Energy Union design: key lessons from the European Semester

GBE input paper for the consultation on "Streamlining of planning and reporting obligations as part of the Energy Union governance"[1]

Summary and aim of this paper

The aim of this paper is to aid a discussion on Energy Union governance design options by drawing conclusions from the hybrid planning & reporting processes behind the European Semester. To summarise, key success factors for efficient Energy Union governance are:

- A modular approach which includes a high level dialogue between the Commission and Member States, guided by indicators rooted in law;
- A long-term planning requirement to 2050 (both of these elements are not explicitly covered by the consultation);
- A sectoral planning and reporting framework with legally binding templates;
- Active involvement of key stakeholders at every level of the decision making process, and
- "Permeability": Serious climate / energy shortfalls are structural issues and the European Semester which addresses structural issues should reflect this. Alternatively, another means of directly tabling structural climate and energy issues to Finance Ministries must be adopted.

The European Semester

The European Semester is the key governance instrument of the EU's Economic and Monetary Union. Each year, the Commission undertakes a detailed analysis of EU Member States' plans of budgetary, macroeconomic and structural reforms and provides them with country-specific recommendations. These recommendations also contribute to the objectives of the EU's long-term strategy for jobs and growth and the Europe 2020 strategy.

Positive elements of the European Semester

- The Semester synchronises the timing of the economic and fiscal policy planning, reporting and evaluation between the European Commission and EU Member States;
- It monitors, detects, prevents and – to a degree – corrects problematic economic trends such as excessive government deficits or public debt levels;
- It monitors and enforces the Europe 2020 strategy, and
- It governs soft and hard law with enforceability for euro area Member States.

[1] https://goo.gl/xbzaYq

What changed under the European Semester with the introduction of the Energy Union?

Climate and energy matters were removed from the 2015 Semester recommendations, to be 'covered' under the Energy Union, even though a governance process for the Energy Union is yet to be agreed. This has created a gap regarding governance until 2020, and possibly beyond, depending on when and how Energy Union governance materialises.

Lessons for an effective, transparent, coherent, participatory Energy Union design

The rationale for an ambitious Energy Union governance rooted in law is that detecting potential shortfalls in delivering the NECPs early on can not alone prevent delays in the energy transition of an individual Member State, but also of the Energy Union as a whole.

Under the Semester, the Macroeconomic Imbalance Procedure (MIP)[2] aims to identify potential macroeconomic imbalances, to prevent harmful macroeconomic risks and correct those imbalances that are already in place. The MIP is based on a scoreboard of indicators with indicative thresholds (i.e. real estate bubbles, indebtedness or asset prices) which trigger action if they are not met. In such case, Eurozone Member States may face sanctions.

Energy Union governance will also include a number of indicators. The question is how to enforce them if thresholds are breached. **Energy Ministers will be notified. But Finance Ministers will also need to be engaged, particularly where Member State failure is long-standing or deep-seated.**

Enhances ownership, transparency and participation

The Semester largely operates behind closed doors. While NGOs can contact National Semester Officers (typically based in MS capitals), there is little public participation in almost all Member States. It is important that this mistake is not repeated on the Energy Union. Hence, structured and transparent stakeholder involvement (article 192 and 194, TFEU) is key for political acceptance and delivery. (Note: the EEA and JRC will draft Energy Union statements and should also consult civil society stakeholders.) Key proposals, shaped by feedback from meeting with COM officials, are that:

➔A Sherpa person at Prime Minister/Head of government level should ensure continuous agenda-setting at highest level to progress the energy transition

➔An Energy Union Officer (like Semester Officers, see above) could build a bridge between the Commission and Member States. With deep knowledge of the legally binding templates, such an official could play a key role in the planning and reporting process.

Coherent priorities and long-term perspective

The Energy Union must avoid a shift of priorities (as has happened under the European Semester) so as to threaten its credibility as an efficient mechanism to address shortfalls in climate and energy policy.

➔A stable planning and reporting process under the Energy Union requires the preparation and publication of transition plans covering the period to 2050. Legally binding templates for bi-annual

[2] For further information, please find here FAQs (accessed 01.02.2016).

reporting between the Commission, the Council and the Parliament allow for a cost-effective and coherent comparison and aggregation.

➔The national plans need to be updated in 2024 or when significant changes arise.

➔Long-term stability and clear targets that can only be revised upwards enhance investor confidence. The earlier the EU can adapt to a low-carbon energy system ahead of its competitors, the better.

The long term perspective requires more emphasis

The current sectoral planning and reporting requirements for emissions, renewables and energy efficiency are suitable to monitor and compare delivery - and need to be safeguarded. However, an overarching governance process should ensure coherence and consistency of the different planning and reporting timelines and processes and provide recommendations focusing on a set of priorities where action would generate the most impact in climate change mitigation and low carbon energy transition.

This process must start from a long-term perspective to ensure that the bi-annual reports on decarbonisation planning linked to the UNFCCC policies are coherent with the Commission's "Road from Paris" Communication (COM/2016/110) and the long-term planning under the Energy Union. In short, **each MS needs to present a 2050 transition plan no later than 2020 / 2021. In turn, these long term plans need to be an integrated part of the overall governance system, tied into 2030 planning and reporting to ensure coherence, comparability and national ownership**.

This system should also comprise a robust information database, a set of quantitative and qualitative indicators anchored in law (e.g. by comitology) and complementary auxiliary indicators as well as benchmarks, peer review and exchange of best practices. This system should include an enforceable surveillance mechanism that aims to identify potential risks early on, prevent non-compliance, and correct them. As emphasised previously, Finance Ministries must remain engaged, by using the European Semester, or through another means.

Ensure "Permeability" between the Energy Union and the European Semester

There are good reasons to retain links between the Energy Union and the European Semester:

1. The Semester itself has three pillars, as outlined in recent Annual Growth Surveys: pursuing structural reforms, re-launching investment and responsible public finances. These three pillars need to be underpinned by low carbon ambition in order to take account of the macroeconomic impacts of the Energy Union, especially in light of the Paris Agreement and the financial flow adjustment requirements of Article 2. **After the agreement at COP 21, the Semester is no longer fit for purpose and needs to be reformed in any event.**
2. If macroeconomic issues arise, e.g. serious climate/energy shortfalls, the European Semester needs to reflect this, e.g. in the Country-Specific Recommendations. An important point here is that **Finance Ministries which are the main actors in the Semester need to be pressed to engage with climate and energy deliverables**. Without this permeability, a lack of attention under the Semester would devalue or undermine reaching key Energy Union objectives. It will

also draw attention to Member States failing to pull their weight, as inaction undermines collective effort. This will be even more important after 2020 when the Semester may stop monitoring delivery on climate, renewables and energy efficiency.

3. With its focus on fiscal and structural reform matters as well as on investment, an aim of the Semester is to deliver a tax shift (from labour to pollution / emissions / non-renewables). Until now, this **important tool has been under-used and the Commission will also need to deploy it under the Energy Union** (taxation and subsidy reform are mentioned under the Integrated Energy Market pillar) **as a means to boost investment and employment on the one hand, and deliver benefits for climate, environment and resource use on the other**. This is also in line with the Sustainable Development Goals. **The Governance arrangements for Energy Union need to advance the implementation of fiscal instruments needed for the energy transition.**

Energy Union governance structure must help lift roadblocks: planning and reporting can help

There are a number of hurdles that a new governance structure needs to help remove:

How investment is counted

The European System of National and Regional Accounts (ESA 2010), under which Member States report their national budgets, regards public investment (e.g. green investment) as debt without taking into account capital assets relating to it, and its expense-saving capacity. To avoid negative impacts on public debt, many MSs can be forced to invest less in decarbonisation, renewables, energy efficiency, and sustainable energy infrastructure – all of which are key to the functioning of the Energy Union. On the other hand, investment in weapon systems or other military spending does not count toward public debt. Some exemptions are being carved out (e.g. MS investment under the Juncker plan is not being counted as public debt) but a more **comprehensive reform is required.**

Tracking the cost of borrowing

The DIA Core project found that the Weighted Average Cost of Capital (WACC) varied significantly across EU Member States, namely, from 3.5% in Germany to 12% in Greece for onshore wind projects in 2014.

Put simply, it can be more expensive to borrow where investment is most needed. There are solutions to this, one of which is green loans (e.g. via the EIB as a form of quantitative easing) to MSs with high borrowing costs - but such loans would only be made where the MS commits to a secure investment climate (i.e. steady and not sharp reform of feed-in tariffs, etc). Such solutions allow for win-win situations (investment goes to the most indebted MSs; renewables investment is evened out across the Union, etc). **Planning and reporting for Energy Union can help pave the way for these solutions by first committing to measuring and publishing EU WACC data annually.**

Financial profile of energy investment

The Capital Markets Union (CMU) is a key pillar of the so-called Juncker Investment Plan under the Semester. It aims to tackle investment shortages by increasing and diversifying the funding sources for Europe's businesses and long-term projects, and by doing so, can substantially help to provide the investment needed for the Energy Union. However, the CMU needs to ensure that all existing funding lines are divested from fossil fuels and that no new funding can go into fossil fuels. An increasing number of risk analysis underline the fact that fossil fuel investment can become an unprofitable threat. **A first step here is specific MS-by-MS data on the profile of new public and private energy investment, broken down by GHG intensity of investment.** This is in any event required under the financial flows provision of the Paris climate agreement and early adoption will enable the EU gain strategic advantage.

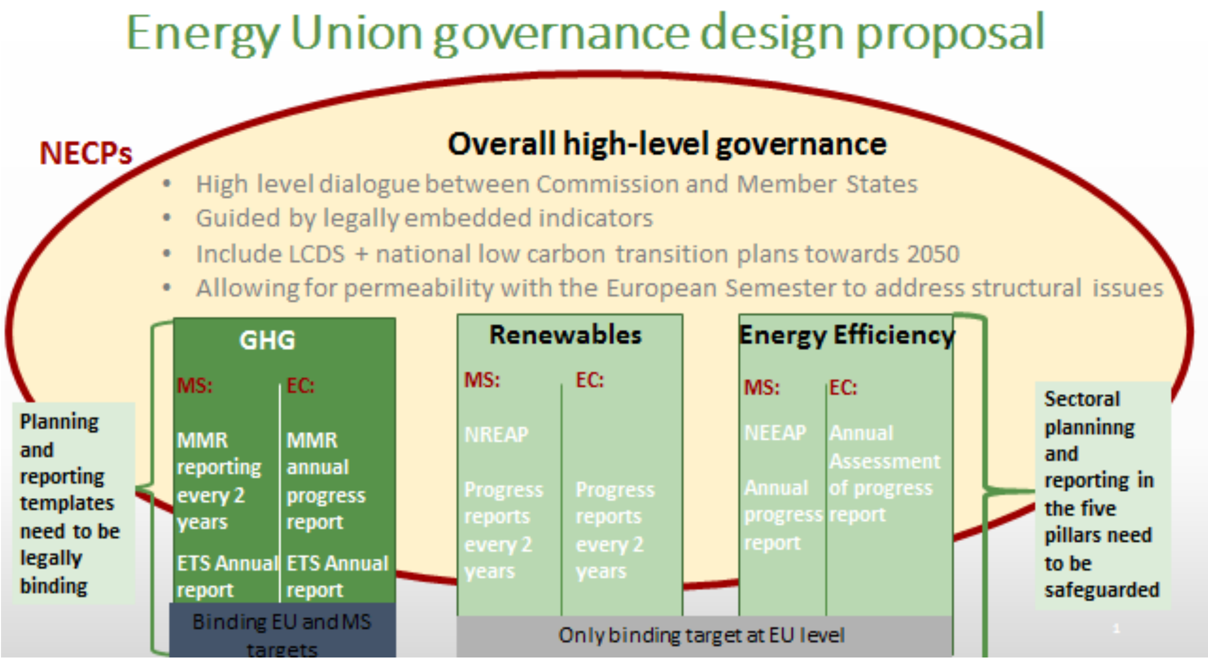

Figure 1: *Schematic representation of Energy Union governance design under GBE proposals*

Source: Green Budget Europe