

Public hearing on
"Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy"
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Jorge Vasconcelos

First of all, I would like to thank the Committee on Industry, Research and Energy of the European Parliament for the kind invitation to attend this public hearing on energy policy and in particular on the European Commission "Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy"¹.

All my professional life has been dedicated to energy, in different areas (research, development, electricity utilities and regulation) and in different European countries. Since 1989 I have been closely involved in the construction of the internal energy market. Over the last years, I had the privilege to set up and to chair the Portuguese Energy Regulatory Authority and the Council of European Energy Regulators (CEER). The personal views I would like to express today inevitably reflect my professional experience and my current regulatory responsibilities but they do not commit any institution. In particular, I would like to point out that the official CEER "Response to the Energy Green Paper" was published in July 2006 and can be downloaded from the CEER website².

My short presentation is divided into three parts:

- first, I will emphasize the global nature of our energy problems;
- second, I will briefly describe the current European energy situation;
- finally, I will assess the proposed EU strategy and I will suggest some implementation priorities for a sustainable, competitive and secure energy future.

1. Europe in the global energy context

The three major energy related concerns we face today in Europe are common to the world community. These concerns are: a) scarcity of fossil fuels - i.e., security of energy supply; b) impact of energy production and consumption on the environment - i.e., sustainability of the current system; c) prices - i.e., competitiveness of the economy.

Improving the competitiveness of the EU economy through better energy prices and services implies a high degree of competition, both internally, i.e., competition among EU energy undertakings within an efficient internal energy market, and externally, i.e., competition between EU and non-EU energy undertakings in terms of economic and technical efficiency. Only fierce, effective competition among undertakings involved in the production and supply of energy, as well as yardstick competition (and regulation) among utilities responsible for energy transmission and distribution can deliver to European energy consumers the best results, both in absolute and in relative terms, hence improving EU competitiveness.

Energy prices for final users also depend on primary energy prices and these are established in international markets. However, we know that especially oil and natural gas markets are very sensitive, not only to the balance between supply and demand, but also to political factors. Therefore, the EU must cooperate with other energy producer and consumer countries in order to provide these international markets with the necessary degree of transparency and stability. Otherwise, competition for scarce fuels can be distorted and EU consumers may suffer in terms of both price and security of supply. The "St. Petersburg Plan of Action Global Energy Security" adopted at the G8 Summit in July 2006³ provides a comprehensive list of initiatives for a "strengthened partnership between all stakeholders to

¹ http://europa.eu.int/comm/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf

² http://www.ceer-eu.org/portal/page/portal/CEER_HOME/CEER_PUBLICATIONS/CEER_DOCUMENTS/CEER-Response_ToGP_2006-07-11.pdf

³ <http://en.g8russia.ru/docs/11-print.html>

enhance global energy security". It remains to be seen whether this Action Plan will be properly and quickly implemented.

Cooperation is also inevitable while addressing the sustainability concern. Many environmental problems and climate change in particular are global - they cannot be solved individually by the EU or by any single country.

In 2003 the EU represented 16% of total world energy final consumption, second to the United States (22%) and ahead of China (14%), Russia (6%), India and Japan (5% each). The EU average degree of energy import dependency is 50% (77% for oil, 53% for gas and 35% for solid fuels). Although not a major producer of primary energy, the EU is a major supplier of innovative energy technologies. Therefore, the EU is a major player in the world energy scene. Indeed, the EU is the largest economy in the world (GDP 10,380 billion € in 2004) and it is also the largest exporting economy (1,025 billion € in 2004) ⁴.

In summary: strong competition among EU energy undertakings and strong multilateral cooperation with other countries and organizations are essential for achieving EU strategic energy policy goals.

2. The EU internal energy situation: consumers, suppliers, markets and policies

From 1990 to 2003, final energy consumption in the EU increased by 12%. The largest increases happened in transportation (+26%) and in households (+16%), while industry consumption decreased by 4%.

EU final energy consumption is mainly related to transport (30%), industry (28%) and households (27%). It is mainly covered by oil (42%), natural gas (24%) and electricity (20%).

In 2003, fossil fuels accounted for 55% of total electricity generation. The major contributors were coal (31% of total) and natural gas (19% of total); oil accounted for just 5% of total electricity generation. Nuclear and renewables accounted for, respectively, 31% and 13% of total electricity generation ⁵.

These figures clearly show that if the EU wishes to change its pattern of energy consumption, reducing both demand and oil imports, it must address the transport sector in first place. This was recently recognized in the *Mid-term review of the European Commission's 2001 Transport White Paper* ⁶.

Improved energy efficiency, both in generation, transmission/distribution and use is of utmost importance for Europe. End-use efficiency concerns not only transportation, but also households, services and industry.

In the 1990s, the EU launched the most ambitious energy restructuring programme in the world. According to the EU objective, national energy markets (electricity and natural gas) should be fully liberalized and simultaneously integrated into one single European market.

⁴ European Commission, *Energy and Transports in Figures 2005*, March 2006,

http://europa.eu.int/comm/dgs/energy_transport/figures/pocketbook/doc/2005/etif_2005_general_en.pdf

⁵ Ibidem

⁶ http://ec.europa.eu/transport/transport_policy_review/doc/com_2006_0314_transport_policy_review_en.pdf :

"Transport policy is closely intertwined with energy policy, on the basis of common objectives: lowering CO2 emissions and reducing EU import dependency on fossil fuels.

A major user of energy, transport accounts for some 71% of all oil consumption in the EU. Road transport uses 60% of all oil; air transport accounts for some 9% of overall oil consumption. Rail transport uses roughly 75% of electricity and 25% of fossil fuels.

The high cost of fossil fuels and the need to reduce our strategic dependency should mean a optimisation of the potential of each mode of transport.

These challenges reinforce the environmental priority of mastering energy use. Initiatives such as those announced in the Green Paper on energy efficiency need to be pursued with urgency; the Commission will come forward in autumn 2006 with an Action Plan on energy efficiency. A European energy policy which aims at ensuring competitiveness, security of supply and environmental protection has to focus, inter alia, on further transport policies which reduce energy consumption by improving fuel efficiency on the vehicle side and gradually replacing oil by other fuels be it biofuels, natural gas, hydrogen, electricity or others."

The main features of this project are: freedom of investment and freedom of energy trade throughout Europe (i.e., full wholesale competition), freedom of choice for all energy consumers by July 2007 (i.e., full retail competition) and regulated access to all transmission and distribution networks, as well as to LNG facilities. The legal framework was established in 1996/1998 and substantially reviewed and improved in 2003.

The EU energy regulatory framework has been jointly developed by the European Commission and by national energy regulatory authorities through the CEER, sometimes via voluntary industry agreements.

Although not perfect and not yet complete, the legal and regulatory frameworks provide a good basis for the development of a competitive energy industry in the EU. However, so far practical results are below expectations. This is due to two main factors:

a) Industry structure and competition policy

While some Member States decided to split the former national incumbent utilities into several undertakings, other Member States allowed their "national champions" to grow abroad without reducing market share at home and even without proper unbundling. In some areas, namely in the EU geographical centre, market power is very high. This problem is composed by insufficient unbundling of generation/supply and network activities, thus creating important barriers to the development of a truly integrated and efficient EU energy market.

Application of competition policy to the energy sector is not always consistent, both as regards differences between national and EC authorities, as well as differences in the application of different instruments at EC level (merger control, state aid, anti-trust). Improved consistency and clear guidelines are urgently needed.

b) Regulatory gap

Although independent national energy regulatory authorities have now been established in all Member States, their powers vary from country to country. This makes regulatory harmonization difficult. Moreover, regulation of cross-border issues (cross-border trade, transmission tariffs, congestion management, etc.) is performed under comitology procedures which have proved to be totally inadequate. While at national level regulation is performed by independent authorities, at EU level cross-border regulation is performed by Member States. This regulatory gap hinders and delays completion of an efficient internal energy market. An institutional solution to overcome the regulatory gap - either through innovative schemes of collective decision-making involving the EC and national regulatory authorities or through the classic EU Agency model - is also urgent.

As regards EU energy policy, it is well known that there is none, in spite of regular calls for such a common policy in moments of energy crisis (from 1973 to Hampton Court, 2005).

In summary: improved end-use energy efficiency is much needed, especially in the transport sector; inconsistent application of competition policy to the energy sector enabled a few large undertakings that also control network facilities to dominate electricity and natural gas supply; the regulatory gap must be overcome in order to enable the development of truly integrated and efficient EU energy markets; a conclusive debate about EU energy policy is welcome.

3. European Strategy for Sustainable, Competitive and Secure Energy:

assessing the overall approach and priorities

In my view, the "*Green Paper on a European Strategy for Sustainable, Competitive and Secure Energy*", issued by the European Commission on March 8, 2006, is a very good basis for discussing the future of energy policy in Europe. It identifies the main challenges and it contains many interesting and new ideas.

I believe that the future EU energy policy - whatever political and institutional shape it will assume - should include two major lines of action: 1) complete the internal energy market; 2) improve coordination of EU initiatives within the framework of bilateral and multilateral cooperation in the global energy context.

Just before the 2006 Spring European Council, together with some former EC Energy Commissioners and EU energy regulators, I publicly supported a paper that contains practical and simple suggestions to complete the internal energy market⁷. I believe these suggestions remain valid and should be assigned the highest priority:

- 1) Apply, implement and enforce all relevant directives and regulations.
- 2) Remove all political and administrative barriers which prevent or delay construction of much needed interconnectors and LNG terminals, promoting investment in such infrastructures.
- 3) Facilitate the physical and operational integration of national grids into single European electricity and natural gas networks.
- 4) Prevent the growth and reduce the market power of supply companies which have a dominant position within the borders of every distribution network.
- 5) Enable EU and non-EU companies to compete in all wholesale and retail energy markets while separating the network companies from the interests of all users.
- 6) Do not interfere in mergers and acquisitions beyond the strict application of competition law.
- 7) Facilitate customers' choice of supplier across all network and political borders.
- 8) Enable the active participation of consumers in energy markets and promote new market mechanisms for energy services aimed at improving energy efficiency.
- 9) Harmonize the competences of national regulatory authorities, reinforce their independence and give their European body regulatory implementing powers on cross-border issues at EU level.
- 10) Internalize environmental costs into energy prices in the most transparent way, using the electricity and gas markets as much as possible and harmonizing all relevant instruments (emissions trading, green certificates, taxes, subsidies, etc.), according to European law.

The challenges we face today in the energy field require innovative solutions. Innovation is needed at different levels: technological, institutional and entrepreneurial. The EU energy strategy should actively support innovation in all these areas.

Technological innovation is needed regarding the way we manage energy systems, produce, transmit and use energy. EU support is important not only to promote more R&D and to invent new technologies, but also to apply already available technologies (for instance, the current IT potential is not sufficiently exploited in the energy industry).

Institutional innovation is urgent as regards regulation and governance of the internal energy market (e.g. through the proposed European Centre for European Networks), as well as inclusion of the energy dimension into EU external policy.

Entrepreneurial innovation is essential for stimulating competition and efficiency. Therefore, the EU should facilitate through appropriate incentives the development of small and medium size pan-European undertakings providing innovative energy services.

Identifying the challenges of a sustainable, competitive and secure energy future is a matter of common sense; however, pretending that "common wisdom" will deliver the necessary solutions and create a new energy paradigm is just wishful thinking.

Imagining a future EU energy policy based on the common denominator of Member States past energy policies is a futile exercise the Green Paper carefully avoided. I hope that the ongoing debate it has triggered will allow the EC and the European Parliament to be consistently forward-looking.

⁷ Published in the Financial Times, March 23, 2006.