ambitions, if pursued in a cost-effective and socially just way, while ensuring power system adequacy and supply security, overlap with recent policy priorities set by the European Commission.

Box II – Bilateral and Multilateral Channels of Financial and Technical Co-operation Between the EU and WB6

Several European actors and initiatives are working to bilaterally and multilaterally provide financial and technical support for the energy transition in the WB6:

- The **European Investment Bank (EIB)**, and **European Bank for Reconstruction and Development (EBRD)** provide multilateral financing for large projects in the power and transport sector, bilaterally or through framework programmes, and accompanied by technical assistance. Alongside lending facilities for small-scale energy efficiency measures in the private sector, both banks are involved in the **Western Balkans Investment Framework**, which merges public loans and grants with private investments to expand transport and energy connectivity, provide support for the environment, the social economy, the digital agenda and a new Green Agenda for the WB.¹¹
- **Germany's technical co-operation agency GIZ** supports development of national renewable energy markets and promotes energy efficiency in the region. It provides support to the Contracting Parties to the Energy Community for climate planning processes (NECPs and NDCs) and coordinates the Open Regional Fund sponsored by Germany and the EU.
- The **Open Regional Fund for South-East Europe** has been supporting energy sector reform and energy efficiency in the WB6 since 2008, building capacities with regard to the EU Energy Strategy 2030, the UN Sustainable Development Goals, and responsibilities under the Paris Agreement.
- The **EU's External Investment Plan** allocates a budget for guarantees under the multi-annual financial framework to be granted by the EIB. During the 2014–2020, the EU guaranteed over €23 billion worth of EIB operations in pre-accession and neighbourhood countries. Local private sector support, social and economic infrastructure development, and climate change mitigation were thematic objectives¹².
- The **EU's Instrument for Pre-Accession Assistance** is its primary vehicle for financial support of candidate and potential candidate countries. In 2014–2020, it comprised 12 programmes with a total allocation of €11.7 billion. Support for institution-building, inter-regional co-operation, and rural development are among its five goals. This assistance also aims to prepare candidate countries for the EU cohesion policy and access to the European Structural Funds and Cohesion Fund, once they have joined the Union.

¹¹ <https://www.eib.org/en/press/all/2019-170-eib-pledge-for-the-western-balkans-investments-in-competitiveness-innovation-and-climate-are-top-priorities>

¹² <https://www.cgdev.org/sites/default/files/eus-financial-architecture-external-investment-progress-challenges-and-options.pdf>

EU Engagement with China on Infrastructure Investments in the Western Balkans

China is increasingly active in the region's energy sector. The EU needs to develop a two-pronged strategy for dealing with this influence. In 2019, the EU officially recognised China as a 'co-operation partner, economic competitor and systemic rival,' and criticised China's economic activity in the WB6 region for neglecting aspects of socio-economic and financial sustainability.¹³

Demand for funding of large energy and transport infrastructure projects in the WB6 has been in part satisfied by developers from China, financed by Chinese policy banks and/or implemented by state-owned enterprises (SOEs). This type of foreign investment falls under China's flagship foreign policy, the Belt and Road Initiative (BRI). This diffuse international strategy has the broad aim of accessing and interconnecting regional markets. It also aims to foster worldwide co-operation through large-scale investments, especially in infrastructure. Chinese ambitions, besides answering the strong global demand for infrastructure, are believed to be seeking out strategic investments of geopolitical importance, while also engaging Chinese surplus capital abroad. In doing so, they tap new markets for SOEs and develop their technical capacities. All WB6 countries other than Kosovo, whose independence Beijing does not recognise, have signed memoranda of understanding with China on the BRI. Serbia, the largest WB6 economy, is also the primary recipient of Chinese finance in the region and has particularly amicable relations

with China.¹⁴ It notably became the first European country for which the Asian Infrastructure Investment Bank, a multilateral development bank under strong Chinese influence, proposed a project for emergency assistance in response to the COVID-19 pandemic.¹⁵

From the WB6's perspective, China's engagement via provision of funding, engineering capacity, and infrastructure development represents both risks and opportunities. Regarding large coal-fired power plants, these risks include health and climate impacts, insufficient socio-economic developmental benefits, and large debt obligations. In view of massive fiscal spending needed during and after the COVID-19 pandemic to rehabilitate national economies, it is not yet clear whether Chinese overseas investments will continue at their previous scale.

Also unclear is whether the EU and Germany would seize their opportunity to fill a potential gap China might leave in the WB6. In any case, the EU should pursue a two-pronged strategy to address China's influence. On the one hand, China has repeatedly committed to 'greening' the BRI and the EU should engage with China to see if agreement is achievable on joint sustainability principles for infrastructure investments in the WB6. On the other hand, the EU should make a credible offer to support clean energy investments; one that is more attractive than potential Chinese investments in fossil fuels.

¹³ European Commission (2019): <https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf>

¹⁴ <https://europeanwesternbalkans.com/2020/05/15/will-serbia-have-to-choose-between-china-and-the-eu/>

¹⁵ <https://www.aiib.org/en/projects/details/2020/proposed/Serbia-Emergency-Assistance-to-Public-Health-Sector->

Policy Recommendations for the EU and Germany Vis-à-vis China

The European Union, during the German presidency of the European Council and beyond, should:

Define high standards for investments in energy infrastructure in the WB6 and use them as benchmarks when negotiating a Sino-European Green Partnership. For instance, this should include the compliance with EU environmental and state aid rules.

Support the WB6 countries in stress testing the debt burden and carbon lock-in resulting from recent and on-going infrastructure investments, including Chinese-financed energy-projects. This could benefit from European multilateral development banks' expertise in life-cycle and scenario analysis.

Balance Chinese influence in the Western Balkans by making firm commitments to the EU accession process and providing financial assistance that is fiscally sustainable, rapidly available, easily accessible and tied to reform obligations. This should be independent of whether Chinese overseas investments remain high during and after the COVID-19 crisis.

Given Chinese global leadership in solar and wind energy investment, manufacturing, and deployment, the EU should seek avenues to facilitate Chinese overseas development finance in green technologies, and identify and resolve barriers for green projects. This could attract Chinese green investments, potentially trigger knowledge transfers to traditional energy regions in the WB6, and support the regions in becoming green manufacturing centres.

Policy Recommendations to Advance Energy Transition in the WB6

The European Union, during the German presidency of the European Council and beyond, should:

Spell out how candidate countries and the WB6 as a whole will be integrated into the EU's long-term response and recovery packages during and after the COVID-19 crisis. Sustainable development of energy sectors and integration of markets should be at the heart of these measures because of their cost-effectiveness and various co-benefits.

Provide strong financial incentives tied to credible conditions, implemented by the EU institutions and with public relations for visibility. This should include emphasis on Just Transition within the EU's energy diplomacy with the region.

In drafting and implementing the announced *Economic and Investment Plan for the region*, prioritise the energy transition and ensure that grants and mobilised funds do not benefit high-carbon industries, thereby undermining the energy transition's efforts.

Earmark a significant share of the scaled-up EU budget guarantee mechanism and project funds for sustainable energy development and renewable energy sources in the WB6. Large-scale financial support should be conditional on regional/cross-border co-operation. Established European and various non-governmental actors from member states could, as mediators, facilitate such co-operation.

Support coal- and carbon-intensive regions in developing Just Transition strategies. Draw on experiences of EU member states and the Platform for Coal Regions in Transition.

Include stress testing of the WB6's long-term energy and climate plans against the Paris Agreement and EU climate targets in technical assistance provided to WB6 governments to develop national climate and energy plans (NECPs) and nationally determined contributions (NDCs).

Strengthen the Energy Community Treaty for which a new mandate is being negotiated; to include a binding climate dimension, a credible mechanism for non-compliance financial penalties, and a strengthened and clarified role for the Secretariat in state aid enforcement.

Make the Green Agenda for the Western Balkans a credible extension of the EGD. This should include the condition of financial and political concessions on approval and implementation of NECPs compatible with the EU's climate ambitions, and advancing energy sector and legal reforms.

Use processes such as the EU Western Balkan Summit and the Berlin Process, as well as the Regional Cooperation Council and High-Level Group on Central and South-Eastern Europe Connectivity. They should be backed as additional avenues for delivering the above objectives – sustainable renewable energy, efficiency, power market integration, and diversification of supply.

Strongly reflect the WB6's strategic importance and the multiple benefits of promoting the clean energy transition in the region when revising the EU's Energy Diplomacy Action Plan, as envisaged by the German presidency.

Recommended Reading

Balkan Green Foundation - <https://wb6energyprospect.com/>

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