

## COUNTERING ENERGY GOVERNANCE AND STATE CAPTURE RISKS IN THE WESTERN BALKANS AND TURKEY

Policy Brief No. 5, July 2016

### SEE and its persistent corruption challenge

Corruption is frequently referred to as a “global concern”. This is especially true in the region of the Western Balkans and Southeast Europe (SEE) where a number of interconnected problems – armed conflicts, trans-border crime, communist legacy, low level of development – have more recently conspired with the economic, geopolitical and migration crises to turn bribery and abuse of public office into a systemic problem that citizens have started to characterise more and more as state capture. Weak democratic traditions, networks of political protectionism, economic oligarchy, and opaque business practices nurtured by corruption and links with organized crime, have been preventing the success of critical reform initiatives in the most important sectors in the economy.

This reasoning can apply for almost all publicly controlled sectors in SEE, but are particularly nascent in the energy sector, which has been understudied in terms of governance deficits and corruption pressures despite the daily reports about energy sector corruption in the media. Opportunities and resources for illicit practices and/or mismanagement in the energy sector in SEE are ample, whereas internal constraints and external conditionalities remain insufficient to overcome critical energy security risks and sectorial vulnerabilities. Among the most critical energy governance deficits are the widespread corruption risks in the **mismanagement of the state-owned energy enterprises (SOEs)**, the **irregularities in**

#### KEY POINTS

- The most critical energy governance deficits in the SEE region are the mismanagement of state-owned energy enterprises (SOEs), the irregularities and corruption risks in the public procurement contracts, and the slow progress in the liberalization and the integration of regional energy markets.
- Regional governments have been reluctant to open their electricity markets maintaining regulated prices for households and businesses - a measure aimed at preserving social peace, which increases political interference, distorts competition, and increases corruption risks.
- The widespread energy poverty in SEE should be addressed through energy efficiency measures and by providing consumers with access to alternative energy sources. Subsidies are counterproductive as they generate fiscal imbalances for energy SOEs ultimately weighing on the country's economic development.
- The implementation of the EU energy acquis has been uneven across SEE, with the establishment of a competent and independent regulator being one of the most challenging tasks outstanding.
- SEE countries should introduce more transparency and higher corporate governance standards for SOEs that reduce political interference in the management of these companies.
- A major governance challenge is the lack of political agreement on long-term national energy strategies perpetuating ad-hoc decision making, often the product of undue third-party influence.



Co-funded by the European Union and the Central European Initiative (CEI).  
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the public procurement contracts and the slow progress in liberalising and de-monopolising the energy sector, which isolates the corrupt networks from the disruptive market forces<sup>1</sup>. The failure of allowing more competition in the sector has been reinforced by the negative implications of the EU - Russia economic and geo-political standoff in the region, on the one hand, and by the dependence of the ruling elite on party financing from companies operating in the energy sector. The large-scale energy projects across the region have been exploited by local groups aiming to increase their wealth at the expense of the national energy policy priorities.

## Corporate governance of energy SOEs

In Southeast Europe, the outstanding considerable involvement of governments in the economy generates a number of red flags for potential conflicts of interest between public institutions and the business sector. The comprehensive assessment of the SEE region, performed by the Southeast Europe Leadership for Development and Integrity (SELDI), outlines three main **recommendations for improving the overall anti-corruption environment and for generating tangible results in the fight against corruption**<sup>2</sup>. Among those is the need to increase the transparency of energy decision-making and the accountability of the corporate management in SOEs. One should also limit the intervention of the political elite in the governance of SOEs, which instead should focus its efforts on defining a clear energy regulatory framework and consistent long-term policy. The goals of transparency, accountability, policy consistency and effective management of critical public sectors are also part of the Western Balkans' path towards joining the EU.

The overcoming of energy governance deficits requires the **consistent implementation of corporate governance standards in the management of SOEs. This is necessary to ensure that the companies are**

**profitable, efficiently managed and corruption risks are avoided.** The vicious circle of subsidised pricing, energy poverty, energy inefficiency and low investment in infrastructure modernisation can be, if not broken, at least alleviated by the government by imposing sound, transparent and independent management structures and procedures.

Previous studies have indicated that **better corporate governance of SOEs leads towards not only company-level, but also state-level positive externalities**<sup>3</sup>. Specifically, governance reform impacts the SOEs' operational performance in the sense that labour productivity, tariffs and, most importantly, the magnitude and quality of services coverage tend to improve if there is a solid legal and ownership framework, professional board and staff, fiscal discipline, a good performance management and monitoring system and a high degree of transparency, both voluntarily (activity reports, disclosures) as well as during audits.<sup>4</sup> With better governance comes better access to both national and international capital markets and, thus, to alternative financing sources which can be used to build infrastructure or provide critical services to an energy poor population. Furthermore, practice has shown that SOEs can actually save money via better governance and can therefore redirect their resources where these are most needed, such as critical infrastructure or projects aimed at increasing energy efficiency.<sup>5</sup> Perhaps most importantly, better governance also means increased revenue for the state as a whole through annual dividends "cashed in" from financially strong SOEs.

The OECD Guidelines on Corporate Governance of SOEs stipulate that **the legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets** where state-owned enterprises and private sector companies compete in order to avoid market distortions and corruption risks. The operational autonomy of management boards and executives is a guarantee for the company's independence, shielding away the

<sup>1</sup> This policy brief is based upon a comprehensive background study *Regional Energy Governance and State Capture Assessment Report*, produced by SELDI through a process of desktop research, in-depth interviews, and consultations with regional energy stakeholders.

<sup>2</sup> SELDI (2015), *Anticorruption Reloaded: Assessment of Southeast Europe*, Sofia, 2015.

<sup>3</sup> OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition*, OECD Publishing, Paris.

<sup>4</sup> World Bank Group, *Corporate Governance of State-Owned Enterprises. A Toolkit*, 2014, p. 16, <http://documents.worldbank.org/curated/en/2014/10/20286791/corporate-governance-state-owned-enterprises-toolkit>, last accessed on 09.05.2016.

<sup>5</sup> Ibid, p. 17.

potential political oversight of the SOEs. An effective legal and regulatory framework for SOEs is a key precondition for preventing the misuse of the control of the SOEs for political reasons. A weak legal framework may leave space for political patronage, corruption allegations, illegal financial transfers, etc.

The OECD guidelines also mandate a clear separation between the political parties and the management of SOEs. A very important indicator of the proper work of CEOs is the process of their hiring. Arbitrary layoffs and employment are a sign of bad public management, however **even more problematic are cases indicating connections of CEOs and boards with political parties.** In almost all Western Balkan countries, the Board of Directors of energy SOEs are dominated by party appointments. In the seven analysed countries, there is evidence of at least 27 political figures having a seat at the energy SOEs boards<sup>6</sup>. In many cases, this is a form of reward for senior members of political parties. In Serbia, and Albania, for example, it has become a common practice to divide public enterprises' boards between political parties after elections as part of the power sharing agreement<sup>78</sup>. As a case in hand, in Macedonia, the recent wire-tapping scandal revealed how the head of the PM's cabinet allegedly ordered the ELEM CEO to employ the people on a list prepared by the Interior Ministry. The arbitrary hiring process in energy SOEs could not only be a drag on their administrative capacity but could also negatively impact the companies' operational costs.

The mistrust caused by the opacity and/or suspected or overt corruption is the major obstacle before good corporate governance in the sector. **Corruption practices and the lack of transparency** affect multiple processes across the board - from SOEs' financial viability and attractiveness (discourages investors by increasing risks) to its ability to service its customers and to create overall wealth (misallocation of limited resources). An analysis of the compliance of energy SOEs against the internationally-approved OECD corporate governance guidelines shows that corporate principles are far from being respected in the region.

Energy SOEs largely lack transparent rules and effective cost/benefit decision-making procedures while political pressure benefits closely-related business circles<sup>9</sup>. In some cases, the right corporate governance framework has been set up, but the rules are not effectively implemented. In the case of Turkey, the state is effectively managing SOEs through explicit and direct instructions to CEOs. Besides, the ministry and the parliament maintain control of SOEs through its budget as the ministry has the authority to demand a long-term budget rather than an annual one<sup>10</sup>.

In light of the above, it is evident that the current system of governance of state-owned enterprises in SEE is prone to abuses of public funds and corruption risks. Sufficient public scrutiny over a comprehensive reporting mechanism is, thus, necessary to increase the transparency of governance and improve the management of SOEs. Many companies in the region have not only failed to upload their annual financial reports for 2014 and 2015, but have also not provided historical data before 2009/2008. Most companies present a bare minimum of financial information and do not provide any detailed narrative overview of their activities or recent management decisions. Financial reports uploaded on webpages lack cash flow statements and/or unconsolidated cash flow information. Instead, companies' balance sheets offer only the final free cash flow for the reporting period. One of the worst identified case studies in the region have been Albanian energy SOEs, which do not publish their financial statements at their websites at all. In addition, most SOEs in the region do not publish a detailed overview of current activities related to their energy projects. Information about the SOEs' public procurement is also scarce. And it is often almost impossible to find data about the tenders in a given year as information on many contracts is missing or are considered closed procedures under national law.

<sup>6</sup> According to data, provided by the SELDI partners.

<sup>7</sup> Serbia's Anti-corruption Agency has imposed a measure of recommendation for dismissal of Srbijagas' director from this position due to conflict of interest. This is so since he was also the President of the Supervisory Boards of the Banatski Dvor underground gas storage and of joint-stock insurance company Sogaz, as well as Member of the Supervisory Board of Yugorosgaz. In addition, he is the Director of the company South Stream.

<sup>8</sup> SELDI. Regional Energy Governance and State Capture Assessment Report. Sofia, 2016.

<sup>9</sup> Management of Publicly Owned Enterprises in Kosovo, GAP (2015) <http://www.institutigap.org/documents/8557489987445884547.pdf>

<sup>10</sup> The instructions, which cover the duties and responsibilities of energy SOEs, are determined by legislation and each and every implementation is subject to the law, experts from EPDK interviewed on 8 October 2015 stated.

## Financial governance implications

The existing **energy governance deficits in the region have translated into erratic financial results**. The regulation-subsidy model, applied across the region, renders SOEs' performance highly dependent on the State<sup>11</sup>. The SOEs are forced by the energy regulator to sell below market price thus accumulating tariff deficits. SOEs are starved from the excess funds necessary to build new capacity or modernise existing energy facilities, crucial for the improvement of the region's energy efficiency, supply security, and the overcoming of energy poverty.

The Serbian state-owned wholesale supply and distribution company, EPS, and its natural gas counterpart, Srbijagas, are for example among the companies facing the biggest financial risks. EPS' troubles are related to its tariff deficit formed by the regulated power tariffs maintained below cost of generation due to political pressure and to the company's inability to improve its debt collection. News about EPS's financial challenges were initially published in 2013 when the company reported that it needs to borrow EUR 450 million in order to avoid bankruptcy. At the same time EPS has been overstaffed often with political cadres. Its current position of a de-facto monopolist on the electricity market has somewhat alleviated its difficult financial situation but the long term financial sustainability of the company is in danger. Similarly, Srbijagas has accumulated significant debt as a result of uncollected receivables from the municipal heating plants and some privileged industrial gas consumers. Huge debt write-offs to final users in 2012 and 2013 resulted in significant losses for the wholesale gas supplier. Similar to the EPS situation, the main culprit has been the company's unsustainable gas pricing policy applied from 2008 to 2012, which is responsible for around 40 percent of Srbijagas' losses.

The artificial maintenance of energy prices at a low level, does not solve the existing problem of energy poverty, which needs to be addressed through energy efficiency measures and the access to alternative fuels, and not via below-cost pricing. **Energy poverty affects**

**a large share of the population in SEE**, e.g. data shows that around 40% of the citizens in Serbia cannot adequately heat their homes<sup>12</sup>. Citizens in the region are captive to an inefficient energy model – faced severe affordability constraints, and pressed by accessibility challenges due to spatial and technical limitations, they choose to resort to inefficient coal and wood at the expense of air quality and health hazards.

The financial outlook of state-owned energy enterprises in SEE has become increasingly problematic in the 2009 – 2014 period. The main problems continue to be the intra-system indebtedness and the inefficient governance, which represent a major financial drain undermining the financial health of the companies in the region. Additionally, scarce public information on the involvement of state-owned enterprises in large energy infrastructure projects suggests that **SOEs are likely to get stranded with enormous costs, while being squeezed to retain the social functions** that restrict their investment opportunities. The lack of capacity to manage large projects and to identify and mitigate project risks has led to management collapse of SOEs in favour of banks, service providers and subcontractors. The uncertainty over the predictability of cash in and outflows due to the constantly changing regulatory framework and the siphoning of company funds through public procurement tenders increases the credit risk and thus the borrowing costs for the SOEs. The latter discourages investment in infrastructure and efficiency, which undermines the energy security of the whole country.

Although the financial results of the wholesale gas and power suppliers have worsened as a result of the misguided pricing policies, the SOEs generally still have a stable financial position. Like noted before, the positive outlook should be regarded with caution as there are a lot of unknowns in relation to the companies' long-term financial position in the SEE region. Above all, the companies' liquidity has been squeezed, while new debt has been accumulated. The latter is especially true for the Serbian companies, Srbijagas and EPS, but increasingly also

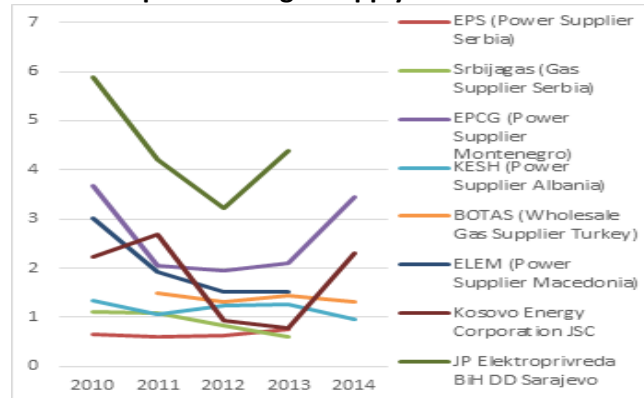
<sup>11</sup> For example, apart from Turkey, all Western Balkan countries have preserved artificially low electricity and natural gas tariffs for household consumers.

<sup>12</sup> CSD (2015). Serbia: National Energy Security Indicators and Policy Challenges. Country Factsheet.



for the Albanian Power Corporation (KESH). The Macedonian power wholesale monopoly, ELEM, is also among the firms showing deteriorating financial indicators<sup>13</sup>. The Serbian largest power and gas companies are the most exposed to short-term liquidity risks as both firms have current ratios below 1 pointing to the danger that they might not be able to repay their short-term debts, if they came due at any point of time. The debt ratio, on the other hand, shows that the SOEs are not extensively leveraged and under normal circumstances would be able to cover and/or refinance their debts. This is especially true for utilities, where higher debt ratios are considered sustainable as companies control a steady cashflow from regular final consumers.

**Figure 1. Current ratio of selected SOEs in the area of wholesale power and gas supply**

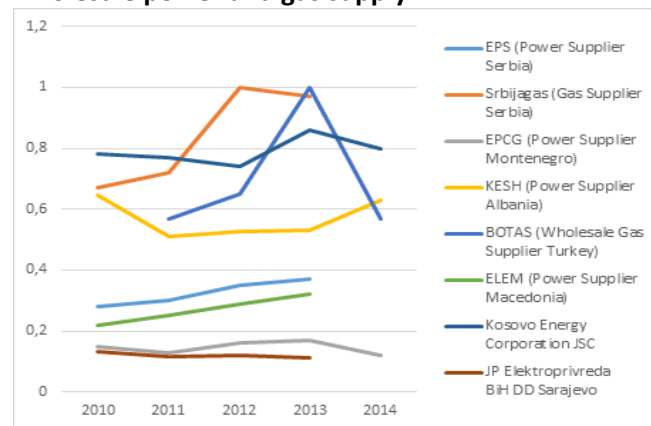


Source: Own calculations based on the available Annual Reports of the SOEs and other official sources<sup>14</sup>.

A notable exception here is Srbijagas, which has accumulated a large debt exposure to its owner Gazprom over the last five years as it is paying one of the highest import gas prices in Europe, and is mandated to resell the gas to its final clients at a loss. Srbijagas also faces a non-sustainable long-term debt

comprising EUR 806 million as it is unable to collect its payments from clients including the socially-sensitive district heating companies and the large gas-intensive industrial complexes such as HIP-Petrochimia and the Paracin glass factory. The Montenegrin wholesale power supplier has also been facing rising debt ratios as households have accumulated more than EUR 134 million in unpaid electricity bills by early 2016. The company has also struggled to obtain payments from one of the largest power consumers in the country, the aluminium firm, KAP. To prevent the latter's practice of non-paying its bills, under pressure from its private minority shareholders, the EPCG management board decided to halt the power supply to KAP in early 2013. Despite the decision, it was later discovered by the European Network of Transmission System Operators for Electricity (ENTSO-E) that the government continued to supply KAP with electricity procured by the transmission systems operator from the European electricity grid<sup>15</sup>.

**Figure 2. Debt ratio of selected SOEs in the area of wholesale power and gas supply**



Source: Own calculations based on the available Annual Reports of the SOEs and other official sources.

<sup>13</sup> Many of the SOEs have not yet published their annual financial reports for 2014 and 2015 making the assessment of their current financial management almost impossible.

<sup>14</sup> Own calculations based on: **Bosnia and Herzegovina**: Annual Report of JP Elektroprivreda BiH d.d. Sarajevo, <http://www.elektroprivreda.ba/stranica/izvjestaji-o-poslovanju>, last accessed on 09.05.2016; Annual Report of JP ELEKTROPRIVERDE HZ HB, <http://www.ephzhhb.ba/publikacije/godisnja-izvjesca/>, last accessed on 09.05.2016; Financial balance of Elektroprivreda Republike Srpske a.d. Trebinje, [www.blberza.com/Pages/FinRepBalance.aspx?code=ERST&type=1&year=2012&semiannual=0](http://www.blberza.com/Pages/FinRepBalance.aspx?code=ERST&type=1&year=2012&semiannual=0), last accessed on 09.05.2016; **Macedonia**: MEPSO, Separate Financial Statements and Independent Auditor's Reports, <http://www.mepso.com.mk/en-us/Listanijelzveshtai.aspx?categoryID=135>,

last accessed on 09.05.2016; **ELEM**, Reports on Financial Results, [http://www.elem.com.mk/index.php?option=com\\_content&view=article&id=362&Itemid=166&lang=mk](http://www.elem.com.mk/index.php?option=com_content&view=article&id=362&Itemid=166&lang=mk), last accessed on 09.05.2016; **Turkey**: Annual Reports of the SOEs and The Courts of Accounts (TCA) SOE Reports; **Kosovo**: Policy and Monitoring Unit of Public Enterprises at the Ministry of Economic Development of the Republic of Kosovo; **Albania**: National Registration Centre; **Serbia**: Business Registry Agency; **Montenegro**: the analysed companies by utilising free access to public information.

<sup>15</sup> Prelec, Marko (2014). Winners and Losers: Who Benefits from high-level corruption in the South East Europe Energy Sector?. SEE Change Net.

## Public procurement mismanagement and corrupt practices

Public procurement is a key economic development tool and also a means for redistributing national income. As such it is highly prone to corruption, fraud, and other forms of abuse of public financial resources. Thus, increasing accountability for public procurement in the energy sector is a matter of particular importance to the citizens of SEE. Despite some limited progress in terms of anti-corruption measures and prevention of the misuse of public funds in general, the major problems in public procurement such as conflicts of interest, the rigging of tender criteria and the inefficiency of public spending have remained. In the energy sector, public procurement plays a substantial role in a number of activities ranging from building large-scale infrastructure to purchasing materials and awarding consultancy and financial services. Public procurement has traditionally been vulnerable to corruption pressures in young democracies especially when it comes to large tenders and lack of competition, which is typical for the energy sector. Energy enterprises are commonly ranked among the top largest public procurers in the region both in terms of awarded public procurement contracts, and in terms of spending.

In cases where energy operators are as well contracting authorities, due to the ease of regulatory procedures for sectorial contracting authorities (utilities regulation), corruption may be visible in the extensive use of restrictive procedures (lack of competition/ limited access to the market); tailor-made tenders (with highly individualized technical specifications); deviation in implementation of the contracts (mostly works and supplies that are largely consumed by energy providers); failure to meet technical specifications or quality standards described in the terms and conditions of the tender; to fictional contracts (works, goods and services) that were never implemented. Even in cases where competitive bidding processes are used, broad (rather than detailed) specifications and manifestly impractical

terms and conditions leave scope for post tender negotiations with bidders and consequent bribes.

The major factors contributing to heightened corruption risks in the energy sector public procurement can be summarized as follows:

- considerable economic interests at stake, strong political lobbies and substantial national and international financial resources involved in the energy sector;
- lack of genuine competition and strong monopolization of individual segments in the energy sector construction, maintenance and engineering firms;
- lack of transparency, public awareness and independent expert assessment plus restricted access to information on national security grounds;
- the technical complexity of the energy sector;
- share of non-competitive public procurement contracts in the energy sector is systematically higher than the share of competitive contracts for the rest of the economy<sup>16</sup>.

## Transparency challenges

The **lack of transparency in the management of public procurement is one of the clearest indicators of compromised governance** as it prevents taxpayers from understanding the structure of public spending. Although the data on public procurement contracts is generally available to citizens, there is only limited energy-specific public procurement information, which further prevents comparisons across sectors and countries. Albania is a typical example, as energy SOEs do not publish sufficient information about the tenders issued. Data on complaints about public procurement mismanagement is more specific but lacks detail and does not provide basis for relevant conclusions.<sup>17</sup> Another example is Kosovo, which provides data on companies awarding public procurement contracts, as well as information about the lowest bid and the procurement process, but omits explaining the rationale for dismissing losing candidates (whose names are not made public). The **information on public procurement in the Serbian energy sector is**

<sup>16</sup> CSD (2014), *Energy Sector Governance and Energy (In)Security in Bulgaria*, Center for the Study of Democracy, Sofia, 2014.

<sup>17</sup> Albania's partner *Author's Calculation, based on Public Procurement Commission Reports (2015)*.

**also limited** since aggregate data for the entire sector does not exist in the Public Procurement Office, and because due to the Public Procurement Law, tenders resulting from international agreements are not mandatory. Similarly, in Montenegro, there is no energy sector-specific data on public procurement and in order to see how the public funds are being spent in the energy sector, one needs to submit an official request through the free-access-to-information law, which could prolong the verification process indefinitely. The only reports that are being compiled in Montenegro are the individual annual reports of contracting authorities for which there is no legal obligation to be published, and the consolidated report for all contracting authorities that is being compiled by the Public Procurement Administration on an annual basis. In addition, in Montenegro, the Law regulates the procedures up to the moment of the signing of the contract, while the implementation of the contracts is not being controlled. Meanwhile, the number of criminal charges is negligible<sup>18</sup>, and competent institutions do not prosecute disputable cases. As visible in Table 1, the public procurement reporting in the largest power company in the country has been highly inconsistent both in terms of planning and actual implementation. This raises the question whether the difference in the amounts reported by the government and the state-owned company is the product of unaccounted funds siphoned out or simply a sign of negligence.

**Table 1. Inconsistency in Reporting the Implementation of the Public Procurement Budget in Montenegro's largest energy company, EPCG in 2012, million Euro**

|  | Planned budget | Completed budget |
|--|----------------|------------------|
| <b>EPCG</b>                              | 141 514 376    | 86 168 074.31    |
| <b>Public procurement administration</b> | 174 575 497,00 | 138 216 835,37   |

Source: Montenegrin Public Procurement Portal, <http://portal.ujn.gov.me/delta2015/login.jsp?locale=en&>

<sup>18</sup> For example, in 2014, the Public Procurement Administration received zero criminal charges for suspicions of corruption, conflict of interest, and breach of anti-corruption rules. The Public Procurement Administration, Report on Public Procurement in 2014, May 2015.

<sup>19</sup> Center for the Study of Democracy (2014). *Energy Sector Governance and Energy (In)Security in Bulgaria*.

<sup>20</sup> A good example has been the management of the public procurement procedure in the Serbian section of the Russian-led South Stream pipeline,

(planned budget) and Annual Public Procurement Report of EPCG for 2012, obtained through free access to information (completed budget).

## Competition restrictions

One common corruption red flag in the SEE region in the energy public procurement domain is the general **restriction of competition in tendering**. The contracting authorities are often tinkering with the exemption requirements and are imposing exclusive criteria in order to limit the amount of competition for each contract. The exclusion criteria may often be tailored to fit the profile of a specific company. This is often done by directly influencing the public procurement notice drafting process through the illicit transfer of funds or capturing of senior managers in the SOEs<sup>19</sup>. In some cases such as in the Serbian intergovernmental agreements, **energy contracts could be even exempted from the whole public procurement process**. In such instances, good governance principles of transparency, efficiency and competition are put aside in order to directly allocate contracts to a well-vested private interest<sup>20</sup>.

Kosovo's Transmission, System and Market Operator (KOSTT) for example has awarded 31 contracts from December 2010 to January 2014 under a negotiated procurement procedure without notice, as well as 2 contracts with negotiated procurement procedure after the contract's publication.<sup>21</sup> The same issue was detected in Macedonia's public procurement procedures of the wholesale power supplier, ELEM (see Table 2). Contracts under this type of procedure are practically a 'four eyes agreement' concluded between the state-owned companies' officials and private contractors. The implementation does not provide for open and/or equal access for each economic player<sup>22</sup> thus hindering competitive bidding. Taking into account the size of these contracts, especially when it comes to large-scale projects, there is a significant corruption risk involved. Contracts of higher-than-market-value

which was fully exempted from the public procurement law as it was the product of an intergovernmental agreement between Russia and Serbia.

<sup>21</sup> Public Procurement Regulatory Commission, [https://krpp.rks.gov.net/Default.aspx?PID=Notices&LID=2&PCID=1&CtlID=SearchNotices&stat=2&PPRCMenu\\_OpenNode=114](https://krpp.rks.gov.net/Default.aspx?PID=Notices&LID=2&PCID=1&CtlID=SearchNotices&stat=2&PPRCMenu_OpenNode=114), last accessed on 09.05.2016.

<sup>22</sup> CCC (2014). Handbook for Companies to Participate in Public Procurement. Center for Civic Communications (CCC), <http://goo.gl/07fd2V> (Macedonian), last accessed on 09.05.2016.

prices are often the result of signed procurement procedures without a public notice. More than 13% of ELEM's public procurement tenders between 2009 and 2014 have been structured in this way amounting to close to a third of the total public procurement

amount, while another 36% are the product of negotiated procedure after the publication of a notice.

**Table 2. Macedonia's power producer and wholesale supplier (ELEM) Procurement Contracts (2009 – 2014)**

| No. contracts:  | 2009       | 2010       | 2011       | 2012       | 2013       | 2014       | No. contracts ('09-'14) | Total Amount (EUR) | %           |
|---|------------|------------|------------|------------|------------|------------|-------------------------|--------------------|-------------|
| Open Procedure  | 384        | 406        | 362        | 336        | 214        | 209        | 1911                    | 373 432 008        | 46,8%       |
| Restricted Procedure  | 13         | 3          | 5          | 1          | 0          | 0          | 22                      | 29 253 698         | 3,7%        |
| Negotiated procedure without prior publication of a contract notice | 39         | 37         | 29         | 82         | 137        | 70         | 394                     | 106 265 053        | 13,3%       |
| Negotiated procedure with prior publication of a contract notice    | 3          | 0          | 6          | 3          | 1          | 0          | 13                      | 289 365 123        | 36,2%       |
| <b>TOTAL</b>  | <b>439</b> | <b>446</b> | <b>402</b> | <b>422</b> | <b>352</b> | <b>279</b> | <b>2340</b>             | <b>798 315 882</b> | <b>100%</b> |

Source: Macedonian Center for International Cooperation (MCIC), own calculations based on the data from the Macedonian Electronic System for Public Procurement ([www.e-nabavki.gov.mk](http://www.e-nabavki.gov.mk))

Probably more than any other domain, the specific nature of the energy sector is conducive to the **circumvention of highly competitive** procedures, which in turn creates favourable environment for corruption and state capture. Often the opaque environment of public procurement in the energy sector is based on the exclusive criteria for access and safety of energy sites, the effective technology monopoly at the micro level for a number of supplies, the ambiguous legal nature of energy export transactions, the lack of effective in-house financial audits, and the lack of monitoring and control with respect to public procurement efficiency exercised by the energy or any other control body. The share of open procedures where a single tender has been submitted is indicative of the progressive establishment of discriminatory specifications. Open procedures in principle attract broad interest and the number of submitted tenders would typically be higher. Yet, even with open tendering, **public procurement with single bidding is a serious red-flag for corruption** due to at least two factors: a) entry barriers – contracting authorities may have designed the tender specifications to fit the profile of a specific

company or a combination of companies (which is more often the case) – and b) political embeddedness, i.e. tacit knowledge and relationships that allow politically connected firms to bid in tenders with difficult or impossible requirements that will later be amended or ignored through low implementation controls.

Another **distortion of competition** may happen in case the **tender criteria are leaked secretly to bidders** in an open procedure to help them develop a winning offer, but also to allow other bidders participate in order to create fake competition. The Kosovo Anti-Corruption Agency annulled one tender due to suspicions of bid rigging related to the leaking of tender documents. Furthermore, bribes either demanded or offered as a way of securing the tender's winning bid before the beginning of the procedure or popularly called "setting-up tenders"<sup>23</sup>. Based on anecdotal evidence and the monopolisation of contracts in the hands of a few well-connected companies, it can be concluded that a large portion of the public procurement in the

<sup>23</sup> Enis Veliu, Dyshime për kurdisje të tenderit në KOSTT, 2014, National Newspaper "Zeri", <http://old.zeri.info/artikulli/29759/undefined>, last accessed on 09.05.2016.



energy sector of the region has been predetermined in one way or another.

### Box 1. Public procurement strains in Albanian energy SOEs

Fingers were already pointed at some energy SOEs in Albania, one of which is the Albanian Electricity Power Distribution System Operator (OSHEE) which was accused by the company GEN-I Tirana for favouring the companies EFT and GSA by providing confidential information and allowing this way a harmonisation of their offers. Following the complaints of GEN-I, the Competition Authority of Albania (CAA) has launched a probe against OSHEE. According to GEN-I, OSHEE, EFT and GSA illegally colluded in order to set the power sales tenders organised by the power supplier between January and July, 2014. The claims are that EFT and GSA coordinated power purchase bids by bidding a price that is only a few cents below that of GEN-I and other competitors allowing EFT and GSA to capture the largest share of the electricity import market. These uncompetitive and illegal practices have cost taxpayers millions of euro according to GEN-I. In December 2015 the Competition Authority decided to close the investigations on the case, by outlining that no competition restriction is seen and suggesting internal or external audits to OSHEE for the case.

Source: Decision 388, 14.12.2015, [http://www.caa.gov.al/uploads/decisions/VKK\\_388\\_Hetimi\\_thelluar.pdf](http://www.caa.gov.al/uploads/decisions/VKK_388_Hetimi_thelluar.pdf)

<sup>24</sup> Albania, Macedonia, Serbia, Montenegro and Turkey are EU candidate countries. Internet page of European Commission/European Neighbourhood Policy and Enlargement Negotiations, [http://ec.europa.eu/enlargement/countries/check-current-status/index\\_en.htm#pc](http://ec.europa.eu/enlargement/countries/check-current-status/index_en.htm#pc), last accessed on 21.11.2015.

<sup>25</sup> Bosnia and Herzegovina and Kosovo are EU potential candidate countries. This group of countries was promised the prospect of joining when they are considered ready. Internet page of European Commission/European Neighbourhood Policy and Enlargement Negotiations, [http://ec.europa.eu/enlargement/countries/check-current-status/index\\_en.htm#pc](http://ec.europa.eu/enlargement/countries/check-current-status/index_en.htm#pc), last accessed on 21.11.2015.

<sup>26</sup> The Western Balkan countries beside those listed above also included Croatia, but after Croatia became member of the EU on 1 July 2013, it was considered that it “left” this region of Western Balkans. This scope of Western Balkans without Croatia after its accession to the EU is visible from EU’s position, but also from other stakeholders such as the European Investment Bank, EBRD, the scope of the Western Balkans Summit 2015 in Vienna. Sources: Internet page of the European Commission/Trade, <http://ec.europa.eu/trade/policy/countries-and-regions/regions/western-balkans/>, last assessed on 21.11.2015; Internet page of the European Investment Bank/Western Balkans <http://www.eib.org/projects/regions/enlargement/the-western-balkans/>, last accessed on 21.11.2015; EBRD, (2013), Energy Sector Strategy,

## Energy Market Liberalization

The EU candidates<sup>24</sup> or potential candidates<sup>25</sup> in SEE<sup>26</sup> (Albania, Kosovo, Serbia, Bosnia and Herzegovina, Macedonia and Montenegro) and Turkey are obliged to reform their energy sectors to adopt the EU energy acquis as part of their accession negotiations. Some of the objectives of the energy acquis include a transition to a low-carbon economy, increased security of supply, institutional transparency, bigger share of renewables in the final energy consumption, increased energy efficiency, as well as the liberalisation of region’s energy markets. The successful implementation of the energy acquis requires adequate institutional set-up, and political commitment to difficult reforms that would ultimately dismantle entrenched private domestic and foreign state interests in the energy sector. The Western Balkan countries (Turkey is only an observer) are also Contracting Parties to the Energy Community Treaty<sup>27</sup>, which provides the guidelines to the Energy Community organisation aiming to support the adoption and implementation of the EU energy acquis by acting as a regional monitor<sup>28</sup>.

The most important aspects of the regulatory reform promoted by the European Energy Community are the liberalisation of the natural gas and electricity markets, the creation of national and regional power and gas exchanges, and the completion of regional energy cooperation projects boosting interconnectedness and preventing supply crises.

<http://www.ebrd.com/downloads/policies/sector/energy-sector-strategy.pdf>, last accessed on 21.11.2015; Internet page of Europe Integration Foreign Affairs Federal Ministry Republic of Austria/Western Balkans Summit Vienna 2015, <http://www.bmeia.gv.at/en/european-foreign-policy/foreign-policy/western-balkans-summit-vienna-2015/>, last accessed on 21.11.2015.

<sup>27</sup> Some of the more specific objectives of the Energy Community include: enhancement of security of supply; increase of competition; attracting investment in power generation and network; creating an integrated energy market enabling integration with the EU market. Internet page of Energy Community/About us, [https://www.energy-community.org/portal/page/portal/ENC\\_HOME/ENERGY\\_COMMUNITY](https://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY), last accessed on 21.11.2015.

<sup>28</sup> For example, when the Third Energy Package implementation deadline was disregarded by the Contracting Parties, Dirk Buschle, Deputy Director of the Energy Community Secretariat reacted by stating that “*So the 1 January 2015, the day when the implementation deadline for the Third Package expired, was not necessarily predestined to be anything but an ordinary day*”. Source: Energy Community Secretariat, (2015), Annual Implementation Report 2014/2015, [https://www.energy-community.org/portal/page/portal/ENC\\_HOME/DOCS/3872267/EnC\\_IR\\_2015WEB.pdf](https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3872267/EnC_IR_2015WEB.pdf), last accessed on 21.11.2015.

The reform agenda is largely consistent with the EU so-called Third Energy Package<sup>29</sup>, which primary objective is the unbundling of the ownership of power and gas production companies from that of transmission and distribution networks. A secondary objective has been the establishment of the regulatory framework for full market liberalisation. The latter depends on ensuring a strong, competent and independent regulatory body that does not succumb to pressure from politicians. More importantly though, is that the opening up of local energy system to the regional power and gas hubs would bring more competition exerting pressure on incumbent, dominant players on largely closed domestic markets.

With regard to the success of the regulatory reform, one needs to consider the so-called **“implementation gap” between the formal adoption of laws and their practical enforcement**. The data available from Global Integrity on the Western Balkans indicates that the countries tend to establish a good formal legal framework, which, however, fails to produce the indented effects on curbing corruption because of poor implementation<sup>30</sup>.

**Figure 3. State of implementation of the Third Energy Package in the Western Balkans**

| Measure                                | Albania               | Bosnia and Herzegovina | Kosovo*               | FYR of Macedonia      | Montenegro            | Serbia                |
|--|-----------------------|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Primary Law(s)                         | Accomplished          | Insufficient progress  | Pending               | Critical              | Accomplished          | Accomplished          |
| Complementary Legal Acts               | Insufficient progress | Insufficient progress  | Insufficient progress | Insufficient progress | Pending               | Pending               |
| Organised Day-ahead Market             | Insufficient progress | Insufficient progress  | Insufficient progress | Insufficient progress | Insufficient progress | Accomplished          |
| National Balancing Market              | Insufficient progress | Significant progress   | Pending               | Insufficient progress | Significant progress  | Significant progress  |
| Regional Capacity Allocation           | Pending               | Pending                | Pending               | Critical              | Pending               | Critical              |
| Price Deregulation                     | Critical              | Critical               | Critical              | Critical              | Pending               | Significant progress  |
| DSO Unbundling                         | Critical              | Critical               | Significant progress  | Critical              | Critical              | Insufficient progress |
| TSO Unbundling                         | Pending               | Insufficient progress  | Insufficient progress | Insufficient progress | Pending               | Insufficient progress |
| NRA Independence                       | Insufficient progress | Insufficient progress  | Insufficient progress | Insufficient progress | Insufficient progress | Insufficient progress |
| Implementation of Inter-TSO Agreements | /                     | /                      | Critical              | /                     | /                     | Critical              |

Critical: Critical    Significant delay: Significant delay    Insufficient progress: Insufficient progress    Pending: Pending  
 Progress on track: Progress on track    Significant progress: Significant progress    Accomplished: Accomplished

Source: Energy Community/Energy Community WB6 Monitoring, March 2016<sup>31</sup>.

In this sense, the adoption of the EU energy acquis might not be followed by a proper practical

enforcement in each country since this would require an overhaul of the whole energy system. Since 2008, the Energy Community dispute settlement mechanism offers important information on the level of compliance with EU energy law: at the moment there are 15 open cases on various aspects of the Energy Community Treaty, which are part of both group and single country cases,<sup>32</sup> providing a signal that full compliance with the Treaty has been a difficult process.

The region's energy sector transformation towards becoming a well-functioning part of the planned European internal energy market, as required by the Third energy package of the EU, is taking place at a very slow pace. As electricity in the region has traditionally been provided as a universal good, regulating its sale on a competitive market is very far from being completed except partially in Turkey. Albeit slowly, some progress was made towards liberalizing the electricity market by changing key legislation to comply with EU requirements. Apart from Macedonia, all countries in the region have begun developing a national balancing market in the power sector allowing for more competition and ensuring the system's resilience during peak demand periods. However, the completion of the reform would require the unbundling of the national TSOs and DSOs, a step that had been undertaken only by the main electricity company in Serbia, EPS. Serbia is also the only country with an organised day-ahead market. The quotes on the Serbian power market now follow closely the Hungarian, Romanian and Bulgarian power exchanges.

Apart from Kosovo and Bosnia & Herzegovina all other countries have taken steps towards energy price deregulation but have limited their efforts only to the larger industrial energy clients. Below-market household tariffs regulation remains the name of the game everywhere apart from Turkey, where household prices are fixed but at a level close to the market. Maintaining power and gas tariffs below cost of production has had a detrimental effect on

<sup>29</sup> Directive 2009/72/EC.

<sup>30</sup> Alina Mungiu-Pippidi, "The South Eastern Europe" in Mungiu-Pippidi, A. (ed.) (2015). *The Anticorruption Report, Volume 3: Government Favouritism in Europe*. Barbara Budrich Publishers, p. 53, available at <http://anticorruption.eu/publications/volume-3-government-favouritism-in-europe/>, last accessed on 09.05.2016.

<sup>31</sup> Internet page of Energy Community/Energy Community WB6 Monitoring, <https://www.energy->

[community.org/portal/page/portal/ENC\\_HOME/AREAS\\_OF\\_WORK/WB6/Monitoring](https://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/WB6/Monitoring), last accessed on 30.11.2015.

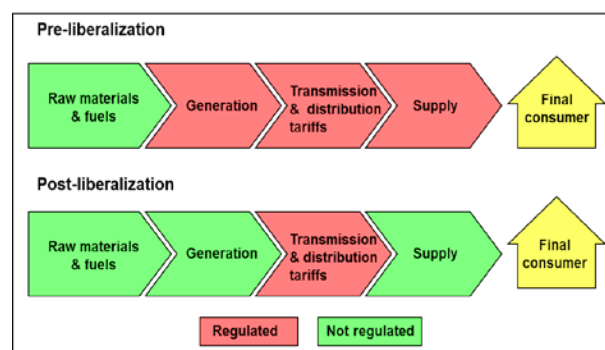
<sup>32</sup> Internet page of Energy Community/Enforcement, [https://www.energy-community.org/portal/page/portal/ENC\\_HOME/AREAS\\_OF\\_WORK/Dispute/Settlement](https://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/Dispute/Settlement), last accessed on 21.11.2015.

the financial stability of the state-owned energy sector and has led to underinvestment in new infrastructure and modernisation over time, while at the same time has benefitted the formation of many well-connected rent-seekers who have taken advantage of arbitrage opportunities between regulated and market prices. Case studies of similar practices abound in the region but the most egregious incidents have been recorded in Bosnia & Herzegovina where the general managers of the state-owned power generation companies have colluded on a number of occasions with private traders to sell surplus electricity below the counter at below market prices, hence significantly reducing the SOEs' profits on behalf of well-connected private players.

A key precondition for the success of the Third Energy Package is the establishment of a strong independent regulator. A comparative visual depiction of the Western Balkan countries' performance in implementing the Third Energy Package (Figure 3) indicates that Bosnia and Herzegovina does not show any progress in implementing the necessary legislative changes ensuring the independence of the regulatory authority. In BiH's case, the government nominates the regulatory commission and the parliament approves it. However, the fragmented political structure of the country, in which there are multiple, competing energy regulatory bodies, makes decision-making inefficient and often the product of political bargaining between the competing factions.<sup>33</sup> In most of the other countries in the region, the energy regulator is at least functionally and legally independent from the executive branch. However, the problem with the lack of autonomy on staff appointments and budget determination persists. Kosovo needs to transpose the EU energy acquis in relation to the independence and functionality of the regulator. Although Albania and Turkey have transposed a large part of the energy acquis and have pushed through laws banning former politicians or employees in energy companies to join the management of the regulatory bodies, the two countries' limited progress in key energy sector reforms such as the power market opening in Albania and the de-monopolisation of the gas sector in Turkey raises red flags about potential outside meddling in the regulators' decision-making.

In order to ensure free market competition, the European Commission has emphasised the importance of an independent national regulatory authority, with sufficient power and discretion to guarantee the correct application of the legislation in this field.<sup>34</sup> In effect, it is precisely the role of the regulators to deal away with any non-market concentration of monopoly power, which is the usual source of corruption and state capture.

**Figure 4. Power market prior to and after liberalization as per the vision of the energy acquis**



Source: CSD, 2014, Energy Sector Governance and Energy (In)Security in Bulgaria.

A common non-compliance practice across the region with regard to the Third Package implementation is the **lack of proper unbundling in the power sector**. The SEE countries are either unbundled only on paper, or specific aspects of the unbundling process like the separation of the financial statements or that of the management control are still not in place. The unbundling is a herculean task for the majority of SEE states as clear separation of energy generation and supply from transmission involves the break-up of state-owned energy monopolies, used successfully for masking the financial and regulatory deficits of the system. On the one hand, state-owned energy companies are reluctant to face tougher competition, and on the other, politicians fear the impact from a sudden price liberalisation. Therefore, policy makers in the region are prone to maintain the status-quo and push only for "on-paper" reforms that transform the regulatory framework formalistically.

<sup>33</sup> Energy Community Secretariat, (2015), Annual Report 2014/2015, [https://www.energy-](https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3872267/EnC_IR_2015WEB.pdf)

[community.org/portal/page/portal/ENC\\_HOME/DOCS/3872267/EnC\\_IR\\_2015WEB.pdf](https://www.energy-community.org/portal/page/portal/ENC_HOME/DOCS/3872267/EnC_IR_2015WEB.pdf), last accessed on 23.11.2015.

<sup>34</sup> Directive 2009/72/EC – preamble 33.

In order to guarantee the sustainable modernization and liberalization of the energy market and comply with EU regulation, the government should focus on implementing reforms in three main areas:

- ensuring total independence of the regulatory authority, as well as the effectiveness and quality of its decision-making process;
- unbundling of the transmission and distribution system operators in order to enhance competition;
- extending access to the open electricity market to small enterprises and household consumers.

On the other hand, **market liberalisation per se will not automatically provide for more competition.** An apt example is Montenegro where although the electricity market is opened, private companies are not interested in participating in it. This is mainly caused by the market dominance of the vertically integrated state-owned company, EPCG, the relatively low price of electricity, the under-developed infrastructure and the size of the electricity market in the country.<sup>35</sup> Hence, the Montenegrin authorities have been resisting the unbundling process claiming that it would compromise the financial viability of the energy sector.

## Box 2. Capture risks on the gas markets in Turkey and Macedonia

After the initial burst of activity to promote competition and limit state involvement, the pace of natural gas reform in **Turkey** slowed down. To a certain degree, the lack of readiness in the state-owned natural gas supplier (BOTAS) to cede market power

played a major role. BOTAS has had an almost complete monopoly on imports, storage, distribution and the sale of natural gas. The EU has been critical towards BOTAS by stating that it has not been unbundled to meet the requirements of the Natural Gas Market law.<sup>36</sup> Hence the energy regulator has proposed an amendment to facilitate the unbundling of BOTAS and the reform of gas import tendering procedures.<sup>37</sup> This reform package has been on the agenda of the Turkish energy authorities at least for the last ten years but BOTAS has successfully resisted change heavily lobbying the government to preserve its monopoly on imports and wholesale supply. This policy arrangement is in line with BOTAS' strategic partnership with Gazprom, which remains the main gas supplier to Turkey, controlling more than half of the total gas supply in the country.

The private company Makpetrol<sup>38</sup> dominates the **Macedonian** gas market with important role in determining the gas price in the country, which is one of most expensive in the region, based on an exclusive agreement with Gazprom.<sup>39</sup> Makpetrol is also one of the dispute parties, the second being the government, to the still ongoing issue about the ownership of the gas transmission pipeline. This problem is holding back the development of the gas sector including the gasification of the biggest urban areas.<sup>40</sup> The dispute is at least a decade long and it has begun when Makpetrol demanded that it owns the state-owned pipeline, since it has invested in this infrastructure. Although the legal dispute has not got its closure at court, the functional solution which became a de facto permanent one is founding the

<sup>35</sup> Media statement in *Elektroprivreda*, No. 356, Niksic, February 2015 - [http://www.epcg.com/sites/epcg.com/files/multimedia/gallery/files/2013/08/list\\_365.pdf](http://www.epcg.com/sites/epcg.com/files/multimedia/gallery/files/2013/08/list_365.pdf), last accessed on 09.05.2016.

<sup>36</sup> European Commission, (2013), Turkey 2013 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2013/package/brochures/turkey\\_2013.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/brochures/turkey_2013.pdf), last accessed on 22.11.2015.

<sup>37</sup> Drew Leifheit, (2015), Liberalizing Turkey's Gas Market: BOTAS Loosening the Reins, Natural gas Europe, <http://www.naturalgaseurope.com/botas-liberalizing-turkeys-gas-market>, last accessed on 22.11.2015.

<sup>38</sup> Makpetrol's core business is retail and wholesale of oil, oil products, natural gas and biodiesel. Source: Internet page of Makpetrol, [https://www.makpetrol.com.mk/zamakpetrol\\_en.asp](https://www.makpetrol.com.mk/zamakpetrol_en.asp), last accessed on 09.05.2016.

<sup>39</sup> Energy Regulatory Commission, (2015), Annual report 2014, [http://www.erc.org.mk/odluki/2015.05.15\\_Godisen%20izvestaj%20za%20rabota%20na%20Regulatornata%20komisija%20za%20Energetika%20na%20RM%20za%202014%20godina\\_FINAL.pdf](http://www.erc.org.mk/odluki/2015.05.15_Godisen%20izvestaj%20za%20rabota%20na%20Regulatornata%20komisija%20za%20Energetika%20na%20RM%20za%202014%20godina_FINAL.pdf), last accessed on 09.05.2016.

<sup>40</sup> European Commission, (2010), Macedonia 2010 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2010/package/mk\\_rapport\\_2010\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2010/package/mk_rapport_2010_en.pdf); European Commission, (2011), Macedonia 2011 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2011/package/mk\\_rapport\\_2011\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/mk_rapport_2011_en.pdf); European Commission, (2012), Macedonia 2012 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2012/package/mk\\_rapport\\_2012\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2012/package/mk_rapport_2012_en.pdf); European Commission, (2013), Macedonia 2013 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2013/package/mk\\_rapport\\_2013.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2013/package/mk_rapport_2013.pdf); European Commission, (2014), Macedonia 2014 Progress Report, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2014/20141008-the-former-yugoslav-republic-of-macedonia-progress-report\\_en.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2014/20141008-the-former-yugoslav-republic-of-macedonia-progress-report_en.pdf); European Commission, (2015), Macedonia Report 2015, [http://ec.europa.eu/enlargement/pdf/key\\_documents/2015/20151110-report\\_the\\_former\\_yugoslav\\_republic\\_of\\_macedonia.pdf](http://ec.europa.eu/enlargement/pdf/key_documents/2015/20151110-report_the_former_yugoslav_republic_of_macedonia.pdf), last accessed on 09.05.2016.



company GA-MA owned both by the state and Makpetrol<sup>41</sup> to operate the gas transmission system. Both companies have been embroiled in alleged capture – risk deals, which have been news in the media.

Nonetheless, almost all countries in the region opened their markets on 1 January 2015 in compliance with the Third Energy Package enabling everyone to select an electricity supplier of their choice. Macedonia, though, made an ad-hoc decision to delay this liberalisation process by five years, preventing small consumers and households to choose their own electricity supplier. Hence, Macedonia breached the Energy Community Treaty and the Energy Community Secretariat began an infringement procedure against the country. The postponement of the electricity market liberalisation benefitted the incumbent distribution monopoly, EVN, which would have faced fierce competition from private trading companies providing better terms to household consumers. The private power traders were damaged by the government decision as many of their pre-signed contracts with clients automatically became void. This is a yet another case showing how the government has been shielding the monopoly of the incumbent private electricity supply company at the detriment of the competitors and the final consumers.

## Conclusions and policy recommendations

One of the main obstacles to the implementation of effective energy reforms in the SEE region is the existence of persistent energy governance deficits related to the corporate mismanagement of state-owned energy enterprises, the dependence and incompetence of energy regulators, and the inconsistency of the energy policy. **Improving the governance of the energy sector, including the functioning and management of state-owned energy companies in the SEE region is thus essential for achieving both effective anti-corruption results and progress towards EU integration.** Improving the governance of the energy sector, including the functioning and management of state-owned energy

companies entails, at a minimum, the implementation of the following actions:

- **Increasing transparency and access to energy data.** This is especially true when data on spending and financial governance of SOEs in the energy sectors is concerned. To improve knowledge about the energy sector, an external independent annual energy policy review should be commissioned by the national parliaments and executed by special inter-party working groups, which includes the following: a) an assessment of energy policy performance vis-a-vis the stated priorities for the year, the programming budget, and the strategic goals; b) an evaluation of the financial state of state-owned energy enterprises and an identification of the risks to the sector's development, including required state guarantees and risks of hidden privatization; c) an outline of the priority areas of development of the energy policy for the next year.
- Introducing **compulsory corporate governance standards for energy sector state-owned enterprises** following the best international principles such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises. **SEE countries lack compliance with and in particular practical implementation of the majority of the OECD principles.** The standards should ensure reporting and **disclosure of data and information** regarding financial results, implementing the existing practices and methods, used by publicly traded companies; key financial indicators for monitoring and assessment of the operational management performance; as well as consistent and comparative over time reporting of implemented programs and policies, including key indicators for monitoring their implementation and for allowing ex-ante, mid-term and ex-post impact assessment.
- Reducing the political leadership's **direct involvement in the operational management of energy enterprises** and instead focusing on policy development, the provision of public information, and control functions. The

<sup>41</sup> Ana Stojilovska, (2011), Scanning Macedonia's performance under the European Commission's Progress Report's Chapter 21: A race with obstacles? – Part II, Analytica,

<http://www.analyticamk.org/images/stories/files/report/2011/043/11043policyreport.pdf>, last accessed on 09.05.2016.

compliance with EU priorities and directives, necessitates a shift in national energy policy in SEE away from its excessive focus on adding generating capacities towards ensuring the stability and security of energy supply, reducing energy poverty, and improving energy efficiency.

- Introducing international accounting standards in the reporting of energy SOEs such as **the international financial reporting standards (IFRS)** that increases the transparency of transactions through unified disclosure procedures and allows for an easier comparison of the financial standing of different energy SOEs. Currently, annual financial accounts are not only often missing, but the reporting principles are also very inconsistent in terms of reporting data and depth of analysis and disclosure.

**Additional action** which should be taken in SEE to improve governance across the region include:

- Introducing **prioritization and selection of large investments projects** in the decision-making process, based on clear and transparent procedures and fact-based analyses, synchronized with the EU priorities, and in line with the capacity of national administrations.
- **Increasing the administrative capacity of national energy regulators**, their independence from political and economic interests and their transparency and accountability to both the National Parliaments and the general public.
- Building consensus on long-term priorities, backed-up with national energy strategy, approved by major political parties, in line with EU priorities and programmatic documents. Implement as fast as possible the EU Third liberalisation package in terms of regulatory changes and institutional practices, and with a view of EU accession prospects.