

## Yesterday's energy champions, today's cheats

By Paul Domjan

**The commitment to 'free and undistorted competition' was symbolically cast aside at the 21-23 June EU summit and, amid the fanfare and horse-trading of Nicolas Sarkozy's debut and Tony Blair's swansong, the third, and nominally final, deadline of 1 July set by the European Commission for the 'full liberalisation' of Europe's energy markets has slipped quietly by.**

A return to *dirigiste* protectionism in Brussels may now have consigned this agenda, critical to Europe's long-term energy and economic security, to history. Energy has long been considered a strategic resource by governments. In the post-war decades, the provision of reliable and cheap energy by vertically integrated national champions fuelled Europe's economic re-birth.

Integrating the entire energy cycle – generation, transmission and distribution – into a single management structure allowed them to internalise the interactions between these different assets that had historically proved too complex for the market-place.

Governments believed that allowing these firms to attain and enjoy monopoly privileges would near-guarantee cheap, secure energy supply.

This model no longer works. Lack of competition inevitably reduced efficiency and advances in information technology make possible near-perfect price and capacity information. As such, vertically-integrated firms are now neither the only, nor the best, source of cheap, secure energy.

Countries that have fully broken up former monopolists have enjoyed commensurate benefits. Britain pushed through two waves of energy deregulation in the 1990s and subsequently enjoyed the lowest average prices and achieved the greatest diversity of supply in Europe. In spite of consistent prodding from Brussels, continental leaders only began re-examining their ossifying energy markets following last winter's Ukrainian energy shock.

Despite differing degrees of liberalisation, energy markets remain very highly concentrated, isolated within national boundaries and often fragmented along regional lines. In Germany, for example, the four major energy firms effectively divided up the regional energy markets following liberalisation in 1998 and continue to dominate them to this day. As a result, German domestic consumers pay some of the highest energy prices in Europe despite relatively low wholesale prices.

A second, related problem is the lack of cross-border interconnection and, thus, competition. Monopolist providers are, rationally, loathe to invest in infrastructure that will increase the competition they face and this, combined with the bureaucratic and regulatory hurdles involved with building cross-border links, means that energy networks remain largely isolated within borders. Energy prices vary as much as 100% between member states in part because discrete networks prevent them from responding to supply and demand across the continent. Unfortunately, those countries, such as the Baltic states, that are most likely to face an energy shock are those that are least integrated into the European grid. The vertical integration of firms prevents new entrants – the building block of competition – into the energy markets by controlling access to network capacity.

This phenomenon extends beyond national borders. Europe's energy giants have of late been taking advantage of their domestic dominance to sign opaque long-term contracts and swap assets with foreign-owned, vertically-integrated firms such as Russia's Gazprom. These arrangements capture existing network capacity almost exclusively for the duopoly at the expense of the consumer, involve sufficient capital to plausibly affect foreign policy and are carefully constructed to avoid competition review by Brussels.

In the wake of May's EU-Russia summit, ENI, E.On Ruhrgas and GdF called for better relations with Russia. Their vision of European energy liberalisation was best enunciated by Domenico Dispenza, the chief operating officer of ENI, who argued that "international and national companies must work together".

But while it is acceptable for two private sector firms operating in a competitive market to agree long-term pricing, it is pernicious for near-monopolists to do so in order to bolster their earnings at the expense of their customers' pocket-books and their continent's security. European governments must realise that geology and technology have transformed the energy industry and must re-assess

their markets accordingly. While vertically integrated national champions provided cheap, secure energy in the past, only competitive, international markets can do so today.

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