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# CONCESSIONS IN THE HYDROPOWER SECTOR IN ALBANIA – CHALLENGES AND OPPORTUNITIES

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**Abstract:**

*Coming out of a centralized system, faced with a small market which would not be able to create economies of scale, much competition from the other Western Balkan states, political challenges on strategies for attracting foreign investments, poor government budget, informal economy, Albania was in a desperate need to find its niche in the market. Albania is a market of 3.5 million people, with a yearly low-medium income averaging 4000 USD yearly/PP. As the emigrated population grew more and more distant from the home country, settling and integrating within their new resident countries, and the phenomena happening before the start of the world financial crises, Albania could no longer rely on remittances to boost its economy. The country had to take economic measures to attract new foreign capital. The enormous increase in FDI flows across countries is one of the clearest signs of the globalization of the world economy over the past 20 years (UNCTAD, 2006). Also, Chakrabarti (2001) concludes that “the relation between FDI and many of the controversial variables (namely, tax, wages, openness, exchange rate, tariffs, growth and trade balance) are highly sensitive to small alterations in the conditioning information set”.*

**Key words:** energy, hydropower, loan, concession, bank

## 1. Introduction

With no economies of scale, low purchasing power, small markets, low exports, decreasing remittances, low efficiency in tax collections, and as a consequence poor public finances, Albania was in a desperate need to introduce Public Private Partnerships, if it ever needed to turn the country around, and start investing in infrastructure projects.

The first attempt of an Albanian government to seek building and renewing infrastructure, and to seek the increase of new capital through foreign investments was in 2004, with the 25 year of a BOT granted concessions of the only Albanian international airport “Mother Teresa”. The Airport would be a great cost on the government budget if the attempt was to use public finances to build it. With the granting of the concession, new capital, expertise and employment were secured for a modern and efficient operation of the Albanian International Airport.

With the new democratic party government taking office in 2005, inheriting poor public finances, private public partnerships, mainly through concessions were seen as the only solution to attract foreign investment and increase new capital in the Albanian market.

The question that remained was which sector presented abundant opportunities in the Albanian market, for the investors to be interested in. The government had to make sure that the sector chosen would offer abundant opportunities to foreign and local investors.

## **2. Hydropower sector: an opportunity**

In early 2007, new legislative measures and an amendment to the already existing law on concession were made, to support Private Public Partnerships through concession:

- Law No. 9663 dated on 18/12/2006 “On concessions”;
- Council of Ministers Decision No.27, dated on 19/1/2007 “On approval of rules for evaluation and concession procedures”, changed with MCD No. 87 dated on 16.01.2008
- Council of Ministers Decision No.150, dated on 22/03/2007 “For the organization and function of Concession’s Treated Agency” (ATRAKO).
- Minister’s decision No.536, dated on 27/07/2007 “On regulations approval for the administration of the documents and requests for concessionary agreements and “Bonus evaluation criteria”

*Reasons why Concessions in the hydropower sector became primary focus with increasing interest:* after careful considerations, taking also into account major shortages of electricity in the country that were slowing down economic growth, the hydropower sector was seen as the most vital, presenting enormous potential for the private sector.

Albania uses only 35 % of the country hydroelectric potential. Some 98 % of its energy up to 2007 was a result of pure clean energy from already outdated hydropower plants and an even more outdated transmission system. With the last hydropower plant, Koman completed in 1986 no more investments took place in this sector. Below are values of production and consumption, which were taken into consideration, while assessing the need for concessions in the Albanian hydropower sector.

**Table 1: Electricity Generation and Consumption in Albania**

Type of energy produced	2004	2005	Change (%)
Annual Production (GWh)	5,491.10	5,486.00	-0.0928
Gas fired Thermoelectric	0	0	0
Coal fired Thermoelectric	0	0	0
Nuclear	0	0	0
Hydroelectric	5,389.00	5,391.01	0.0374
HFO fired Thermoelectric	76.00	74.99	-1.3342
Other RES	26.10	20.00	-23.3628
Imports (GWh)	478.52	503.96	0.0532
Exports (GWh)	0	0	0
Consumption (GWh)	5,969.62	5,989.96	0.3407

Source: KESH, 2006

Albania is blessed with 44,000 km<sup>2</sup> of hydrological territory and that calculates to about 60 % larger than its actual geographical territory. Albanian hydropower potential is presented through its main eight rivers. The hydropower potential in use up to 2007 was of approx. 1500 MW and the opportunities, if the entire eight rivers are optimized in their hydropower potential, the output could reach up to 17TWh.

### 3. Concessions - a real opportunity for hydropower sector

Hydropower is clean and renewable source of energy and it makes room for inexpensive production of electricity. Unfortunately this great source of energy can also drain public finances quite quickly. In most cases hydropower projects require the building of a dam and much land for reservoirs. The dams are expensive to build and the government also will be faced with the cost of expropriation, for this purpose.

Large storage hydropower plants investments are not the only opportunity for concessions. Of much interest are also the smaller tributaries of rivers which could make room for developing of small hydropower potential in the country. This sort of development could not only attract foreign investment but also local capital. Hart (2003) pointed out that the private concessionaire may have incentives to save at the expense of quality of service.

According to the public information released on the website of the Ministry of Economy, Trade and Energy (3), starting from 2007, the government of Albania, represented by the METE worked together with the private sector and granted

in total over 164 concession contracts for the construction of 435 small, medium and large hydropower with concessions.

**Table 2: Number of concessions for HPP in Albania 2007-2013**

Year	Number of contrasts	Number of HPP	The value of investment (ALL)	Power (kw)
2007	3	3	935,066,767	17,800
2008	26	37	36,389,681,955	173,098
2009	56	163	193,126,091,502	840,884
2010	6	19	1,545,604,390	15,518
2011	14	51	39,188,496,098	307,616
2012	12	50	10,327,770,621	86,625
2013	47	112	63,574,803,912	489,386
<b>Total</b>	<b>164</b>	<b>435</b>	<b>345,087,515,245</b>	<b>1,930,927</b>

Source: Ministry of Economy, Trade and Energy of Albania (METE) 2013

The concession for **hydropower** plants make up for over **1930 MW** in installed capacity and more than **345 billion of ALL** approximately **2.5 billion of Euros** in private investments. The capital to secure this investment has **Albanian and foreign origin**, nevertheless the government provided a new window of opportunity for the liquid local capital to be invested in this high return field .

The offers for concessions were valued based on solicited and unsolicited proposals. The unsolicited proposal gave room to a foreign or local investor to make their own due diligence to indentify on a project with potential, and if being the first investor to do so, they would also be granted bonus points before entering into an international/national competition, or tender.

Not only did the government of Albania provide for a great solution to build expensive hydropower projects through PPP-s , it also provided for saving public finances for due diligence and studies, which through unsolicited proposals could be carried out from the private investor. The hydropower potential of the country, if it would be in depth studied by the Albanian government could engage large financial and time resources. After all, it is proven that private companies despite of well studied government research will back up and conduct their own research. Therefore it was seen suitable, for the process to start in the least time possible, to propose to private companies' unsolicited proposals on a concession tender phase.

Foreign private companies, placed Albania in their map of market due diligence, with some multinational companies in the energy sector that expressed interest to develop some of the largest hydropower projects.

The Devoll Project, one of the largest storage hydropower project currently in the southeast Europe, with investment capital of approx 1bn Euros, came as a result of

a BOOT concession from the Austrian company EVN AG and Statkraft AS, each holding 50% of the investment share with the Ministry of Economy Trade and Energy. The project concession was ratified by the Albanian Parliament in April 2009, and is expected to last for over 6-7 years in construction time. It will have a total capacity of 319 MW, with three large asphalt core dams, and it will create over 3500 new employment opportunities.

To sum up the advantages of introducing public private partnership through concessions in hydropower resulted in attracting large amount of foreign capital in the Albanian market and freeing up local capital creating also employment opportunities. The Albanian government saved up financial resources from its public finances to be used in other social services, and attracted the best foreign expertise in building hydropower plants.

#### **4. Downfalls of the process**

Although many opportunities were created the process had also its downfalls. The first downfall came as the lack of experience, through no fault of their own, (this was also a new process of learning by doing) of the Albanian administration to create the best and most efficient paper work to support these concession agreements. In 2010, when most of the small hydropower plants, mainly granted to Albanian investors, were supposed to start work, *out of 260 more than 30 were in their construction phase*. This situation was misused by the current main opposition party in that time, the Socialist Party of Albania. The government was accused for mismanagement of concession contracts and lack of professionalism in granting this contract to private investors. They were accused of misuse of public property, and favouring clientelism while granting concessions.

The opposition party was purposely misinforming the public, knowing the peculiarities of feelings of the Albanian population when it comes to public resources, and were not targeting the real reasons why many contracts still after 3 years were not implemented. As previously mentioned hydropower plants require careful planning and studies in their pre-construction phase in order to optimize the project in the construction and operation phase. In many cases the optimization of small hydropower projects in their pre-construction phase require over 1-2 years time of careful topographic, geological, hydrological, environmental and social assessment studies. This factor was completely disregarded by the opposition in their attempt to diminish the importance of hydropower concessions, maybe for lack of professionalism in understanding the process or purposely used for misinformation to the general public. Hydropower project, regardless of their size, are costly and require not only private equity financing, but in many cases bank loans. The financial crisis, which strongly hit the banking sector in the early 2008 continuing to the end of 2009, when most of this concession contracts were in the phase of applying for bank loans to support their investments, acted as a major show-stopper, delaying construction time for many of the small hydropower plants projected to commence in the early 2010.

Another reason indirectly related to delaying of the process was the tender evaluation criteria. One of the many qualification criteria for a company to be granted a concession contract was of course the amount of financial capital to be invested. More capital meant larger investment, greater technology attraction, and greater know-how received; in some of the cases also meant larger employment. Taking into consideration the great demand and competition coming from the business side to invest in this flourishing sector, the investment cost, in number terms, was artificially increased to make possible winning the bid for the concession contract.

As the liquidity crisis erupted, with banks tightening credit loan measures, companies had to provide a well studied business plan justifying their investment costs, and in many cases they had to provide a percentage of the loan though collateral. It turned out that artificially raising their investment costs was a bubble, and a good reason for companies not to be granted the necessary loan from commercial banks, slowing down the construction time, for most of the small hydro power investments.

Lack of experience in optimizing the studies was another reason for companies to miss out on bank loans. Often the not well studied technical and engineering details of the project failed to match the promised investment costs, therefore failing the company to get granted on a loan.

### **5. The infrastructure to make this granted concession an investment reality**

According to study conducted by Eduardo Engel, Ronald Fischer and Alexander Galetovic, it is argued that PPP and government spending are perfect substitutes at the margin; savings at the beginning are of course foregone revenues later. The theory of saving now to forego future revenues, and not leave other generations with a major debt for infrastructural developments, was an incentive to push the Albanian administration to seriously introduce concession agreements to invest in one of its more prominent sectors of the economy. Sources from the World Bank claim that Albania will not be able to pay its current loan in the next 17 years. One can only imagine how much debt we could leave to our children if the government decided to finance and build these hydropower plants itself.

*Measures taken to make this granted concession an investment reality:*

1. Step in rights: it is a new measure the government introduced in the amendment of the concession law, which gives banks the right to step in and gain replace the concessionaire unable to pay the bank loan. These rights will help the bank place less strict conditions for investments loans.
2. Power Purchasing Agreements: A form of contract signed between the concessionaire and the government to guarantee purchasing of electricity produced from small HPP, less than 15 MW, for a period up to 15 years. Most of these investments in hydropower are as small as they will be unable to export electricity outside Albania. In order to guarantee market for them, the

concessionaire can sign a PPA with the Albanian Power Corporation ( KESH) for the purchasing of the power produced, for a period up to 15 years, or less, upon the concessionaire request.

## 6. Conclusions and recommendations

Sometimes investors are likely to be relatively footloose, and could easily decide to move on to other locations offering even more generous incentives before the expected benefits in the first location have been realized (see e.g. Flamm 1984 and McLure 1999). Therefore I believe it can be taken new measures to improve the legal and financial infrastructure for concessions in the hydropower sector.

First of all, **fiscal incentives** by lowering taxation for the investment years. The neo-classical economic thinking, supports the assumption that the more money is left in the hands of the private companies, the more they will invest and create wealth, better than the state can. Financial incentives usually come in forms of lowering taxation for capital investments, export, VAT, profits, sales and more. Offering tax incentives makes a country's investment climate more favorable. (Wells and others, 2001). In the short run, low taxes could translate into speeding up the realization of the investment. Also surveys of investors have found that the tax system is significantly no less important than a country's basic economic and institutional environment (OECD 1995, Wunder 2001).

Second, **financial incentives** will prevent same downfalls caused by crises in banking system. These incentives do not always come in form of cash from the government to the investor, but mainly in forms like risk coverage, free information, lending below market provisions and more. Measures like the PPA or the Step in rights are also considered financial incentives.

Third, **market and regulatory privileges**: Governments could, on short or long term, grant market or regulatory privileges to the concessionaire in the hydropower sector. They could support the investor by lowering the requirements in granting the required licensing or even give "bundling" rights to the concessionaries.

Fourth, **renegotiation of concession contracts** to extend construction time and avoid penalties. The government can renegotiate some of the contracts which construction time has expired, if the concessionaire is able to justify on solid grounds, reasons of why the investment has not taken place yet.

Despite downfalls on the concession agreements in the hydropower sector in the Albanian market, there is no reason to underestimate their value for the current economic situation of Albania. This private investment should be supported, for the added value they bring into the economy, as they free up public finances to be used for other social serviced much needed in the county, and they create efficiency, in public investments more than governments in the developing countries can. So, the above described positive effects accrue not only to the investing firms but also to local producers, thereby benefiting the economy as a whole (Blomstrom and Kokko, 1998)

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