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Differentiated Integration in the Energy Sector and Its Contribution to the European Goals of Affordability, Security of Supply and Sustainability

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Abstract

This policy paper studies the role of differentiated integration in the field of energy – where an EU-level compromise is not always reachable due to strong heterogeneity among member states. The paper starts with an analysis of how differentiated integration in energy has been evolving, in order to take stock of main trends and emerging challenges. The empirical part builds on an analysis of three case studies of differentiated integration – the Energy Community, the Pentalateral Energy Forum and the Covenant of Mayors. These institutions have been selected because they diverge along several lines (e.g., rationale for promoting differentiated integration, objectives, composition, regulatory features, organisational features), allowing for a relevant comparative evaluation of their effectiveness in boosting integration. Even if all the differentiated integration institutions have limitations of some sort, the findings mostly point to three success stories, which helped advance EU integration and reach the three key objectives of EU policy-making in energy: affordability, security of supply and sustainability.

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Executive summary

The process of creating a unified EU energy market has advanced substantially to date, allowing the EU to reduce its energy import costs and to increase its security of supply. As decarbonisation efforts deepen at the EU level, further integration, coordination and consistency in the EU approach is needed to achieve key synergies and economies of scale and avoid sharp divergences across the Union. Member states are however reluctant to relinquish sovereignty in this strategic sector, where broad heterogeneity is evident (e.g., in energy mixes, different energy infrastructure, geographical specificities, historical legacies, etc.). A top-down approach to EU energy policy-making is thus not always politically feasible, while differentiated integration does represent a technical and political solution becoming, in some cases, unavoidable.

Two main approaches are identified for promoting differentiated integration in the energy sector: enhancing regional cooperation and creating coalitions of the willing. Regional cooperation mechanisms are likely to emerge from the need to enhance coordination among interdependent countries, while coalitions of the willing aim to incentivise the faster pursuit of EU energy objectives by countries or sub-national actors that voluntarily show such ambition. Beyond this distinction, the picture of differentiation in the energy sector is extremely diverse in its objectives, types of regulatory commitment, level of engagement of EU institutions and organisational features.

The three case studies assessed mirror this variety and have all achieved results in advancing integration and promoting EU energy policy objectives. Slower progress in achieving integration in certain areas is however observed in each of them. The treaty-based international organisation “Energy Community” aims at enhancing cooperation between eastern and south-eastern neighbouring countries of the EU. It promotes the adoption of the *acquis communautaire* through a high degree of institutionalisation, a multi-faceted regulatory scope and sanctioning powers. This scheme has succeeded in fostering energy integration between EU member states and the neighbouring countries, also by reducing disputes in the region’s energy sector. However, progress remains limited in specific areas such as antitrust regulation enforcement and the creation of a truly competitive energy market. The backlog between EU energy law adoption and its implementation in the Energy Community countries is also increasing. The second type of differentiation analysed is the “Pentalateral Energy Forum”, a regional organisation promoting integration in northwest Europe characterised by a low degree of institutionalisation and no enforcement functions. Such mechanism succeeded in achieving regional market coupling and in providing standards for integration elsewhere in Europe. If on the one side its flexibility, membership and size may be considered keys to advancing integration, on the other side this approach might accentuate differences between contracting and non-contracting parties unless its members make efforts to integrate with non-contracting parties as well. The “coalition of the willing” typology is also studied through the analysis of the “Covenant of Mayors”, a voluntary organisation comprising sub-national level actors that share the ambition to accelerate their path towards the achievement of EU climate goals. While such approach allows for a broader participation and so far has played an important role in engaging actors and backing the EU vision, the lack of binding obligations and enforcement, as well as the weak political coordination with national governments, create limitations to its effectiveness.

The comparative analysis shows the diversity of differentiation arrangements that can be put in place. It also demonstrates that very different arrangements can be brought back to two categories: enhanced regional cooperation schemes or coalitions of the willing (or both simultaneously). The case studies are, for the most part, success stories. The comparative analysis also displays how differentiated integration arrangements with very different degrees of institutionalisation, binding nature of the rules, membership, mandate and so on can all contribute to effectiveness. There is no “one size fits all” approach in differentiation. Bottom-up initiatives should be welcomed and encouraged by the EU. The EU should promote coordination with other levels of government to ensure consistency and maximise effectiveness. The EU should also push member states that belong to a regional organisation to also pursue integration with other neighbours that do not belong to the regional organisation, in order to avoid negative effects on political unity. Finally, the EU should promote differentiation through both enhanced regional cooperation and coalitions of the willing as one of the tools to achieve synergies that are key to reaching decarbonisation goals cost-effectively.

Introduction

As the process of the European Union integration continues, scholars have observed an increase in differentiated integration (DI) arrangements. These include formal and informal mechanisms allowing opt-ins and -outs, exemptions or other forms of heterogeneous and flexible implementation of EU policies (Andersen and Sitter 2006, Holzinger and Schimmelfennig 2012, Kölliker 2001 and 2006, Stubb 1996). Differentiated integration is also interpreted as a political solution to overcome negotiation deadlocks (Schimmelfennig 2019). Differentiated integration has been specifically observed in the area of energy (Andersen and Sitter 2006, 2009 and 2015, De Jong and Groot 2013, De Jong and Egenhofer 2014, Ahner et al. 2012, Eberlein 2010, Handke 2018).

This paper discusses the rationale behind the promotion and adoption of differentiated arrangements in the energy sector and assesses their effectiveness. In particular, it discusses how differentiated integration in the energy field is effective in promoting the three key EU energy policy goals of affordability (or economic competitiveness), security of supply and sustainability (or decarbonisation).

This will be done through three case studies, which have been selected to illustrate the diversity of differentiated integration institutions: the Energy Community, the Pentalateral Energy Forum and the Covenant of Mayors. Indeed, these differentiated integration schemes radically differ from one another on many grounds, ranging from the type of membership to the degree of institutionalisation. The analysis is conducted using the framework elaborated by Lavenex and Križić (2019). The empirical findings are grounded on semi-structured interviews with personnel of the three differentiated integration institutions analysed (see Annex 1).

1. Key themes in European integration in the areas of energy and climate

European integration in the energy field has so far mostly consisted in efforts to establish an internal European market for gas and electricity. Both the construction of physical infrastructure connecting European countries and the harmonisation of regulations across the EU were necessary to achieve this objective. Although conceptually distinct, the process of liberalisation is closely intertwined to that of integration, as liberalisation became the standard market organisation principle to which all EU member states were required to adhere.

Establishing an internal energy market has been a painstaking process. It was met with substantial opposition by incumbent companies opposed to liberalisation and by a number of EU member states that were reluctant to integrate markets with their neighbours and/or to liberalise. This led to a number of pragmatic compromises, such as watered-down legislation, delays and derogations that provided member states with a certain degree of flexibility in implementing reforms championed by the European Commission. The outcome has been a somewhat “fuzzy” liberalisation (Andersen and Sitter 2009). As argued by Ahner et al. (2012), the EU is set to remain heterogeneous because of its diversity. The process of EU integration has seen a constant effort to manage heterogeneity, rather than to reduce or eliminate it.

Although the process of creating a single EU energy market is not complete, a substantial degree of integration has been achieved to date. Integration has allowed Europe to reduce energy import costs and boost its security of energy supply (Franza 2020). The persistence of missing links requires additional fine-tuning, more so in electricity than in gas, but the next steps will be more technical and less political.

Whereas the focus has long been on market integration to improve competitiveness and security of supply, decarbonisation is now the key theme in the EU also with regard to integration. The climate targets are binding collectively for the EU. Member states have the obligation to draft their own National Energy and Climate Plans (NECPs). EU-level coordination and consistency among national decarbonisation efforts are important to achieve increasingly ambitious greenhouse gas emission targets cost efficiently.

Key synergies and economies of scale can be achieved through cooperation between member states, for example by favouring the construction of renewable energy capacity in the countries with the lowest costs of production. The Strategy for Energy System Integration (European Commission 2020b) underscores that the EU is taking a holistic view of the EU energy system, also from a cross-border perspective. A harmonious approach is needed to avoid a situation where costly energy transition efforts by frontrunners are frustrated by climate laggards. Sharp divergences between member states on climate are not desirable for European integration, also from a social, political and economic perspective.

However, even if EU-wide ambitious visions and targets are beneficial, a top-down approach to EU energy policy-making is not always politically feasible because backlashes in integration (and decarbonisation) can occur if member states' interests are not adequately taken into account.

One of the key reasons why differentiated integration is needed in energy is that EU member states have different energy mixes, which affects their posture in energy policy issues. The energy mix of a country is often based on domestic resource endowment and geographical/geological features. There is significant inertia to change because infrastructure, economic geography, job market, household appliances, commercial appliances and so on are all predominantly geared towards specific energy carriers.


Natural gas plays a fundamental role in the energy mix of some countries, such as Italy, which may make them sensitive to affordability and security of supply issues. Within this group, there are countries for which gas is specifically important in either heating or electricity, making them attentive to social considerations. Other countries, such as Poland, are heavily reliant on coal, which makes them reluctant to approve the EU-wide adoption of CO₂ prices. Some countries are economically dependent on heavy industry clusters, which run more efficiently on non-electric energy carriers. These countries will tend to look favourably at clean molecules for decarbonisation. Some countries like France, on the other hand, are reliant on nuclear energy and are much more electrified already. Pro-nuclear states are incentivised to discuss certain topics among themselves, such as nuclear waste management. In sum, intra-EU coalitions form among countries with similar energy mixes and interests.

Energy infrastructure greatly affects member states' positions in energy policy-making and their need to cooperate specifically with other member states. Historical legacies, such as the East–West direction of gas infrastructure in Europe, have played a role in shaping security of supply priorities. Some countries are integrated with neighbours for historical reasons, which creates bonds of interdependence and coordination needs. The opposite can also be true, where a need for coordination emerges to fill missing gaps in European energy infrastructure to avoid “energy islands”, such as the Iberian Peninsula or the Baltic republics.

Energy is one of the most strategic sectors for states, which are reluctant to relinquish sovereignty in this area. This is proven by the fact that Article 194 of the Lisbon Treaty specifies that a member state has a sovereign right to determine its energy mix.

It can be useful to encourage national or sub-national actors that are willing to deepen market integration or the pursuit of other EU energy policy objectives (namely greenhouse gas emission reduction) to do so when an EU-level compromise is not reachable.

Sometimes, it can be useful to purposefully narrow down the geographic scope for integration by encouraging member states to cooperate with their immediate neighbours, when regional challenges require a regional response. Closer regional cooperation is also, to an extent, unavoidable. Willing or not, thanks to the high levels



of energy market integration already achieved, decisions made in one member state (for example, adding wind capacity, phasing out nuclear or coal, or introducing a capacity market) now have a direct impact on the energy systems of neighbouring member states (by impacting prices, flows, network congestion and so on). Enhanced regional coordination can be a suitable way to tackle cross-border interdependencies.

Reflecting the analysis above, we can identify two broad approaches for promoting DI arrangements in the energy sector: creating coalitions of the willing and enhancing regional cooperation. Coalitions of the willing emerge from the ambition to incentivise a faster pursuit of EU energy objectives by countries or sub-national actors that show higher-than-average levels of ambition. These DI arrangements will probably tend to rely predominantly on soft power and soft law, i.e., attempts to “lead by example” through persuasion rather than coercive means. Coalitions of the willing are likely to be inclusive, as they should accept any willing party without discrimination. Regional cooperation mechanisms can take different shapes and involve different degrees of institutionalisation. They can be bottom-up initiatives or they can be mandated by the EU. They emerge from the need to enhance coordination among interdependent countries. Regional cooperation is more likely to lead to discrimination in the sense that it is likely to lead to the formation of “regional clubs”.

Beyond this distinction, the picture of differentiated integration in energy is extremely diverse. DI institutions differ in terms of national or sub-national membership, inclusion of non-EU member states, degree of institutionalisation, thematic/sectorial coverage, legal nature of the commitments, geographic focus and so on. The same country or sub-national entity can simultaneously belong to more than one DI institution (for a list of differentiated integration institutions in energy, see De Jong and Groot 2013, Benelux Union 2016, CEEP 2018).

In this paper three case studies, with different institutional set-ups and features that account for the diversity of differentiated integration institutions, have been selected to assess what impacts, if any, DI has had on effectiveness in promoting key EU energy policy goals: the Energy Community is a mechanism for regional cooperation that gathers non-EU member states and promotes the adoption of the *acquis communautaire* through a high degree of institutionalisation and sanctioning powers; the Pentalateral Energy Forum is a mechanism for regional cooperation mechanism of north-western Europe that mostly includes EU member states with the addition of Switzerland and has a low degree of institutionalisation; and the Covenant of Mayors is a coalition of the willing comprising sub-national level actors (cities) that are willing to cooperate on climate change. In order to analyse comparatively such diverse arrangements that differ in their objectives, their composition and their degree of institutionalisation, to name but a few features, this paper will describe them by distinguishing between regulatory and organisational dimensions, following Lavenex and Križić (2019). This will add knowledge on the current status of DI in energy in Europe, contributing to the debate on whether it is effective in promoting EU energy policy objectives.

	Energy Community	Pentalateral Energy Forum	Covenant of Mayors
Main objectives	To create an integrated pan-European energy market across the borders of the EU	To promote bilateral cooperation between north-western European TSOs To integrate electricity (and gas) markets To discuss cross-border trade issues to improve security of delivery and system adequacy	To reduce their CO ₂ emissions by at least 40 per cent To increase their resilience to the impacts of climate change To take action to alleviate energy poverty
Composition	EU 27 Serbia, Montenegro, Bosnia-Herzegovina, Albania, North Macedonia, Kosovo, Ukraine, Moldova and Georgia as contracting parties and Norway, Turkey and Armenia as observers	Austria, Belgium, Germany, France, Luxembourg, the Netherlands and Switzerland	Local democratically constituted authorities
Regulatory features	Full commitment of members to apply EU rules, which are binding. Time lag for applying binding rules for differentiated members Legal commitment is formally wide and leads to harmonisation with EU law	Partial commitment for non-binding decisions Soft law, since no treaty and producing no binding decisions	Full commitment at EU level by states and therefore their cities Community method by the states but transgovernmentalism by the local authorities as the differentiation comes from the implementation Harmonisation to EU law but voluntarily
Organisational features	Agenda setting and policy formulation→Ministerial council Policy implementation→Contracting party governments and/or sub-national actors such as energy companies, regulatory agencies, competition authorities and other public authorities Policy enforcement→National authorities and Energy Community Secretariat and Ministerial Council	Agenda setting and policy formulation→Ministerial meetings Policy implementation→States EU and non-EU members Policy enforcement→No policy enforcement capacity	Agenda setting and policy formulation→European Commission Policy implementation→Local authorities signatories of the Covenant Policy enforcement→No policy enforcement capacity
Coalition of the willing	No	Yes	Yes
Regional cooperation	Yes	Yes	No

2. The Energy Community

2.1 Objectives and composition

The Energy Community, comprising the EU and most of its eastern and south-eastern neighbours,¹ is a treaty-based international organisation established in 2005 to create an integrated pan-European energy market across the borders of the EU. Integration is pursued by promoting the adoption of energy *acquis communautaire* by non-EU member states through a legally binding framework. In doing this, the organisation seeks to boost energy affordability, security of supply and sustainability in the region through the typical EU toolbox – for instance by helping to create a stable investment environment; integrating markets through both physical infrastructure and regulatory harmonisation; and promoting ambitious environmental regulation and cross-border synergies to achieve economies of scale and positive interdependencies.

2.2 Regulatory dimension

The Energy Community has a multifaceted regulatory scope. The standard procedure is for the Energy Community to make EU rules binding on contracting parties under Title 2 (starting from an initiative by the European Commission). However, under Title 3, rules adopted by the Energy Community can also be made binding for selected EU member states, typically those located in central-eastern Europe that share borders with contracting parties (Energy Community 2005). This provides the Energy Community with a further and less-known differentiated integration capacity inside EU borders. The rationale for Title 3 originates from the need for enhanced cooperation between neighbouring countries with interdependent energy systems (as highlighted in the previous chapter). Finally, Title 4 foresees that certain rules adopted by the Energy Community can also extend to the entire EU (Energy Community 2005). This is a distinctive feature that cannot be found in other differentiated integration institutions. Theoretically, a rule adopted under Title 4 could thus even supersede EU law. Understandably, this procedure is not frequently used, to ensure stability in (and control over) EU energy law.²

While the formal objective of the Energy Community is that all rules should be applied to all contracting parties, in practice there are so many rules affecting the energy sector in the EU that not all of them have actually been transferred. Only the most important EU energy rules tend to be transferred to non-EU member states through the Energy Community. Moreover, there is a significant time lag between the adoption of a new rule in the EU and its adoption in Energy Community contracting

1 Membership includes all EU member states, Serbia, Montenegro, Bosnia and Herzegovina, Albania, North Macedonia, Kosovo, Ukraine, Moldova and Georgia as contracting parties and Norway, Turkey and Armenia as observers.

2 Title 4 envisages concrete mechanisms on how to respond in case of disruption of energy supply. It was triggered in 2008 producing regulation through a procedural act: Procedural Act 2008/02/MC-EnC of the Ministerial Council of the Energy Community of 11 December 2008 on the Establishment of a Security of Supply Coordination Group.

parties. This time lag has been increasing over time together with the dimension and sophistication of the *acquis communautaire*.

In terms of legal quality of regulatory commitments, the Energy Community reflects the “community method”. Commitments are enshrined in EU legislation and EU rules have primacy over national rules. The organisation however has its roots in intergovernmental cooperation (having been established by an international public law treaty in 2005). The European Court of Justice cannot enforce rules for the Energy Community and their enforceability depends on the Ministerial Council (Buschle 2016).

The Energy Community also employs other instruments in addition to legally binding norms. It notably has Coordination Groups for the exchange of best practices and experiences. For instance, the Distribution System Operator (DSO) and Transmission System Operator (TSO) Coordination Groups have proved useful by elaborating bottom-up guidelines to reform the energy sector and by sharing unbundling best practices. The Energy Community Regulatory Board takes both legally binding decisions and decisions that are not legally binding.

The extent of legal commitment is formally wide and leads to harmonisation with EU law. Energy Community parties commit to the harmonisation and the application of the *acquis communautaire* within their borders. This stricter approach is complementary to approximation of national laws to EU laws in some other agreements with non-EU member states in energy, such as the Association Agreement with Ukraine and other agreements with Western Balkan countries.

2.3 Organisational dimension

When it comes to the organisational dimension, the main institution for decision-taking is the Ministerial Council, which sets the agenda and formulates policies as per Article 47 of the Treaty Establishing the Energy Community (Energy Community 2005). The Secretariat also has a role in agenda setting and policy formulation. Policy implementation is performed by individual contracting party governments and/or sub-national actors such as energy companies, regulatory agencies, competition authorities and other public authorities. With regard to enforcement, the first line lies with the national authorities. The second line – activated in case of an infringement procedure against a contracting party – lies with the Energy Community Secretariat and Ministerial Council. The Ministerial Council may delegate power to other institutions, such as the Permanent High Level Group or the Energy Community Regulatory Body.

The European Commission is not an institution under the Energy Community treaty but it has an important role because it is the institution from which the *acquis* that the Energy Community has the mandate to transfer to contracting parties originates. Other important stakeholders are international financial institutions (European Bank for Reconstruction and Development, World Bank), which are also important for agenda setting; and increasingly also civil society, which contributes to agenda

setting and participates in policy formulation both through informal campaigns or through more formal channels such as complaints to the Secretariat for alleged breaches of EU energy laws by contracting parties. Overall, a governance patchwork of institutions and procedures, both formal and informal, is in place. Single contracting parties are in charge of implementation but there are also monitoring and enforcement mechanisms and the Energy Community holds countries accountable for non-compliance. In practice, all available enforcement possibilities mentioned in the Treaty have been used, and an infringement procedure is no longer an exception. Sanctions have notably been adopted against Bosnia-Herzegovina. Strong accountability and enforcement have been a key factor to develop this differentiated integration institution into a community built on rule of law. Without a functioning enforcement system, the Energy Community would have remained on the soft governance side of cooperation.

2.4 How effective has the Energy Community been?

The Energy Community has been effective in promoting EU principles and energy integration between EU and non-EU member states in a number of areas. For example, the Energy Community has had an important role in promoting gas market reform in Ukraine, a key transit country for the EU. Ukraine suffers from weak governance and was involved until December 2019 in a complex transit contract dispute with Russia. If Ukraine had not been a contracting party and if the Energy Community were not endowed with strong enforcement tools, Ukraine would have not laid the ground for (and finally started to adopt) EU gas rules on unbundling, an important condition for the renewal of the transit contract between Ukraine and Russia. Interestingly, the application of EU standards to the management of the Ukraine gas network was requested by the Russians as a guarantee in the contract negotiations.

Furthermore, the Energy Community engaged in dispute settlement between investors and governments in the region, contributing to the amicable solution of numerous cases. Before the establishment of the Energy Community, the degree of conflict in the region was higher. Without the Energy Community's mediation, there would have been a wave of arbitrations, leading to legal uncertainty and deterioration in the investment environment (Interview 1). More sober results have been scored in the area of antitrust regulation. The reason is that enforcement is largely lacking: even if sector-specific EU rules (as well as general competition EU rules) have been transposed in the Energy Community region, there are no bodies that can monitor and enforce competition in Energy Community contracting parties. The energy sectors of contracting parties are still very much dominated by state-controlled incumbents. It is very difficult to create an open, liquid, traded market with third-party access to infrastructure and actual competition, with legal tools alone. The Third Energy Package³ has formally been applied to contracting parties but its

3 A package of legislation comprising: Electricity Directive (2009/72/EC), Natural Gas Directive (2009/73/EC), ACER Regulation (EC) No 713/2009, Electricity Regulation (EC) No 714/2009, Natural Gas Transmission Networks Regulation (EC) No 715/2009.

practical impact has so far been limited. Beyond the areas of security of supply and affordability, another positive effect of the Energy Community was the application of the Large Combustion Plants Directive, leading to CO₂ emission reduction in the region (European Parliament and Council of the EU 2001). Progress remains more limited in the area of decarbonisation (Interview 1).

3. The Pentalateral Energy Forum

3.1 Objectives and composition

The Pentalateral Energy Forum (PEF) is a regional organisation of north-western Europe that includes EU member states with the addition of Switzerland. It was born to some extent as a bottom-up initiative and it is temporary (at least in theory). The PEF was established through a Memorandum of Understanding (MoU) in 2007. It emerged as an umbrella for earlier, scattered bilateral cooperation between north-western European TSOs that wanted to integrate electricity (and gas) markets and discuss cross-border trade issues to improve security of delivery and system adequacy, pursuant to the broader objective of internal market creation that was set out at the EU level.

The signatories to the MoU were the governments of Belgium, Luxembourg, The Netherlands, Germany and France, as well as the respective National Regulatory Authorities, TSOs and power exchanges – later joined by Austria and Switzerland and their respective authorities and companies. Given its mandate, it enjoyed the support of the European Commission, which had favoured the emergence of Regional Initiatives in gas and electricity based on the conviction that regional fora were the best instruments to start integrating markets, at least in an interim period – waiting for the creation of a pan-European market. It also enjoys the support of the Benelux Secretariat, which is responsible for the management of PEF processes. The Benelux Secretariat is the only “institutional”, legally grounded and permanent feature of the PEF.

3.2 Regulatory and organisational dimension

Unlike the Energy Community, the PEF has a low degree of institutionalisation. It does not adopt binding decisions and is deprived of enforcement functions. The agenda is set by ministries of contracting parties in informal settings but the PEF acts in pursuit of common EU objectives, trying to step up ambition when integration processes are stuck and when EU frameworks that need to be implemented leave room for interpretation. TSOs also play a role in agenda setting through informal channels. Ministers or Directors-General convene when there are indications that consensus can be reached in certain policy areas. When a common position is reached, it can then be brought to the EU level. The PEF has itself often asked for an EU framework covering issues deemed important by regional ministers, namely on flexibility and

flexibility markets. In May 2020, for instance, the PEF issued a declaration on the importance of hydrogen for decarbonisation, and this has been one of the stepping stones for the European Hydrogen Strategy (European Commission 2020a).

There is no legal obligation for participating states to do anything that has been decided by the PEF. There is only soft law, such as political declarations and MoUs. There are more stringent frameworks within which the PEF has to work, for example EU regulations on gas market functioning, but they do not originate from the PEF itself. For example, risk preparedness, capacity calculation and security coordination have to be done at a regional level according to EU law, and the PEF region is one of the fora where these legally binding measures have to be formulated and implemented.

3.3 How effective has the PEF been?

The PEF played an important role in integrating the electricity markets of the region at a time when the process of EU market integration was stuck. From this perspective, the initiative has been trailblazing and served as an inspiration for integration elsewhere. The PEF was a key player in achieving northwest European market coupling. Concrete integration principles and timetables were set out since its very foundational document (the Annexes to the 2007 MoU). The market coupling model that was implemented in north-western Europe thanks to the PEF later became the standard for electricity market integration between Italy and Slovenia, in central-eastern Europe, in the Iberian Peninsula and in Scandinavia.

Thanks to contacts established within the PEF, joint ventures of TSOs were established to provide a central auction point for the transmission of electricity capacity across borders. The PEF has also created a regional service authority that monitors cross-border electricity flows, thereby helping security of delivery and system balancing. Cross-border trade in electricity is expected to increase as decarbonisation deepens, and the EU aims at creating synergies, encouraging the investment in renewables in the countries with the lowest costs of production. System integration, including across borders, is going to be important to have a cost-efficient energy transition. The PEF has also promoted integration of gas markets in the region. It notably was pioneering in employing the PRISMA capacity booking platform that then became standard throughout Europe.⁴

According to senior officials familiar with the PEF, a key quality that has enabled the forum to be successful has been the right size of its membership and its flexibility. The PEF comprises a critical mass of interdependent countries with advanced energy systems, where consensus can be reached more easily than in settings open to all 27 member states. It is able to gather voluntarily and bring things forward to the EU after having reached internal consensus (Interview 4).

However, it could be argued that by advancing cooperation only within a specific region, the PEF could risk accentuating differences between contracting parties and

4 PRISMA is the joint capacity booking platform of major European Transmission System Operators.

non-contracting parties. While membership and effort in the PEF is a no-brainer for Benelux countries, which are surrounded by other PEF contracting parties, other countries (Germany, France, Austria and Switzerland) should not neglect integration and cooperation with other neighbouring countries belonging to central-eastern Europe and the Mediterranean region. These countries should ensure that their work and progress within the PEF does not result in unbridgeable differences with other neighbouring countries. The solution is not to stop working within the PEF. Instead, these countries should continue working within the PEF but also intensify integration efforts with other neighbouring countries.

4. The Covenant of Mayors

4.1 Objectives and composition

The European Commission has a wide range of policies in place in support of European cities in the area of climate change, despite not having direct responsibilities at the local level. One of the most prominent initiatives is the Covenant of Mayors (CoM), launched in 2008 by the EU Commission with the ambition to gather local governments voluntarily committed to achieving and exceeding the EU's climate and energy goals. The European Commission then tried to launch similar initiatives to engage with mayors and supra-local entities beyond the EU's borders reaching out to the Eastern Partnership region, and in the Southern Mediterranean region.

After the launch in 2014 of a sister initiative called "Majors Adapt" focusing on adaptation to climate change, the two were merged into a single entity in 2016, the "Covenant of Mayors for Climate and Energy". The initiative is also part of the Global Covenant of Mayors for Climate and Energy.

In Europe, CoM signatories pledge to reduce their CO₂ emissions by at least 40 per cent,⁵ to increase their resilience to the impact of climate change and to take action to alleviate energy poverty. A political board composed of 17 mayors and elected local representatives defines the strategic orientation of the initiative.

The CoM is open to all local, democratically constituted authorities, whatever their size and the stage of implementation of their energy and climate policies. Some coordinators (public authorities) provide strategic guidance as well as technical and financial support to the signatories, while supporters (associations of local and regional authorities, networks, thematic agencies, federations and non-profit organisations) help promote the cause at the widest possible level (Tortola and Couperus 2020).

5 This might likely change if a more ambitious EU target by 2030 is confirmed.

4.2 Regulatory dimension

The relation between signatories of the Covenant of Mayors and the Covenant itself is not legalised; and although the signatories' goals are to comply with those of the EU, the relation between signatories and the CoM as an institution is voluntary. The CoM commitments are translated through the Sustainable Energy and Climate Action Plans (SECAPs) and associated monitoring reports are prepared by signatories. Signatories should assess their local context through a Baseline Emission Inventory and a Risk and Vulnerability Assessment, and later identify coherent mitigation and adaptation actions. This commitment marks the beginning of a process whereby local governments report on implementation progress every two years. The Commission supports authorities that have committed to the initiative through the Covenant of Mayors Office with financial and technical support and through the Joint Research Centre, which provides a scientific assessment of plans and also draws conclusions on the commitments taken. Signatories can also benefit from networking with others on funding opportunities and best practices.

Signatories that have developed their SECAP in coordination with the national plan have found the initiative even more successful because at the beginning of the initiative, the local level was directly in touch with the European level and thus complemented the work of the member states; however this is not the case in member states where the coordination between signatories of the Covenant and ministries or national government is not fluid (Interview 2). The CoM is pushing to have better coordination with the national level, for example integrating energy systems with actions that can be developed at the local level such as integrating mobility with energy efficiency measures.

However, as the relation between signatories and the Covenant is not legally binding, the Covenant looks for support from both mayors in office and opposition when local authorities request to be part of the CoM. That way, belonging to the Covenant will not be a political issue if there is a change of government. According to officers of the CoM, belonging is "about the sustainability of the overall commitment [...] we have very strong principles that we uphold" (Interview 3). The CoM accepts tailored approaches for signatories. On the other hand, the CoM laments "the lack of mandates, some regulatory challenges, the fact that the frameworks at the national level have been a little bit fuzzy for a while; not really guaranteeing some of the powers that local governments would need" (Interview 3). This limits the local governments' effectiveness in pursuing CoM and EU goals.

In that sense, the work done by the CoM is policy-oriented and the only participation in different sites of governance is either through the political board of the CoM, which has regular meetings with the European Commission, or through member states that take into consideration what municipalities do under the CoM umbrella and complement national plans with local level plans.

Regarding the regulatory scope, signatories of the Covenant retain large room for manoeuvre to implement projects and policies. Implementation is done by the municipalities following technical recommendations of regional coordinators in

the Covenant's office. A municipality establishes its own commitments and usually meets them (see Bertoldi et al. 2020 on the CoM signatories' performance). However, to reach 2050 neutrality objectives, cities and local authorities will have to enhance their role as key players.

4.3 Organisational dimension

The CoM is managed through bottom-up governance. Regarding the organisational dimension, neither the CoM nor its members participate in agenda setting. The European Commission and the European Parliament are in charge of agenda setting together with the member states. However, the political board of the Covenant of Mayors can participate through regular meetings with the Commission and willing member states. There are differences between the member states, and are some listen to the inputs of local entities more than others. The Netherlands and Italy, for example, have consultation mechanisms that work well, according to the CoM's office. In any case, the goals of the European Union are those of the CoM and when it comes to policy formulation, the CoM's signatories can decide to go further than the goals set by the EU; although this may be only possible for big cities that have greater financial and technical capacities.

Decision-taking and policy implementation fall into the hands of the municipalities, which draft the plan for approval by the CoM's office and subsequent implementation at the local level with capacity-building, technical and possibly financial support from the CoM's office and the regional coordinators of the Covenant. It is in policy evaluation that the CoM has a bigger role. The Covenant's office has continuous exchange with the European Commission and reports the feedback received from the signatories.

The CoM does not have the power to enforce plans if municipalities do not follow through. It can theoretically expel an entity from its initiative but once a city updates and complies with what was agreed with the CoM, it can be included again without consequences (Interview 5). The CoM pursues harmonisation of EU law and promotes the alignment of local actions plans with NECPs and Nationally Determined Contributions.

4.4 How effective has the Covenant of Mayors been?

The features of the Covenant facilitate the capacity to attract new members and make sure that each one can undertake policy implementation and problem-solving as it sees fit. The absence of differentiation would hamper the effectiveness of the CoM; for example, if every city was obliged to comply with a certain policy, small towns or villages might be left behind for lack of technical capacities; also, depending on different needs and geographies, the policy-making, implementation and solutions required for problem solving are completely different. In any case, the differentiated membership, which translates into tailored action plans for each municipality, and

without negative consequences for those not complying, gives the differentiated integration of the Covenant's signatories a pathway to function and cooperate in a non-homogeneous flexible manner that advances EU integration and the pursuit of EU goals.

Conclusions

Differentiated integration is a solution to advance EU integration and it has also been a way forward for integration in the areas of energy and climate, where heterogeneity is a key feature. Sovereign authority over energy mixes, different energy infrastructure, geographical specificities, historical legacies and other factors shape priorities and reduce the scope for full integration.

While the focus of integration in energy has so far been on market integration and liberalisation, decarbonisation is becoming a more important theme. This will open up new challenges and opportunities. While synergies and coordination among EU member states can enable cost-efficient energy transition solutions, member states also have different comparative advantages and preferences on decarbonisation pathways. Differentiated integration can play a role, provided that this does not result in a dilution of climate ambition. The "coalition of the willing" approach, which is one of the two principal approaches to differentiated integration that we have identified in energy next to the enhanced regional cooperation approach, can play an important role in stepping up climate ambitions although it needs to be complemented by binding obligations and enforcement.

The comparative analysis demonstrates the diversity of differentiation arrangements that can be put in place. It also shows that very different arrangements can be brought back to two categories: enhanced regional cooperation schemes or coalitions of the willing (or both simultaneously). The case studies are, for the most part, success stories. They have helped pursue the three EU energy objectives of affordability, security of supply and sustainability by enhancing integration among their parties.

Nevertheless, these three case studies reveal that differentiated integration in this field has encountered some obstacles as well. For example, when political coordination between different actors is absent, the differentiated institutions are not as effective as they could be; for instance, signatory cities of the Covenant of Mayors would be more incisive if they coordinated their actions with the national governments. Some other limitations exist: the lack of enforcement (in the case of the Covenant of Mayors); a growing backlog in adopting the *acquis communautaire* as this becomes increasingly complex, and limited progress in specific thematic areas such as antitrust and establishing a truly competitive market (in the case of the Energy Community); and the risk of accentuating differences between contracting parties and non-contracting parties in default of mitigation strategies by some contracting parties (in the case of the Pentilateral Energy Forum).

In spite of these limitations, the comparative analysis allows us to demonstrate that DI arrangements with very different degrees of institutionalisation, binding nature of the rules, membership, mandate and so on can all contribute to effectiveness. There is no “one size fits all” approach in differentiation. Bottom-up initiatives should be welcomed and encouraged by the EU. The EU should promote coordination with other levels of government to ensure consistency and maximise effectiveness. It should also push member states that belong to a regional organisation to also pursue integration with other neighbours that do not belong to the regional organisation, in order to avoid negative effects on political unity. Finally, the EU should promote differentiation through both enhanced regional cooperation and coalitions of the willing as one of the tools to achieve synergies that are key to reaching decarbonisation goals cost-effectively.

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Annex 1. List of interviews

Interview 1: Energy Community officer, online, 23 June 2020

Interview 2: officer from a regional coordinator of the Covenant of Mayors, online, 29 July 2020

Interview 3: two officers of the Covenant of Mayors Office, online, 9 September 2020

Interview 4: Pentalateral Energy Forum officer, online, 16 October 2020

Interview 5: two officers from a regional coordinator of the Covenant of Mayors, online, 9 July 2020



EU Integration and Differentiation
for Effectiveness and Accountability

Differentiation has become the new normal in the European Union (EU) and one of the most crucial matters in defining its future. A certain degree of differentiation has always been part of the European integration project since its early days. The Eurozone and the Schengen area have further consolidated this trend into long-term projects of differentiated integration among EU Member States.

A number of unprecedented internal and external challenges to the EU, however, including the financial and economic crisis, the migration phenomenon, renewed geopolitical tensions and Brexit, have reinforced today the belief that **more flexibility is needed within the complex EU machinery**. A Permanent Structured Cooperation, for example, has been launched in the field of defence, enabling groups of willing and able Member States to join forces through new, flexible arrangements. Differentiation could offer a way forward also in many other key policy fields within the Union, where uniformity is undesirable or unattainable, as well as in the design of EU external action within an increasingly unstable global environment, offering manifold models of cooperation between the EU and candidate countries, potential accession countries and associated third countries.

EU IDEA's key goal is to address **whether, how much and what form of differentiation is not only compatible with, but is also conducive to a more effective, cohesive and democratic EU**. The basic claim of the project is that differentiation is not only necessary to address current challenges more effectively, by making the Union more resilient and responsive to citizens. Differentiation is also desirable as long as such flexibility is compatible with the core principles of the EU's constitutionalism and identity, sustainable in terms of governance, and acceptable to EU citizens, Member States and affected third partners.



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