

The effect of State aid on the electricity market in the Balkans

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Introduction

This study examines the compatibility of the European Union's State aid rules and the electricity market liberalization objectives in the Balkans. The European Union (EU) has long begun the process of electricity liberalization by prompting that a single electric market will bring about affordable electricity for European citizens and sustainable development. Accordingly, the EU introduced a series of reforms to ensure market liberalization within Europe. Some of the reforms involve the breakup of monopolies in the electricity market, privatization of state-owned entities, and the need to increase the cross-border electricity interconnection lines.

Although many of the countries in Europe have finished most of the regulatory reforms to achieve an open electric market, seeking investments in the electricity interconnection lines and power generation remains a challenge. As for the former, in November 2017, the EU Commission proposed that all EU countries should achieve interconnection of at least 15 percent of their installed electricity production capacity by 2020.¹ To assist in this goal, the Commission has created funds such as the Connecting Europe Facility (CEF), planning to invest 33 billion euro to increase energy transport and digital infrastructure between 2014 and 2020.² Specifically, 4.5 out of a 5.85 billion euro fund dedicated for energy projects will be given in the form of grants. A new proposition in 2018 is set to increase this budget to 42.3 billion where 8.7 billion will be dedicated to the energy sector.

With regard to electricity production, the European Commission directive requires countries to achieve security of electricity supply.³ Yet, for some of them, especially those in the Balkans, reaching this security implies building new capacities at home and/or securing a source outside of their country. Balkan states often argue that energy projects are expensive and access to finance is a major constraint, thus, attracting private investors to these projects remains a challenge. Consequentially, many of those countries have attracted investors in the power generation by guaranteeing certain shares of the market for a particular period of time or guaranteeing loans. This method of guaranteeing sales is often called the Power Purchase Agreement (PPA), which essentially means a closure of the electricity market from other competitors.

Recent investments in power plants in the Balkan countries seem to be at odds with the EU's competition and State aid laws. The goal of the common electricity market is being risked by recent involvement of State aid in the energy projects. The EU's objective of investment in power grids may be severely jeopardized by investments with PPA and other instruments, which violate State aid rules. Accordingly, the aim of this research is to provide a comprehensive review of the electricity projects based on coal that are in breach of the EU laws on State aid and their impact on the electricity liberalization goal. In addition, per capita electricity consumption in the resource-rich Balkan countries is well below the EU average. As a result, there is potential to attract investments without risking a functional free market.

1 The European Commission. Electricity Interconnection Targets. Source: <https://bit.ly/2BbsGQp>

2 The European Commission. Connecting Europe Facility (CEF). Source: <https://bit.ly/2ynXqgz>

3 Directive 2005/89/EC — measures to safeguard security of electricity supply and infrastructure investment. Source: <https://bit.ly/2WXRDUH>

Our preliminary review of the case law, EC Secretariat's assessments, and the contracts suggests that there are several projects in various countries in the Balkans that might be classified as in breach with State aid laws that risk the closure of their market. This paper will use case studies to show how State aid is impairing the EU goal of open market in the electricity sector in the Balkans. Some of the case studies that will be reviewed are the following: a) Kosovo's recent contract with ContourGlobal to build a 500 MW Thermal Power Plant (TPP); b) Serbia's loan guarantee for the "Kolubara" TPP; c) Bosnia and Herzegovina's plan to grant aid for the construction of "Tusla 7" TPP.

The paper draws a number of conclusions regarding State aid in the Balkan countries. One important conclusion is that State aid authorities of the Contracting Parties (CP) of Energy Community Treaty (ECT) have limited ability and/or independence to assess State aid measures. The EC Secretariat has restricted legal power to prevent State aid violations of the CP. However, other legal repercussions in countries like Bulgaria and Hungary serve as an example of the consequences for not complying with State aid laws. Finally, CPs have capacities to attract electricity projects without State aid support, since they are rich in resources and have under-consuming electricity markets compared to the EU countries.

1. Electricity market liberalization in the EU

The EU has been committed to liberalize and integrate the internal electricity markets of current and aspiring Member States as part of the big goal to create a single EU electricity market. Specific actions, both through legislation and investments, have been taken toward achieving this goal. The core competition rules of Treaty of the Functioning of the European Union (TFEU) indicate that no market player can abuse with a dominant position in an internal market or receive favorable (institutional) treatment. In 2009, the EU entered into force its Third Energy Package (TEP) to regulate the internal energy markets. The relevant directive on electricity aims to primarily achieve effective unbundling in the internal electricity markets by separating the transmission operations from generation or supply companies.⁴ An independent transmission body is expected to increase competition by applying adequate control mechanisms and opening the market for new entrants. In addition, the TEP seeks to increase the cross-border cooperation between transmission bodies and independence of energy regulatory offices. Together, these initiatives would enhance competition in internal electricity markets of Member States and thus generate equal incentives for investors that plan to engage in the power production sector.

The EU has been engaged to fostering initiatives in line with the TEP and other directives by financing and promoting relevant projects. Specifically, it has created the funding instrument Connecting Europe Facility (CEF) that will provide funding, among others, for energy projects during the period of 2014 to 2020. More than 4 billion euro out of 5.85 billion euro fund dedicated for energy projects will be given in form of grants.⁵ At present, there are several investments being made across the EU and its borders on improving connectivity to networks and increasing transmission capacities. These projects are evaluated to ensure security of energy supply and as a result lower prices for consumers and industries. The European Network of Transmission System Operators for Electricity (ENTSO-E) investment plans to present dozens of ongoing network connection projects across Europe - many of which are planned to be commissioned before 2030 (see Figure 1).⁶

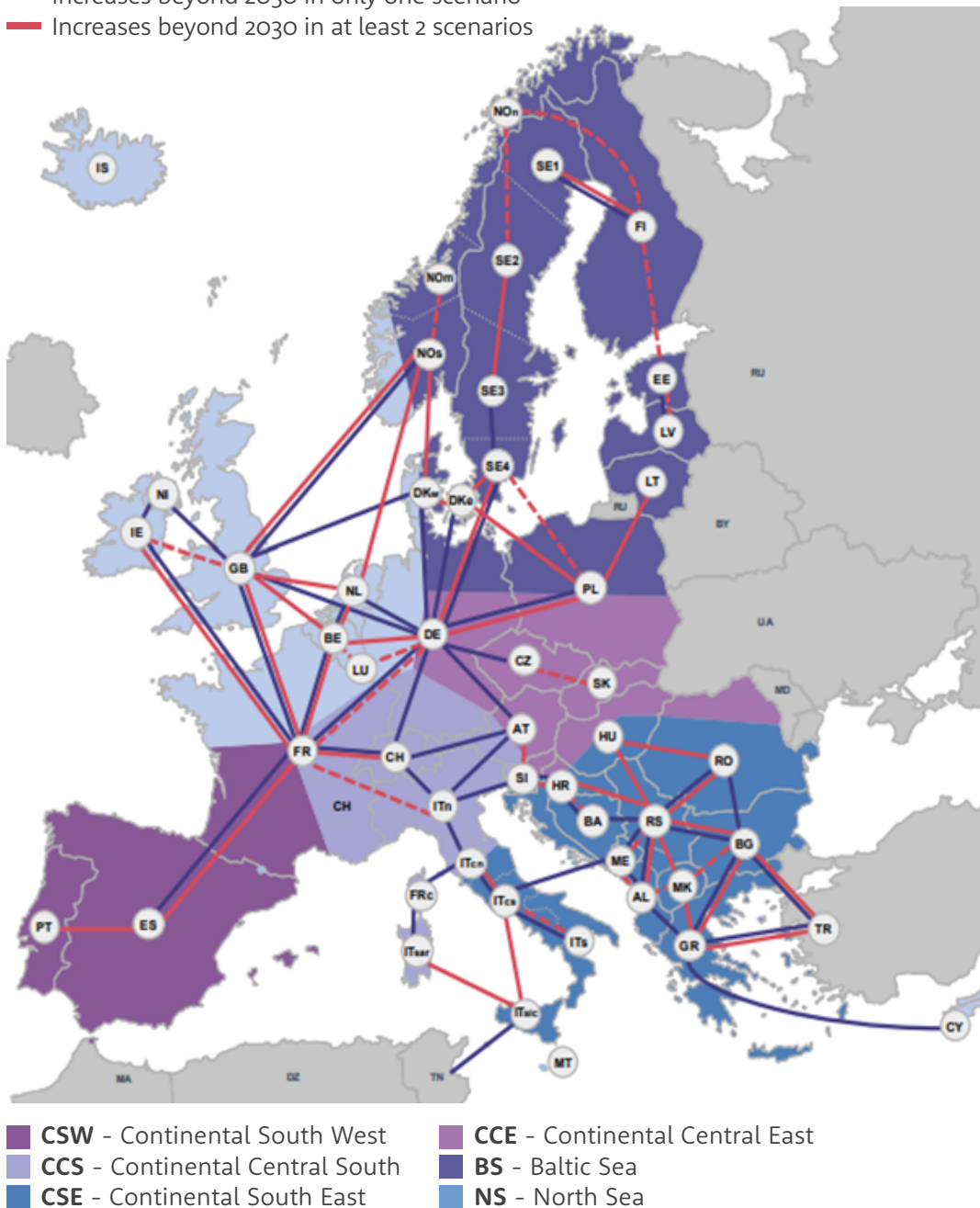
4 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity. Source: <https://bit.ly/2EySpol>

5 The European Commission. Connecting Europe Facility. Source: <https://bit.ly/2aMgvJu>

6 ENTSOE. Regional Investment Plans. Source: <https://bit.ly/2QVpvVT>

Figure 1. Current and planned investments in interconnection projects across Europe

- Increases already identified in TYNDP 2016
- - - Increases beyond 2030 in only one scenario
- Increases beyond 2030 in at least 2 scenarios



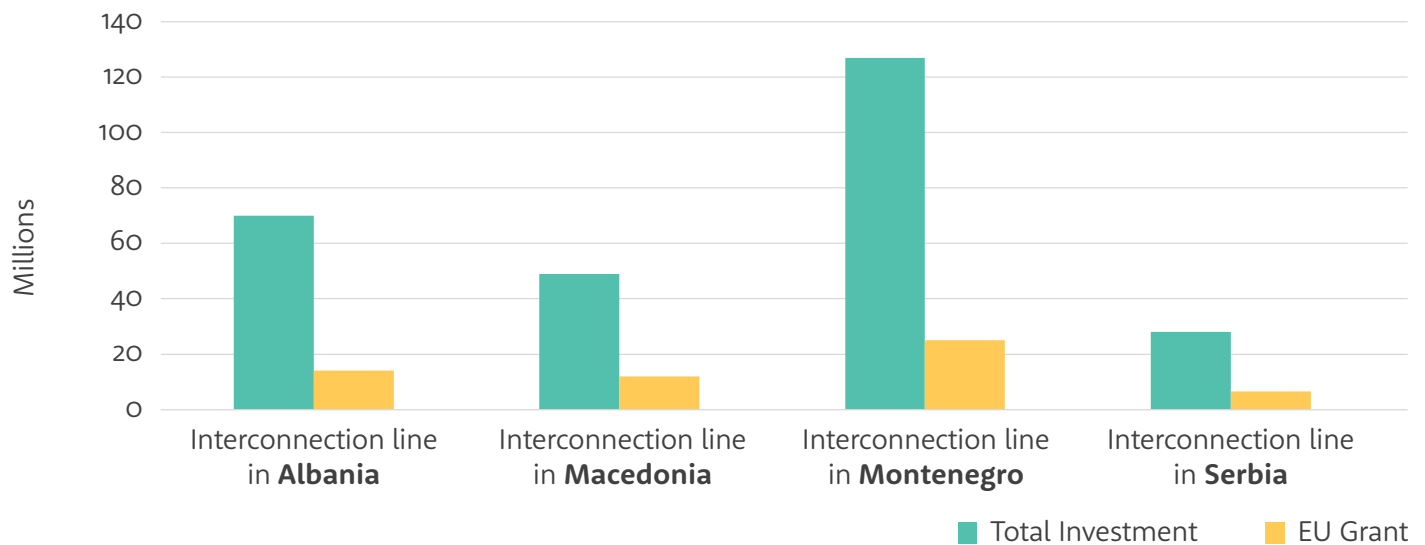
Source: ENTSOE⁷

Moreover, in 2014, the EU initiated the Connectivity Agenda that aims to increase the connection capacities between countries in the Western Balkans and thus create a regional electricity market. In joint meetings and summits that took place from 2015, there have been several energy projects initiated where the EU and each country pledged financial means. Specifically, in the period 2015–2017, the EU grants for the four prioritized electricity projects – which are outnumbered by interconnection networks – in Albania, Macedonia, Montenegro and Serbia amount to 108.4 million euro or 30 percent of the total investments value (see Figure 2).⁸

⁷ Ibid

⁸ Western Balkans Investment Framework (WBIF). Co-financing of Investment Projects in the Western Balkans in 2015–2017. Source: <https://bit.ly/2BpObMg>

Figure 2. Main investments in energy infrastructure in Western Balkans 2015-2017



Source: Western Balkans Investment Framework

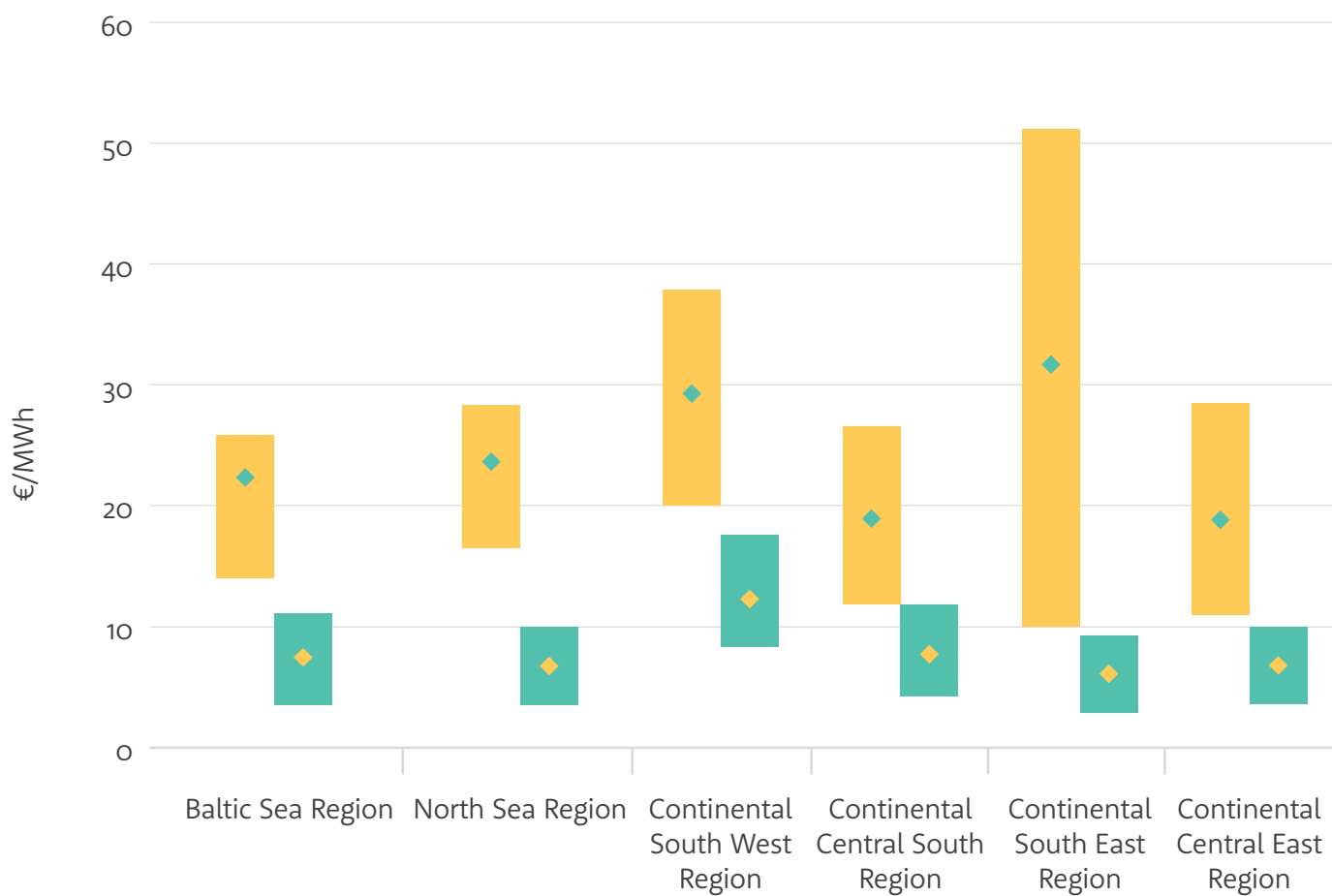
A similar interconnection line between Kosovo and Albania that costs 70 million euro, initiated prior to the selection of these four priority investments in Western Balkans, was commissioned in 2016.⁹

According to ENTSOE's evaluation reports, an increase in power generation capacities in Europe will have a positive impact in the welfare of the EU society. But, the scenarios show substantial differences in the amount of impact dependent on the fact if the newly built power capacities will be accompanied by investments in interconnection lines too. If adequate investments in both areas occur, the impact in reducing the marginal cost of electricity will be significant. According to ENTSOE, by increasing power generation capacities in the near future countries across Europe are expected to reduce their marginal cost of electricity production on average by 7 €/MWh to 10 €/MWh. However, if such investments are accompanied with investments in improving the interconnection infrastructure too - which will foster power exchange, better planning, and cooperation between countries - that will have a greater impact on reducing their marginal cost of electricity production. Specifically, marginal cost will be reduced on average by 18 to 33 €/MWh (Figure 3).¹⁰ As such, the EU has been supporting all strategic initiatives in increasing the transmitting capacities too.

⁹ SeeNews. Albania-Kosovo 400Kv power link goes live. Source: <https://bit.ly/2SRGiKs>

¹⁰ ENTSOE. Regional Investment Plans. Source: <https://bit.ly/2QVpvVT>

Figure 3. The impact of new generation capacities and interconnection lines on reducing the marginal cost of electricity production in Europe



◆ No Grid scenario ◆ 2040 scenarios with scenario grid

Source: ENTSOE¹¹

¹¹ Ibid

2. State aid rules

2.1. State aid under the EU and the Energy Community Treaty

The EU State aid regime is generally defined in the Articles 107 to 109 of the Treaty on the Functioning of the European Union (TFEU). The Court of Justice in the EU (CJEU) provides further interpretations of those rules through case law. Article 107 of the TFEU defines State aid as “[...] any aid granted by a Member State or through state resources in any form whatsoever which distorts, or threatens to distort, competition by favoring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the internal market.¹²” In other words, if an entity receives any government assistance, and as a result gains an advantage over competitors, it is considered anti-competitive and qualifies as State aid.

The European Commission is responsible for ensuring that any measure undertaken by the Member States is compatible with State aid laws.¹³ The Commission using the disposition of these laws has discretionary power to review national actions and determine whether a certain measure qualifies as compatible aid. A preliminary test, established in the case law, for determining whether a state measure qualifies as incompatible aid, requires each of the following broad components to be recognized by the Commission or the EU court:

A state must provide an economic advantage to an undertaking,¹⁴ or an entity, which would not have occurred under normal market conditions. In addition, the advantage has to be selective to a particular undertaking or production and not be applicable to the general economy.

The economic advantage received by the entity must come from the state through public¹⁵ resources. The concept of state resources consists of a wide range of methods including tax breaks, subsidies, grants, sale of public land, special loans, guarantees, long-term purchase agreements, etc. A more extensive definition of state resources is given in the case law.

The measure undertaken by a state is likely to distort competition between Member States. During the investigation, the Commission or the CJEU does not have to prove that a certain measure will distort competition; instead it only has to show that it is likely to produce such results.

States have traditionally owned and invested in many energy production or transmission companies. However, those rules do not preclude states to invest in state-owned enterprises as long as the investments are conducted in a similar manner as a private investor investing in a private company.¹⁶ If the publicly owned enterprise uses public authority resources to carry out a certain public policy, then that measure may constitute as State aid.¹⁷

¹² Article 107 (1) of the TFEU. Source: <https://bit.ly/2QQbso3>

¹³ The European Union. Competition and State aid and Control. Source: <https://bit.ly/1mqMYpA>

¹⁴ The jurisprudence defines undertaking as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed. Page 4. Source: <https://bit.ly/2OFnbwR>

¹⁵ The concept of public or state resources encompasses all levels of state administration including central, local government or any public authority.

¹⁶ Article 345 of the TFEU states that The Treaty in no way prejudice the rules in Member States governing the system of property ownership. Source: <https://bit.ly/2OHGooT>

¹⁷ Ibid

The rules of the Energy Community Treaty (ECT) on what constitutes State aid are not any different. The Energy Community is an international organization formed, by the EU and other non-EU countries in Europe, to extend the EU acquis in energy, competition and environmental law to the members of the ECT.¹⁸ When signing the treaty, members of the ECT agreed to start enacting the EU's main legislation on electricity, competition and environment. With regard to State aid, Article 18 of the ECT directly corresponds to Article 107 of the TFEU, which requires ECT members to prohibit State aid that distorts competition and affects the energy trade between the Contracting Parties (CPs).¹⁹ This treaty is legally binding to the CPs.

In addition to the treaty, non-EU members in the Balkans are signatory of the Stabilization and Association Agreements (SAA), which generally prohibits countries to engage in State aid actions as part of the broader obligation to implement the EU acquis. The Commission undertakes an analysis regarding potential breach of EU acquis on competition and State aid during EU Negotiation process.²⁰

Along with international obligations, Contracting Parties of the ECT have internally adopted the Law on State aid (LSA) and the Law on Competition Protection (LCP).²¹ They have also appointed institutional authorities to enforce competition laws.

Therefore, regardless of whether a country is a member of the EU, all countries in Europe are subject to the laws prohibiting State aid to protect competition within Europe. Both the EU and ECT reference the State aid acquis on what constitutes State aid. However, on the procedural part, there is a distinction between Member States of the EU and the CPs of the ECT which will be explained in Section 2.4.

The aim of the competition laws is to maintain a leveled playing field for all countries whereby avoiding destructive subsidy races leading to the waste of public resources. So, if each of the above-listed criteria is present, that particular state measure constitutes a breach of the EU State aid laws unless it falls within the instances where State aid is considered compatible.

¹⁸ EU – Energy Community Treaty. Source: <https://bit.ly/2SzjY3S>

¹⁹ State Aid Rules and Effectiveness of State Aid Control in the Electricity Sector under the Energy Community Treaty. Page 9. Source: <https://bit.ly/2QD8Nv2>

²⁰ European Neighborhood Policy and Enlargement Negotiations. Chapter 8. Source: <https://bit.ly/2tg95ci>

²¹ State Aid Rules and Effectiveness of State Aid Control in the Electricity Sector under the Energy Community Treaty. Source: <https://bit.ly/2QD8Nv2>

2.2. Compatible State aid

Despite the negative aspects, State aid can be beneficial. It can assist states in achieving a policy objective that is desirable for the society, while minimizing the effect on competition. Article 107 of the treaty permits the Commission to classify an aid as compatible aid.²² The Commission has a duty to investigate national measures and evaluate whether the measures are in line with the EU energy objective or are subject to various exemptions. For a state measure to qualify as compatible aid, at least one of the following criteria must be present:

State aid granted for social character or reversing natural disaster effects are considered mandatory exemptions.²³ For example, having access to electricity is considered a necessary good; therefore, states have designed social policies for those who cannot afford electricity. In this regard, an aid is compatible if the government gives consumers a voucher to buy electricity without indicating where the electricity must be purchased. The Commission should be notified that the social policy or the natural disaster intervention in fact does not constitute an advantage to a specific undertaking.

Discretionary exemptions are those exemptions deemed by the Commission to be compatible with the EU laws and objectives.²⁴ That is, whether an aid is given to support the economic development of areas with a vastly low standard of living and underemployment. Another case is if an aid is given to support culture heritage conservation without affecting trade. Unlike the mandatory exactions, the discretionary exemptions are subject to the Commission's review in order to classify an aid as compatible. Given that the general scope of these exemptions is very vague, the Commission has adopted guidelines to guide Member States to adhere to compatible aid under the Article 107 (3) exemptions. The new set of guidelines adopted in 2014 is called the Energy and Environmental Aid Guidelines 2014 – 2020 (EEAG).²⁵

Another set of exemptions comes from the Article 106 (2) of the TFEU called the Services of General Economic Interest (SGEI).²⁶ This section allows State aid under unusual circumstances when the energy provider is required to provide energy at an affordable rate, and as a result acquires losses. The state may then be allowed to compensate losses. Those rare actions are permissible, given that energy is considered a necessity and therefore qualifies as a service of general economic interest. In those cases, the state is not giving an advantage to a specific undertaking, but rather they are compensating for the inevitable losses.

The General Block Exemption Regulations (GBER) is an important regulatory framework that allows states to initiate projects without consulting the Commission.²⁷ This Article specifies the condition in which a State aid is automatically considered compatible aid and therefore evades the requirement to notify the Commission of the state measure. Under GBER framework, the Commission permits aid in areas such as ports, airports, culture support and multi-functional sports arenas. The amount of aid that falls within GBER criteria constitutes about 95 percent of all granted aid.²⁸ This reduced the burden of the Commission and allowed them to focus on projects that have more potential to distort the competition among

²² Article 107 (2) of the TFEU. Source: <https://bit.ly/2QQbso3>

²³ Ibid

²⁴ Ibid

²⁵ Guidelines on State aid for environmental protection and energy 2014–2020. Source: <https://bit.ly/2DvGVCb>

²⁶ Article 106 (2) of the TFEU. Source: <https://bit.ly/2OBXKfM>

²⁷ Article 109 – Block Exemption Regulations. Source: <https://bit.ly/2pTpRLU>

²⁸ General Block Exemption Regulation. Source: <https://bit.ly/2B1cnp7>

Member States. GBER is more applicable to Member States of the EU and not replicable to all CP of the ECT.

De Minimis State aid regulation permits Member States to grant aid not exceeding 200,000 euro over a period of three years.²⁹ This action is deemed permissible by the Commission as the amount of aid provided by the state because of the limited ability to distort the market. Similar to GBER, de minimis applies more to Members of the EU and not to every CP of the ECT.

The listed criteria are just some of the ways in which an aid can be considered compatible. However, whenever an aid has the potential to adversely affect trade within Member States, the Commission will rule against that action to protect the competition.

2.3. Legal consequences of noncompliance with the EU and ECT State aid rules

2.3.1. Noncompliance with the EU State aid rules

Although State aid is prohibited in Europe, the consequences of noncompliance differ depending on whether a country is part of the EU or the ECT. The EU Member States are responsible for notifying the Commission prior to taking any measure that may involve State aid except when it falls within GBER or de minimis regulations.³⁰ If the Commission concludes that the aid is not in line with Article 107, the state is instructed to abolish or modify the measure during a time requested by the Commission. If the state refuses to comply with the Commission's decision, the Commission or other interested states in the EU can follow the case to the CJEU.³¹

In addition to CJEU, the competitors of the beneficiary of the aid can refer to national courts. The court may then suspend the measure or instruct the recipient to reimburse the aid (aid recovery).³² National courts can also order the cancellation of the contract if the measure is not authorized by the Commission and constitutes illegal aid.

2.3.2. Noncompliance with ECT State aid rules

As mentioned previously, an important distinction between the State aid rules of the ECT and those of the EU is the notification procedures. The ECT does not entail the formation of any institution responsible for receiving the notification of an aid. The rules of the ECT reference the EU State aid rules except Art. 108 TFEU which regulates the procedures regarding the notification of an aid. Consequently, CPs of the ECT are not obliged to notify an aid to the EC Secretariat before they implement it.

Even if the Secretariat of the ECT makes a legally binding decision that a member of the ECT has violated State aid rules, there is limited power to prevent the measure. Articles 90-92 of the ECT on the Implementation of Decisions and Dispute Settlement states that a "failure by a Party to comply with the Treaty or to implement a Decision [...] may be brought to the attention of the Ministerial Council."³³ The Ministerial Council with a simple majority vote can decide whether a CP has breached the rules of the ECT, whereas a unanimous decision within the Ministerial Council has to be made in order to conclude that a "serious breach" of the ECT has occurred. In case a serious breach is concluded, a country's voting right may be suspended and

29 COMMISSION REGULATION (EC) No 1998/2006. Source: <https://bit.ly/2z4Eti4>

30 The 2013 revision of the State aid Procedural Regulation. Source: <https://bit.ly/2SijBQ1>

31 Article 108 – Aids granted by States. Source: <https://bit.ly/2T3m4uo>

32 The European Union. Competition and State aid and Control. Source: <https://bit.ly/2Lkimch>

33 Chapter V – Procedural Acts. Art. 90. Source: <https://bit.ly/2DCozNc>

excluded from meetings.³⁴ Given the power limitations of the ECT, the Secretariat has difficulties in preventing incompatible State aid measures.

However, unlawful aid can also be addressed at a state level using national courts. Since CP of the ECT have adopted national laws on competition and State aid, competitors of the beneficiary of the aid can take the case to the national courts. Depending on the national law, judges may order the public authority responsible for offering the grant to pay damages to the competitor or even cancel contracts to restore the competition in the internal market.

Violation of State aid rules by a non-EU Balkan country may also complicate the EU accession negotiation process. Under international law, signatory countries of the SAA have a duty to implement EU acquis on State aid. Failure of one country to uphold this obligation gives the Commission the power to state that a breach of SAA has been made, and may decide to further terminate EU accession negotiations.³⁵

Ultimately, whether a country is part of the EU or the ECT, breaching the laws on State aid may send destructive signals to the economy of a country. States engaging in long-term contracts that violate competition laws have to pay penalties for not implementing the project as it was initially agreed in the contract. This creates severe uncertainties in public policies.

2.4. Procedures to comply with State aid rules under ECT

In addition to international laws, Contracting Parties of the ECT have adopted national State aid laws. Generally, these laws require the formation of a national State aid department responsible for providing professional and administrative support to a national Commission for State aid. The national Commission is a decision making body for national aid. The national laws require the state to notify the aid to the national authority before implementing it. Failure to notify the aid is considered illegal aid and may lead to aid recovery.

If an aid is notified to the national State aid authority, they must review and assess whether the measures are compatible with the national State aid law. A helpful tool during a preliminary assessment is the EEAG guideline.³⁶ These guidelines reflect the EU Commission's view regarding various support schemes and their compatibility with EU laws on competition. If the measure cannot be properly analyzed, the State aid authority can seek assistance from the Secretariat of the Energy Community in writing, or from some other international organizations with State aid expertise.³⁷

If the national department or commission does not assess or wrongly assesses a State aid measure, then the Secretariat will send a notice (opinion) regarding the compatibility of the aid case with ECT rules. The national department should implement the Secretariat's assessment to avoid the possibility of opening a dispute settlement procedure and other potential lawsuits at a national level.

³⁴ Ibid

³⁵ Reply to the Reasoned Request in Case ECS-11/14. Page 5. Paragraph 22. Source: <https://bit.ly/2Eyzv1n>

³⁶ Guidelines on State aid for environmental protection and energy 2014-2020. Source: <https://bit.ly/2DvGVcb>

³⁷ Kosovo Law on State aid. Art. 13(3). Source: <https://bit.ly/2N5s6b6>

Serbia Law on State aid. Art.10(5).Source: <https://bit.ly/2DCpGfP>

3. Assessment of the effect of State aid on the electricity market liberalization objective

The EU has long established the goal of creating a single electricity market in Europe. Achieving this objective, besides market liberalization reforms, requires investments in power grids. Higher interconnection lines allow countries to freely trade electricity whereby reducing or eliminating energy shortages. As a result, the EU has created various funds, such as the Connecting Europe Facility (CEF), which allocates 33 billion euro toward boosting energy transport and digital infrastructure between 2014 and 2020.³⁸ The EU Commission creates a list of EU projects of common interest that can qualify for the CEF funding. In 2018, a new proposal was to increase the budget to 42.3 billion euro for the CEF funding where 8.7 billion was designated for energy. However, despite the investment in power grids, this paper argues that if the EU does not ensure that State aid projects in electricity are prevented, investments in power grids will be ineffective at bringing about the results intended.

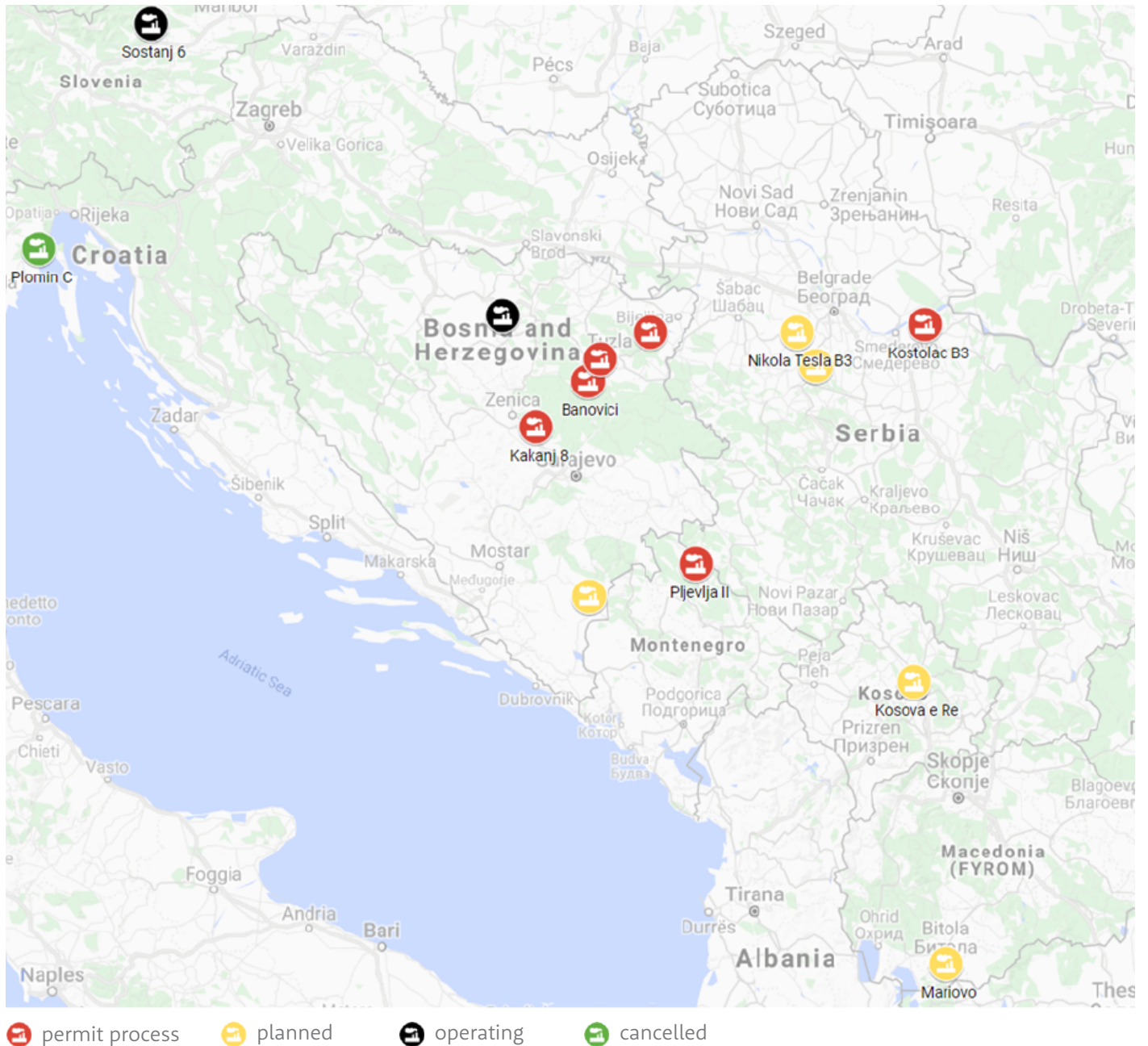
Countries in the Balkans are calling on the security of electricity supply directive to build new capacities.³⁹ Arguing that attracting investments in the electricity is a challenge, therefore offering sales guarantee to investments or other state support is necessary. Figure 4 displays the planned coal capacities in the Balkans for 2012 and 2020.⁴⁰

³⁸ The European Commission. Connecting Europe Facility (CEF). Source: <https://bit.ly/2ynXqgz>

³⁹ Directive 2005/89/EC — measures to safeguard security of electricity supply and infrastructure investment
Source: <https://bit.ly/2WXRDU>

⁴⁰ Bankwatch Network. Coal in the Balkans. Source: <http://bit.ly/2FGsxsm>

Figure 4. Planned coal capacities in the Balkan 2012 - 2020

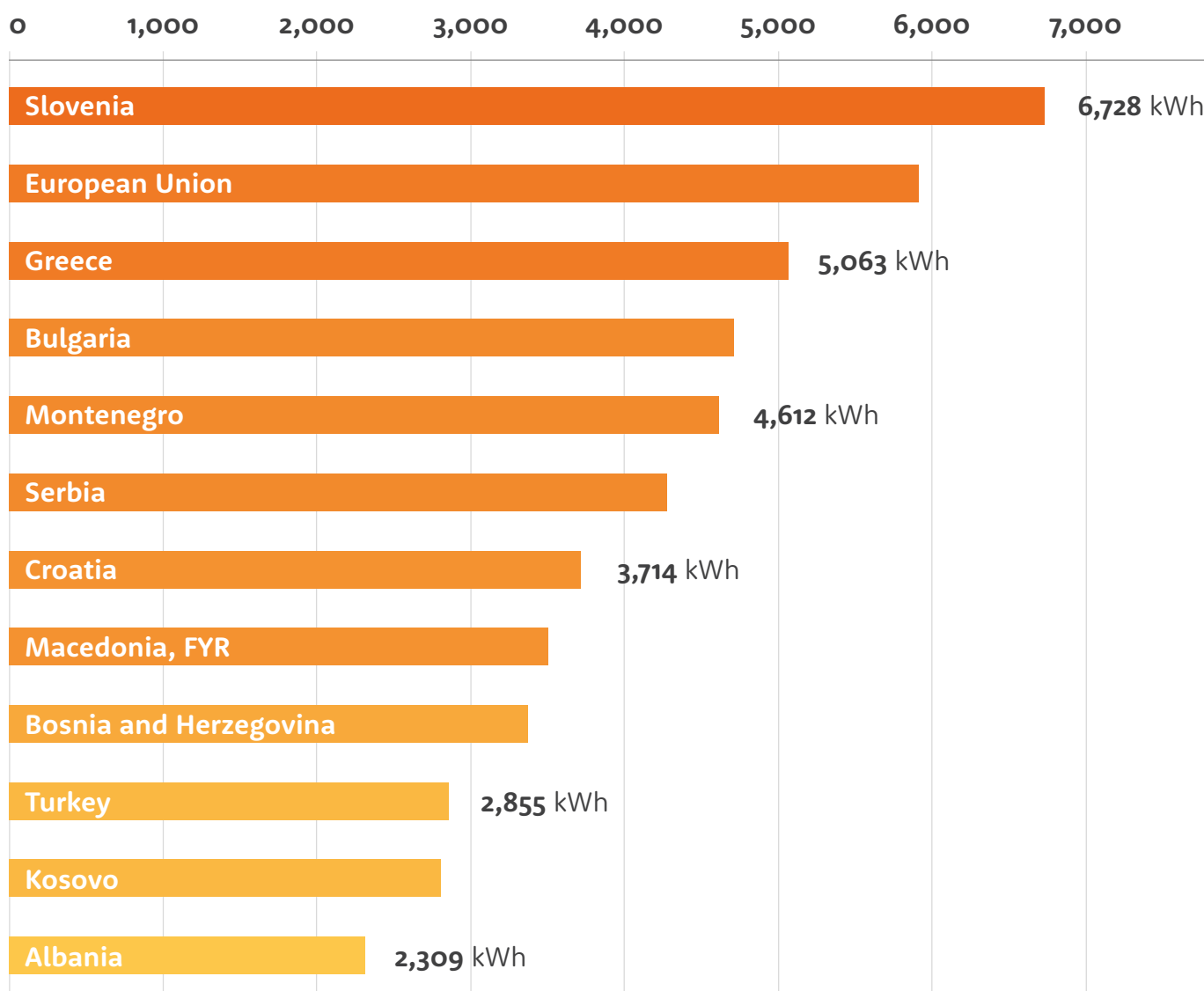


Source: Bankwatch Network

However, Balkan countries possess abundant resources to support not only coal power plants, but also renewable energy capacities. International financial organizations such as European Bank for Reconstruction and Development (EBRD) and the World Bank (WB) have refused to support coal power plants because they amassed sufficient facts to show that the Balkans have a potential to build renewable capacities which are feasible. In addition to the availability of resources, investors can produce electricity in a region that is under-consuming due to unavailability of the power. Figure 5 shows that the per capita electricity consumption in the Balkan countries is well below the average consumption of the EU.⁴¹

41 The World Bank. Electric power consumption (kWh per capita). Source: <http://bit.ly/2PHze1W>

Figure 5. Electric power consumptions kWh per capita in 2014



Source: The World Bank

In addition to the availability of natural resources and the potential for electricity consumption growth, Balkan countries are highly interconnected, in part due to EU grants. Therefore, attracting investments in the electricity market does not need to be done with State aid.

The following case studies show the extent to which some of the Balkan countries are or have been engaged in State aid violation. The selection of the cases is done based on the information gathered from the Energy Community Secretariat.

3.1. Kosovo case study (TPP “Kosova e Re”)

One example where the Energy Community Treaty (ECT), together with the EU institutions, has been ineffective at preventing a State aid project is Kosovo. Both institutions have spent years promoting the electricity liberalization process in Kosovo. In May 2017, the Energy Regulatory Office in Kosovo completed and approved the entire regulatory framework, which is in compliance with the requirements of the EU’s Third Energy Package. In addition to enacting policy reforms, the German government provided grants to support the interconnection grid between Kosovo and Albania for 16.5 million euro. This effort was done in order to integrate Kosovo electricity market into the EU single market.

However, in 2017, Kosovo government signed a Power Purchase Agreement (PPA) with ContourGlobal (GenCo) to build the “Kosova e Re” power plant with a net capacity of 450 MW. In this PPA, the government established the obligation to pay for capacity charge and buy electricity generated by GenCo for a period of 20 years. The agreement states that target price is 80 €/MWh and will be guaranteed for the whole period. After becoming operational, “Kosova e Re” will be the largest power plant in Kosovo; the other being – Kosova B, a state-owned company that was built in the 1980s with a net capacity of about 300 MW. Based on the PPA, the government will establish an institution “NKEC” to act as intermediary between Kosovo, GenCo, and distribution companies in Kosovo. NKEC will be obliged to buy the GenCo electricity at a guaranteed price that comprises of a high capacity charge fee. This PPA is foreseen to disincentivize investors from entering the electricity market in Kosovo for a period of 20 years. It does not allow NKEC and energy supply companies to buy electricity at potentially lower prices in open markets in Kosovo and other regions.

The construction of the “Kosova e Re” power plant will close Kosovo’s electricity from the European market. Kosovo will be obliged by contract to buy all the electricity from the new coal power plant even if trading price is lower in the international market. Based on the Secretariat’s projections, the average price of electricity in the region in 2023 will be around 50-60 €/MWh or 20-30 €/MWh less than the price to be paid to GenCo for the 20 year period.⁴² The result of the new power plant in Kosovo will likely make the interconnection lines ineffective, given that Kosovo will not engage in trade with other European countries.

Despite the disruptive effect on competition, “Kosova e Re” TPP violates national and international law. According to the EC Secretariat’s preliminary assessment, the “Kosova e Re” TPP is at odds with European laws on competition and State aid.⁴³ The Kosovo government has entered into a contract with an entity which will build the new power plant without seeking the approval of the national Department for State aid as is required by law. The Kosovo Law on State aid authorizes the department to monitor and evaluate individual projects and decide whether it is in compliance with national and international obligations. In case the department is not capable of doing the evaluation, according to Art. 13(3) of the Kosovo State aid law, it can seek assistance from the Secretariat.⁴⁴ Furthermore, in its final decision, the national Commission must take into account the assessment of the Secretariat.⁴⁵ However, Kosovo authority requested no assistance prior to signing the contract.

⁴² Kopac: Citizens will pay for the high construction cost of “Kosova e Re”. Interview. Source: Koha Ditore. February 13, 2019.

⁴³ Energy Community Treaty. Preliminary assessment of “Kosova e Re” TPP. Letter sent from ECT to the Minister of Economic Development of Kosovo, Mr. Valdrin Lluka.

⁴⁴ Law on State aid. Article 8. Source: <https://bit.ly/2vBomlO>

⁴⁵ Law on State aid. Article 13(3). Source: <https://bit.ly/2vBomlO>

As of October 2015, Kosovo is a signatory of Stabilization and Association Agreement. Article 77 (c) of this agreement, similar to the EU laws, prohibits engagement of state support on entities that may affect competitions.⁴⁶ Failure to comply with this agreement might stop the EU accession negotiation.

Currently, ContourGlobal (GenCo) is in the final stages of securing a loan to finance the TPP “Kosova e Re” project. Once the loan is finalized, the project will have to go to the Kosovo parliament for approval. The current Kosovo government has given full support to the project, however, it is not clear whether they will secure the necessary votes when the project passes through the parliament.

If the project is approved, Kosovo risks suspension of voting rights at the Ministerial Council of the EC Secretariat, impairs the chances of EU accession given that it does not withhold the SAA agreement and receives lawsuits at the national courts for breaching the national law on State aid.

Table 1. Summary of the aid characteristics in Kosovo and impact on competition

Project name	Form of aid	Potentially in breach of ECT and the EU laws	Impact on competition	Market share of TPP
“Kosova e Re” TPP	Power Purchase Agreement (PPA) for 20 years	Article 18 of ECT; Article 107 of TFEU;	Under the PPA agreement, when the project becomes operational, the electricity market in Kosovo will essentially close for 20 years blocking the development of any competition and removing the chances and incentives for liberalized energy market.	50 % of the electricity generation
	Back to Back Purchase Agreement	Third Energy Package rules adapted by Kosovo, requires energy companies to be open to competition.	Electricity suppliers will be obliged to buy the entire electricity from NKEC depriving them from buying electricity at cheaper market prices in Kosovo or the region for 20 years.	
	Paid for capacity	Energy and Environmental Aid Guidelines 2014 – 2020 (EEAG) adequacy generation should be analysed and quantified.	The paid for capacity measure puts GenCo in an adventurous position over other electricity generators in Kosovo. It removes the possibility of other generators such as KEK or imported electricity, to address the generation adequacy problem.	

⁴⁶ Stabilization and Association Agreement between the European Union, of the one part, and Kosovo, of the other part. Article 77 (c). Source: <https://bit.ly/2UKEuAY>

Project name	Form of aid	Potentially in breach of ECT and the EU laws	Impact on competition	Market share of TPP
	Lignite Supply Agreement	Article 18 of ECT; Article 107 of TFEU;	Under this agreement, NKEC privileges GenCo in lignite supply over other generator competitors. It effectively guarantees the most efficient coal for a lower price, leaving other competitors with less efficient coal for higher price.	
	Free Generation Grid Access	Article 15 of Directive 2009/72/EC	All the fees for the use of the system will be charged to NKEC as opposed to GenCo. Other electricity generators are responsible to cover those fees making them less competitive. Exempting only GenCo from this payment constitutes discrimination against other generators and it is at odds with market-based balancing. Kosovo government will have to either subsidize grid usage and transfer of balancing or socialize the cost using back to back agreements and then charging final customers.	
	Site Transfer Agreement	Article 18 of ECT; Article 107 of TFEU;	Site transfer agreement constitutes another State aid in the contract. Kosovo government will transfer parts of state land for a price way below market price. This is another selective advantage for GenCo and not other electricity generators.	

3.2. Serbia case study (TPP “Kolubara B”)

Serbia is another Balkan country which has had issues regarding violation of national and international obligations on competition and State aid. Although Serbia has undertaken various legislative actions to reform its internal electricity market, proper enforcement of these policies remains a challenge. As of 2009, the Serbian parliament adopted the Serbian Competition Law (SCL) and the Law on State aid Control.⁴⁷ In addition to legal framework to further develop the electricity competition, Serbia invested 28 million euro in the Trans-Balkan Electricity Corridor (II) on power grids. Out of this investment, 6.6 million, or 24 percent, is granted mostly from Instrument for Pre-Accession Assistance (IPA II).⁴⁸

In 2011, the publicly owned company EPS and the Italian company Edison SpA entered into a contract to jointly construct two blocks of 355 MW each, within the Kolubara B power plant. The total investment in this project was estimated to be over 2 billion euro.⁴⁹

In July 2016, the Energy Community Secretariat sent a letter to the Republic of Serbia for its failure to comply with ECT and EU acquis on State aid. The case involved the state support to Elektroprivreda Srbije (EPS) for the “Kolubara B” TPP. In particular, the Secretariat raised concern that Serbian authorities have offered four state guarantees to be used for loans from international financial institutions, and have engaged in a transfer of property and land from the state to the EPS for the TPP project.⁵⁰ From this preliminary assessment, the Secretariat concluded that the authority responsible to enforce the law on State aid Control has failed to evaluate that four of the actions taken from the Serbian government were incompatible with ECT internal market Articles 18 and 19 and EU acquis.⁵¹ The only brief assessment that was made by the Commission for State Aid Control was not in line with EU laws.

The first two measures involving state loan guarantees were 52 million euro for the Procurement of the ECS System, and 80 million euro for Environmental Improvement project. Both of these measures were sought from the European Bank for Reconstruction and Development (EBRD). The last two measures were state loan guarantees worth 90 million euro and 18 million euro grant from Kreditanstalt für Wiederaufbau (KfW). The third State aid measure that concerned EC Secretariat is the transfer of property, including land and building, for the development of “Kolubara B” worth 12.7 million euro.⁵²

In June 2018, the ECT in accordance with Article 2 of the Dispute Settlement Procedures, decided to close the case of “Kolubara B” given that the State aid commission in Serbia has recognized and adopted the complaint.⁵³ The first two measures were modified while the third was assessed not to constitute state aid. As a result, the case is closed the “Kolubara B” is operational.⁵⁴

47 The Serbian Competition Law (SCL). Official Gazette, No. 51/2009; The Law on State aid Control. Official Gazette, No. 51/09; LSAC;

48 Instrument for Pre-Accession Assistance (IPA II) 2014-2020. Page. 11. Source: <https://bit.ly/zRVzibD>

49 EPS accepts Edison’s offer for construction of Kolubara B. Source: <https://bit.ly/2Cc7FWe>

50 Energy Community Treaty. Case ECS 11/14: Serbia/State aid. Source: <https://bit.ly/2QQ42op>

51 Ibid

52 Reply to the Reasoned Request in Case ECS-11/14. Source: <https://bit.ly/2Eyzv1n>

53 Case ECS 11/14. Serbia/State aid. Source: <https://bit.ly/2QQ42op>

54 Gecic Law firm. Case Closed: Energy Community Drops Dispute Against EPS and Republic of Serbia Over Kolubara B Project. Source: <https://bit.ly/2DEzozj>

Table 2. Summary of the aid characteristics in Serbia and impact on competition

Project name	Form of aid	Potentially in breach of ECT and the EU laws	Impact on competition	Market share
“Kolubara B” TPP	State guarantee	Article 18 and 19 of ECT; Article 107 of TFEU;	State guarantees enable certain undertaking to take advantage of more affordable credit access making other entities in the same sector less competitive.	20 % of TPP ⁵⁵
	State guarantee	Article 18 and 19 of ECT; Article 107 of TFEU;		
	State guarantee	Article 18 and 19 of ECT; Article 107 of TFEU;		
	State guarantee	Article 18 and 19 of ECT; Article 107 of TFEU;		
	Transfer of property	Article 18 and 19 of ECT; Article 107 of TFEU;		
	Site Transfer	Article 18 of ECT; Article 107 of TFEU;	Site transfer agreement is a form of State aid. Serbian government will transfer state land including buildings for a price below market value. This is another selective advantage that makes the beneficiary of the aid more competitive in the market.	

3.3. Bosnia and Herzegovina case study (TPP “Tuzla 7”)

Bosnia and Herzegovina (BiH) is another Balkan country grappling with disputes over violation of competition and State aid laws. Similar to other countries in the region, BiH has taken various reforms on competition. In 2005, the BiH government has adopted the federal Act on Competition (AC)⁵⁶ and later, the Law on the System of State Aid, enforced by the State Aid Council. In addition to national laws, BiH, as a member of ECT and a signatory of SAA,⁵⁷ has an international obligation to enforce the EU competition and State aid laws.

After years of planning to build new capacities, the public power utility company Elektroprivreda Bosne i Hercegovine (EPBiH), which operates TPP “Tuzla”, decided to build another unit called “Tuzla 7” with 450 MW capacity. In November 2017, EPBiH signed an agreement with China ExIm Bank for preliminary financing of this project. The State Aid Council of Bosnia and Herzegovina reviewed the agreement, and after eight days of receiving the application from the Federal Ministry of Finance, concluded that it was compatible with national and international laws on State aid.⁵⁸ After being informed on the decision of the BiH Council, the Energy Community Secretariat sent a letter to the members of parliament of the BiH Federation advising not to approve the loan guarantee of 614 million euro as it is contrary to ECT and EU State aid laws.⁵⁹

According to EC Secretariat, the state loan guarantee includes not only the loan and interest, but also “other associated costs under the Agreement on the Credit Line.”⁶⁰ Given that the terms of the agreement are not clear, the guarantee cannot be accurately measured, as is required by law. In addition, the EC Secretariat refuted the findings of the State Aid Council by claiming that the guarantee constitutes more than 80 percent of the loan. The letter also warned members of parliament that EPBiH does not qualify as a provider of services of general economic interest since it has more than one public service obligation and the guarantee is not a “compensation” for the provider of a service of general economic interest.⁶¹

Failure to comply with ECT State aid obligation could instigate the Secretariat to open infringement procedures against Bosnia and Herzegovina. The EU commission can also impair chances of BiH EU accession. Finally, breaches of State aid laws are followed with extensive and costly aid recovery measures.

The project currently waits the approval of the parliament. If the project passes, the BiH is another country that might lose voting rights in the EC Ministerial Council as well as deal with lawsuits interlay.

Table 3. Summary of the aid characteristics in Bosnia and Herzegovina and impact on competition

Project name	Form of aid	Potentially in breach of ECT and the EU laws	Impact on competition	Market share in TPP
“Tuzla 7” TPP	State guarantee	Article 18 and 19 of ECT; Article 107 of TFEU;	State guarantees enable certain undertaking to take advantage of more affordable credit access making other entities in the same sector less competitive.	20% ⁶²

⁵⁶ Official Gazette of BiH, No. 48/05

⁵⁷ European Neighbourhood Policy And Enlargement Negotiations. Bosnia and Herzegovina. Source: <https://bit.ly/2z1PVay>

⁵⁸ Bankwatch. NGO. Source: <https://bit.ly/2STdFZI>

⁵⁹ Letter from ECT to members of the Parliament of the Federation of BiH. Source: <https://bit.ly/2rD2UPB>

⁶⁰ Ibid

⁶¹ Ibid

⁶² As of 2013 TPP generation. Page 11. Source: <https://bit.ly/2S1nkNR>

3.4. Bulgaria case study (TPP “Maritsa East 3”)

A similar situation of State aid violations in the electricity market occurred in Bulgaria. The two U.S. power companies, AES and ContourGlobal entered into a Power Purchase Agreement (PPA) contract with the public power provider NEK for a 15-year period. The two coal power plants generate about 20 percent of Bulgaria’s electricity. AES has invested 1.2 billion euro in a 670 MW thermal power plant in the Maritsa East coal-mining composite in southeastern Bulgaria. This project started operating in 2011. ContourGlobal is the other company who took hold of a 908 MW plant in the same complex with a supply contract with NEK instated until 2024.⁶³

State Energy and Water Regulatory Commission (SEWRC) initiated an investigation into the nature of the PPA contracts and the effect on the market. The investigation included both contracts, one signed by public provider NEK with AES owning “Maritsa Iztok 1” thermal power plants, and the other, ContourGlobal owning “Maritsa Iztok 3” plant. The investigation concluded that the methods obliging state-owned power company NEK to buy all the electricity production of the two electricity companies are at odds with the requirements of the Third Energy Package.⁶⁴ According to SEWRC, this provided a competitive advantage to the American companies over the existing and new market players. The regulator indicated that both contracts constitute unlawful State aid and are in breach of the Article 107 of the TFEU.

To prevent distortion of the competition, in May 2014, the energy regulator requested from NEK to renegotiate the power supply contracts. It was told to secure a price reduction of at least 30 percent to contract, which the regulator said breached the European Union competition rules.

The Bulgarian case should serve CP of the ECT to learn about the severe consequences that can follow if a country proceeds with project which constitutes incompatible State aid.

Table 4. Summary of the State aid characteristics and impact on competition

Industry	Form of aid	State aid under ECT and the EU	Impact on competition	Market share in TPP
Electricity AES and ContourGlobal	Power Purchase Agreement (PPA) for 15 years.	Article 18 of ECT; Article 107 of TFEU;	Electricity suppliers will be obliged to buy the entire electricity from NEK depriving them from buying electricity at cheaper market prices in Bulgaria or the region for 15 years.	80%

⁶³ Seenews. Bulgaria seeks EU scrutiny of RES incentives, PPAs with two TPPs. Source: <https://bit.ly/2qOqOXZ>

⁶⁴ Ibid

3.5. Hungary case study

Between 1990 and early 2000s, several power plants in Hungary entered into Purchasing Power Agreements with the state-owned enterprise Magyar Villamos Művek (MVM). Based on these agreements, the power plants would sell all capacity to MVM that was in charge to supply that electricity to distribution companies. In the early 2000s, 80 percent of the electricity demand in Hungary was covered from such PPAs. Half of the PPAs (10) were still in force upon Hungary's accession to the EU, where the latest PPA was expected to last until 2024. The government's liabilities included covering the operating costs of the power plants and paying such electricity production prices that would be sufficient enough to ensure an 8 percent equity rate of return. The price that the power plants received was comprised of the capacity fee, paid for the reserved capacities and electricity fee.

The EU Commission analyzed the PPAs in Hungary and decided that based on the EU energy laws, they amount to State aid. The Commission's decision noted among others that such PPAs could not be considered as implementing the Service of General Economic Interest (SGEI) for security of supply since the PPAs do not refer to SGEI. Most importantly, PPAs do not comply with the SGEI rule. The PPAs were selective, concluded from a specific sector and the purchase obligation was given to a state-owned company, MVM, which uses state resources. The decision points out that such PPAs distort the market and protect the power plants under the PPAs from all operating risks. The Commission did not accept the argument that PPAs were concluded prior to Hungary's accession into the EU and may have been in line with national laws at the time. As such, the Commission decided that the aid granted amounted to unlawful State aid and that the PPAs had to be canceled. The granted aid had to be recovered as well.⁶⁵

The Hungarian case is another example for the CP of the ECT to show the complications that can ensue if a country implements a project with incompatible State aid.

Table 5. Summary of the State aid characteristics and impact on competition

Industry	Form of aid	State aid under ECT and the EU	Impact on competition	Market share in TPP
Electricity 10 Power plants after Hungary Accession to the EU	Power Purchase Agreement (PPA)s for long periods.	Article 18 of ECT; Article 107 of TFEU;	Electricity suppliers will be obliged to buy the entire electricity from MVM depriving them from buying electricity at cheaper market prices in Hungary or the region for long periods.	20%

⁶⁵ Official Journal of the European Union. COMMISSION DECISION of 4 June 2008 on the State aid C 41/05 awarded by Hungary through Power Purchase Agreements. Source: <https://bit.ly/zsu3XS8>

4. State aid Authority

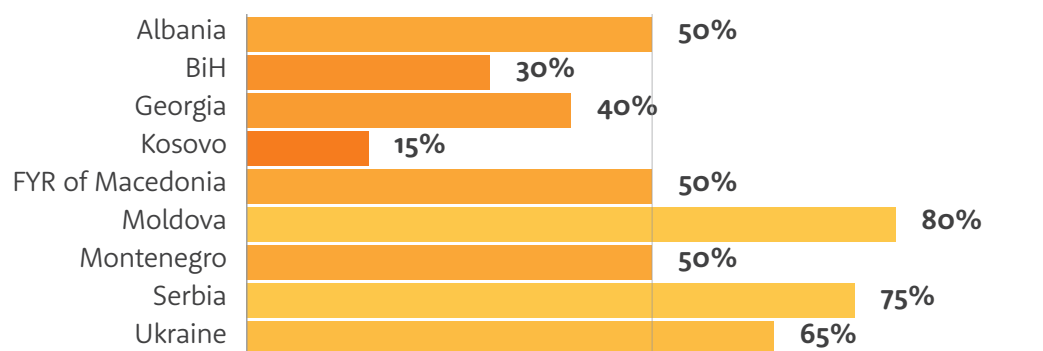
Unlike the EU, which has a clear notification and authorization procedure for State aid, Member Parties of the Energy Community are, for the most part, left independent to implement State aid laws.⁶⁶ Since 2009 and onward, member countries of the ECT have established State aid authorities as part of SAA obligation.⁶⁷ Most of these authorities operate within the Ministry of Finance and are responsible for monitoring/approving projects according to State aid laws. In cases where an aid is unlawfully granted, the measure should either be abolished, altered or if proceeded may lead to aid recovery.

The Energy Secretariat has a monitoring and advising responsibility over State aid authorities of the Member Parties about implementation of Art. 18 and 19 of the Treaty. However, the Secretariat's ability to ensure implementation of the rules of each Contracting Party of the Treaty is limited. The main challenge is the transparency of data with regard to State aid especially in the energy sector.⁶⁸ According to the Secretariat Annual Implementation Report, State aid authorities of the contracting parties in the Balkan lack independence from the government. Projects that were initiated by the government have either been not assessed, or incorrectly assessed by the State aid authorities in the Western Balkans.

The SAA required the formation of state aid monitoring authorities, however it did not specify the operational design of those authorities. Therefore, examining the institutional formation of aid authorities in the Balkan countries shows that they are closely linked with the government.⁶⁹

Besides the lack of independence, State aid authorities have limited human capacities to properly implement State aid laws. In its Annual Implementation Report, the Secretariat has evaluated the capacity of state aid authorities of each member of the ECT (Figure 6).

Figure 6. Energy Community Secretariat evaluating State aid authority



Source: Annual Implementation Report

A similar conclusion is drawn about ECT State aid authorities in the European Commission Progress Reports 2018.⁷⁰ The EU Commission reiterates the need of the State aid authorities to be independent of the government and properly staffed in order to enforce EU acquis on State aid.

66 State Aid Rules and Effectiveness of State Aid Control in the Electricity Sector under the Energy Community Treaty. Source: <https://bit.ly/2QD8Nvz>

67 Competition Authorities in South Eastern Europe. Page 66. Source: <https://bit.ly/2GvgXQP>

68 Energy Community Secretariat's Implementation Report 2018. Source: <https://www.energy-community.org/>

69 Competition Authorities in South Eastern Europe. Page 69. Source: <https://bit.ly/2GvgXQP>

70 European Commission Progress Reports 2018. Source: <https://bit.ly/2qKfLPG>

5. Conclusion and recommendations

In general, sectors dominated by publicly owned enterprises are mainly exposed to state interventions of numerous types. Engagement in State aid methods such as subsidies, loan guarantees, sale or privatization of public lands with the aim of promoting one country's economic prospect has been destructive to competition. Unlawful state aid measures not only waste public resources, but also prevent a sustainable economic development of the subsidized sector. Traditionally power generation plants have been publicly owned, therefore they have been prone to various state interventions.

For this reason, the European Union has enacted various regulatory reforms to prevent the distortion of competition through State aid. Besides the regulatory reforms, the EU, throughout various programs such as Connecting Europe Facility (CEF) has invested on the interconnection grids with the aim of creating an efficient single electricity market in the EU. Kosovo has been a beneficiary of various EU grants to modernize its electricity interconnection infrastructure. As a result, it is one of the few countries in the Western Balkan region to be so well integrated with the regional market in terms of infrastructure.

However, the recent contract that was signed by the Government of Kosovo and the American company ContourGlobal has severely impaired Kosovo's prospect to integrate in the EU electricity market. The contract, which is at odds with the EU and Energy Community Treaty (ECT) State aid laws, has made the power grids futile, as Kosovo's electricity market will be closed for 20 years. A similar engagement of long-term Power Purchase Agreement has grappled Bulgaria and Hungary. Both countries have significantly closed their market with the EU by violating State aid laws. They later dealt with serious consequences during their accession negotiations.

State aid breaches are found in other member countries of the Energy Community Treaty too. Although the method of aid varies, the results are clear. They all distort the electricity competition of the Balkan countries and hinder the prospect of a single electricity market with a leveled playing field.

The findings of this paper suggest that the EU and EC Secretariat have not been very effective at tackling State aid. The EU has not used its grants as a means to incentivize countries to enforce *acquis* on State aid, while the EC Secretariat's jurisdiction to prevent State aid violation is limited. National State aid authorities have either been unwilling or incapable to properly assess State aid violations.

In light of these issues, the GAP Institute in cooperation of Vienna Institute for International Economic Studies (wiiw) recommend:

- The EU should be firmer in regards to State aid rules as it puts its own investment and objective at risk of not being accomplished. The EU Commission should use the enforcement of State aid law as a requirement for the allocation of pre-accession funds such as IPA, CEF or any other benefits like visa liberalization, etc.
- The Energy Community Treaty should organize additional workshops with State aid authorities of its member countries and train them on the rules and procedures of State aid. This would improve the ECT Member State's investigative and decision-making powers. Its Annual Implementation Report unequivocally displays the need to elevate the enforcement of EU acquis on State aid.
- The EU Commission should review national achievements with regard to combating State aid. Specifically, they should monitor the existence and use of sanctions for State aid cases and display those on the yearly EU Progress Report.
- The ECT and the EU Commission should review whether State aid authorities are enforcing the recovery of unlawful or non-compliant aid.

Note that this is a working paper, as a result, based on the discussions during the presentation of the paper, additional recommendations will be included in the final version.

GAP Institute is a Think Tank established in October 2007 in Kosovo. It aims to bridge the gap between the governance and citizens and between problems and solutions for the advancement of Kosovo society. This is achieved through advocating for good governance, monitoring the work of public institutions and providing concrete recommendations on public policy. With a professional research team, GAP addresses country's economic, political and social challenges.

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The effect of State aid on the
electricity market in the Balkans