

South-East Europe Regional Energy Market: challenges and opportunities for Romania

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Abstract

The paper takes as its starting point the Athens Memorandum signed by countries of South-East Europe whereby a regional energy market in power and gas will be developed. The aim under the Athens Memorandum is that the South-East Europe Regional Energy Market (SEEREM) will be liberalized in a phased manner from 2005, and—ultimately—that this will form part of the EU's internal energy market. The subject of the paper is the extent to which Romania, one of the biggest countries in South-East Europe and traditionally a net energy exporter to the region, complies with requirements under the Athens Memorandum, and outstanding challenges related to successful SEREM accession.

The paper argues that much progress has been made in energy sector reform in Romania: power prices have increased, payments discipline in the power sector has improved, independent regulators have been established for power and gas sectors, and power and gas utilities have been restructured. Nevertheless, a number of challenges remain if Romania is to fully benefit from participation in the SEEREM. Further power price increases will be required in the medium term, whilst payments discipline remains poor by industry best practice standards. In the gas sector, retail prices do not reflect border prices, and payments discipline remains a problem. The paper argues that gas price reform would likely have adverse affordability impacts, and proposes means to mitigate these through rationalization of existing social safety nets for gas and heat. On investment requirements, the paper notes that these are significant in power generation, and proposes a contract framework that would support mobilization of finance.

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0. Introduction

Under the Athens Memorandum, signed in November 2002, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, Kosovo, Former Yugoslav Republic of Macedonia, Romania, Serbia and Montenegro, and Turkey agreed to develop a regional energy market in power and gas from 2005. Requirements under the Athens Memorandum largely mirror the (revised) European Union energy directives.¹ Indeed, it is envisaged under the Athens Memorandum that the South-East Europe Regional Energy Market (SEEREM) will become part of the EU's wider internal energy market.

Regional energy market development poses three key sets of challenges for Romania: (i) the need to move to energy industry economic and financial viability without Government support; (ii) the need for institutional reform through industry commercialization/restructuring and regulatory development (iii) the need to mobilize finance for investments.

Whilst reforms towards fulfillment of these challenges (and meeting of Athens Memorandum requirements) do not diverge from what would be appropriate absent regional market development (e.g. price reform, industry commercialization, etc.), certain measures become more prescient in the regional market context (e.g. reform of gas pricing), and there is a need to ensure consistency of national level reforms with wider regional initiatives (e.g. as regards market design and transmission pricing).

Irrespective of any difference between appropriate measures in a national/regional context, the Athens

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¹ Directive 2003/54/EC (power) and Directive 2003/55/EC (gas).

Memorandum provides a benchmark for the energy sector reform process in Romania. This benchmark is highly relevant in the Romanian context given the country's aspirations towards EU accession and to become a major player in the SEEREM. The need for Romania's compliance with the Athens Memorandum thus provides one motivation for this paper.

Another motivation for the paper is to illustrate country level reforms required to support regional energy market development. For example, establishment of a regional power market in a transition economy/emerging market context is unlikely to succeed without country level tariff reform, regulatory reform, etc. The intention in the paper is to illustrate to other countries in South-East Europe (SEE) Romania's response to challenges posed by regional market development. It is hoped that analysis of the Romanian experience would also be valuable in the context of other current regional energy market initiatives, for example, in South Africa, Indochina, Central America, and South America.

The paper assesses Romanian power, gas and heat reform in the context of regional energy market development. The paper discusses the current extent of compliance with requirements under the Athens Memorandum, and outlines outstanding challenges if Romania is to be a successful player in the regional market, maintaining and increasing (economic) net exports to neighboring countries.

The main messages in the paper are that effective tariffs—reflecting tariffs and payments discipline—are still below cost recovery levels in the Romanian energy sector. In the power sector, power tariffs will have to increase over time to support finance of investments. Collections remains a problem in the power sector, with failure to pay by large state owned enterprises, and a high degree of non-cash settlement. In the gas sector, the main challenge is to increase tariffs to reflect border prices. Though some progress has been made here, further increases are necessary.

On the institutional reform side, Romania has made good progress. Outstanding challenges are to further commercialize both the gas and power sectors, through private sector participation where this is feasible.

Regarding investments, major rehabilitation of power generation assets is required in the medium term. Failure to secure investments could see Romania go from its current status as a net exporter of power to SEE, to a country dependent on imports/suffering from insecurity of supply.

The paper starts with an overview of the Athens Memorandum establishing the SEEREM. Next energy industry financial viability is considered. In addition to looking at power and gas sector effective tariffs, the impact of gas price increases on heat sector affordability is assessed. The paper then covers progress in institu-

tional reform as required under the Athens Memorandum, and outlines remaining challenges. The paper finishes with a discussion of investments needed in the power sector, together with the contract framework for securing investment finance.

1. The Athens Memorandum²

In recognition of potential gains from increased trade, and as part of a wider movement to deeper regional integration, the governments of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Greece, Kosovo, Romania, Turkey, and Serbia and Montenegro signed the “Athens Memorandum—2002” whereby they have agreed to develop a SEEREM.

Under the Athens Memorandum, participating countries have committed to undertake the following steps:

Policy

- Energy strategy to be adopted.
- *Effective tariffs and affordability*
- Power tariffs and payments discipline to be such that effective tariffs cover costs.
- Social safety net for the power sector to be in place.

Regulation

- Independent regulator to be set up.
- Grid codes to be adopted and implemented.
- Transmission tariff methodologies to be adopted.

Industry commercialization and restructuring

- Increased utility transparency to be achieved through application of International Accounting Standards (IAS) and best practice on corruption abatement as advised by a reputable international body to be adopted.
- Transmission system operator to be set up. This entity should be independent at least in terms of its legal form, organization and decision making from other activities not relating to transmission.
- Distribution system operator(s) to be set up. This entity should be independent at least in terms of its legal form, organization and decision making from other activities not relating to distribution.

Market development

- Information exchange between national dispatch centers to commence, moving to tele-information exchange amongst dispatch centers.
- Commercial codes to be developed.
- Open network access and liberalization of the market for non-household consumers to take place in a phased manner from 2005.

²See Kennedy and Besant-Jones (2004) for a detailed discussion of the Athens Memorandum and SEEREM development.

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