



STABILITY PACT  
FOR SOUTH EASTERN EUROPE



## Speeches

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8 May 2006, Munich

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at the Energy Investment Round Table  
organised by the "Deutsches Ostforum München"

#### The Treaty establishing the Energy Community has been initialled What's next?

##### Introduction

The Treaty itself focuses on the creation of a stable regulatory framework for the integration of local natural gas and electricity markets into the EU Single Energy market. The activities of the Energy Community focus on:

- The implementation of the so-called **acquis communautaire** on energy, environment, competition and renewable energy sources
- The setting-up of a specific **regulatory framework** for the efficient operation of gas and electricity markets, including the creation of a single mechanism for cross-border transmission/transportation of Network Energy
- And finally, the Treaty creates a gas and electricity **market without internal frontiers**, which entails the prohibition of customs duties and quantitative restrictions inside countries of SEE and the European Union; this energy internal market also calls for the adoption of a common external energy trade policy regarding third countries.

Treaty will not enter into force before its ratification by the EU and at least six countries of South Eastern Europe. So far Albania, Bulgaria, Kosovo and Macedonia have already ratified the Treaty. The European Parliament is expected to do so within a fortnight. Ratification alone will not suffice. In order to attract industrial and financial investors in the region and meet the large funding needs for energy infrastructure, all stakeholders must work together to create the right environment for a speedy and effective implementation of

the energy community treaty.

Four sets of conditions must be fulfilled to reach this goal

- 1) The cornerstone of that environment relates to the establishment of political stability in tandem with social cohesion.
- 2) The second pre-requisite concerns the existence of stable and attractive market features, including effective electricity and gas regulatory frameworks allowing for healthy competition and fair pricing, full compliance with long-term commitments and availability of skilled workforce
- 3) The third condition is the need for regionally concerted investment strategies.
- 4) The fourth condition relates to easy access to public funding

### **Political and social stability**

Political stability as key to investment in the region Conducting business in South Eastern countries increases the risk profile of a company. Konrad Reuss, a managing director at Standard & Poor's was quoted for saying that: "if political stability comes, it will be positive for the region. If it does not, it will impact quite negatively. There's no middle ground. It's either/or".

This warning must be taken seriously, because when the Austrian company EVN recently acquired the Macedonian distribution power utility ESM, its rating was downgraded by both Standard & Poor's and Moody's. Everyone in the audience understands the impact of ratings on the borrowing capacity of a company, which affects the long-term financing of a project.

As I already explained yesterday, much progress has been made to achieve political stability in the region thanks to the Association and Stabilisation agreements and the accession and pre-accession instruments. There are however significant milestones lying ahead on the path to political stability. Let me name two of them. The first one will be the outcome of forthcoming referendum in Montenegro and the second one will be the conclusion of a sustainable settlement for Kosovo.

No political stability without social cohesion

Political stability is also strongly co-related to social cohesion. Inspired by the market-oriented principles set out in the Treaty, the governments of the region have started the unbundling and restructuring process of their state-owned energy companies. This ongoing process is resulting in lay-offs. Furthermore, in order to become profitable and attract investments, energy tariffs are being progressively raised and effective billing and payment collection policies are being enforced. These measures are causing affordability problems for the poorest segments of the population. The Stability Pact believes that social cohesion must underpin economic development and remains a key factor of stability in the region. All stakeholders must therefore help the governments in the region to address these issues.

### **Stable and attractive market features**

Properly implemented market reforms Of course the governments of the region did not wait until the conclusion of the Treaty to start adapting their local energy markets and regulatory bodies. After the launch of the Athens Process, working groups were set up to devise an Electricity Transition Strategy and a Market option paper. Governments have enacted a set of laws to implement the measures set out in both papers. The same exercise is being done

for the gas sector. BUT the courageous reforms that are currently being translated into new laws and regulations **must also be effectively put into practice**. Otherwise, the creation of a single energy market could cause adverse effects. For example, experts are already warning that energy will be traded with neighbouring SEE countries, only if energy suppliers can ascertain that market conditions are attractive enough. So, if new pricing, billing and debt collection policies are not properly enforced and regulated by market-oriented independent agencies, energy is likely to be directed to more reliable EU markets (Southern Italy, for instance).

Moreover, investors will look at the opportunities to sell energy across the borders. If they suspect that cross-border transmission mechanisms are not put in place or will not work properly, they will be reluctant to invest. Compliance with legal commitments (*P acta sunt servanda*) SEE governments or state-owned power utilities are doing their best to offer investors attractive terms and conditions. These include, in particular, primary fuel supply agreements, long-term concessions, off-take agreements, distribution monopolies, independent market-based pricing. Also banks usually lend money against collaterals in the form of pledged assets i.e. shares in the energy company. In the event that the collateral does not provide enough security, they will ask for additional guarantees from the state. If an energy company defaults on a loan, banks want to be sure they will be able to execute their collaterals.

It is of the utmost importance that **contractual obligations endorsed by them are fulfilled in spite of government changes**. In this respect, we need address following questions:

- a) How can the stakeholders help guaranteeing that the commitments taken by governments/state power utilities of the region will be respected?
- b) How can the investors obtain assurance that the EU/EC will not challenge the legality of exclusive terms & conditions granted by the SEE governments?

Availability of skilled workforce and know-how  
The construction and subsequent operation and maintenance of new power plants will require the availability of skilled workforce. We have to think now what measures we could adopt to foster investment in human capital and life-long learning schemes.

### **Need for regionally concerted investment strategies**

The countries of South Eastern Europe, especially in the Western Balkans, don't have, in general, large, rich and densely populated urban areas that provide room for purely national energy policies. The fragmentation of local energy markets therefore requires prioritizing investment projects across the countries and designing trans-national energy policies. The Generation Investment Study, also called GIS report, published in December 2004 under the responsibility of the World Bank, calculated that a regionally integrated approach (as opposed to purely national approaches) could achieve a saving of nearly 10% in total investment needs.

The GIS also identified a number of priority projects that will serve as starting basis. Since then, various parameters have changed dramatically. The prices of gas have soared and even thermal coal prices have increased. This GIS report is thus being updated to take these changes into account. The possibility to connect South Eastern Europe to the Russian and Ukrainian grids will also be given due consideration. Another very important issue is how the carbon emission trading schemes will affect the balance between rehabilitation of old power plants and construction of new ones. Both Bulgaria and Romania have signed the

Kyoto Protocol, but other SEE countries might follow cue in their respective accession process.

a) While it is left to the local governments to propose priority investment projects related to the development of the Energy Community, **all stakeholders want to understand how consultation processes will prioritise projects (location, source of energy, etc)**. In this context and in view of the need to diversify sources of energy, what could be the specific role of nuclear energy and coal/lignite?

b) Furthermore it **urgent to design trans-national energy policies** that will serve local populations and businesses in the most efficient way so as to achieve economies of scale. Otherwise investors might be reluctant to enter into such projects. In what forum will this coordination take place?

c) The crucial decisions **to better interconnect these fragmented markets with transmission lines** need to be adopted under the coordination of an appropriate panel.

### **Need for easy access to public funding**

International financial institutions play a crucial role in the region in providing advisory services, structuring deals and funding projects. They have been involved in many privatisations and concession of power plants. Recently the successful conclusion of negotiations on the Energy 4 project worth USD 286.6 mn (KM 455.1 mn) in Bosnia and Herzegovina provides a good example of successful cooperation between IFIs. While the negotiations were mainly led by the WB, the main investors in the single largest investment in Bosnia ever include the European Investment Bank with USD 116mn and the European Bank for Reconstruction and Development with USD 67 mn, WB itself lending USD 67 mn.

Complex cross-border projects yet require stronger co-ordination mechanisms between IFIs in order to help loan applicants to ease compliance with technical and environmental due diligence requests, while avoiding work duplication and minimizing cost.

The World Bank has already earmarked an envelope of USD 1 billion to support energy infrastructure projects under an APL fund with a straightforward conditionality. If the Commission can certify that projects comply with the Energy

Community Treaty, the World Bank will release funding. Both EBRD and EIB will keep their own work methodologies, but agreed to harmonize their funding application procedures. We cannot but welcome their efforts

Last but not least, industrial investors would like to receive better guidance on how they can obtain EU funds available for energy projects.

### **Conclusions**

The reforms induced by the Treaty are the only way forward but opportunities lying ahead are huge. I invite the business community to take up the challenge in this part of Europe that belongs to the European Union.