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Stepping up the greenification of the power sector in the Western Balkans

The energy sector in most Western Balkan countries is characterised by a heavy dependency on coal and outdated production facilities¹, posing severe environmental challenges to the region. Possessing significant renewable energy potential², the Western Balkan Six (WB6)³ in theory have good prospects of making a successful energy transition. In terms of natural resources, the region is also well placed as Albania and Serbia possess solid reserves of metals and rare earths that are needed to develop energy transition technologies, such as batteries, smart grids, solar panels and windmills.⁴ Yet the transition is hampered by several economic and political factors, such as a highly centralised energy market with only a few large suppliers, dynamics of clientelism and controversial outside investment (such as from China). This policy brief analyses the current challenges that prevent energy diversification and greenification in the region and asks how the recently launched EU Green Agenda for the Western Balkans can address these challenges.

The power sector in the Western Balkans and the energy transition

Decades of underinvestment coupled with a lack of supporting economic incentives and legislative frameworks for renewable energy diversification have caused the

Western Balkan energy sectors to lag behind the European Union.⁵ Figure 1 shows the electricity production balance in the WB6 in 2019.⁶ All Western Balkan countries, except Albania, are heavily dependent on coal. This combustible fuel is not only harming ecosystems and human health, but is also likely to become a stranded asset in the near future⁷, resulting in significant job losses. Another traditional regional energy source is hydropower.

1 The World Bank & Energy Sector Management Assistance Program, "[Western Balkans: Directions for the Energy Sector](#)", June 2018, 4.

2 IRENA, "[Renewable Energy Market Analysis: Southeast Europe](#)", 2019, 15.

3 These are Albania, Bosnia and Herzegovina, Kosovo*, Montenegro, North Macedonia and Serbia.

* Statement from RES foundation: This designation is without prejudice to positions on status, and is in line with UNSCR 1244/1999.

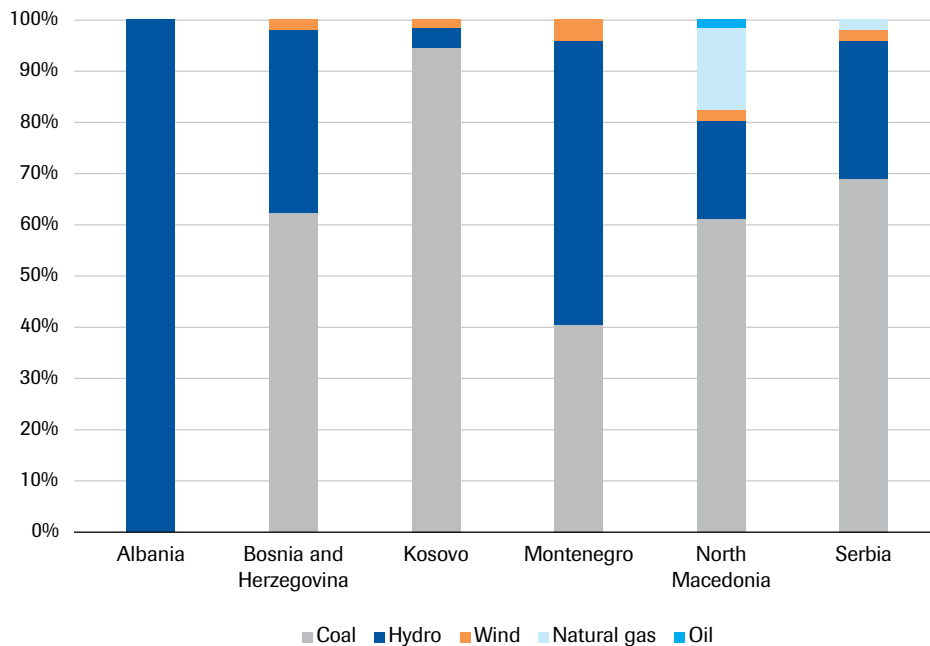
4 Frédéric Simon, "[Critical Raw Materials](#)", *Euractiv*, Special report, December 2020, 14.

5 Pippa Gallop, Ioana Ciuta & Davor Pehchevski, "[Two-speed energy transition in the Western Balkans](#)", *CEEBankwatch*, June 4, 2020, 1.

6 International Environment Agency, "[Electricity Information 2020](#)", accessed June 14, 2021.

7 Martin Voß, Lutz Weischer and Martin Schön-Chanishvili, "[Supporting the Western Balkans' Energy Transition: An Imperative Task for the German EU Council Presidency](#)", *Germanwatch*, July 2020, 2.

Figure 1 Electricity production balance in Contracting Parties in 2019. Source: IEA⁸



Yet despite hydropower being a renewable energy source, small hydropower plants in particular have been found to cause serious environmental and biodiversity damage throughout the region.⁹

A timely transition is especially crucial for the Western Balkans, as it is projected to be one of the most heavily impacted regions in Europe¹⁰. Moreover, a transition to an energy-efficient and renewable power sector could foster regional prosperity and resilience.¹¹

Nevertheless, several economic and political factors are hampering the energy transition in the region. First, the incomplete transition from state-controlled energy sectors to open and regionally integrated

markets¹² has meant that the energy markets are dominated by single suppliers and that incumbent utilities are owned by governments. Across the Western Balkan Six, eight incumbent producers retain 93% of the total electricity produced in the region.¹³ This highly centralised governance of resources does not allow for real competition. In addition, distorting subsidies and state aid keep the price of energy artificially low, while sustaining an unprofitable and inefficient coal-based electricity market.¹⁴

Second, and related to the previous point, the energy sector in the Western Balkans is characterised by vested interests in coal and hydropower, making the energy transition highly vulnerable to dynamics of

⁸ Data for Montenegro is from 2018.

⁹ Pippa Gallop, Igor Vejnović & Davor Pehchevski, "Western Balkans hydropower. Who pays, who profits?", *CEEBankwatch*, September 2019, 5.

¹⁰ European Commission, "Guidelines for the Implementation of the Green Agenda for the Western Balkans", SWD (2020) 223 final, October 6, 2020, 2.

¹¹ Martin Voß, Lutz Weischer and Martin Schön-Chanishvili, "Supporting the Western Balkans' Energy Transition: An Imperative Task for the German EU Council Presidency", 2.

¹² Martin Voß, Lutz Weischer and Martin Schön-Chanishvili, "Supporting the Western Balkans' Energy Transition: An Imperative Task for the German EU Council Presidency", 3.

¹³ Energy Community Secretariat, "WB6 Energy Transition Tracker", February 2021, 5.

¹⁴ Damir Miljević, "Investments into the past. An analysis of Direct Subsidies to Coal and Lignite Electricity Production in the Energy Community Contracting Parties 2018–2019", *Energy Community Secretariat*, December 2020, 5.

clientelism and corruption. According to Marco Prelec, energy projects (including in renewables) can easily be exploited for personal or partisan advantage: tenders may lead to bribes and projects may be assigned to companies close to the government.¹⁵ In addition, energy laws may be tailored to privilege certain parts of the sector over others. For example, in North Macedonia the former deputy prime minister, Kocho Angjushev, was accused of conflict of interest as a result of sponsoring a law (Regulation No. 29) which particularly benefited hydropower producers while his family owned one-third of the small hydropower plants in the country.¹⁶

Third powers also play a role in obstructing the WB6's energy transition. For instance, Chinese-backed funding for new coal power plants¹⁷ is enabling the region's continued investment in coal.¹⁸ In addition, countries participating in the EU Emissions Trading System (ETS) contribute to the status quo in the region's energy sector by allowing imports of electricity from outdated plants. In 2019, EU ETS countries imported 33TWh of electricity, 19% of which came from the Western Balkans.^{19,20}

Nevertheless, there are some encouraging signs. In its 2020 Implementation Report, the Energy Community outlined several improvements in market-oriented and sustainable energy reforms.²¹ For instance, the report notes that Montenegro introduced a cap-and-trade scheme, that in Kosovo* the power generation company ContourGlobal abandoned its plan to build the so-called *Kosova e Re* coal power plant²², that North Macedonia introduced a coal phaseout programme and that the deployment of green electricity is increasing in many of the Contracting Parties (such as Albania, North Macedonia and Montenegro).

The prospects of the Green Agenda for the Western Balkans

The Green Agenda for the Western Balkans is not the first effort by the EU to spur a transition in the Western Balkans' energy sectors. The EU has been engaged with the region through a variety of initiatives and platforms. All WB6 countries are Contracting Parties to the Energy Community Treaty, a unique form of the EU's external energy governance established in 2005. The Energy Community aims to establish a stable regulatory and market framework while creating an integrated energy market in line with EU climate goals.²³ Moreover, the Initiative for Coal Regions in Transition in the Western Balkans and Ukraine, launched by the European Commission in December 2020, aims to facilitate a just transition away from coal and towards a carbon-neutral economy.²⁴

15 Prelec, Marko, "[Winners and Losers: Who benefits from high-level corruption in the South East Europe energy sector?](#)", *South East Europe Sustainable Energy Policy*, June 2014, 12.

16 Nieves Zúñiga, "[Examining State Capture. Undue Influence on Law-Making and the Judiciary in the Western Balkans and Turkey](#)", *Transparency International*, December 2020, 17-18.

17 Wouter Zweers, Vladimir Shopov, Frans-Paul van der Putten, Mirela Petkova & Maarten Lemstra, "[China and the EU in the Western Balkans](#)", *Clingendael*, August 31, 2020, 48.

18 In September 2020, China declared its intentions to cut its greenhouse gas emissions and become [carbon neutral by 2060](#). This may have repercussions on the funding of coal projects in the Western Balkans.

19 Chris Rosslowe, "[The path of least resistance. How electricity generated from coal is leaking into the EU](#)", *Sandbag*, January 2020, 18-19.

20 It must be noted that the [Carbon Border Adjustment Mechanism](#) (CBAM) is likely to curtail this practice, as it will put a carbon price on certain imports from non-EU countries which do not meet the standards of the EU's emissions policy. The European Commission is expected to table a proposal mid-July.

21 Energy Community Secretariat, "[Annual Implementation Report 2020: Energy reforms move ahead despite Covid-19](#)", November 23, 2020.

22 Igor Todorović, "[ContourGlobal abandons Kosova e Re project, exits coal altogether](#)", *Balkan Green Energy News*, March 17, 2020.

23 Energy Community, "[Who we are](#)", accessed June 15.

24 European Commission, "[Initiative for coal regions in transition in the Western Balkans and Ukraine](#)", December 2020.

The Green Agenda for the Western Balkans builds on these efforts.²⁵ It sets a blueprint for possible actions to facilitate a swift alignment with, amongst other things, the EU energy *acquis*. In the decarbonisation pillar, key actions to achieve a clean energy transition include the alignment with EU Climate Law and early inclusion of the WB6 in the EU ETS. Among the commitments given in Sofia, the Western Balkans agreed to introduce carbon pricing instruments.²⁶ Such a commitment has already yielded positive signs as countries such as Bosnia and Herzegovina and Serbia have halted coal projects following the calculation of the expected carbon expenses.²⁷

Yet the initiative is still in its early stages – an Action Plan is still being drawn up by the Regional Cooperation Council – and the Green Agenda will face some significant challenges in its implementation. As yet there is little clarity on how the commitments made under the Green Agenda will be enforced.²⁸ Poor implementation has long been a key obstacle in the greenification and diversification of the WB6 energy sectors. For instance, back in 2005, the Western Balkans committed to reducing emissions from large combustion plants under the Large Combustion Plant Directive sponsored by the Energy Community Treaty. Sixteen years after the signing of the treaty and three and a half years after the expiration of the 2017 deadline, none of the five Contracting Parties using lignite for electricity production met the requirements of the directive.²⁹ Therefore, without

an overarching governance mechanism that takes this challenge into account, the Green Agenda runs the risk of being poorly implemented.

Similarly, there is still little clarity on whether and how the Green Agenda will address some of the underlying obstacles to the energy sector's greenification and diversification, such as the centralised governance of resources, the dynamics of clientelism and the use of illegal state aid. As Contracting Parties of the Energy Community, the Western Balkans have a legal obligation to address any distortion of competition, including state aid. Nevertheless, this obligation is being systematically overlooked by state aid authorities that seem to lack both the capacity and autonomy to enforce state aid rules.³⁰ While the WB6, in their Sofia Declaration on the Green Agenda for the Western Balkans, have agreed to “strive to decrease and gradually phase out coal subsidies, strictly respecting state aid rules”, there is little clarity in the initial agreement on how this will be enforced.³¹

Also of note is the fact that the Staff Working Document on the Green Agenda for the Western Balkans talks of natural gas as a “stepping stone in the gradual decarbonisation”³², despite the concerns expressed by regional civil society organisations.³³ In fact, investing in gas risks creating a lock-in effect from one fossil fuel to another at the expense of renewable energy development. Moreover, the absence of gas infrastructures in the region implies substantial investments in facilities which risk becoming stranded in the forthcoming decades.

25 European Commission, “[Guidelines for the Implementation of the Green Agenda for the Western Balkans](#)”, SWD (2020) 223 final, October 6, 2020.

26 Regional Cooperation Council, “[Sofia Declaration on the Green Agenda for the Western Balkans](#)”, November 10, 2020, 2.

27 Igor Todorović, “[Tuzla 7 coal plant project in BiH sunk by GE's exit, officials reveal](#)”, *Balkan Green Energy News*, June 7, 2021.

28 European Environmental Bureau, “[Green Agenda for the Western Balkans: Joint civil society statement in the wake of the Sofia Summit](#)”, December 23, 2020.

29 Energy Community Secretariat, “[Annual Implementation Report 2020](#)”, November 1, 2020, 18.

30 CAN Europe, “[Coal in the Western Balkans is dead. It's time to pull the state-aid plug!](#)”, November 6, 2020.

31 Regional Cooperation Council, “[Sofia Declaration on the Green Agenda for the Western Balkans](#)”, November 10, 2020, 2.

32 European Commission, “[Guidelines for the Implementation of the Green Agenda for the Western Balkans](#)”, SWD (2020) 223 final, October 6, 2020, 4.

33 European Environmental Bureau, “[Green Agenda for the Western Balkans: Joint civil society statement in the wake of the Sofia Summit](#)”, December 23, 2020.

Conclusion and recommendations

Achieving a sustainable energy transition in the Western Balkans can bring considerable benefits to the region. The EU's Green Agenda for the Western Balkans is therefore a welcome initiative. Yet the WB6 are facing significant political and economic challenges in diversifying and greenifying their energy sectors. The EU would do well to ensure that its Agenda has teeth, facilitates market liberalisation, tackles illegal state aid, does not encourage investments in soon-to-be-stranded resources and can offset foreign (e.g. Chinese) investments in coal.

In the light of the challenges ahead, the following parameters could be considered in the implementation of the Green Agenda and in the drafting of the Action Plan by the Regional Cooperation Council:

- The EU may consider setting up a coherent governance framework around its Green Agenda for the Western Balkans
 - placing an emphasis on monitoring, compliance and legal enforcement – to prevent poor implementation of the agreed commitments. In doing so, it may first want to evaluate and draw its lessons from the implementation of the Energy Community Treaty.
 - The EU may also consider intensifying its efforts to combat issues of corruption, clientelism and lack of transparency and closely integrate these efforts with the activities surrounding the Green Agenda for the Western Balkans. The EU could attach binding criteria to its funds
- in accordance with the Green Agenda objectives. In addition, it could closely monitor the tendering of new projects in renewables to avoid the infiltration of private vested interests.
- Carbon pricing represents a persuasive tool to speed up the energy transition in the Western Balkans, as it would make coal uneconomic. At the same time, the revenues generated could be used to improve clean energy capacity.³⁴ The Green Agenda for the Western Balkans talks about exploring the inclusion of the WB6 in the EU ETS. The EU might seize this opportunity and provide concrete technical and political assistance to build significant administrative capacity in order to make the early inclusion of the WB6 in the EU ETS feasible. In this process and in sight of an overhaul of the current ETS proposed by the Commission for mid-July³⁵, it is essential to emphasise the importance of Article 10c of the current version of the ETS Directive³⁶ and safeguard a derogation for the transitional free allocation of allowances, enabling the parties to gradually modernise their energy sectors.
 - Finally, the EU would do well to present itself as a credible and active partner, by supporting the region with effective and robust financing structures that can offset funding for fossil fuels in the region (such as from China). In addition to investments in renewable energy production and infrastructures, the EU could consider investing in the sustainable extraction of raw materials needed for energy transition technologies.

34 Kantor & E3M, [“A carbon pricing design for the Energy Community. Final Report”](#), January 2021, 7.






35 European Parliament. [“Fit For 55 Package under the European Green Deal”](#), *Legislative Train Schedule*, accessed June 24, 2021.

36 See European Parliament, [“DIRECTIVE \(EU\) 2018/410 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 March 2018 amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, and Decision \(EU\) 2015/1814”](#), *Official Journal of the European Union*, March 19, 2018, 17.

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