

United Nations Conference on Trade and Development
Ad Hoc Expert Meeting on Energy Services
Geneva, 6 June 2003

ANNOTATIONS TO THE PROGRAMME OF WORK

Note by the UNCTAD secretariat

1. Discussion during the meeting will be organized around three themes.

First theme. *Structural reform of the energy sector; specific features of energy markets; examples of energy market liberalization.*

2. While, until quite recently, Governments worldwide have considered the energy sector too crucial to be left to market forces, at present countries in all regions are reforming it. Structural reform is meant to cut costs and improve the economic performance and efficiency of the energy sector by imposing free-market disciplines and commercial criteria. It can refer to a range of policy measures and take several different forms, including privatization, increasing competition, de-monopolization and deregulation. Regulatory reform is itself part of a wider phenomenon whereby Governments are drawing back from direct intervention in markets. Even in the context of liberalization and internationalization of energy systems, some responsibilities remain with individual national governments. For example, governments grant or refuse planning permission for installations; they decide on the suitability of starting oil/gas extraction operations in specific geographical areas; they create and oversee standards for health and safety and for environmental protection; they impose and collect taxes on energy activities; and they are responsible for negotiating and implementing bilateral, regional or multilateral agreements, including those on trade and investment, affecting energy systems.

3. The energy sector is capital-intensive and requires significant investments in the infrastructure system. Private investments are particularly needed by developing countries to catch up with their fast-growing demand for energy. World energy demand is projected to grow by between 60 and 65 per cent by 2020, with two-thirds of this increase deriving from China and other developing countries.

4. The energy sector has certain peculiarities that make competition-related issues particularly relevant and call for a careful scrutiny of anti-competitive practices and the development of appropriate competition rules. In the gas and electricity sectors, the core of competition rules would deal with the right of access to infrastructures; unbundling industry segments through vertical separation of production, transmission and distribution and/or horizontal detachment; and consumer choice, by establishing eligibility thresholds for choice of suppliers among the different classes of customers. These structural remedies are designed

to reduce excessive market power in the non-competitive segments of the gas and electricity industry by curbing the incentives for self-dealing among incumbent operators controlling transmission and distribution networks. Other key structural elements of competitive gas and electricity markets pertain to the ability of market operators to enter and build new infrastructure in a reasonable timeframe; the development of reasonable technical standards; and the establishment of an independent regulatory authority to guarantee fair and non-discriminatory competition and dispute resolution among competing actors in the market. There are two additional areas in which competition policy is necessary if competitive energy markets are going to be established: merger policy and subsidies. Merger and acquisition activity may aim at reaggregating functions, such as generation and distribution, which may have been disaggregated to create competition. Subsidies have been commonly used in the energy sector and may increasingly affect cross-border trade of energy goods and services.

5. Lack of regulatory transparency may hinder the development of non-discriminatory energy markets. Opaque, discriminatory and arbitrary technical regulations and other regulatory requirements may hinder effective market access. Given the importance of licensing and procurement in the energy industry, the same holds true for rules on authorization and tendering procedures for the construction and the operation of new extraction, generation and transport capacity. In addition to regulatory transparency, there is a need for market transparency. In a competitive context, especially in the gas and electricity segments of the industry, all market participants need access to timely information on prices, transmission capacity, congestion, scheduled volumes, and other data relevant to efficient and fair business transactions. Obstructions in the flow of market information can distort competition as effectively as physical constraints. Enhanced transparency will improve market efficiency by reducing transaction costs and market distortions. It also has the potential to reduce the incentives for corruption. Finally, it can generate positive spillovers in terms of good governance in other areas of domestic regulatory conduct. On the other hand, creating official and transparent channels for providing information to market actors can be extremely complex. In particular, developing countries must overcome what for many of them are acute informational deficits regarding the nature and importance of domestic regulatory impediments.

Second theme. *The ongoing "request-offer" process within the GATS negotiations.*

6. Negotiating proposals relating to the energy services sector have been submitted during the first phase of the GATS negotiations by Canada, Chile, Cuba, the European Union, Japan, Norway, the United States, and Venezuela. Energy services have been included in the requests and offers of several countries (mainly developed countries). Four main points seem to emerge from an analysis of the requests on energy services. First of all, they call for a broad liberalization of the sector under Modes 1,2 and 3. Secondly, in certain cases they seem to "expand" the scope of the GATS, by including concepts such as "technological neutrality". This notion is not developed in the GATS, but was introduced in the negotiations on basic telecommunications in order to expand the existing coverage of commitments. Considering that renewable energy sources are becoming increasingly attractive from an environmental point of view and increasingly competitive from a cost point of view as compared to non-renewable energy sources, the concept of "technological neutrality" and its inclusion in the liberalization commitments may have crucial business repercussions in the future. Thirdly, some requests refer to the need for additional commitments in the energy sector, such as the setting up of an independent regulatory system separate from, and not accountable to, any supplier of energy services and/or other government agency with energy interests; or the

establishment of non-discriminatory, objective and timely regulatory procedures governing transportation and transmission of energy. These elements of the requests impinge upon domestic regulations. Fourthly, by calling for a broad liberalization of the energy sector, the requests go beyond the three energy-related entries included in the W/120 list and address directly classification-related issues.

Third theme. *Possible implications of the negotiations on energy services for developing countries.*

7. There are very close links between the energy sector, economic growth, poverty alleviation and sustainable development. Energy is one of the dimensions of poverty and development. It supports the provision of basic needs such as cooked food, a comfortable living temperature, lighting, the use of appliances, communication and transport. Energy also fuels productive activities, including agriculture, manufacture, mining and trade. Energy poverty may be defined as the absence of sufficient choice in accessing adequate, affordable, reliable, high-quality, safe and environmentally benign energy services to support economic and human development.¹

8. A series of specific questions seem to confront developing countries in the ongoing multilateral negotiations on energy services. On the one hand they aim at achieving more reliable and efficient access to energy and energy security, and on the other at obtaining a greater share of the energy “business”. On the first aspect, for most developing countries improved access to energy means expanding supply in line with their economic growth. This implies an increasing need for foreign investment and the establishment of more competitive and liberalized energy markets. Developed country experience, however, is that competition and liberalization have tended to reduce costs but also increased the risks of local shortages to consumers, mainly because of under-investment. Private profitability, market efficiency and cost reduction on one hand, and security of supply, public service obligations and development goals on the other, have to be reconciled, otherwise, the liberalization of energy markets may magnify the existing problems of access to energy, increase equity imbalances and jeopardize sustainable development prospects.

9. On the second aspect – namely obtaining greater participation in the energy business – energy-exporting developing countries should combine exports of energy sources with enhancing professional capacities, human resources training and technological improvements in the services segment of the energy industry. Those developments would be instrumental in creating export opportunities for local firms in the energy services sector and related sectors, and in promoting overall economic growth and diversification.

10. Liberalized energy markets alone cannot be expected to meet the needs of the most vulnerable groups of the population or to protect the environment. Private companies, if free to choose, would most likely invest in utilities serving cities and large urban areas and would “cherry pick” profitable networks. Targeted government policies are therefore needed to harness market efficiency for the protection of public goals. Many Governments consider electricity a public service. In the previous monopoly system, governments would mandate provision of electricity to the poor and to rural areas where users were dispersed and network connections therefore more costly. Tariffs might have a structure in which all users in a given category, such as households, paid the same price per unit of electricity, no matter how much

¹ UNDP, UNDESA, World Energy Council, *World Energy Assessment – Energy and the challenge of sustainability*, 2000, page 44.

it cost to supply them. A monopoly operator would be subject to the obligation to supply and connect. Liberalization, and in particular the introduction of competition, may jeopardize such arrangements. Unless forced to do so, private companies, which compete for business, are not particularly willing to deliver services that are a burden for their balance. Several countries that have opened their electricity markets to competition have included specific provisions related to consumer protection in their legislation.² Considering that one of the main problems that developing countries wish to tackle by liberalizing their power market is the inadequacy of electrical supply, they may consider addressing this issue, possibly in the form of qualifications to market access commitments. However, if developing countries compete among themselves to attract private investment in the power sector, companies may be reluctant to accept public service obligations. The inclusion of public service obligations in a multilaterally negotiated instrument may be an option to avoid developing countries having to lower their expectations in relation to private operators.

² For example, Article 3.2 of the EC Electricity Directive (Directive 96/92/EC) states that: “Member States may impose on undertakings operating in the electricity sector, in the general economic interest, public service obligations which may relate to security, including security of supply, regularity, quality and price of supplies and to environmental protection”.