CUTS International

Background Note

Competition Policy and Domestic Regulatory Framework in the Energy Sector in Kenya: Experience and Lessons Learnt.

Introduction

Over the last few decades, many countries have been radically reforming their economies under the broad framework involving privatization and liberalization. The rationale has been that public utilities are highly inefficient and cause a huge drain on government resources (Amol, 2006). It is also based on the premise that regulated private or public monopolies will introduce competition which will improve efficiency and lower prices for consumers. However; experience shows that a fair amount of government intervention is desirable particularly in instances where an economy may remain susceptible to market failures. Thus, competition laws and sector regulations share common goals and play complementary roles in fostering success in competitive markets and safeguarding consumer welfare.

In Kenya, economic reforms in many sectors began in the 1980's through the Structural Adjustment Programmes. Competition laws were enacted under the Restrictive Trade Practices, Monopolies and Price Control Act of 1989. The intentions of the law are to allow government to encourage competition in production of goods and services and reduce direct control of prices in the entire economy.However, the operational distinctions between economic and technical regulations and competition regulation can be blurred.

For instance, although competition laws are aimed at curtailing opportunities for abuses, favouritism and exploitation that may arise following deregulation and privatization, sector regulators have equally been given responsibilities for competition issues in their respective sectors in Kenya. But more importantly, the Competition Authority has neither jurisdiction over regulated sectors nor advocacy powers. In the meantime, commercial energy, dominated by petroleum and electricity, are perceived to be (or remain) highly uncompetitive despite the existence of these laws and regulations.

Research Problem

Several concerns have been raised about the state and performance of energy sector in Kenya. The concerns touch on a range of issues including among others, escalating consumer prices, unreliability of energy supplies, entry barriers for provision of services, collusions and environment concerns. These complaints come at a time when the sector has witnessed the disintegration and consolidation of a number of operations and segments in the sector. In the power sector, consumer tariffs are relatively high and out of reach for the low-income group majority of who live in the rural areas. Kenya's electricity tariffs do not compare well with major trade competitors. For instance, while it costs US$ 6.8 per kWh in

Kenya, the same goes for US$2.4/kWh in South Africa, US$1.5/kWh in Egypt and US$5.5/kWh in Mauritius (Mwangi et-al, 2003). The relatively high tariffs lead to increased cost of production in the manufacturing sector thereby reducing the competitiveness of Kenyan products in external markets. In the 1990's, especially during drought periods, an average of 20,000 jobs were being lost every year following closure or relocation of industries to other countries due to costly and unreliable energy.

The petroleum industry does not fair any better. Today, the petroleum industry is constrained by limited supply of fuels including LPG, domestic production of motor fuels which do not meet internationally quality standards, inadequate distribution infrastructure in remote areas, price leadership which inhibits competition and insufficient legal and regulatory framework to guide the sub-sector operations in consonance with international best practice. In addition, the liberalisation of the petroleum industry in 1994 has resulted in the entry of new players some of who not only compromise safety, health and environmental standards but also deny government fiscal revenue through dumping of export fuels and adulteration of motor vehicle fuels with lowly taxed kerosene. Besides, the impact of oil prices and the increased affinity for oil use implies enlarged import bills and balance of payment problems. At the micro level, increased oil prices reduce household disposable incomes (available for other needs) and raises production costs in most sectors, including both industry and agriculture, hence damaging competitiveness (UNCTAD, 2006).

Apparently, privatization of the energy sector has partially facilitated the movement from government-owned enterprises with monopolies and restricted entry to private ones operating under market conditions i.e. the entry of Independent Power Producers. However, the structural changes have not done enough to improve competitive conditions in the sector and enhance consumer welfare despite the existence of competition laws and sector regulations. For instance, some of the pertinent issues specific to competition laws and energy sector regulations are as follows:-

- Regarding the prevailing escalation of prices for petroleum products, Part IV of the Restrictive Trade Practices, Monopolies and Price Control Act 504 of 1989 relating to the control and display of prices hasn't been used since 1994 when petroleum products were removed from price control regimes. On the other hand, although one of the objectives of the ERC under section 5(b) of the Energy Act 2006 is to protect the interest of consumers, investor and other stakeholder interests, it can only make proposals to the Minister for Energy as to the appropriate regulations as far as energy sector regulations are concerned.

- The Monopolies and Price Control Act does not explicitly provide for the control of dominance behavior. However, the energy sector is largely characterized by dominant firms. The electricity sector is dominated by the Kenya Electricity Generating Company (KenGen) which generates over 70% of the country's total electricity supply and the Kenya Power and Lighting Company (KPLC) which is the sole transmitter and distributor of electricity. KenGen suppliers power to KPLC through a Power Purchase Agreement (PPA). On the other hand, the petroleum market exhibits oligopolistic tendencies and is controlled by five major firms (KIPPRA 2008).

- There are several exemptions to the restrictive trade practices. These exemptions have the effect of removing the public sector from the scope of the Act. The utilities sectors, including the energy sector lie within these exemptions and are therefore not subject to the general competition law.

- The decisions of the competition authority are not binding but rather recommendations subject to the approval of the Minister. This reduces the autonomy of the competition authority.

- There are no clear relationships between the competition authority and the energy regulatory commission, the latter of which has the power to set reviews and adjust electric power tariffs and tariff structures and investigate tariff charges.

The above issues have led to questions about the management of competition and regulations that economic reforms and liberalization processes have set in motion. For instance, what kind of competition policy and regulatory framework is required to address the specific concerns within the energy sector? Is there coordination between competition commission and the energy sector regulators? The project seeks to find answers for these complex set of questions.

It is in this regard that CUTS International, Centre for International Trade, Economics and Environment, Nairobi has commissioned a study entitled '**Competition Policy and Domestic Regulatory Framework in the Energy Sector in Kenya: Experience and Lessons Learnt'. This Study is envisaged to:**

- assess the institutional framework of the national competition policy and the regulatory structures;
- review and evaluate the competition policy and regulatory framework of the energy sector in light of energy sector reforms;
- undertake a comparative analysis of competition and regulatory framework in energy sector in other countries;

It is against this background that this scoping Workshop has been organised to seek views and recommendations from various stakeholders in the context of the subject related area. It is expected that the stakeholders will be able to make valued contributions and recommendations in line with the proposed objectives to help fine tune and enrich the scope of the envisaged study for the benefit of the Consumers and producers in Kenya.