Issues and Questions: The European Council's Energy Action Plan

By Michael Schuetz, Michael Kilpper and Michael Fraas*

On 8-9 March 2007, the European Council debated energy and climate policy as one of the key challenges in the years ahead. The Council set ambitious goals for reducing greenhouse gases with firm targets that underpin Europe's leadership in global climate protection. In order to help achieve a global agreement for the period after 2012, the European Council adopted a 2-step approach to setting future EU climate goals. By 2020, the EU will cut its greenhouse gas emissions by 30% as against 1990, provided that other developed countries make comparable emission reduction pledges. Otherwise, the EU will pursue a binding unilateral reduction target of at least 20% by 2020.

The European Council also agreed on a comprehensive European Energy Action Plan[1]. In the following we will focus on three of the five areas of this Action Plan: energy efficiency and renewable energies, internal market for electricity and gas and finally international energy policy. Two areas, energy technologies and security of supply, are omitted due to lack of space but also due to the fact that they are not part of the specific areas of expertise of the authors. The aim of this article is to identify the main issues, problems and questions to be solved in these three fields.

Energy Efficiency and Renewable Energies

Given the importance the Spring European Council put on climate change combined with the disaccord on the role of nuclear energy, it is logical that the EU pursues an ambitious energy efficiency and renewable energy policy.

The European Council made tangible progress in relation to energy efficiency and renewable energies. The member states agreed to meet the 20% target of prospective savings identified by the Commission as measured against the forecasts for 2020. Next to combating climate change, it is considered important to counteract price risks and over-dependency on supply sources by improving energy efficiency. It requires action in the five priority fields identified in the Council conclusions of 23 November 2006[2] and also supports the EU Commission in its plan to develop a proposal for an international agreement on energy efficiency.

European leaders also want to create incentives and reliable conditions for renewable energies in order to keep and extend Europe's technological lead in this area. The member states have consequently agreed to a binding target of a 20% share of renewable energies in the overall EU energy mix by 2020. Biofuels will be required to make up10 % of petrol and diesel consumption in the transport sector of the member states by 2020.

The strongest part seems to be energy efficiency. It is at the heart of a strategy that tries to combine energy security, environmental protection and economic competitiveness in a single approach. The problems that come along with a 20% target refer to the economics behind any energy efficiency policy as well as to the issue of viable policy instruments.

As rebound effects cannot be ignored, and not easily (if at all) be quantified, it is absolutely sensible to refrain – as the Council has done – from setting binding targets. Energy efficiency (or better: energy productivity) is the result of human actions, an aggregate of uncountable individual decisions. It is here, where the problems can be found: how do we get people to save energy and employ more efficient means?

The EU has decided to use targets as the primary instrument to increase energy efficiency. However, targets themselves do not increase energy efficiency. There is the risk that setting targets may lead to neglecting the necessary next step: implementing concrete measures to achieve the targets.

Whereas this point can be made for targets for renewable electricity production or biofuels, too, energy efficiency targets are also difficult for another reason: In order for targets to be viable, they need to be measurable. However, progress in energy efficiency is difficult to quantify. This leads to the partial transfers of political influence from legislators to statisticians. Furthermore, there is the risk that a considerable amount of administrative capacity is absorbed by developing and negotiating methodologies instead of being used for implementing relevant policy instruments. The slow-going implementation of the European Eco-Design-Directive may be an example in this respect.

The situation is different for renewables. As it refers solely to the inputs

* Michael Schuetz, Michael Kilpper and Michael Fraas work in the DG Energy of the German Federal Ministry of Economics and Technology on EU energy policy. They write in a private capacity. Michael Schuetz and Michael Kilpper work in the Energy Efficiency Division and Michael Fraas works in the Legal Division responsible for the regulation of electricity and gas markets.
See footnotes at end of text.

of energy production, a binding target can be achieved. Criticism might address the need for directly subsidizing renewables once emission trading for fossil fuels changes the relative prices of these technologies to their benefit. However, the policy now adopted will lead to more pragmatic questions: how should the burdens be shared among EU member states? And how can such a system be made efficient? Much will depend on the flexibility of the approach in the short-run. In the long run, Europe might wish to think about harmonization of its support schemes for renewables in order to make full use of comparative advantages of natural differences.

Internal Market for Gas and Electricity

The Commission's sector inquiry on the gas and electricity markets[3] has identified deficiencies in implementing liberalised electricity and gas markets in the EU. Two issues will be most prominent in the future discussion on improving this situation: unbundling and the EU's influence on national regulators.

In its report of January 2007[4] the European Commission suggested Ownership Unbundling or - alternatively - system operation separated from ownership of the assets ("Independent System Operator", ISO). The European Commission clearly prefers the former.

There is mutual consent among Member States to make unbundling more effective. Hence the European Council's Energy Action Plan emphasizes the need of effective unbundling, based on "independently run and adequately regulated network operation systems which guarantee equal and open access to transport infrastructures and independence of decisions on investment in infrastructure"[5].

However the means for achieving more effective unbundling are controversially discussed. What are the shortfalls of the existing unbundling rules? What is ownership unbundling useful for? Is it a "panacea" to solve all problems with regard to gas and electricity networks?

Current EU rules require legal, functional and informational unbundling as well as unbundling of accounts. Although not required by European law, 11 Member States already have adopted ownership unbundling, as contended in a European Commission's statement[6]. There are Member States where the transmission networks are privately-owned (e.g., in Germany), and there are others where such networks are owned by public sector bodies such as the state, regions or local authorities (e.g., in the Netherlands or Sweden).

From the European Commission's viewpoint legal unbundling does not suppress the conflict of interest that stems from vertical integration. In particular, the European Commission stresses insufficiencies with regard to non-discriminatory access to information, third party access and investment incentives. According to the European Commission's report[7], economic evidence shows that Ownership Unbundling is the most effective means to ensure choice for energy users and to encourage investments in networks.

Ownership Unbundling is the most effective, clearest and "easiest" means to prevent discriminations in the network. However, it does not make regulation redundant. An "unbundled" grid operator has to be controlled, too, in particular with respect to grid fees. Ownership Unbundling does not necessarily and not automatically encourage investments. The "unbundled" grid operator pursues at first its own interests that are not always identical with grid users' interests.

The ownership structure regarding the networks differs in each Member State. Networks are owned in some Member States by public sector bodies (e.g., state agencies, regional or local authorities), in other Member States by private companies. In 7 of the 11 Member States where, according to the Commission's statement, ownership unbundling of the electricity transmission networks is already practised, the State is owner of the networks as well as of generation or supply companies. It is arguable if such a situation can be qualified as Ownership Unbundling stricto sensu, even though the respective entities are under control of different government authorities. And the question must be raised, why state ownership in networks shall be privileged compared to private ownership.

Not all "pros" and "cons" can be discussed here. Nevertheless Ownership Unbundling can be a solution. But it is not the only one. Other solutions such as the creation of an ISO or improving the existing requirements shall not be excluded.

Aside from strengthening national regulators' competences and independence, the European Commission suggested strengthening the co-ordination of regulators at the EU-level with regard to cross-border matters. To this end it proposed (i) to reinforce the current co-operation, (ii) to introduce a formalised network of European regulators (ERGEG plus) which shall be vested with the power to make binding decisions or (iii) to create a European regulatory authority.

In its European Energy Action Plan the European Council favoured the establishment of an inde-

pendent mechanism for national regulators to co-operate and take decisions on important cross-border issues.

However, when designing the institutional structure of an EU-wide co-operation mechanism it should be considered that such a mechanism has to be independent from industry, national governments as well as the European Commission. This mechanism should implement rules. It should not be vested with legislative powers. The rules to be applied by the mechanism shall be made by the appropriate legislative bodies. The mechanism shall apply law with regard to cross-border regulatory matters, but not competition law. The application of the latter should remain in the hands of the cartel authorities.

International Energy Policy

The March 2006 Commission Green Paper, "A European Strategy for Sustainable, Competitive and Secure Energy", followed by the so called "Solana-paper" published jointly by the High Representative of the Council and the European Commission[8] were the first approaches to describe and define roles and ambitions of the EU in this field in a comprehensive way. However, many initiatives already existed. What was new was the outright claim, that "the need for a coherent and coordinated external policy for energy in Europe is imperative"[9]. Out of a patchwork of initiatives a comprehensive although not coherent new EU policy is in the making.

The International Energy Policy section of the Energy Action Plan is based on the core document, "An Energy Policy for Europe", of the Commission's "energy package" published in January[10]. However, in contrast to the ambitious rhetoric on the importance of an EU external energy policy, the international section of the Energy Action Plan is rather frugal. Next to codifying the goal of developing a "common voice" it contains a list of the most important existing and projected initiatives and areas for action, thereby giving a good overview on the scope and character of the EU's external energy policy. The building blocks of this policy can be roughly classified into four groups:

Firstly, the EU has numerous bilateral relations with non-EU-countries, where energy issues play an increasing part. The most important and most conflict prone is the one with Russia. Other partnerships and dialogues take place with big consumer countries like the USA or emerging economies like China, India or Brazil. They normally take the form of yearly summits supplemented by working groups.

Secondly, the EU is involved in several regional initiatives in its "Hinterland". Among them are Euro-Med for the Mediterranean and the Baku-initiative for Central Asia and the Caspian and Black Sea region. The advantage of regional initiatives is, that next to increasing the dialogue of the EU with its neighbours, they could also help to facilitate cooperation between the countries of the respective region. The envisaged partnership with Africa is difficult to label. Whereas the above mentioned regional initiatives assemble neighbouring areas which share at least some common features, this new endeavour has its aim at a whole and diverse continent. The decisive question will be, if the African Union will be able to act as the EU's counterpart in the new partnership.

Thirdly, there is the relatively new European Neighbourhood Policy (ENP). Its objective is to develop a comprehensive and coherent approach for the EU towards its neighbouring countries and regions. Up to now, its main role is the provision of an umbrella for the provision of financial aid. However, a thematic dimension of the ENP is developing. It remains to be seen if it will merely be a sum of existing initiatives or if something genuinely new will develop.

Lastly, there is the Energy Community, initially designed for South East Europe, but now developing steadily into a model on how to expand the EU's approach of a common energy market. It is distinct from the other initiatives above, in the sense that its approach is the legally binding inclusion of certain countries (and Kosovo) into the EU's energy market (which includes the implementation of certain parts of the aquis communautaire) underpinned by a secretariat and decision making bodies modelled alongside the EU bodies including a rotating presidency[11]. Up to now this approach is not in question, since all countries involved are, at least potentially, candidate countries for EU membership, hence they have an interest in implementing EU rules. However, it is questionable if this rather rigid approach could be suitable for other neighbouring regions of the EU.

In contrast to other policy areas, this rather random structure stems from the fact that the EU's external energy policy is developing within an institutional framework distinct from other domains of EU energy policy.

The European Community has no explicit competence on energy; the necessary legal basis has to be drawn from the legal basis of other policy areas, which are interlinked with energy issues. The EU's policy on electricity and gas markets for example stems from the Communities' competence for creating the common market. The environment articles provide the basis for many other energy initiatives. To

conclude, most internal energy policies have a clear legal basis, which leads to clear procedures.

For external energy policy, as for the EU's foreign affairs in general, Member States retain their prerogative. Therefore, a comprehensive and coherent external energy policy would require prolonged unanimity by all 27 Member States, which is unrealistic. Therefore, the EU's external energy policy consists of piecemeal initiatives and fora, in areas where a legal basis exists or for which step by step an agreement among the Member States can be reached.

This incoherence is also reflected in the various actors involved. The rotating EU presidencies play an important role. Since Member States differ with respect to their experiences, priorities and interests, every presidency can give a new impetus. This helps to avoid that certain aspects are neglected and it facilitates new initiatives. However, it may lead to a patchwork approach to policy. The existing plethora of often overlapping activities and initiatives may stem from the system of rotating presidencies. Additionally, although presidencies see themselves as representatives of the Member States, this is often not reciprocated by every individual Member State. Existing rivalries or lack of trust can decrease the role of the respective presidency as a sole negotiator for the EU in external affairs.

The Council has appointed a High Representative to coordinate and act as spokesperson in foreign and security policy. However, his concern mainly is the "classic foreign and security policy" – world conflicts. He also lacks the necessary resources – staff and expertise – for a specialist policy like energy.

Finally, the Commission plays an ever-increasing role in the EU's external energy policy. This stems from the fact that the Commission is the only institution, which combines resources and consistency. The presidency may draft and negotiate a summit paper, but the Commission's services will be the ones who will do the follow up. However, the Commission services are not a monolithic block. Although the Commissioner for Energy and the Directorate General for Energy and Transport (DG TREN) are the most active Commission actors in the field of external energy policy, the Commissioner and DG for External Relations (DG RELEX) have identified energy as one of their priorities. Whereas TREN has its emphasis on sectoral (energy) fora and initiatives, RELEX has its focus on bilateral relations with non-EU-countries and on the European Neighbourhood Policy.

The envisaged constitutional treaty will only partially streamline this institutional framework. According to the conclusions of the June European Council[12], there will be a specific competence for energy policy. The merging of the office of the High Representative with the one of the Commissioner for external relations will decrease the number of actors, the new position of President of the European Council will improve continuity. What remains to be seen, is the share of roles between the Energy Commissioner and the future holders of these two new offices.

Although a more clearly defined legal basis and streamlined institutions will increase transparency and smoothness of the policy process, political factors will likely remain more important than legal considerations. Most notably, Member States will remain strong in foreign policy. Given the different interests but also different traditions of Member States (e.g., on the role of government in the energy sector and in infrastructure development) it will remain difficult to achieve a coherent external energy policy. However, the EU surely will further increase its activities in this field. Since external energy relations are more based on dialogue and funding in contrast to regulation, the lack of a clear transfer of competence from Member States to the EU will not be a hindrance for further initiatives. Therefore, the likely outcome will be a dual foreign policy: both the EU and the Member States are active, with periodic attempts for coordination. The resulting unavoidable incoherence can also be seen as strength, since, given a minimum of coordination to avoid gross contradictions, it would increase the ability of the EU and its Member States to react adequately to external challenges. The EU as well as the individual Member States can concentrate on what they are best equipped for and common objectives could be pursued via different channels.

Footnotes

[1] Brussels European Council 8/9 March 2007 – Presidency Conclusions, Annex I (Council document 7224/1/07).

[2] Council conclusions on the Commission's Action Plan on Energy Efficiency (Council document 15210/06).

[3] http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html

[4] Communication from the Commission to the Council and the European Parliament: Prospects for the Internal Gas and Electricity Market. COM(2006) 841 final (cf. http://ec.europa.eu/energy/electricity/report_2006/index_en.htm).

[5] Cf. footnote 1.

[6] Communication from the Commission to the Council and the European Parliament: An Energy Policy for Europe. COM(2007) 1 final (cf. http://ec.europa.eu/energy/energy_policy/documents_en.htm).

[7] Cf. footnote 4.

[8] An External Policy to Serve Europe's Energy Interest. Paper from Commission/SG/HR to the European Council. (cf. http://ec.europa.eu/external_relations/energy/index.htm).

[9] The website on External Energy Policy of the European Commission's DG External Relations starts with this claim (http://ec.europa.eu/external_relations/energy/index.htm).

[10] Cf. footnote 6.

[11] http://www.energy-community.org/

[12] European Council 21/22 June 2007 – Presidency Conclusions, Annex I (Council document 11177/1/07).

Announcement

10th Annual IAEE/USAEE Session at ASSA Meeting

New Orleans, Louisiana, USA - January 4, 2008

Hilton Riverside Hotel, Chequero Room – 10:15am

Hot Topics in Energy Modeling

Presiding: Carol Dahl, Colorado School of Mines

Reid W. Click and Robert J. Weiner, George Washington University – *Resource Nationalism Meets the Market: Modeling Political Risk and the Value of Petroleum Reserves*

Erin Baker, University of Massachusetts, Haewon Chon, University of Maryland, Leon Clarke, Joint Global Change Research Institute, and Jeffrey Keisler, University of Massachusetts – *Uncertainty, Climate Change, and Advanced Solar R&D*

Thomas K. Lee, Marymount University and John Zyren, U. S. Energy Information Administration – *The Source and Transmission of Volatility in Petroleum Markets*

Cynthia Lin - University of California, Davis -- *Do Firms Interact Strategically?: A Structural Model of the Multi-Stage Investment Timing Game in Offshore Petroleum Production*

Discussants: **Douglas Reynolds,** University of Alaska-Fairbanks
James L. Smith, Southern Methodist University
Frederick L. Joutz, George Washington University
Wumi Iledare, Louisiana State University

Abstracts will be posted soon at http://www.iaee.org/en/conferences/

Abstracts are posted at http://www.iaee.org/en/conferences/

The meeting is part of the Allied Social Science Association meetings (ASSA).
For complete program information please visit http://www.vanderbilt.edu/AEA/Annual_Meeting/index.htm

Also, please watch for the IAEE/USAEE Cocktail Party.