

Regional Cooperation on Energy in the Western Balkans

Energy transition is the most significant challenge for Western Balkans. The region primarily depends on fossil fuels, mostly coal, for energy. The energy transition is at its inception, and the focus of governments on renewables is negligible. However, with the desire to become EU members, and because the EU surrounds the region, the green transition is inevitable in Western Balkan countries. The region will soon be subject to the EU rules and regulations, particularly those related to decarbonization. Slowness or the lack of green transition would reflect on the effectiveness and competitiveness of the region's economies. Also, regional integration is necessary for the effective green transition, and mechanisms such as the Energy Community and the Berlin Process could be utilized. But, despite the debate, the region remains fragmented.

To address this issue, the Council for Inclusive Governance (CIG) in cooperation with the Federal Foreign Office of Germany (AA) organized on July 22, 2023, in Skopje, North Macedonia, another roundtable for the high officials of the main political parties from the Western Balkans to address energy transition in the region. The roundtable is part of a larger initiative on strengthening the region in the face of new geopolitical challenges conducted by CIG and supported by AA. The event focused on discussing the prospects for the green transition and the increase in using renewables, as well as how the improved regional cooperation could help in this regard and how to use it to address these issues better. Apart from political representatives, the roundtable also included several energy experts from the region, who provided the other participants with their insights on the most challenging aspects of the issue. The discussions were held under the Chatham House Rule. This report drafted by CIG Senior Associate Igor Novaković does not necessarily represent the views of individual participants, CIG, or AA. It simply reflects the discussion as a whole and CIG is solely responsible for its content.

Challenges of Energy Security and Transition

The region remains highly dependent on fossil fuels, in particular lignite, a type of coal with low energy efficiency. Historically, lignite and other types of coal were used due to the abundant deposits, and as such, it was the cheapest energy source for most Western Balkans countries (excluding Albania). However, coal dependency now represents a challenge, while the region remains one of the most carbon-intensive in Europe. Other related issues are the lack of focus on renewables, particularly solar and wind, obligations of the region concerning the EU and the Energy Community (EC), focus on natural gas as an alternative energy source, energy efficiency, energy conservation, and others.

Regarding coal (lignite), mines and power plants are inefficient and hamper competitiveness. On the other hand, coal power plants are mostly obsolete, and the only way to improve their efficiency and environmental sustainability would be their modernization or reconstruction. But even with

the improvement of policies and investment cycles, there is an international consensus on global coal and other fossil fuels phase-out due to environmental challenges. Furthermore, as one participant outlined, the coal power plants cannot be sufficiently adjusted to comply with the EU environmental requirements. “It was tried all over Europe, and it failed.” Another participant said there is no hope for restoring the coal power plants. “These plants cannot be revived; they are dead!”

The EU has recently introduced the Carbon Border Adjustment Mechanism (CBAM), which would introduce an import tariff on carbon-intensive goods from abroad. While it would allow the EU to claim the international leadership when it comes to phasing out coal, it would also impose challenges for the economies of the Western Balkans. In the past few decades, the power industry and transport sectors in the Western Balkans have even increased when it comes to fossil fuel consumption. But with the CBAM mechanism in place, this competitiveness will be gradually eliminated due to the EU import tax imposed in phases. Hence, the transition is both needed and necessary.

Another issue is energy efficiency and conservation, which is “another side of the medallion” of the green transition. In other words, it is also about reducing unnecessary energy consumption and eliminating unnecessary losses. One of the significant problems in the Western Balkans is that since the outbreak of the Yugoslav wars, electricity has been used as one of the significant sources of heating for households. This fact is causing enormous grid losses, thus highlighting the issue of energy poverty. Data about the grid losses are staggering. While the world average is 8% and the EU’s average is 6%, Western Balkan’s lag: Albania 24%, Bosnia 8%, Kosovo 15%, Montenegro 18%, Macedonia 20%, and Serbia 15%. Reasons for that lie in the lack of district heating networks or inefficient existing district heating networks, said a participant from Kosovo.

Therefore, there is a challenge in reducing energy poverty through effective policies and inventive solutions focused on energy efficiency and spreading renewable energy sources. In that regard, a participants from Montenegro outlined her experience with the pilot program for so-called “prosumers,” offering loans for installing solar panels on rooftops of households and residential buildings. Similar programs were launched recently in other Western Balkans countries, but all need to be expanded. Also, they should be complemented with energy efficiency solutions and models for individuals and households cooperating on energy production. One of the participants has outlined solutions for that, including the “energy cooperatives,” which could improve the investment cycles, bounding of smaller investments, and cooperation on improving energy efficiency between the households and residential buildings.

Firewood is another challenge since, with the rise of prices of other energy sources, households turn to firewood as an alternative source of energy. During the heating season, the prices go up enormously. On the other hand, firewood (and biomass) is a carbon-neutral source and could be seen as a partial alternative and a heating source. Hence, the focus of the region’s countries should be set on balanced usage of this source as well as reforestation. This would be helpful both as a fuel source and for reducing carbon in the atmosphere.

An additional issue is the usage of natural gas. Several years ago, it was considered an alternative energy source, much cleaner than coal. However, natural gas also has a carbon footprint, and the

sources are mostly not domestic, thus being subject to political challenges that the war in Ukraine emphasized. Nowadays, gas is used mainly for heating, in particular in Serbia. In other words, there are no industrial demands for natural gas, and the industrial facilities use the gas mostly as a heating source, not for industrial production. Hence, natural gas could be used only as a transition fuel, not as a solution. All policies and solutions should take that into account, but at the same time they should also focus on the security of supply and lowering costs. A participant from North Macedonia stressed that in that regard, the construction of interconnectors in the region is significant, in terms of security of supply, but also for price lowering and limiting opportunities for the “weaponization” of natural gas supply by the third countries. A participant from Kosovo outlined that the challenge related to natural gas is also valid for Kosovo and Albania, which do not use gas as a power source. “Gas prices also affect the price of energy coming from the other energy sources.”

Regarding hydropower, it is a potential source but in the Western Balkans it is mostly limited to small streams and rivers, as the major rivers have already been utilized. But, there are other challenges related to the environment and carbon reduction/preservation (ecosystems, drainage, waste fields, swamps, etc.), which makes them not a desirable source of energy. In other words, the focus of the Western Balkans should be on solar and wind as sources of clean and renewable energy.

One of the energy experts said that the example of coal power plant construction in the past could also serve as a source of inspiration for the future. “All major coal power plants were built in less than ten years. We take that as an inspiration and plan an investment cycle in renewables. There is no reason why we should not be successful in the same timeframe and get rid of fossil fuels by 2033.”

A participant from Bosnia outlined that there are also employment, social justice and fair transition issues. He stressed that it is not just about the transition to new energy sources but also about jobs and social stability. “20,000 people are working in industries related to coal energy production, including mining. The current approach of the financial institutions was directed on establishing social programs for those workers while lacking answers about their future employment, but also about the new sources of energy that should replace coal.” He concluded that the region needs a new type of approach from the EU, international and financial institutions, and a new impetus for regional cooperation.

Regional Energy Cooperation

Regional cooperation in the field of energy is not a novelty. In 2006, the EU established the Energy Community (EC), an international organization that brought together the EU, Western Balkans, Ukraine, Moldova, and Georgia. In other words, the principal aim of the EC was to create an integrated and sustainable energy market that would be set for integration with the EU and the applications of the EU rules and regulations. However, this organization did not fulfill its purpose entirely, and the regional energy market remains fragmented, while the transposition of the EU rules and regulations did not go smoothly.

At the 2022 Berlin Summit (of the Berlin Process), leaders of the Western Balkans 6 have adopted the Declaration on Energy Security and Green Transition, which emphasizes the commitment of the countries of the region to improve cooperation in transforming energy sectors and the European Green Deal.¹ The Energy Community should conceptualize regional cooperation by the end of 2023, which should be translated into laws, regulations, and strategies. In December 2022, the Energy Community Ministerial Council adopted 2030 targets to reduce primary and final energy consumption, accelerate renewables uptake, and reduce greenhouse gas emissions to achieve climate neutrality by 2050. They have also adopted a new electricity package that should enable the full integration of the Energy Community members into the EU market and support the development of renewables and phasing out of coal as a primary energy source. The EC Ministerial Council also agreed on the target of 31% of renewable energy sources for the region and the national renewable targets that should enable the EC to reach the percentage.

One of the critical elements of this process is regional market integration, or market coupling, as it aims to form one interconnected European market for electricity and integrate the region into it. It should link control areas and market areas to harmonize different systems of electricity exchanges and reduce price differences.² As one expert outlined, it is about creating one specific algorithm that sets prices throughout the market. In other words, it is about forming one interconnected market for electricity.

Market integration is essential because of the region's energy efficiency and dependency on fossil fuels. An integrated market would allow the more efficient use of the resources, but there is also a need to coordinate investments while allowing the investors to invest freely. "Currently, the investments are hampered with barriers, while the interconnectivity is relatively low in all segments." A participant from Kosovo said that the interconnectivity in the region should be coordinated at the multilateral level instead of bilateral, as all of the region's countries would have better results.

"Last September, the EU Commission, with the Energy Community, proposed a set of laws for regional market integration, and these rules have to be applied equally in all countries," said a participant. One of the most important is the EU Regulation on CBAM, which will affect the region's economic works and will be (gradually) reflected in all of the products. Regional integration and establishing the regional energy market would ensure the level playing field, allow more efficient adaptation to the CBAM mechanism, and an overall trade with the EU. "By 2030, the region has to have an efficient carbon emissions trading scheme." Also, another expert claimed that when it comes to the EC, there are no "soft contractual obligations" – everything is strict; by the end of 2023 – all power plants in the Balkans have to respond to the directive, and this is a moment when the EC Treaty "makes or breaks."

"The challenge is that the region is not integrated for now, and CBAM foresees exemptions for those countries that are integrated with the EU." Hence, the region has to draw from the experience of the EU and reach the stage where administrative borders do not matter. The EU countries are split into zones operating almost independently but integrated into the market." Despite the region

¹ Previously, at the 2020 Sofia Summit of the Berlin Process, the leaders have endorsed the Green Agenda for the Western Balkans, which is in line with the European Green Deal.

² <https://www.next-kraftwerke.com/knowledge/market-coupling>

being integrated into ENTSO-E, for example, the bilateral nature of their integration and a lack of an actual regional market does not allow them to influence policies.

“In essence, there is a governance problem,” stressed one of the participants. The region could agree on how to apply the rules, and the most obvious example is the EU itself.” At the political level, governments of the region have to ensure that the EU rules are adopted and transposed into laws. In the second stage, governments should enforce cooperation at the technical level. Cooperation has to be done in the spirit of solidarity. A participant outlined that after full interconnectivity is established, countries should also look for optimization as a goal “to fill the gaps in electricity supply.” “For example, 100% of Albania’s electricity production comes from hydropower plants, which means that during certain months it has to import electricity. Regional integration would allow better coordination of electricity production and supply. Albania could achieve cheaper supply during months when it has to import and supply other countries in the region when its electricity production is from hydro.” Some others outlined that “with the regional integration and coordination, there would be better predictability of consumption, as electricity has to be consumed when it is produced.”

Some also spoke about the need to focus on decreasing energy consumption, which goes hand in hand with the issue of energy poverty. “If we reduce the energy consumption, there would be huge savings that could allow the growth of GDP in the region by 5 percent.”

Others worried that the CBAM mechanism will cost the region the most, and exemptions are urgently needed. “It is not just about energy; it is also about fertilizers and food security, as CBAM will target certain products in the first phase, including producing fertilizers as one of the most carbon-intensive.” Experts have reiterated that the Regulation related to exemption from CBAM is in preparation, but to be applied to the Western Balkans, the region’s countries should integrate their market with the EU, as the Declaration foresaw.

The region’s old “Achilles heel” – political issues – is one of the most critical challenges for the integration. A participant from Kosovo stressed the political problem between Serbia and Kosovo – as it has a cost to both sides, consumers and traders. Kosovo’s and Serbia’s interconnection was blocked after Kosovo joined the electricity block with Albania; Serbia blocked the interconnection, making life harder for both Kosovo and Serbia, affecting trade between traders and partners. “The interconnection was never a part of the dialogue, and this question related to the issues covered by the EC.”

Other participants outlined that cross-border problems are a massive impediment in the region – not just electricity but gas and water. “They have to be tackled.”

“We can produce the laws and regulations. Our biggest issues are funding and the means to implement. In other words, we need money and time,” – said a participant from Bosnia. Several others outlined the need for a particular investment mechanism for the energy transition in the region.”

A participant from Serbia stressed that the region always hits the same wall – the political one. “To ask for the financial support, we should pull our act together. We should go beyond our petty

squabbles and act in a unified front. However, also we should ask ourselves some questions: do we have the political courage, do we have legislation, and do we have a legal capacity and know how to absorb the funds?” Also, he stressed the need to have independent institutions: “in some states, including Serbia, the key positions in the administration are in acting status, so they cannot act independently as they are under the influence of the executive.”

One of the experts stressed that energy from renewables is an exciting commodity for many investors, and there are different models to approach them. “One of them is that state provides land for the installment of solar power plants and windmills and offers a power purchase agreement (priority purchase).”

Conclusions and recommendations

Participants came up with several conclusions and recommendations related to the issue of energy transition, phasing out coal, regional cooperation, and the increase of renewables. Conclusions and recommendations were not necessarily based on consensus but encompassed the essence of the discussions at the roundtable.

- Investments in coal power plants or coal mines make should be phased out. The EU surrounds the region, and all carbon-intensive industries will be taxed. Coal power plants, as well as the carbon-intensive industries in the region, cause massive air pollution. Furthermore, the EU attempts proved that they cannot be reconstructed desirably. Consequently, the region should focus on renewables, particularly solar and wind, to replace the coal power plants. The plan has to be bold, and it is possible to do this by 2033.
- Natural gas cannot be considered an alternative source of energy. Firstly, it also has a carbon footprint and is a fossil fuel. The second issue is that sources of natural gas in the region are relatively small. Thus, the supply comes from foreign countries. However, at the current stage, it is essential to continue with the natural gas interconnector’s construction throughout the Western Balkans, between the region’s countries and the neighboring EU member states.
- The region should also invest in massive reforestation of the region. It would have immense benefits, including the improvement of hydropower, the fight against land erosion, and a biomass fuel that is carbon neutral.
- The government has to address the issue of energy poverty through new investments in district heating, subsidies for prosumers, and new heating technologies. Also, governments should encourage the establishment of “climate assemblies” and “energy cooperatives” at the local level, aimed at the collaboration of individuals in local energy production and energy conservation.
- The region has to pull its act together, and governments should use existing mechanisms and signed and endorsed documents through the EC and the Berlin Process. The primary goal should be establishing effective regional governance, energy market coupling and interconnectivity, and more effective cooperation at the operational level. This should lead to integration with the EU energy market, increased competitiveness, efficiency and optimization, region’s attractiveness for energy production investments, balancing of capacities and supply and eventual coordination of investments.

- Besides this multilateral action, the government and legislatures should speed up the adoption of relevant laws and strategies to integrate into the regional market. Reforms in the energy sphere have to go hand in hand with environmental laws.
- EU should establish an investment fund for energy projects in the Western Balkans. However, governments must prove they are reliable partners that can implement regulative and administrative frameworks.
- CBAM is a challenge for the region, but to tackle it, the region has to integrate its energy market to achieve exemptions. The regional energy market will ensure a level playing field for the region and political and economic benefits in the future.
- Phasing out coal is not just a challenge related to energy but also to the social sphere. Thousands of people work in the systems that produce energy from coal, and their jobs will be in peril. Governments and the EU should consider this, design social programs, and generate new employment opportunities to mitigate these challenges.
- One of the significant challenges to integration into the regional energy market is political issues. An example of such an issue is the blocked electricity interconnection between Kosovo and Serbia. These issues must be urgently addressed to remove obstacles to creating the regional market.
- One critical issue is the fight against corruption and individual interests that slow down reforms. In the region, sectorial and individual interests blocked or slowed down proactive policies related to phasing out coal, support for renewables, etc.
- There is a general lack of understanding of the importance of energy transition. The region needs experts to effectively “translate” and explain the issues to the broader population.

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