# EU Energy Infrastructure Policy – Unintended Redistribution of Economic Opportunities?

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In 1987, the European Union adopted the Single European Act extending the scope of the internal market. A 1988 green paper proposed to include also the energy sector in this work (Commission of the European Communities, 1988). In order to realise such free trade in energy within and across the member states, *free access to infrastructure services and further investments in infrastructure* were seen as pivotal measures. Control over infrastructure by a single supplier would not be compatible with the right of energy consumers to exercise free choice of whom to supply their energy. To ensure an independent energy infrastructure thus became the most important policy issue in the internal market project of Europe, challenging the hitherto dominant vertical integration mode of organising electricity supply.

At the core of the many political aims formulated for the internal energy market project were lower energy costs for consumers, thought to arise from price competition between suppliers, and hence, an increase in welfare at the European level. Lower costs for the European energy-intensive industry was singled out as particularly important to increase its global competitive power. The internal energy market project as such reflected the general free market credo that consumers would be the true beneficiaries. Lower prices and the zero-sum competition expected to emerge, would, on the other hand, produce both winners and losers among European energy producers/suppliers.

After cumbersome negotiations, the European Union arrived at directives specifying some minimum rules for non-discriminating access to infrastructure, in 1996 for the electricity market and in 1998 for the natural gas market. Another decision (decision No 96/391/EC) identified bottlenecks in the European energy infrastructure, and set down guidelines for funding of infrastructure projects aimed at removing these. A period of euphoria followed in which the European Commission reported swift progress in implementation of the directives. Into the 2000s, however, the European Commission came to describe the situation quite differently, reporting on major asymmetries between the member states in implementation of the directives (Commission of the European Communities, 2000, 2001, 2002, 2003a). The Commission proposed new measures and shorter deadlines for full market opening and urged the Council to adopt these in order to rescue the internal market project. Revised electricity and gas market directives were adopted in 2003 (European Parliament and the Council, 2003a, 2003b) as a second legislative package for a full liberalisation of European electricity and gas markets, as well as a new Regulation on cross-border exchanges in electricity (European Parliament and the Council, 2003c) and new

guidelines for trans-European energy networks (Commission of the European Communities, 2003b).

Despite of these revisions, concerns voiced by consumers of limited choice and new entrants on barriers to access of infrastructure made the European Commission launch an inquiry into competition in gas and electricity markets in 2005. In its 2007 communication, the Commission concluded that the objectives of market opening had not yet been achieved, that major barriers to free competition still remained and that significant rises in gas and electricity wholesale prices had taken place that could not be fully explained by higher primary fuel costs and environmental obligations[1] The Commission concluded that wholesale gas and electricity markets remained national in scope and maintained the high level of concentration of the pre-liberalisation period, giving scope for exercising market power.

Concerning access to infrastructure, the Commission concluded that the vertical integration between network and supply interests had negative repercussions for market entry and incentives to invest in networks. The Commission report stated that new entrants lacked effective access to networks (in gas, also to storage and to liquid natural gas terminals) despite the existing unbundling provisions and that operators of the network/infrastructure were suspected of favouring their own affiliates (discrimination). It further stated that vertical integration had led to a situation where operational and investment decisions were not taken in the interest of network/infrastructure operations, but on the basis of the supply interests of the integrated company (including grid connection for competing power plants). Additionally, the report stated that a high level of integration of generation/imports and supply interests within the same group reduced the incentives for incumbents to trade on wholesale markets and to lack of liquidity in these markets, in turn an entry barrier to both the gas and electricity markets. Insufficient or unavailable cross-border transmission capacity was still viewed as a barrier to market integration. A range of other barriers were listed, to mention only lack of transparency, reliability and timeliness of information on network availability, especially for electricity interconnections and gas transit pipelines.

In order to again push the internal market project, the European Commission proposed the adoption of a third legislative package on the internal electricity and gas market as part of its comprehensive 2007 energy and climate policy package. Here, the Commission stated the main objective to have a complete internal energy market with open competition and effective regulation in place by January 2009, with a real European grid working as a one single grid. A number of measures were proposed:

[1] Commission of the European Communities, Inquiry pursuant to Article 17 of Regulation (EC) No 1/2003 into the European gas and electricity sectors (Final Report),{SEC(2006) 1724}, Brussels, 10.1.2007, COM(2006) 851 final

- New rules to avoid discrimination, through a clearer separation of energy production from energy distribution, with a clear preference for full ownership unbundling
- A new single body at the EU level, or at a minimum a European network of Independent Regulators to make European-wide regulation functioning, not least to facilitate cross-border trade
- Proposals to speed up investments in key bottlenecks, typically occurring at borders between countries and for offshore-wind power connections
- New legislation to ensure minimum requirements for transparency
- Common minimum, binding network security standards

The 2007 Spring European Council failed to discuss the proposals, certainly reflecting great internal disagreement. Instead, they invited the Commission to come up with more detailed legislative proposals. Strong internal disagreement also characterised the Energy Council meeting in June 2007, with the full unbundling of ownership as the most contentious issue dividing the member state ministers. Despite the absence of any clear advice, the European Commission 19 September lauched its new legislative package, which included proposals for:

- ownership unbundling in production and transmission (unbundling at the lower distribution level had been omitted)
- creation of independent national regulators (to be funded from outside the ministry structure)
- establishment of an EU-wide regulatory agency overseen cross-border trade
- new formal co-operation mechanisms between national transmission system operators
- a proposal to prevent take-over of transmission systems by third countries (referred to as the Gazprom-clause)
- new requirements fore reporting to regulator to ensure greater transparency concerning grid tariffs

The major problems for the EU Commission in getting adopted a clear legislative mandate to ensure free third party access to energy infrastructure and act on bottlenecks have left serious doubts about gains of European energy consumers compared to what they were promised 19 years ago when the European Commission launched its idea of an internal energy market. The failure is allegedly proven by the sharp recent rise in electricity prices above pre-liberalization levels, attributed partly to lack of competition stemming from market concentration at the supply side and discrimination in access to infrastructure, lack of incentives to invest in additional infrastructure.

The electro-intensive industries in Europe is particularly disillusioned by the non-functioning electricity market, gradually losing opportunities to engage in negotiations of long-term contracts that in the past ensured stable business conditions, without reaping new opportunities in a competitive market. As a consequence, the international competitive position of many European electro-intensive industries is said to have deteriorated sharply.

On the other hand, major energy suppliers in several member states appear to have managed better than feared, linking their prices to the cost of operating the marginal (highest cost) plant to meet electricity demand in the system and relatively well sheltered from competition.

This study investigates further the EU energy infrastructure policy processes aimed at creating independency in infrastructure operation and pace in development of additional infrastructure. *We ask for explanations to why the interests of energy consumers (free access and absence of bottlenecks in energy infrastructure to promote lower energy prices) appear to have lost ground relative to those of energy suppliers in the process.*

Next, the study discusses likely development for EU energy infrastructure policy in the near future, and implications for Nordic energy system agents, informed by the state of current driving forces identified above.

**Multilevel explanatory framework**

The study will take on a multi-level analysis approach, meaning that possible determinants for the policy outcomes at the EU level would be scrutinised at the sub-national, national, EU, and global levels (Skjærseth & Wettestad, 2002). The starting point is that EU policy reflects the weighing of different sub-national interests and considerations up against each other, with energy-intensive industries and the energy industry as key interest groups tied to making and implementation of EU internal energy market and energy infrastructure policies. At the bottom line, these and other interest groups make their claims via national governments, who aggregate and integrate them in the decision-making processes at the EU-level (in the Council). They also lobby EU institutions more directly through all-European industry federations.

Given the discrepancy between policy outcome and policy intentions regarding measures benefiting energy consumers relative to energy producers, a starting hypothesis would be that *the relative political leverage of the two industry groups* differed and changed in the period in energy infrastructure policy processes at member state and the European Union levels. Typical indicators of 'political leverage' would be the resources available for lobbying in different stages of policy development as well as the degree of internal unity and cohesion within the Euro-federations. *We expect the policy outcome to reflect stronger lobbying resources and internal unity within energy industry federations than within energy consumer federations.*

A second explanatory approach assumes less direct influence by industrial groups but rather that the policy outcome reflects the preferences of the member state governments (Moravcsik, 1991;1998;1999). This approach implies that the Council will be the most powerful player in the policy-making process, and that we should focus on the shifting aims and priorities of the political executives in key member states. The corresponding main hypothesis will be that *lack of energy infrastructure policy development reflects the most powerful member state coalition in the council.* Potential factors underlying national governmental postitions could be:

- The relative political leverage of energy producers and energy consumers (and shifts in such relative leverage), reflected e.g. in the relative national economic weight and employment production by the two groups of industries. The corresponding hypothesis reflecting the EU policy outcome would be higher leverage over time for producer- than consumer industries within the most powerful Council coalition's respective constituencies.

- Ideological variation and shifts over time within the member states concerning views on the free trade/welfare nexus. The corresponding hypothesis reflecting the EU policy outcome would be skepticism towards free trade/growing scepticim within national governments belonging to the most powerful Council coalition

- Changes in energy policy priorities of member state executives (climate and energy security bringing in new dominant views on the relationship between competition/low energy prices and welfare. The hypothesis reflecting the EU policy outcome would be higher focus on and greater problems of achieving national goals concerning lower national climate gas reductions and better import/export balances within national governments belonging to the most powerful Council coalition

- At the aggregate Council level, the corresponding hypothesis reflecting the EU policy outcome would be changes in composition of the Council (new member states added in 2004) with different political leverage for industry groups (producer and consumer groups), different ideological views on competition/free trade and different policy priorities

A third explanatory perspective turns to the EU level executive, *the European Commission*, and the *European Parliament* as co-decider to the Council, for determinants of policy outcome, key institutions in the 'Brussels game" alongside the Council (Hooghe and Marks, 2001; Sbragia 2000; Weale et al., 2000). The Commission has a unique position as initiator of policies, as watchdog for member state implementation and in the provision of expertise and input throughout the decision-making process. *The corresponding explanatory hypothesis will postulate that lack of policy development to ensure an independent energy infrastructure development/lower energy prices reflects decisions made by the Commission and the European Parliament.*

Different factors could have contributed to lack of policy-driven independent energy infrastructure development, such as:

- A shift in policy priority (climate change and energy security bringing in new views on the relationship between competition/lower energy prices and welfare)

- A shift in the political power of directorates (with less leverage of DG Competition and DG Enterprise compared to DG Energy and DG Environment)

A final explanatory perspective would bring in international circumstances relevant for explaining the policy outcome. Here, we could think of a 'global energy anarchy situation' driver of EU policy-making, either directly or indirectly via impacts on member states and the Council positions. After 2000, energy has increasingly been interconnected to global security issues, with fear of supply interruptions of oil from the Middle East and natural gas from Russia, eager to use natural gas as an instrument to gain leverage in international politics. The corresponding hypothesis reflecting the EU policy outcome would be that such global anarchic tendencies have spilled over into EU policy-making, increasing the skepticism about free trade as the proper model to ensure national and EU energy security goals.

We could also think of global climate policy trends driving EU policies. Within global climate negotiations, the 'cap and trade' vs 'breaking technological trajectories' differ as preferred solutions, the former oriented towards market agents choosing the least cost solution once caps have been established and latter towards greater involvement by governmental agents in supporting diverse technologies. The corresponding hypothesis would be that such larger international disputes have trickeled down into EU decision-making with more skepticism of free-market and higher acceptance of regulated solutions.

We could finally think of a more general global trend shift driving EU-policy making. Different organizational scholars point to the global diffusion of policy concepts as driver of national policy changes, just like the energy sector free trade and competition reforms evolved as an international phenomenon in the 1990s (DiMaggio & Powell, 1991). There are signs that competition, fragmentation and 'splitting of functions' as principle for public policy (new public management) is increasingly replaced by the new public policy principle 'whole of government', stating the need for more co-ordination in public sector affairs in order for complex problems to be resolved. (Christensen & Lægereid, 2007). A corresponding explanatory hypothesis would postulate that the lack of outcome in EU policy aimed at splitting and fragmenting energy production and infrastructure have been influenced by the spreading of the new 'whole-of-government' ideas spreading at the global level, trickling down into the EU or national levels, i.e. that the EU policy outcome reflects a *global diffusion of new ideas concerning what should be proper energy market policy in a complex world.*

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