



**SÜDOSTEUROPA-
GESELLSCHAFT**



in cooperation with
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**TUTZING CONFERENCE
“SECURING ENERGY SUPPLY IN EUROPE
THE ECONOMIC AND POLITICAL FRAMEWORK”**

The Athens Treaty Establishing the Energy Community

Introduction:

The Energy Community Treaty - that has entered into force on the first of July this year - is at the heart of the EU energy policies. It has set up a legal framework that enhances security of supply both in South Eastern Europe and in the EU by creating competitive energy markets compatible with sustainable development. This initiative has been launched and managed by the European Commission with the active support of the Stability Pact as a prerequisite to maintain social cohesion (some local populations still suffer from serious power cuts, especially in Albania and Kosovo) and to meet the future demand for energy resulting from economic growth. From a political viewpoint, it was also a unique opportunity to formalise the commitment of SEE countries to regional co-operation, including mutual assistance in case of disruption events.

What are the daunting challenges that the EU will be facing in the future in the field of energy security?

- There is an urgent need to replace the ageing EU infrastructure to meet expected energy demand. Circa one trillion euros will be needed over the next 20 years;
- EU 's dependency on import of primary fuels is likely to rise from 50% today to around 70% in the next 20 to 30 years if we do no manage to make our domestic energy markets more competitive;
- The imported primary fuels are concentrated in a few countries. About half the known natural gas reserves are located in Russia and Iran, while most of the oil reserves are in Russia, Saudi Arabia, Irak and Iran. In several of these countries the political situation is unpredictable in the mid-long term;
- World energy demand is expected rise by some 60% by 2030 due to the growth in the global economy driven in particular by China and India. (Global oil consumption has increased by 20% since 1994). As a result, oil and gas prices are rising. They have nearly doubled in the EU over the past 2 years.
- The growth in energy consumption is expected to boost the emission of greenhouse gases and cause our climate to become warmer.

In order to address this new energy landscape, the European Commission outlined its strategy in a couple of green papers. It rests now on five pillars:

1. The creation of competitive internal energy markets
2. The diversification of the energy mix, suppliers and supply routes
3. Energy efficiency/saving
4. Solidarity
5. An external energy policy

The Energy Community and the five pillars of the European Commission's strategy

How does the Energy Community Treaty aim at meeting these objectives?

1. Creation of competitive internal energy markets

Only the creation of competitive markets without internal barriers can attract and stimulate investments, while maintaining affordable prices for individuals and companies.

To keep the supply of energy in line with demand in SEE, the investment needs were estimated at about EUR 20bn by the Generation Investment Study commissioned by the World Bank. These investments are needed to:

- Restore the old infrastructure (which lacked proper maintenance and was partly destroyed by the bloody conflicts in the nineties) and;
- Construct new power plants and cross-border transmission lines

Unfortunately, the states of SEE are not in the position to finance these projects themselves due to their very limited capacity to take additional debt. Moreover, the Donors community is showing signs of fatigue in a context where many infrastructure projects are in competition.

Against this background, the Energy Community Treaty created the best conditions for the least-cost projects to emerge. Indeed, because of the fragmentation of local energy markets in SEE, the creation of a unique energy market offers genuine opportunities to amortise investments by selling electricity across the borders both within SEE and outside SEE to countries like Italy.

It is important to recall here that the energy prices and power utilities used to be heavily subsidized by the State. Therefore the introduction of new cost-reflective tariffs will, in a first stage, increase the prices paid by the final consumers and create affordability problems for the most vulnerable segments of the population. The restructuring of power utilities will also trigger redundancies. We are fully aware of these problems and, in order to address these issues, a Memorandum of understanding on the social pillar of the Energy Community Treaty has been prepared. The next Ministerial Council on 17 November 2006 will hopefully endorse a joint declaration recognising the importance of this memorandum.

Last but not least, the integration of local natural gas and electricity markets into the EU Single Energy market represents for SEE countries a very important political step

in a key-economic sector before accession to the European Union. This is why many people compared this Treaty to the European Coal and Steel Community Treaty that paved the way for the European Community

2. Diversification of the energy mix, suppliers and supply routes

As such the states of SEE, like any EU member state, are free to choose what energy mix suits them better, but the Energy Community has worked as a catalyst for them to rethink and improve their energy mix. This holds true in particular for Albania that relies on hydropower plants for the production of 98% of its electricity.

- Coal is staging a comeback borrowing on the promise of clean coal technologies. UNMIK/Kosovo will exploit its mines of lignite (brown coal) and build two new power plants. Serbia will do the same with Kolubara B.
- Both Bulgaria and Romania will keep their nuclear power generation capacity afloat by building a new nuclear plant in Belene (Bulgaria) and two new nuclear reactors in Cernavoda (Romania).
- The level of gasification in the region is relatively weak, except in Bulgaria and Romania. This is why most countries are studying the possibility to increase (Serbia, Croatia and BiH) or create from scratch (Albania and Montenegro) gas networks. But there will be no dash for gas, especially if the adoption of the Kyoto Protocol makes investments in hydropower plants more attractive. The region will also provide substantial gas storage capacity in its depleted gas fields and serve as transit areas for new pipelines supplying the EU.
- Renewable energy is already playing an important role in the region, namely thanks to the potential of small hydropower plants. Biomass and wind energy, though not a priority, could also be developed in rural areas.

The diversification of suppliers and supply routes could be made possible by the construction of LNG facilities in Croatia (in Krk) or Albania. This would make it possible to import gas from Algeria, Qatar or Iran. Likewise, pipelines coming from Turkey could be built. For example the Nabucco pipeline could bring gas from the Caspian Basin to Austria and supply between 5% to 10% of the EU demand during 15 years.

Another example is the Trans-Adriatic Pipeline (TAP). All these projects are designed to curb the dependence on Russian gas (about 90%) in the region.

3. **Energy efficiency/Saving**

The aim of the European Commission is to reduce consumption of energy by 20% by 2020.

Article 32 of the Energy Community Treaty enables the Energy Community to take measures to foster effective demand management policies, while article 35 empowers the Energy Community to adopt measures to enhance development in the area of energy efficiency.

As in Eastern Europe, the cost of energy in SEE was traditionally highly subsidized. But low energy prices stemmed from deliberate state policies rather than from low primary fuels prices charged by the former Soviet Union. As a result, people and companies had no incentive to save energy and the present levels of energy intensity are significantly higher than in EU countries. This implies that by implementing appropriate energy efficiency programs, SEE states could easily decrease their energy consumption by 10%. It is expected that recent price hikes of primary fuels combined with the increase in energy prices to final consumers induced by market reforms should provide a strong incentive to consumers to save energy and use the most efficient technologies. Furthermore, based on the experience of some Eastern European countries, the electricity intensities are expected to fall as the economy diversifies away from energy intensive industries.

The government of Serbia recently issued the first draft of a framework convention on sustainable energy development in the Balkans, which focuses on the need to promote distributed energy generation (i.e. modular electric generation or storage near the point of use) in remote rural areas. This convention could not only help to reduce the high technical losses in the transmission/transport of energy (more than 10% of the energy produced), but also encourage the use of renewable energy (small-scale biomass or hydropower plants) in remote rural/mountainous areas. At the same time,

it could contribute to fulfilling public service obligation to populations living in isolated areas. We understand that the last PHLG has put this Convention on hold.

Energy savings can be achieved in following sectors:

- Power utilities (better efficiency, reduction technical losses in transmission, distributed energy generation)
- Transport (use of public transport, tolls, bio-fuels, multi-modal transport train/inland navigation e.g. Danube Commission)
- Housing (better insulation, metering systems, rational use of lighting/cooling)
- Energy-intensive industries (carbon trading schemes, new technologies)

4. Solidarity

In the EU, there are currently no solidarity mechanisms among member states to prevent energy supply crises and manage them if they occur.

In contrast, the Energy Community Treaty has innovated by creating an obligation of mutual assistance in the event of disruption in the energy supply (articles 44 to 46).

On the occasion of the last Ministerial Council held in Luxemburg on 8 June 2006, the Stability Pact urged the parties to make use of these provisions in the Treaty. The purpose was to prevent the “Beggar thy neighbour” policies that magnified the unwanted side effects of the gas dispute between Ukraine and Gazprom early this year.

Indeed, if next winter is as difficult as last year, gas and electricity supplies could again come under threat. Due to under-investment in the Russia’s gas infrastructure, soaring domestic demand in Russia or other reasons, Gazprom might not be able to meet demand in South Eastern Europe fully. Moreover, electricity supplies could also be adversely affected by the planned decommissioning of units III and IV of the Kozloduy nuclear power plant in Bulgaria. Once these two nuclear reactors are retired, Bulgaria’s ability to export electricity will be severely constrained.

Against this background, the Stability Pact called upon the Parties to the Treaty, -but also the countries that play a role in their energy supply chain- to devise an emergency scheme, plan their gas and electricity needs over the coming winter period and appoint national co-ordinators to facilitate and expedite co-ordination between countries.

5. **An external energy policy**

The aim of the European Commission is that the Member States speak with a common voice so as to maximise the benefits of a coherent external policy. It would prevent major gas suppliers to play one Member State off against another one.

The Energy Community Treaty restricts the scope of this external policy to trading issues. But no one doubts that by enlarging the European internal energy market to the countries of South Eastern Europe, the Commission has not only set the stage for more competitive markets but has also increased the potential bargaining power of the EU vis-à-vis its external energy partners. If the Energy Community is further extended to Norway, Moldova, Turkey and Ukraine, this power will increase accordingly.

This bargaining power could be used to address Russia 's new energy imperialism and negotiate a partnership whereby Gazprom would allow third party access to its pipelines in exchange for access to European retail markets where profit margins are several times higher than in production.

This would also bolster the position of the EU in the Caspian Basin where Russia and China are very active. Countries of the Caucasus Basin and central Asia used to be afraid of China, but not anymore. China is conducting business in a very friendly manner without imposing any conditionality on human rights. Over the past year China, India, Russia and Iran have signed energy deals with one another and have begun creating a central Asian "energy club" that would have its own energy market. The Shanghai Co-operation Organisation not only includes China, Russia, but is also about to invite Iran, India and Pakistan to be full members. The economic end game

seems to be to dilute US and EU efforts to dominate the Caspian Sea's energy reserves

Of course such external energy policy is clashing with the competences of the Member States in the field of energy. It will be hard to convince some Member states to abandon their "national champion" policies and their expected benefits in terms of privileged relationships with Russia (E.ON). This is another reason why the European Commission very much favours cross-border consolidation inside the European internal energy market.

Conclusions

As we have seen, the Energy Community Treaty has assigned very ambitious targets to the countries of South Eastern Europe to address the future challenges of energy security. In some areas, it goes even further than the currently existing obligations endorsed by EU Member States.

These countries are now in the process of implementing the necessary reforms and will have to overcome substantial social and economic hurdles in a very short time frame. This will require a lot of political courage, but we believe that the outcome will justify the efforts.

The Energy Community Treaty shows that countries of South Eastern Europe can successfully work together, which is a key political objective of the stabilisation process in the region.

The Stability Pact is proud of the development of this initiative as it is also a major building block of an emerging regional economic strategy, which includes a free trade agreement, infrastructure, a regional investment framework, a regional broadband market and of course, efforts to address crime and corruption. Put simply, this Treaty gives regional co-operation true credibility.