

Romania energy policy: Much ado about nothing

2012 will be yet another critical year for the Romanian electricity sector. In the short term, it must cope with the sluggish recovery of electricity demand after the 2009-2010 drop in consumption and the spiking of wholesale electricity prices above EEX's German prices caused by last year's drought.

This year is also rather crucial for the long-term health of the sector as well. The resumption of investment in new generation capacity, such as the nuclear expansion of Cernavoda (1,400 MW) and the 1,000-MW pumped storage project in Tarnita-Lapustesti, is overdue and must occur this year if the country is to avoid serious capacity shortages after 2015. The government estimates that between 4,000 MW and 5,000 MW of installed capacity (mostly coal) needs to be replaced by 2020 and about 13,000 MW by 2035. In addition, Romania must present a clear liberalization plan for its electricity and gas markets as well as prepare for post-2013 compliance with EU environmental directives.

However, insufficient public funding for essential investment combined with an absence of significant private investment caused partly by bad public policies present a gloomy outlook for 2012 and beyond.

The twin pillars of the government's energy strategy to be implemented this year are more like crutches. Neither is helpful in our opinion and should be regarded more as an evasion than an attempt at a meaningful solution to the problems confronting the gas and electricity markets.

The first crutch is the planned launch this year of initial public offerings (IPOs) or secondary public listings of state-owned companies on the Bucharest Stock Exchange. Hidroelectrica, Nuclearelectrica and the gas producer Romgaz are to be the subject of IPOs, but the government is willing to float only small packages of 10-15%. The other companies are Transelectrica and Transgaz, which are already listed on the exchange.

The second crutch is to introduce professional, private management into some state-owned energy companies as a way to end chronic inefficiencies and management incompetence. Hidroelectrica will be among the first to receive new management in the first quarter of 2012.

Neither measure addresses the most basic requirement of the electricity sector today, which is full market liberalization, which in turn would attract the required new investment. Both merely serve to prop up state control over the energy sector (especially in the generation sector), ensuring that policy making remains opaque and harmful to the private sector. The government's reluctance to step back blocks liberalization of the electricity and gas markets. Certainly it might help state-owned companies in the

short term, which benefit from hidden subsidies, or customers who continue to enjoy cheap energy. But for as long as the gas and electricity markets remain under state control, no significant investment in the energy infrastructure can be expected.

The dry summer in 2011 exposed the capacity shortcomings of the generation sector, significantly denting Hidroelectrica's output as well as endangering operations at the nuclear power plant in Cernavoda. The old and inefficient coal and gas-fired generation fleets were severely overstretched. And consumers ended up paying for the system's inefficiency, as wholesale prices soared compared to historical averages.

Listing companies on the exchange might improve the liquidity of the exchange, but it will hardly make electricity generators better off. Investors are unlikely to be interested by such opportunities since the share packages are so small. Potential investors, who would be held captive by crony managements and opaque regulation, will be scared off.

It is still unclear if the government will allow generators to keep the money raised from IPOs to fund modernization of assets or whether these funds will be used to reduce the budget deficit. And the timing for IPOs is not ideal. IPOs are unlikely to be successful given the weak market conditions. Recall the failure last year of the government's attempt to sell a residual package in Petrom, Romania's most successful company.

The idea of private management makes sense in principle but it is largely window dressing. The government has the means to impose strict targets on today's management if it wishes. Incompetent management is only partly to blame for the inefficiency of the sector. Political interference and cronyism are just as damaging.

Furthermore, the selection criteria and targets to be imposed on new management are still undefined and where they are defined, they are unclear. Moreover, the impact of new management will be limited for profitable generators like Hidroelectrica, which have prolonged most of their long-term supply contracts until 2018 at prices well below the average prices on Opcom.

Instead of the measures outlined above, the government should resume privatization of coal and gas-fired assets. It should liberalize the market and do its level best to keep investors sweet. And it must restart projects blocked by the government's own mistakes. These are very difficult decisions which need to be taken quickly. Parliamentary elections later this year will make it that much harder to embark upon the changes described. And so we should expect that 2012, like 2011, will be yet another critical year in which nothing critical gets done.

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