# Power Sector Reform and Private Sector Participation in Transition Economies

**Energy Charter Secretariat**

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www.ebrd.com

# Outline

1. Energy sector challenges in transition economies

2. EBRD Sector Reform Priorities

3. The Challenges of Power Sector Privatisation

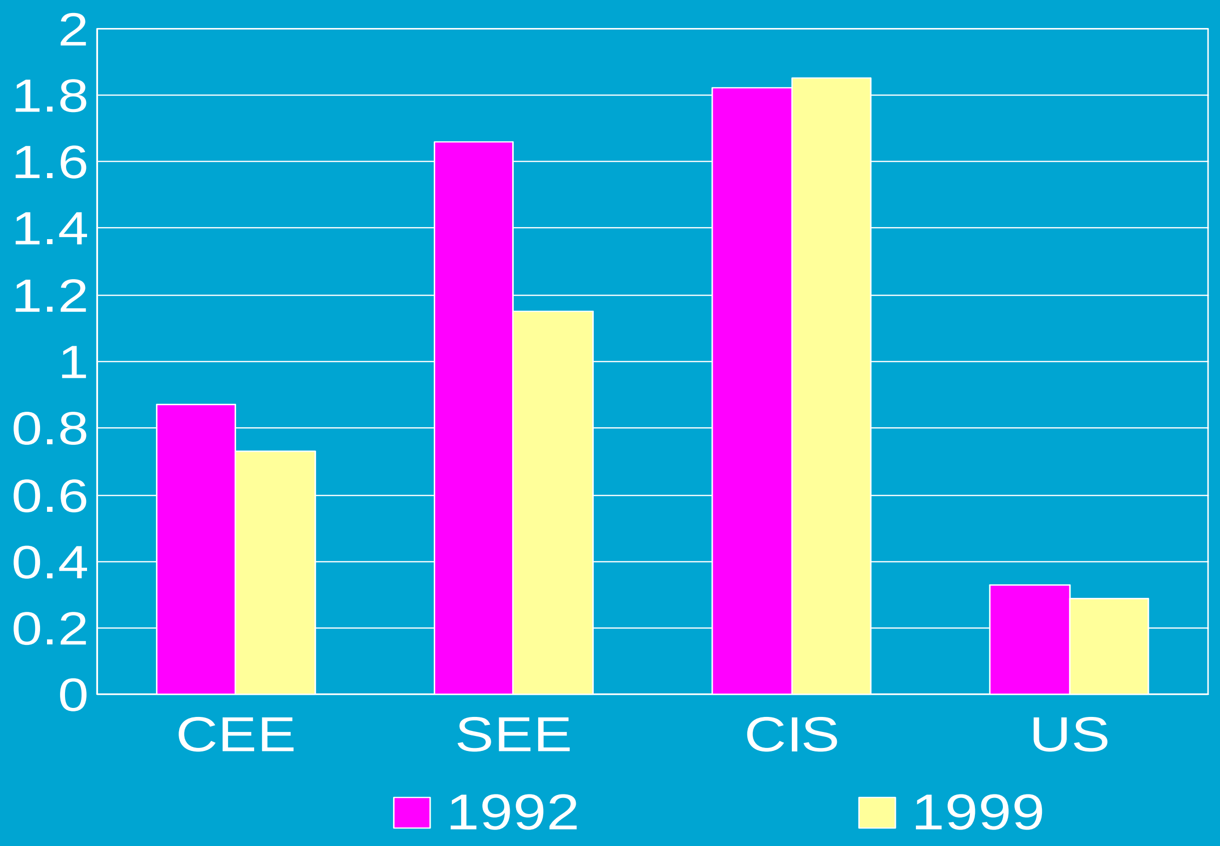
4.  Other Policy Challenges

5. Policy Recommendations

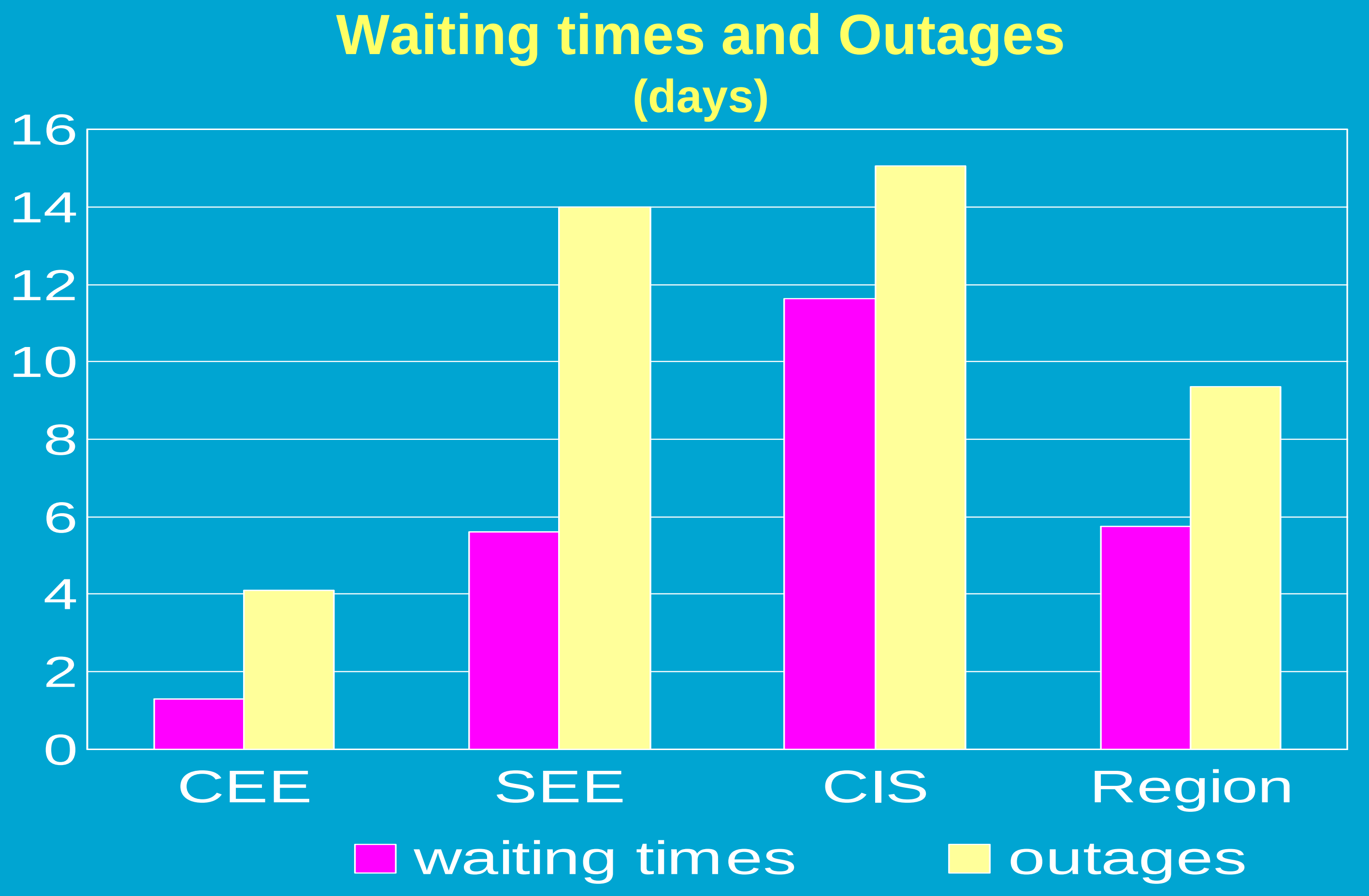
# 1. Energy sector challenges in transition economies

- High energy intensity
- Low operational efficiency and plant availability in power and heat generation
- High losses in the transmission and distribution of electricity, heat and gas
- Low level of tariffs and low cash collection
- Poor environmental, health and safety management

# Energy Intensity is high ...



# Access/reliability of services to business are still low




Source: BEEPS (2002)

# 2. EBRD Sector Reform Priorities …

- **Corporatisation and Commercialisation of Public Sector Entities**
  - *Cost reflective tariffs and elimination of cross subsidies.*
  - *Improvement of cash collections*
  - *Commercialisation and corporatisation*

- **Privatisation**
  - *Private participation in generation and distribution/supply as a means to promote competition and operational efficiency.*
  - *Introduction of the private sector according to the specific priorities facing the industry.*

# 2. EBRD Sector Reform Priorities … ctd

- **Competition**
  - *Restructuring of energy utilities to separate natural monopoly functions from potentially competitive elements.*
  - *Sound economic regulation of the energy sector*
  - *Improve the trading structure of the wholesale energy market.*

## EBRD OBJECTIVES

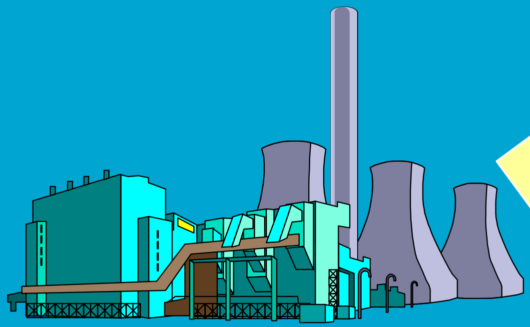
- *To improve the investment climate and allow the development of energy sector on market principles;*
- *To improve energy efficiency and the quality of energy services;*
- *To improve environmental performance*

# 3. The Challenges of Power Sector Privatisation …

- Privatisation has proven to be an effective means of attracting private investors and a way of attracting FDI, particularly through the selection of a strategic investor by open international tenders.

- Some of the arguments for private ownership, are even stronger for transition economies:
  - the need to access capital to meet growing demand and improve quality of service
  - Payment discipline provided by private ownership
  - Commercial skills.

# 3. The Challenges of Power Sector Privatisation the Global Power Market

No Banks

No Investors

# 3. The Challenges of Power Sector Privatisation … Ctd

- Significant decline in private sector appetite
- Risk of unemployment and
- Separation of profit maximisation from broader “social” objectives
- Social and political opposition (e.g. to tariff increases)

The EBRD played an active role in catalysing the privatisation of distribution in several countries, including Armenia, Kazakhstan, Kyrgyzstan, Moldova, Romania and Ukraine.

# … Additional benefits of privatisation in the energy sector

- Declining losses and improvements in system security
- Incentives for industrial users to improve energy efficiency and to move away from energy-intensive production methods
- Improvements in efficiency resulting from private participation may in turn reduce the price increases necessary to ensure the viability of the power sector.

# 4. Other Policy Challenges

**Transmission/Distribution: NATURAL MONOPOLY**

- **Transmission** In many countries there is a state-owned grid operator subject to very slow unbundling (Challenges of long-term contracts)

**Retail and wholesale trading:**

**CAN BE OPEN TO COMPETITION**

- Wholesale trading: progressive liberalisation for EU accession countries, with some private entry

# SEE Regional Market

## The Athens Memorandum

- Reform steps to support phased market opening
- Industry unbundling, development of regulatory framework, market design
- Non household liberalization from 2005, on basis of bilateral contracts
- EC, IFIs, donors working together to fulfill this objective

# …. Crucial regulatory choices

## Distribution

- **<u>Price cap regulation (RPI-X)</u>** based on:
  - <u>Expected cost</u>: total cost vs. disaggregated analysis
  - <u>Expected efficiency improvement</u>: industry-wide and company specific

## Grid

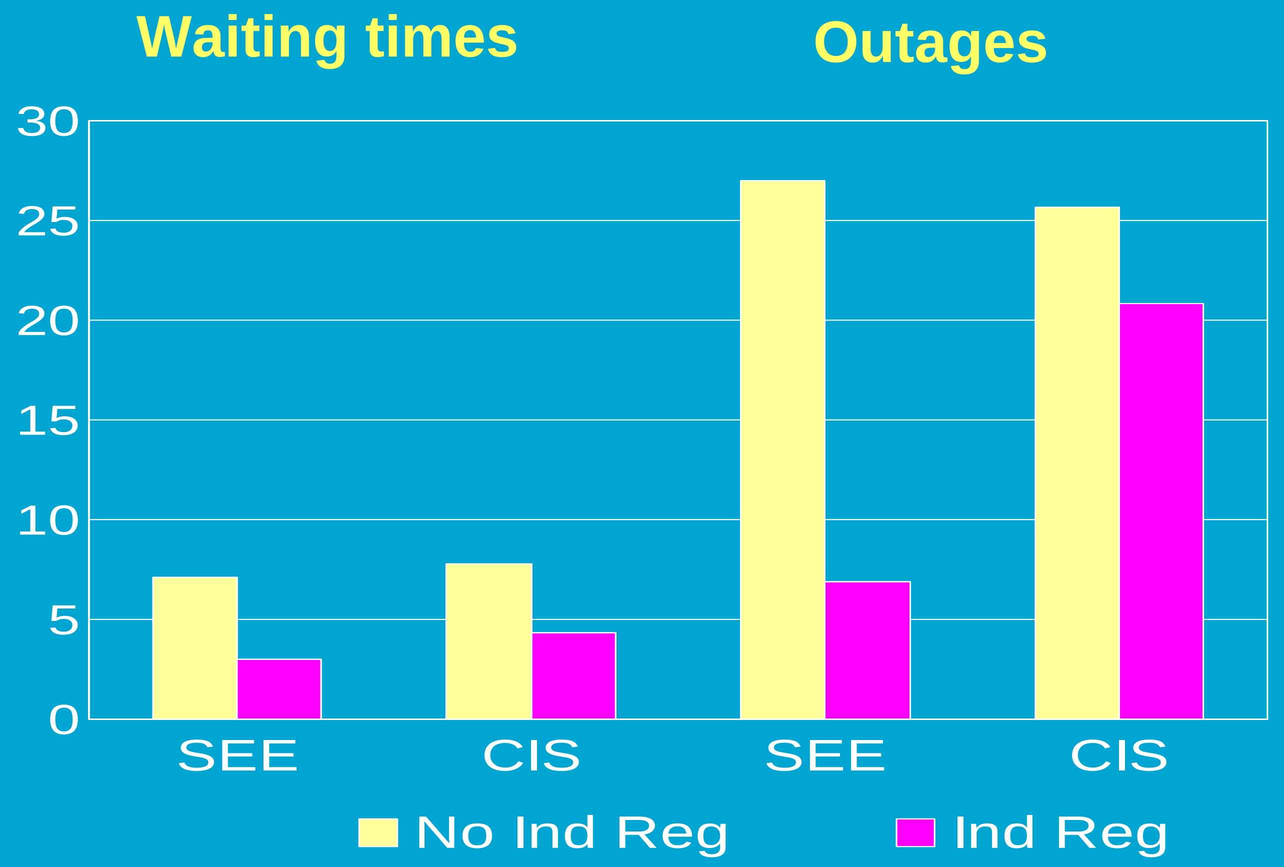
- **<u>Unbundling</u>** of transmission and system balancing
  - Transmission: connecting new generation and building inter-connectors
  - System balancing:
    - Clear rules to protect system integrity
    - Marginal or average pricing (pool vs. NETA)

# Determinants of Effective Regulation

- Predictable and "reasonable" regulation (which in turns requires an extensive consultation process)
- Strong independent regulator
- Transparency of rules and effective enforcement
- Appeal procedures determined

**Effective regulation reduces regulatory risks (cost of capital) and improves incentives to attract new capital**

# … Setting up an independent regulator makes a difference …




Source: BEEPS (2002)

# Additional Issues

- Renewable energy
- Distributed generation
- Security of supply

  - network stability
  - interruptions
  - supply of resources (coal, oil, gas)
  - inter-connectors
  - flexible generation (small gas plants)

# 5. Policy Recommendations

- Sequencing matters:
  - establishing an effective regulatory structure before privatising energy utilities
    - separation between operational and regulatory rules
    - independent settlement of disputes
  - introduce greater competition if possible before privatisation – particularly now
    - A single buyer and seller of wholesale energy may be useful as an interim arrangement until the legal, regulatory and financial systems become sufficiently credible to support competitive trading.

# Contact at the EBRD

**Power and Energy Utilities**
Director: Tony Marsh
Tel: +44 20 7338 7660
Fax: +44 20 7338 7280
Email: marsha@ebrd.com

**Office of the Chief Economist**
Maria Vagliasindi, Senior Economist
Tel: +44 20 7338 7213
Fax: +44 20 7338 6110
Email: vagliasm@ebrd.com

Website: www.ebrd.com