



**Economic Commission for Europe**

**RESTRUCTURING:  
DEVELOPMENTS AND KEY ISSUES**

**Energy Transformations in  
Central and East Europe**

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# CONTENTS

- **Background**
  - Major energy policy drivers
  - State of economic reforms
  - Benefits of post-1990 transition
- **Common issues across sub-regions**
- **Sub-regional differences & peculiarities**
  - Central Europe and Baltics (EU-8)
  - Southeast Europe (Balkan countries)
  - Russian Federation
  - Eastern Europe and Central Asia
- **Concluding remarks**



# **MAJOR DRIVERS** **OF ENERGY POLICY**

- **Economic efficiency**
  - Aim of post-1990 economic transformation
  - Likewise of current EU liberalization
- **Energy security**
  - Strong re-emergence on public/policy agenda
  - Creeping into foreign policy arena
- **Environmental protection**
  - Climate change of most concern



# STATE OF ECONOMIC REFORMS

## Three categories of countries

- **Transition completed or nearly so**
  - Pluralistic democracies
  - Sustained market-based reforms
- **Stuck in partial reform equilibrium**
  - Concentrated/entrenched political and corporate elites
  - Critical reform threshold not reached
- **Nonreformers**
  - Centralized political power
  - State administered economy



# **BENEFITS OF POST-1990 TRANSITION; ENERGY SECTOR**

- **Market oriented & institutional reforms, and decentralization**
- **Introduction of legal and regulatory frameworks**
- **Corporatization of state companies**
  - semi-autonomous legal entities/ joint stock companies
  - some privatisation
- **Partial liberalization of energy prices**
- **Increased openness to foreign investment**



# **COMMON ISSUES** **ACROSS SUB-REGIONS**

- **Better implementation of legal & regulatory framework needed**
- **Monopolistic/ oligopolistic structures**
- **Significant state ownership & influence**
- **High energy intensity/low efficiency**
- **Energy prices & tariff adjustments required**
- **Outdated and aging infrastructure**
- **Insufficient investment/ capital constraints**
- **Better balance between economic and environmental objectives**



# CENTRAL EUROPE & BALTICS

## (EU-8)

- **Most advanced sub region**
- **Impetus for restructuring/reforms**
  - **Post-1990 economic transition**
  - **But also EU market liberalization**
    - **Progress similar to EU-15**
- **EU liberalization unfinished**
  - **Further legal unbundling, open access, etc.**
  - **Limited market competition**
  - **Regulatory process not sufficiently arms-length**
- **Diseconomies of scale for domestic companies**



## CENTRAL EUROPE & BALTICS (2)

- **Aging and polluting infrastructure**
  - E.g., almost all electric power capacity needs to be replaced or rehabilitated
- **Reliance on Russia for hydrocarbons**
  - Historical reasons & geographic proximity
  - Diversification important objective
- **Fuel mix skewed to indigenous coal**
  - Coal industry significantly restructured
  - Energy security vs. environment
- **Gradual convergence to EU-15**
  - E.g., energy intensity, price levels



# SOUTHEAST EUROPE (Balkans)

- **Reforms less advanced than EU-8**
  - Energy prices not at economic levels
  - Energy intensity high
    - Energy intensive industrial structure
  - Poor governance (transparency, accountability, etc.)
  - Institutional capacity weak
- **Significant infrastructure modernization required**
  - E.g., newest thermal power station 35 years of age
  - Greater financial viability needed
  - Better payment discipline needed



## SOUTHEAST EUROPE (2)

- **Moving towards *acquis communautaire***
  - Proximity and pull of EU
- **Energy Community Treaty (Oct 2005)**
  - To implement *acquis communautaire* on energy, environment & competition
  - Regulatory framework in place
  - Most progress on electricity
  - Emerging regional electricity market
- **Plans for regional natural gas market**
  - Western corridor infrastructure development
  - Objective to diversify imports & transit routes a priority (e.g., Central Asia via Turkey)



# RUSSIAN FEDERATION

- **Legal, policy and institutional framework in place (particularly, upstream)**
  - Less developed regarding downstream
  - Application uncertain and not predictable?
- **Some roll-back of post-1990 measures**
  - Partial correction of excesses (privatization)
  - Centralizing tendency
  - Opposite trend to EU on market liberalization
    - Different perception on role of market and state
  - However, some future internal TPA and unbundling possible?



# RUSSIAN FEDERATION (2)

- **Strong state influence**
  - State ownership; particularly gas & export infrastructure
  - Can be subject to vagrancies of political interference
  - Could lead to inefficiencies and under-investment
  - But, state-owned companies are now more commercially minded
- **Constraints on foreign ownership & investment**
  - Ownership of resources & technology may not aligned
  - Lack of foreign scrutiny and management discipline
  - Possible under investment



# RUSSIAN FEDERATION (3)

- **Internal energy market:**
  - Monopolistic/tightly oligopolistic
  - Energy prices significantly below world levels
- **External markets:**
  - Access controlled by state
  - Downstream market integration objective
  - Need for diversification of export/transit routes
  - Eastward diversification planned
    - But not yet competitor for western Europe



# RUSSIAN FEDERATION (4)

- **Economic dominate environmental objectives**
  - Internal push for carbon reduction low
  - Monetarization of carbon credits distant hope
  - Though Gazprom- Dresdner carbon trading venture
  - Post-Kyoto era open question
- **Increased international assertiveness**
  - Energy becoming more politicized
  - Foreign policy tool or distortion of foreign policy



# EASTERN EUROPE<sup>1</sup> & CENTRAL ASIA

- **Wide differences among countries**
  - E.g., restructuring, openness to foreign capital, etc.
  - E.g., Kazakhstan vs. Ukraine & Belarus
- **Incomplete transition**
  - Slow adjustment to international price levels
  - No dramatic shift in composition of economic output
- **Severe capital constraints in energy importing countries**
  - Made worse by pricing policies
- **Infrastructure old and aging**

1. Ukraine, Belarus, Caucasus



# EASTERN EUROPE<sup>1</sup> & CENTRAL ASIA (2)

- **Pricing subsidies**
  - Institutionalized
  - Built into political consensus
  - Social issues
- **CIS prospects poor for quick improvement**
  - Inertia or inability to move forward
- **Fair sharing of export revenues?**
  - Economic development
- **Caspian resources increasingly important**
  - Diversification of export routes

1. Ukraine, Belarus, Caucasus



# CONCLUDING REMARKS

- **State ownership & influence**
  - Strategic and symbolic importance
  - Social considerations
- **Oligopolistic structures**
- **Improvement needed**
  - Transparency
  - Modern management methods
  - Corporate governance
- **Energy intensity high/low energy efficiency**
  - Restructuring of composition of economic output
- **Need for economic energy prices**

