Energy Community Secretariat

One year after the Wachau Manifesto –

Making the Energy Community climate and energy transition a success

In June 2018, the Secretariat published a Wachau Manifesto as a wake-up call for the Energy Community Contracting Parties to follow the EU's energy sector decarbonisation pathway and prepare for the manifold changes and challenges that this second transition would entail. The magnitude of these challenges is even greater as the Energy Community's first transition, the one supposed to transform post-socialist sectors into open and integrated markets, remains unfinished. A year later, the gap between the increasingly ambitious decarbonisation policy in the EU and the lack of ambition in most Contracting Parties became even wider. What is more, it threatens to undermine the future of the Energy Community as an energy and climate integration tool.

A brief reminder: The Energy Community was created in 2005 as a mechanism for the integration of a pan-European energy market, based on the same legal framework for EU and non-EU countries in Europe. Since its creation in 2005, the Energy Community aimed at increasing congruency: the Contracting Parties committed to follow the EU's rules on reforming electricity and gas markets, protect the environment from pollution and other adverse impacts of energy production and improve energy efficiency and the deployment of renewables.

Given the importance of sustainable development for the region's future, we consider it of utmost importance that the European Union extends the same high level of ambition, expressed in targets and rules, when it comes to reducing the energy sectors' detrimental impact on the climate. The European Commission has the right of initiative in the Energy Community.

The most visible gap in the Contracting Parties is arguably the absence of a greenhouse gas emission reduction target. The nationally determined contributions communicated by the Contracting Parties to the UNFCCC under the Paris Agreement do not make up for this, as they are lagging behind the ambitions shown by other European countries. As a consequence, the energy sectors, dominated by coal-fired power generation in many of the Contracting Parties, are not subject to a carbon price, let alone participation in the EU's main instrument to combat climate change, the Emissions Trading Scheme (ETS).

The lack of a carbon price results in a competitive advantage for the Contracting Parties' incumbents, which under the Energy Community Treaty export electricity cheaply to EU Member States, and attract investments which fail to respect the European greenhouse gas emission standards and prices. With the price of CO_2 emissions having surged last year to close to 30 EUR/t, even several outdated coal power plants in the Contracting Parties are profitable again. Our experience suggests that investment in new coal-fired generation is also done in contravention of European State aid rules, which lack vigorous enforcement in the Energy Community. Carbon investments in the Contracting Parties, mostly in new coal-fired power plants, are often supported by finance from third countries such as China, at terms not in line with European rules.

In a truly vicious circle, this disparity encourages internal opposition to the closure of even the oldest, most polluting power plants and deeper market reforms (as the continuation of the status quo allows for windfall profits on the EU power market). It also provides arguments for external criticism of further integration of Contracting Parties in the internal market (concerning e.g. the synchronization of the

Ukrainian electricity grid with the rest of Europe, as it would facilitate imports from the enormous coal fleet in Ukraine).

It is clear that this situation cannot last forever. Be it part of the accession negotiations, be it on account of EU Member States' potential actions against what they perceive as unfair competition, or be it by the ever more active civil society, at one point the pressure will force the Contracting Parties to stop their carbon subsidies and introduce carbon prices. The later this point comes, the more regret investments will have taken place, and the greater the shock for the power sectors in the countries affected, as well as their customers. Yet large-scale bankruptcies and turmoil is the last thing the geopolitically sensitive Contracting Parties should be exposed to.

To avoid such shocks and adverse consequences, it is high time for action not only by the Contracting Parties, but also the European Union. Remaining true to the visions developed for the Energy Community over a decade ago, the EU must again become a white knight in a region courted by many players. Letting the Energy Community countries drift further away from European policy and law in the sphere of the energy transition may become irreparable. At the same time, the action needs to be well-dosed and gradual, as shocks may occur otherwise.

We suggest a number of building blocks as input to the energy transition discussion:

1. **Adoption of comprehensive decarbonization targets for 2030 (energy efficiency, renewables and greenhouse gas emissions), as well as the incorporation of the Clean Energy Package (and in particular the Governance Regulation requiring National Energy and Climate Plans).** Without targets and a legislative framework, subsequent measures risk to remain piecemeal and will create a regime not harmonized with the European Union's in terms of content and timing.
2. **Adopting a more holistic approach to the ongoing electricity market reform and integration process.** Neither the Energy Community enforcement mechanism nor top-down actions proposed in regional schemes such as CESEC or the WB6 process have resulted in the regional market integration process passing the point of no return. Including bottom-up actions may increase effectiveness, ownership and transparency, but also allow for the adaptations necessary for the energy transition process to succeed. The National Energy and Climate Plans, currently under preparation by the Contracting Parties, could simply be expanded in the area of energy market reforms and cross-border integration. On a project level, feasibility studies for all new generation and infrastructure projects should clearly indicate the amount of GHG and a realistic carbon price covering the entire lifetime of the power plant. Both measures would need to be complemented by stronger regional coordination in the Energy Community bodies.
3. **Phasing out subsidies for carbon fuels and immediately putting an end to non-compliant State aid to the coal sector.** When drafting integrated Energy and Climate Plans in line with the Governance Regulation, the Contracting Parties should include targets and actions in that respect.
4. **Strengthening of the Energy Community's State aid enforcement regime to close the enforcement gap in the Contracting Parties.** The Energy Community Secretariat should be empowered with similar competences as the European Commission. This may also require access to the European courts. The current discussions on Treaty amendments risk to fall short in ambition in this respect.
5. **Introduction of moderate carbon prices in all Contracting Parties.** Experience in Ukraine and many EU Member States shows that this is possible. As a minimum, windfall profits made by energy companies selling to markets subject to carbon prices/an ETS should be taxed. The tax could be raised gradually. The income generated could be dedicated to similar purposes

as under the ETS Directive in the European Union (renewables support, energy efficiency measures, sustainable transport) and for supporting coal regions in transition. EU and other IFIs (co)financing could be conditioned on the existence of an effective carbon price scheme.

6. **Establishment of multi-stakeholder round tables discussing the timing and roadmap for coal phase-out in each affected Contracting Party.** The national platforms should include all relevant stakeholders such as trade unions, mayors from coal regions, ministries in charge of finance, energy, environment and social affairs, mining companies and owners of thermal power plants, civil society, etc. They should be complemented by a Coal Regions in Transition Platform on the level of the Energy Community in which the EU could not only share its experience but also streamline the necessary financial support with the required action on national and local level.
7. **Immediate implementation of auction-based support for renewables in all Contracting Parties.** While several Contracting Parties already transposed the required provisions into their legislation, the three most coal-dependent countries (Bosnia and Herzegovina, Kosovo*, Serbia) resist abandoning their non-efficient feed-in tariff regimes.
8. **Contracting Parties should be included in the EU's renewable development platform established under the new Renewables Directive, allowing them to participate in trading renewable energy quota between Contracting Parties and Member States, in addition to bilateral cooperation agreements.** Contracting Parties should also benefit from any future financial instrument on the level of the EU, helping to reduce the cost of capital for renewable energy projects. This would significantly help tapping into the Contracting Parties' outstanding potential for wind and solar. Additional funds to support the energy transition in the Contracting Parties should be explored.
9. To exploit the dormant potential of local and small-scale innovation, **the transition in the Energy Community should be supported by a facility or fund enabling innovative research and start-ups in the area of energy and climate technology, use-of-technology or services (including digital)**, which could lead to sustainable local job creation.
10. **Balancing power generation with the protection of the environment is particularly important in the area of hydropower investments.** Insufficient environmental rules and practices have contributed to unsustainable hydropower investments in the Contracting Parties. A well-balanced approach could be facilitated through bilateral or regional agreements on hydropower usage. Regional agreements could also be concluded for the increased protection of a number of cross-national rivers and river basins in the region. Bilateral disputes could be resolved in the framework of the Energy Community's Dispute Resolution and Negotiation Centre.

One year ago, we concluded that the Contracting Parties have the potential to come out as winners not losers of the energy transition. This still holds true, but the time to act has come. Given vested interests in the status quo in many Contracting Parties, they need clear signals from the European Union and other external partners to make them aware of the substantial changes they are expected to undertake to reform their energy systems. They also need additional financial support to implement these changes. Together with old and new partners from authorities, donors and civil society, the Energy Community Secretariat is ready to support and guide the process.

Vienna, 20 June 2019

Janez Kopač
Director

Dirk Buschle
Deputy Director