

IAI Round Table
WHAT MODELS FOR EUROPEAN ENERGY GOVERNANCE?
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Is the EU governance model for energy and climate change effective?

The 2030 Policy Framework for Energy and Climate Change presented by the European Commission in January 2014 “aims to make the European Union's economy and energy system more competitive, secure and sustainable”¹. In this strategic document, the role of governance in pursuing environmental targets is, for the first time, explicitly addressed. Here I reflect on some of the critical aspects presented in this governance proposal. I will also argue that although the focus on governance is surely a step in the right direction, the main ingredient for growth and for a competitive economy consists in a European industrial policy. To achieve this, two crucial steps should be taken: empowering, on one hand, the Energy and Industrial Commissioners through a specific delegation on behalf of Member States governments; defining, on the other, a European strategic and long-term industrial vision.

Historically, the debate on the European strategy for energy and climate change has focused on the objectives themselves to be achieved in terms of reducing greenhouse gas emissions, development of renewable energy and energy efficiency (leaving the identification of the tools to pursue them to sectorial initiatives) and little or nothing on the underpinning model of governance. The two themes, objectives and governance, however, are closely related both on a European level and nationally as the model of governance contributes to determining progress, associated costs, and the choice of instruments (coercive, market or otherwise) to employ.

The issue of EU governance of the energy framework is even more complex and multi-faced, if one further considers that the EU external governance—i.e. towards third countries primary sources producers, institutions, markets- remains separate and distinct from EU internal governance –i.e. relations with Member States. In general, for a regulator, the issue of governance is delicate because it concerns the role of EU institutions and their relations with Member States’ governments and is inevitably linked to the nature of the target to be achieved. For example, is it a goal at the European Union level, or is it translated into individual national targets for Member States? Are they indicative or binding targets? Is there a single target or three separate targets for greenhouse gas emissions (GHG), renewable energy sources (RES) and energy efficiency (EE) ?

The position of the Italian Authority and CEER (Council of European Energy Regulators) has always been to maintain the role of Government policy, which is entrusted with defining targets, separate from that of regulation, which has the task of selecting the most effective tools to ensure the achievement of such targets in an economically efficient way.

¹ Please see http://ec.europa.eu/clima/policies/2030/index_en.htm

1. The Commission's efforts on governance.

The EU's governance in the field of energy is based on an inherent contradiction: while regulation is increasingly centralized, or at least coordinated among National Regulatory Authorities (NRAs) through ACER (the Agency of Cooperation of Energy Regulators) and CEER (the Council of European Energy Regulators), industrial policy falls, instead, within the national domain. Regulation is based on a principle of governance, which, in turn, is grounded on both a shared responsibility amongst NRAs and a consolidated process of stake-holder participation through consultation procedures; industrial policy, on the contrary, is grounded on principles of government, thus based on Member States' national political strategies, especially in relation to the choice of energy mix; recent examples of completely independent national choices are offered by the German "Energiewende", France's nuclear programme, Italy's solar plants.

In 2007 the, so-called, 20-20-20 Energy Package² partially broke this policy agreement on the independency of national fuel mix choices, by centrally prescribing the proportion of RES to Member States. Initially, the Commission had to face the resistance of Member States to a top-down approach to energy policies; the implicit governance model, based on poorly defined and voluntary measures established by the EU and ineffectively implemented by Member States drove the Commission to change model of governance with the "20-20-20 Energy and Climate Change Package" and define a framework of "clear obligations on RES,EE,CO₂ at the national level, accompanied by increased supervision by the Commission" with reference both to the final results and to the progress achieved. The main fragility remained in a weak enforcement mechanism.

This model, however, again proved ineffective to achieve the targets set by the Commission, as shown in 2013 by the Commission Assessment Report on RES³.

The new *2030 Framework on Energy and Climate Change*, proposed in January 2014 and to be established by the Council in October, once again introduces a new governance and emphasizes the single EU target on GHGs reduction by 2030, the lack of defined objectives at the Member State level and consequentially bestows greater flexibility / discretion upon each member.

The model of governance has thus assumed explicit relevance to complete the internal energy market and achieve the EU climate policy targets; it requires specific consideration.

In more detail, the implementation of the EU energy and climate change program entails four different sequential processes: 1. The definition of EU and Member States targets; 2. The implementation of these targets; 3. Assessment procedures; 4. Enforcement.

² The climate and energy package comprises four pieces of complementary legislation which are intended to deliver on the 20-20-20 targets:

the Emissions Trading Directive: Directive 2003/87/EC <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02003L0087-20090625>

The Effort Sharing Decision http://ec.europa.eu/clima/policies/effort/framework/index_en.htm

Renewable Energy Directive Directive 2009/28/EC http://europa.eu/legislation_summaries/energy/renewable_energy/en0009_en.htm

Energy Efficiency Directive 2012/27/EU <http://eur-lex.europa.eu/legalcontent/EN/TXT/?qid=1399375279076&uri=CELEX:52013DC0762>

³ Renewable energy progress report, 2013 (Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. See link: http://ec.europa.eu/energy/renewables/reports/reports_en.htm).

In this regard, the 2030 Framework for Energy and Climate envisages that:

1. The EU climate change target (GHGs reduction) is set by the Commission at the EU level, while energy policy decisions –energy savings target and fuel mix- are defined at Member State level;
2. Member States are also responsible for the implementation (through national tools, implementation measures and adjustment patterns);
3. Assessment, however, is allocated to the Commission and is achieved through the analysis, in an iterative procedure, of National Plans and their consistency with the EU targets. This demonstrates an extraordinary optimism in Member States’ capacities to build National strategies that are somehow consistent with both each other and with the single, common objective. The recent experience on national plans for emission trading schemes (ETS) constitutes a warning signal that cannot be disregarded.
4. Finally, enforcement falls within the responsibility of the Member State, as the Commission has no enforcement power.

The subsidiarity principle is thus respected by this new process, but will it work ?

The Commission itself suggests in the same document that “in a second stage, should the cooperative approach prove ineffective, it may be necessary to adjust the normative model for the management of these policies, foreseeing greater powers to EC organs”. This statement is not promising and introduces further uncertainty to a regulatory framework that, on the contrary, calls for further certainty and stable rules to promote long-term investments.

So far, I have briefly described the Commission’s vision for the governance towards Member States. It is clear that this vision has not remained stable, but rather has been subject to change over the course of time.

2. Regulators on EU governance issues.

Recently EU Regulators have, for the first time, directly addressed the issue of governance in their proposal to the incoming Commissioners: “Energy Regulation: a Bridge to 2025” (September 19th)⁴.

An entire chapter is dedicated to governance issues, with the aim of balancing a drive towards Europeanization and the necessary role and cooperation of NRAs to fit local needs. In particular Acer, as the agency of European regulators, will be called upon to play a greater role in a more Europeanized energy sector. Its governance, however, already reflects various checks and balances established in the Third Package. These are designed to take account of national specificities when making decisions

⁴ For further information on the Bridge paper please consult:

http://www.acer.europa.eu/Official_documents/Public_consultations/Pages/PC_2014_O_01.aspxbridge

For the Bridge 2025 Conclusion paper please see:

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/SD052005/Supporting%20document%20to%20ACER%20Recommendation%2005-2014%20-%20Energy%20Regulation%20A%20Bridge%20to%202025%20Conclusions%20Paper.pdf

needed to achieve the IEM. These checks and balances are achieved in a number of ways: through the respective roles of the Agency's Director and its three boards; through the establishment of the Agency's rules and budget through the EU processes; through the rights of any party to appeal decisions; and, through the broader requirements of stakeholder consultation, namely transparency and accountability.

In the Regulators' vision, robust and fit-for-purpose governance arrangements for the Single Energy Market should address the roles of all relevant actors with specific tasks under the Third Package and network codes— including ACER and NRAs - and the interactions between ACER, NRAs and regulated entities. It was also recognized that any lack of clear governance, institutional or cooperation arrangements hampers the decision-making and implementation processes, as already experienced in the early implementation of the network codes.

On the other hand, Regulators are also aware of the need for a flexible approach, to best reflect the divergent levels of energy market development across the EU; in gas markets, for example, the Bridge paper put emphasis on a more targeted approach in certain regions. This is considered more efficient than adding another layer of one-size-fits-all intervention at EU level. So-called regional initiatives are therefore welcomed, optimising cooperation while developing satisfactory overall regional governance arrangements.

3. The Targets: the industrial impact

It is not only the governance that creates problems for a EU energy policy implementation, the three goals themselves that make up the EU's energy strategy (internal energy market, energy security, climate change) also imply potential contrasts that may be difficult to govern.

Reconciling three conflicting targets is challenging: the Internal Energy Market (IEM), still to be completed, is a core target of the Commission; this requires complex actions, including measures to level the playing field, addressing Member States' incumbent monopolists, investing in cross border interconnections within Member States and setting new rules to avoid any potential entry barriers set by Member State grid monopolists, in order to allow for the new services and functions required by the new electricity paradigm.

Although complex, this target is underpinned by an inherent cooperation among Member States that is founded on EU regulation and the corresponding regulatory institutions (for energy ACER and CEER and Antitrust Agencies). A major element of the IEM, however, namely, investments in cross-border infrastructure and the selection of the projects of common interest (PCIs), may contrast with the political strategies put in place by Member States to achieve the goal of security of supply.

Indeed, security of supply requires addressing third country monopolists and producers outside the EU, and implies the choice of primary source imports, namely gas from Russia, the Mediterranean, Turkey, or shale gas, etc.; diverse geopolitical issues, including the differences between Northern and Southern Member States, may jeopardize a common approach. This would require a EU external policy.

Climate change and low carbon economy also involves governance issues and cost sharing. The decrease of GHGs is addressed through energy efficiency measures and increases in the share of

renewable sources, in accordance to Member State's National Plans; it is also partly dealt with market tools and mechanisms (ETS) that cannot properly work in non-competitive markets.⁵

In this regard, one main question relates to the nature of the targets –the cost-effectiveness of one general target (GHG reduction) versus three separate binding targets to be implemented. This choice of governance has important consequences for the cost-effectiveness of the policies and for the industrial impact of energy policy costs on Member States' economies.

The Oxford Institute for Energy Studies estimated that EU industries have witnessed a yearly 3,5% increase in energy prices since 2008, due mainly to climate change policies in EU.⁶ The industrial impact of the latter policies affects both the demand of energy-intensive industries and the energy supply chain i.e. electricity producers. As for the first effect, we must ask for example, what is the impact of the increase of energy costs on energy-intensive firms? Will de-industrialization of EU and industrial migration prevail or will carbon leakage become even more problematic? The Oxford Institute estimates that the EU's share of global export market for energy-intensive goods over the period to 2035 will decrease by 10% (from today's 36%), Japan by 3% (from today 7%), US will increase by 1% (from today's 10%), China by 3% (from today's 7%), India and Middle East by 2% (from today's 2% and 3% respectively). This contrasts with the January 2014 Commission's Communication for a "EU Industrial Renaissance"⁷.

Concerning the electricity supply-chain, furthermore, the EU is confronted with what is the impact of the increased share of RES on traditional power plants? Capacity of generation is needed to ensure security of supply in the transition towards a new electricity paradigm. Traditional gas-fired plants, for instance, will be called upon to assure security and continuity of supply as the percentage of intermittent and less predictable RES increases, at least until technological innovation allows for electricity storage and flexibility mechanisms. Will EU regulation provide effective flexibility (e.g. capacity remuneration markets) to ensure a safe transition to a sustainable energy framework? Or will Member States have to individually address these economic issues? Currently, the Commission only assesses the compatibility of Member States' incentive schemes and capacity remuneration mechanisms with EU regulation on State Aid.

4. Policy Recommendations

As a final remark, it can be observed that in this context, although the importance of governance cannot be overlooked, the risk of Europe falling into a trap of excessive bureaucracy is ever so real.

Policy recommendations refer to strengthening both the Government and the Governance in the EU energy field. First, on the Government side, there is an urgent need for a EU industrial policy, or at least a EU-level coordination of Member States' industrial policies.

⁵ The January 2014 -EC Communication requires 30% improvement in energy efficiency (measures include energy performance of buildings, labelling of electric appliances, etc) NOT BINDING; it also requires an increased share of renewables sources, up to 27% of total energy mix at EU level; these targets requires regulation to promote innovative investment (smart grids) and prevent grid operators from raising barriers (eg DSO as neutral market facilitators); 40% reduction of GHGs emissions relative to 1990 –i.e. EU core target for climate change.

⁶ Oxford Institute for energy studies, Costs competitiveness and climate policy: distortions across Europe, April 2014.

⁷ European Commission - MEMO/14/37 22/01/2014

An example of success can be found in the US, where in 2009 with the launch of ARPA-E⁸, the Federal Advanced Research Project Agency for Energy, the Federal Government identified a strategic role for the energy sector. Not generic subsidies but mission oriented large research programmes are the core of US public intervention. ARPA-E is financed by the Federal programme (ARRA)⁹ and is already producing spill-over effects on industrial innovative technologies –much in the same way the Federal Agency on the Defence Sector (ARDA) did by producing extraordinary industrial innovative technologies from military research after WWII (eg GPS, ICT technologies, etc), thus enabling American firms to gain a global leadership in frontier sectors. It is evident that in Europe this process would have to be gradual, and that a series of important amendments would have to be assessed within the margins provided for in the EU Treaties.

A network of national scientific research centres for industrial innovation, coordinated by the Commission, is under construction. Within the Commission's Joint Research Centre¹⁰, in fact, the ESEP-N (European Science for Energy Policy Network)¹¹ will soon be launched to strengthen networks and link national scientific research centres to promote the industrialization of innovative technologies (from prototype to industrial deployment, following the example of the Fraunhofer institute¹²).

Secondly, the urgent need of a EU energy strategy towards energy producing third countries is clear.

From the governance perspective a lesson can also be learned from Regulators, and has been emphasized in the aforementioned Bridge to 2025, which consists of the opportunity of also offering flexible approaches, for example, regional initiatives, market coupling and shared electricity and gas trading platforms. These to take into account the different degrees of development of the various Member States' energy markets and promote integration through a targeted approach for those regions that are in the condition to participate effectively.

To conclude, the potential contradictions between IEM targets and climate change and the difficulty of defining a clear governance in the lack of EU industrial strategies are further evident from the recent nomination of two Commissioners for energy: Alenka Bratušek as Commissioner for Energy Union and Cañete as Commissioner for Climate Action and Energy. One should focus on the IEM and the other on energy and climate targets. They however, appear to have similar tasks and objectives, at least according to President Juncker's mission letter¹³. This appointed Bratušek “to bring about a resilient Energy Union, with a forward-looking climate change policy” and Cañete to “contribute to establishing a European Energy Union with a forward-looking climate change policy”¹⁴

⁸ For more information on ARPA-E, please visit <http://arpa-e.energy.gov/>

⁹ Please visit <http://www.recovery.gov/arra/Pages/default.aspx> for further information on ARRA.

¹⁰ The Joint Research Centre (JRC) is the European Commission's in-house science service which employs scientists to carry out research in order to provide independent scientific advice and support to EU policy. For further information please visit <https://ec.europa.eu/jrc/>

¹¹ A detailed description of the ESEP network can be found at:

http://www.italiadecide.it/public/documenti/2014/9/29092014_Energy_Transition_in_Europe_European_Science_for_Energy_Policy.pdf

¹² Further information on the Fraunhofer institute is available at <http://www.fraunhofer.de/en.html>

¹³ For further information on Juncker's mission letters to Commissioners please see:

http://ec.europa.eu/about/juncker-commission/commissioners-designate/index_en.htm

¹⁴ A new Energy Union project team to be headed by European Commission Vice President-designate and former Slovenian Prime Minister Alenka Bratusek will "steer and coordinate" new bundled portfolios, including Climate Action and Energy.

Environmentalists said they were worried that in the restructuring of portfolios, environment and climate action had been "marginalised". "Instead of putting sustainability central to his new team, Juncker has decided to relegate it to the margins by scrapping the dedicated posts of a climate and an environment commissioner and appointing a deregulation first Vice-President to put a

This double nomination, though may seem to account for the complexity of the issues, does very little to help resolve problems related to a clear definition of responsibilities, scope of action and governance.

competitiveness filter on all initiatives”, potential merger of the climate and energy portfolios. Other comments from skeptics felt “A merger of the two portfolios would risk weakening both agendas”.