

During the last course of years the energy sector in Europe has been characterised by the processes of reorganisation. This correlates to the processes of functional, accounting and controlling unbundling of vertical, monopolistic companies according to different activities such as production, transmission, distribution and supply. It also correlates to the process of electricity market liberalisation. When observing current various experiences of Western European countries, in general, we can say that the overall process has started with restructuring of companies which was followed by the liberalisation of the electricity market and privatisation. All the countries have followed this procedure obeying the laws proscribed by the common European legislation. However, countries outside the EU, have mostly kept their vertically-monopolistic organisation of the energy sector. With the accession to the EU, new Member States needed to swiftly fulfil the requirements set by the EU legislation. A well-functioning energy market should encourage efficient investment decisions in the regional power market.

In the case of SEE, through its own and recently founded institutions, the EU is trying to encourage the countries of the region to be more determined in taking action towards creating coordinated conditions for organising a common energy market. SEE countries have been going through extensive economic, political and institutional changes already since the nineties. Changes in the infrastructure sector represent an important segment of their transition reforms. The SEE region possesses the potential to constitute an important electricity reform experiment for the whole world. This is because these countries have been given a clear reform model to follow, have been given access to substantial amounts of technical assistance and because reform is happening in the context of associated reforms in other sectors and the government. These are the main reasons why SEE could prove to be a test of both the transferability of the EU reform model within the EU, but also its transferability to a set of developing countries in general. World Bank, the European Bank for Reconstruction and Development (EBRD) and the EU are carefully monitoring this experiment.

During the past two decades the SEE electricity sector has gone through extensive reforms raising the importance of regulation. In view of the electricity sector, the reforms were primarily aimed at changing the centralized organization of monopolistic utilities and introducing market-oriented structures and public regulation. There is a perception that privately owned generating companies are able to move faster toward the efficiency frontier's competition and a stronger desire for higher

profits are expected to drive changes resulting in a more efficient system. The EU initiative to establish

the regional electricity market compatible with the internal electricity market of the EU facilitated these changes. Diversifying energy sources and developing alternative supply routes are some of the advantages that trading on the electricity market should enable. One of the main driving factors in the process of adoption of the EU *acquis communautaire* is mostly related to both the aspirations to a membership in the EU and to a realization that without major investments in generation and transmission capacities, consumers might suffer from future supply shortages. This would suggest that successful liberalization of economic activities also requires a certain amount of political acceptability. Considering the current business climate, investments needed for revitalisation, development and modernisation of the electricity sector are mostly to be achieved by project financing arrangements.

Financial institutions funding such projects require the presence of a regulatory framework that is capable of ensuring certainty and transparency over the long run in order to reduce investment risks. Therefore, a stable legal framework is necessary to attract investment. In theory, reform is to raise efficiency and lower costs and prices providing for a competitive and integrated energy market. Best practice in regulatory reform involves three of the main aspects: form, progress, and outcome of regulation. A well-constructed, stable regulatory framework is one of the prerequisites for achieving a transparent, competitive electricity market that is efficient, cost-reflective and able to attract foreign investment necessary for providing its development. In addition, achieving a stable regulatory framework country by country would be a significant step forward towards the creation of a common energy market that would help the region to realize its potential. All countries of the region inclined to the EU are required to implement the EU Energy Policy and pursue its three fundamental objectives: competitiveness, security of supply and sustainability. Having relatively small systems integrate into a larger one is beneficial to power trade and market competitiveness especially when resource endowments differ across countries. The existence of a wholesale market is statistically significantly positive for prices. A big step towards the goal of the common market

was the signing of the Energy Community Treaty. Driven by the main goal of creating a stable regulatory and market framework capable of attracting investment in the energy sector, The Energy Community Treaty is the main legislative framework that operates in regard to establishment and development of the Energy Community in SEE.

The question remains whether national energy policies of the countries in the region will be

able to achieve a coherent regional energy policy. A key factor in the success of reform will be the institutional and administrative capacity of the established national energy and regulatory authorities. However, looking at the quality of governance across the region, it can be noticed that it substantially varies and in most cases falls behind that of other members of the EU. Considering past experiences, reforms have encountered difficulties in a number of countries having a far more complex path than anticipated. One of the reasons for this occurrence is the need for real time balancing of supply and demand which requires better design and regulation than most other deregulated sectors. Another difficulty arises from rebalancing tariffs to cost-recovering levels as it is an important precondition to an effective market. This raises the issues

of political sensitivity through social aspect of reform as reform which raises tariffs will have significant effects and may cause political difficulty in a region where incomes are generally low and have a wide dispersion. Low-income households spend a significant share of income on utility services and the potential difficulties that these socially vulnerable consumers would have in affording further tariff increases is often used as an argument against tariff reform.

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