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(Item 7 of the joint provisional agenda)

COMMITTEE ON SUSTAINABLE ENERGY

REFORMING ENERGY PRICING AND SUBSIDIES

Introduction

1. At their annual sessions in 2001, the UNECE Committees on Sustainable Energy and on Environmental Policy established a Task Force on Environment and Energy for the period 2002-2005 with a mandate to develop non-legally binding guidelines for decision-makers on reforming energy prices to support sustainable energy development. The guidelines should help, inter alia, in preventing and reducing energy-related environmental impact and waste of energy.

2. Energy and environmental experts were designated by a number of UNECE Governments to participate in the Task Force. As a first step, the joint Task Force, with the assistance of the secretariat and its consultants, prepared parts I and II of the guidelines, namely, on (a) reforming energy pricing in countries in transition, and (b) reforming energy subsidies throughout the UNECE region. The Committee on Sustainable Energy, at its twelfth session, held on 20-21 November 2002 in Geneva, discussed the results of the Task Force activities and made a number of amendments to the Summary of Recommendations of the guidelines. The revised Summary of Recommendations as annexed to the present document was checked and approved by the Committee Bureau, thereafter.

3. The Committee on Sustainable Energy agreed that, once the Committee on Environmental Policy has approved the guidelines, these could be transmitted, thereafter, through the Working Group of Senior Officials, to the Ministerial Conference "Environment for Europe" in Kiev, for endorsement.
4. For technical reasons, the descriptive parts of the guidelines are issued as addendums 1 and 2 to the present document.
5. The Task Force will continue the preparation of the remaining part of the guidelines, on the internalization of external costs from energy production and use, up to the year 2005. The Czech Republic has agreed to be coordinator on this subject and it has developed, in cooperation with the secretariat, a work plan and time schedule. These were adopted by the Task Force and agreed by the Committee on Sustainable Energy.

Annex

SUMMARY OF RECOMMENDATIONS ON REFORMING ENERGY PRICING IN COUNTRIES IN TRANSITION

The primary goal of energy pricing reform should be to create a well-functioning competitive market, aimed at increasing economic efficiency and improving quality of energy services. It should fully take into account the economic, environmental and social concerns of governments and society, in promoting the 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 aimed at:
 - (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 environmental 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 higher-quality service at justifiable and cost-saving 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) The pricing mechanism is made transparent.
5. **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 liberalisation of energy markets would bring, eventually, prices to market level.
6. 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 by compensating social-support measures, in order to mitigate any 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.

7. **Ensure** that energy prices provide market signals that motivate consumers to conserve energy and that promote energy efficiency and use of renewables.

8. **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.

9. **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.

10. **Ensure** transparency in justifying cost items and provide access of public to information on the price structure and price changes.

SUMMARY OF RECOMMENDATIONS ON REFORMING ENERGY SUBSIDIES

Recalling the recommendation of the Plan of Implementation of the World Summit on Sustainable Development (WSSD), 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.