

# C | E N E R G Y   C L I M A T E   H O U S E

## P | S

### Background Briefing Paper

## Effective Regional Energy Policy Cooperation in South East Europe: A Proposal

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### Key Points

The implementation of regional energy policy cooperation initiatives is a priority of both the Energy Union and the so-called 2030 Energy and Climate Framework. The Energy Union proposal has singled out south east Europe as one area in which to act.

This report identifies the seven key elements that need to be addressed to bring existing and planned regional energy policy cooperation initiatives in south east Europe to life: i) a sound geographical definition, ii) a governance structure, iii) voluntary participation, iv) exchange of information and best practice, v) the development of an external dimension, vi) regional infrastructure planning and development and vii) streamlining the financing instruments across the region.

The study finds that significant progress has been made in many areas, and makes concrete proposals to unlock the full potential of coordination in those areas where there is limited progress. These proposals have been tested in discussions in the region.

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This proposal was presented to and discussed with seminar participants in Sofia on 3-4 June 2015. The seminar aimed to accelerate dialogue between governmental representatives from south east Europe, independent experts, think tanks, academia, NGOs and industry, and was organised by CEPS in cooperation with the Deputy Prime Minister for EU Funds and Economic Policies, the Ministry of Energy of the Republic of Bulgaria, the Ministry of Foreign Affairs of the Republic of Bulgaria and the Administration of the President of the Republic of Bulgaria. The event was a follow-up to a CEPS workshop held in Brussels on the topic of regional approaches to achieving EU energy objectives. For details and the CEPS-led project on regional energy policy cooperation (see <http://www.ceps.eu/content/Regionalisation-of-EU-energy-policies>).



# A Proposal for Effective Regional Energy Policy Cooperation in South East Europe

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The implementation of regional energy policy cooperation initiatives is among the European Commission's priorities in achieving its energy and climate goals and establishing an Energy Union. In addition, the European Commission Communication on the 2030 climate and energy framework underlines the need for the enhanced coherence of national energy policies and national energy plans. The European Energy Security Strategy, published in May 2014, calls for mechanisms that allow member states "to inform each other of important decisions related to their energy mix prior to their adoption" – essentially envisioning collaboration on a European level in national energy plans setting. The importance of a "regional approach" was reiterated at the 26-27 June 2014 European Council Conclusions, in which they mention "further implementing and integrating the European energy market based on a regional approach".

Most recently, the Energy Union Package of 25 February 2015 stated that a regional approach will be applied in several areas: in preventive and emergency plans for energy crisis response; energy system adequacy assessments; regional action plans for electricity interconnections; regional cooperation groups and operational centres for "cross-border electricity and gas flows" management; and energy policies integration "at regional level as a step towards full EU-wide market integration" (European Commission 2015A). Achieving regional coherence and convergence of energy policies is recognised as a key stage towards establishing "a fully integrated Single Energy Market". Moreover, the Energy Union Package stresses the importance of "improving cooperation, solidarity and trust" particularly in south east Europe. The political will to apply a regional approach to enforcing the Energy Union Package was communicated in the European Council Conclusions on the Energy Union on 19 March 2015, which confirms that "developing a more effective, flexible market design which should go together with enhanced regional cooperation, including with neighbouring countries."

## Benefits of Regional Cooperation

With the advent of the Energy Union, regional cooperation is now incorporated into the second dimension of the emerging Energy Union concept, which makes reference to "stronger regional cooperation arrangements, within a European framework" (Štefcovic, 2015). Behind the idea of a regional approach is the belief that the creation of an internal energy market is facilitated by fast-tracking regional cooperation in quasi-governance structures, which address regional challenges and opportunities. Regional market integration is seen to foster the enhanced coherence of national energy policies and national energy and climate plans, thereby facilitating the completion of the internal energy market. Regional energy policy cooperation thus becomes a stepping-stone towards an EU integrated energy market.

A larger market offers various benefits. For example, security of supply is improved through better interconnections, more flexibility through access to a wider range of energy sources and generally lower capital requirements as a result of a decreased level of generation investment. Cooperation between countries or regions can reduce vulnerability to both gas and electricity supply disruptions. The integration of renewable energy sources will require further interconnections; after 2020, 'physical cooperation' between member states will be needed to cope with the challenge of renewable integration. Politically, this has been addressed by the EU cross-border transmission capacity targets of 10% and 15% by 2020 and 2030 respectively, agreed upon by the European Council. Southeast Europe (SEE) also has huge potential for energy efficiency or innovation in the heat sector.

## Towards a Framework for Regional Energy Cooperation

The fact that regional energy policy cooperation initiatives develop bottom-up means that there is a high heterogeneity among the different initiatives. But they all apply one or several of the four modes of cooperation:

1. Simple information-sharing,
2. Joint information and knowledge creation in selected areas,
3. Common policies in selected areas and,
4. Joint instruments.

These different modes can be implemented alone or in parallel in existing initiatives and regional energy arrangements such as the Danube Energy Forum, the Mediterranean Energy Forum, the Pentalateral Energy Forum, the North Seas Countries' Offshore Grid Initiative, the Baltic Energy Market Interconnection Plan and the Nordic Cooperation Partnership. The Pentalateral Energy Forum – essentially bottom-up – is of particular interest because it links to the German Energiewende, thereby seeking ways of making different energy transition models compatible with each other via bilateral or multilateral agreements. All instruments can be relatively easily combined with existing more top-down European approaches, such as the Energy Community (EnC) or the Agency for the Cooperation of Energy Regulators (ACER).

### A Proposal for Regional Cooperation Initiatives in South East Europe

The creation of the Central East South Europe Gas Connectivity (CESEC) High Level Group and the region's explicit mention in the Energy Union Package has generated unprecedented political momentum in the region. This is a first step towards a geographical definition of the region (see the following point). This political momentum should be used, in particular to develop the following core elements to kick-start a regional energy cooperation framework.

#### **1. A sound geographical definition of south east Europe**

In the past, regional energy cooperation initiatives in SEE have been held back, partly because of a lack of geographical definition and political fragmentation. The CSEE Gas Connectivity High-Level Group offers a unique opportunity for the geographical definition of the current membership (Austria, Bulgaria, Croatia, Greece, Hungary, Italy, Romania, Slovenia and Slovakia) to be enlarged to other, also non-EU countries. This group can serve as a reference point for further activities, especially if it can develop into a true 'Energy Cooperation Platform'. A precondition is that countries have the possibility to join. Progress in the region is likely to be facilitated if it is approached as an entirety by European institutions and independent financing bodies, organisations or foundations to achieve lasting sustainable reforms in the energy sector. Countries not currently belonging to the CSEE Gas Connectivity HL Group should be given the opportunity to 'opt-in', at least into specific activities with regional impact.

#### **2. A governance structure**

To date, 'governance' has been addressed by a mix of market integration, TSO and regulators' cooperation, and some degree of political cooperation, e.g. government cooperation on the security of supply such as generation adequacy. The CSEE Gas Connectivity HL Group offers an opportunity to embed governance in an already existing structure, which can be enlarged if so wished. The planned Memorandum of Understanding to be approved on July 10<sup>th</sup> in Zagreb, Croatia will focus on the HL Group's work on gas interconnectors in the region. In order to allow regional energy policy co-operation to go further, a separate document will be probably needed, for example in the form of a political declaration stating intent to commit to expanding the Group's scope to issues beyond gas connectivity, such as electricity, heat and energy efficiency.

### **3. Voluntary participation ('opt-in')**

As regional cooperation is voluntary, we propose an opt-in model for membership in 'thematic groups'. All states in a given region could opt into the arrangement if they fulfil minimum criteria. These criteria would need to be defined, but most likely will be partly related to EU energy policy objectives. Offering states the opportunity to design partnerships for mutual benefit as opposed to simple compliance with regulations will create a sense of purpose and ownership in the process. This would allow member countries to go beyond information and knowledge-sharing and accept common policies or even joint instruments.<sup>1</sup>

### **4. Exchange of information and best practice**

All member states of the 'CSEE Regional Initiative' would participate in an exercise to share information and exchange best practice, as happens, for example, in the context of the Pentalateral Forum. This can be seen as the 'entry ticket'. Given the complexity of the region and the somewhat limited governmental capacity, it should be the European Commission, under certain circumstances supported by the Energy Community Secretariat, which could be organising this activity. An example could be the catalogues of projects compiled by the EU and the Energy Community respectively: Projects of Common Interest and Projects of Energy Community Interests.

### **5. Development of an external dimension**

While the 'SEE regional initiative' is firmly embedded in the EU and Energy Community framework(s), activities in the region will impact neighbouring countries. An immediate priority should therefore be to develop 'mechanisms for co-operation' with countries not belonging to the EU or the Energy Community, which are compatible with existing EU laws, treaties and frameworks. One example could be Turkey. An 'SEE regional initiative' will also facilitate inter-regional dialogue within Europe on issues of mutual benefit, such as statistical transfer of renewables across two or more European regions.

### **6. Regional infrastructure planning and investment**

SEE is already well interconnected but needs some additional infrastructure to fill the gaps in the regional network, i.e. strengthening, upgrade and maintenance of electricity interconnectors as well as natural gas interconnectors with reverse flow capacity. It is therefore important that electricity and gas grids have some sort of common concept. The region is also in need of a coordinated approach in the electricity sector in the form of regional power exchanges and network codes. More top-down elements in grid planning – as opposed to the current bottom-up aggregation of national wish lists might need to be introduced. This could be done on a European level in dialogue with regional cooperation structures. A more centralised approach could allow for more strategic, small-scale and cost-efficient projects for the physical connectivity of both electricity and gas markets to be identified as more impactful than cross-national capital-intensive infrastructural projects. These small-scale projects could create an efficient environment and incentives for engaging in focused and functional cross-border cooperation mechanisms. A first step in this direction would be joining and refining the EU's Projects of Common Interest and the Projects of Energy Community Interest Lists.

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<sup>1</sup> Creating a framework where a large number of countries with different fuel mixes, national preferences, and vulnerabilities, degrees of energy market liberalisation under different jurisdictions is complicated. Yet, applying an inclusive regional stakeholders' definition seems to be key to establishing a trusted cooperation framework. As regional energy cooperation offers economic benefits and potential access to further financial incentives, some regional stakeholders might be stimulated to undergo reforms in order to join these regional cooperation initiatives. Hence, while benefiting directly and meeting national objectives, they will be complying with EU objectives towards a European Single Energy Market.

## 7. *Streamlining financing instruments across the region*

As with governance and infrastructure planning, a regional approach to public financing will probably be required. South east Europe is negatively impacted by the lack of regional approach to the Balkans by EU financing institutions and funding programmes.<sup>2</sup> Generally, the various financial instruments do not operate in a harmonised and coordinated manner in the region.<sup>3</sup> A framework for regional energy policy cooperation in SEE could provide for gradual convergence of existing financing instruments; eventually making it feasible to finance regional cross-border projects between non-EU and EU member states. It could also help to generate competition for finance between countries and regions. Another way, at least theoretically, could be through increasing the percentage of EU funding for regional energy projects.

### Making it Work Requires Trust

The lack of communication and effective cooperation among south east European states can in part be attributed to the systemic lack of trust resulting from historical and partly unresolved conflicts. The best means of overcoming this is through European mediators, such as the European Commission, to highlight the potential gains for all involved of regional cooperation, in this case for energy consumers. This is where regional energy cooperation frameworks will play a major role.

In parallel, it is important that citizens have trust in regional initiatives. Hence, regional initiatives need to be more than just a framework for business. Citizen and other stakeholder involvement will need to be guaranteed in discussions on the impact of energy price liberalisation, energy prices, energy poverty but also transparency in financing large-scale infrastructure. Most likely, the EU will need to play an instrumental role in this process by bringing all relevant stakeholders in the region together to discuss the pros and cons of pursuing EU energy objectives.

A lack of transparency impedes greater EU engagement in the region. In addition, greater emphasis should be placed on understanding and addressing the concerns of stakeholders in the region that critical energy infrastructure and market actors may be controlled by foreign investors or private interests, the so-called state capture. The degree of influence of these interests on national energy policies could be further assessed through the European Commission. Steps in this direction have already been taken. This would both increase the trust of south east European citizens in the EU but also eliminate corrupt practices and increase the transparency of issues of concern to the EU, international financing institutions and international investors.

### Possible Priorities

Central and south east European energy policy cooperation requires a practical and problem-solving approach in which countries are free to join an initiative. A top-down political platform for this could be the SEE Gas Connectivity High Level Group, whereas the bottom-up operational role would still need to be found. The potential of the Energy Commission under the SEE Cooperation Process Parliamentary Assembly could be explored. Ensuring that these two governance structures are intra-operational is a pressing and priority challenge. The initiative is most likely to be successful if it manages to pool rather than duplicate existing initiatives while avoiding setting up new structures.

<sup>2</sup> A commonly cited example is the planned Bulgaria-Serbia gas interconnector, whose construction is pending as funds are unavailable to complete the Serbian stretch of the pipeline.

<sup>3</sup> One such example is the Green for Growth Fund ([www.ggf.lu](http://www.ggf.lu)), supported by KfW Development Bank and the European Investment Bank, a fund, which is available to Western Balkan states, Ukraine, Moldova, Georgia, Armenia and Azerbaijan and Turkey but is not available to the EU-member states in the region (Greece, Bulgaria and Romania).

Another key element is to address concrete measures, projects and actions, especially adopting no-regret measures. A number of such measures have been identified and could be explored and revised as the process unfolds.

- Regional electricity emergency frameworks
- Regional SEE and CSEE gas market
- Renovation of the heating sector
- Regional research initiatives, e.g. storage potential of SEE, district heating, high-efficiency stoves, waste heating etc.
- Market coupling
- Integration of renewable energy at regional level
- Streamlining of finance instruments
- Energy efficiency policy: exchange of information and best-practice
- Market-based approaches to electricity and heat pricing
- Regional power exchanges
- Gas market integration and gas hubs

### Concluding remarks

The above proposal is meant as a contribution to give impetus to the Energy Union innovation on regional energy policy cooperation. The proposal, if implemented, could be the first step for SEE towards better integration in the region and within the EU's internal energy market. It could also offer the prospect of achieving the EU's energy and climate objectives.

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