CEPS COMMENTARY
Thinking ahead for Europe

Making the most of Energy Union

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Energy Union has become the latest buzzword of the new Juncker Commission, in very much the same way that the 'Europe 2020 Strategy' had been for its predecessor, Barroso II. The EU is finally accepting that energy is too important to be ignored. Recent years have given us sufficient evidence that energy matters for the economy, for the environment, for social cohesion and solidarity and for local development and municipalities. Citizens care deeply about these areas, and the EU must be seen as addressing them. Energy Union should also be seen – at least from the perspective of the European Commission – as an attempt to infuse a new dynamic into the stuttering energy market and a more complicated climate change debate.

Although the term was first coined by the former Polish Prime Minister and now Council President Donald Tusk, it was Commission President Jean-Claude Juncker who, by elevating it to a Commission mission statement, succeeded in forging a new EU consensus on energy and climate change at the October European Council meeting. For the first time since the 2007-09 climate and energy package was agreed, there is a consensus on energy and climate change. Essentially this was made possible by linking the internal energy market and climate change agendas to security of supply, solidarity and infrastructure. This notably meets the interests of Central and Eastern Europe as well as the peripheral member states.

That energy is now part of the EU's mission statement must be a welcome development. But the European Commission will soon need to give it real meaning and substance.

What Energy Union do we need?

The European Commission, led by Vice President Maroš Šefčovič, will need to develop a credible strategy before Energy Union can become reality. For the time being, Vice President Šefčovič relies on a broad and inclusive concept, essentially repackaging the existing priorities such as the internal energy market, security of supply, climate change, energy efficiency/demand moderation and research. But more is needed. Soon he will require a plan to address the trade-offs that exist, for example between the speed of building up renewable energy and creating a single market or between phasing out state interventions and moving to a low-carbon electricity sector.

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What should the priorities be? Some are obvious and progress is already underway. They include notably the 2030 Climate and Energy Framework as well as the reform of the European Emissions Trading System, including the efforts to deal with carbon leakage. Other priorities include work on the EU's energy retail markets or industrial policy. The most difficult challenge for Mr Šefčovič will be to break down silos to develop a truly integrated and coherent policy to achieve the EU's commitments in GHG emissions reductions while safeguarding competitiveness and ensuring security of energy supply. At the same time, this will also be the litmus test of whether the Juncker Commission can live up to its self-declared objective to focus on the big issues.

Six priorities for Energy Union

- The first and obvious starting point is the internal market for electricity and gas. Under the current market conditions, there will be very little if any market-driven investments in any technology, especially low-carbon ones. Almost all investment decisions taken today are backed up by dedicated support mechanisms, such as feed-in tariffs for renewables (and now also for nuclear) and capacity payments for conventional power. This will also mean that further supply will continue to be added to the existing, already saturated system, which will further depress wholesale power prices. Markets are not in equilibrium and will therefore not even pay for keeping critical power plants running to ensure security of supply. Hence, the need for capacity mechanisms. But what is probably the most worrying development from the EU's perspective is that all of these support schemes are designed as national policy instruments. Already today, the internal electricity market is far from completed due to a high share of national taxes and levies in end-consumer prices. With a growing number of national subsidy mechanisms and depressed wholesale prices, the share of (national) taxes and levies in the overall price can only increase.

  Overcapacity can be addressed by ensuring that the least (carbon-)efficient power plants go out of business, for example, as a result of the EU CO_2 price,[1] regulation or the prohibition of coal. Different member states seem to favour different instruments. The efficiency and security of the market can be partly addressed by better integrating renewables into the market, e.g. by direct marketing and balancing obligations of renewables. Some of this has been addressed by the Guidelines on Environmental and Energy Aid 2014-2020, but a more coordinated regional energy policy or 'regional energy unions' are needed to address the above-mentioned issues effectively.

- Given the physical connections and market coupling, the cross-border implications of national energy policies have become most evident at regional level, e.g. in central-western Europe. This is why the Pentalateral Forum has been created. Regional approaches or unions offer the possibility of aligning national support policies, e.g. for renewables or conventional power generation ("capacity mechanisms") and linking them to infrastructure development, for example by setting regional targets for both renewables and grid infrastructure, and possibly exemptions and compensation for energy-intensive consumers. An EU framework by the European Commission, for example in the form of a Communication would be required to define the remit and limits of regional approaches ("unions"), in addition to the Guidelines on Environmental and Energy Aid. The European Commission could think about providing incentives for member states to develop regional

[1] The internal electricity market will not be able to achieve EU energy and climate objectives without reform of the EU Emissions Trading System (ETS). This means that the Market Stability Reserve (MSR) should enter into force as soon as possible, combined with a commitment to withdraw allowances to address oversupply in the ETS.

renewables policies for example by granting regional targets a higher weight than national targets[2] or by providing infrastructure support. Regional approaches might turn out to be the most effective way to implement the 2030 climate and energy framework, which is far more decentralised than its predecessor.

a) Regional energy unions also offer the possibility to identify research priorities at regional level. This should increase member states' and other stakeholders' buy-in, an objective that the SET-Plan tries to achieve.

b) Electricity infrastructure as a matter of principle should be left to regional energy unions, except in the cases where the EU can provide additional incentives for more European approaches.

- Regional 'energy unions' should be mirrored by the creation of 'local' ones focusing on local government and cities, notably 'smart' cities. Europe's urban areas generate some 85% of Europe's GDP, are responsible for 80% of the energy consumed and produce – directly or indirectly – 75% of Europe's greenhouse gases.[3] Many local initiatives and notably local distribution companies have demonstrated that 'smart' technologies can increase productivity and resource efficiency by the integration of hitherto separate infrastructures through ICT and 'Big Data'. A successful Energy Union focusing on secure and clean energy, jobs and growth must support local initiatives that deploy smart technologies. The EU cannot do this on its own but it can improve coordination and set a more appropriate regulatory framework.[4] To date, local initiatives have been ignored or seen as a problem rather than as a solution.
- An Energy Union will also need to develop an industrial strategy for the EU energy transition, taking the 'industrial industrial renaissance' further. This calls for the reinforcement of innovation and innovation policy to facilitate the transition of industrial sectors towards a low-carbon future. On the one hand, this will require a framework to address carbon leakage and think about new options for the longer term. This will especially require a global climate change agreement that at a minimum creates transparency of all countries' contributions. On the other hand, such a transition will require focusing on new value chains that the EU's transition to a low-carbon sector could unlock. An example is the paper and pulp industry's 2050 roadmap to a low- carbon bio economy, which has identified the ambition to be at the heart of the 2050 bio-economy, an essential platform for a range of bio-based products and the recycling society. The new NER400 – the successor to NER300, a funding programmes for innovative low-carbon energy demonstration projects - should become operational as soon as possible.
- A crucial element of Energy Union will be infrastructure. Less will be more. It is especially gas infrastructure that will be required to give meaning to solidarity and thereby build trust within the EU. To be successful, the EU will probably need to abstain from its usual reflex to focus on too many projects to please each and every member state. The European Energy Security Strategy has made a good start in reducing the number of projects to 10

[2] Effectively, this means that EU member states that agree on a joint target would have to do less on average than EU member states pursuing a national target.

[3] It is no coincidence that cities are presented as a global priority in the newly published "Better Growth, Better Climate" report released by the Global Commission on the Economy and Climate (http://newclimateeconomy.report/).

[4] Critical coordination tasks and priorities for the regulatory framework have been identified in a previous Commentary: Jorge Núñez Ferrer and Christian Egenhofer, "(Smart) Cities: A missed opportunity for the growth and jobs agenda", CEPS Commentary, 4 October 2014.

short-term and 17 long-term projects. But even more focus might be needed. The first priority should be to honour the EU's commitment to address the vulnerability of energy islands as well as to increase reverse flow capacity. Next will be to better connect the East with the West and the South with the North. This can be done with a limited number of projects.[5] The EU should also think about the need for redundant gas infrastructure[6] in a few cases in order to increase security of supply. Electricity infrastructure should be left to 'regional energy unions' or to member states with very few exceptions. Most of the time, electricity infrastructure is not hindered by money or money alone but by other obstacles, which have to do with the member states in question.

- Finally, much of the success of energy union will depend on how the debate on joint purchasing develops, which potentially could turn toxic. While many stakeholders are critical or even opposed to joint purchasing, it could have a number of merits. For example, it could help 'lifting' infrastructure for new import pipelines from Central Asia, the Caspian Sea, Israel and Cyprus, Northern Iraq or in some more distant time, Iran. Joint purchasing could offer security of demand for importers, something they have been asking for a long time. It could also provide a framework for LNG imports if TTIP is late or fails. One way forward could be to explore the possibility of creating a private company to aggregate the demand of importers, as two Japanese utilities are doing.[7]

In short, we applaud the move by the European Union to put energy at the centre for the first time. This acknowledges its importance for citizens in east and west and north and south, for the EU's economy, well-being and security. And who knows, it may even attract the attention of Europe's neighbours.

But there are risks. The first is that the Energy Union remains a bureaucratic attempt of the Commission to repackage a previously sound but increasingly ailing agenda of an internal energy market. There are also political risks, which go far beyond the 'institutional' ones typical for administrations and other large organisations. Member states may give in to the temptation to make Energy Union become a vehicle for asking the EU to pay for what they should pay for themselves or to do what they have failed to do in the past. The other risk, and one that is potentially equally poisonous, is that Energy Union becomes a platform for anti-Russian sentiments and action. There is evidence that this potential danger may materialise in some member states. This would quickly drive Energy Union into the security and defence corner, far removed from its original meaning, resulting in the creation of more division in the EU than unity.

[5] For example, the Klaipėda-Kiemėnai pipeline connecting Latvia to the Lithuanian LNG terminal in Klaipėda; the Greek-Bulgarian interconnector securing access to Shah Deniz gas in Bulgaria; the Poland-Lithuania interconnector addressing the energy isolation of the Baltics; Spain-France "Midcat" interconnector allowing for LNG deliveries stranded in Spain to flow north; and the TANAP (Turkey-Greece) pipeline securing access to Caspian gas deliveries to southern Europe.

[6] An energy system that relies on a single fuel, a single transmission line or even a single computer or telecommunication system is inherently more vulnerable than one that relies on a diversity of, and redundancy among, some resources or lines.

[7] See Fabio Genoese, Anna Dimitrova and Christian Egenhofer, "Energy Union: Can Europe learn from Japan's joint gas purchasing"?, CEPS Commentary, 11 December 2014.