Albania: Dark Energy Scenario

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The Albanian energy crisis caused by the lack of precipitation is expected to have negative effects on the economy, which includes the reduction of capital investments by KESH and OSHEE, trade deficit and new pressures on the growth of public debt.

In the next three months, at least EUR 70 million will be needed for the import of electricity, announced OSHEE, and this should concern many institutions, because of the possible collapse of interconnections and the history of failure in production diversification, from Vlora thermal power plant to wind and solar plants.

During the 27 years transition, Albania has suffered a number of crises in the production of electricity, due to dependence of energy system on the amount of precipitation. Since the Fier Thermal Power Plant ceased operations in mid-2000, the production of electricity from hydro power covers 100% of domestic production. The successive governments have abandoned plans to diversify production or, at best, failed to implement them. The construction of Vlora thermal power plant cost EUR 100 million, spent on corrupt tender procedures, after which a serious defect was found in the construction, and it has remained a dysfunctional facility until today, while the state is in the proceedings before the international courts with the company that constructed the power plant. Although the periods of drought crisis occurred later, governments have found ad hoc solutions, without providing long-term solutions until today. Due to neglect, the drought has caused a chain reaction, turning the deficit of domestic production into a real fiscal and economic crisis.

The current situation is such that due to a lack of precipitation electricity production is at a historical minimum. Energy trading director at OSHEE, Elton Sevrani, said that due to prolonged drought, it would take EUR 25 million a month to cover domestic consumption, which in hot days reaches up to 18 million KWh per day. Last year, OSHEE imported electricity only to cover losses, so the current import costs are considerably higher than in 2016.

According to estimates, at least EUR 70 million will be needed to cover consumers' needs by October. This amount exceeds OSHEE budget, but other entities will also be included in the combination. In the budget for 2017, a reserve fund in the amount of EUR 22 million is planned for emergency import. This amount is sufficient for only one month import if the drought continues. An additional EUR 22 million fund, as part of the World Bank's loan, should be updated in September after the establishment of a new government, but even that will not be enough. In the worst year, due to lack of precipitation, EUR 100 million was needed for imports. This year, the state is in a similar situation. This amount, financed with the increased income of OSHEE, goes abroad, rather than being redirected to investments or other domestic costs.

The budget is exposed, there is a risk for capital investments

Experience has shown that the lack of domestic electricity production generates fiscal risks that contribute to the growth of public debt at the end of the year and which are the cause of a chaos in the entire power system.

In 2017, under the pressure of the IMF, the Albanian government formed a budget reserve of EUR 22 million. Funds can be used for electricity import in case of crisis in domestic production. This is a part of the fund for capital expenditures of EUR 530 million. Sources from the Ministry of Finance claim that there will be a budget rebalancing at the beginning of September in order to allow the import of electricity. At the end of May, the budget had a surplus of EUR 46 million, which, together with contingency funds in the amount of EUR 21 million, make a total of EUR 87 million that could be spent on imports.

Experts from OSHEE warn that EUR 23 million were spent on imports this month. Sources claim that the company can finance from its budget only imports for August and that this will be realized by redirecting the investment fund. If the drought continues, it is inevitable to provide state guarantees for the company.

In 2005, the government of Prime Minister Berisha implemented the policy of supplying electricity in cases of insufficient domestic production. This practice turned into a precedent that lasted several years and that resulted in a new crisis, a fiscal crisis.

After 2009, the budget support for electricity was at a high level. Imports of electricity in 2011 and 2012 were directly financed from the budget. This precedent was a trigger for criticism by the international financial institutions. The guaranteed excess of OSHEE at the end of 2013 amounted to EUR 217 million and this amount was increased by EUR 97.4 million by the end of 2014. According to the Ministry of Finance, the budget guarantees for KESH are EUR 210 million, which is 2.02% of GDP.

This led to the growth of public debt to 71% of GDP, which is the highest level in the region, and there was no longer any room for financing electricity imports through debt, and on the other hand, power cuts bring even higher costs for the entire economy.

The Chain reaction

Electricity production decrease has a chain effect on the slowdown of the economy. The trade deficit further accelerates foreign exchange outflow. Institutions that monitor economic development have begun pointing to these negative effects.

The Governor of the National Bank, Genti Seyko said at a press conference earlier this week that economic growth has been slowed down in the second quarter of 2017 as a result of climatic conditions that have most impact on agriculture and electricity production.

The reduction of the OSHEE investment plan and directing contingency funds from the budget mean less work for companies for which OSHEE provided the main revenues in the previous three years, after completed tenders for the reconstruction of transmission lines and substations across the country.

Avoiding strategy for investments in new resources

At present, the Albanian government is implementing a power sector recovery strategy by 2020, but it does not foresee the diversification of energy sources. The three phases of this strategy are aimed at saving the system from collapse, due to the debt of one billion dollars and completely amortized networks in the distribution sector. The main goals are the restructuring of KESH's debt and the improvement of management in the sector, especially in the distribution.

The investment plan includes the investment of Statkraft in a cascade hydropower plants on the Devoll river, small hydropower plants and Albania-Kosovo interconnection, which is out of operation a year after its construction due to Kosovo-Serbia conflict.

Albania is rich in natural resources - water, sun, oil, which are sufficient not only to cover the country's energy needs, but also to turn Albania into a net exporter. But since the 1980s, when the last hydropower plant was built, the governments did not seriously consider the issue of increasing production capacities. Hundreds of small hydro power plants have higher environmental costs than the contribution to the improvement of trade balance. According to the Energy Regulatory Authority ERE, the number of private small hydropower plants increased to 138 last year, from 100 in 2015.

Numerous companies turned to investments in small hydropower plants. Renewable energy market is guaranteed and production costs are covered at the end of the investment. According to ERE data, domestic production amounted to 7.136.351 MWh last year, of which 5.091.616 MW were produced by hydropower plants owned by KESH and 2.044.735 MWh by private power plants with concessions, accounting for 27% of total domestic production. However, investing in small hydropower plants does not prevent a crisis in the event of drought.

Most of these facilities have no accumulation reservoirs and do not produce electricity in the summer period. The only new reservoir is HPP Banjes, but Statkraft sells electricity on the free market. Devoll Hydropower is participating in tenders organized by OSHEE to cover losses, offering the same or higher price in relation to power exchange.

Scissors for investment plans?

From 2013 until the end of 2016, there was a point for ranking the success of reforms, which was related to power sector. The World Bank's Recovery Project has provided assistance to operators on the market. OSHEE added this fund to its improved revenues (in particular the collection of old debts), while KESH, in addition to favorable hydrological situation and exports realized in 2016, started to collect money from OSHEE on behalf of old claims. However, it seems that the positive performance of the power sector has reduced the vigilance at the end of the four-year period, leading to a situation in which the country's supply is endangered.

OSHEE spent EUR 22 million on import for July, while KESH has a fund of EUR 22.4 million from the World Bank loan, but it is still unclear which company will bear the burden of import if the rest of the year is to be marked by a medium amount of precipitation. The cuts, as happened in other cases, will affect investments, which ERE understands quite well.

A few days ago, ERE approved KESH and OSHEE investment plans for 2017, which foresee investments of EUR 114.6 and EUR 45. But there is a great chance that these plans will be revised due to reserving funds for emergency situations, if the weather conditions are not changed and the cascade on the Drin river remains at a minimum level.

This happens when companies have not managed to fully implement investment plans even in more favorable years. In 2016, OSHEE achieved 61% of the plan. At the beginning of last year, the distributor estimated investment costs to EUR 100 million, out of which it achieved only EUR 60.7 million. Most of the money was spent on reconstruction of medium and low voltage network.

If investments during the past year are taken into account, KESH is in the same position. According to official data, 64% of investments were achieved. The available funds in the initial plan amounted to EUR 27 million, and EUR 17.2 million was agreed.

Situation at KESH

The Drin River Cascade, which has the largest share in the country's supply, does not have its best days. Average flows this year are between 50 and 60% lower than the multi-year average. Average production at the beginning of July amounted to 7,400 MWh per day, and for the period from July 7, in August and September, production is planned to be 3,500 MWh per day, in order to achieve a 271-meter quota in the Fierzes accumulation reservoir, which is necessary to ensure sustainability of the system, KESH said.

In this situation KESH is likely to revise its economic and financial plan. The planned production in 2017 is 3,800 GWh. However, during the spring (when Fierzes accumulation reservoir is regularly filled), lower flows are recorded in relation to the multi-year average, which is why production of 2,900 GWh is expected in 2017.

Another challenge for operators are tariffs. Operators have applied for a tariff review, except OSHEE, but ERE estimated that maintaining the existing tariff level guarantees sufficient revenues for the companies.

This is still an issue for KESH, given that the production will be 900 GWh below the plan, with the sale of electricity at a lower price than the price proposed by the company, which does not provide covering the operating costs for 2017. This led to the need to consider the economic and financial program for this year. It is normal that the revision of this program will affect the investment plan, KESH said.

Drought threatens to sink OST

Albania's power system functions as a chain that consists of three companies - KESH, OSHEE and OST. The reflection of this situation is what happens to OST, a transmission system operator that is not in its best days, due to the lack of funds to repay the loans that go to collection this year in the amount of EUR 25 million. OST requested a revision of the transfer fee twice, but this request was not taken into account. In the explanation of its request, OST claimed that the fee of 0.65 Albanian leks per KWh applied today does not provide funds for repayment of loans and necessary investments.

In this situation, OST demanded a tariff increase of 1.17 leks per KWh, but ERE did not consider this request, but it has ordered that KESH and OSHEE pay its debts to OST. However, under existing conditions, OSHEE manages to pay only current bills. Unless a solution is found for the current situation, the company could be forced to suspend the payment of its obligations, which amount to EUR 60 million.

How the power exchange will affect the situation?

In accordance with the law, as of January 1, 2018, the power exchange should start its market operations. Bearing in mind the slow progress in the implementation of reforms, there is a concern that the legal deadline will not be followed. In any case, the existence of power exchange would be a bonus in the event of a weather condition that currently occurs in the country. Certainly, a clearer picture of the situation and optimal usage of capacities would guarantee an objective price. The report of the Secretariat of the Energy Community states the remark that in accordance with the Action Plan the Minister of Energy should have made a decision on the legal structure before March 31, 2017, which did not happen. This could affect the shift of the deadline for the opening of power exchange after January 1, 2018, and consequently, the realization of benefits that the power exchange brings.

A risk of the transmission system collapse

Experts estimate that uncertainty of the transmission system should be a greater concern than the import of electricity. This system has overcome tough times, even when imports reached 18 million KWh per day, however, predictability reduces the vulnerability of the system.

The lack of predictability limits the transmission system, and in exceptional cases, the outage of a line from the function can cause a collapse of the system, the power cut in the optimistic scenario would be 4 to 5 hours in the whole country, and in the pessimistic scenario even longer.

One of the problems in the transmission system is the fact that even more than a year after it was completed, the interconnection with Kosovo has not been put into operation yet. The Secretariat has announced taking measures against Serbia, but there is still no solution to resolve the situation in which the investment worth more than tens of millions of euros is suspended.