

COMMISSION OF THE EUROPEAN COMMUNITIES

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THE INTERNAL ENERGY MARKET

FIRST PROGRESS REPORT

INTRODUCTION

The Single European Act gave new impetus to the creation of the common market called for in the 1957 Treaty of Rome, and fixed 31 December 1992 as the deadline for completion of the internal market. Under the new Article 8a of the EEC Treaty "the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

Energy is no exception, and it should be pointed out that failure to open up the energy markets will mean falling short of the final goal. Energy often accounts for a not inconsiderable proportion of production costs and the compartmentalization of markets is liable to be detrimental to certain industries.

In May 1988 the Commission approved a working paper on the internal energy market.

This communication was based on the Council's position concerning new energy policy objectives for 1995 and convergence of the policies of the Member States.¹

Both Parliament, in its resolution of May 1989,² and the Economic and Social Committee, in its information report,³ backed this approach.

1 Council Resolution of 16 September 1986 - OJ C 241, 25.9.1986, p. 1.

2 Parliamentary resolution - OJ C 158, 26.6.1989, p. 515.

3 Information report - CES 69/88 fin - ENERG 129.

The prospects which emerged from the Commission's working paper of May 1988 prompted broad discussion, but were not challenged by any of the institutions, receiving instead a positive reception.

Indeed, there was unanimous approval of the essential features of the policy for implementing an internal energy market.

On the other hand, while some progress has been made there is still a long way to go. The European Council in Rhodes, in December 1988, quite understandably quoted energy as one of the areas in which it was vital that the pace of change be speeded up.

The energy ministers discussed the matter at length, both in Luxembourg in June 1988 and in Athens in September, and on 6 November in Brussels they took a number of particularly important policy decisions giving full support to the course of action launched by the Commission.

In addition, in both May and November 1989, the Council confirmed its desire to head towards greater integration of the internal energy market, on the basis of the Commission's proposals.

It is significant that the same wish was expressed in July 1989 in the conclusions of the Summit of the Heads of State of the seven most industrialized countries (Sommet de l'Arche), who singled out the compartmentalized energy market as one of the obstacles to economic efficiency in the major industrialized countries.

The paper of May 1988 was intended to serve as a basis for future action and drew up an inventory of obstacles to greater integration of the energy market. It gauged the distance still to be covered on the road to a truly

integrated market. The communication also looked at the main issues of the general problem of integrating the energy market within the single market programme.

Paragraph 36 of the communication called on the Commission to submit a progress report taking stock of action under way and proposing guidelines for future work. The present communication is a response to that mandate.

I. PROGRESS SO FAR

With less than 1000 days to go before the scheduled completion of the large internal market, work on the internal energy market which has been under way for nearly two years needs to be presented. It is useful also to see it in its economic context.

1. Energy and the implementation of the White Paper

Energy products, like any other industrial products, are subject to the common rules introduced for the implementation of the internal market.

- (a) Work will soon be completed on the harmonization of standards and technical specifications.

Standards for petroleum products will be adopted before 31 December 1992, once CEN has completed its work.

A similar examination is being carried out for solid fuels by the United Nations Economic Commission for Europe. Since the market is already operating without any notable technical barriers, harmonization is not required so urgently.

As for production equipment, the standardization bodies CEN and CENELEC have been asked to draw up an inventory of existing standards and work out standardization programmes identifying priorities.

The energy sectors covered are:

- the production, transport and distribution of electricity - high and low voltage;
- the transport and distribution of gas and heat;
- the exploration and extraction of gas and oil;
- the exploration and extraction of coal and other solid fuels.

Further measures are under way in the nuclear sector under the Illustrative Nuclear Programme (PINP) adopted by the Commission on 28 July 1989 (COM(89) 347). This programme advocates the standardization of nuclear equipment and components with due regard to safety requirements.

With regard to energy-consuming equipment, the Commission has concentrated its efforts on certain types of equipment for which directives based on the "new approach" have been adopted. These include:

- low-voltage electrical equipment;
- simple pressure vessels;

- electro-magnetic compatibility;
- gas appliances.

Heat exchangers are also being standardized.

Efforts in the energy-saving field have concerned the labelling of domestic appliances in order to improve consumer information on energy conservation.

- (b) A considerable advance was made on public contracts in the energy sector with the common position adopted by the Council on the Commission proposal on 29 March 1990. The directive should be adopted in autumn 1990 and will enter into force on 1 January 1993. It will cover the entire energy sector, except for purchases of energy. However, the directive will provide for the possible exemption of oil, gas and coal exploration and production, under certain conditions, on the basis of a Commission authorization procedure. There are plans to review the scope of the directive at the end of 1995 in the light of its operating record.
- (c) At least one broad issue still has to be resolved: the level of the reference rates for excise duties. In addition to the internal market aspect, this issue is of fundamental importance in view of its potential impact on energy policy (energy management and diversification) and on the environment (emissions).

2. Application of existing Community law

The working paper of May 1988 (Section 49 *et seq.*) stressed the need to apply all the provisions of Community law more rigorously in order to achieve the internal energy market on the basis of increased competition.

Following a systematic analysis of the obstacles listed in the document, and following certain complaints, emphasis was placed on the following four points:

- vertical contracts, between producers of coal and electricity;
- State aids to energy, where greater transparency was shown to be necessary - the results of a global study on State aids should soon be available;
- certain aspects of the operation of the oil and gas market, in particular prospecting and production concessions;
- exclusive rights to import, export, transport and distribute gas and electricity.

In addition, a report is now being completed on national legislation and regulations which may constitute infringements with regard to electricity.

Moreover, on the basis of its own powers, notably Articles 37, 85, 86, 90 and 93 of the EEC Treaty, the Commission will continue to devote special attention to distortions of competition, with particular regard to prices, whether they are the result of State aids or corporate practices.

The Commission has pursued its assessment of several dossiers relating to the dismantling of oil monopolies in certain more recent Member

States. It has also examined the compatibility with the Treaty of certain new provisions in Member States which have undertaken reforms in the electricity sector.

3. New legislation

In order to supplement the existing body of rules and regulations so as to take account of the particular features of the internal energy market, the Commission has adopted four proposals intended to deal with those provisions constituting the biggest obstacles to the energy market (opacity of prices, compartmentalization of the markets). The proposals all respect the "golden triangle" of any energy policy: prices, investment and trade.

They cover:

- transparency of energy prices charged to industrial consumers of gas and electricity;
- increased trade through the obligation to provide gas and electricity transit;
- better exchange of information on energy investments of a certain scale.

These proposals are currently being discussed and have already received a favourable opinion from the Economic and Social Committee.

They were also endorsed by Parliament, though some reservations became apparent during the discussion on gas transit.

After its initial general discussion in October 1989, the Council will be returning to the matter in May 1990.

A decision should then be taken regarding the two proposals based on Article 213 (investment and transparency of prices). As for the trade proposals based on Article 100a, a common position is expected for the proposal concerning electricity transit, while for gas transit, Parliament, having organized a hearing so as to gather information, will adopt a position in June.

The proposals complement one another. By affecting all the parties involved in the energy sector they form a consistent whole which should help to develop relations within the sector. However, this is only a beginning. To complete the task, the Commission has chosen to set up two advisory committees, one comprising representatives of the national administrations and the other made up of users and suppliers of gas and electricity. In opting for this solution, the Commission wished to show both that it is not working according to a preconceived model and that certain ideas have to be defined in advance.

4. A changing economic context

The trends referred to above seem to have begun materializing, if only partially, in some sectors.

From the institutional point of view, it can be seen that certain Member States have begun a radical revision of their energy production, transport and distribution structures.

The completion of the internal market, technological progress and the changing needs of industry mean that monopolies and exclusive or special rights are often no longer suited to meeting the requirements of the Community economy. For instance, the construction of a private gas pipeline for use by third parties or of a plant producing energy for the sole use of an industrial site are scarcely conceivable within traditional monopolistic structures.

A further example, this time in the field of transit, is the conclusion of a contract between three Member States to supply gas.

In the nuclear field, too, agreements on fuel reprocessing and reactor safety have been concluded between three Member States wishing to abandon their national approaches in favour of a joint tackling of tasks and activities.

A recent Commission study based on the Cecchini report showed that integration, e.g. of the electricity market, should lead to ever greater savings each year - reaching between ECU 5 and 11 billion in 2010 - without jeopardising security of supply or quality of service. This figure represents the amount won from fuel costs and investment and does not include other gains which might result from a restructuring of the equipment industry and from the emergence of a more competitive consumer environment.

Even if one cannot talk of a causal link between the proposals put forward by the Commission and action taken by certain Member States or economic operators, the latter are already taking decisions

anticipating certain trends in the internal energy market and significant change is under way in the energy sector. For almost a year now attitudes have been changing and a somewhat more open climate has been felt, encouraging the Commission in its work to complete the internal market.

II. THE OBJECTIVES

The creation of the internal energy market must comply with the general objectives set out in the White Paper while at the same time respecting the specific features of the energy sector.

The Council Resolution of 16 September 1986 concerning new Community energy policy objectives for 1995 stated that the energy policy of the Community and of the Member States should endeavour to achieve "greater integration, free from barriers to trade, of the internal energy market with a view to improving security of supply, reducing costs and improving economic competitiveness." Such is the Commission's three-pronged approach.

1. Free movement of products

The free movement of products calls for various measures to be introduced to adapt certain existing structures and privileges.

In this respect, the general provisions of the Treaties concern the abuse of dominant positions and the existence or exercise of special

or exclusive rights, which must be applied without any discrimination.

Work to harmonize national legislation, based on Article 100a, will also be undertaken to help create a Community framework facilitating the introduction of common standards in areas relating to the technical quality of products and materials, environmental protection and even energy taxation.

2. Security of supply

The gradual opening-up of the markets will place those in charge of the various energy sources in a new competitive environment and must clearly not serve to undermine security of supply.

On the contrary, the gradual opening-up of the markets is likely to make for a more flexible supply, thereby improving the level of security of supply.

However, this needs to be backed up by defining the notion of security of supply at Community level.

Such security will call for an improvement - substantial in certain Member States - in transport and distribution networks for the various energy products. It also calls for certain improvements in infrastructure and a stepping-up of work on energy saving, the rational use of energy and the development of new and renewable energy sources.

However, better security of supply means defining and implementing a

common commercial policy guaranteeing diversification of resources.

Lastly, the new framework programme of Community activities in the field of research and technological development 1990-1994 includes specific energy programmes to guarantee security of supply.

3. Improving competitiveness

Since the opening-up of the markets will mean reduced costs, it is important that the energy sector be made more competitive. To this end, market conditions must be made more transparent, including prices, costs, aids and state intervention.

Harmonization of standards and technical specifications is a second means of reducing costs and will round off the work already undertaken in this field to other ends.

Lastly, encouragement of research and development and the demonstration of new technologies ought to lead to lower costs and thus to energy savings, resulting in a more competitive European economy.

III. THE LEGAL INSTRUMENTS

The provisions of the Treaty constitute a full and varied arsenal with which to complete the single market, especially in the energy sector.

The principles are clear: a ban on quantitative import and export restrictions between Member States and on any measures having equivalent effect (Articles 30 to 36); adjustment of monopolies of a commercial character so as to avoid discrimination (Article 37); a ban on agreements or abuse of a dominant position which may distort competition and affect trade between Member States (Articles 85 and 86); exposure to competition for undertakings enjoying special or exclusive rights (Article 90); transparency of State aids and monitoring of their compatibility with the common market.

At the same time, in a bid to encourage the implementation of the internal energy market, the Commission has undertaken to propose specific legislation, based in particular on Article 100a, to harmonize national provisions.

This will strengthen the link between the internal market and energy policy at Community level. This approach also has the advantage of involving Parliament as well as the Council, and offers an opportunity for closer contact with the parties concerned, both in the industry and on the consumers' side.

Thus at its 955th meeting on 8 March 1989 the Commission decided to take a gradual approach based on the implementation of various procedures which would lead to a balanced solution. This solution will take account not only of economic constraints specific to the energy sector but also of the regional and social dimensions of the problems raised.

IV. THE DIRECTION OF FUTURE WORK

Recent economic and industrial trends and the political will to speed up work on the completion of the internal energy market mean that the Commission must define the course of its future work, taking account of the guidelines set out in the recent communication on energy and the environment.¹

1. Security of supply

The internal energy market cannot be set up until the notion of security of supply has been defined. It is this notion which will define the scope of the internal energy market and place it in the context of the energy policy.

The role of Community resources, the optimum degree of diversification of sources or forms of energy, the degree of competition to maintain in the market, the scope of the regulations on the production, distribution and use of energy and the interconnection of networks all have to be defined.

Such definition must make clearer the conditions required for the optimum allocation of resources, which in economic terms means the efficient use of the various sources of energy.

This will shed light on how and to what extent the national dimension can gradually be replaced by the Community dimension, taking account

1 COM(89) 369.

of the different energy situations in the Member States.

Proposals along these lines will be put forward shortly.

2. The external dimension

Definition of the concept of security of supply must take account of the external dimension: the wish for a guaranteed level of energy supply security is intended not only to make the most of national and Community resources, but also to reduce the Community's energy dependence. That is why it is vital to define the terms of an external energy policy as quickly as possible.

The Commission will study specific solutions, in the context of relations with neighbouring countries, to the problems with which some non-member countries (EFTA, Central or Eastern European or Mediterranean countries) may be confronted, particularly when gas and electricity transit rights are expanded.

Particular attention will also be paid to future relations with the Gulf countries.

The Commission will also examine the extent to which the energy supply contracts concluded by Member States or under their supervision perpetuate compartmentalization of markets.

In addition, it will study the scope for promoting cooperation between the various buyers (e.g. of natural gas or coal) with a view to increasing their negotiating strength, while respecting competition law.

In the spirit of openness it showed in agreeing to discuss energy matters within the GATT, the Commission will be making proposals before the end of 1990 to extend the commercial policy to include energy products (rules of origin, common import and export arrangements).

3. Making the most of networks

As they operate at present, the electricity and, in particular, gas networks are not making the most of resources. While the rate of use of gas networks in the United States can, according to figures presented at the hearings organized by Parliament, be as high as 80%, the corresponding figure for some Member States of the Community can be less than 40%.

- (a) One way of increasing trade in gas and electricity so as to make the industry more efficient and provide a wider range of choice for the consumer might be to facilitate access to the network for third parties.

While the different physical characteristics of gas and electricity obviously preclude identical conditions of access for those products, technical solutions are clearly possible, as has been proven in other countries.

This being so, discussion is under way in the advisory committees referred to above. At the beginning of 1991 the Commission will receive an analytical report showing the pros and cons and the

possible ways of facilitating access to the networks for third parties, such as the "common carrier", "open access" or "unbundling", in which such activities as production, importation, transport and distribution are separate and distinct.

- (b) Increased use of the networks would mean supplementing existing installations in such a way that any user in any of the Member States would have a choice of supply. Energy infrastructure needs to be built, therefore. Thus a number of international interconnections are needed in the electricity sector. The gas sector, meanwhile, requires work on a larger scale, since it will be offering a new source of energy to several Member States currently without gas.

In this context, the Commission has on its own initiative launched the REGEN programme as part of the Community's regional policy. Improvements to energy infrastructure will be broadened in 1990 under the more general angle of trans-European networks.

4. Improving market transparency

In order to complete the proposal for a directive on the transparency of prices currently in course of adoption, there needs to be transparency in the way in which prices are arrived at, and therefore some degree of transparency of costs, particularly in sectors where

there is not enough competition (no possibility of substitution, monopolies or exclusive rights, state-owned companies).

Current texts on tariff structures will therefore be brought back up to date so as to encourage the convergence of national tariff structures.

The Commission will also be drawing up a regulation to provide information on the costs of producing or acquiring energy and measures to harmonize the principles of passing on costs in prices. It will put forward positive proposals at the beginning of 1991.

5. Harmonization of standards and technical specifications

Opening up the markets means reducing the existing technical disparities between energy sources in the Member States.

Increased technical cooperation should therefore be planned so as to harmonize decision-making processes in the Member States for type-approval or equipment approval. The gradual opening-up of public contracts also calls for a speeding-up of standardization work.

To facilitate the development of interconnections and thus of exchanges of energy, a study will be made of the desirability of technical harmonization promoting network compatibility.

Greater harmonization will also be needed to abolish barriers to the

single energy market resulting in particular from differing degrees of environmental protection.

Insufficient harmonisation in any particular field is no reason to slow down work on other aspects of the internal energy market.

Proposals on these points, including the standardization of equipment, will be forthcoming this year.

CONCLUSION

While initial efforts towards the completion of the internal energy market have begun to produce positive results, the most important work has still to be undertaken.

This work is all the more necessary given that the creation of a single market is a vital political objective from which no sector, whatever its nature, may be excluded.

In this regard neither the diversity of rules and regulations in the Member States, nor the differing availability of resources in the Community nor the lack of harmonization in a particular field of activity can be used as a pretext for slowing down work on other aspects of the internal energy market.

No effort should be spared in working towards the deadline for the completion of a large internal market including the energy sector by the end of 1992.