

# ESSAY

## TWO-SPEED ENERGY UNION

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### PROSPECTS OF DIFFERENTIATED EU ENERGY POLICY COOPERATION AND THE PERSPECTIVE OF THE VISEGRAD GROUP

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#### ABSTRACT

*Regionalising the implementation of EU energy policy legislation and strategy building is an important tool of the Energy Union in pursuing its goals, but empowering regions might meet with the resurfacing discussion on differentiated cooperation. The paper outlines the recent developments of the Energy Union and the energy cooperation of the Visegrad Group – one of the main regional initiatives in energy cooperation. The paper presents the energy policy issues the Energy Union and the Visegrad cooperation faces, and outlines two scenarios of potential differentiated cooperation as a reaction to those issues. It finds, that such complex regional differentiated cooperation mechanisms might face challenges possibly preventing them to occur.*

## INTRODUCTION

As the European Union celebrated the 60<sup>th</sup> anniversary of the Treaty of Rome on March 25, overshadowed by Brexit, the discussion on the future of the block have gained momentum again. Jean-Claude Juncker, president of the European Commission, presented his white paper on the subject on the 1<sup>st</sup> of March, as well as the European Council adopted the Rome Declaration on the 25<sup>th</sup> of March 2017. The white paper outlined five scenarios for the way forward for the EU27. The scenarios range from reduced to increased integration, and one (Scenario 3: “Those Who Want More Do More”) is based on the concept of multi-speed Europe (European Commission 2017). The Declaration of Rome also includes the following phrasing: “We will act together, at different paces and intensity where necessary, while moving in the same direction [...]” (emphasis added) (European Council 2017).

The idea of allowing two or more tiers to form within the EU based on the Members’ different readiness for integration is not new, yet official communication has tended to avoid it until recently. The very idea of drawing a line of division between Member States based on ‘how much Europe’ they want and accept tends to provoke powerful political reactions.

Not on political but on policy level, however, such division is not only possible but also existing. The legal possibility of forming “Enhanced Cooperation” within a group of Member States was presented in 1997 the Treaty of Amsterdam, and the Schengen Area or the Eurozone also do not include every EU Member, although based on a different legal framework. The scenario, mentioned above, is also envisages forming such coalitions of the willing in specific [policy] areas.

Energy policy could be one key policy area for such an emerging, coalition-based cooperation. The Treaty of Lisbon in 2007 created the

basis for sharing competences in the sphere of energy policy. Since then the creation of the internal energy market has accelerated, and many other aspects of energy policy witnessed more cooperation or at least coordination on the EU-level. Yet, still significant differences remain both in capabilities and policy directions between Members. These differences will likely become more and more significant as the EU is undergoing an energy transition to a low-carbon economy.

While some basic goals and directions are accepted EU-wide, there are numerous conflicts between Member States and/or the European Commission on the tools, speed and ways of achieving them. Such disagreements could leave several like-minded Member States wanting to enhance their level of cooperation, or on the contrary, restricting their participation but allowing others to move forward.

The Visegrad Group usually shares similar or identical position on EU energy policies. Their similar economic and historical predicament, their focus on energy security and the involvement of the state in the energy sector provide a rather solid differentiation within the EU. Many of those aspects are shared with other Member States joined in or after 2004. Yet the cooperation on energy issues among the Visegrad Countries has strong roots; it is one of the most important and active policy-level cooperation within the V4 Group.

The current essay is a preliminary investigation into the question: whether and how could the EU integration in energy policy become multi-speed. The essay explores both the legal and political framework of differentiated cooperation and the evolution of energy policy within the EU and the Visegrad format during the recent years. It shows how regionalisation became an increasingly important aspect of the EU energy policy and how can this process be traced in case of the V4. It concludes by identifying the divisive lines in EU energy policy where

differentiated cooperation might occur and proposes two illustrative case studies.

## POLITICAL AND LEGAL FRAMEWORK OF DIFFERENTIATED COOPERATION

A number of concepts are dealing with how differentiated integration can play out on a political, theoretical level (for an overview see (Holzinger and Schimmelfennig 2012)). As mentioned, there are several policy areas where not all EU Member States participate at all, or if yes, certain parts of the *acquis communautaire* are not applicable in their case. Up until now it is more common to have ‘negative’ differentiated cooperation, i.e. certain Member States not participating (opting-out) in a, by design, EU-wide cooperation, like Schengen or the Eurozone. ‘Constructive’ differentiated cooperation, where by the original design the pro-integration Member States do not aim for full participation, has happened in only few cases yet.

The legal framework for differentiated cooperation can take several, but not necessarily clearly distinguishable forms as “in reality the boundaries between several categories are often quite fuzzy” (Blockmans 2014, 5). The tool of Enhanced Cooperation has been introduced in the Treaty of Amsterdam and is designed to allow a group of Member States to pursue further integration. It is regulated by Title IV of the Treaty on European Union, and Part Six, Title III of the Treaty on the Functioning of the European Union. The Treaties do not specify the scope of the Enhanced Cooperation, i.e. do not limit how many policy areas or what depth of additional integration is allowed. They specify, however, a set of rules to be followed:

- Enhanced Cooperation shall aim to further the objectives and interest of the EU. It shall not undermine the internal market or

economic, social and territorial cohesion. It shall not constitute a trade barrier inside the EU nor distort intra-block competition.

- Enhanced Cooperation is only possible in the non-exclusive competences<sup>1</sup> of the EU. It can be formed only as ‘last resort’, if no other solution is feasible to promote integration.
- Although such cooperation would use the institutions of the EU, the legislation approved under it is not part of the *acquis*, therefore not binding for the non-participating Member States. Also the financial costs related to the implementation of the Enhanced Cooperation are to be covered by its participants only, and not by the EU budget.
- A minimum of 9 Member States are required, but the initiative needs to be open for every Member. The initiative basically needs to be approved by the Commission, the Parliament (except for CFSP) and the Council (with QMV, but unanimously in case of CFSP).

There are only few examples of Enhanced Cooperation (e.g. divorce law and patent law, proposals for a financial transaction tax and an EU public prosecutor office as the most recent initiative), yet no such framework has emerged or have been negotiated yet in energy policy. Since energy (and the closely related environmental) policy is shared competence, there is no direct legal obstacle of forming Enhanced Cooperation in common energy policy. However, the creation of competition rules for the internal market is an exclusive competence of the EU, and creating the internal energy market is the main objective of the common energy policy. Therefore this might be limiting the areas where Enhanced Cooperation would be possible to form (López-Ibor Mayor 2009).

It has also been argued, that no Enhanced Cooperation could be formed on topics falling out of the general competences of the EU either (ClientEarth 2010). Even if certain Member States come to agreement on – with an extreme example – banning nuclear power production in their own countries, they could not use the Enhanced Cooperation format, as Treaties do not empower the EU with deciding on such issues in general.

Should the Treaties be amended and new policy powers granted on EU level, differentiated cooperation can take a different approach: allowing not for additional cooperation but not taking part in the new EU policy for Member States with permanent opt-outs or temporary derogations. If new policy areas would be added or extended, certain Member States could allow for further integration by pulling out from them by the unanimous agreement of all Member States. Based on the current practice<sup>2</sup> it is less likely, however, that a significant group of Member States (e.g. the whole Visegrad Group) would be granted such an exemption. This attitude could however change, should the current discussion on differentiated cooperation gain momentum and such approaches would prevail.

A third, but somewhat outlier option is to form an alternative framework of cooperation outside the European Union, as an international agreement. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union aka the Fiscal Stability Treaty is a prime example. The Treaty was signed in 2012 by all but two Member States. It is completely built upon the monetary policy framework of the EU, yet is not part of the *acquis*. Similar agreements could be possible in the scope of energy policy as well.

## THE EVOLUTION OF ENERGY POLICY COOPERATION IN THE EU AND THE V4

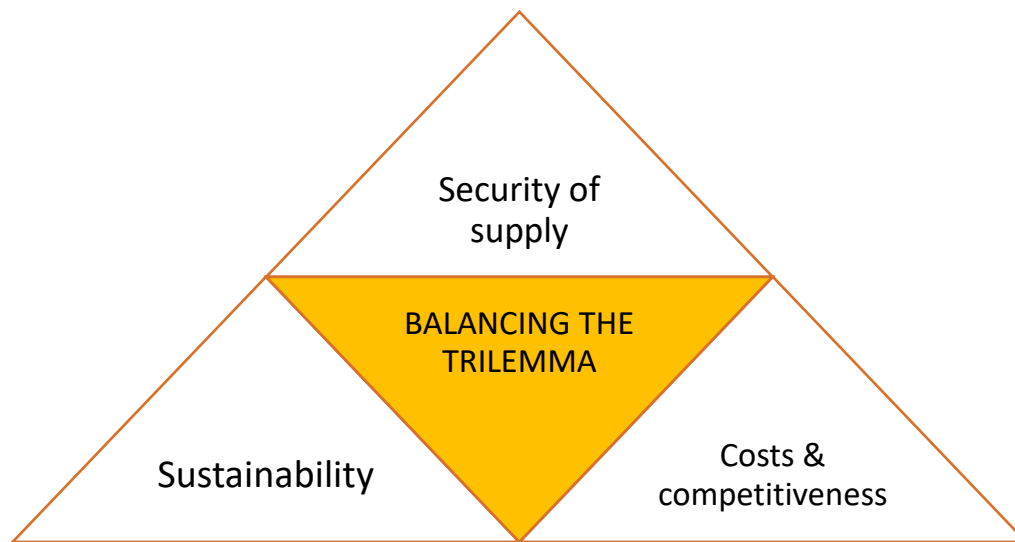
### EUROPEAN UNION – BIRTH OF THE ENERGY UNION

Energy policy is shared competence between Member States and the EU, and the exact distribution of responsibilities is defined by Article 194 of the TFEU<sup>3</sup>. The Article defines four areas of EU to which the common policy should aim for:

- “ensure the functioning of the energy market;
- ensure security of energy supply in the Union;
- promote energy efficiency and energy saving and the development of new and renewable forms of energy; and
- promote the interconnection of energy networks.”

These are the results of long development with gradual widening of EU coordinated areas and budgets. One aspect has not changed, however: the complete sovereignty of Member States over shaping their energy mix (with what sources and with which technologies they produce energy)<sup>4</sup>.

The areas of the common energy policy, recreate the well-known energy trilemma. The term was coined by the World Energy Council and refers to the three basic requirements of a modern energy system (from the perspective of the consumer): 1. Security of supply or sometimes vaguely referred to as energy security. 2. Affordability of using energy through competitive market structures. 3. Environmental sustainability of the energy system (localised pollution, GHG-emissions).



Ever since the Treaty of Rome, the central aim of the European integration was to create an internal energy market. At first the liberalisation of the national energy markets was propagated by the Commission (see the Second Energy Package in 2003), and as a next step to open up competition between national markets by supporting physical and legal interconnection of electricity and gas markets (Newbery et al. 2013). This process is currently still under way based on the Third Energy Package adopted in 2009, the market design rules adopted continuously and most recently a new set of proposed legislation as Winter Package in December 2016.

The internal energy market should have been finalised by now according to the original schedule in 2014, yet significant efforts are still needed especially in terms of physical interconnections. Partially as a response to governments' and companies' inactivity, the EU has developed its own support schemes and funds, but important, multi-billion € investments in electrical transmission networks and gas interconnectors are still missing (Sartori and Colantoni 2015).

Energy security and the climate agenda (sustainability) are later additions and are more contested policy areas as they are more



politicised than the creation of the internal energy market. In 2007 the Commission puts forward the 2020 goals and the Renewable Energy Directive containing legally binding targets for Member States. As the EU and several of its Member States aimed for a leading role in global climate action in the late 2000s, sustainability became an increasingly integral part of the common energy policy framework. Following the gas supply crises of 2006 and 2009 the issue of gas supply and transit was securitised both by Member States and the Commission (Maltby 2013). The disruption of Russian gas supplies and Ukrainian transit in early 2006 and 2009 due to political conflicts have highlighted the dependency of many (new) Member States on Russian natural gas shipped through Ukraine. The events created a window of opportunity to frame the supply security question as a common EU issue both by several Member States and the Commission. As a result the Security of Gas Supply Regulation was accepted in 2010 establishing an EU security of supply framework.

In terms of legal background the Lisbon Treaty is still the most defining step in the evolution of the EU energy policy. In political terms, however, the creation of the Energy Union could become of similar significance. The years 2007-2010 have witnessed major legislative advance in the internal energy market (3<sup>rd</sup> Energy Package), sustainability (RED and 2020 framework) and security of supply (SoS regulation) – all based on Article 194. Yet the Energy Union concept constitutes the idea of balancing the three different aspects and forming a truly single European energy policy.

The concept of Energy Union was developed in several stages. The original idea (under the name of Energy Community<sup>5</sup>) proposed by Jacques Delors et al. in their essay of 2010<sup>6</sup>. The word Energy Union was coined several years later by Donald Tusk (then Polish Prime

Minister), who in an influential<sup>7</sup> essay called for an Energy Union solely for countering the Russian dependency and forming a united block of gas consumers (Tusk 2014).

The Energy Union as an idea was eventually institutionalised by Jean-Claude Juncker, as he listed it as one of his five priorities as the candidate for the Presidency of the European Commission in 2014. His initial, brief proposal put competitiveness, diversification and economic interest in focus. Later these expanded into the five dimensions of the Energy Union, endorsed by the European Council on March 19 2015:

- Diversification, energy security and solidarity between Member States.
- A fully integrated energy market without technical (infrastructural) or regulatory barriers.
- Energy efficiency for security and prosperity.
- Emission reduction and global leading role in renewables.
- Supporting research and innovation to drive the energy transition.

The plan partially integrates the ideas of the Delors and Tusk plans, but the concept of energy transition is more deeply rooted in its core. The Energy Union framework itself did not bring new elements to the legal environment of EU energy policy and neither did it introduce new targets or significant new governance structures, and was received as “being a list of all the things the Commission is currently doing, with some extra ‘asks’” (Helm 2015, 4). The Energy Union was, however, a useful political instrument: the Commission was able to pursue the Europeanization of a key sector while in many other areas the unity of the EU suffered blows (e.g. Brexit, Eurozone, migration

quotas), and the development of the common energy policy is favoured by the EU citizens as well (Keay and Buchan 2015).

The framework did more than creating a political tool as it put a “fundamental transformation” of the EU energy system as a core and inevitable need and therefore a strategic vision and an umbrella for the previously fragmented EU energy policy. The current energy transition is one in a series of paradigmatic changes in the energy consumption and production patterns of human society<sup>8</sup>, and it is driven by the need for decarbonisation, the extensive use of renewable energy sources, decentralisation of consumption, empowerment of consumers (‘prosumers’), increasing energy efficiency and changing the business model of the centralised energy system in place. These ideas in Europe were first extensively developed under the concept of *Energiewende* in Germany following the decision of gradually but rapidly shutting down the country’s nuclear power plants supposedly replacing them with renewable capacities backed up with strong federal support scheme.

The legal foundation of the Commission’s work (i.e. the TFEU) has not changed however, and no extra competencies are paired with the new concept. Yet achieving an EU-led energy transition, the core idea behind Energy Union, is practically impossible without extending the competences and institutions of the European Union (Glachant 2015). To bridge this gap, the Commission pursued its work on building and fine-tuning the internal market, strengthening energy security and advancing sustainability. Such smaller steps can: 1. make the three areas of energy policy more balanced fine-tuning their relation; 2. evoke functionalist mechanisms to slowly expand the competences of the common energy policy. The following achievements have been

reached under the Energy Union framework in the last years with a rather reserved support from the Member States (Fischer 2017).

1. The financial crisis and the subsequent slow growth restrained the ambitions and the 2030 climate framework was accepted by the Council in a much less ambitious form during the last months of the Barroso Commission<sup>9</sup>. The Juncker Commission had to adapt to the accepted framework but also has to finalize the important governance mechanisms for the 2030 climate framework. Yet it is already apparent that likely more responsibility will rest with the Member States than in the case of the 2020 framework (Fischer 2017). Member States would not work completely on their own however: their integrated climate and energy plans would be consulted not just by the Commission but neighbouring countries as well fostering a regional approach in forming national strategies.
2. The Energy Security Strategy released in 2014 by the former Commission, partially as a response to the Ukrainian conflict, was an update on the current situation (with stress tests) and a vague list of future steps needed to be taken. Under the Energy Union framework, though being one of the five dimensions, only moderate steps were taken. The sustainable energy package of early 2016 contained the ex-ante revision of intergovernmental agreements of oil and gas trade<sup>10</sup>, accepted by the EU Council in March 2017. The package also calls for the regionalization of energy security risk assessments (Member States will need to prepare Risk Assessments, Preventive Action Plans and Emergency Plans at regional level). It also introduces a solidarity principle (prioritising protected customers). The external dimension of energy security,

i.e. “speaking with one voice” did not move forward however, as the Council Conclusions on EU Energy Diplomacy (in 2015) have not included significant new elements.

3. The evolution of the internal market under the Energy Union framework is represented mainly by the sizable Winter Package of late 2016 (Clean Energy for All Europeans). The package proposes numerous evolutionary changes in the operation of the common market still to be accepted by the European Parliament and the Council. The package focuses on the electricity market as its development is more advanced than that of the gas market, and the energy transition is more disruptive in this field. Large part of the package is trying to resolve market issues caused by those disruptions: facilitate the intra-day coupling of markets; empower consumers as active participants in demand management and local electricity generation; limit the market distortion by capacity schemes of Member States; encourage cross-border cooperation in renewable support schemes; enhance regional cooperation and risk preparedness in by introducing Regional Operating Centres (Buchan and Keay 2016).

In conclusion, the Energy Union has not yet introduced significant changes in the EU energy policy (similar to the changes of the Third Energy Package or the 2020 framework). It shows, however, the Commission willingness to react to the developing energy transition in Europe. As no new competencies are rendered to the framework, the Commission mainly focuses on what it knows best: creating and shaping the common energy market and through that also the area of energy security and sustainability as well. In this development process the formal and informal role of regional cooperation between Member States will be increasingly important.

This approach builds upon the process of regional gas and electricity market integration on a more technical level, based on regional initiatives and controlled by ACER<sup>11</sup>. Regionalism is not new, it has been in the toolset of the common energy policy prior the Energy Union, but rather focusing on the technical development of the common market (De Jong and Egenhofer 2014). By inviting regions to participate as new, formal or informal units in strategic, policy shaping processes, the Commission not only allows functionalist mechanisms to enter into play (creating spill overs by increased cooperation). It also possibly allows for more flexibility and “openness to finding other methods for constructing a continental market – notably via multiple initiatives at regional levels with varying levels of ambition and focus.” (Stang 2017, 49). This might also possibly lead to, or at least encourage discussions on, differentiated cooperation in terms of energy policy within the EU.

#### VISEGRAD COOPERATION – ENERGY SECURITY AND MARKETS IN THE FOCUS

Energy policy cooperation within the Visegrad framework is not the only regional energy cooperation inside the EU, but it is a unique one based on its history and because “it combines political cooperation within the V4 with energy market cooperation” (De Jong and Egenhofer 2014, 3). The energy sector and policies of V4 Member States share many similarities forming the basis of the cooperation, and also providing the reason, why the energy sector became the most prominent policy area within the Visegrad cooperation. Visegrad countries have:

- developed economies with post-socialist heritage, relatively high rate of poverty (including fuel poverty) and energy intensity;
- liberalized, developing (interconnecting) energy markets with significant state intervention (e.g. end-user price subsidies, state ownership of major assets), struggling with underinvestment in energy infrastructure;
- having a diverse energy mix (renewables and nuclear included), facing with monopolistic import dependence and energy supply security for gas;

During the history of Visegrad Group, the cooperation on the field of energy has undergone a spectacular evolution to a point where energy can be considered probably the most sophisticated sectoral cooperation within the V4 framework. Although North-South direction of infrastructure development and coordination of power sector development already appears in the founding Declaration of the Visegrad Cooperation in 1991, in terms of energy cooperation only the post-2000 era bears real significance (Törő, Butler, and Grüber 2014).

Following the EU-accession the further development of energy cooperation was characterised by solid widening and deepening at the same time. The main energy policy decisions on the European Council or Council agenda have seen a preceding V4 (or occasionally V4+) consultation providing a common position. Although less visible, such consultations were crucial in increasing the negotiating power of the V4 block and contributed to their strengthening voice and increasing decision-shaping ability in the Council on energy and climate issues (Bocquillon and Maltby 2017). The main mission was, however, to integrate and strengthen the security dimension within the EU energy policy discourse (Świątkowska 2011).

Apart from policy coordination and discussion, the major project was the creation of a common electricity and gas market in the region. The concept evolved gradually from initial information exchanges and coordination of positions envisaged by V4 presidential programs of 2003/04 and 2004/05 but the main idea remained to forego the common EU energy markets and build a regional stepping stone towards it.

Electricity interconnections were and still are more developed between the countries than gas (Kaszab et al. 2013), and the cooperation of the four TSOs<sup>12</sup> was already given by forming CENTREL in 1992. Day-ahead market coupling was pursued as an EU backed, ACER coordinated project, and became reality in 2012 September between the Czech Republic, Hungary and Slovakia. The day-ahead market was joined by Romania in 2014 forming the 4M project<sup>13</sup>. Although Poland also signed the MoU on joining the market coupling project, it has not done so yet, and is more connected to Sweden, i.e. to the North-Western coupling zone. This underlines how physical and market conditions can overrule the political boundaries of the V4 cooperation.

The development of the common V4 gas market is far more politicized, and security-focused. In terms of gas supply security, V4 countries are in varyingly vulnerable situation, but in terms of price security, all of them are heavily affected by monopolistic pricing by Gazprom (Nosko et al. 2010<sup>14</sup>). The Ukrainian-Russian gas crises of 2006 and 2009 as well as the political tension since the annexation of Crimea and the following ongoing disputes and uncertainty of future transit have provided a significant push, and gas supply and transport security are recurring, top priority issues ever since. As a result, gas supply security has been securitised among the V4 countries and dominated



the energy policy agenda, political discussions and external communications of the group.

Besides the political activity, the Visegrad Group proposed diversification and development of interconnectors as practical solutions for the supply security issues. The North-South gas corridor connecting the Polish LNG-terminal in Swinoujscie and the proposed Croatian LNG-terminal at Omisajl became the flagship project for the V4, since the corridor's idea first appeared in 2006. This would not only allow access to LNG for the landlocked V4 members, but would also increase cross-border capacities and therefore pooling resources in case of a crisis and increasing competition. Apart from the N-S corridor, the V4 repeatedly called for diversification of supply sources as well<sup>15</sup>.

As a result, the gas policy cooperation became one of the most institutionalised V4 activity<sup>16</sup>. Despite some advancement however<sup>17</sup>, the gas supply security situation of the V4 countries is still not resolved, not only because of missing infrastructure, but because of regulatory shortcomings, e.g. the missing harmonisation of security of supply legislation among each other (Slobodian et al. 2016).

Energy (gas supply) security remained the main common topic of V4 under the Energy Union framework as well. Partially because the original Energy Union concept (focusing almost exclusively on energy security) was proposed by Poland, and also because the conflict situation in Ukraine and the emerging cooperation, especially in gas trade, with Kyiv as well. The Energy Union framework caused (or coincided with), however, some dissent among the V4 Group: at first the Group was unable to issue a common position on the Energy Union (in March 2015), later the proposal of the Commission to change the

legality check of energy Intergovernmental Agreements to *ex ante* inquiries, and the Report on the 2015-2016 Czech presidency states that “on some issues the V4 were unable to find a common position, which only confirms the trend towards fragmentation of V4 energy cooperation” (Visegrad Group 2016; Misik 2016).

There is still widespread agreement among the Group on the importance of energy security, yet the perception of threats might have changed, partially due to the Nord Stream 2 project. Poland, Slovakia and Hungary are vocal opponents of the highly controversial and politically sensitive project, yet the Czech Republic was rather modest in opposing the project (Kalan 2016). The Turkish Stream<sup>18</sup> project also was able to cause frictions, as Slovakia and Hungary supported two, practically opposing projects (Eastring vs. TESLA) for transiting the Russian gas to the CEE markets, should the new pipeline be built with such capacity. There is widespread consensus in the Group on supporting nuclear energy and technological neutrality, yet possible Russian nuclear investments (especially in Hungary) could be a source for tensions. In terms of climate and environmental policies the block is clearly favouring competitiveness and safeguarding consumers over a German-style *Energiewende*, but Poland’s decreasing openness for implementing green policies might also hinder a common approach in those areas.

Despite any potential disagreements between the Members, the V4 Group maintains a solid position in terms of sovereignty of their energy mix. Most of their public statements, especially in relation to EU policies, pin down the clause of TFEU 194 on the non-interference of EU competences to the ability of Member States of defining their own energy mix. This policy is not unique, it is widespread within the EU, and has not been challenged yet by Member States or the

Commission. Keeping full sovereignty over the energy mix is important for the Group not only from an energy security perspective (having the ability to install domestic capacities maintaining a certain level of domestic production even if it's not efficient), but also from an economic and social one (maintaining the use of coal or nuclear even with state interventions, or favouring lower retail prices over introducing renewable support schemes).

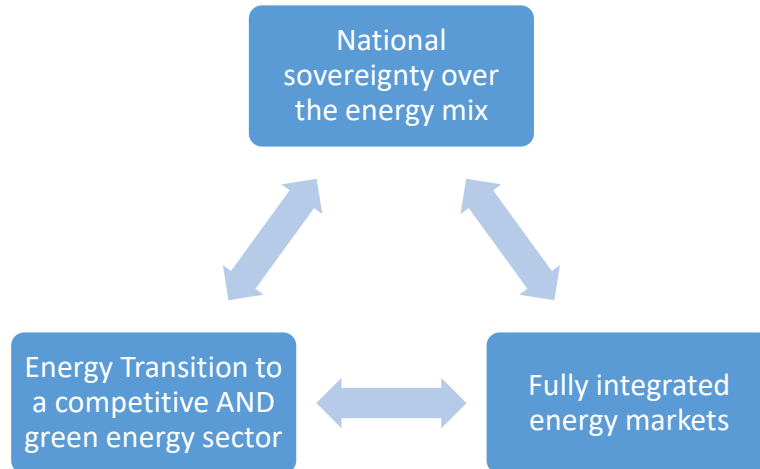
We may conclude that the Visegrad energy cooperation is clearly politically driven and is a political project. Formulating common positions towards the EU and forming a single block in certain external energy diplomacy issues gives weight to the countries. In terms of market integration the block is a useful and efficient tool to translate the functional EU legislation (e.g. network codes) to a gradually evolving market. Yet the primary goal behind the market (and infrastructure) development is to tackle the energy security risk, perceived as a major threat on political level.

## THE POTENTIAL FOR DIFFERENTIATED COOPERATION UNDER THE ENERGY UNION – WITH OR WITHOUT THE V4?

### THE PARADOX OF THE CURRENT ENERGY SYSTEM

The EU faces a paradox that its goals (fully integrated markets, energy transition, and competitiveness) and tools, abilities (either by the word of the Treaties or most importantly by the interpretation of the Treaties and the lack of political capital invested in the Commission by Member States) do not meet (Zachmann 2015). The paradox may be shown as an 'impossible triangle' where only two

points can be achieved under the status quo, but not all three at the same time<sup>19</sup>.



1. If Member States can hold full sovereignty over their energy mix and the way to achieve it, they can introduce support schemes or other legal frameworks to increase the share of renewables or maintain nuclear or fossil capacities. These heavily distort the long term price signals on the market and reduce investments. As a result competitive<sup>20</sup> and green energy sector on national level could only be achieved at the expense of limiting trade (not to let the low prices, achieved by subsidies or some comparative advantage<sup>21</sup> ‘out’ of the national market), or exerting significant negative externalities to neighbouring countries (exporting low prices to countries which cannot guarantee necessary investments under such low prices, or buying excessive amounts of storage and/or balancing capacities imposing higher prices or even energy security risk to the exporter country). This would likely force disadvantaged countries to reconsider their participation in the integrated market.

2. Achieving energy transition with a fully integrated market would mean that economic efficiency (i.e. prices based on comparative advantages) would determine the quantity and location of various energy generating capacities and trade between Member States, and with third states. This would empty national sovereignty as a Member State would not be able to decide on its domestic energy mix or maintain any desired level of domestic (backup) generation capacity without distorting the market.
3. It would be likely possible to develop an integrated energy market between countries with sovereignty over their energy mixes. Such scenario would, however, not allow for any green revolution of the energy sector – if some countries would pursue energy transition, the situation would transform to the scenario no. 1 (above). If countries resort to use conventional energy sources without state interventions, the necessary investments for an energy transition (generation capacities, but especially development of the transmission and distribution system) would likely not occur. Maintaining the current, traditional utility business model presumably excludes a wide energy transition, within our current technological and economic predicament.

This paradox is not extreme in the sense that there is a possibility to find compromise between the aspects with efficient market and regulatory design. The aim is to underline, it is likely not possible to “eat the cake and have the cake”, especially not all three slices of it<sup>22</sup>. The question is, if all Member States can subscribe to such a compromise, or some differentiated cooperation would likely arise to solve a political stalemate. Or the level of ambition has to be reduced, even though the Energy Union package was supported by Member

States<sup>23</sup>. Until such decisions are made on political level, uncertainty on the markets will remain strong and hinder developments in the energy sector.

#### REGIONALISATION AND THE POTENTIAL FOR ENHANCED COOPERATION

Currently regions are the building blocks of the common market integration. The local and functional cooperation of TSO's, national regulators are indispensable for introducing flexibility in the implementation of common market rules in terms of order or local specificities – even though the end-goal is common (De Jong and Groot 2013). This way smaller units implement gradually the common network codes developed by ACER, and a resulting patchwork of regions with emerging physical and legal interconnectedness will create the single energy market (first in electricity, later in gas presumably). In many terms market integration has already happened at least on regional level – a certain level of market liberalisation is common and practically all EU countries have coupled wholesale markets with at least few neighbouring markets (or will be soon, e.g. Bulgaria).

The Winter Package (if adopted) and the recent policies of the Commission point towards an increasing, and more policy oriented use of regional cooperation, even in less directly common market related issues (Stang 2017). The Commission might have a twofold reason to move into this direction.

- First the Commission possibly observed that throughout the process of establishing interconnectivity with neighbouring countries, many Member States have developed formal and informal procedures for

cooperation and coordination, i.e. the transaction cost of any future common project either in terms of energy security or reviewing national plans for 2030 might become easier and politically less sensitive. Some spill-over effects have also likely emerged as cross-border network developments were somewhat coordinated with neighbouring countries

- Second the Commission would likely try to imbue regions with more flexibility in making basic energy policy decisions. It has likely observed that “[R]ecent national policy decisions in some countries and continuing uncertainty in others have already led to various degrees of market reactions and impacts on investment decisions in neighbouring countries.” (De Jong and Groot 2013, 12). In order to tackle potential conflicts and reap the benefits of cooperation, delegating some minor competences to regional level can send the message to solve such issues according to the principle of subsidiarity, closer to its origin.

The role of the regions is strengthening and it seems less likely that on short term an EU level response could be formulated to tackle the challenges of the energy transition due to the paradox at the core of the EU energy policy. Therefore it could be tempting for certain regions to pursue some form of differentiated (enhanced) cooperation scheme and give their own answers to those challenges, reduce uncertainty in their own regional markets, and try to shape the future of the Energy Union.

The next subchapter will briefly introduce two scenarios of such an enhanced cooperation – one in line with the principles behind the V4 energy cooperation, and one possibly leaving the Visegrad Group outside its scope.

POTENTIAL SCENARIOS FOR DIFFERENTIATED  
COOPERATION  
SCHENGENISATION OF ENERGY POLICY

This scenario would see increased, voluntary coordination of fuel mixes among its members on a regional basis, leading to the “Schengenisation” (De Jong and Groot 2013, 30) of energy policy, i.e. increased pooling of sovereignty over energy policy decisions and in general creating a much more centralised market cooperation scheme. The main reason behind doing so is legislative and economic efficiency. By coordinating investments in the renewable sector and distribute them according to economic baselines could generate 15-30 billion € additional wealth in the EU by 2030 (Newbery et al. 2013). It would also likely reduce the need and the costs of capacity mechanisms<sup>24</sup>, and also renewable subsidies. The governance of the newly formed ‘club’ could be managed by creating a regional regulatory authority and TSO (under the auspices of ACER and ENTSO-E/G respectively, to ensure harmonised operation with the general EU framework).

This scenario would acknowledge, that for several Member States (e.g. likely the V4) it would be unacceptable to move forward with revising the Treaties<sup>25</sup> and expanding the EU powers, but others want to move forward through some form of secondary legislation (Delors et al. 2010). It is not straightforward, however, how such differentiated cooperation would be possible. Enhanced Cooperation should not overstep the limits of the Treaties, and safeguarding national sovereignty of energy mixes is clearly stated in Article 194 of TFEU. It would also had to be argued, that such Enhanced Cooperation does not affect negatively the common market, i.e. maintaining proper



market functions between the participants and outsiders of the Enhanced Cooperation, and ensure that no harm is done to the outsiders. A multilateral, intergovernmental treaty is a more likely possibility like in the case of the Fiscal Pact, as it would face less restrictions, yet still, the participants of the differentiated cooperation would likely need to offer proof, that outsiders would not suffer economic or energy security harms.

The Pentalateral Energy Forum could be the main contender to form the base of such a differentiated cooperation. The regional initiative comprising of Austria, the Benelux states, France and Germany was formed in 2005 and promotes cross-border cooperation on energy exchange. The Forum, while helping to establish the regional market, served as a best practice of regional TSO and regulatory cooperation for the rest of Europe (De Jong and Egenhofer 2014). The main driver behind taking the next step could be Germany as the country is trying to translate the core of the *Energiewende* into EU energy policy decisions, and to help its own domestic transition process (Szulecki et al. 2016). Also the countries are much more reliant on each other in terms of electricity flows (especially Germany and Austria), but also capacity adequacy (France and Belgium both will possibly face capacity adequacy issues). France has also embarked on a (modest) energy transition, decreasing the share of nuclear power, and Belgium (nuclear power plants) and the Netherlands (decreasing gas production) also face serious energy policy challenges.

Should such a differentiated cooperation be formed, it would have various effects of non-participating countries – among them most likely the Visegrad Group. It would not bring solution to the current issue of loop-flows<sup>26</sup>, and likely wouldn't affect price differences in the

short term. On the long-term, however, it might create similar situations as described in energy policy paradoxes 1 and 3.

#### FOCUS ON ENERGY SECURITY

The second scenario deliberately envisages a differentiated cooperation that could emerge on the basis of the current Visegrad energy cooperation framework. Such initiative would most likely focus on the issue of energy security. Not only because it is the central topic in the V4 framework, but also because the energy security framework within the EU is less developed than the size and integration of its energy market would suggest (López-Ibor Mayor 2009).

Advanced gas supply security measures could be proposed and taken in domestic and external directions: introducing stricter rules for solidarity, increased and common mandatory strategic gas storages, more coordinated crisis management procedures. In terms of external actions the idea of common gas purchases proposed by Donald Tusk and propagated by Poland in general could resurface – although not only many Member States have opposed it but it might also contradict the rules of the common market (Szulecki et al. 2016). In general, the EU energy diplomacy aspect could not be significant part of any differentiated cooperation as the common foreign and security policy is more consensual and politically sensitive issue.

An important development could be however the introduction of advanced electricity market security regulations and procedures. As the January electricity supply crisis in the Balkans has shown, the solidarity rules and their enforcement is far from adequate (Bauerova 2017). Activities to enhance the cyber security of the energy networks (information sharing, common response group) would also be a timely

and important step forward a more comprehensive energy security cooperation.

Such differentiated cooperation would enable the V4 to gain some political momentum, and also to shift back the energy policy focus towards energy security issues. Yet, currently most of such issues are of the sphere of external policy, and have various sensitive implications (e.g. issue of Ukrainian transit and Nord Stream 2). Also if any new institutions or investments would be needed, it would likely not be financed by the EU budget (certainly not under an Enhanced Cooperation scheme). The differentiated cooperation could gain supporters mainly from the region of CESEC<sup>27</sup> – energy security perceptions and priorities largely differ in South- and Western Europe (Austvik 2016).

## CONCLUSION

It is apparent, that more flexibility is needed, if the EU wants to pursue more effectively its energy policy agenda. Either by delegating more decision making ability to the Commission, which can later relegate the implementation to the regional level with room for local solutions and different scheduling.

Although the slow and gradual empowerment of regions in the Energy Union framework would likely induce discussions on forming differentiated cooperation, doing so would require a political push and compromise so powerful and complex as only a few can be found in every decade in the history of the European integration. Energy policy is a key economic, social and security issue, substantially altering its current framework is less likely, until the EU is faced with even bigger political challenges.

It is questionable, if the V4 is united and indeed influential enough to pursue such an agenda. Although the Group will undoubtedly work further on strengthening the energy security discussion and framework, it is hesitant to delegate or pool sovereignty to regional or EU level, what would be crucial for a truly transformative energy security agenda.

The energy transition and Germany could likely become another core for a potential differentiated cooperation. Although the Pentalateral Forum seems a promising root for such an initiative, forming a block to pursue regionalised energy transition in faces several significant hurdles, presented above.

Although these are by far not the only potential topics or groups, some form of advanced cooperation could stem from, they illustrate that it is less likely for regions to form cooperation mechanisms for wider energy policy goals (energy security, energy transition). The main hurdle for regions to implement such advanced cooperation, even in minor scale, is the number and severity of externalities likely arising, as energy markets and infrastructure are more and more connected, interdependent.

To avoid such externalities, it is possible, however, that some distinct policy issues could be dealt with on the EU level, allowing for few states to opt-out or delay the implementation – also a form of flexibility. There are several issues, where potentially most of the Member States could come to an agreement in the coming years: expanding the role and power of ACER, introducing a common renewable support scheme and/or some sort of capacity mechanism, approving stricter solidarity rules in case of supply crises, especially

in electricity. These would be smaller but less fragmented steps towards finding a forward looking balance in the energy trilemma.

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<sup>1</sup> TFEU Part One, Title I, Article 3 defines exclusive competences, e.g. customs union, commercial policy, competition rules for the internal market.

<sup>2</sup> Currently only 4 Member States have opt-outs in 5 policy areas, never with more than two Members in a single policy area.

<sup>3</sup> Securing nuclear energy use and fuel supply was also key area regulated by the separate, later merged Euratom Treaty. Its scope and area has not changed or expanded significantly, and up until now it has not pursued a policy prescriptive or agenda setter role.

<sup>4</sup> As Article 194 of TFEU puts it: “[Measures taken under shared competence] shall not affect a Member State's right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply”.

<sup>5</sup> Not to be confused with the Energy Community, the body of the Energy Community Treaty, established in 2006 to foster cooperation with the EU and its neighbouring countries on adopting the EU's energy *acquis communautaire*, and as such, one of the main tools of EU external energy policy.

<sup>6</sup> The authors argue that the preceding developments have completely fragmented the EU energy policy and deeper cooperation (Energy Community) is needed even if not all Member States are ready to participate (i.e. propose differentiated cooperation) (Delors et al. 2010). Yet the economic crisis and a sentiment of renationalising energy assets have not allowed the idea to shape policies for a while (Austvik 2016).

<sup>7</sup> Although the proposal dismissed the sustainability aspect of the common energy policy, as well as marginalised the non-supply security related aspects of the common market, it received more attention. The proposal was preceded by the annexation of Crimea and significant political tensions between the EU and its Members, and Russia; as well it was also part of Donald Tusk's run for the Presidency of the European Council.

<sup>8</sup> For detailed, historical overview on energy transitions, see (Smil 2010).

<sup>9</sup> Both target values (emission, renewables) and governance scheme (common, flexible targets instead of binding ones for member States) was watered down significantly compared to

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the original Commission proposal (Tagliapietra and Zachmann 2017).

<sup>10</sup> A significant political win for the Commission as it receives the right to act as a benign censor for energy IGAs, a sovereign tool of the Member States' external energy relations.

<sup>11</sup> The Agency for the Cooperation of Energy Regulators is an EU forum for National Regulatory Authorities. ACER is developing the technical legal framework of the common market (network codes).

<sup>12</sup> Transmission System Operator – the company responsible for the operation and development of the transmission network of electricity and gas, ensuring the security and reliability of transit and supply to the distribution networks to which most consumers are connected to.

<sup>13</sup> For details see

<https://www.hupx.hu/en/Market%20Coupling/marketcouplinghistory/Pages/4mmc.aspx>.

<sup>14</sup> This exposure was well presented in the antitrust case of the Commission against Gazprom as the Commission investigated, what damages the unfair and often illegal pricing mechanism of

Gazprom caused to several CEE countries, including the Visegrad Group. For summary and evaluation see <http://bruegel.org/2015/04/the-gazprom-case-good-timing-or-bad-timing/>.

<sup>15</sup> They support the TANAP/TAP project, and repeatedly signalled to Washington on political level the positive energy security aspects of supplying US LNG to Europe.

<sup>16</sup> In 2009 the Hungarian presidency created the High Level Energy Working Group in order to foster the cooperation especially in the gas market and N-S corridor, which prepared the high-level V4+ Budapest Summit on 24 February 2010. The Summit put political impetus behind the project N-S corridor project, while trying to secure the needed EU funding for it. The Declaration also created *ad hoc* Expert Working Groups under the HLG for the N-S corridor (and LNG terminals), oil and gas crisis management and the 2020 EU energy and climate policy framework. The Polish presidency in 2013 established the V4 Forum for Gas Market Integration and presented the Road Map for gas market integration. The Road Map envisages the adoption of the developed EU network codes, and developing a Target Model based on the European one. There are numerous model to choose and proceed with, but as with the electricity market coupling, the inclusion of neighbouring states (especially Austria with the Central European Gas Hub) would be largely inefficient (Ascari 2013).

<sup>17</sup> The inauguration of the Swinoujscie Terminal and the Slovakia-Hungary interconnector are important steps, but still important interconnector capacities are missing especially between Poland and Slovakia and the Czech Republic, as well as the Croatian LNG project has been advancing particularly slowly. The 2014 stress test by the Commission has shown that V4 countries (especially Hungary and Poland) are still exposed to gas supply security disruptions from Russia, yet the used

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scenarios are rather extreme and development compared to the 2009 situation can be observed indeed in terms of resilience in the group.

<sup>18</sup> The pipeline would replace the cancelled South Stream project and would supply Turkey with Russian gas, but could also supply the European market, if the second phase (2 additional lines) is built with the connecting infrastructure through the Balkans.

<sup>19</sup> This model is based on mainly the electricity sector, as that is going to be likely in the centre of the future energy system due to electrification and the much larger potential for generating electricity than other fuels from renewable sources.

<sup>20</sup> In this sense competitiveness refers also to the affordability of energy prices for the end user.

<sup>21</sup> Such advantage can be large renewable energy potential as a natural resource, or a large gas market with diversified supply options allowing for cheaper gas prices, or a large fleet of nuclear power plants operating on their marginal operational cost. Using domestic coal stocks can also lead to cheaper domestic prices, yet such scenarios falls short from being considered green.

<sup>22</sup> Disruptive and paradigm shifting changes in technology of electricity production, distribution and consumption are possible and even forecasted. Such changes could fundamentally alter the predicaments. Yet, based on the slow reaction time of the energy sector (including regulation) and the long investment cycles, it is reasonable to expect no radical shifts in the following years, when answers to the paradox are likely have to be offered.

<sup>23</sup> Approaching 2020 in many cases becomes apparent that national targets and rhetoric is hard to meet if at all possible. Abandoning ambitions would be likely most unfortunate for the environmental, economic and social future of the EU, yet in case of the 2030 goals a somewhat decreased level of ambition can be observed as noted in a previous chapter.

<sup>24</sup> Additional fee paid for the availability of flexible generation capacities – usually conventional coal and gas power plants, but possibly also for demand-management structures.

<sup>25</sup> Without revising, and in this case expanding, the Treaties, granting opt-outs for certain countries is also impossible, therefore negative differentiated cooperation (creating a general framework without certain Member States) is not an option either.

<sup>26</sup> These unplanned and uncontrolled electricity flows result in the Polish, Czech and Slovak (sometimes Hungarian) systems, when large quantities of electricity produced by wind farms in the Northern Sea travel through the regional system to Austria and Bavaria, as the domestic high-voltage North-South connections in Germany are inadequate. The sketched cooperation would not accelerate the development of the

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German domestic transmission network and would certainly not decouple the German and Austrian markets.

<sup>27</sup> The Central and South Eastern Europe Gas Connectivity group intends to accelerate gas supply diversification and the integration of the gas markets of Austria, Bulgaria, Croatia, Greece, Hungary, Italy, Romania, Slovakia, Slovenia and six Energy Community members (Balkan countries and Ukraine).