

Integration of the EU energy market and lowering energy costs in Europe

Issue note for the ECOFIN

Low-cost and reliable energy is critical for the competitiveness of Europe, our businesses and households. High energy prices have major macroeconomic consequences that hinder economic growth, hence undermine the European way of life. The impact of the energy crisis on potential output in the euro area of around 1 percentage point of GDP indicates high macroeconomic costs of the current set-up of the EU energy market.

The Polish Presidency is organising an informal dinner to discuss energy prices on the margins of the January ECOFIN. In order to prepare the Ministers' discussion, the Presidency had invited the IMF to present at the EFC its analytical work on the energy market integration.

The IMF indicates in its note that the EU energy prices gap vis-a-vis US is substantially larger post-2022. There has been growing energy price divergence between Member States and increased energy price volatility across Europe. Such divergence hurts aggregate output, export growth, and energy security. The underlying reasons for inefficiency arise from largely decentralised planning and investment, inefficient production, and excessive national redundancies. Electrification and renewables are essential to lowering energy costs and improving energy security, but require an integrated energy system to fully realize gains and minimize costs. A fully effective European energy market is still to be created.

While the EU deserves credit for developing several regional electricity trading markets and interconnectors, the system remains fragmented. Reducing this fragmentation requires further market integration, greater use of existing interconnectors and increasing the capacity of the grid, especially across borders.

According to the IMF, transforming Europe's energy system is a significant undertaking and should be done as cost-effectively as possible. This requires working at the EU level to create an integrated system, technologically neutral, that delivers reliable energy at low cost. Lowering energy costs requires a policy choice. Countries can either act independently, prioritizing local concerns, or adopt a coordinated strategy with shared planning and investment. Essentially, the IMF points out that the needed approach involves:

- *Regional-level collaboration.* An integrated EU energy system is a public good. Designing energy systems, based only on national considerations and decision-making, leads to the loss of scale and inefficient outcomes.
- *Institutional reform.* Addressing regulatory and technical issues hampering more efficient market functioning.

Reducing energy prices requires a clear strategy and a concerted effort to create wise policies. Different countries need different solutions. However, there are tools to act at the EU level to bring the energy prices down. The reconceptualization is needed regarding technology neutrality and development of new technologies in electricity generation, transmission, and storage. The traditional nuclear energy is important for the energy transition and should be a part of the European strategy. Sufficient capacity and providing security of supply might be the most efficient solution at the EU level, could lower the cost at the system level hence increase the EU's competitiveness. Common European actions are needed to lower energy prices for end-users in the mid- to long-term, and to create a genuine energy union.

Issues for discussion

- *Do you consider the European energy market construction as a key issue to be tackled in order to lower energy costs and improve the EU's competitiveness?*
- *Should the EU develop an effective common approach to capacity market that would ensure security of supply at affordable costs?*