TOOLS FOR BUILDING EU CLIMATE CONSENSUS

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BRINGING THE CEE MEMBER STATES ON BOARD

Thomas Spencer and Anna Korppoo

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ULKOPOLIITTINEN INSTITUUTTI
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- In the wake of the Copenhagen climate summit, momentum remains for the development of the EU's climate policy. The EU's climate narrative is increasingly shifting towards an emphasis on long-term self-interest, while the international context recedes.

- Finding the consensus within the EU remains a challenge. In particular, the Central and Eastern European Member States have traditionally formed an important part of a more moderate block in EU climate politics.

- If the EU is to increase its 2020 emissions target, strategies will need to be developed to more explicitly integrate the concerns and interests of CEE Member States into the EU's climate narrative and concrete policy.

- In order to generate broader buy-in among EU Member States, climate policy should be more explicitly linked to overlapping, and immediately desirable, policy agendas.

- In addition, the issues of low-carbon financing; energy security and key low-carbon technologies provide opportunities to more strongly address the interests of CEE Member States, as policy milestones are pending in these areas in 2010 and 2011.

- The approach should not entail horse trading among unrelated issues, but rather greater strategic coordination of EU climate, energy and cohesion policy based on the goals of the 2020 Strategy. If low-carbon growth is to become a linchpin of the EU's economic strategy, it follows that this agenda should also be more strongly integrated into EU cohesion policy.

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Despite the lack of a global agreement in Copenhagen, momentum remains for the further development of EU climate policy, as indeed it does in many other countries. A 2010 Deutsche Bank report surveying the development of climate policies worldwide concluded that "...'the race is on' for countries to achieve a green economy". A wide range of EU initiatives on energy and climate are expected this year, providing opportunities to enhance the coherence and impact of EU policy.

But building consensus is always a challenge. This is exemplified by Member States' differing views around a possible increase of the EU's 2020 emissions target. Several countries including the UK, the Netherlands, Germany, France, Sweden and Denmark are pushing for this, while another grouping centred around Italy and Poland advocate retaining the *status quo*. The Central and Eastern European (CEE) Member States have traditionally played an important role within the more moderate group, although the issue is clearly more complex than a simplistic dialectic between "ambitious" old Member States and more "moderate" new Member States.

Nevertheless, the CEE Member States do share some common perceptions and positions on EU climate policy—certain common themes reoccur alongside their profound differences. If the EU is to accelerate its decarbonisation, strategies need to be developed to more explicitly integrate the priorities and concerns of CEE countries into the EU's climate narrative and concrete policy. This paper argues that the issues of low-carbon financing; energy security and key low-carbon technologies provide opportunities to do so, with milestones for policy development pending in 2010 and 2011. If low-carbon growth is to become a linchpin of the EU's economic strategy, it follows that this agenda should also be more strongly integrated into EU cohesion policy.

Factors driving EU policy: The EU climate narrative

After Copenhagen, the driving forces for the development of climate policy have shifted from the horse trading of international negotiations to a colder calculus of economic self-interest. Countries like China and the USA, who could not be shifted in Copenhagen, are pouring vast sums into clean tech sectors, presaging the beginning of what some are calling a new "space race" for clean sources of energy and employment.

This narrative is also increasingly coming to the fore in Europe. The Commission argues that "concrete and determined action to become the most climate friendly region in the world... is in the EU's self-interest"[1]. The benefits are defined in terms of economic recovery and sustained competitiveness; job creation; energy security; innovation and resource efficiency. Yet while the EU is already a leader in clean technology innovation and deployment, other countries like China, the US, and South Korea are seen to be catching up fast. In 2009 green economic stimulus in China amounted to around USD 230 billion; in the US to USD 80 billion; combined EU level and Member State stimulus to just €25 billion.

1 The European Commission, "International climate policy post-Copenhagen: Acting now to reinvigorate global action on climate change", COM(2010) 86, pp.8.

In the run-up to Copenhagen, a group of seven CEE Member States joined together to lobby for a post-2012 climate deal that would allow them to continue to sell surplus emissions rights (AAUs), and effectively blocked the formation of a common EU position in the international negotiations on this issue. The issue of surplus AAUs is particularly fraught, as it symbolizes the economic hardship and upheaval experienced by CEE Member States which led to the collapse of their emissions post-1990. Moreover, environmental investments from their sale provide a financing instrument in sectors with high financial barriers (i.e. high costs of capital and discount rates) and high social utility of mitigation measures, e.g. the residential housing stock.

Nine CEE countries also joined together to lobby, successfully, for "fast-start" climate financing contributions by EU Member States to be voluntary; they were not successful in negotiating a division of long-term financing responsibilities based on GDP, rather the formula places a "considerable" weight also on emissions.

Text box 1: Two examples of common negotiating positions among CEE countries (Source: Point Carbon News)

Changed economic circumstances are also driving EU policy development. The economic recession has caused a lasting downward shift in GDP and emissions trajectories—in the case of GHGs by as much as 5 % globally in 2020 compared to pre-crisis projections, according to the IEA. As a consequence, the EU's 20 % target is expected to be easier to achieve that originally anticipated. Furthermore, during the course of the downturn a large buffer of un-used emissions allowances has built up. In turn this could dampen the incentive provided by the EU emissions trading scheme (ETS) to shift toward low-carbon investment patterns and technology deployment.

Moreover, despite the worst recession since the Great Depression, persistently higher fossil fuel prices are now expected than was modelled in the Commission's 2007 impact assessment of the Climate and Energy Package. The 2007 impact assessment projected oil prices as USD 61 per barrel in 2020, compared to around USD 70 already today. In turn, this increases the expected profitability of low-carbon technologies and energy saving measures. Largely as a result of these two factors, i.e. the economic recession and expected higher fossil fuel prices, in 2010 the costs of the 20 % target are modelled by the Commission to be some 30 % cheaper that was estimated in 2007.

Finally, another major motivator for strengthening EU policy is the perceived need to put the EU on a more feasible long-term decarbonisation path, avoiding higher costs of accelerated decarbonisation post-2020 and the possible premature decommissioning of high-carbon assets.

Thus the narrative driving forward EU climate policy (as indeed elsewhere) is increasingly one of long-term economic self-interest. Stricter climate targets are seen both as an *end* in themselves (i.e. as the EU's contribution to global climate mitigation consistent with the goal of limiting the rise in average global temperatures to 2°C), and a *means* to other ends—driving forward competitiveness, innovation, integration, and resource security. However, with the effort needed to reach the 20 % target now significantly reduced, current EU climate policy is seen as a less effective lever of these agendas: hence the momentum behind a reassessment of the 2020 target.

Common themes and concerns among the CEE countries

The CEE Member States share a common experience of transition from a centrally planned to a market economy; from authoritarian to open, democratic governance; and from the highly integrated economic space of the former Soviet Union and Council for Mutual Economic Assistance to independent statehood and membership in the EU. Clearly there are profound differences within this heterogeneous group, from fuel mixes and economic structure, to culture and history. Nevertheless, there are common themes and concerns among them, which reoccur despite their heterogeneity.

In the upheaval of the fall of socialism, a collapse of economic activity and thus energy consumption took place. In most of the CEE countries, GDP started recovering during the first half of the 1990s, with the length of the recovery to 1990 levels varying

Photo: European Commission

from 1996 for Poland, to 2006 for Lithuania. By 2007 GDP had reached between 20 % above 1990 levels for Lithuania, and 90 % above 1990 levels for Poland. GDP per capita was between 41 % of the EU27 average for Bulgaria, and 90 % of the EU27 average for Slovenia. As a result of the collapse of GDP and their relative economic disadvantage in the EU, economic growth and convergence are clearly fundamental priorities for CEE Member States.

In general, socialism left a legacy of monolithic fuel complexes; high resource inefficiencies; integrated energy networks with a high import dependency (largely on Russia), and high environmental degradation. It also left positive legacies, for example high penetration of combined heat and power and district heating, and high use of public transport. The post socialist transition has mitigated some of the negative legacies, effecting significant cuts in energy intensity, while reversing some of the positive legacies, driving for example a decline of public in favour of high-carbon private transport.

Due to a range of factors, notably the transition to a market economy, privatisation, liberalisation, economic restructuring, removal of subsidies and targeted policy, a significant decrease in energy intensity of GDP has taken place in all of these countries since the mid-1990s. Amongst other factors, tapping the socialist "inefficiency reserve" has allowed sustained economic growth to be decoupled from growth in GHG emissions (figure 1). In 2007 emissions were on average 30 % below 1990 levels, contributing to the perspective in these countries that they have made their contribution to climate mitigation, and now others should do their bit. Nonetheless, energy intensity remains higher than the EU average by a factor of 2.3; reducing it will require further targeted, purposeful policies beyond the transition to a market economy and a liberalized energy sector.

The former socialist countries shared a high degree of energy infrastructure integration that relied on (subsidised) energy imports from Russia: "energy was one of the leashes through which Russia kept its republic and the satellite countries of CEE dependant…".[2] Path dependency implies that CEE countries remain relatively more dependant on energy imports. For example, CEE countries make up 7 of the 8 highest scores on the EU gas *risky external energy supply* index developed by Le Coq and Paltseva.[3] Alongside legacies in material infrastructure, history casts psychological shadows too, contributing to the politicization of the energy security issue. Finally, rapid economic growth and chronic underinvestment in the energy sector pose significant challenges for many CEE countries to secure adequate generation capacity. Energy security is thus another priority common to many CEE countries.

The CEE countries also share the experience of accession to the EU. Implementing the environmental

2 Diana Ürge-Vorsatz, Gergana Miladinova, László Paizs, "Energy in transition: From the iron curtain to the European Union", Energy Policy 34 (2006), pp. 2280.

3 Chloé Le Coq and Elena Paltseva, "Measuring the security of external energy supply in the European Union", Energy Policy 37 (2009) 4474–4481. The countries scoring highest on the index are: Slovakia, Hungary, Latvia, Lithuania, Bulgaria, Romania, Austria, Estonia.

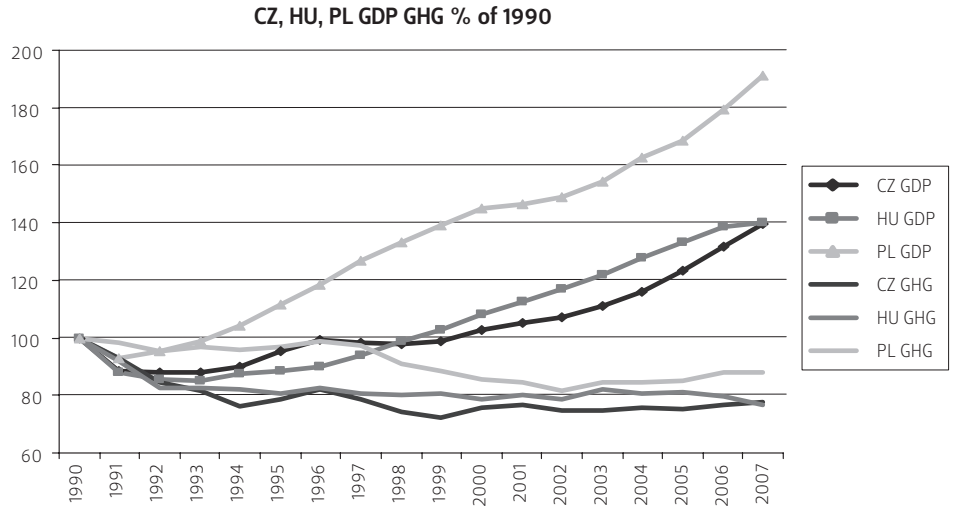

Figure 1: GDP and GHG emissions in Czech Republic, Hungary and Poland, as a percent of 1990 levels (IEA;UNFCCC).

aquis communitaire placed heavy administrative and financial burdens on CEE countries. Commission estimates put the costs of implementation at 80–110 billion Euros, or 2–3 % of the affected countries' GDP. At the same time, there were significant benefits, with estimates suggesting that Poland for example would suffer 60 000 to 120 000 fewer cases of chronic bronchitis as a result of better air quality, according to a study by Ecotec Research and Consulting. This "love-hate" relationship still persists. Despite overwhelming agreement on the benefits of EU accession, the EU is still perceived with a certain lack of ownership, given a perception that its agenda is still dominated by the interests of larger Member States.

After firstly the hardship of the post-Socialist transition; and then stringent reforms and perceived sacrifices to accede to the EU, CEE countries may view further impositions from Brussels and the prospect of a third, daunting transition to a low-carbon economy with a certain reticence. Rather, reaping the benefits of hard-won political and economic stability are fundamental priorities for CEE countries. If the EU is to accelerate its decarbonisation, it will be necessary to show that the transition to a low-carbon economy can be compatible with, or even facilitative of, these goals.

Financing the transition

CEE countries have significant low-cost mitigation potential, which would need to be tapped if the EU is to move domestically beyond its 20 % target in a cost-effective manner. How to finance this is a crucial question. The effort-sharing agreement of 2008 already contains instruments for significant financial flows to CEE Member States, with the EU15 giving up 9.1 % of their auction rights to the new Member States. Nevertheless, consideration could be given to mainstreaming climate policy into the EU budget and cohesion policy, as well as new sources of climate finance and delivery mechanisms, given looming constrains on public budgets.

The political priority given to climate change in the EU is largely not reflected in the current EU budget. Roughly €3.9 billion, or 3 %, of the EU budget can be considered as direct climate financing.[4] There is also incoherence between policy goals in the deployment of the EU budget. Just 2.4 % of funding from the Cohesion and Structural Funds will be invested in energy efficiency and renewable energy 2007–2013 in the CEE Member States; 55 % of the €55 billion allocated to the transport sector would be invested in road building, a relatively high-carbon form of transport. The next financial perspective offers a key chance to more strongly integrate climate change and cohesion policy within the EU budget, and could potentially be linked to the debate around the EU's 2020 target.

Innovative sources of finance may also need to be further developed to support the EU's low-carbon transition. Gross revenues from auctioning emissions allowances could amount to some €25.8 billion in 2020, depending on the carbon price. Another

4 Iain Begg, "EU Expenditure to Support Transitions to a Low-Carbon Economy", EU Consent EU Budget Working Paper No. 9, 2009, pp. 8–9.

Country	Share of gas in total energy consumption (%)	Share of non-EU, non-Norwegian import of gas consumption (%)
Bulgaria	*14*	*89.6*
Czech Republic	*16*	*78.4*
Estonia	*15*	*100.0*
Hungary	*41*	*66.0*
Latvia	*30*	*100.0*
Lithuania	*29*	*100.0*
Poland	*13*	*49.7*
Romania	*36*	*30.7*
Slovakia	*29*	*100.0*
Slovenia	*12*	*83.3*

Table 1: Gas import dependency in CEE countries (Source: IEA; Eurostat)

option under discussion is a tax in the non-ETS sector which could generate up to €50 billion by 2020, according to the Commission. There are also existing instruments, such as the pilot renewable energy and efficiency fund between the EIB and the Commission, which could offer a model for instruments to reinvest any carbon revenues at the EU-level.

A central conclusion is therefore that financing mechanisms, especially for sectors not covered by ETS or EU regulatory policy, may be a central tool to build consensus around EU climate policy. The politics of this may be fraught, given a background of looming constraints to public budgets and the ambiguous, but ultimately unprecedented, Greek solidarity package; this in turn might increase the momentum around innovative solutions, such as the pending revision of the energy taxation directive.

Energy security

Many CEE countries have a relatively high import dependency for gas as well as varying levels of reliance on gas in the energy mix (table 1); the historical experience of subjugation within the Soviet Union and the Council for Mutual Economic Assistance still contributes to the politicization of this issue. In addition, driven by rapid economic growth and chronic underinvestment in the energy sector since the 1990s, CEE countries face a significant challenge to secure generation capacity. The recession may have given some respite, but economic growth, and hence energy demand, is expected to rebound relatively swiftly in these countries. Finally, many CEE Member States are poorly integrated into the EU energy grid. Addressing the issue of energy security is thus a precondition to securing support for climate policy.

In recent years, especially after the 2009 gas crisis which revealed the inadequacy of crisis response mechanisms and interstate interconnections, EU energy policy has placed greater emphasis on the internal tools of energy security, rather than external policy. Continued development of an integrated, flexible energy market is seen as one crucial pillar of energy security.

Continued implementation of the 3rd Energy Internal Market Package is thus important, especially for those CEE countries which remain poorly integrated into the EU energy network. The package foresees the further unbundling and liberalization of energy markets, as well as enhanced cooperation and dialogue between energy regulators via the platform of the Agency for Cooperation of Energy Regulators (ACER), in order ultimately to facilitate the better integration of EU energy grids. However, further reforms of tariff and regulatory conditions may be required to create a viable framework for investments in the expansion of the EU energy grid.[5] In the longer term, the mandate of ACER may also need to be further developed, as it currently lacks a clear mission or decisional powers. The up-coming Energy Infrastructure Package and the Energy Action Plan

5 The development of a transnational energy grid has some characteristics of a public good, requiring regulatory intervention to deliver socially optimal solutions and limit free-riding. Market and regulatory conditions in the EU still contain barriers to the development of such a grid in both gas and electricity

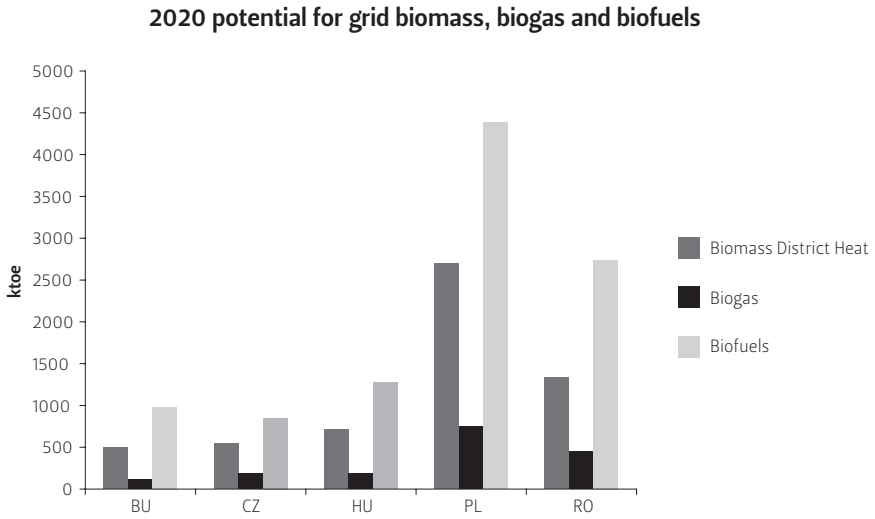

Figure 2: 2020 potential for grid biomass, biogas and biofuels (Source: Green x Database)

thus provide key opportunities to enhanced EU energy policy, while simultaneously better accounting for the security concerns of CEE Member States.

The European Energy Program for Recovery (EEPR) perhaps provides an indication of the possible future direction of policy approaches. Roughly €1 billion out of the total €3.9 billion was allocated to projects involving CEE member states, with the investments simultaneously addressing market integration, cohesion, energy security, and decarbonisation. Other examples of such projects relevant for the region could be the further integration of Baltic states in the Nordic energy grid; or gas and electricity interconnectors between Poland and Germany. With the EEPR as a model, consideration might be given to EU-level mechanisms to support priority energy security and internal market projects, for example gas interconnectors and storage facilities. In autumn the Commission will present a proposal for the restructuring of the TEN-E (Trans-European Networks Energy) program, primarily concerning funds for gas and electricity interconnectors. This could be a golden opportunity both to expand the funding and set a clear priority on climate-relevant investments that also address the energy security concerns of vulnerable EU Member States.

However, a distinction still needs to be made between energy security defined in terms of crisis management mechanisms and market integration, and energy security through a diversification of supply. LNG is an option for Bulgaria, via Greece, and perhaps for Poland, although at quite high-cost. Pipeline gas from the Caspian to South Eastern Europe would be small in volume, but significant enough for diversification. Unconventional gas, e.g. shale-gas, holds out potential for Poland, Hungary, Bulgaria, and Romania, but is still a largely unknown variable, the impact of which may become clearer in the next five or so years. Nonetheless, it can be expected that shale-gas developments, either directly or indirectly through international gas markets, will influence the EU gas market in terms of competitiveness and supply security in the medium term. Although the Commission's consultation document for the 2011–2020 Energy Strategy doesn't directly address shale-gas, it is likely that the Energy Strategy could.

Greater focus could also be placed on enhancing the synergies between climate policy and energy security. Climate policy, especially energy efficiency, can mitigate not only the supply and price risks associated with fossil fuels, but also—by reducing energy demand—risks of underinvestment in extra capacity. CEE countries have the potential to save ca. 13 % against projected electricity consumption in 2020, and 19 % against projected consumption of thermal fuels, according to research by Ecofys. However, studies indicate that the EU's would need to dramatically enhance its energy efficiency policy if it is to meet its 20 % energy saving target by 2020, and push forward the development of national energy efficiency policy. In this regard, stronger links could be made between energy efficiency policy and the social, economic and security concerns of CEE countries.

Poland has made energy security a key theme of its 2011 EU presidency. Development of some of the policy options discussed here may offer approaches to build EU climate consensus. Some of these are

already underway, e.g. the 3rd Energy Internal Market Package, and require commitment from the Commission and Member States to implement. But better linkages could be drawn between the agenda of the single market and energy security on the one hand, and climate policy on the other. Future energy policy initiatives, for example the up-coming Energy Infrastructure Package and the Energy Action Plan, offer the opportunity to do so.

Aligning strengths and needs

The EU generates about a third of its electricity from coal; coal makes up 92 % of Poland's electricity generation, and its share is predicted to remain at 57 % in 2030, according to the national energy strategy. While not expected to make a significant contribution to the 2020 target, carbon capture and storage (CCS) will thus be an important element of the EU's decarbonisation strategy. Moreover, CCS represents a potentially huge global market for equipment and operational expertise, which the EU risks losing to other, more proactive players.

The EU has two main instruments for developing CCS. The first was the European Energy Program for Recovery, which allocated €1 billion for 6 CCS demonstration projects. The second is the 300 million emissions permits in the New Entrants Reserve (NER), the monetisation of which is expected to provide between €4–7 billion for CCS and innovative renewable energy projects. Eligible projects could be determined by mid-2011, but the Commission has indicated that it may delay the auctioning of the emissions permits from the NER until 2013. Given this, it may be necessary for the European Investment Bank to step in and provide funding earlier to kick-start the projects on time. The process for selecting projects and knowledge sharing of the project experience may be very important to give CEE countries reliant on coal confidence that they can benefit from the development of a key low-carbon technology and meet EU climate goals. In the longer-term, additional funding, e.g. from the EU budget, will also need to be found.

In addition to CCS, biomass is a key low-carbon technology, especially in the case of CEE countries which have significant supply potential at relatively lower costs. There are large potentials for biogas development; biomass fired district heating and generation of biofuels (see figure 3). There is also often an absence of policy in CEE countries to drive the uptake in these areas, although many CEE member states have identified biomass as a key to achieving renewable energy targets. The pending energy taxation directive, if focused on the CO_2 content of fuels, could incentivise these fuels and spur the growth of the industry. The mid-term budget review completed in 2009 evinced relatively broad consensus that the Common Agricultural Policy's (CAP) direct subsidies to agricultural producers should be reduced in favour of a greater focus on the CAP's second pillar of rural development, or redirected to the headline Technology, Research and Innovation. A stronger orientation in the budget towards the contribution of the land-use sector to climate, development and innovation goals, for example through support for biomass-based energy systems, could be considered.

There is also scope for multilateral and bilateral climate partnerships to support affordable low-carbon development and building EU climate consensus. These could be within the framework of EU policy, e.g. the upcoming Energy Action Plan, or undertaken bilaterally between interested Member States. Examples could be a Polish-German climate innovation partnership exploiting shared interests and experiences, e.g. between the Ruhr and Katovice coal districts; enhanced cooperation through existing frameworks, e.g. the Baltic Energy Market and Interconnection Plan, for example on wind energy and grid integration, or the Energy Community for South Eastern Europe on gas infrastructure. Joint initiatives undertaken by a group of EU Member States on areas such as renewables and efficiency; grid development and clean coal technologies may be one way of creating a critical mass for strengthening EU climate policy. These could help demonstrate the benefits of climate policy, in terms of fostering innovation clusters; investment; labour market re-skilling and job creation.

Conclusion

The EU's climate narrative is increasingly emphasizing EU self-interest above the horse-trading of international negotiations. However, if the EU is to accelerate its decarbonisation and seize the perceived benefits thereof, internal consensus still needs to be built. In particular, the EU will need to convince CEE

Member States that such a transition is compatible with, or even facilitative of, their priorities, in particular economic growth and modernization as well as energy security.

Some of the policy options to do so are already underway; here stronger and more coherent linkages could be made between the policy priorities of the EU, in particular building the EU internal energy market; strengthening climate policy and enhancing energy security. "Rebranding" policy initiatives in spheres that do exhibit explicit synergies could help to win a broader basis of support among Member States. The vision of a reliable, sustainable and competitive energy system should be seen as indivisible, whereby the internal energy market cannot be achieved without the impetus of climate and energy security policy, and visa versa.

In addition, there is scope for pending policy decisions in relevant spheres to more explicitly take account of the concerns of CEE Member States, with a view to building support for a stronger EU climate policy. Examples include the upcoming Energy Action Plan; the Energy Infrastructure Package and the Budget Review. Here active engagement from Member States and the Commission would be needed to develop consensus-building policy options. The approach should not entail horse trading among unrelated issues, but rather greater strategic coordination of EU climate, energy and cohesion policy based on the goals of the 2020 Strategy.

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