

EnC Ministerial Council 24.10.2013

## Orientation Debate:

### Obstacles to further opening of EnC energy markets

The EU energy liberalisation process, which started in the 1990ies, replaced the traditional national energy sector design (state-owned monopolies, absence of competition) by a **market-based model**. The aim was to introduce competition between several energy producers and suppliers within the own country and beyond. The current EU energy acquis is built on the idea that competition in the energy sector can significantly increase social welfare through lower prices, adequate investment signals and more secure supplies (i.e. through diversification). However, the process towards more energy competition was burdensome in the EU, with significant implementation deficits in various Member States<sup>1</sup>.

The liberalisation process in the Energy Community (EnC), which started later, followed the same patterns as in the EU and proved to be similarly difficult. Despite the undeniable progress in the last years, Contracting Parties have often been criticised for **deficits in the implementation** of the energy acquis in the past<sup>2</sup>. Indeed, only few Contracting Parties have already implemented competitive energy markets in which several producers and suppliers compete within and beyond country borders. In reality, most EnC energy markets are still dominated by a single incumbent operator today, often state-owned and shielded by monopolies, single-buyer models<sup>3</sup> or the exclusion of price competition<sup>4</sup>. Despite their small size, most energy markets in the EnC remain national, with very limited cross-border trade<sup>5</sup>.

While the advantages from competition, interconnection and free energy prices may be clear according to the textbook, it has to be acknowledged that EnC governments and regulators **face enormous difficulties** when trying to reform their systems. The political and economic challenges in the liberalisation process are even bigger as the advantages of competition sometimes do not kick in immediately, but only mid-term<sup>6</sup>.

It may therefore be useful to shed some light on the **problems that are behind the "implementation gap"**. In order to better understand the political obstacles to energy liberalisation in the EnC, it may be worthwhile to analyse e.g. what the underlying reasons for the hesitation to allow more (cross-border) competition are; whether the practical and political obstacles to liberalisation have been sufficiently analysed and discussed; whether potential negative effects of market opening have been underestimated; whether the expectations in terms of implementation of the EnC acquis are realistic; whether the "textbook" approach of the Third Package is appropriate for the whole EnC and whether specific solutions might be needed which are more realistic and adapted to the situation in the EnC.

It is therefore proposed to have an open debate on these issues in the meeting of the Ministerial Council on 24.10.2013. This debate is all the more timely in view of the ongoing reflection on the future of the Energy Community, aiming at improve in particular its working methods.

<sup>1</sup> See e.g. Commission Communication "Making the internal energy market work" (COM/2012/0663 final) of 15.11.2012.

<sup>2</sup> See e.g. 2013 and previous Annual Implementation Reports by the EnC Secretariat; see for similar comments from the Donors' Community e.g. point 7 of the Conclusions of the 7th Ministerial Council meeting (Zagreb, 18.12.2009). See also the Report by the European Commission on the EnC under Article 7 of Decision 2006/500/EC (COM(2011) 105 final) of 11.03.2011.

<sup>3</sup> In a single buyer model, all generation needs to be sold to one single entity.  
See e.g. [www.http://rru.worldbank.org/documents/publicpolicyjournal/225Lovei-1211.pdf](http://rru.worldbank.org/documents/publicpolicyjournal/225Lovei-1211.pdf)

<sup>4</sup> See EnC 2013 Implementation Report, p 10: *"The domestic supplier (still a factual, or in the case of Albania and Ukraine, even a legal monopoly) will normally buy from traders only if and to the extent domestic generation does not suffice to satisfy their demand. Their demand is determined by the bulk of domestic customers which are supplied at regulated prices. This includes households and SMEs, and often also large industries. The relation between the "public" supplier and the incumbent generation company is determined by factual exclusivity. In many countries, they are part of the same vertically integrated and state-owned undertaking."*

<sup>5</sup> See EnC 2013 Implementation Report, p 10/11: *"With the exemption of a few non-regulated customers and situations when domestic generation does not suffice, trading on regional markets is still not developed in the Energy Community. As the incumbent generator sells by default all its energy to domestic and regulated consumers, none remains available for real cross-border trade, especially as the region is alarmingly short of generation capacity. The standard market model is essentially locking-in all domestic generation and leaves space for new entrants only in exceptional situations."*

<sup>6</sup> A typical example being *price regulation*, which may, in the short term, lead to price increases, while the positive effects (attracting new suppliers and investments, reduced effective burden for consumers through end of subsidies prices) may materialise usually only later.

## Issues for discussion

1.

Where do you see the main difficulties to implement the EnC acquis?

2.

Do you consider that Article 24 of the Treaty on adaptations has been sufficiently taken into account when adopting new pieces of EU legislation in the Energy Community?

3.

Are the positive effects of cross-border competition overestimated and the risks of competition underestimated?

or

can we consider that the risks of competition are transitory and that cross-border competition is generally beneficial for Contracting Parties (welfare-enhancing)?

4.

Should energy price-regulation be tolerated in the EnC

or

should energy price-regulation be abolished to attract necessary investments and avoid subsidies for energy companies?

5.

Are Energy Community rules sufficiently enforced? (concerning in particular the implementation of the basic market opening rules)

If not, what could be done to strengthen enforcement?