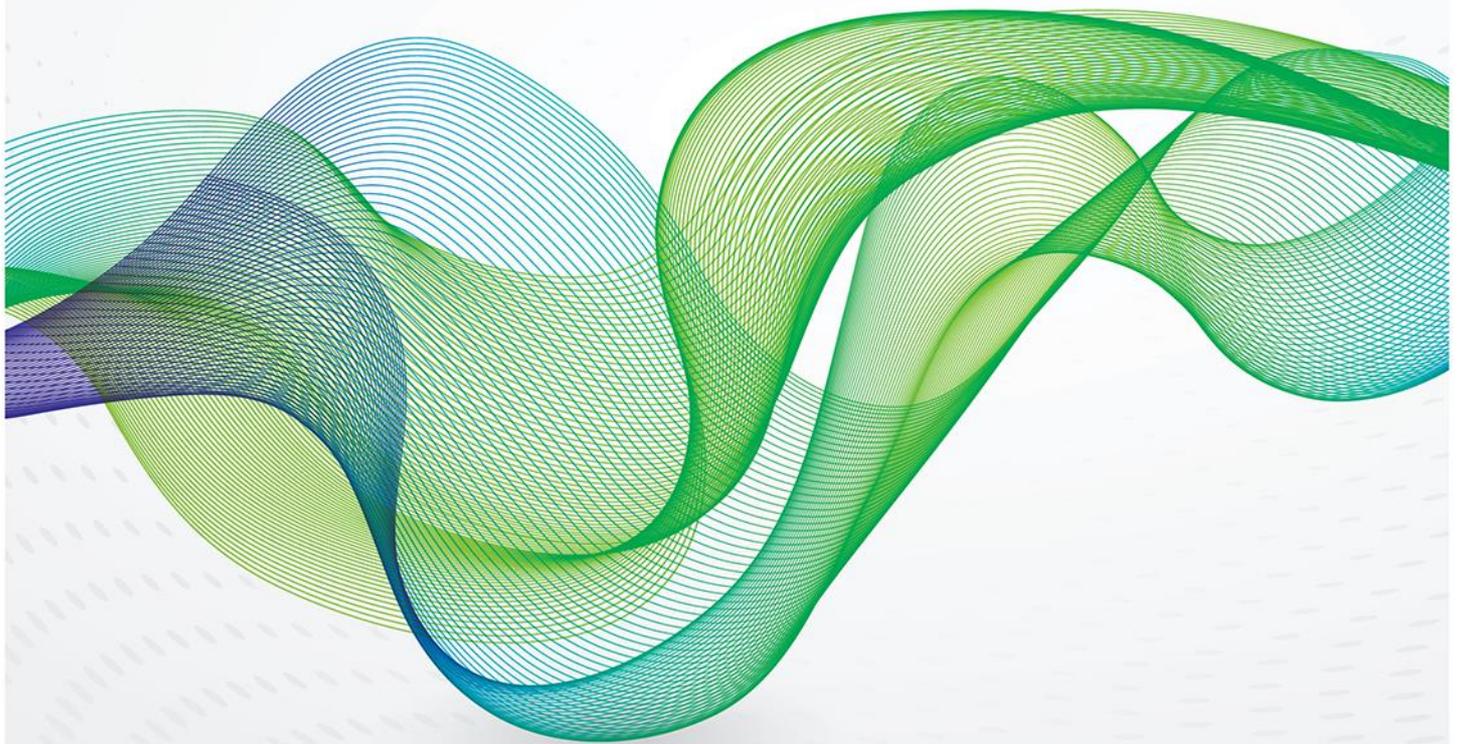




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# Europe's 'Energy Union' plan: a reasonable start to a long journey



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On February 25, the European Commission unveiled its plan for an “Energy Union”<sup>1</sup>. This concept was first launched by Poland last year, in the wake of the crisis with Russia over Ukraine and its implications for gas security, and has since taken on a far wider dimension.

The Commission advertises its proposals for Europe’s energy union as the start of a great leap forward. Maros Sefcovic, the Commission vice president in charge of the energy union project, called it the biggest change in European energy policy since the 1951 European Coal and Steel Community treaty that was the building block for the European Union’s subsequent creation<sup>2</sup>. Certainly, if approved by national governments and the European Parliament, the energy union plan would advance existing EU energy policy on many fronts. It also signals a more joined-up approach by the Commission in combining energy and climate policies. Underlining this was the Commission’s simultaneous release of its paper setting out Europe’s negotiating stance in the forthcoming international climate talks in Paris at the end of this year<sup>3</sup>.

So far, the Commission has not matched its bold rhetoric on policies with any comparably bold governance proposal to enforce these policies in the EU’s 28 member states. If there is one element one would expect from a plan to create an energy union, it is some new form of governance from the centre, for that is what all unions of states require. The energy union paper gives us a vision – “an integrated governance and monitoring process, to make sure that energy-related actions at the European, regional, national and local level all contribute to the Energy Union’s objective”. However, the only concrete application of this governance which the paper mentions is to secure “implementation of the agreed 2030 targets on renewables, energy efficiency, (emissions from sectors outside) the Emissions Trading System and interconnections”. Unfortunately, a governance vacuum has already developed here.

These 2030 targets were agreed on by EU governments in October 2014. While there are still national or regional targets in relation to non-ETS emissions and to network interconnections, the October decision on the 2030 headline goals abandoned, from 2020 onwards, the national targets that currently exist for renewables and efficiency. These were dropped because a number of countries, notably the UK and some east European states, had grown tired of pursuing energy decarbonisation through what they see as expensive and cost-ineffective renewable and efficiency programmes at the expense of other options (chiefly nuclear and cleaner coal). Therefore, any new energy union governance system will be fortunate if it can just prevent such countries from backsliding on their existing renewable and efficiency programmes, let alone spurring them on to the new efforts in the reform, integration and decarbonisation of energy markets that are proposed in the energy union plan. The Commission says it “will launch a dynamic governance process” for the energy union - but use of the word ‘dynamic’ suggests the Commission has little idea where this process might end up, though it does suggest that the process would not be identical to the system of financial supervision governing Eurozone members (which it couldn’t possibly be anyway).

However, two new elements of lower-level governance are clearly proposed. One is for the “significant reinforcement of the powers and independence of the Agency for Cooperation of Energy Regulators (ACER) to carry out regulatory functions at the European level in order to enable it to effectively oversee the development of the internal energy market and the related market rules as well as to deal with all cross-border issues necessary to create a seamless internal market”. This proposal reverses the Commission’s earlier insistence on a fairly

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<sup>1</sup> A Framework Strategy for a Resilient Energy Union with a Forward-Looking Climate Change Policy, COM (2015) 80 final.

<sup>2</sup> Press conference, February 25.

<sup>3</sup> The Paris Protocol – A blueprint for tackling global climate change beyond 2020, COM (2015) 81 final.

subordinate role for ACER. The other new suggestion is to upgrade the operational role of the two European Networks of Transmission System Operators (ENTSOs) for electricity and gas. The Commission says they will have to create regional operational centres, “so that they can effectively plan and *manage* [emphasis added] cross-border electricity and gas flows”. It is becoming clear that these ENTSOs need to lead the planning of Europe’s increasingly complex meshed energy grids, but that they should also carry out top-down management of energy flows seems to indicate a lack of Commission confidence that the free flow of market forces is sufficient to do the job.

Despite all this, the energy union plan does at last provide a “joined-up approach” to EU energy and climate policy, which has often been absent in the past. Previous Commission energy proposals have been criticised for the lack of a “joined-up” approach. The various policy elements have often seemed to reflect different objectives, stem from different powers and to have been developed more or less in isolation from each other. The Commission has been accused of having a “silo” mentality, where each of its directorates was pursuing its own agenda with little overall coordination. For instance, the single market proposals have seemed entirely separate from the goal of a fundamental transition to a low carbon energy system. Even in its language the Commission has often seemed to be talking about separate elements or “pillars”. There are signs in the latest proposals that the Commission has recognised the problem and is trying to address it. Instead of “pillars” the Commission is now talking of “mutually-reinforcing and closely interrelated dimensions”. Its proposed electricity market reform is not set only in the context of the single market; it is now clearly aimed at facilitating the energy transition, integrating renewable sources and encouraging demand response. Indeed, there is much more prominent reference to the demand-side than in previous policies. The Commission argues that we need to “empower consumers through providing them with information, choice and through creating flexibility to manage demand as well as supply”. It suggests that “it is necessary to fundamentally rethink energy efficiency and treat it as an energy source in its own right, representing the value of energy saved... Most of the work has to be done at national, regional and local level, but the Commission can play a strong role creating the appropriate framework for progress”. It also points out that this will only work if market prices set the right signals. So while it is not clear what the Commission has in mind by a “fundamental rethink” of energy efficiency and “ambitious redesign” of electricity markets, it is clearly placing both goals in the framework of the transition to a low carbon energy system and signalling its intention to develop a more joined-up policy approach. Whether this is achievable, given the governance problems, is of course an open question.

One way to assess the Commission’s proposals is to examine the degree to which they make up for the three main miscalculations that have dogged EU energy and climate policy in recent years – an over-estimate of the impact of liberalisation in integrating Europe’s energy market; an underestimate of the cost of Europe’s clean energy policies; and the false assumption that the external context for EU policy, both in terms of energy prices and energy security, would remain essentially unchanged.

**Liberalisation.** The Commission still sees the internal energy market as the energy union’s one foundation, and “full implementation and strict enforcement” of all existing internal market legislation is “the first priority to establish the energy union”. Yet in terms of what was for many years the Commission’s main instrument of liberalisation – the unbundling of transmission system operators (TSOs) from vertically integrated energy groups so these systems could serve as common carriers of energy for all – the Commission can already declare victory. The Commission has already pronounced 96 of the approximately 100 transmission systems in Europe compliant with EU legislation. Victory in this battle has not, however, triggered the hoped for increase in cross-border infrastructure that it was assumed unbundled TSOs would build. So as a further incentive, the EU passed the 2013 infrastructure regulation that prioritised a number of cross-border projects of common interest (PCIs), streamlined national planning procedures for them, and provided a modest amount of EU funding for them. As an additional spur to action to link

isolated peripheral markets in Iberia and the Baltics to the core EU market, a target of a minimum interconnection of 10 per cent of installed electricity capacity has now been set. As part of its energy union package, the Commission has produced a paper on how it intends to monitor and police achievement of this target, even though this will be no panacea because many other internal EU borders, with a far higher level of electricity interconnection than 10 per cent, still suffer congestion<sup>4</sup>.

However, upgrading ACER may speed the ‘Europeanisation’ of cross-border trading arrangements through harmonised network codes. Under the present system, negotiating a network code is a back-and-forth process between the ENTSOs, ACER and the Commission that takes about three years. Part of the reason for this is that ACER acts through recommendations and opinions, with limited decision-making rights. That is the way the Commission wanted it; it wanted to keep control of ACER and was in turn reluctant to give ACER supervisory powers over the ENTSOs. Now, apparently this will change. Another change of Commission heart is its active encouragement of regional cooperation by national regulators and TSOs to forge regional gas and electricity markets. The Commission was once lukewarm about regional market initiatives, which it now says should be developed “as a step towards full EU-wide market integration”. The Commission suggests it is happy for this regional cooperation to be a bottom-up process, except in central and south east Europe where inadequate markets require some top-down solutions “as an urgent priority”.

**Cost.** Clean energy costs have ballooned due to the under-performance of the ETS, the instrument designed to be the most cost-effective means of cutting emissions, and the over-performance of renewable energy, rewarded by national subsidies designed with maximum deployment rather than minimum cost in mind. Proud of the ETS as its creation, the Commission says the ETS should “fully play its role as a technology-neutral, cost-effective and EU-wide driver for low carbon investments”. Except that it hasn’t played this role so far. Although the Commission has put forward long-term reforms to fine-tune liquidity in the ETS, its energy union paper does not address the urgent need to apply this reform as soon as possible. Likewise, the energy union paper tiptoes around the problem of ballooning renewable subsidies. It says the Commission’s issuance last year of state aid rules to temper the excesses of these national subsidies “can only be a first step” to making them more compatible with the internal energy market. But it shrinks from repeating the proposal it once made to create a Europe-wide subsidy system that would be more cost-effective in supporting renewables. Miguel Arias Canete, the Commissioner responsible for energy and climate policy, rightly said ordinary citizens will tend to judge the energy union plan by the prices they end up paying for electricity. However, he created a hostage to fortune in predicting that his plans for reform of the electricity market, of renewables and of demand side response, “will ensure consumers benefit from lower prices”<sup>5</sup>.

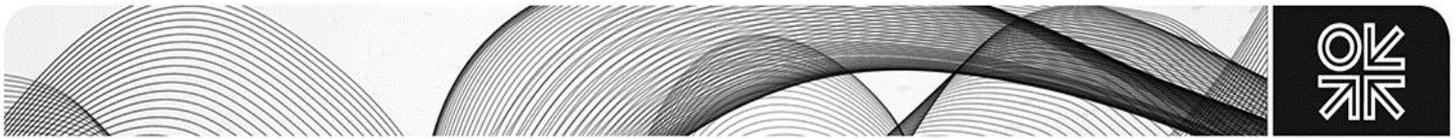
**External context.** The volatility of the world oil price, the shale revolution’s lowering of US energy costs, and the question marks placed over nuclear safety and gas supply reliability raised by Japan’s Fukushima accident and by the crisis with Russia over Ukraine, have unsettled certainties about energy prices and energy security that current EU policies were based on. The EU cannot do much to alter these factors, except make the best of them (although the Commission communication on the energy union rather laughably talks of current low oil and gas prices providing “an historic opportunity” to “reset the EU’s energy policy in the right direction”, when in fact low global fossil fuel prices simply magnify the real cost of clean energy policies in Europe).

Mindful of these vagaries in world energy, the energy union paper says the EU “must be able to react to unexpected events, seize new opportunities and adapt to future trends”. That would be nice, if the EU were not a federation of 28 countries with widely differing interests but often

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<sup>4</sup> Achieving the 10% Electricity Target – Making Europe’s electricity grid fit for 2020, COM (2015) 82 final

<sup>5</sup> Press conference, February 25.



required to act by unanimity. Nonetheless, the energy union paper contains some sensible precautions against external energy emergencies. In particular, it tempers the idea, which was attached to the original Polish proposal for an energy union, of allowing, even encouraging member states to negotiate jointly to buy gas from monopoly suppliers like Russia. Instead of this kind of buyers' cartel becoming a normal feature, the energy paper only talks of assessing the option of "voluntary demand aggregation mechanisms for collective purchasing of gas *during a crisis* [emphasis added]. Thus, it would only be an emergency measure. One suggestion, not included in the energy union paper, has been that east European states worried about their reliance on Gazprom could buy options on (non-Russian) LNG that they could exercise in any crisis with Moscow. The energy union paper also stresses the need for member states to develop gas-sharing contingency plans on a regional basis. This is sensible because at present individual member states develop national emergency plans that often count the same molecule of gas twice.

**Political momentum.** The prime concern of Poland in proposing the concept of an energy union was its worry about the security of energy imports from Russia, Europe's dominant outside supplier of fossil and nuclear fuels. The energy plan caters to this concern, and to the imbalance of power that small east European member states feel when negotiating with Russia's Gazprom monopoly. The Commission is proposing that it should join a member state's negotiating team in any new intergovernmental agreement with a third country, to guard against that member state getting an unfair deal. Nor is the Commission suggesting any rush to resume general diplomatic relations in energy with Moscow. All it says about Russia is "when the conditions are right, the EU will consider reframing the energy relationship with Russia based on a level playing field in terms of market opening, fair competition, environmental protection and safety, for the mutual benefit of both sides". This is too much for Hungary's maverick prime minister, Viktor Orban, who has complained that the energy union would restrict Hungary's sovereign right to re-negotiate its gas deal with Moscow, as it has just done, without prior consultation with Brussels. But the distance that Brussels is now taking from Moscow, coupled with plenty of warm words in the energy union plan about energy security solidarity among the EU's membership, appears enough to satisfy other east European states.

Yet the energy union concept has evolved far beyond energy security. The slogan of energy union has been picked up by the Commission and many west European states to give political momentum to the EU's existing agenda, much of which does not interest the east Europeans, particularly its climate, renewable and efficiency policies. However, the latter have not complained that their energy union idea has been hijacked for other, wider purposes. As surprising, and as positive, as this acquiescence from east Europe has been the acceptance by many other member states that EU energy and climate policies needed something to give them a boost - and why not call it energy union?