

## Internal and external regionalisation of energy policies: the European Union's market governance approach

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# ***IEP WORKING PAPER***

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## **Analysen und Positionen zur Europapolitik**

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### **Internal and External Regionalisation of Energy Policies: The European Union's Market Governance Approach**

Severin Fischer\*

#### **Abstract**

This paper analyzes the regionalisation of energy policies in the EU. Contrasting with broader concepts of regionalisation, the paper proposes a narrow spatial definition of the concept with policy oriented and economic functions. The concept of regionalisation can then be used in order to analyse processes inside the regional system of the EU and outside the EU. Focusing on the policy level, the article proceeds with an overview of energy market developments and regulatory governance for the analysis of regionalisation processes in the framework of energy policies, putting special emphasis on the regional challenges the Commission was facing in its attempt to liberalise energy markets. The following two sections stress the internal regionalisation of energy markets through regional regulatory cooperation and the external regionalisation by setting up regional cooperation platforms with third party countries, according to their function for European energy supply and their geographical location. The European Neighbourhood Policy and the Energy Community for South-Eastern Europe serve as models for this rather new trend in European energy policies. The paper concludes that internally, regionalisation could lead the way to a functioning market for electricity and gas in the EU and externally deliver a higher degree of energy security and improved investment conditions in partner countries.

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## Introduction

The 'regional question' had a crucial impact on European integration research in the 1980s and 1990s. The idea of a 'Europe of the Regions', its institutionalisation by the establishment of the 'Committee of the Regions' with representatives from regional and local authorities, and the regional perspective on minority questions were central features of this European integration period.<sup>1</sup> Today, this trend of regionalisation has more or less disappeared and provided new space for a new regionalisation perspective, concentrating more on economic and regulatory aspects of regional integration and on new phenomena, such as the regionalisation of energy policies and energy markets.

Energy policies and regionalisation share one central feature: both terms are as multi-layered as they are difficult to restrict in their broad meaning. On the one hand, energy policy has made its way up from a low interest field of politics with merely two different, but interconnected interests – controlling prices and creating independence from external supplies – to a multidimensional and high priority topic. Today, forward-looking energy policy encompasses a balance of three different and complex themes: competitiveness, security of supply and environmental soundness/climate change. Things have also changed over the years from a sectoral perspective. While oil markets were at the centre of the debate for several decades, other energy sources such as natural gas and renewable energies have become increasingly important. Therefore, pressing issues like securing natural gas supplies from countries outside the European Union and the construction of new pipelines, as well as the restructuring of electricity markets for environmental reasons posed new challenges to the design of national and European energy policy.

On the other hand, the concept of regions, regionalism and regionalisation has seen an inflationary use in academic literature. It includes rather complex constructions of global or cultural regions and as well as identity, sub-national or local regions, which may be based on one single interest. Neither the area of energy policy nor the concept of regionalisation can easily be limited to a common understanding of the topic, nor can both frameworks just simply be combined without being more or less selective.

This article grasps the opportunity to present a rather modern trend of regionalisation in the context of European Union energy policy by limiting the range of both concepts to a more narrow definition. In a first step, regionalisation will be conceptualised as a spatial term, attached with a special policy oriented and economic function. The concept of regionalisation can then either be used inside or outside the European Union: in the first case under the

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<sup>1</sup> Cf. Keating, Michael/Loughlin, John (eds.) (1997): *The Political Economy of Regionalism*, London/Portland, p. 1.

umbrella of the regional system EU and in the second case by analysing the EU as one of several regional actors involved in the process of regionalisation or regionalism in international affairs.

Focusing on the policy level, the article proceeds with an overview of energy market developments and regulatory governance in order to analyse regionalisation processes in the framework of EU energy policies. The issues the Commission was facing in its attempt to liberalise the energy markets will be highlighted.

The next two parts of this article then focus on the internal regionalisation of energy markets through regional regulatory cooperation and the external regionalisation through the creation of regional cooperation platforms with third party countries, according to their function for European energy supply and their geographical location. The European Neighbourhood Policy and the Energy Community serve as examples for this rather new trend in European energy policies.

In the end, concluding remarks will concentrate on the role of regionalisation in internal and external energy policies.

### **Region, Regionalism, Regionalisation**

The use of 'region' as a scientific term is as widespread as it is unclear. It depends strongly on the disciplinary background and personal interest of the researcher. Nevertheless, all disciplines seem to share a few 'cornerstones' for its conception, as Peter Schmitt-Egner states:

"Regardless of its subnational, transnational or international character, we understand the region to be *a spatial partial unit of medium size and intermediary character whose material substratum is based on territory.*"<sup>2</sup>

If one streamlines this broad definition, the term region refers to four basic aspects: space, scale, function and subject matter.<sup>3</sup> While space seems to be a straightforward criterion of an originally geographical term, scale refers to a certain size a region has to consist of. As one defining aspect of regions, scale indicates the existence of some larger unit and – in most cases – a smaller one; hence, a region has to be medium-sized. The aspect of function has a similar meaning in the sense that a region does not exist in a vacuum but rather has to make

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<sup>2</sup> Schmitt-Egner, Peter (2002): *The Concept of 'Region': Theoretical and methodological Notes on its Reconstruction*, in: *European Integration*, Vol. 24, No 3, p. 181.

<sup>3</sup> Schmitt-Egner (2002): pp. 181-182.

a connection between a larger and a smaller unit. Finally, the subject matter is of great importance, especially with regard to the political or economic nature of a region.<sup>4</sup>

With a still relatively broad definition of the term region, referring to space, scale, function and subject matter, the next question arising leads to the systemic environment in which the region of interest is integrated. Regions are commonly situated within a regional system. Politically speaking, states can be bound in a federal system or can be part of an organisation of international law. From an economic point of view, regions can be markets, located within a customs union or a similar system. Note that this does not yet define the size of a system, which can be worldwide (UN, WTO), continental (EU, ASEAN), subnational ('Länder', 'gouvernements') or local (township, village). In this article, the term region shall be understood in its transnational meaning, with groups of states or economic stakeholders from different states as regional actors.

As one consequence of the manifold and diverse creations of regions and regional systems, the idea of 'regionalism' is deeply embedded in international politics. In the literature, regionalism is mainly described as an idea of integrating nation states into federations or alliances based on shared ideals or economic interests in a (broader or closer) community.<sup>5</sup> One condition for this process of integration is the creation of institutions that move a transnational region beyond the purely intergovernmental interaction of the states involved. Regionalism is nothing new, or, as Louise Fawcett states: "From a longer perspective, however, regionalism has always been with us."<sup>6</sup> European states have been cooperating on different levels for centuries. Despite the generally conceived bottom-up approach of regionalism, some scholars argue that the term regionalism could also be used with regard to a top-down approach, when centralised authorities are overloaded and in search for rationalisation.<sup>7</sup>

Finally, the term 'regionalisation' is most commonly used to describe the process of devolution, whereas the regional action space is defined from outside. This process strongly depends on the degree of autonomy of the action unit.<sup>8</sup> In most cases of regionalisation, competences are redistributed from an upper level to a lower level in order to make institutions more efficient or more legitimate. Beyond a certain direction of the redistribution of power, regionalisation processes generally involve more actors and can additionally be

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<sup>4</sup> For further reading on the function of regions: Schmitt-Egner (2002), pp. 179-200.

<sup>5</sup> cf. Kössler, Ariane/Zimmek, Martin (eds.) (2008): *Elements of Regional Integration. A Multidimensional Approach*, Baden-Baden.

<sup>6</sup> Fawcett, Louise (2008): *Regionalism in World Politics: Past and Present*, in: Kössler/Zimmek (2008), p. 18.

<sup>7</sup> Keating, Michael (1998): *Territorial Politics in Europe – A Zero-Sum Game? The New Regionalism. Territorial Competition and Political Restructuring in Western Europe*, EUI Working Paper RSC No. 98/39, San Domenico, p. 2.

<sup>8</sup> Schmitt-Egner (2002): p. 186.

encouraged and conducted by non-state actors.<sup>9</sup> Therefore, the process of regionalisation can be contradictory to regionalism which is a more state-emanating political phenomenon, concentrating on the transfer of powers to a new and in most cases international organisation.<sup>10</sup>

By transferring these theoretical terms into present-day politics, the European Union and its member states find themselves in a rather difficult situation at the moment. The process of globalisation is pushing political actors to come up with new solutions for complex problems, while at the same time, a rather new trend towards micro-regionalism is questioning centralised policy-making. Along with this difficult situation for the European Union as a political actor, European energy policies provide their own special globalisation and regionalisation phenomena. On the one hand, setting up efficient environmental policies and delivering a high degree of energy security requires solutions on a global level. On the other hand, market building and regulatory governance is still dominated by national, and in some cases sub-national, actors. The regionalisation of energy security strategies and the improvement of regulatory governance, starting from the internal market, is therefore a more and more interesting topic for academic research.

### **The Process of Liberalisation in the EU Internal Energy Market**

In the past, a lot of criticism has been raised on the limited idea of European integration as a process of market liberalisation.<sup>11</sup> Despite the fact that without a 'European idea' the existing institutions, norms and identities would most likely not exist, economic interests certainly played a vital role in creating the European Union of today. The free flow of goods, services and people represent the success of European integration in political as well as economic terms. Nevertheless, the development of a functioning internal market has been a long struggle which is far from complete. For a long time, the energy sector has been one of the slow movers with regard to liberalisation and de-monopolisation.

As an advocate of market integration and equipped with a comparatively powerful competence on competition law<sup>12</sup>, the European Commission initiated the first steps towards a market opening of the mainly monopolistic structures in most electricity and natural gas sectors in the EU in the 1990s. One of the reasons for this fairly late start was the specific

<sup>9</sup> Murray, Philomena (2008): *Regional Power Europe? The Place of the EU in Comparative Regional Integration Analysis*, in: Kössler/Zimmek (2008), p. 61.

<sup>10</sup> Murray (2008), p. 61.

<sup>11</sup> Scharpf, Fritz W. (1999): *Governing in Europe. Effective and Democratic?*, Oxford/New York.

<sup>12</sup> The competence to „address appropriate directives or decisions to Member States“ (Art. 86.3 ECT) by the Commission in order to protect competition in the internal market is generally described as the most important tool for the EU's competition policy.

structure of both markets: First of all, both sectors are grid-bound. Consequently, the establishment of trade must be based on the cooperation of three branches within the market: generation (electricity) or import (gas), transmission and distribution. Second, both sectors were organised by states and public authorities for decades. Therefore, establishing market access for non-state actors was difficult – an issue similar to the opening of other formerly state-owned sectors. While state monopolies in oil and coal markets were slowly dissolved by competition law over time, gas and electricity markets remained resistant for much longer due to their special sector related features.

After unexpected and successful liberalisation negotiations in air traffic and telecommunication services, the European Commission felt delighted to tackle the problems of the electricity and gas sector in the 1990s.<sup>13</sup> The basic idea behind these liberalisation attempts was to guarantee more competitive energy prices and equal market conditions within Europe by abolishing state protection for single companies. At the same time, companies should be forced to work more efficiently. After succeeding in establishing directives on transparency and free carriage through third party territory in 1990, the Commission enforced a complete market opening and third party access (TPA) to all grids. The process of 'negative integration', the dissolution of national regulations in order to encourage cross-border trade, was the first step; using the European Court of Justice and judicial law remained a medium of last resort. 'Positive integration' in the meaning of developing of new market rules was supposed to follow in the coming steps, assuming the agreement of the member states in the Council.<sup>14</sup>

In 1991, the Commission presented its first ambitious proposal for a directive on the rules for the common electricity market. This poorly prepared attempt failed soon due to the strong resistance by a majority of the member states.<sup>15</sup> Another proposal in December 1993 was by far not as ambitious as the first one and demonstrated the Commission's insight that a one-step approach towards a single market would not be successful under the given conditions. The Commission came up with a new two-fold-strategy: First, the new proposal was not as far reaching in its content and could be agreed upon by most member states. Second, the Commission opened up infringement procedures against most member states at the European Court of Justice during the same time, in order to put some pressure on the negotiations. By following this strategy, the Commission forced the Council of Ministers to choose between two options: The member states could shape their own liberalisation

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<sup>13</sup> Schmidt, Susanne K. (1998): *Liberalisierung in Europa. Die Rolle der Europäischen Kommission*, Frankfurt/New York, p. 183.

<sup>14</sup> cf. Scharpf (1999): Chapter 2.

<sup>15</sup> cf. Schmidt (1998): p. 218 et seq.

package by finding a solution in negotiations or they could follow the court's ruling which could potentially worsen their present situation by far.<sup>16</sup>

Finally, the council agreed on a directive establishing common rules for the European electricity markets in 1996, followed by a directive on gas markets in 1998. Although both sectors were treated with the same approach, an important difference has to be mentioned at this point. While a special feature of electricity markets is the challenge to organise supply according to short-term demand within a limited time period, gas markets are based on long-term contracts with suppliers. In most cases, these supplies come in most cases from countries outside the European Union. This inevitably leads to slightly different approaches in the two sectors: While capacity management stands in the centre of electricity market governance, securing long term energy security is one of the main challenges in the gas sector.

After the implementation of the first energy market liberalisation rules in national law, EU officials quickly realised that market liberalisation would not be a self-fulfilling prophecy; especially after taking note of market reports on the resistance of market structures to liberalisation and the lack of cross-border trade in most member states. Therefore, another internal market package had to be set up. In 2003, the European Parliament and the Council of Energy Ministers agreed on another energy market package with even stricter rules, forcing member states to establish regulatory authorities for energy markets and setting up stricter unbundling rules for transmission, distribution and generation. The Commission illustrated credibly that vertically integrated companies pose a serious obstacle to free market conditions.<sup>17</sup> Therefore, the Commission argued that either stricter unbundling (the separation of generation, transmission and distribution/supply) should take place or more transparent rules on the companies' internal calculations would have to be introduced. Member states partially followed the Commission's argumentation and established stricter rules for third party access to the grids as well as market transparency.

After following a strictly centralised regulatory approach to internal market development during the first two energy market liberalisation packages, this process slowly came to an end. Due to a whole range of developments, the European Commission changed this top-down strategy with the 3<sup>rd</sup> Internal Market Package.

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<sup>16</sup> *ibid.*: p. 231 et seq.

<sup>17</sup> In the context of energy markets, a vertically integrated company is defined by controlling all steps from generation/import to transmission and distribution under the roof of one management. Especially in a liberalised market, this can lead to problems regarding open competition or discrimination of third parties.



### Internal Regionalisation: Analysing the 3<sup>rd</sup> Internal Energy Market Package

The implementation of the 2003 internal market directives did not mean an end to the Commission's work on EU internal market development for electricity and gas. As the Commission comments in the explanatory statement for its next initiative:

"[...] the process of developing real competitive markets is far from complete. In practice, far too many of the EU's citizens and businesses lack a real choice of supplier. Market fragmentation along national borders, a high degree of vertical integration and high market concentration are at the root of the lack of a truly internal market."<sup>18</sup>

Although consumers did not yet enjoy all advantages of a fully liberalised market, another set of problems started to appear on the surface.

First of all, a series of large electricity blackouts in Italy (2003) and Germany (2006) demonstrated that – apart from other aspects such as the modernisation of physical infrastructure – European coordination of transmission network operators had to be improved. Second, the European gas markets suffered from unique supply disruptions. In 2006 and 2009 Russian gas supplies through Ukrainian networks were stopped due to disputes between the two mainly state-owned gas companies *Gazprom* and *Naftogaz*. Given the difficulties in quickly re-establishing gas deliveries from Russia, supplies from other EU member states were by far insufficient to compensate affected regions. Again, physical infrastructure was missing. Third, since the last internal market decisions, the European Union had become larger. The big accession of 2004 was followed by a smaller enlargement in 2007. Hence, the internal market grew tremendously in size and territory. Finally, environmental questions gained importance. Climate policy had become a more pressing issue, compared to the beginning of the liberalisation process in the early 1990s. This created new challenges for energy markets, namely the integration of large scale renewable energies as well as switching from centralised fossil power plants to decentralised small generation. In order to fulfil the European Union energy strategy to achieve 20% renewable energies in consumption by 2020 and to reduce carbon emissions by at least 20% until 2020, massive investments had to be encouraged and new electricity generation capacities had to be integrated into the electricity market.<sup>19</sup> After all, energy security issues, climate change and enlargement forced the European Commission to adapt its internal market strategy to a

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<sup>18</sup> European Commission (2007): Proposal for a directive of the European Parliament and of the Council amending directive 2003/54/EC concerning common rules for the internal market in electricity, COM (2007) 528 final, p. 2.

<sup>19</sup> Council of the European Union (2007): European Council (Brussels) 8./9. March 2007, Conclusions by the Presidency, 7224/1/07 REV 1, Brussels; for further reading on the EU energy strategy: Geden, Oliver/Fischer, Severin (2008): *Die Energie- und Klimapolitik der Europäischen Union. Bestandsaufnahme und Perspektiven*, Baden-Baden.

changing market environment, while at the same time following the old principles of market opening and harmonisation of market rules.

With its proposals for the '3<sup>rd</sup> Internal Energy Market Package' in September 2007, the European Commission followed a slightly new track on the road towards the completion of the internal market for electricity and gas.<sup>20</sup> Institutionalisation of a formerly loose and voluntary cooperation mechanism between transmission system operators (TSOs) and among national regulatory authorities (NROs) at the EU level was one central aspect. The Commission even suggested the establishment of an Agency for the Cooperation of Energy Regulators (ACER) which demonstrated a completely new instrument to enhance cooperation on European market rules by creating centralised institutions. In the same run, the European Regulators' Group for Electricity and Gas (ERGEG) and the European Network of Transmission System Operators (ENTSO) for Electricity and Gas were institutionalised according to the proposals for the legislative package. Besides these institutionalisation processes, the Florence Forum for Electricity and the Madrid Forum for Natural Gas still serve as informal cooperation platform for stakeholders in both branches.

This institutionalisation was welcomed by most member states while at the same time linked with another important issue: the regionalisation of cooperation and the creation of regional energy markets. This process was a clear consequence of the enlargement process and the new challenges mentioned above.

### *Regionalisation in the internal market legislation*

While regionalisation did not play a major role in the original Commission proposals for the 3<sup>rd</sup> Internal Market Package, several articles were introduced into the legal texts during the negotiations between member states and the European Parliament, clearly stating the importance of regional cooperation. In the new directive on common rules for the internal market in electricity, Article 6 refers explicitly to regional cooperation:

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<sup>20</sup> European Commission (2007): Proposal for a directive of the European Parliament and of the Council amending directive 2003/54/EC concerning common rules for the internal market in electricity, COM (2007) 528 final; Proposal for a directive of the European Parliament and of the Council amending Directive 2003/55/EC concerning common rules for the internal market in natural gas, COM (2007) 529 final; Proposal for a regulation of the European Parliament and of the Council establishing an agency for the cooperation of energy regulators, COM (2007) 530 final; Proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 1228/2003 on conditions for the access to the network for cross-border exchanges in electricity, COM (2007) 531 final; Proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) 1775/2005 on conditions for access to the natural gas transmission networks, COM (2007) 532 final.

“Article 6

Promotion of regional cooperation

1. Member States as well as the regulatory authorities shall cooperate with each other for the purpose of integrating their national markets at one or more regional levels, as a first step towards the creation of a fully liberalised internal market. In particular, the regulator authorities where Member States have so provided or Member States shall promote and facilitate the cooperation of transmission system operators at a regional level, including on cross-border issues, with the aim of creating a competitive internal market in electricity, foster the consistency of their legal, regulatory and technical framework and facilitate integration of the isolated systems forming electricity islands that persist in the Community. [...]

2. The Agency shall cooperate with national regulatory authorities and transmission system operators to ensure the compatibility of regulatory frameworks between the regions with the aim of creating a competitive internal market in electricity. Where the Agency considers that binding rules on such cooperation are required, it shall make appropriate recommendations.

3. Member States shall ensure, through the implementation of this Directive, that transmission system operators have one or more integrated system(s) at regional level covering two or more Member States for capacity allocation and for checking the security of the network. [...]”<sup>21</sup>

In the directive for common rules on gas markets, the legal provisions go even further and promote the term of ‘regional solidarity’.<sup>22</sup> In order to ensure a higher level of energy security, ‘member states shall cooperate in order to promote regional and bilateral solidarity’. In addition, the European Commission’s proposal for a new gas security regulation from June 2009 also concentrates on a regional approach in order to improve early warning and establish common measures in case of a supply disruption.<sup>23</sup>

The cooperation of regulators (ERGEG) and transmission operators (ENTSO) have been assigned a formal status at the EU level. One of their central tasks will be the operationalisation of regional cooperation mechanisms. The voluntary group of regulators (CEER) and the institutionalised ERGEG have both already been involved in establishing regional initiatives with regard to this task.

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<sup>21</sup> European Communities (2009): Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, Art. 6.

<sup>22</sup> European Communities (2009): Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, Art. 6.

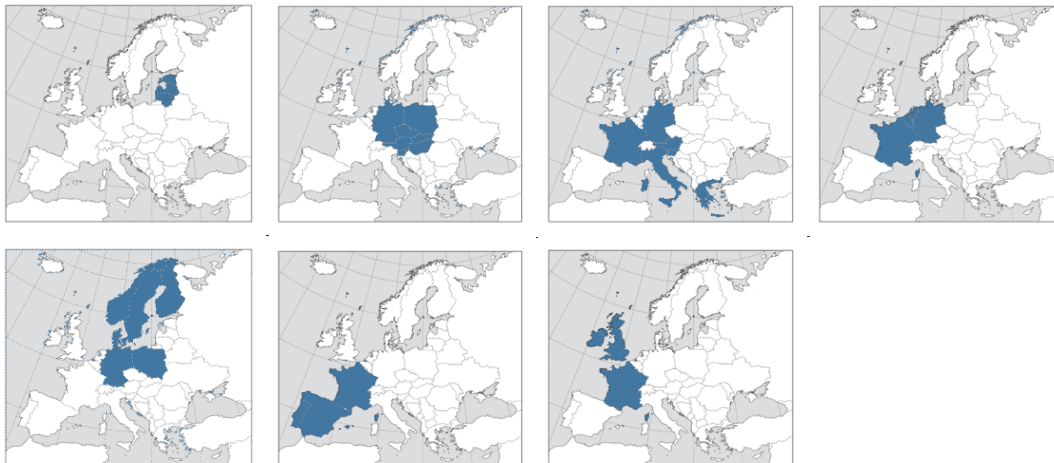
<sup>23</sup> European Commission (2009): Proposal for a regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/EC, COM(2009) 363 final, 16.07.2009, p.8.

### *EREG's Regional Initiatives*

In 2006, European Regulators and the European Commission set up a Regional Initiative Framework for Regulatory Authorities. Due to the fact that cross-border issues cannot be dealt with effectively by national regulators and that supranational regulation does not exist so far, regional regulatory cooperation seems to be one possible track towards market integration. By creating seven regional electricity initiatives and three regional gas initiatives, the first steps towards the interim regional market development were taken. Conduct and organisation were assigned to ERGEG. One central idea behind the Regional Initiatives is to bring all key stakeholders, including the European Commission, regulators, transmission system operators, market participants and member states together.<sup>24</sup> This also gives the regulator the opportunity to create new market dynamics and to ensure 'market discipline' in order to achieve the determined goals. At the same time, as Glachant and Lévêque argue, regulators could not be held responsible for everything happening in the markets.<sup>25</sup>



Regulators' Regional Initiatives for Gas (Source: ERGEG)



Regulators' Regional Initiatives for Electricity (Source: ERGEG)

<sup>24</sup> ERGEG (2008): *The Regional Initiatives – Europe's key to energy market integration, ERGEG Regional Initiatives Annual Report*, February 2008, Brussels, p. 5.

<sup>25</sup> Glachant, Jean-Michel/Lévêque, Francois (2009): *The electricity internal market in the European Union: what to do next?*, in: (eidem): *Electricity Reform in Europe. Towards a Single Energy Market*, Cheltenham/Northampton, pp. 25-26.

For the time being, ERGEG's Regional Initiatives seem to be relatively successful in implementing some of their central targets: the creation of coherence and convergence.<sup>26</sup> While transparency is one of the priority issues to both, electricity and gas markets across Europe, each of them has special features. The short-term and long-term coordination of capacity calculation, allocation and balancing is important for electricity markets, while interoperability of different gas market systems is a specific problem in the gas sector.

In the future, Regional Initiatives will focus on even greater convergence by using the recently established Regional Initiatives Group (RIG) and focusing on a better exchange of information, especially between Transmission System Operators. The formal status and the institutionalisation of the system operator cooperation in ENTSO will be another positive contribution to this process.

The role of internal regionalisation for European energy market integration cannot be described as lying in the centre of European policy-makers' interest. It rather seems to be an intermediary step towards full market integration. Due to the growing size of the EU and the increasing complexity of regulatory tasks, it might nevertheless be a long-term solution for a stable and competitive energy supply in Europe along with common market rules.

### **External Regionalisation: Stabilising the Neighbourhood, Securing Investments**

While regional cooperation in the internal market mainly concentrates on efficiency aspects and the interconnection of national markets, external regionalisation has a slightly different focus. By understanding regionalisation as a process of creating an intermediate spatial area, the European Union has to be considered as one actor among many others. Therefore, an analysis has to focus on the constellation from an outside point of view.

The 'external dimension' has been one of the central features of energy policy development in the recent past. Speaking 'with one voice' and creating an even playing field with major suppliers were core features of Europe's energy strategy and the energy action plan of 2007-2009.<sup>27</sup> Despite the mainly positive reaction this strategic goal received from most actors involved, the policy framework remained rather imprecise. The difficulty in developing this common approach has two interconnected reasons:

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<sup>26</sup> ERGEG (2009): *Second ERI Coherence and Convergence Report. An ERGEG Conclusion Paper*, 11 March 2009, Brussels.

<sup>27</sup> cf. Geden/Fischer (2008); for further information on the EU Energy Action Plan 2007-2009: EU Energy Policy Monitoring (2009): <http://energy.iep-berlin.de>.

1. Energy policy is not an explicitly Europeanised policy field. External energy policy is therefore even further away from EU policy-making competences than most of the other external matters. Member states are dominant the scene in comparison with EU policy actors.
2. While policy actors tend to defend the perspective, that 'politics matter', reality paints a different picture. Neither governments nor parliaments decide on imports and supply contracts. Economic actors, in this case energy companies, dominate the international energy game. While political actors can structure internal markets, they become more and more powerless when the playing field becomes international. Therefore, creating solid common framework conditions could be a crucial aspect of an external energy policy.

Taking these framework conditions into account, the EU concentrates more than ever on the development of common market rules in cooperation with its partners. This offers advantages for both sides: stable and secure conditions can foster investments and guarantee at the same time a high level of reliability. Nevertheless, the partner countries in this approach are rather divergent, ranging from major gas and oil suppliers, such as Russia or Algeria, to neighbouring transit countries, such as the Ukraine or Belarus, and connected energy markets, such as Serbia, Croatia or Albania. Despite their different role and function in international energy policy cooperation, their regional affiliation is a decisive aspect for the selection of policy instruments and formats for cooperation. The 'one size fits all strategy' does not seem to be a successful one for energy related issues. At this point, the concept of regionalisation enters the stage.

Two major projects appear appropriate when analysing the external regionalisation of EU energy policy: Developments in the context of the European Neighbourhood Policy (ENP) and regulatory governance under the roof of the Energy Community.

### *Regional Energy Cooperation in the Framework of the European Neighbourhood Policy*

The ENP can be described as one of the major outcomes of the big enlargement of 2004.<sup>28</sup> While the EU's borders were formerly located in Central Europe, mostly along the 'iron curtain', suddenly St. Petersburg and the Black Sea became EU border regions. Due to this changing framework conditions, a new policy approach for the new neighbourhood had to be

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<sup>28</sup> cf. Böttger, Katrin (2009): *Die Regionale Dimension der Europäischen Nachbarschaftspolitik in Osteuropa: Ukraine und Moldau*, in: Europäisches Zentrum für Föderalismusforschung (ed.) (2008): *Jahrbuch des Föderalismus 2007*, Baden-Baden, pp. 589-603.

constructed. At the same time, Southern European Member States complained about the lack of clear strategies for the Mediterranean neighbours in Northern Africa and the Near East. The European Commission seized the opportunity to develop a completely new concept for the EU's policy approach towards the enlarged neighbourhood: The European Neighbourhood Policy.

From the beginning, the ENP was primarily focused on bilateral arrangements and association agreements. Conditionality as one major aspect of cooperation was introduced, but with rather mixed results. While some countries accepted obligations due to the perspective of moving closer towards EU membership, others were rather sceptical and less active in implementing European standards. In the field of energy policy, the situation was even more complex. Some norms and regulations, such as the promotion of renewable energies, energy efficiency measures etc., are aimed of being exported to all ENP countries. But despite that general approach, most ENP partner countries have different functions within Europe's energy strategy. While Ukraine, Algeria or Azerbaijan are highly important due to their role as supplier or transit country, Israel, Morocco or Armenia seem to be less meaningful for the establishment of an external energy policy approach. Therefore, bilateral action plans were constructed based on the specific situation of each country. However, some problems cannot be solved on a bilateral level. In order to coordinate electricity or gas transit across borders, common market rules for regions have to be established. Adding to that, cooperation between supplier and transit country becomes more and more important which again raises the importance of regional cooperation. At the same time, cooperation in the East is much more fruitful with regard to the conditionality approach than it is in the South.<sup>29</sup>

After being in place for a couple of years, the first few evaluations of the ENP were not overwhelmingly positive. The same can be stated for the chapter energy under the ENP umbrella. This result in combination with a desire for further and deeper cooperation with Mediterranean countries, inspired French president Nicolas Sarkozy to propose his model for a Mediterranean Union in 2007. Soon, this regional initiative was followed by a Swedish-Polish proposal for a new Eastern Partnership. Both concepts were developed in accordance with the ENP, but as independent fora of multilateral cooperation. The idea behind both initiatives was the strengthening of regional coordination and cooperation, also focusing on energy issues.<sup>30</sup>

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<sup>29</sup> Fischer, Severin/Lippert, Barbara (2009): *Energieaußenpolitik und Nachbarschaft*, in: OSTEUROPA 9/2009 (forthcoming).

<sup>30</sup> For regionalisation in the Mediterranean: Calleya, Stephen (2008): *Regional Security and Euro-Mediterranean relations*, in: Kössler/Zimmek (2008): pp. 29-56, especially pp. 51-56.

Within the Mediterranean cooperation format (which was renamed several times and finally established as 'Union for the Mediterranean'<sup>31</sup>), the multilateral-regional approach is of high importance. From the point of view of an energy policy actor, this makes sense for several reasons. Challenges to and interests of the countries within the cooperation forum are quite similar. Most countries play a role as supplier of natural gas and will be needed in the future in order to promote solar energy in the Sahara and to transport it to Europe. These huge projects could not be handled by single states or within the framework of bilateral cooperation, because they tend to have a regional and multilateral perspective. However, moving towards market integration with the EU's internal energy market does not seem to be realistic within a reasonably short period of time, also due to the lack of incentives because of the missing membership perspective for the participating countries.

The idea of an intensified Eastern Partnership also consists of multilateral elements, but is rather focussed on a mixed strategy of bilateral and multilateral cooperation. Due to the role most partner countries play as third party to an EU-Russia gas and oil supply relationship, a regional perspective in the sense of multilateral cooperation is not as fruitful as it might seem in the South. An exception could be the Southern Caucasus, although even in this region different interests might lead to different policy solutions. Despite the lack of common regional interests beyond the one dimensional relationship with the EU, another policy feature can be developed further in the East that does not apply on a large scale to the South: market governance export and common rules on energy markets. Due to the interest in a future EU accession and in massive investments in the markets by EU companies, the application of conditionality might have a positive result. Incentives for market reforms seem to be rather high.

All in all, the European Neighbourhood Policy and the two regional initiatives described above offer a suitable framework for cooperation in the energy sector. Nevertheless, extent and approach have to vary according to the regional environment and the status of EU-ENP partner country relation.

### *Regionalisation for Integration: The Energy Community*

While countries in the EU's Eastern neighbourhood are not directly involved in any accession negotiations, another region outside of the EU border regime is approaching future membership: the former-Yugoslav Republics and Albania. The realistic and foreseeable

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<sup>31</sup> Union for the Mediterranean (2008): Final Statement by the Meeting of Foreign Ministers, 3-4 November 2008, Marseilles.



perspective of EU membership leads to slightly different framework conditions for these countries than for countries without such a membership perspective. The most successful instrument of EU regulatory governance, the accession policy, can be used in these cases. The economically and politically attractive option of becoming a EU member state can tempt states to internalise external rules, even if the costs of this process might be relatively high. The potential new members expect the gains of integration into the internal market as well as the security offered by the community to be higher than the costs.

In 2002 and 2003, the EU started the Athens Process for those countries, labelled under the name Western Balkans. After signing two memoranda on energy market reforms, the Energy Community for South-Eastern Europe was established in 2005. The Energy Community is a unique example of sectoral integration outside the EU, while at the same time presents a useful blue print for one possible way of external regionalisation. Following the idea of neo-functionalists that integrating one sector in most cases leads to the integration of other sectors, the energy sector was chosen as a Petri dish.

The harmonisation of market rules as well as a stable regulation of the energy markets was at the centre of the Energy Community's work from the beginning. All participating countries agreed on implementing the core features of the EU's 2003 directives on common rules for electricity and gas markets. Beyond that, parts of the EU legislation in the area of oil stocks or environmental provision had to be adopted. The implementation of Energy Community legislation went along with high bureaucratic costs and fundamental changes in energy market structures for the participating countries. Nevertheless, the carrots of revenues from a higher level of energy security and from investments in infrastructure by companies from the EU market seemed to be comparatively more attractive. The EU was even in the position to create an institutional structure in Western Balkan countries, similar to the internal institutional structure in the EU. The main incentive for this institutionalisation lies in the high reform needs of the economies.<sup>32</sup>

So far, the Energy Community represents a unique model of regionalisation, sectoral integration and of the process of enlargement within one single institution. Due to the region's specific situation, the model can hardly be transferred to other regions outside the EU. In spite of this fact, the Energy Community is a role model for regulatory export in the context of the EU's foreign relations.

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<sup>32</sup> Hofer, Stephan (2007): *Die Europäische Union als Regelexporteur. Die Europäisierung der Energiepolitik in Bulgarien, Serbien und der Ukraine*, Baden-Baden, p. 177.

## Conclusions

Regionalisation has become a topic of growing interest to EU policy-makers in the field of energy.<sup>33</sup> While the ways in which regionalisation processes have been conducted strongly differ, some central features are common to the internal as well as to the external dimension. One of the major aspects is the idea of regulatory governance. Analysing this governance model is important for EU policy research for two reasons: First, it characterises the EU like no other policy mode, second, the EU exports this model all over the world.<sup>34</sup> While observing and analysing the multi-dimensional regionalisation processes in EU energy policies, concentrating on the aspect of regulation was therefore beneficial.

The process of internal regionalisation can be described as a merely technical adaptation towards achieving the strategic goal of creating a true internal market for electricity and gas, which has so far mainly worked for the cooperation between regulators. By including provisions for the role of regional markets and for the institutionalisation of regional cooperation into the 3<sup>rd</sup> internal market package, the European Union has for the first time formalised an important change in its liberalisation and internal market policy. Due to the pressure from enlargement and the fast moving target of climate and energy security policies, this step was a administrative reaction to physical needs. Although regionalisation is supposed to be no more than an intermediate step towards the final goal of full market integration, it could at the same time introduce innovative 'best practise' models for further market development.<sup>35</sup> This aspect should be in the centre of future debates on regionalisation processes among TSOs and other stakeholders.

In its external relations, the EU is using the concept of regionalisation in a similar way. Regulatory governance is applied in order to deliver a higher degree of energy security and a sound investment environment. At the same time, the EU's policy reacts to the different situation of partner countries. Since the Western Balkan countries are close to EU membership, the full adaptation of market norms must be in the centre of cooperation. At the same time, partner countries in the European Neighbourhood Policy are treated with different approaches, depending on their specific needs or their role in the EU's energy strategy. Additionally, regional initiatives such as the Union for the Mediterranean or the Eastern Partnership serve as platforms for enhanced regional and multilateral energy cooperation.

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<sup>33</sup> Glachant, Jean-Michel/Lévêque, Francois (2009): *The electricity internal market in the European Union: what to do next?*, in: (idem): *Electricity Reform in Europe. Towards a Single Energy Market*, Cheltenham/Northampton, pp. 3-32.

<sup>34</sup> Murray (2008): p. 59.

<sup>35</sup> Glachant/Lévêque (2009): p. 27.

While one cannot be sure whether the model of internal regionalisation will be maintained over the coming years, it can still serve as a blueprint for further integration processes among other formerly publicly managed sectors in the process of liberalisation and integration. In the external dimension, regionalisation and regulatory governance generally go hand in hand and will remain an important instrument for Europe's market governance approach.