THE ROLE OF THE ENERGY COMMUNITY WITHIN THE EU REGIONAL COOPERATION

Victoria **Musteaţă**
The Academy of Economic Studies, București, România
victoriamusteata@yahoo.com

Abstract: *In the last decade we have seen the creation process of a common Energy Policy, which was gradually adopted by all Community countries, and has promoted an integrated competitive European energy market, increased security of supply and supported the use renewable energy sources. But in order for this policy to work efficiently, it also had to promote international cooperation with its neighbors and energy suppliers. With the view of establishing an Integrated Energy Market Organization in South-Eastern Europe, the European Community, along with nine other countries, has signed on 25 October 2005 the treaty establishing the Energy Community. Our research aims to investigate the potential of the European Union to promote security of energy supply and energy markets integration through the Energy Community. The article uses data from theoretical and empirical research on the economic and politic relations between the members of the Energy Community in order to establish the positive and negative outcomes of six year of collaboration.*

Keywords: European Energy Community, EU energy policy, EU external relations, market integration, Europeanization, Regional integration, Neo-functionalism, Stability Pact for South East Europe
JEL Classification: F15, F59, N74, O19, O31

INTRODUCTION

The last decade of the 20th century was characterized by a series of conflicts in the South Eastern European (SEE) region generated by the process of break up of Yugoslavian Republic.

In order to promote peace, prosperity and stability in the region, the European Union, along with other international organizations, met with the representatives of all the countries from the region on 10th of June 1999 in Cologne, and adopted a Stability Pact for South Eastern Europe. To achieve the set objective, it was agreed to set up a South Eastern Europe Regional Table divided in three Working Tables. During the discussions of the Working Table II, which focused on economic reconstruction, co-operation and development matters, the idea of a South-East Europe Regional Energy Market for electricity and natural gas was born, as a key to economic reconstruction of the region. The idea was further developed by the Athens Memorandums of Understanding on Electricity and Gas, and finally a legal framework was created and signed in 2005. Thus came into existence the European Energy Community (EEC) (Stability Pact for South Eastern Europe 1999).

The general objective of the Energy Community is to create a stable regulatory and market framework at national, regional and pan-European level in the area of electricity, gas, oil, environment and renewable energy. The treaty recognizes that the objective will be achieved only if the parties involved attract investment in power generation and networks, enhance competition, support the creation of an integrated energy market, promote security of supply and energy efficiency, and implement energy-sector specific social actions (DG COMM, 2005).

In order to achieve the set objective, the parties have taken the legally binding obligation to implement the relevant acquis communautaire, to set up regulatory structures and to liberalize their energy markets. It is considered that a single stable regulatory framework in the region will create a more attractive market for investors, will encourage the creation of new jobs for the skilled labor force, and will generate a positive spill-over effect to other sectors of the economy. Another factor that should not be underestimated is the political one. By signing the treaty, the countries of SEE have committed to regional cooperation in the energy sector, therefore it encourages communication and integration between countries that might otherwise be hesitant to co-operate (Energy Community, 2005).

The approach of maintaining peace and promoting economic recovery through the creation of a common energy market is not a new one. In fact, it dates back to the creation of the European Coal and Steel Community (ECSC) in 1951, the treaty that lead to the foundation of the European Union. The founding father of that treaty, Robert Schuman, believed that war can be prevented and unification can be achieved if the enemy states combine their economies in just one important economic sector. He followed the neofunctionalist school of thought which considered that the integration of an individual sector of the economy would generate a positive spill-over effect to other sectors of the economy and further the process of integration until a full economical and political integration of the region will be achieved. The neo-functionalism theory explains that as the economic interdependence between nations grows; only a supranational organization will have the capacity to resolve disputes and build international legal regimes, therefore the supranational market rules will ultimately replace the national regulatory regimes and thus, the nations will integrate not only economically but also politically.

The proof of a spill over effect can already be seen in the period of existence of the EEC, which started with the integration of the energy markets of gas and electricity and in the last years has added to its scope the dimension of social responsibility and the integration of the oil market as

well. As one of the commission official stated a reform in the energy sector will have an effect on transport, environment and social policy (Renner, 2009).

However there is a big difference between the Energy Community and the European Coal and Steel Community, and that is the greater influence of one of its members, namely the European Union, in the decision making process. EU uses a conditionality mechanism, promising the possibility of joining EU, in urging the adoption and implementation of the aquis. On one side, this can be viewed as a good thing, since it encourages faster reform and greater cooperation between member states within the Community. After all, ECSC was considered as a failure in its first thirty years of existence, since the member states were reluctant to work on supranational level and preferred to put national interests before Community ones (the founder of the neofunctionalist theory Ernest Haas has even stated in 1975 that regional integration theories are obsolete in Western Europe). Due to the authority EU, and as we can observe from the progress achieved up until now, this might not be the case within the Energy Community. But, on another side, the reforms are often followed by painful consequences on the short run (such as rise in prices) and these consequences may lead to reluctance from the people, and subsequently the elected officials, of the SEE member states to desire further integration and reform. Therefore, if positive effects will not prevail the negative ones by 2016 (when the treaty expires) the EEC might cease to exist.

1. CONTRACTING PARTIES OVERVIEW PRE AND POST EUROPEAN ENERGY COMMUNITY

Besides the European Union, the nine Contracting Parties of the European Energy Community are: Albania, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia, Moldova, Montenegro, Serbia, Ukraine and UNMIK.

Since Moldova and Ukraine have joined the community only recently, and are geographically separate from the other member states, we will evaluate their progress independently from the countries of South Eastern Europe.

The seven countries of SEE share a common dreadful history since they all were formed by the break-up of the Socialist Federal Republic (SFR) of Yugoslavia in the 1990s characterized by its violent conflicts. Since the main tactics of the war were to destroy key infrastructures, in order to weaken the opponent's economies, after the conflicts finally came to an end the region's economies and much of its energy infrastructure was almost completely devastated. Adding that to the fact that

key energy infrastructure was built in the 1960 and the 1970 with standard Soviet technology, it becomes obvious that the energy market in the region requires significant investment to rehabilitate existing infrastructure and to build new more technologically advanced facilities. Due to lack of domestic investment, the SEE region countries should aim to attract foreign investments, but hardly any investors are attracted to small individual markets characterized by political instability. Another key element of the SEE countries is that they are greatly interdependent in their energy market generation and transmission: they are all connected to the same electricity grid and share common pipelines for oil and gas. This interdependency represents the impetus of creating a common energy market rather than aim for self-sufficiency in power generation at national level. A study carried out by World Bank in 2005 has estimated that the creation of a single, fully interconnected power network in the SEE would save around 10% of total electricity expenses during the period 2005-2020, savings derived from reduction of the need for new power generating capacity (International Energy Agency, 2008).

Some results in market integration and rehabilitation were already achieved before the creation of the Energy Community in 2005, namely the reconnection of the two sub-regional electricity transmission networks and their resynchronization with the Union for the Coordination of the Transmission of Electricity in 2004. Some of the oil infrastructure was also rehabilitated, 40% of oil refineries were operational by 2005, but with low energy performance and high environmental impact. Much work remained to be done in the next years, work that required large investment funding. As an International Energy Agency report on the region stated, in order for the market to attract investment, a comprehensive and coherent national and regional energy policy must be put in place as soon as possible. And this will be best achieved through a coordinated effort within the Energy Community (International Energy Agency, 2008).

The Energy Community has been in force since July 2006, and in six years of existence many favorable results were achieved with respect to the implementation of the acquis communautaire into national energy policies. As an Energy Community Secretariat report from 2011 shows, the member states from SEE have largely transposed the relevant aquis on Electricity and Gas into national policies even though they did so not within the set timeframe. The leader within the region is Croatia, which transposed all required legislation and is currently working on aligning its energy legislation with the so-called Third Package (a voluntary legislative package adopted in 2009 that focuses on the on the promotion of renewable energy within the internal market in electricity and gas). Montenegro and UNMIK have largely changed their national legislation in 2010; and FYR of

Macedonia, Serbia have followed them in 2011. Albania is currently in progress of amending its primary legislation, while Bosnia and Herzegovina is lagging behind and requires a coordinated effort of diverse authorities along with EEC secretariat support in order to achieve progress (Energy Community Secretariat, 2011).

The competition acquis is transposed in all contracting parties' national policies; however Montenegro still has to make improvements of its legislation. A significant progress was achieved in 2010-2011 in the transposition of the energy efficiency directives, Croatia, FYR of Macedonia, Montenegro and UNMIK have already adopted energy efficiency laws, whereas Albania and Serbia have advanced draft laws that are expected to be adopted as soon as possible. Once again Bosnia and Herzegovina is lagging behind, and is only preparing energy efficiency legislation.

Another area that recorded considerable development in the last few years was the one on implementation of environmental impact assessment directives and renewable energy directives. The strong motivation of the contracting parties to adopt the required legislation is high because it is strongly related to low interest investments granted by public donors in the area. That is why the parties have not only reached the formal requirements of the treaty, but also have developed energy strategy plans for the promotion of renewable energy in order to provide additional security to investor might want to finance hydro, biomass, wind and solar projects in the region.

According to the Memorandum of Understanding on Social Issues, the Contracting Parties have prepared Social Action Plans and have started to transpose them in their national legislation. However, as the EEC Secretariat report states, a lot of work still has to be done, since the Action Plans do not present detailed measures, operational tasks and timetables at implementing the social goals and objectives. Also a lack in follow-up and monitoring activities is observed, whereas the main problem of implementation is considered by all Social Action Plans as the lack of funding (Energy Community Secretariat, 2011).

Another directive that is currently under work, is the one related to the crude oil and petroleum stockholding system. Most contracting parties have to comply to the directive by 2020, and as the EEC Secretariat report from 2011 states that all countries have a realistic chance of meeting that target.

Moldova and Ukraine have only recently joined the EEC, however in accordance with their Accession Protocols, plans for the implementation of the acquis on electricity and gas were developed and most of the directives were transposed into national legislation. With respect to competition law, Ukraine is ahead if Moldova since its competition legislation adequately

transposes the acquis and has created a fairly independent Antimonopoly Committee, whereas Moldovan legislation is not in compliance with the requirements of the EEC treaty. The deadlines for the implementation of aquis on environment, renewable energy, energy efficiency and oil have not yet expired and plans of implementation are currently in development. The Memorandum of Understanding on Social Issues was signed by both parties in October 2011; therefore a Social Action Plan has not been yet submitted to the secretary of EEC (Energy Community Secretariat, 2011).

Although the overall progress achieved by all contracting parties in the transposition of the acquis communautaire is satisfactory, the development and enforcement of secondary legislation is also needed. In some cases the legal acts comply with the acquis but are not consistently applied into practice. This case is greatly observed with regards to market opening and competition, most of the energy companies are state owned (or the state is a major shareholder) or significant concentration in the retail market is detected. On a regional level, a continuous obstruction by a number of countries of allowing UNMIK to fully participate in regional mechanisms damages cooperation in market integration programs.

The Electricity transmission and distribution networks in the contracting parties show evidence of relatively high distribution losses and the electricity suppliers still struggle with bad debts and low collection rates. In 2009 all countries accounting for more than 12% of the total output and Albania and Moldova have reported more than 50% of distribution losses out of total output in 2008. Although this numbers considerably decline in the following years, taking into consideration that only 5%-6% of the distribution losses are generated by technical reasons, it becomes obvious that it impedes actual and potential investment in the region (World Bank, 2012).

In conclusion we might state that in the last six years a lot of progress has been achieved within the contracting parties' legislative reforms and in the following years a greater focus should be put on the implementation of the law so as to create an integrated market attractive for foreign investment from private sources. The EEC secretariat has already pushed forward a Community funded initiative in analyzing key investment projects, but it is up to the member states (with the full support of the Secretariat) to find the most favorable funding possibilities.

2. THE EUROPEAN UNION'S AGENDA

The countries from the South Eastern Europe (for which the European Energy Community Treaty was originally intended), along with Moldova and Ukraine are strategically located between the European Union and the hydrocarbon-rich regions of the East (Russia, the Caspian basin and Middle East), and therefore, play an important role in the transit of energy resources to Europe. EU is extremely interested in maintaining a high degree of cooperation with these countries in order to ensure a safer security of supply of hydrocarbons that transit their territories. Furthermore, as EU places a strategic role on energy resource diversification and seeks to create new transport corridors from the Caspian Region to the member states, a stable, secure and EU integrated energy market in the SEE countries is not only desirable but also cost effective.

A study elaborated within the REACCESS project (Risk of Energy Availability - Common Corridors for Europe Supply Security) has recently performed a comparative assessment of two natural gas pipeline projects: Interconnector Turkey-Greece-Italy (ITGI) and Trans Adriatic Pipeline (TAP), in terms of their social, economical and political risks. The two projects are developed in the context of the Southern Gas Corridor – an important element of European Union's energy policy that plans to determine the most advantageous routes of long-term gas transports from the Caspian Region to EU. The REACCESS methodology attributes to each country that will participate in the process of energy supply, a socio-economic energy risk determined by an interactive factor analysis of various economic, politic social and energy variables, and afterwards aggregates the risk indices of the countries involved in the corridor in order to determine the overall risk of that specific corridor. The main difference between the two energy corridors is that TAP includes Albania as a transit country, whereas ITGI passes through Greece directly to Italy avoiding Albania. It is obvious that TAP project would be more cost effective because it decreases the length of the pipeline, but as the REACCESS study determined it would be also riskier since Albania has the highest socio-economic energy risk within the countries participating in the TAP pipeline (National Technical University of Athens, 2011).

Through the EEC, the EU not only promotes good cooperation on energy matters within the region but also aims to achieve better (more cost effective) ways of accessing energy resources from abroad for itself. By cooperating within the EEC, Albania will decrease its country's risk (especially since it is mostly affected by the energy variables of the index) and therefore would become a transit country through the TAP pipeline, benefiting itself and the EU as well. Other

countries that are also involved in the development of Southern Gas Corridor projects and also desire to become EEC member are Turkey and Georgia. As compared to Albania, EU does not have the option to exclude these countries out of the transiting countries list; therefore cooperation on energy maters within the EEC will be greatly beneficial in ensuring security of supply for EU.

European Union holds great responsibility for the long-term stability and sustainable development of the SEE region since it was one of the parties involved in the development of the Stability Pact. By doing so, EU has emerged as a global player in maintaining peace and promoting democracy in the world, therefore the way that progress is reached in SEE region directly reflects on EU external abilities as a global player. This became even more important as EU created an External Action Service in order to promote itself as one entity on the global market.

In recently developed Europeanization theories, researchers try to establish the goals EU pursues in its external relations in the world and how positive results are achieved. First of all, EU promotes its model of regionalism and market integration as a pathway to peace and welfare in other parts of the world. Secondly, it encourages commitment to market-building and economic liberalization through the creation of a multilaterally managed regulatory framework for liberal markets. And third, EU supports the endorsement of such constitutional norms as human rights, rule of law and democracy. As these studies have shown, the positive endorsement of such goals, at the current moment, is strongly related to the accession mechanism, countries that seek to become a part of the EU are more likely to endorse EU goals (Schimmelfennig, 2007). But since the current economic situation in Europe does not give hope for a fast accession to the SEE states, the way they form their own regional market and develop independently from EU, might give incentives for other regions in the world to follow.

As a conclusion we might state that the way EU handles its external relations with the SEE countries through the EEC and how fast positive results are achieved, will have a great influence on how the External Action Service is viewed as a key player in promoting EU external relations in the world.

CONCLUSIONS

The European Energy Community plays an important role for all the parties involved. For the contracting parties of SEE, Moldova and Ukraine represent the main institution through which their internal energy markets are integrated with the EU energy market, thus granting access to so much

needed investments that would be otherwise difficult to obtain. And for the European Union, EEC represents an institution through which it can achieve political stability in a region with great proximity to its member states, and by doing so decreasing the risks involved in the process of transiting vital hydrocarbons from the Caspian region to EU countries.

So far good results were achieved by the contracting parties in terms of transposing the aquis communautaire in national legislative frameworks, but much more effort must be put in the actual compliance to these laws. Unfortunately, since the main focus of the EEC in the last six years was put on the transposition of the acquis, not many crucial investments were made in energy infrastructure, and therefore the end-users were not able to actually see the benefits of joining the EEC, such as the creation of new job opportunities or easier access to energy resources. What they actually experienced was a rise in prices, due to increases in energy tariffs and market integration (researches show that market integration leads to short-term price increases), loss of credibility that their county might soon join the EU and corruption related to the privatization of state owned energy infrastructures.

In order for the cooperation to be more effective in the next years, the EEC along with the donors (World Bank, EBRD, EIR and others) has to actually bring investment into the region and act as guarantor for businesses that want to finance in energy infrastructure. In this way, the people of the countries will see first hand the benefits of being an EEC member and will endorse, through elections, those political parties that favor international cooperation above nationalistic interests.

By doing so, the European Union will place itself as e key player in the world, as a promoter of peace, stability and democracy; will illustrate the benefits of joining the EEC to Turkey and Georgia; and therefore, will have the ability to improve its own security of supply by the creation of new energy corridors that will pass through the South Eastern European Region.

REFERENCES

Deitz, L., Stirton, L.,Wright, K. (2009) *South East Europe's electricity sector: Attractions, obstacles and challenges of Europeanization*, Utilities Policy, vol. 17, pp 4-12.

Knezović, S. (2009) *EU's Conditionality Mechanism in South East Europe – Lessons Learned and Challenges for the Future*, Journal on European Perspectives of the Western Balkans, Vol. 1, No. 1, pp. 93-113.

Renner, S. (2009) *The Energy Community of Southeast Europe: A neofunctionalist project of regional integration*, European Integration Online Papers, Vol. 13, no. 1, accessed on May 2012 at http://eiop.or.at/eiop/index.php/eiop/article/view/2009_001a/86.

Sandholtz, W., Stone Sweet, A. (2010) *Neo-functionalism and Supranational Governance*, Working Paper, accessed in May 2012 http://works.bepress.com/alec_stone_sweet/38.

Schimmelfennig, F. (2007) *Europeanization beyond Europe*, Living Reviews in European Governance, vol. 2, accessed in May 2012 at http://www.livingreviews.org/lreg-2007-1.

Sprout, R., Swedberg, J. (2009) *Peace and Security in Eastern Europe & Eurasia*, Working Paper Series on the Transition Countries, U.S. Agency for International Development, Washington DC, accessed on May 2012 at http://www.usaid.gov/locations/europe_eurasia/wp/peace__security_in_ee_june_2009.pdf.

***DG COMM – Directorate General Communication Brussels (2005) *The EU and South East Europe sign a historic treaty to boost energy integration*, Press Release, Reference: IP/05/1346, accessed in May 2012 http://europa.eu/rapid/searchAction.do.

***Energy Community (2005) *Energy Community Treaty*, accessed in May 2012 at http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/Treaty

***Energy Community Secretariat (2011) *Annual report on the implementation of the aquis under the treaty establishing the Energy Community*, accessed in May 2012 at http://www.energy-community.org/portal/page/portal/ENC_HOME/DOCUMENTS?library.category=157.

***European Commission (2011) *Report on the Energy Community*, Report from the commission to the European parliament and the council, accessed in May 2012 at http://www.energy-community.org/portal/page/portal/ENC_HOME/DOCUMENTS?library.category=156.

***International Energy Agency (2008) *Energy in the Western Balkans*, the path to reform and reconstruction, accessed in May 2012 at http://www.iea.org/publications/freepublications/

***National Technical University of Athens (2011) *Economic and Socio Political Risk Assessment for ITGI and TAP Natural Gas Pipeline Projects*, accessed in May 2012 at http://reaccess.epu.ntua.gr/LinkClick.aspx?fileticket=mDLSDa5ijug%3d&tabid=582&mid=1096.

***Stability Pact for South Eastern Europe, SCSP Constituent Document, Cologne 10 June 1999, accessed on May 2012 at http://www.stabilitypact.org/constituent/990610-cologne.asp.

***World Bank, *Electric power transmission and distribution losses (% of output)*, accessed in May 2012 at at http://data.worldbank.org/indicator/EG.ELC.LOSS.ZS.