# PROJECT FINANCING IN ALBANIA: *FOCUS ON ELECTRICITY GENERATION*

*BY*

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## Abstract

Albania's energy policy has undergone futile changes in the past 22 years due to economic and social turmoil. Energy balance, production and consumption, has shifted the Country from an exporter to an importer of energy. According to the National Agency for Energy, Albania currently exports over half of its current total power consumption. The Albanian Government has undertaken a series of measures to improve the country's energy policy through: introduction of new laws and regulations; improvement of the distribution system; rehabilitation of the transmission network; decrease technical and non-technical transmission losses; introduce electricity saving incentives; increase existing HPP capacities; and privatization of the distribution system.[1] In spite of these continues efforts, the Government has failed to create an open energy production market; the pace of development has been very slow and it is not yet at comparable levels with its neighboring countries.

This paper will analyze the current balance of energy and present the countries potential not only to meet its current needs but also be an exporter of electricity. It will stipulate that main obstacles for reaching the desired levels are: *legal framework* – not clear guidelines for renewable energies, connection to the greed and secured sale of energy produced; and, the *rule of law* – difficulty of doing business in Albania.

The Government does not have the financial means for rehabilitating the current electricity production plants and the existing network; hence foreign direct investment if outmost importance in improving the *status quo*. This paper will present obstacles faced by potential investors interested to do finance energy projects in Albania and identify potential solutions such as: equity and mezzanine financing.




[1] In December 2009 the Czech Company CEZ purchased 72% of outstanding shares the Albanian Distribution Network for EUR 102 Million, thus becoming the major stakeholder of the company.

## Acknowledgements

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## List of Abbreviations

| | |
|---|---|
| **CCGT** | Combined Cycle Gas Turbine |
| **EBRD** | European Bank for Reconstruction and Development |
| **EC** | European Commission |
| **EIB** | European Investment Bank |
| **EU** | European Union |
| **FDI** | Foreign Direct Investments |
| **GDP** | Gross Domestic Product |
| **HPP** | Hydro Power Plant |
| **ICT** | Information and Communication Technology |
| **IEA** | International Energy Agency |
| **IMF** | International Monetary Fund |
| **METE** | Ministry of Economy, Transport and Energy |
| **MFI** | Multilateral Financing Institutions |
| **NEAP** | National Energy Action Plan |
| **NES** | National Energy Strategy |
| **NGO** | Non Governmental Organization |
| **OSSH** | Electricity Distributor in Albania |
| **KESH** | Albanian Energy Company |
| **RES** | Renewable Energy Sources |
| **SEE** | South East Europe |
| **TPP** | Thermal Power Plant |
| **UNDP** | United Nations Development Programme |
| **WB** | World Bank |

## Introduction

Albania is currently facing a complex set of development challenges as an economically weak country, with one of the lowest GDP/capita in Europe. It is still a country under transition and in the midst of numerous reforms of its public institutions, legislation and policy agenda. After the collapse of communism in 1990, Albania embarked on a transformation journey which is still ongoing. For the past 22 years, the country has faced immense challenges some of which set it back dramatically such as the armed conflict of 1997.[2] These social and economic turmoil have had immense impacts on reforms necessary to democratize various sectors of the economy. Although Albania has a *de jure* fully free market economy, *de facto* the biggest sectors of the economy are still under state monopoly.

This paper will identify the country's attempts to create a competitive and fair market for its electricity production, transmission and dispatch. Analysis based on data gathered through primary and secondary research will argue whether these attempts have been successful; and if so at which degree. According to the International Energy Agency factsheet, *Albania has been slower in developing its long-term energy policies and strategies for energy security and efficiency and in creating the appropriate institutions to implement sustainable reforms of energy markets than most countries in Central Europe.*[3] This paper will present an overview of the current situation; analyze the pace of progress in comparison with neighboring countries; and, identify weaknesses hampering the progress of energy policies and strategic actions.

Project financing, as a major determinant of a free market, will serve as a comparison for establishing the level of "*democratization*" in this sector. The Country as such is too weak

[2] In 1997, after the collapse of pyramidal schemes Albania entered into a civil war and the government lost control for over 6 months. Many public administration institutions were dissolved and an interim government managed to restore order in 1998. Human casualties during this year are presumed to be over 2000 while the country's GDP reached levels lower than in 1990.

[3] International Energy Agency: http://www.iea.org/country/country_blurb/albania.asp, Last Accessed on May 22nd 2012

to invest in energy infrastructure, thus external financial support is of outmost importance be that private financing; international aid or multilateral financing. In order to attract foreign investments the country has to open its energy market. This reform requires thorough legal, strategic planning and institutional synchronizing their work towards one joint goal: attracting foreign investments. Up to date Albania has progressed in attracting investments in various fields of its economy but the energy sector remains under state monopoly and reform has been very slow and disorganized.

Various studies have been undertaken to analyze the energy situation in Albania from Ministry of Economy, Trade and Economy titled "Plans of Albanian Government for development of renewable energy", from National Agency of Natural Resources titled "Invest in Albania's natural resources'; from AgriPolicy titled "Renewable Energy and its impact on rural development in Albania'; International Energy Agency " Energy in the Western Balkans" and a series of periodic analysis from the World Bank, EBRD, EC and other relevant institutions. National and international financial institutions periodically report on indicators determining the ease to do business in Albania.[4] These reports are the basis of this paper and the information gathered will be synthesized and tailored to analyze project financing for energy production in Albania and offer potential solutions.

To create a comprehensive and non-bias analytical approach interviews were organized with: Ministry of Economy, Trade and Energy (Ms. Llambrini Misto, Advisor to the Minister); representatives from the World Bank (Ms. Elona Cela); KESH (Ms. Donika Dimashi, Director of Distribution Division); and EU center for Energy (Ms. Tsvetelina Borissova, Legal Advisor). Secondary research was based solely on official papers produced by EBRD, WB, IEA and other relevant institutions within the energy field. All papers reviewed can be found at the end of this paper under references.



[4] All above mentioned reports are listed in the Bibliography part of this report for your consideration.

Chapter 1 will present the country's balance of power giving detailed information on demand; supply; and, unexplored resources. The purpose is to identify the countries potential and introduce sources of energy to improve the electricity trade deficit by using available resources more effectively and at a larger scale. The legal framework will be addressed in Chapter 2. The focus will be to present the legislation, more importantly, legal impediments for private investors to enter the energy market. Specificities of project financing legislation and current developments will be presented in Chapter 3. Conclusions and recommendations deriving from the respective analysis will be presented in Chapter 4.

*Country Summary*

The table below shows the main macroeconomic indicators of the country:

**Table 1**: Albania Country Summary Table

| **Demographical Information** | |
|---|---|
| Population, millions [5] | 2.8 |
| Land area, thousand sq km | 28.75 |
| **Macroeconomic Information** [6] | |
| GDP, billion US$ | 24.99 |
| Real GDP growth rate, percent | 2.5 |
| Foreign direct investment (net), million US$ | 641 |
| **Electricity disposition, billion kWh** | |
| Generation | 5.2 |
| Consumption | 6.6 |
| Exports | 0.00 |
| Imports | 0.6 |



[5] Census 2011 http://census.al/, Last Accessed on May 22nd 2012
[6] CIA World Factbook https://www.cia.gov/library/publications/the-world-factbook/geos/al.html, Last Accessed on May 22nd 2012

# 1. Albania's Power Balance

Albania's energy mix has experienced a drastic shift from '90 when the country covered over 90% of its needs while today 53% of total primary energy sources are imported. Imported energy is based on oil products and it constitutes approximately 26% of country's trade deficit, respectively EUR 330 Million. According to Albania's Energy Sector Strategy these amounts are expected to double or even triple by 2020. This chapter will identify the current energy balance in the country, its reserves and forecasts for the future.

## 1.1. Electricity Production

According to Enerdata[7] Albania is one of the few countries in the world who produce electricity solely from renewable sources respectively hydro and thermal. There are 83 hydro power plants in the country, the biggest being: Koman (600 MW), Vau i Dejes (250 MW) and Fierza (500 MW). Total production capacity is 1695 MW, of which 1446 MW hydro and 213 MW thermal.[8]

As of 2007, a series of initiatives have been undertaken to improve the capacities of current hydropower plants, build new smaller hydro-plants and diversify the electricity production mix.[9] In 2009 a new oil-fired plant was commissioned, with capacity of 97 MW for a total cost of $ 112 Million. This project is supported from the WB ($ 22 million), EBRD ($ 37.5 million), EIB ($37.5 million) and KESH ($12.6 million).[10] The plant was tested in 2010 and analyses proved it was within Albania's and EU standards. Although the plant is



[7] Renewable Energy and Energy Efficiency Partnership http://www.reeep.org/index.php?id=9353&text=policy&special=viewitem&cid=1, Last Accessed on May 22nd 2012

[8] METE, "Summary – The National Energy Strategy and Plan of Action", Page 7 http://unfccc.int/resource/cd_roms/soge/material/SEM_SUP1_albania.pdf, Last Accessed on May 22nd 2012

[9] A list of all energy related projects in Albania, provided by Energy Efficiency Community can be found here: http://www.eec.org.al/Projects.html, Last Accessed on May 22nd 2012

[10] The World Bank, "Power Sector Generation and Restructuring Project" http://web.worldbank.org/external/projects/main?Projectid=P077526&theSitePK=40941&pagePK=64283627&menuPK=228424&piPK=73230, Last Accessed on May 22nd 2012

fully operational it has not yet started production. Other oil powered thermal plants exist in the Fier region but they are not functional due to high cost of rehabilitation.

There are various initiatives to produce energy privately, but these are limited to sporadic individuals and their production is solely for personal consumption. These mini hydro-plants are not connected to the main grid and are subject to fluctuation due to the seasonal supply of water. There are no data available on the number of private plants, nor on their production capacity.

The transmission network grants access to electricity to the whole country with a network of over 2.500 km. The rehabilitation of the network has been slow and as a result losses in transmission are significantly high, reaching up to 35% in 2009 and are currently 9%. In 2010 cost of distribution constituted 28% of the retail price of electricity. Transmission losses are caused by:

1- Technical problems[11] - Tackled by the Power Transmission and Distribution Project.
2- Non-technical problems – illegal connection to the grid and no remuneration for the electricity consumed. The privatized distribution company undertook a series of action to decrease these losses through installment of new meters, stricter punishment rules in collaboration with Law Enforcement Agencies; and rehabilitation of the whole network system.

The picture below represents the existing Albania's energy infrastructure:



[11] Yuriko Sakairi, Yasuhiro Kawabata, "Power Transmission and Distribution Project" http://www.jica.go.jp/english/operations/evaluation/oda_loan/post/2008/pdf/e_project40_full.pdf, Last Accessed on May 22nd 2012

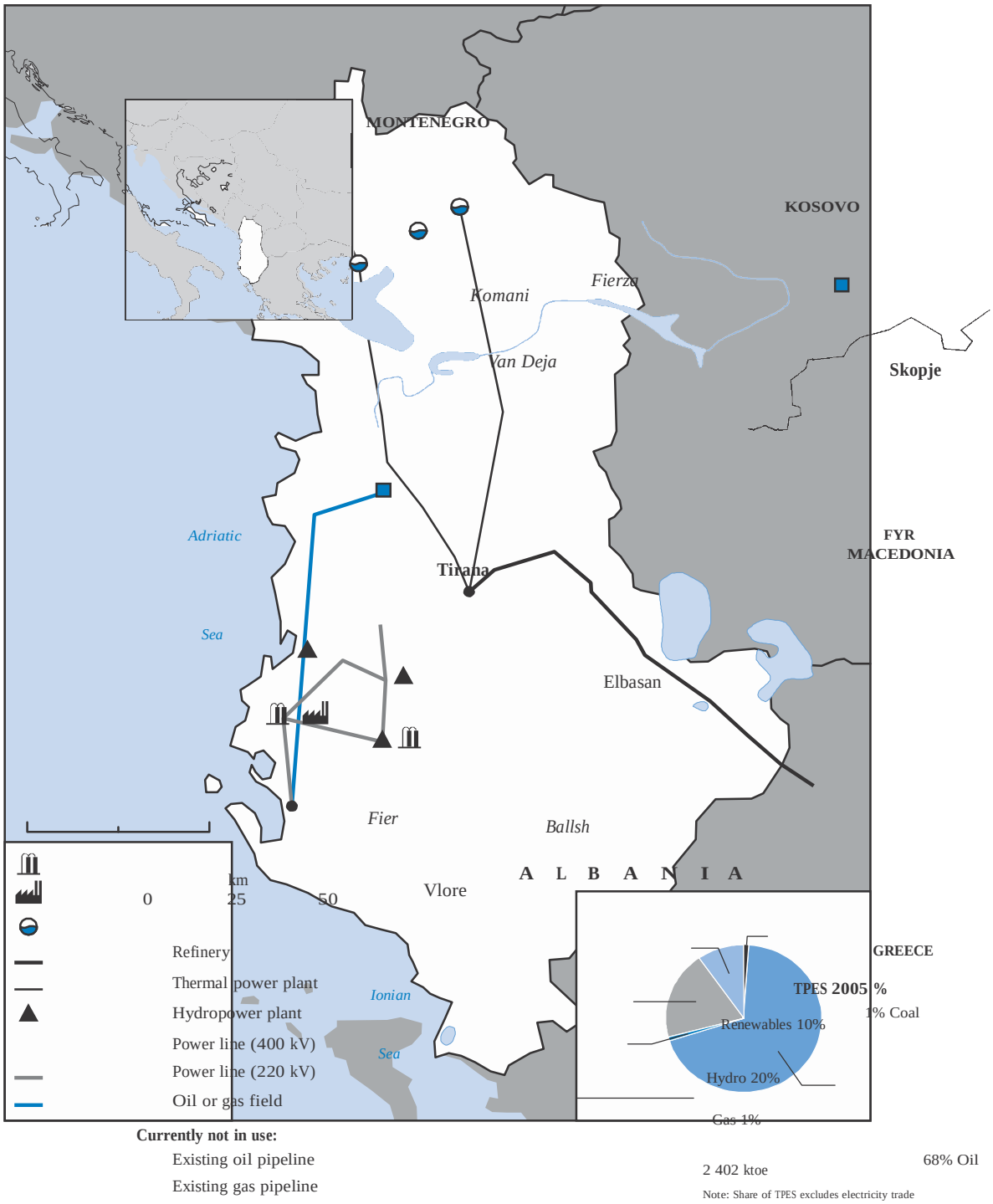


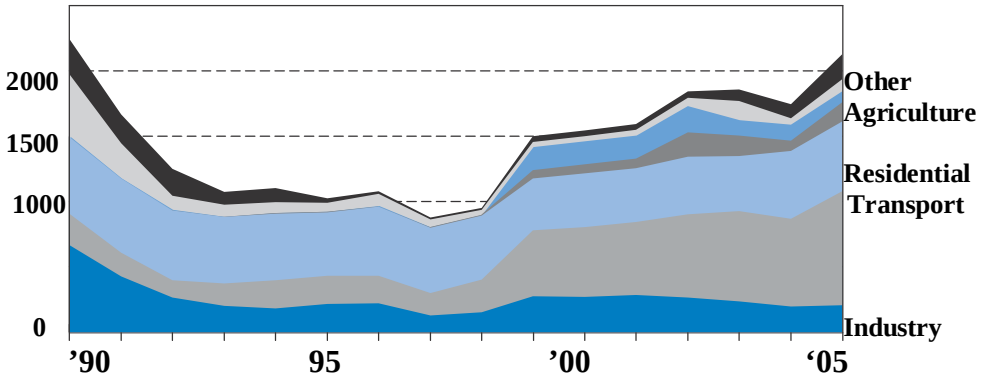

**Table 2**: Albania's energy infrastructure [12] **Source**: IEA

[12] IEA, "Energy in the Western Balkans; The path to reform and reconstruction' page 121

### 1.2. 2.2 Energy Consumption

During the last 22 years Albania has undergone immense social changes; it became a democratic society '90; had great emigration waves in '91-'92; had a "civil war" in'97; and as of '00 has been experiencing a constant slow pace growth. This social and economic turmoil has had direct impact on energy demand and consumption. As presented in Table 3, energy consumption in Albania dropped by 50% during the first 5 years of democracy 1990-1995, reaching its lowest in 1997 during the "civil war". As of 1997 a rather constant growth has followed. It needs be noted that Industry has had the sharpest drop by over 70%, agriculture and others have had a considerable increase. Transport has experienced the biggest increase, almost tenfold.

**Table 3**: Albania's Total Final Consumption by sector [13]




**Source**: EIA

Although consumption levels of energy in 2005 are still below those of 1990's, as of 1998 Albania shifted from an exporter to an importer of electric power. Import levels reached their peak in '07 constituting 70% of total consumption (3.95 billion KW). Rehabilitation of transmission lines and increase in the capacity of hydro plans has decreased imports to 50%. Imported electricity comes solely from oil based plants.

Discrepancies between demand - supply and reliance solely on hydro power make the electric supply unreliable. Consequently, the managing company subjects the population to electricity shortages; which among other things, has increased consumption of fuel based

[13] IEA, "Energy in the Western Balkans; The path to reform and reconstruction' page 124

energy producers such as generators. There is no data available on the amount of fuel used to produce energy. Table 4 provides an overview of electricity consumption from 1998 till 2007. As it can be identified imports have almost double during this period. Exports have also increased due to the seasonal nature of Hydropower. During winter and spring production is more than the country can absorb while during summer it is too low. Unfortunately, the energy produced can not be preserved; as a result it is sold to neighboring countries.

**Table 4:** Gross consumption in Albania 1998 - 2007[14]

| **Description** | **1998** | **1999** | **2000** | **2001** | **2002** | **2003** | **2004** | **2005** | **2006** | **2007** |
|---|---|---|---|---|---|---|---|---|---|---|
| Gross inland consumption | 1.911 | 1.809 | 1.824 | 1.934 | 1.861 | 2.055 | 2.258 | 2.278 | 2.156 | 2.130 |
| **Primary production** | 1.345 | 1.113 | 987 | 933 | 896 | 1.012 | 1.178 | 1.149 | 1.33 | 1.11 |
| **Import** | 626 | 761 | 858 | 1.007 | 971 | 1.164 | 1.149 | 1.175 | 935 | 1.264 |
| **Export** | 60 | 65 | 21 | 6 | 6 | 121 | 69 | 46 | 109 | 244 |

**Source**: Agripolicy

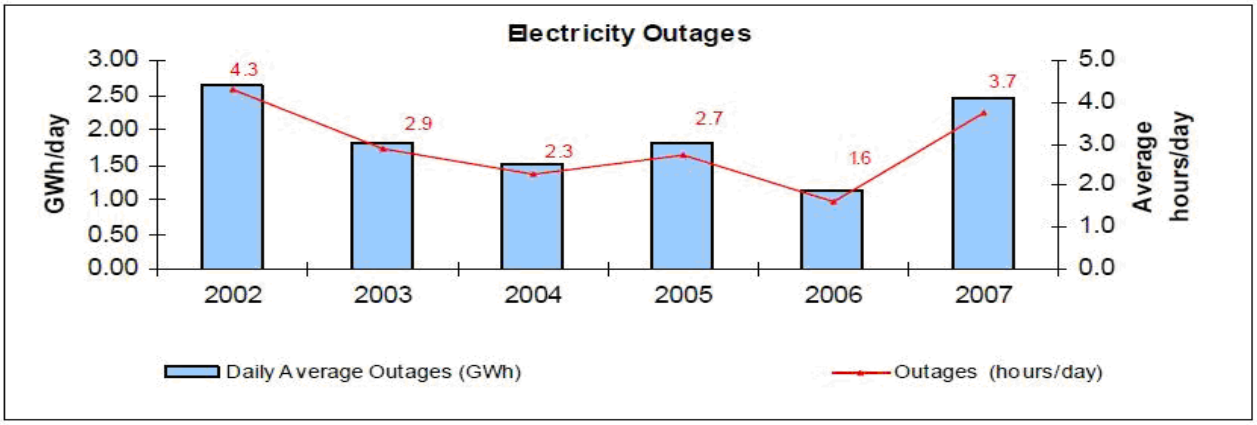
Inability to collect payment from end line customers has caused major problems for the distribution company. As a result, higher prices have been placed to regular customer to cover incurring losses. In collaboration with the Ministry of Justice, CEZ undertook a major program to disconnect from the grid "illegal" costumers. The program has been successful but there are still many areas that the law could not yet reach such as villages in Tropoja (north) and Lazarat village (south).

High reliance on imports and low collection rates has lead to continuous power shortages, reaching their peak in 2007 as presented in the table below:



[14] Agripolicy, "Renewale Energy and its impact on rural development in Albania" http://www.euroqualityfiles.net/AgriPolicy/Report%202.2/Agripolicy%20WP2%20D2%20Albania%20Final.pdf , Last Accessed on May 22nd 2012

**Table 5**: Electricity outages, 2002 – 2007[15]




**Source**: EBRD

It needs be note that since the privatization of OSSH by CEZ the situation has improved radically. Currently power shortages are set only to neighborhoods who have a negative "record", meaning they did not pay their eclectic bills for the last 6 months or paid irregularly. Tirana has very rarely experienced power cuts in the last 3 years.

### 1.3. 2.3 Resources

According to the METE: "*Strategy on Energy and Action Plan*"[16] Albania is utilizing only a limited source of its primary energy sources[17]. Furthermore resources utilized are not in their full potential. While the country relies solely on Hydropower, research shows that solar, wind, biomass, oil and gas have great potential to match the gap between demand and supply and even surpass it.



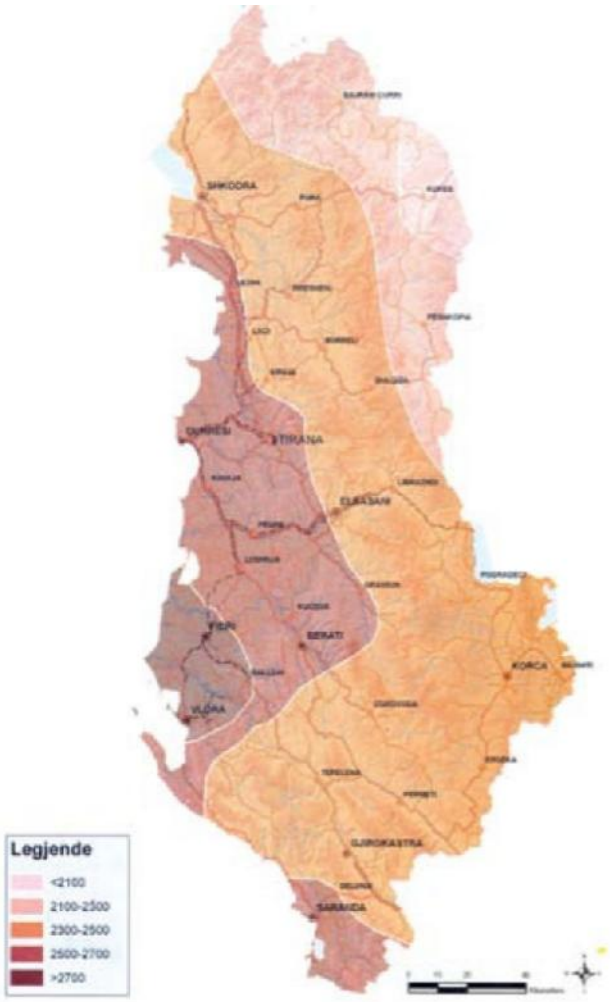
[15] EBRD, Renewable Development Initiative http://ebrdrenewables.com/sites/renew/countries/Albania/profile.aspx, Last Accessed on May 22nd 2012
[16] METE, "Summary – National Energy Strategy and Action Plan", Page 8
[17] Primary energy is an energy form found in nature that has not been subjected to any conversion or transformation process.

### *1.3.1. Hydropower*

Albania is renowned for its hydropower potential but according to the Ministry of Economy, Finance and Energy, the country only utilizes 35% of its capacities. Total Hydropower reserves are estimated to be around 3000 MW, which could cover the country's electricity needs threefold.

### *1.3.2. Solar Energy*

**Table 6:** Solar Radiation




**Source**: National Agency of Natural Resources

[18]Solar Energy in Albania is estimated to be between 1500 – 1700 KWh/m2 per year. Annual radiation varies from 3.2 – 6 kWh/m2/ day making solar energy a promising source of energy. Research shows that installed capacity as at approximately 9MW, mainly for private usage. National Energy Action Plan identifies solar as a potential source for household power generating through installment of small panel on the roof tops. Rather than a mass production source, solar can improve the efficiency of electricity usage by filling a niche for heating purposes.

[18] National Agency of Natural Resources, Renewable Energy in Albania, Page 10 http://www.akbn.gov.al/editor_files/file/content/E.%20Rinovueshme.pdf, Last Accessed on May 22nd 2012

### *1.3.3. Oil, gas and coal*

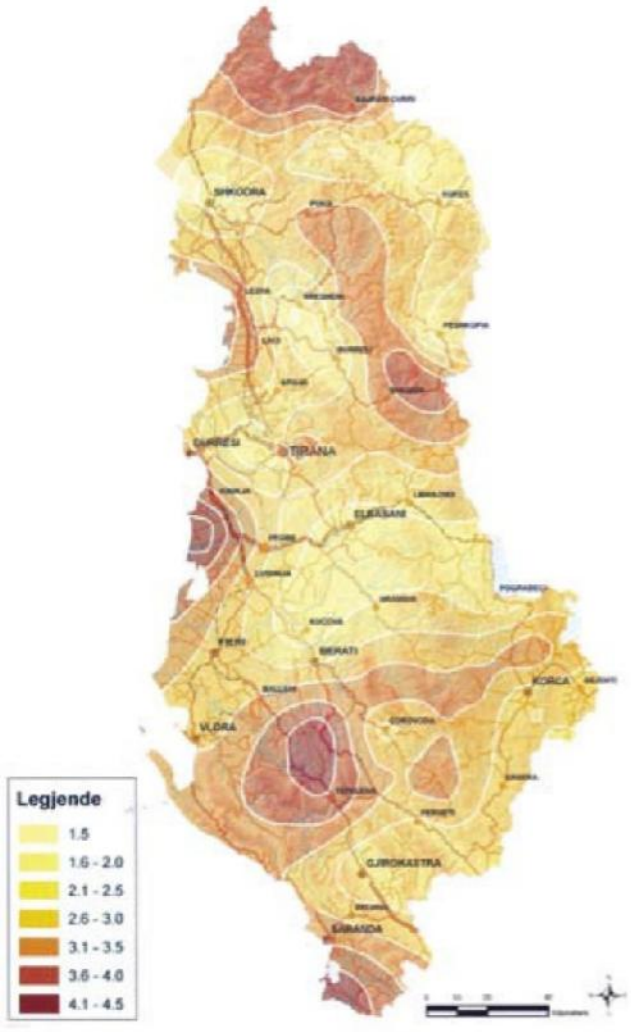
Albania has moderate reserves of oil, gas and coal. Explored sites show promising results and further exploitations are being conducted by foreign companies. ARMO – company responsible for these reserves is currently under discussion to be privatized and due to "sensitivity" of information statistics on its reserves is not fully disclosed. Nevertheless, estimates show that there is high potential for generating electricity through these reserves.

### *1.3.4. Wind*

In cooperation with the Italian government, a new plan has been introduced to build a wind park in the Albanian Jonian coast with a capacity of 1300 MW. The generated energy will be sufficient to cover the current needs of the country and with potential to export to Italy through undersea transmission lines. The plan is currently disputed by environmentalists and tourism experts as the windmills would be built in a highly touristic area.

This plan is currently being evaluated and a feasibility study is underway.

**Table 7**: Wind Speed[19]




**Source:** National Agency of Natural Resources

[19] National Agency of Natural Resources, Renewable Energy in Albania, Page 12 http://www.akbn.gov.al/editor_files/file/content/E.%20Rinovueshme.pdf, Last Accessed on May 22nd 2012

### *1.3.5. Geothermal*

Geothermal resources in Albania could not be used for energy generation due to their low temperatures (20 – 33 degrees). Current Geothermal plants are oil induced.

## 1.4. Challenges and Obstacles

The data presented above shows that Albania has great potential in covering their local needs and also being an exporter of electric power. Although in 1990 energy needs were higher than in 2008 the country was able to cover its needs, whilst today it relies almost 50% on imports. Main impediments for this have been:

1- Old and not rehabilitated hydro power plants;

2- Abandonment of small hydro power plants;

3- Non rehabilitation of transmission system;

4- Mismanagement of dispatch; and

5- Technical and non technical losses during transmission.

After the privatization of the distribution system the situation was improved considerably as the network was rehabilitated and losses were decreased. Nevertheless, the country's energy production is still under strict monopoly from the government and this has been an impediment in improving the energy trade balance due to: lack of funds for investments and slow pace of institutional reforms.

Furthermore, Albania is solely relying on renewable energy sources, all being seasonal and dependant on uncontrollable parameters. The country lacks base production which can be man created and can be put in operation and stopped whenever necessary. Energy plants from coal, oil or other storable energy sources would create such a base and their function would be only precautionary and utilized only during times of need.

Albania's constant population growth will lead to constant increase for energy demand. This demand can be reached only through improving of the current network; increase on current plant potentials; and introduction of new sources of energy production.

# 2. Energy Legislation and Regulations

Chapter 3 will analyze the legal framework for electricity production, transmission and dispatch in Albania. The focus will be to analyze possibilities for attracting private investors to enter the energy market focusing on; relevant laws; secondary source of regulation and the general rule of law in the country. This chapter will provide an overview of the legal framework, relevant institutions and the institutional challenges foreign investors face in their attempt to enter the market.

## 2.1. Legal Framework

According to the IEA, during the last seven years Albania has improved its legal framework through introducing new laws for the production and distribution of electricity. The establishment of a new energy regulatory body created grounds for future sustainable developments, while the privatization of the distribution system has improved access to electricity for the general population. Below are presented some of the core elements that define the legal framework in Albania: laws; strategic planning; international agreements; and national and regional development trends.

### *2.1.1. Laws and Regulations*

The production and distribution of energy in Albania operates under the guidance of the following prevailing laws.

- *Law on Hydrocarbons*[20] established the sovereignty of the state over its hydrocarbon resources which paved the ground for private investors. The law was introduced in 1993. In 1994 this law was further improved by the introduction of the *Law on Fiscal System of Hydrocarbons Sector*[21], which created additional security for investors as they were exempted from taxation or other fiscal duties.
- *Law on Regulation of Power Sector*[22] governs the economic integrity and effectiveness of the production and distribution of electricity. The law stipulates that electricity tariffs should be based on real market values thus covering all incurring cost for delivering electricity to each end costumer. A standard 7.5% increase in tariffs is introduced and will be operational until the price for electricity reaches real market value. Furthermore, the law requires all new producers entering the market, with capacity over 100MW shall be from a renewable source and 2% can come from other sources. Article 38 identifies privileged producers which include: HPP with capacity up to 10 MW and other RES-E with capacity up to 25 MW; coogenerators with capacity up to 100 MW; auto-producers using renewables with capacity up to 10 MW. These producers will have favorable treatment while they dispatch either as preferential buyers or better purchase price.
- *Law on facilitating conditions establishment for new power generation resources construction*[23] stipulates requirements for obtaining a certificate for the construction of



[20] *Law on Hydrocarbons* No# 7746 date 29.07.1994. Official Translation: http://www.minfin.gov.al/minfin/pub/2_law_no_7853_1252_1.pdf, Last Accessed on May 22nd 2012
[21] *Law on Fiscal System of Hydrocarbons Sector* No# 7811 12.04.1994. Official Translation: http://www.minfin.gov.al/minfin/pub/16_7811l1994_on_approval_of_the_deecre_1266_1.pdf, Last Accessed on May 22nd 2012
[22] *Law on Regulation of Power Sector* No. 9072, dated 22.05.2003. Official Translation: http://www.minfin.gov.al/minfin/pub/14_law_9072_date_22_05_2003_1316_1.pdf, Last Accessed on May 22nd 2012
[23] *Law on facilitating conditions establishment for new power generation resources construction* No # 8987, Dated 24.12.2002. Official Translation: http://www.mete.gov.al/doc/20090206090215_final_regulation_for_construction_authorization_as_approved_by_com.pdf, Last Accessed on May 22nd 2012

a new power resource. Furthermore, Article 2 states that all power producers using renewables shall be exempted from custom duties.

- *Law on Concessions*[24] has a specific chapter on Energy attempting to attract external investments. The law supports small HPP's with an installed capacity of less than 15 MW, lifespan less than 35 years and a cost of up to EUR 20 million. [25] In order to connect the generated power to the main greed the generating company (Concessionaire) should sign a "Power Purchase Agreement for Electric Energy"[26] with KESH. In this contract KESH agrees to purchase the produced energy based on the Concession Agreement, the Law no. 9470, date 02.02.2006 and the law no. 8527, date 23.09.1999. The price of energy for the Concessionaire[27] is decided according to the market price in reference of electricity in Euro/MWh (average import price realized during the previous year from the public company) multiplied with the exchange rate Euro/ALL for the previous year multiplied with the rate 1.1 (that represents 10% bonus for the improve in technical distribution network losses). The contract lasts for 15 years. There are currently 104 Concessionaire Contract but only 18 have started construction.

In '05 the Parliament introduced to the parliament a new *Law on Energy Efficiency* promoting the efficient use of energy and the energy sector as a whole. The law is not yet ratified but the developing bodies are making it in compliance with EU Directive 2009/28/EC on promotion of renewable energy production. This law will take RES



[24] *Law on Concessions* No. 9663, dated 18.23. 2006. Official Translation: http://www.mete.gov.al/doc/20070213212937_decision_no.27,_dated_19.janar.2007-pdf.pdf, Last Accessed on May 22nd 2012
[25] "Rules for the evaluation and granting of concessions" http://www.mete.gov.al/doc/20070213212937_decision_no.27,_dated_19.janar.2007-pdf.pdf, Last Accessed on May 22nd 2012
[26] *Regulator Board of Energy* Decision no. 80, date 23.10.2009. http://archive.unctad.org/sections/wcmu/docs/ciem3_Eridita.pdf, Last Accessed on May 22nd 2012
[27] Decision of the Council of the Ministers no. 27, date 10.01.2007 http://archive.unctad.org/sections/wcmu/docs/ciem3_Eridita.pdf Page 6 , Last Accessed on May 22nd 2012

production another step further and establish an RES fund. Nevertheless, the law has been under discussion for the past 7 years and no agreement is yet in sight.

### *2.1.2. International Agreements*

Under the guidance of the above mentioned laws, the Albanian government entered various regional and international agreements to meet the *acquis communautaire* requirements and improve the energy situation in Albania. The most important international agreements are:

- ✓ *Energy Charter Treaty* [28]– Signed in December 1994, this treaty served as the legal basis for cooperation between all signatory parties.
- ✓ *Energy Community Treaty*[29] – Signed in October '05, this treaty between EU and South –Eastern Europe requires signatory parties to create a regional energy market which would fit into the framework of the Internal Energy Market of EU.
- ✓ *Kyoto Protoco*[30]*l* – Signed on September '04, this treaty ascertains that Albania will comply with Carbon Emission goals and promote renewable energies. Nevertheless, Albania is a Non-Annex 1 country thus development of non renewable projects in the energy field will be within the predetermined parameters.

EU Progress Report for Albania[31], acknowledged the developments in the energy field and it's compliance with the signed treaties. Nevertheless, they stress on the slow pace of change in this sector and the overall operational glitches which are hampering the integration of Albania into a Regional Energy Market.

[28] Energy Charter, Treaty 1994. http://www.encharter.org/index.php?id=28, Last Accessed on May 22nd 2012
[29] Energy Community, Albania country profile http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/EU/Albania, Last Accessed on May 22nd 2012
[30] United Nations, Framework Convention on Climate Change, Signatory Parties http://unfccc.int/parties_and_observers/parties/non_annex_i/items/2833.php, Last Accessed on May 22nd 2012
[31] European Commision, " Albania 2011, Progress Report" dated 12.10.11 http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/al_rapport_2011_en.pdf, Last Accessed on May 22nd 2012

The main identified problems are: miss-coordination among institutions; overlapping laws; detailed determinations on who can connect to the grid; non-transparent concessionaire approvals; and, not clear development strategies.

### *2.1.3. Strategies of Action*

Under the governance of the above mentioned laws and the international Agreements, two major strategic plans are developed:

- ✓ *National Energy Strategy*[32] – Updated in April 2007 this strategy aims to develop an energy sector that can secure energy supply to its costumers; meet energy demands; keep energy prices low; protect the environment; and improve the quality of life of the population. The main objectives of the strategy are:
  - ✓ Security of supply through diversification of supply
  - ✓ Construction of new generation plants and inter-connection lines
  - ✓ Incentivizing the use of renewable energy sources
- ✓ *National Energy Action Plan* – Based on the Strategy this plan lays specific actions to be undertaken in order to ensure stability of supply and meet market demands. Although this plan was introduced in 2007, very few steps have been taken to implement the identified projects.

## 2.2. Regulatory Institutions

On a Ministerial Level, the *Ministry of Economy, Trade and Energy* is responsible for the energy sector and they are the authors of the National Energy Strategy and its Action Plan. The Ministry constitutes of three responsible directorates: Energy Policy Directorate – responsible for Electricity; Hydrocarbons and Mines – responsible for mining; and

[32] METE, Summary of National Energy Strategy
http://unfccc.int/resource/cd_roms/soge/material/SEM_SUP1_albania.pdf

Competition Directorate – responsible for market reforms. The Ministry also monitors the activities of *KESH* – responsible for Energy Production. .

*National Resource Agency*, a branch of the ministry, is responsible for the preparation of the energy strategy and its implementation; drafting primary and secondary legislation for energy sector and preparing analysis and development scenarios of the energy sector. There are two scenarios developed: passive and active. According to current data and analysis by INSTAT Albania has been following a passive scenario with minimum efforts to avert collapse. Although, the relevant agencies have managed to elaborate various strategies and action plans, most has not been able to materialize.

### 2.3. Challenges and Obstacles

Energy sector in Albania has experienced a series of efforts to reform the legal framework and institutional infrastructure. Despite all efforts, according to IAE, Albania has not progressed at desirable and expected levels. The main challenges that hamper the countries progress are:

- Governmental Perspective:
  - *Rule of Law or lack of* – the impact this fundamental norm of state creation has on potential investors is three fold: 1) Corruption, investors are scared away from bureaucrats who see their positions not as a set of responsibilities to improve the current situation but as entitlements; 2) Low rate of collection from creditors, lack of coordination with law enforcing agencies makes Albania a country with the highest rates of loss during transmission. This is due to illegal connections to the grid and non payment of incurring debts; and 3) Weak and corrupted courts, although laws attribute many benefits to investors and give space for many privileges, in case of disputes the courts are not always a source of justice.

- *Institutional democracy or balance of power* – Institutions have very strict hierarchy of power with no checks and balances from outside stakeholders. Despite Non-Governmental-Organizations there are no cross checking's between different institutions. The Ministry has ultimate power over all agencies and none is independent to bring forward misconduct.
- *Slow pace development* – The law on Renewables has been and still is under discussion for the past 7 years and the end is still not in sight.

- Legal Perspective:
  - *Overlapping laws* – For the same type of electricity generation method there are various overlapping laws which contradict themselves and there is no possibility to determine which prevails in case of dispute. While the Law on Power generation favors RES plants over 100 MW the law on concessionaires only grants permition to connect to the grid plants under 15 MW.
  - *Non-specific laws:* Law on Power generation states that privilege treatment would be given to RES plants but these privileges are not stipulated anywhere in the law.
  - *Discriminatory price* – New RES plants to be constructed will receive a smaller price for the electricity produced than the already existing plants.
  - *No bankruptcy proceedings for RES plants* – There is no legal framework from protecting investors in case of bankruptcy.
- Institutional perspective:
  - The distribution network is still connected with dispatching, which according to the Government contract with CEZ had to be separated within this year. This has complicated the relationship between the production and distribution company.

- The Albanian Energy Corporation is currently under scrutiny whether it should be privatized, and if so at which price. If it gets privatized there is no legal specification on how connection to the grid will work for RES plants and for which prices.

## 3. Project Financing

Despite all identified impediments foreign direct investments in (FDI) in Albania are still high, especially in the energy sector. In this chapter there will be an analysis of the countries potential to diversify its energy mix through foreign investments. This analysis will be targeted towards the biggest active banks.

### 3.1. Ease of doing business in Albania

EU accession has long been set as a high priority objective to the countries of the SEE region. Consequently, they have been promptly liberalizing their economic frameworks and improving conditions for doing business, and thus have been attracting foreign direct investments (FDI). Croatia and Serbia have experienced a more stable growth of FDI, while the remaining countries have been slower to attract investments. Nevertheless, total FDI in the region saw a drastic decline in 2008, as a result of the global economic downturn. Countries with economies less exposed to foreign investments, such as Albania or Montenegro, were less affected.

**Table 8:** Inward FDI in the SEE region (USD million) in the period 2001-2009[33]

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Albania | 5.5 | 6.0 | 6.5 | 2.2 | 3.0 |
| Bosnia and Herzegovina | 6.9 | 6.8 | 5.5 | (3.0) | 0.5 |
| Bulgaria | 6.3 | 6.2 | 6.0 | (6.5) | (2.0) |
| Croatia | 4.7 | 5.4 | 2.3 | (5.0) | 1.1 |
| Macedonia, FYR | 4.0 | 5.9 | 5.0 | (1.3) | 1.9 |
| Montenegro | 8.6 | 10.7 | 7.5 | (4.0) | (2.0) |
| Romania | 7.9 | 6.2 | 7.1 | (7.8) | 0.5 |
| Serbia | 5.2 | 6.9 | 5.4 | (4.0) | 1.5 |
| **AVERAGE** | **6.1** | **6.8** | **5.7** | **(3.7)** | **0.6** |

**Source:** UnctadStata

[33] UnctadStata http://unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=89 , Last accessed on 10th of May 2012

Albania managed to mitigate its exposure to global market volatilities by its limited reliance on the export channels, which conversely would have had a devastating effect on its economy, and by allowing a modest reliability on the international financial markets. The country's monetary policy framework, careful banking supervision and its flexible exchange rate also had stabilizing effects. In addition, in 2010 the Albanian economy experienced a successful phase of privatization and FDI inflows, providing a stimulus to economic activity and leading to a growth of 3.3% in the respective year. Major privatization deals involving FDI included the following[34]: sale of 12.6% of shares in mobile telecommunication company AMC to the Greek telecommunications group COSMOTE, for €48.2 million; the sale of 76% of shares in the energy distributor (OSSh) to the Czech company CEZ for €102 million; investments in the cement industry by Antea Cement (Italy), Colacem Albania (Italy), Cementos Aguila (Italy); the fourth mobile telephony license was sold to the Post-Telecommunication of Kosovo for €7.5 million.

These factors demonstrate that Albania has managed to establish a robust economic structure, with attractive conditions for FDI and lending for large infrastructure projects.

### 3.2. Financing need for energy infrastructure in Albania

The conflicts in the SEE during the 1990's have had a devastating effect on the region's economy and infrastructure, including the energy sector. As a result of the damaged infrastructure and the countries' lack of cooperation on the harmonization of energy markets, the European Union initiated the Energy Community Treaty, signed by all of the SEE countries in 2005, with the aim to foster a regional approach to energy security, thereby improving the utilization of existing supply and production capacities, as well as optimizing future investments in the region. The Energy Community is also focused on harmonizing

[34] Ministry of Economy, Trade and Energy, "Foreign Direct Investment in Albania 2010" http://www.mete.gov.al/upload/fdi_report_2010.pdf , Last accessed on 10th of May 2012

regulations between the signatory countries and the EU, which has been accomplished through the adoption by Energy Community members of key EU Directives and Regulations, which require the full liberalization of their domestic electricity markets by January 2015.

Under the Energy Community framework, each member country has assessed and reviewed its need for generation assets, as well as its gas and electricity transmission infrastructure. As a result, member countries have compiled a list of "Priority Projects", whose implementation is considered to be an urgent priority in order for their respective countries to achieve security of energy supply. The estimated total cost of these projects is approximately EUR 15 billion, of which EUR 10 billion is for electricity generation assets alone.

With limited funds available, these projects will be competing for financing on a global basis, from both equity partners and lenders. To date, sourcing financing for energy projects in Albania has proven to be a very difficult task. Given the slow pace of regulatory reforms in the infrastructure related sectors, foreign investors have been reluctant to participate in financing infrastructure projects. In addition, the lending community that is present in the Country is typically focused on retail banking, with little experience or focus on financing large infrastructure projects.

Infrastructure financing, including various forms of structured financing, is at a very early stage of development in Albania. This is predominantly due to the fact that the legislative framework does not always provide enough assurance to both investors and lenders for the financing of standalone projects, without at least some support from the government. The lack of financing resources to support the development of infrastructure projects, along with other country-specific challenges, are thus considered to be the most significant hurdles to building the next fleet of electricity generation assets.

The financing gap detailed above has primarily been addressed by development banks such as the EBRD and EIB, various governmental agencies, and EU funds, all of which are bringing funds to the region, in order to help the SEE countries improve their infrastructure and thereby enhance their economic competitiveness.

A thorough analysis of the financing activity of Multilateral Financing Institutions (MFIs) in Albania shows that MFIs are playing a significant role in reshaping the energy market by providing funds to various projects, primarily through grants or direct lending.

Particularly in Albania, there has been an increasing trend of MFI support for numerous infrastructure projects, demonstrating an increasing confidence level for lenders and proving that Albania is working towards establishing a suitable economic, legal and political environment for financing and development of future projects.

According to the Energy Community, the following are priority projects in Albania:

**Table 9:** Priority energy projects in Albania[35]

| Electricity Interconnection Projects | Country | Value (MEUR) | kV | Financing | Status |
|---|---|---|---|---|---|
| Interconnection Tirana - Podgorica | Albania \ Montenegro | 51.2 | 400 | Public Loan | Ended Dec 2010 |
| Substation Tirana 2 - Kosovo B | Albania \ Kosovo | 91.3 | 400 | Public \ Private | Start 2009 |
| Bitola-Elbasan-Durres-Foggia | Macedonia \ Albania \ Italy | 450 | 400 and 400/220 | Public \ Private | No date |
| **TOTAL** | | **592.50** | **3,310.00** | | |
| **Energy Generation Project** | **Country** | **Value (MEUR)** | **MW** | **Financing** | **Status** |
| CCPT Vlore | Albania | 92 | 97 | IDA, EBRD, EIB | Operational by Oct 09 |
| Ashta HPP Drin River | Albania | 160 | 50 | Private investors | Finalized Nov. 07 |
| 3-4 HPP Devoll's River | Albania | 950 | 340 | Private investors | Finalized 2017 |
| Skavica HPP | Albania | 550 | 350 | Private investors | Under Negotiation |
| CCPT Korca | Albania | 185 | 350 | Private investors | Feasibility Study |
| Three HPPs - Vjosa | Albania | TBD | 400 | Private investors | Tendering |
| **TOTAL** | | **1,937.00** | **8,418.40** | | |
| **Gas transmission networks** | **Country** | **Value (MEUR)** | **Length** | **Financing** | **Status** |
| Trans Adriatic | Greece \ Albania \ Italy | 1100 | | Private Investors | Feasibility Study |
| Greece Albania Pipeline | Greece \ Albania | 202 | | Private Investors | Feasibility Study |
| Trans Adriatic Fier - Puglia | Albania \ Greece | 800 | | Private Investors | Finished in 2011 |
| Ionian - Adriatic Pipeline | AL \ MNT \ CRO \ B&H | 230 | | Public\Private | Feasibility Study Done |
| **TOTAL** | | **2,332.00** | | | |
| **TOTAL INVESTMENT NEED** | | **4,861.50** | | | |

**Sources:** Energy Community

As noted on the above list, the energy generation projects are estimated to cost almost EUR 2 billion, thus will categorically require the involvement of foreign investors and MFIs.

[35] Energy Community, "Report of the Energy Community Secretariat on priority projects and next steps", 2011, http://www.energy-community.org/pls/portal/docs/1068185.PDF , Last accessed on 10th of May 2012

As mentioned in Chapter 1, the CCGT Vlora project has already received backing from the World Bank, EBRD, and EIB, whereas the HPPs are all being tendered to private investors and have already attracted great interest from some of the largest players in the energy industry.

Following Albania's recent update of the energy strategy, it is evident that the country will be in need of additional source of funding for renewable projects, such as wind and solar projects. As previously mentioned, commercial lenders are not expected to fill the financing gap, thus it will be up to MFIs to maintain their supporting position and help fund the projects.

### 3.3. Commercial lending activities

The banking sector was one of the first industries to be liberalized in the Albania, as the privatization of banks provided the means to attract new capital to support economic growth. The market share of foreign-owned banks in Albania has been increasing steadily, which has resulted in an overall improvement in banking services and enhanced competition.

Despite the high growth rates, financial intermediation in Albania is still considered to be low. However, further legal and institutional reforms, which are a necessary part of the EU integration process, should have a positive effect on the development of Albania's economy and its banking sector.

A study prepared by Serdon Business Consultancy, entitled "Access to Financing in Southeast Europe", surveyed commercial banks' interest in various economic sectors, and has found that their primary appetite is to lend to the real estate, construction and Information Communications and Technology sectors, while the energy and infrastructure sectors were considered to be a lower priority, which has been the case in Albania as well.

Furthermore, the lending community in Albania is typically focused on retail banking, with little experience or focus on financing investment projects. Nevertheless, the EU

integration process, which passed an important milestone with Albania's formal application to become an EU member in April 2009, should lead to stronger economic integration, which should in turn benefit the banking sector, as well as the economy as a whole.

### 3.4. Multilateral financing in Albania

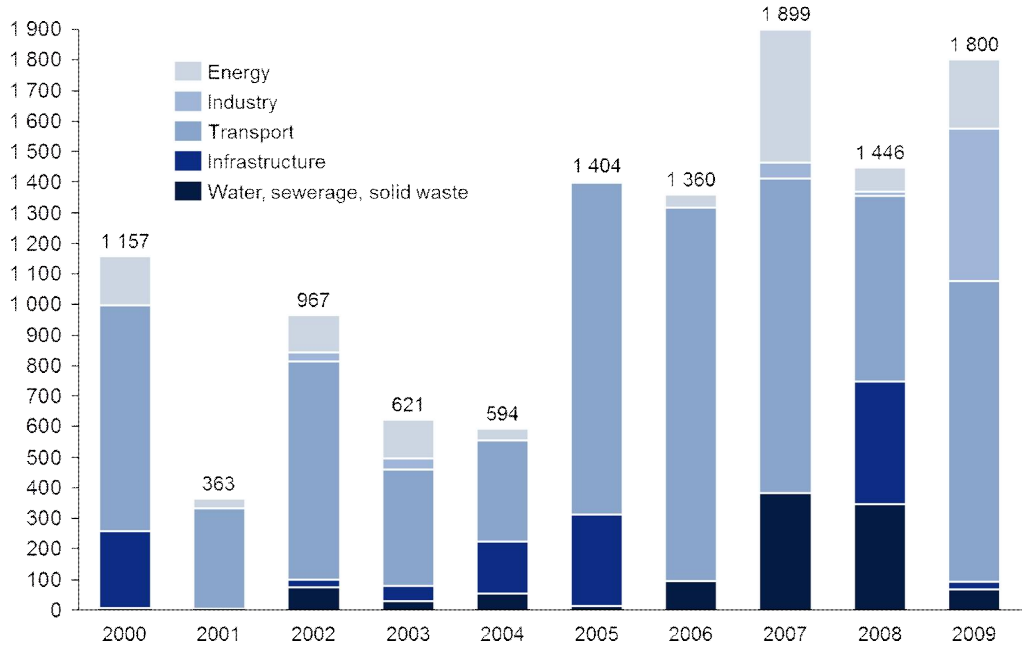
As previously noted, MFIs continue to be an important source of financing for numerous projects in Albania. This analysis focuses on the involvement of European Investment Bank, the European Bank for Reconstruction and Development, and the World Bank, and their prospect of involvement in other future project necessary for the development of Albania's power infrastructure.

#### *3.4.1. The European Investment Bank (EIB)*

The EIB has been actively lending money to the public and private sectors for projects of European interest. It is active in over 140 countries worldwide, with which the EU has cooperation agreements with. Because the EU Member States are the EIB's shareholders, it carries the highest possible credit rating (AAA) on the money markets. As a result, the EIB can raise large amounts of capital on very competitive terms. Due to the fact that the EIB is a not-for–profit organisation, its lending conditions are equally favourable.

The EIB's total lending activity in the SEE region has increased significantly since 2006. Given that the data also includes the current EU-members Romania and Bulgaria, a significant amount of total lending has been apportioned to these two countries, in light of their accession to the union in 2007. The following analysis includes projects of the energy, industry, transport, water, sewerage, and solid waste sectors, which provide a more comparable representation of EIB's involvement in infrastructure financing.

**Table 10**: 2000-2009 EIB financing value (Euro million) by years in the SEE region[36]




**Source**:EIB

The EIB has financed 145 infrastructure projects in the SEE region between 2000 and 2009, of which 8 were in Albania at a total value of EUR 224 million. Two of the projects were from the Energy sector, valued at EUR 70 million. EIB's financial involvement in Albania has been much smaller compared to that of the other regional countries; nevertheless, EIB remains resolute in supporting Albania's development of its aching infrastructure, mostly focusing on road network construction.

### *3.4.2. The European Bank for Reconstruction and Development (EBRD)*

The European Bank for Reconstruction and Development was established in 1991, and since then has become the largest financial investor in its region of operations, which stretches from central Europe and the Western Balkans to central Asia. The EBRD's ability to bear risk on behalf of investors helps the beneficiary countries to enhance their economies.

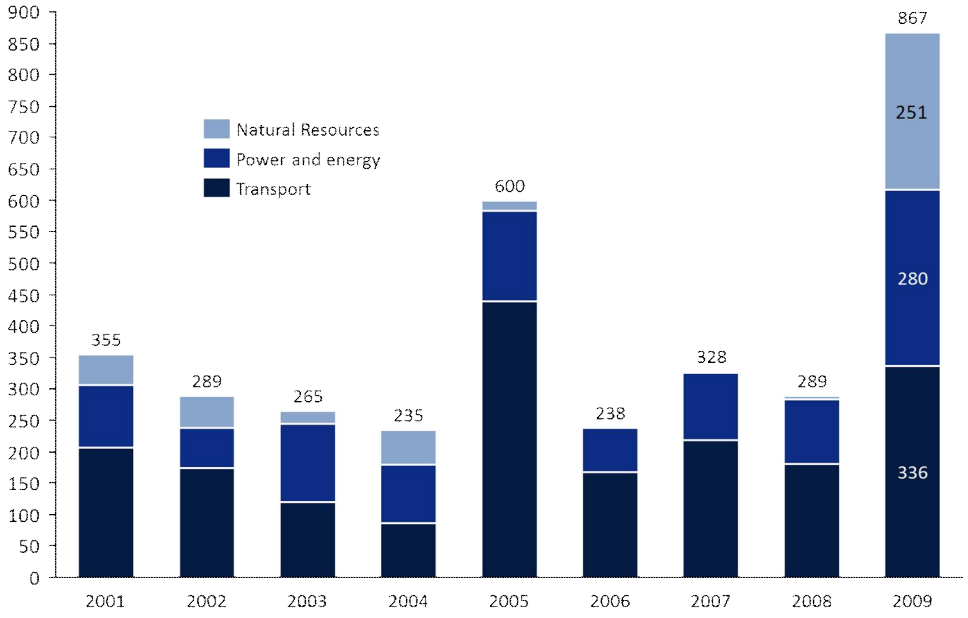
[36] European Investment Bank Database http://www.eib.org/projects/loans/regions/index.htm , Last accessed on 10th of May 2012

While a large share of EBRD's financing is represented by investments for bank lending, at 15%, this institution's investments are also included in natural resources, power & energy, and transportation, which represent 4%, 11% and 18%, respectively, of total EBRD financing in the SEE region.

There were 115 projects financed by the EBRD in the SEE region between 2000 and 2009, among the three highlighted sectors. The total value of financing contributed by the EBRD for projects was EUR 4,296 million, out of which EUR 266 million were invested in Albania for a total of 15 projects.

In response to the global financial crisis, the EBRD significantly increased its lending activity in the SEE region, as a means of addressing the sharp drop in lending by commercial banks. Indeed, the EBRD's total financing in natural resources, power and energy and transport in 2009 amounted to EUR 867 million, which was a substantial increase over the total financing of EUR 289 million that it provided these sectors in 2008.

**Table 11**: 2000-2009 EBRD financing in the SEE countries, breakdown by three sectors (EUR million)[37]

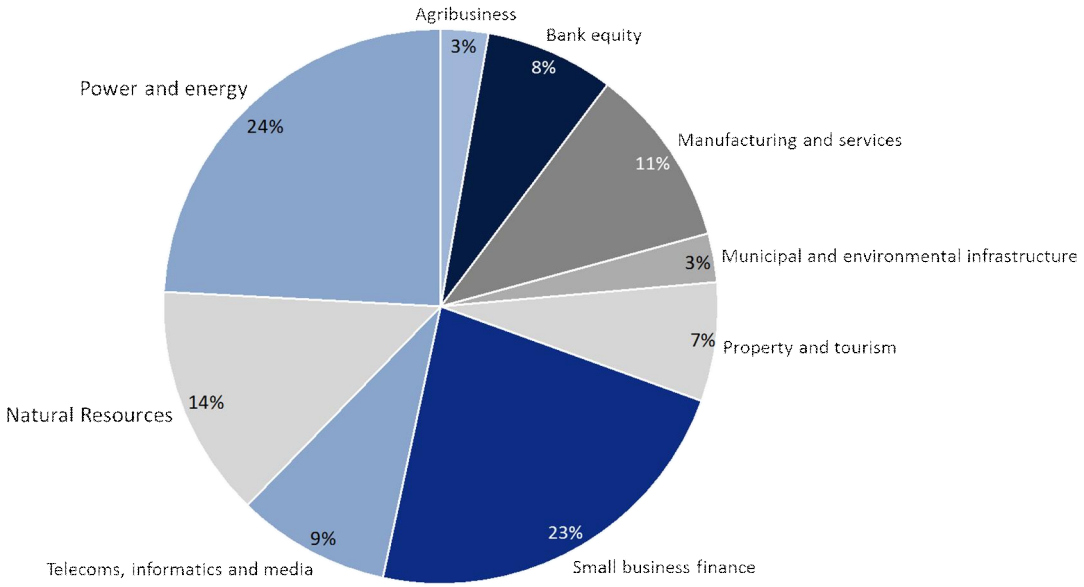



**Source:** EBRD

[37]EBRD Database http://www.ebrd.com/pages/workingwithus/procurement/project/reports.shtml, Last accessed on 10th of May 2012

When comparing the different sectors EBRD has invested in Albania, it is apparent that the highest priority has been given to the Power and Energy sector, at 24%, followed by Small Business Finance and Natural resources, at 23% and 14%, respectively. Thus, the EBRD has observably demonstrated their backing for the advancement of the energy sector in Albania, support which is expected to be maintained throughout the future phases of the development of project within the energy sector.

**Table 12**: 2000-2009 EBRD financing by sector share in Albania[38]



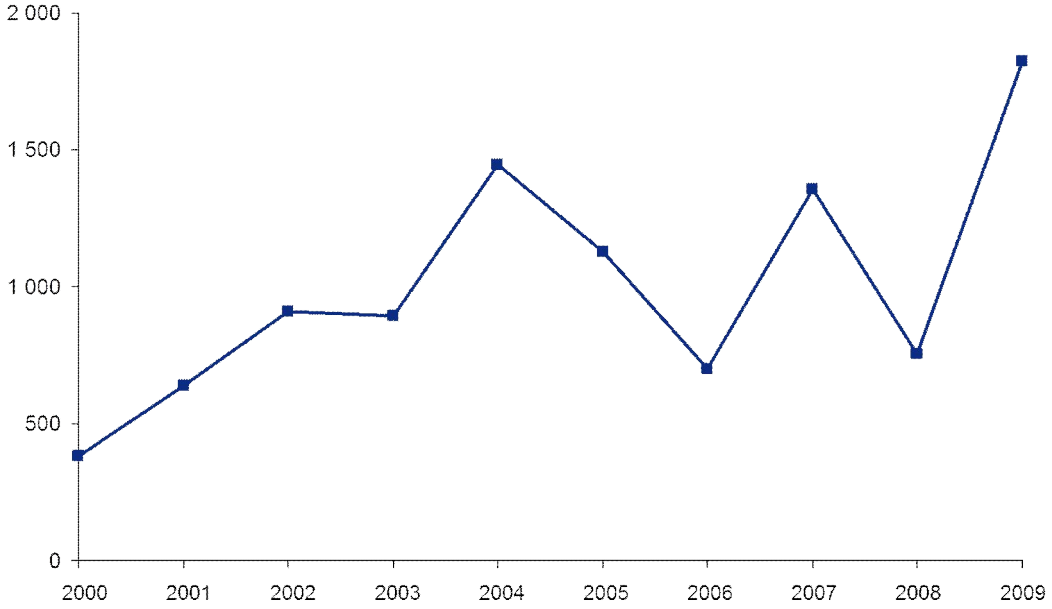

**Source:** EBRD

### *3.4.3. The World Bank*

The World Bank's financing activities in the SEE have grown over the years. However, when compared with the overall financing by the EIB and the EBRD, the World Bank's lending activity has remained relatively stable, although an increase in 2009 as a response to the financial downturn is evident.

[38] EBRD Database http://www.ebrd.com/pages/workingwithus/procurement/project/reports.shtml, Last accessed on 10th of May 2012

**Table 13**: 2000-2009 World Bank total financing value in the SEE region by years (EUR million)[39]




**Source:** The World Bank

As with the EIB and EBRD, Romania has received a significant portion of World Bank financing during the past two decades, accounting for EUR 5,970 million or 35% of the total financing that the World Bank provided to the SEE region. Bulgaria follows with EUR 2,933 million or 17% of regional financing, while Albania is fifth with EUR 1,082 million, or 6% of regional funding coming its way.

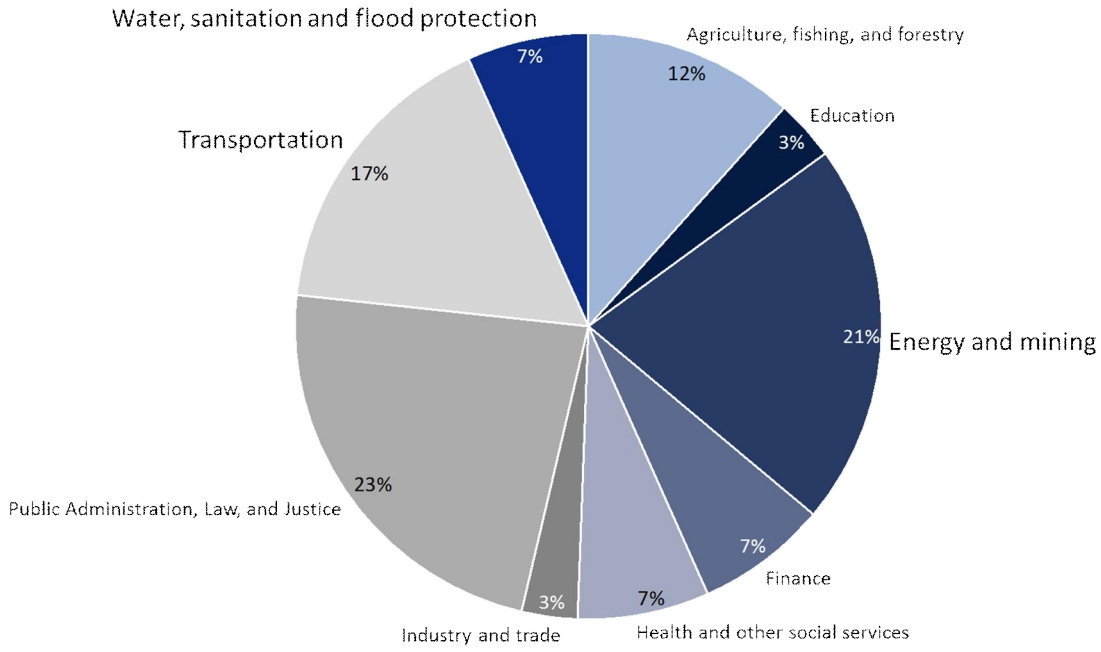
Among the energy & mining, transportation, and water sanitation & flood protection sectors, the World Bank has allocated 8%, 16% and 7%, respectively, of the total World Bank financing in the SEE. Between 2000 and 2009, the World Bank has financed 86 infrastructure projects in the SEE region, with a total financing value of EUR 3,600 million. 16 of those projects, the highest number compared to all other SEE countries, were implemented in Albania.

Moreover, the share of financing for infrastructure projects (i.e. energy & mining, transportation, and water sanitation & flood protection) is 45% of total financing. This figure

[39] The World Bank Database, http://data.worldbank.org/, Last accessed on 10th of May 2012

is way above the World Bank's broader financing activities in the SEE region, yet again proving that the development and advancement of the infrastructure in Albania are a priority for the investment projects of MFIs.

**Table 14:** 1991-2009 World Bank financing value (%) in Albania (by sectors)[40]




**Source**: The World Bank

### 3.5. Challenges and Obstacles

MFI in Albania have and are still playing a significant role in developing energy infrastructure in Albania. Their support has been not only for direct investments but also in capacity building. Nevertheless, for the country's energy sector to thrive, private investor should be able to access the market. A competitive market will lead to: better quality of service at a better price. It needs be noted that the market under analysis is the energy production market and not the distribution channel.

[40] The World Bank Database, http://data.worldbank.org/, Last accessed on 10th of May 2012

There are no evidence of any RES project under implementation at the moment and the main difficulties that have not allowed private investors in Albania are: 1) limited capacities and skills for implementing RES projects; 2) limited capacities and skills in developing special purpose companies for equity or mezzanine financing; 3) rigid banking rules that do not provide access to loans; 4) banking sector focused on other economic areas.

The current situation does not make it easy for lenders nor buyers to enter such high risk – high return projects.

## 4. Conclusions and Recommendations

Chapter 1 provided data that shows Albanias' great potential in covering their local needs and also being an exporter of electric power but the country still relies on imports by more than 50 %. Main impediments identified were: old and not rehabilitated hydro power plants; abandonment of small hydro power plants; non rehabilitation of transmission system; mismanagement of dispatch; technical and non technical losses during transmission; and lack of funds.

Experience with the privatization of distribution network proved that under private ownership the system was greatly improved and the quality of services rendered was much higher for end costumers. This means that if the same were to happen with the energy production sector, Albania could increase and better manage its energy resources. Nevertheless, this is a slow and delicate process which requires a lot of legal synergies and strategic action plans.

The Albanian Government has undertaken a reform of the energy sector but the pace of implementation has been very slow due to: rule of law or lack of; lack of institutional democracy or balance of power; slow pace development and introduction of laws; overlapping laws; non-specific laws: discriminatory price for energy purchase between new

and old energy producers; no bankruptcy proceedings for RES plants; and the distribution network is still connected with dispatching.

Development banks such as EBRD, EIB and The World Bank has provided strategic support in developing the energy sector in Albania but their support has been not sufficient to reach desired levels. Opening the energy production market to private investors would lead to creation of a competitive market. In order to achieve this, the government, in collaboration with international institutions should: 1) increase project financing possibilities in the country through introduction of special purpose incentives. The Central Bank should be the leading institution to encourage loans for private investors interested in RES. 2) coordination of laws is of outmost importance. Although a competitive market is based on the invisible hand concept of governing, clear laws should pave the way to a fair market. 3) capacity building on special purpose financing firms such as mezzanine or equity financing is crucial and on RES project development. 4) law enforcement has to closely collaborate with the transmission and dispatch network company to disconnect free riders and decrease transmission costs.

By creating the basement for a fair competitive energy market, private investors will show the best development through introduction of new financial mechanisms, new technologies or operational improvements. At this determining moment when the sector is reformed, the role of the government is of great impact as they have to balance the needs of investors with the needs of the country. The slow pace of development has its own benefits but it can become detrimental if prolonged indefinitely.

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