

Addressing policy overlaps through the Governance of the Energy Union

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I. What is governance and why is it necessary?

Governance refers to the rules framing the decision-making process. A system of governance establishes the process by which authority is conferred to the decision-maker, and the framework under which that authority will be exerted. It articulates who makes the decisions, as well as how and when they are made. Adequate governance should ensure transparency in the planning of policy, accountability in its implementation, and clarity in its assessment. By doing so, it provides for reliability and accuracy, which is very important to many of the stakeholders.

Climate change policy governance is particularly important, as it needs to deliver the stability and predictability of the price signal required for low-carbon investments. This stability should not be equated with rigidity, as unforeseen events and issues will inevitably emerge. Governance must, however, provide transparent rules to address in an orderly and predictable way any new events, including policies and policy instruments, some of them by definition unforeseen.

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As well as offering a framework to address expected as well as any unexpected events, appropriate governance should deliver integration in planning. Climate policy is complex, made up of a variety of national and international instruments, which inevitably interact. If governance must first ensure the coordination of these instruments to prevent any contradictory action, it should go further and work for the *integration* of policies, and for the exploitation of their possible synergies. Making use of these synergies will be important if we are to raise the level of, and have a chance of achieving the goals of the Paris Agreement in a cost-efficient way.

II. The current Commission Governance proposal

On November 30, 2016, the European Commission released the “Clean Energy for all Europeans” package, which included a proposal on “Governance of the Energy Union”.

The Governance proposal is comprised of a series of plans, strategies and reports (see annex), which are designed to ensure that Member States set targets consistent with long-term EU climate objectives. In addition, the proposal also sets up periodic assessments by the Commission of several of these national plans and reports, with the possibility of issuing recommendations to Member States, based on these assessments.

The Governance proposal promotes the coordination and integration of the policies adopted under the five pillars of the Energy Union ((i) energy security, (ii) integrated energy market, (iii) energy efficiency, (iv) decarbonisation, and (v) research, innovation and competitiveness). It also aims to enhance transparency and accountability of climate action by Member States.

As part of the new Governance regulation the Commission will also publish an annual State of the Energy Union report, covering all five pillars of the Energy Union. It will be comprised of the Commission’s own assessment of Member States progress, as well as recommendations, but will also include reports addressing the different dimensions and elements of the Energy Union (for a brief overview, see annex). It will in particular incorporate, or at least cover, the Carbon Market Report, detailing the functioning of the EU Emissions Trading System (ETS).

One aspect that is specifically addressed is that of overlapping policies, which is crucial if the governance is to enhance policy coherence and integration. The current proposal stipulates that Member States must describe and assess interactions between policies in their integrated national energy and climate

plans (Art 8.2.c). A comparable obligation at the EU level, and a framework to address these overlaps, however, is not included in the European Commission's proposal. For instance, the proposal does not explicitly address overlap between other policies and the ETS.

III. Legislative process

After a debate in the Council, the proposal is currently being discussed in the Parliament. It is scheduled to be voted on in the Environment, Public Health and Food Safety (ENVI) and Industry, Research and Energy (ITRE) Committees in late November 2017. The plenary vote has not been scheduled yet, and its timing will depend on the discussions and the vote within the responsible committees.

Published in May 2017, the Draft Report of the rapporteurs does not propose any amendments that go in the direction of addressing overlapping policies. However, individual amendments that do address the issue directly have since then been tabled.

These amendments range from requesting the Commission to verify and measure – in its assessment of Member State progress – the effects of national policies on the supply-demand balance of the EU ETS, to proposing a fully-fledged mechanism in which the Commission would require Member States to cancel sufficient numbers of allowances to neutralise these effects.

The number of amendments tabled testifies to the importance Members of the European Parliament (MEPs) attach to the issue of overlapping policies, and to the feeling that the issue is not sufficiently addressed in the current Commission proposal.

IV. Addressing interactions through governance

Given the intricacy of the challenges posed by climate change, EU climate policies can be qualified as complex, multi-layered and interactive. These interactions can occur between different levels, as well as between elements of the same package.

Firstly, EU climate policy-making *operates in the context of wider United Nations Framework Convention on Climate Change (UNFCCC) commitments*. Various EU policy instruments *interact at the EU level itself*: the Renewable Energy Directive has for instance a direct impact the demand side of the EU ETS.

Policies adopted at the *Member State level* may also affect *EU level instruments*: e.g. a decision to close coal plants can interact with the EU ETS. Finally, interactions can occur at the *level of the policy instrument* itself (e.g. within the EU ETS).

To deliver coherent climate policies and their effective implementation, the Energy Union must make provisions to address these interactions. By stating that “the Energy Union needs strong Governance ensuring that policies and measures at various levels are coherent, complementary and sufficiently ambitious”, the Commission proposal does acknowledge this to certain degree. It, however, makes no specific provisions to address the issue.

One aspect to be highlighted is that the assessment of these interactions must be carried out at the appropriate level. In this case the term “appropriate” must refer to the level that has jurisdiction (oversight) over the interacting elements.

It is not, and should not be, the objective of a Governance of the Energy Union document to make specific provisions, install mechanisms, and/or seek to address all possible interactions. Nor it should be its task to fix directly any of the elements of the Energy Union (e.g. EU ETS). In addition, given the broad range of components of the Energy Union, and the many combinations of possible interactions, it must be clearly acknowledged that this is neither feasible, nor, for that matter, desirable.

While some interactions have been identified and are to some degree understood, many have not yet emerged. It needs to be acknowledged that they will be unknown at this time. We must accept that there will be future events and interactions which we cannot predict.

The function and responsibility of a governance system, however, is to provide a framework to address any issue when it arises, in a predictable manner. In addition, what policy instrument should constitute the adjustment variable (e.g. Renewable Energy (RE), Energy Efficiency (EE), EU ETS), is one of the issues that the governance should provide process and instruments for.

If the Governance document is not to include references to specific mechanisms dealing with particular policy overlaps, it should nevertheless explicitly articulate the general principles and processes governing the creation of mechanisms deemed necessary. These principles can be articulated as:

1. Overlaps should be acknowledged, identified and quantified.
2. Acknowledgement and quantification should be done at the appropriate level. If the overlap involves policies falling directly under the scope of

the Energy Union, the assessment should take place in the State of the Energy Union report.

3. A recommendation from the European Commission to address the policy overlap should be issued.

It is crucial that the Governance document provides these general principles, and a “coat hanger” for future detailed implementation. The Governance document must simply ensure overlaps are identified, assessed at the appropriate level, and that, mechanically, a process is launched to determine the adequate way to address them. Only then can the governance system provide predictability, as the policy intervention enacted to address the interaction will not have been triggered in an *ad hoc* fashion, but will have been launched based on clear *ex ante* rules.

V. Overlap between EU ETS, Renewable Energy Directive and Energy Efficiency Directive

For illustration purposes, let us consider the case of how other policies overlap with the EU ETS. Measures taken under the Energy Efficiency and the Renewable Energy directives are directly responsible for mitigation outcomes, which are desirable, as they meet other objectives of the EU. However, they also result in a decrease in the demand for EU Allowances (EUAs).

It should be acknowledged that surplus in the EU ETS can originate from three different sources. First, economic actors respond to the carbon price signal. Consequently, carbon costs incentivise investments in low-emission technologies, which is precisely what the ETS was intended to deliver. This results in real greenhouse gases reductions. Secondly, macroeconomic shocks affect industrial output, and therefore the demand for EUAs. Finally, as a third element, is the effect on demand of overlapping policies.

If the principle of addressing interactions at the appropriate level is to be respected, then the impact of these three elements cannot be addressed together, at the same level of governance.

Mitigation actions and their outcomes, as well as macroeconomic shocks affecting the demand for EUAs are specific to the EU ETS, and should be assessed within the Carbon Market Report, which does not currently discuss them in any depth. The Market Stability Reserve (MSR) was put in place to address macroeconomic shocks. Mitigation outcomes produce a surplus that is a “good surplus” and which ought not to be eliminated from the market.

The issue of policy overlap and interaction, by contrast, is not exclusive to the EU ETS but affects many other elements of European climate and energy – and even industrial - policy. One can for instance think of the interaction between the Fuel Quality Directive at the European level and the measures in the transportation sector which Member States must implement under the Effort Sharing Regulation (ESR), or the interaction between the Industrial Emissions Directive and the EU ETS.

Since overlapping policies is an issue affecting a wide variety of dimensions and elements of the Energy Union, addressing the interaction at the level that has jurisdiction over all interacting elements, implies that overlapping policies should not be addressed within the Carbon Market Report, but in the broader context of the State of the Energy Union report.

As the Carbon Market Report itself is foreseen as feeding into the State of the Energy Union report, the section of the latter report addressing overlapping policies should have a much broader scope. It should present a clear assessment of interactions between different policies and elements of the Energy Union, and identify whether these interactions have any undesirable and unforeseen consequences, which need to be addressed.

This may not always be the case. While energy efficiency measures can create unwelcome price distortions in the EU ETS, the interaction between the Fuel Quality Directive and the ESR may actually prove to be a positive synergy.

Finally, once existing overlaps and interactions are assessed in the State of the Energy Union report, those that are identified as unforeseen and unwanted should be addressed. It is crucial that there be provisions to do so in the Governance document.

A governance system should provide predictability, and when harmful overlap requires interfering with an existing policy, predictability requires this intervention does not appear arbitrary. The Governance document should therefore make explicit the conditions under which this intervention can occur, and give the Commission the obligation to recommend the creation of an adequate mechanism.

Currently, both the EU Parliament and the Council propose elements to address overlap of the EU ETS with other policies in the Phase 4 EU ETS debate.

- The Council position includes a mechanism to cancel, from 2024, any allowances held in the Market Stability Reserve above the total number of allowances auctioned the previous year.

- The Parliament, by contrast, proposes a one-off cancellation of 800 million allowances placed in the MSR in 2021. It also proposes that in the event of electricity generation closures in a Member State, the Commission should calculate the number of allowances these closures represent, and the Member State can choose to cancel the corresponding volume of allowances from their auction. There are some signs suggesting the Council looks rather favourably at this proposal.

In the Governance debate, other proposals have been put forward by private sector alliances, making provisions for a mechanism to cancel allowances from the auction, after having measured the effect of overlapping policies on the supply-demand balance of the carbon market. Amendments to introduce similar instruments have been tabled by individual MEPs. However, while fully aligned with the need for such a mechanism, it is felt that the inclusion of specifications for such a mechanism should be beyond the scope of the Governance proposal.

What the Governance document should include is the general principle allowing for the creation of such a mechanism, when a new interaction is identified and described as harmful in the State of the Energy Union report. The presence of these general principles will allow stakeholders to expect when, and in what general direction, the legislative framework will evolve. An enhanced predictability and transparency of intervention would then encourage investment, and facilitate the transition towards a low-carbon society.

VI. Conclusions

The importance of the Governance document cannot be overestimated. In its current format, it includes important provisions on reporting and assessment which should allow for the integration and transparency, at the EU level, of climate and energy policies, many of them planned, designed and implemented at the Member State level, in order to reach common EU objectives.

What the Governance proposal does not currently include are provisions to address interactions between elements of the Energy Union. The most obvious interaction is currently that between EU ETS, RE and EE, but those specific interactions cannot, and should not be seen, as the reason to consider such provisions. Such provisions must be seen in a very broad way as being necessary to address any future interaction between any elements of the Energy Union.

Assessing the interaction, and making provisions for the introduction and modification of such provisions, in a predictable manner, is what the Governance document should include. This is in no way meant to detract for the need, and obligation, of all components of the Energy Union to have their house in order – both in terms of their design, as well as in terms of the governance that ensure their good functioning – at the level where events influence them.

However, when the interaction is not with elements that impact one component, but between components of the Energy Union, then there is a need to have assessment and provisions at the level of the Energy Union, possibly through the use of the State of the Energy Union Report.

In that way, the governance of overlaps must be seen as a fail-safe, and not a replacement of provisions for the good governance of individual components of the Energy Union. As one stakeholder put it, “if action to address overlaps needs to take place, I want it addressed in a coordinated way at the Energy Union level where they can all be examined in a coherent way, not in an ad hoc way; and where the decision is made also in a coherent and transparent manner as to which component of the Energy Union needs adjustment”.

Annex

Document	Periodicity	By Whom	Content
Integrated National Energy and Climate Plans	From 2019: every 10 years, updated after 5 years	Member States	National targets, planned policies and their likely impact in each of the 5 Energy Union dimensions
Long-term Low Emission Strategies	From 2020: every 10 years	Member States	50-year perspective strategies, aiming at fulfilling international climate commitments
Integrated National Energy and Climate Progress Reports	From 2021: every 2 years	Member States	Status of implementation of the integrated national plans, measures taken to address Commission recommendations
Assessment of Progress	From 2021: every 2 years	European Commission	Assessment of national progress reports, and of Union level progress
Recommendations to Member States	When necessary	European Commission	Recommendations to ensure achievement of Energy Union objectives. MS must take 'utmost account' of them.
State of the Energy Union report	Annually	European Commission	<ul style="list-style-type: none"> - Commission assessment of national progress reports - Commission recommendations to Member States - Carbon Market Report - Other reports (on bioenergy, natural gas internal market, etc.)