

DRAFT GUIDELINES ON REFORMING ENERGY PRICING AND SUBSIDIES¹

I. Summary of Recommendations on Reforming Energy Pricing in Countries in Transition

The primary goal of energy pricing reform is to create a well-functioning competitive market, aimed at increasing economic efficiency, improving quality of energy services and integrating the environmental and social concerns, in order to promote sustainable production, transmission and use of energy.

UNECE Governments in countries in transition are encouraged to:

1. Reform the energy sector within a broader framework of macroeconomic restructuring by using measures such as:
 - (a) Commercializing energy commodities and services;
 - (b) Unbundling vertically integrated monopolies;
 - (c) Liberalizing the energy sector through introducing wholesale and retail competition;
 - (d) Promoting the best practices of public/private management of energy companies;
 - (e) Improving environmental performance of the energy sector and gradually proceed with the internalization of external costs.
2. Communicate to the general public, the benefits of energy-sector reform, including market-based pricing reform, emphasizing the resulting gains in economic efficiency and GDP, more efficient use of energy consumption, lower CO₂ and other emissions.
3. Ensure that the energy sector becomes profitable and can attract domestic and foreign investment.
4. Reform tariff regulation to ensure that:
 - (a) Customers receive improved service at justifiable rates;
 - (b) Utilities are given the opportunity to recover all reasonably incurred costs, including a fair return on investment, by adjusting prices, at least to domestically viable economic levels;
 - (c) Make the pricing mechanism transparent;
 - (d) Make it clear that the process to reform tariffs and the tariff-setting mechanisms is ever continuing so that consumers can plan, on the basis of expectations, that liberalization of energy markets will bring, eventually, prices to market level.
5. When adjusting energy prices and tariffs to economic levels, aim to eliminate environmentally harmful subsidies taking into account, in particular, that:
 - (a) Subsidies should be eliminated gradually and with great care. Their removal should be accompanied, when necessary, by compensating social-support measures, in order to mitigate any disproportional negative impacts on the poor;
 - (b) Certain subsidies, such as those to renewables, may be retained for a longer period, where they support sustainable development, but sunset clauses should nonetheless be included and transparency ensured.

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6. Ensure that energy prices provide market signals that motivate consumers to conserve energy and that promote energy efficiency and the use of renewables.
7. Develop income-support mechanisms taking into account local characteristics, household income levels and other relevant factors. The group of consumers eligible for support could be determined based on earlier applications for aid, income level, social vulnerability and voluntary application.
8. Establish a regulatory authority to be responsible for price setting, licensing and regulating energy generation, transmission and distribution. The authority should be independent of day-to-day political interference and must ensure equal conditions and non-discrimination of all sector participants.
9. Ensure transparency in justifying cost items and provide access of public to information on the price structure and price changes.

II. Summary of Recommendations on Reforming Energy Subsidies

Recalling the recommendation of WSSD Plan of Implementation, to take action to phase out energy subsidies that inhibit sustainable development; as well as the energy-related decisions of the Aarhus Ministerial Conference “Environment for Europe”(1998),

UNECE Governments are encouraged to:

1. Reform energy subsidies as part of a broader process of economic and institutional reform aimed at placing more emphasis on the market, removing trade barriers, improving governance of the energy sector and promoting sustainable development.
2. Ensure that price signals reflect to the maximum possible extent the full costs and benefits, including externalities, of supplying and consuming different forms of energy.
3. Remove any subsidies that fail to achieve demonstrable net environmental or social benefits.
4. Favour regional development, education and training, health and social welfare policies over energy subsidies in addressing social issues.
5. Target subsidies, where they are justified, at clearly defined groups and technologies, and devise mechanisms that ensure that the benefits of those subsidies go only to those targeted categories.
6. Carry out a thorough and coherent analysis of all the economic, social and environmental costs and benefits associated with existing or planned subsidy schemes to ensure that the case for them is valid. Where it is not possible to assess properly the full implications of a given subsidy, seek to remove it.
7. Where a subsidy scheme is justified, design it so that it does not undermine incentives for producers and suppliers to provide a service efficiently or for consumers to use energy efficiently, and does not harm the financial health of energy-service providers.
8. Prevent the cost of energy-subsidy schemes from becoming a serious burden on the national finances, and abandon any schemes that involve excessive administration costs.
9. Ensure that the financial costs and the channels through which financial transfers, within subsidy programmes, are made are fully transparent, and communicate that information to the public.
10. Ensure limited duration and regular review of energy-subsidy programmes.

11. Implement reforms in a phased manner, where the economic and social consequences are profound, to soften the financial pain of those who stand to lose out and give them time to adapt.
12. Consider introducing compensating measures that support the incomes of poor households in more direct and effective ways than through energy subsidies.
13. Communicate clearly to the general public the overall benefits of subsidy reform to the economy and to society as a whole.
14. Apply all means for amicable settlement of accounts by non-paying customers including financial charges and fines. Cutting of supplies by energy service providers to non-paying poor households should be applied with care, and under exceptional circumstances.