

RESTRUCTURING THE ENERGY SECTOR IN TRANSITION COUNTRIES

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THE DEVELOPMENT OF NATIONAL AND REGIONAL ENERGY POLICIES IN SOUTH EASTERN EUROPE

Keynote Speech

**BERNARD SNOY, DIRECTOR, WORKING TABLE II
STABILITY PACT FOR SOUTH EASTERN EUROPE**

I am very grateful to the Stadtwerke Leipzig, Verbundnetz Gas AG, the World Bank and to the other institutions, in particular Ombiasy, involved in the organisation of this important conference for inviting the Stability Pact for South Eastern Europe to participate. Let me first of all excuse the absence of Dr. Erhard Busek, Special Co-ordinator of the Stability Pact, who had hoped very much to be here to-day but who was prevented from attending as he had to pay an important visit to the new Serbian Government in Belgrade. I will deliver this keynote address on his behalf.

I would like to highlight to-day the role that the Stability Pact (SP) is playing, alongside other national and international institutions, in the development of national and regional energy policies in South Eastern Europe (SEE).

As you know, the SP was created in 1999 to achieve Stability, Peace, Democracy and Prosperity in SEE through Regional Co-operation. Identifying common challenges for the SEE countries, designing a common agenda to address these challenges, mobilising the resources of the international community in support of that agenda and monitoring its implementation, this is the very *raison d'être* of the Stability Pact. At the same time, the SP aims at preparing the SEE countries for integration into European and international structures and ultimate membership into the European Union through adoption of European (and/or other relevant international) standards. The beneficiary countries of the Stability Pact are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania and Serbia and Montenegro. Moldova joined in 2001 although it does not have the same EU membership prospect as the other SEE countries.

The so-called Athens process, launched in 2002 by the European Commission with the support of the SP, is one of the most remarkable examples of what the SP strives to achieve, namely creating a liberalised and competitive SEE Regional Energy Market that would introduce the EC regulatory model and, in that way, prepare the integration of that market into the wider EU electricity market. Progress has been achieved in an astonishingly short period of time, leading to the signing of a first MoU on the electricity sector by the SEE countries (as well as by UNMIK but with the exception of Moldova, who associated itself unilaterally to the process but is recognised only as an Observer), Greece and Turkey in Athens on 15 November

2002 and to a second MoU, signed again in Athens, incorporating the gas sector, on 8 December 2003. The SEE countries as well as Turkey committed themselves in these two MoUs to introduce common rules based on the EU Directives on electricity and gas which include:

- freedom of non-household customers to choose their supplier,
- cross-border trade and regulated third party access,
- the establishment of an independent energy regulator (responsible for approving tariff methodologies, monitoring of market, allocation of inter-connection capacity and congestion management),
- unbundling (in terms of decision making and management) of generation, transmission and distribution,
- tariff reform,
- energy efficiency, and
- environmental protection.

The two MoUs provide for the establishment of compatible national energy market models as well as for a regional energy market model. The key institutions at the national level are the State Energy Authority, entrusted with the development of energy policy (which has as primary purpose to ensure the provision of energy under secure conditions at competitive prices with high level of public services, energy efficiency and consumer protection), the independent Regulatory Authority and the independent Transmission System Operators for electricity and for gas. The Energy Authority has to draw up, in consultation with the Regulator, National Electricity and Natural Gas Market Action Plans. The enhancement of capacity for national energy policy development and the design of sound national action plans are essential building blocks in the Athens process.

For the governance of the market at the regional level, the MoU provides for a Ministerial Council, a Permanent High Level Group (PHLG) and the SEE Energy Forum (the Athens Forum) bringing together all stakeholders to address market design issues, with the European Commission acting as an impartial Secretariat. The PHLG is to draw up a Regional Electricity and Gas market action plan on the basis of the national inputs and to define regional investment priorities. The criteria to identify priorities will be non discriminatory, transparent and agreed upon by the PHLG and the donors' group. An indicative list of cost effective investments in electricity and natural gas infrastructure that facilitate the operation of the regional market shall be drawn up. To ensure security of supply in electricity, projects should provide for generation adequacy and transmission lines reliability based on UCTE standards. Regarding the natural gas market, focus should be given to the diversification of supplies and the primary goal is the necessary infrastructure to achieve this aim. One of the key originalities of the Athens process is to aim at regional investment optimisation and at making state and regional perspectives compatible.

For the Stability Pact, the Athens process is an initiative that makes sense not only in economic terms but also in political terms as it promotes the wider co-operation

and interdependence that is necessary to consolidate reconciliation and heal the wounds left by the conflicts of the 1990's. In fact it is a unique political chance for the region. In the same way that the European Coal and Steel Community (ECSC) was a prelude to the European Economic Community, we can see this Regional Energy Market as a powerful driver towards greater economic and political integration.

This "Athens Process" would not have been possible without the strong external sponsorship/leadership role of the European Union and the stabilising interest taken in the process by important neighbours of the region such as Greece and Turkey as well as Italy and Austria, who joined the process in the course of 2003. It is also very important that the international community is showing its unity in supporting the process through a common strategy.

We all know that the potential economic benefits for the countries of the region are great:

- increased reliability and security of supply,
- a level playing field with fair conditions for all groups of market participants,
- greater efficiency and lower or at least more competitive prices for the end costumers that will certainly help to further the economic development of the region;
- vastly increased opportunities for intra- and inter-regional trade
- a predictable regulatory environment that should attract private investment and financing;
- enhanced transparency and a greater market discipline that should help in the fight against corruption; and
- a regional framework for determining critical investments should lead to a reduction in overall investment needs.

Nevertheless, the decisions taken in Athens in 2002 and 2003 will also entail numerous transition challenges for the countries of the region and progress will not come painless. I personally believe that the real work still lies ahead of us, as the SEE countries will have to implement the commitments of the MoUs. The Athens process has not only important economic and social implications in terms i.e. of lower costs to the economy, tariff reform for households, improved transparency and governance of utilities and attractiveness for foreign direct investment, but also profound political and institutional implications in terms of security of supply, capacity building at the national and regional level and above all in the context of the SEE countries' move to full integration into the European Union.

After serious internal deliberations in the European Commission, Ms. Loyola de Palacio, Vice President of the European Commission, has asked the EU Council of Ministers for a mandate for the negotiation of an international treaty that would transform the Athens MoU into a legally binding framework for the countries of SEE, involving also the EU. This is a very ambitious endeavour.

To assist the regional players, significant political, technical and financial assistance by the international donor community is called for. I am pleased to see that this international assistance is coming forward and that a common strategy has been endorsed by the donors. I am encouraged by the broad support to the Athens process, which was reiterated at several donor co-ordination meetings jointly organised over the last two years by the European Commission and the Stability Pact. This co-ordination of multilateral and bilateral donors to support the regional integration process in the key energy sector is really unique. It aims, among others as I explained, at strengthening capacities for policy development and independent regulation at the national level and at reaching a common view at the regional level on optimisation of future new investments.

We must also make sure that private investors in the energy sector are made fully aware of the business opportunities created by this Regional Energy Market and are as closely involved as possible in the rehabilitation of generation, transmission and distribution capacities. This was the purpose of the Industry Roundtables organised by the SP and the European Commission: a first Industry Roundtable was organised on 21-22 February 2003 and hosted by the Czech Government. A second one, hosted by the Bulgarian Government, took place in Sofia on 22 October 2003. I can tell you that we perceived in these two roundtables a very significant interest of international electricity and gas companies, some of which are already involved, in one way or another, in the energy sectors of Central or Eastern Europe.

At the same time, the traders and investors who were in Prague and in Sofia felt that the timing envisaged for the liberalisation of the electricity market in SEE was very ambitious. Their perception of the various risks entailed in trading and investing in SEE was still high. While they appreciated the political commitment entailed in the MoU, they asked for more legal certainty. This could be provided by transforming the MoUs into a legally binding treaty. They also wondered if international financial institutions such as the World Bank, the IFC, the MIGA, the EIB and the EBRD could not help to mitigate these risks. Tariff reform and affordability for low-income people were seen as key issues. No private investments would take place unless tariffs could be raised and sustained in real terms to ensure full cost recovery. Energy reforms had to ensure both economic viability and social sustainability. Environmental considerations, including possible liability for past pollution problems, were also important considerations in investment decisions. Last but not least, the situation of the current, mostly state-owned and not yet unbundled, power utilities in the SEE countries had to be addressed and the managers of these utilities had to be won over to the reform process. To overcome the resistance of entrenched interests, a global approach had to be favoured, combining the efforts of the public and private actors. Management contracts, twinning experiences and various forms of Public Private Partnerships could be useful as interim steps.

In conclusion, let me restate how I see the task of the Stability Pact in the SE Energy Sector:

- Providing political support to secure the success of the Athens process of regional integration of the electricity and gas sectors in SEE;
- Urging the countries of the region to deliver on their commitments by the agreed dates;

- Urging them to reform their energy sector not piecemeal but as part of overall national energy policies and strategies, that have been thoroughly and democratically debated to ensure ownership and that incorporate the regional co-operation dimension;
- Assisting the European commission in donors' co-ordination;
- Promoting private sector involvement and investment in the SEE electricity sector;
- Supporting the transformation of the MoU into a binding Treaty along the lines of the European Coal and Steel Treaty.

As mentioned, the European Commission has requested a negotiation mandate from the EU Council, for a legally binding international treaty amongst the current non-EU countries that signed the Athens MoU and a role of guarantor for the European Commission. This is a proposal the Stability Pact favours for the political reasons I already mentioned, namely its impact in terms of building trust, attracting much needed foreign investment in this sector, pooling of strategic resources and prelude to more advanced forms of economic and political integration in European structures. I very much hope that the Commission will very soon be awarded the mandate it is seeking and that the negotiations can start soon and be completed by the end of this year. This would go a long way towards putting in practice the views I very much share that were expressed last year by the European Commission President Romano Prodi when he said that integrating the European Union's South Eastern neighbours as a first step into the European energy market could be one of the most effective ways for the European Union to project its stability to that region.

I thank you very much for your attention.