

*"TOWARDS AN INTERNATIONAL OR SUPRANATIONAL
ELECTRICITY MARKET? BRITISH AND TURKISH CASES"*

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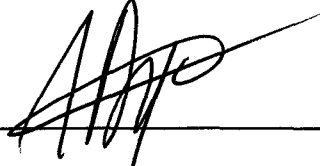
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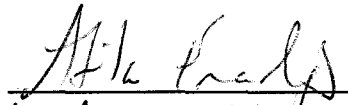
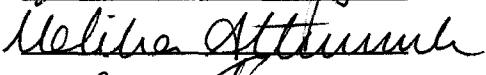
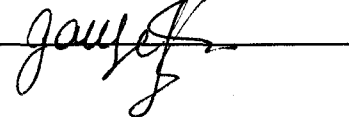
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ABSTRACT

TOWARDS AN INTERNATIONAL OR SUPRANATIONAL ELECTRICITY MARKET? BRITISH AND TURKISH CASES

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This thesis tries to answer the question of whether there is a single electricity market in the European Union. Although some further steps were taken in terms of market integration, this study shows that it is still not possible to talk about a single electricity market. The attempts to create a single electricity market demonstrate the tensions between supranational and national decision making in a vital issue area of energy. States have been reluctant to transfer their sovereignty in energy policy making as they deemed this area vital to their economic and security interests. This study argues that intergovernmental premises, still explain the reluctance of the member states in this context better. The thesis incorporates two case studies; United Kingdom and Turkey. The first case illustrates that though UK is at the forefront of the other member states in adopting the EU electricity directives, it has still resisted transferring its right of control over its sector to the supranational authorities. Also, the British Case shows that the liberalisation process has some negative consequences. Turkish case will be an evidence for that the model of UK is not appropriate for Turkey in the restructuring process due to the differences between the two states in terms of laws and regulations, institutional capabilities and domestic market conditions. This thesis proposes that Turkey shouldn't disregard its

conditions for the sake of EU membership while developing policies in a strategically important area where member states abstain from devolving their rights to the supranational authorities.

Keywords: Energy Policy, Internal Electricity Market, European Union, United Kingdom, Turkey



ÖZ

ULUSLARARASI MI YOKSA ULUSLARÜSTÜ MÜ ELEKTRİK PİYASASINA DOĞRU? İNGİLTERE VE TÜRKİYE ÖRNEKLERİ

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Yüksek Lisans, Uluslararası İlişkiler Bölümü

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Bu tez Avrupa Birliğinde tek bir elektrik piyasasının var olup olmadığı sorusuna cevap vermeye çalışmaktadır. Piyasa entegrasyonu açısından daha başka adımlar atılmış ise de, bu çalışma tek bir elektrik piyasasından bahsetmenin hala mümkün olmadığını göstermektedir. AB’de tek bir elektrik piyasası oluşturma girişimleri enerji alanındaki bu hayati konuda uluslararası ve ulusal düzeyde karar alma süreçleri arasındaki gerilimleri ortaya koymaktadır. Devletler bu alanı kendi ekonomik ve güvenlik çıkarları açısından hayati saydıklarından, enerji politikası oluşturmadaki egemenliklerini devretmekte isteksiz olmuşlardır. Bu çalışma, ‘intergovernmental’ yaklaşımın yine de üye devletlerin bu bağlamdaki isteksizliğini daha iyi açıkladığı tezini savunmaktadır. Tez kapsamında, İngiltere ve Türkiye olmak üzere iki örnek çalışma yer almaktadır. İngiltere’deki durum, bu ülkenin AB elektrik direktiflerini benimsemekte diğer üye devletlerin en başında yer almakla birlikte, kendi sektörü üzerindeki kontrol hakkını uluslararası makamlara devretmeye yine de direnç gösterdiğini örneklerle ortaya koymaktadır. Keza, İngiltere’deki durum, liberalleşme sürecinin bazı olumsuz sonuçlarının bulunduğunu da göstermektedir. Türkiye etüdü ise, iki devlet arasında kanun ve yönetmelikler, kurumsal yetenekler ve iç piyasa koşulları yönünden büyük farklar olması nedeniyle, yeniden yapılanma sürecinde

İngiltere modelinin Türkiye için uygun olmadığının kanıtı olacaktır. Bu tez Türkiye'nin üye devletlerden pek çoğunun kendi karar alma haklarını uluslararası makamlara devretmekten kaçındığı stratejik açıdan önemli bir alanda politikalar geliştirirken, AB üyeliği uğruna kendi koşullarını gözardı etmemesi gerektiği yönünde öneri getirmektedir.

Anahtar kelimeler: Enerji Politikası, Elektrik İç Pazarı, Avrupa Birliği, İngiltere, Türkiye



To My Parents



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LIST OF ABBREVIATIONS

bb/d	: Barrels a day
CEP	: Common Energy Policy
COREPER	: Committee of Permanent Representatives
DG TREN	: Directorate-General for Transport and Energy
DSO	: Distribution System Operator
DTI	: Department of Trade and Industry
EC	: European Commission
ECSC	: European Coal and Steel Community
EdF	: Electricité de France
EEC	: European Economic Community
EMRA	: Energy Market Regulatory Authority
EP	: European Parliament
EU	: European Union
EURATOM	: European Atomic Energy Community
EÜAŞ	: Turkish Electricity Generation Co.
IEA	: International Energy Agency
IEM	: Internal Energy Market
LNG	: Liquefied natural gas
MENR	: Ministry of Energy and Natural Resources
Mgmt	: Management
Mmst	: Million short tons
Mtoe	: Million tonnes of oil equivalent
NETA	: New Electricity Trading Arrangements
Ofgas	: Office of Gas Supply
Ofgem	: Office of Gas and Electricity Markets
PIU	: Performance and Innovation Unit

SEA	: Single European Act
SEM	: Single Electricity Market
TEAŞ	: Turkish Electricity Generation and Transmission Co.
TEDAŞ	: Turkish Electricity Distribution Co.
TEİAŞ	: Turkish Electricity Transmission Co.
TEK	: Turkish Electricity Agency
TETAŞ	: Turkish Electricity Trading and Contracting Co.
TSO	: Transmission System Operator
UK	: United Kingdom



CHAPTER 1

INTRODUCTION

Energy plays a determining role in economic and social life. Today, we are totally dependent on an abundant, uninterrupted and reliable supply of energy in order to ensure sustainable development. Energy policy is a vital and a strategic policy area. The high priority given on to this area can be explained by the fact that energy is the main input into national economies and can be seen as a production factor itself. Continuous energy supply is a necessity for the states in view of the fact that it is the core element in the generation of heat and electricity, which powers our industry, transport and modern way of life. It is a policy field of great strategic importance since the stability of the energy prices highly affects a state's economic competitiveness, domestic capacity and power. Energy accessibility highly influences the wealth and security of a state. Besides, disruption in energy supply severely affects the defense capability of states. Taking these into consideration, energy is an essentially confusing good because it can be seen both as a commodity, which is tradable through commercial means and a strategic asset, which can be used as a foreign policy tool. The limited availability of energy in spite of the growing demand makes states vulnerable in front of the energy producers. Due to the high dependence on energy resources, it is of vital importance for the states to have the control of energy supplies. Therefore, all states have felt the need of taking precautions through developing national, regional or international energy policies. Although the priorities, needs and market structures in the energy sector differ according to the countries' development levels, today we cannot discount the increasing impact of international economic policies on the determination of national policies. Analysing and thereby improving our understanding of the national, regional and international energy policies in the world is of utmost importance. The

high level of interdependence means energy governance must be carried out on many levels at the same time. Because it involves public, societal and private actors, energy governance requires cooperation and regulation between very different kinds of players, making it an especially good case study to analyze the interaction of actors involved in governance.

When we look at the allocation of energy resources in the geographical context, we can see that, energy resources are dispersed unequally in the world and the demand for it grows on a regular basis. But the differences in the economic growth rates of countries and the enormous increase in the population have led to unequal energy use between the countries. Although the developing countries' energy need has grown more rapidly and they have 75 per cent of world population, they can only utilize just about 30 per cent of all world energy resources for commercial reasons. This point out the imbalanced use of energy resources in the world.¹

Energy policy is closely interrelated with the economic, social, security and environmental policies of the countries. When we look at the economic dimension of energy, we see that investment in the energy sector requires vast financial power. For instance, for the nuclear power plant installed in France in 1984 by Framatome (1350 MW), the amount of investment was 1,750 billion dollars. For the Itaipu Dam in Brazil with the capacity of 13.000 MW, an amount of 15 billion dollars was spent in 1983. Energy resources take important part in the world trade. The most powerful industrial firms in the world are usually the firms that are dealing with oil trade and industry. All these industrial giants have quite influential roles in determining the energy policies of the countries. On the other hand, net energy importer countries suffer from the financial burden of the energy resources, they imported. Therefore they try to develop policies to reduce their dependence on outside resources and enhance their national potential and supply security. It is clear that there is an inconsistency between the supply and demand sides of energy. On one hand, there is controlling but a small number of suppliers; on the other hand there is a massive demanding side, which has to adjust itself to the energy prices.

¹ B. Yücel, Enerji Ekonomisi (Ankara: Akay Ofset Matbaacılık, 1994), p. 2.

Energy has always been a politically important factor as well. The reasons behind its political importance can be explained by that oil and natural gas which are necessary fuels in electricity generation, transport and heating, are always regarded as strategic elements by the states. Since the problems in the world energy market generally have political consequences. For instance, although market mechanisms can adjust themselves according to the small changes in the energy prices, history has shown that a political intervention is inevitable when there is a significant change in the energy prices. Middle East, which has the largest oil reserves in the world, has always been an arena for conflict between the powerful states, who want to own the rich oil reserves in the region. The war between Iran and Iraq; the Iraqi invasion of Kuwait (1991); United States' invasion of Iraq (2003) are good examples in this context. Moreover, developing nuclear programs is to a great extent a result of political decisions. Briefly, it can be said that energy has become the main reason behind the political crises in the world.

In addition to the economic and political effects of energy, its impact on the environment should also be taken into consideration. Although energy is a sine qua non for economic growth, huge amount of energy production and distribution lead to environmental pollution. The more economic growth means the more environmental pollution, which is mostly due to the high ratio of energy use. Spread of greenhouse gas emissions and accordingly climate change; problems in managing the nuclear waste; acid rain due to the gas coming from combustion plants and transportation at ground have serious environmental consequences. Until 1960s, the negative impact of energy on human health and environment has not gained a special attention, whereas Chernobyl Nuclear Accident; increasing concerns about air pollution and other environmental problems have begun to attract the attention of the modern societies. In line with the increasing environmental concerns, energy circles try to adopt some measures to decrease the damage of energy facilities on environment. In this context, the role of societal actors should not be undermined overlooked. It has become apparent that the role of societal actors is becoming increasingly important

in the policy-making processes. Therefore developing energy policies that are compatible with environmental policies is of paramount importance.

As it was noted above, energy is associated with various disciplines. For that reason energy analysts have begun to give importance to work together with their colleagues from the fields of social sciences, economics and environment. However, this study does not examine the negative impacts of energy use on environment and the policies of the states in this respect.

Throughout the history, energy sector has faced radical changes in terms of public involvement in line with the political changes in the international arena. In the post-World War II period, the basic trend was nationalization in the energy sector. Following the energy crises of the 1970s, energy sector faced a strong government involvement and control, particularly in the grid-based industries like electricity and nuclear in order to ensure security of supply. Then, in the late 1980s and 1990s, less state intervention, deregulation and privatisation of the energy industry and introduction of competition to the industry have become key trends. Rising technological developments and the globalisation process, which helps the spread of these developments rapidly in the world, have encouraged the attempts to create a competitive environment for the sectors like electricity, telecommunications that were previously accepted as natural monopoly industries and publicly owned properties. These changes have occurred with the worldwide political changes in the late 1980s and 1990s such as the collapse of Soviet Union (the pioneer of the socialist and statist understanding), political changes in Eastern Europe and strengthening of market-based understanding, particularly in the western countries which need energy resources in competitive prices to cope with the harsh economic race in the capitalist world.

Energy policy issues are also at the very roots of the European Community. Three founding treaties of the Community, European Coal and Steel Community (ECSC), The European Atomic Energy Community (EURATOM) and the European Economic Community (EEC) were founded with the aim of developing common

coal and nuclear policies in post-World War II period. But they were largely failed. The invention of other fuels in electricity generation and heating and the increase in coal imports affected the mining sector negatively in 1960s. Although there were some attempts in 1970s and 1980s for the restructuring of the coal industry, coal production has continued to show a downward trend. Increasing environmental concerns and pressure coming from the non-governmental organization (i.e. Greenpeace) in 1990s have proved that solid fuels do not have a competitive power. Even though the mainstay of the ECSC was to form a common coal market in Europe, in last two decades the decisions about coal were relying on supply security or environmental concerns.

Despite the failure of early attempts, the developments towards a Single European Market and the emergence of neo-liberal policies have had a remarkable impact in the European Union (EU) since late 1980s. After the signature of the Single European Act (SEA) in 1987, the European Commission has prepared several legislative initiatives to establish the internal market concepts into the energy sector. It is believed that elimination of trade barriers and enlarged competition between companies across Europe lead to more efficiency, improved customer service and lower prices in the energy sector and accordingly security of supply. However, it is obvious that this is a very difficult task, since national energy markets differ according to ownership and their competitive advantages markedly. Member States with their different energy supply structures and policies, have responded these changes in various ways; some focusing on environmental concerns, some racing ahead with market liberalization and still some with continuing concerns over security of supply or bringing economic development to certain regions. For that reason, a degree of regulation at the European level seems necessary for the efficient operation of market forces so as to preclude abuse of monopoly power and guarantee the entry of new suppliers. The aim with the regulation is also to provide for security of energy supplies, appropriate environmental standards, and quality of supply and energy conservation.² Taking these into account, EU set its objectives on energy policy as to guarantee supply of energy to all consumers at reasonable prices, while

taking the environment into consideration and supporting competition on the European energy market.³ However the political importance of the sector and the plurality of the interests have slowed down a common policy approach at the European level. Therefore it is open to debate how far EU has pursued these objectives and whether there is an internal energy market at the European level, which is fully competitive and liberal.

In this study, specifically, electricity sector reform, which is an important part of the EU energy policy since late 1990s will be addressed. Since, electricity is a crucial input to all industrial production and especially to main services like telecommunications and transport systems. It is the driving force of the economic growth. It has a non-substitutable character. Taking its economic importance and non-substitutable character into consideration, governments pay special attention on ensuring security of energy supply both in the short and long term.⁴ Ensuring security of supply remains one of the central objectives of public policy, even though there have been radical changes in the methods to achieve this objective, such as regulatory reforms and the introduction of market liberalization.

Another characteristic of electricity is that it cannot be stored and supply must be continuously adapted to varying demand.⁵ Therefore, such network natural monopoly industries must inevitably be subject to social control. The political and social demand for control of this market power arises from the non-storability of supply, the dependence of the consumer upon the supplier and the essential nature of the service.⁶ This proves that electricity sector has a sui generis character in adapting a market structure.

² C. Redgwell et al. (eds.), Energy Law in Europe: National, EU and International Law and Institutions (Oxford: Oxford University Press, 2001), p. 978.

³ Kurt Deketelaere, "Energy Policy of the EU and Its Implications for Turkey", paper presented to the Conference on Energy Policy in the EU, Ankara, 10 October 2003.

⁴ OECD, IEA, Electricity Market Reform: An IEA Handbook, 1999, p. 17.

⁵ R. J. Gilbert, et al. (eds.), Comparisons of Electricity Regulation (Cambridge: Cambridge Pres, 1996), p. 2.

⁶ Ibid, p. 3.

After 1980s, the reform of electricity industry has become an increasingly worldwide phenomenon. There has been a tendency towards deregulating, privatising and liberalizing⁷ the electric power industry in the world. The unique character of the electricity industry makes the efforts for liberalizing it an interesting case. However, the ongoing structural change in the electricity industry has occurred in different forms in the countries. In the literature, according to some schools, these differences in the domestic structures and the international setting in which they are located have enforced the adoption of diverse strategies of foreign economic policy⁸ which constitutes a controversy in the EU. On one hand, it is argued that in the present era of “international interdependence”, strategies of foreign economic policy depend on the interaction of domestic and international forces. On the other hand, it is argued that the nation-state has still protected its power to shape strategies of foreign economic policy and abstained from devolving its exclusive rights to the supranational authorities.⁹ Despite the achieved consensus between the member states about the market liberalisation, this reluctance has shown itself in the electricity sector, which is a highly sensitive sector for the economic and social welfare.

These radical changes have also been the very focus of a growing attention to energy-related issues within the framework of the European Community. In 1996 after eight yearlong negotiations, the EU agreed to liberalize its electricity market.¹⁰ This reform was a breaking point in the evolution of a sector that had been run by a natural monopoly and exempted from competition. The internal market policy for electricity has been very controversial, reflecting the heterogeneity of national electricity regimes. Despite the attempts at the EU-level, it seems that differences in national experiences, traditions and political constraints have shaped the existing institutions and affected the regulatory reforms of the EU in the electricity sector.

⁷ Liberalization and privatization are two different terms. Privatization has a more narrow meaning. It is to transfer the property rights from public to private sector, whereas the term 'liberalization' covers the other new market participants as well.

⁸ P. J. Katzenstein (ed.), Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States (Wisconsin: The University of Wisconsin Press, 1978), p. 3.

⁹ *Ibid.*, p. 4.

¹⁰ R. Eising, Bounded Rationality and Policy Learning in EU Negotiations: The Liberalization of the Electricity Supply Industry, EU/Working Papers (Florence: European University Institute, 2000/26), p. 3.

Most of the member states want to defend their established sectoral structures in the EU negotiations. The structures of the member states differ from each other. There is both public and private ownership, with changing degrees of vertical integration. Germany's electricity industry is an example of a private, vertically separated supply structure with regional monopolies, while France has a comprehensive system with only one public, national monopoly, the Electricité de France (EdF), responsible for all aspects of electricity supply. With the adoption of the Electricity Directive, the EU reform was qualified as the *"least common denominator of negotiations between the large member states France, Germany and Britain"*.¹¹ One of the well-known scholars in this area, Janne Haaland Matlary (1997), in her book tries to elucidate why member governments engage in EU level policy-making between the years 1985 and 1992. In this respect, she specifically puts emphasis on the Putnam's Model. Putnam's Model is about the 'two level games' played by the member governments. According to Putnam, governments play games at both domestic and international levels. With the notion of 'two level games', Putnam argues that if any government cannot find any support for a policy in the domestic sphere, it may rely on the international commitments such as binding EU rules. In like manner, at the international level, it may state reasons against the international commitments with the argument that domestic constraints prevent it from fulfilling an international commitment. Matlary tries to approach the Putnam's Model from the energy point of view. For her, this model is a useful approach to comprehend what kind of interests the governments seek in the case of energy. According to her, interests are brought into life in the policy process itself. On account of this, she argues that some interest groups do not favor EU level policy-making, since they are afraid of losing their decision-making power and some, on the contrary, prefer it according to their interests.¹²

According to Matlary, the development of a common energy policy (CEP) was not in fact the result of the concerns on external threats such as supply disruptions; on the contrary it is the outcome of the common internal market program and its principles

¹¹ Ibid.

¹² J. H. Matlary, Energy Policy in the European Union (England: St. Martin's Press, 1997), p.3.

of deregulation. "Deregulation" is a typical policy of the EU. In this context, for her, mainly the European Commission and the European Court of Justice are powerful actors in this policy area.¹³ The European Commission has initiated a program to deregulate the energy sector and dismantle monopolies in the sector, but only few of its proposals were adopted by the member states. Especially, the directive on the internal electricity market¹⁴ has led to controversial debates. She explains the attempts for electricity liberalization with an intergovernmental approach, saying that final negotiation reflects *national differences in market structures, energy policies and market philosophies* in UK, France and Germany.¹⁵ According to intergovernmental approach, member states shape their preferences on the basis of their domestic economic conditions or through the pressure of domestic economic interest groups. This way of thinking can also be seen in many policy analysis of the EU. However, for some theoretical conceptions, like bounded rationality, neo-institutional premises and theories of policy learning, it is not sufficient to explain the regulatory reforms in the Union with only intergovernmental approach. One of the well-known proponents of this line of thought, Rainer Eising argues that member states do not determine their interests just on the basis of their domestic structures and protect them strictly in the Council negotiations. EU level interactions play an important role in the formation of preferences as well.¹⁶ It is true that most of the member states resisted EU liberalization for a long time and tried to limit the scope of it. Intergovernmental approach and other similar approaches explain the opposition towards the sectoral reform well but for Eising, they fell short of explaining the unanimous agreement of the member states on the need for a fundamental reform in the electricity sector.¹⁷

Besides the impacts of national actors and EU-level interactions on the policy-making processes, the role of societal and multinational private actors should be also taken into consideration. For instance non-governmental organizations (NGOs) are

¹³ Ibid., p. 152.

¹⁴ See Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity. (Accessible at http://europa.eu.int/en/comm/dg17/gazel_en.htm).

¹⁵ Eising, *op.cit.*, p.4.

¹⁶ Ibid.

¹⁷ Ibid.

important societal actors, which have an increasing impact on the EU policy-making process. Unlike traditional domestic-policy interest groups, NGOs involved in policy making process often cross national boundaries. In this sense, both transnational organizations and multinational corporations can better put political pressure on supranational authorities. NGOs usually stand for many-sided foreign-policy interests, as some groups are focused on environmental issues while others are driven by political motives. They have their own interests to pursue at the supranational level which leads to close ties to political officials, and propaganda campaigns. They influence policies based on their own conceptions and interests. Their impact on the EU regulations concerning environmental protection can be easily seen. Multinational corporations have also seen as powerful political actors influencing most policy areas, such as energy policies. NGOs and multinational corporations play important roles in both national and international policy-making processes and continue to influence national and supranational actors. However it is obvious that such external forces were formed largely when nation-states engaged with intergovernmental relations with other nation-states.

Even though, there was an important degree of convergence on market liberalization as a policy paradigm particularly after 80s, intergovernmental premises still explain the reluctance of the member states in adopting the internal market principles better than any other theoretical perception. For example, France, while taking steps towards a deregulated electricity market, has acted more cautiously than the other member states, whereas Britain has gone far beyond the requirements of the free market understanding in the energy sector, envisaged by Brussels. In the literature, there are several useful works examining and analyzing the national energy policies of member states. Dominique Finon, in the edited book of McGowan (1996) deals with the process of deregulation and liberalization in the French energy market. According to Finon, state interventionism seems to be prevalent in the future of French energy sector, while the Union is moving towards a "Greater Europe".

Another renowned intellectual, Francis McGowan in the same book, analyses the British energy policy and clearly explains the shift in the British energy policy since

1980s. Before 1980s, public utilities and government funding were vital in coordinating the long-term British energy policy. However, today the private companies determine the energy strategy of Britain. Government only functions as the regulator of the market. For McGowan (1996), while the British government's stress on liberalization is corresponding to the Commission proposals for some energy sectors, the overall approach to energy policy remains much more restricted than that envisaged by the Commission. Hence, UK is expected to stay behind the periphery of European Energy Policy.

As it is understood from the instances, which were noted above, there are differences between the energy policies of the major member states. British understanding of market economy challenges the German social market economy understanding and the French style statist and interventionist energy policies. All these make it harder to develop a common policy at the EU level, which is appropriate for all the member states. But, according to McGowan (1996), despite the conflicting policy objectives, there should be a 'balance of priorities' when decisions are taken.

In the literature, mainly, scholars, who are studying the policies on energy, try to find answers to the questions of why there is a need for CEP in Europe and why it is necessary for the member states. In addition to these, much of the literature focuses on how member governments benefit from such a common policy. There are several analyses on the national energy policies of member states. But, there are very few comparative studies on the national energy policies of states and again very few scholars mention that there can be a balance of priorities in the CEP.

In the light of the studies of intellectuals, this thesis will discuss whether a single electricity market is constituted at the European level. The thesis argues that although some further steps were taken in terms of market integration, it is still not possible to talk about a single electricity market in Europe. Despite the pressure on the member states to transmit their decision-making power to the EU institutions, most of them abstain from devolving their policy-making rights in the case of electricity market regulation. The current developments in the EU showed that EU is still an arena of

political rivalry for member states, which try to pursue their national self-interests. In such a sensitive sector, which is of utmost importance for the functioning of the national economy, member states struggle for a system, which answers the needs of their domestic system.

On the other hand, some negative experiences of the member states after implementing the liberal policies in the electricity sector (i.e. increasing market concentration, price increases for the domestic consumers, increasing unemployment in the sector) and the failure of the EU in creating a single electricity market has led to mistrust over any plans to hand more power to Brussels. In this framework, this work will also try to evaluate the results of the liberal policies that are adopted in the electricity sector in line with the EU Acquis. This study argues that regulation at the European level is essential in order to establish a single electricity market, based on fair competition rules.

United Kingdom and Turkey are investigated within this study as two diverse cases. Britain is taken as a case study in this work due to the fact that it is shown as one of the best examples by the supranational authorities in the EU in terms of meeting the requirements that are envisaged in the EU electricity directives. UK opened its electricity market fully to competition and awarded all its consumers as eligible consumers, meaning that every consumer has the right to choose its own supplier. This study argues that even though UK is at the forefront of the other member states in implementing the liberal policies and adopting the EU electricity directives, it has still resisted transferring its right of control over its electricity market to supranational authorities at the European level. Another point that is stressed in this thesis is the adverse experiences of UK after the implementation of liberal policies in its electricity market. This study shows that the liberal policies are contradicting with the nature of the electricity sector. The British case is a good example to analyze the negative outcomes of the liberalisation process in the electricity sector, although it is seen as one of the most advanced countries in terms of market liberalisation. On the other hand, this study argues that despite the negative consequences of the liberalisation process, UK has drawn lessons from its experiences and tries to

restructure its electricity sector in the light of these experiences. However, it should be noted that UK, as a developed country, has the capability of coping with the negative consequences of the liberalisation process.

In this thesis, finally Turkey will be taken as the second case study, which takes UK as a model during the reformation process of its electricity sector. This case will show that the model of UK is not an appropriate model for Turkey during the restructuring process of the electricity market, since the considered model is incompatible with the market conditions of Turkey. When we look at the privatization model of Britain, we see that there was a very early and successful privatization process in the electricity sector. However, this study puts forward that it is not such that easy for Turkey to adopt a privatization model like Britain. Since there are big differences between the two countries in terms of laws and regulations, institutional capabilities and domestic market conditions (i.e. weak and insufficient network infrastructure). Therefore this study proposes that it is not true for Turkey adopt the model of a country which is economically well-developed. Before adopting the models of such well-developed countries, Turkey firstly should draw lessons from the experiences of such countries, which have already completed the initial stages of the liberalisation process and develop a model, which answers the needs of its own domestic system after a smooth transition process. Although Turkey has enacted a Law in 2001, which is in harmony with the EU Electricity Directive, it is in a deadlock position now due to the neglect of the transition stage to establish the necessary background for the electricity sector such as preparing the necessary law background, restructuring the institutional background and the rehabilitation of the network infrastructure. As a concluding remark, this thesis argues that Turkey shouldn't disregard its conditions for the sake of EU membership while developing policies in a strategically important area where most of the member states abstain from devolving their decision making rights to the supranational authorities.

The studies of well-known scholars, who are examining the EU policy-making process in the case of energy and electricity market liberalisation through various theoretical approaches, are main sources that are utilized during this study. During

the preparation of the thesis, the existing literature on the subject was explored and utilized. The working papers of various organizations like European Commission, International Energy Agency (IEA), Energy Information Administration and Eurelectric, which are specialized in the energy field, were benefited while drafting this study. As well as Green and White Papers of the European Commission, Benchmarking Reports on the European Electricity and Gas Markets, necessary official publications of the EU were the other key sources, which I made use of in my study. Conference papers, journals and academic papers constitute the secondary sources of my thesis.

In the First Chapter, a brief description will be made on how the policies are shaped at the EU level and what kind of roles the EU institutions play in the policy-making process. Importance of lobbying with the key institutions, which is an indicator of EU level interaction, will be touched upon as well. The roles of the Commission, Council and the Parliament in energy policy formulation will be examined in depth. After that, a brief description on the energy balances in the EU will be given. In this chapter, also the attempts for developing a common energy policy since the foundation of European Coal and Steel Community (ECSC) will be explained in a detailed manner. Then the impact political changes in the world on the energy policy formulation at both national and Community levels will be discussed. Evolution of the internal energy market in post-1990 period will be examined thoroughly within this Chapter. The initiatives of the European Commission to set up an internal energy market will be discussed and in this context, Electricity Directive 96/92/EC and Gas Directive 98/30/EC of the EU will be briefly scrutinized. The law-making process in the case of energy and the bargaining power of member states in determining the provisions of the Directives will be handled within this chapter.

In the Second Chapter, firstly the evolution of the Electricity Directive, steps towards a Single Electricity Market (SEM) will be discussed. Then, the common rules in the Directive will be underlined. An overview of the implementation of the Electricity Directive across Europe will be made in this part. Differing means of member states in adapting Electricity Directive 96/92/EC and their reservations on some of the

articles of the Directive will also be reviewed in this Chapter and finally, the impediments in front of the SEM will be discussed.

In the Third Chapter, the British case in terms of electricity market regulation will be examined. Before focusing on the electricity market, general information will be given concerning the overall energy market of Britain. After that the historical development of the British electricity market will be examined in a detailed manner. Then the attitude of the British government in transposing the Electricity Directive of EU, their way of implementing the Directive and its relations with the Union in the case of electricity market reform will be summarized within this chapter.

In the final Chapter, as a candidate country, Turkish case will be taken into consideration. Before looking at the Turkish experience of adopting the EU Electricity Directive, an outlook of Turkish energy market will be given. Secondly, the reformist attempts in the Turkish electricity market since late 1980s and the key challenges in front of the Turkish power sector will be summarized. In line with the attempts to adapt to the EU Acquis in energy policy, a new institutional framework was introduced to regulate and oversee the new market structure. These changing dynamics in the institutional structures in the electricity market and the role of Energy Market Regulatory Authority (EMRA) will be handled within this chapter. Finally Turkey's attempts to harmonize its legislation on the electricity market with that of EU Directive will be scrutinized under this Chapter.

CHAPTER 2

EU POLICY-MAKING IN THE CASE OF ENERGY

Since the very beginning of the EU, there have been many attempts to create a common energy policy for Europe albeit with only partial success. The *raison d'être* behind this failure is usually described with the unwillingness of member states to devolve their sovereignty in this highly sensitive policy area.¹⁸ Although it seems that member states are reluctant to pass their authority on energy matters to supranational bodies, the growing European economic integration; environmental concerns; increasing international competition and even the increased role of the European Commission in the energy sector compel for the "convergence" of national energy policies, creating the basis for a European Energy Policy. However, it is obvious that "convergence" of national energy policies is not yet a reality.¹⁹ But the truth is that the factors noted above have had an increasing impact on member states' policies. In spite of its enclosure in the very first treaties on the European Community, energy was more or less unaffected by common market legislation, and very few energy policy decisions were taken at the Community level.²⁰ Before examining the EU Energy Policy of post-1990 period, it is of utmost importance to grasp the role of energy issues in the European Community and the EU policy-making process. In addition, a deeper understanding of the objectives underlying EU Energy Policy is necessary to perceive the negotiations on electricity and gas market liberalisation. Hence, before concentrating on the policies of the Community regarding the electricity market liberalization in the post-1990 period, first of all, policy-making process at the European level will be elucidated within this chapter.

¹⁸ F. McGowan, "Energy Policy in the EU-Diversity or Convergence?" in F. McGowan, ed., European Energy Policies in a Changing Environment (Heidelberg: Physica-Verl., 1996) p. 1.

¹⁹ Ibid.

²⁰ Ibid.

Then, an overall assessment of the Community policies concerning energy since ECSC will be made in this part.

2.1. Law-Making Process in the EU

The European Commission (EC), European Parliament (EP), Committee of Permanent Representatives (COREPER) and Council of Ministers have quite important roles in the EU policy-making process.²¹ In order to understand the policy-making process in the case of energy, it will be useful to look over what kind of roles the principle EU institutions play. In this context, firstly it will be better to examine the role of the EC, which is the main driving force in the decision-making process. In the Commission, the key role is undertaken by the drafter (chef de dossier), who writes the first draft proposal on a specific issue in between 12-18 months.²² Following this draft proposal, the Commission issues a "Green Paper", a kind of draft document implicating the thoughts and approaches of the Commission on a specific topic in a detailed manner.²³ Views of the non-governmental organizations, private industry and industrial associations are taken into consideration during the groundwork of the Green Paper. After the Green Paper, another document "White Paper", a kind of official announcement of the Commission proposal, containing the thoughts and comments of the relevant interest groups on the Green Paper, is published by the EC. Although there is one "lead" Directorate-General within the Commission, others involved in the legislative process as well. After consulting the other directorate-generals, who are interested in the issue, the draft proposal can be finalized. Especially, such kind of inter-service consultation is common between Directorate-General for Transport and Energy (DG TREN) and Directorate-General for Environment or between DG TREN and Directorate-General for Social Affairs. Final version of the draft is shown to the technical experts (sous chefs) to take their

²¹ Robin Pedler, "Legislative Processes of the EU: What are the Key Processes?" paper presented to the Seminar on EU Public Affairs and Law-Making Processes, Brussels, 3 October 2003.

²² It is not coincidence that lobbying with the drafter is of high priority for some interest groups. During drafting the proposal, various general-directorates under the Commission carry out lobbying facilities among each other. For example, such kind of lobbying is quite usual between the General-Directorate for Transport and Energy and General-Directorate for Environment in the EC.

²³ During drafting the Green Paper, there is tremendous lobbying in the Commission. Since, the Commission needs specific data, schemes, graphics or practical arguments from industrial sector while drafting the Paper.

advice on the issue. In the end, the college of commissioners²⁴ agree on the draft directive with majority voting at least 11/20 in favour. The proposal has to be adopted by the college of commissioners. In preparing the draft directive, experts from member states, special working groups, permanent representatives and other directorate-generals under the EC officially have influence on the legislative process. Other groups, like private firms, NGOs, unions, associations, chambers and other relevant interest groups may usually influence the process in an unofficial manner. This has justified the argument of Rainer Eising, who puts emphasis on the impact of EU level interactions in the formation of member states' preferences.

After the finalization of the draft directive, the EC passes it to the EP.²⁵ In the EP, there are 17 committees and within these committees there are rapporteurs and "shadow rapporteurs", who are elected deputies from the political parties. These rapporteurs try to reach a consensus on the specific directive; they conciliate and prepare a report on it. For the EP's plenary vote, political groupings are more important than national connections. There are eight political parties represented in the EP. Table 2.1.1. indicates these political groups with their number of seats. The EP needs political arguments, therefore, within the EU; diplomats are skilled at lobbying the EP. It is not surprising that lobbying with the "lead" committees, chairman and rapporteurs is quite widespread. 4,677 people are noted representing interest groups, business chambers, regional and local representations, company representations and consultants, which lobby in the EP.²⁶

²⁴ The Commissioner is appointed in every five years. Number of the commissioners is foreseen as 20 and each of them is dominated by each member state. Each Commissioner has a cabinet, composed of 6 people. These officials, working in the cabinet debate on the draft proposals and declare their ideas.

²⁵ There are 626 elected representatives of the political parties in the EP.

²⁶ Robin Pedler, op.cit.

TABLE 2.1.1. Political Groups in the European Parliament

	POLITICAL GROUPS	NUMBER OF SEATS
EPP	European Peoples Party (Christian Democrat Party)	233
PES	Party of European Socialists (Liberals)	180
EDLR	Group of Liberals, Democrats and Reformers	50
Greens/ALE	Greens and Free Europe Alliance	48
GUE/NGL	Confederal Group of United European Left and Nordic Green left	42
EDD	Group for Europe of Democracies and Differences	16
NI	"Non-inscrits"/Non-aligned	27

Source: Robin Pedler, "Legislative Processes of the EU: What are the Key Processes?" paper presented to the Seminar on EU Public Affairs and Law-Making Processes, Brussels, 3 October 2003.

Heads of the member state missions to the EU are represented at the COREPER (Comité des Représentants Permanents). COREPER 1 is gathered every week at the deputy ambassador level to discuss economic and social issues; COREPER 2 meets weekly at the ambassador level to discuss political and foreign affairs. More than 80 per cent of the decisions are taken by COREPER or the Working Parties under it. Usually the working groups are composed of civil servants of the member states. Lobbying in these working parties is a key target for the interest groups.²⁷

The final authority in the decision-making process is the Council of Ministers. Council of Ministers meets four times a year to decide on the broad agenda for the EU. There are nine specialist ministerial councils, which meet four times a year. Foreign ministers meet every month to discuss the general affairs, financial and agricultural policies in the Council. Member States are represented in the Council of

²⁷ Ibid.

Ministers and almost 20 per cent of all the decisions are taken at the ministerial level. In the Council, while taking the decisions, qualified majority voting is essential. Table 2.1.2. shows the weight of votes in the Council. But it is worth to note that the key decision-makers in the EU are permanent representatives and the ambassadors. This confirms that bargaining power of the member states' representatives determine the policy framework to a great extent, which substantiates the intergovernmentalist premises. Therefore, while interest groups are lobbying in the Council, it is significant for them to be close with the member state governments and permanent representatives.

TABLE 2.1.2. Council: Voting Weights After Nice

<u>Member States</u>			<u>New Member States</u>		
<u>Country</u>	<u>Population</u>	<u>Votes</u>	<u>Country</u>	<u>Population</u>	<u>Votes</u>
Germany	82	29			
France	59	29			
Italy	57	29			
Britain	59	29			
Spain	39	27	Poland	39	27
Netherlands	16	13	Romania	23	14
Belgium	10	12	Czech Rep.	10	12
Greece	11	12	Hungary	10	12
Portugal	10	12	Bulgaria	8	10
Sweden	9	10	Slovakia	5	7
Austria	8	10	Lithuania	4	7
Denmark	5	7	Latvia	2	4
Finland	5	7	Slovenia	2	4
Ireland	4	7	Estonia	1	4
Luxembourg	0.4	4	Cyprus	1	4
			Malta	0.4	3
15	374	237	12	109	108

Note: Qualified Majority 'New EU' 258+majority of member states+62 per cent of population

Source: Robin Pedler, *op.cit.*

In the policy-making process, public affairs have quite important role. Taking into account the importance of public affairs, the Commission issued a communiqué on restructuring the dialogue between interest groups and EU institutions. Since then, the standpoints are transmitted to the Commission through vertical European business or national associations and Commission takes position papers from them. Lobbying is quite influential in the EU. For example, initiatives concerning the liberalization of the German electricity market were countered by some of the interest groups in Germany and because of this, works on Energy Law were halted in 1993. The existing energy regime, which is the outcome of such efforts, is quite complicated, since the structure of the energy sector and the way of intervening to the energy markets differ markedly in the member states. However it is not wrong to say that EU level interaction is quite influential in the determination of the policies.

As it was mentioned in the introductory part of this study, energy is a crucial and non-substitutable input in industrial production. Energy costs have an important share in total production costs. It is thought that low pricing policy (such as subsidizing domestic supply and import) to reduce the production costs might deteriorate competition. On the other hand, insufficient domestic sources and dependence on imported fuel might drag a country into a risky situation, which is not preferred. For that reason, most of the governments intervene in the energy sector to protect its market from the price fluctuations in the world energy market. This has restricted the roles of EU institutions in the energy area. International organizations generally have hardly influenced national energy policies.²⁸ As noted above, member states are reluctant to leave their sovereignty on energy matters. However, the exercise of autonomy has become harder to sustain as the international environment becomes more important for national energy policy-making: energy markets and firms are becoming multinational while many of the concerns of recent years such as trade liberalisation and environmental protection are international in essence. The issues which have arisen on a national scale also come out on the international arena.²⁹ The 'internationalisation' of firms and markets has required at least some

²⁸ McGowan, *op.cit.*, p. 11.

²⁹ *Ibid.*, p. 12.

degree of international regulation, although different interest definitions of governments are expected to restrict the scope of such kind of initiatives.³⁰ As a result, it can be asserted that the political shifts in the international arena and the pressure coming from multinational firms with increasing globalisation have enforced the member states to consider the directions of international or supranational mechanisms.

2.2. Energy Balances in the EU

Today, in the EU, the share of energy sector in the industry value added is about 12 per cent and the employment in the energy sector has a 4.5 per cent share in the total industrial employment.³¹

When we look at the share of primary energy resources that are consumed in the EU, we see that oil has a share of 40 per cent, followed by natural gas and nuclear energy, which demonstrates that EU is still largely dependent on oil and natural gas resources that might cause serious threats to the supply security. Table 2.1.3. gives the indicators about the consumption of primary energy resources in the EU member countries.³²

³⁰ Ibid., p. 13.

³¹ Eurostat, Energy and Environment Indicators, Data 1985-2000, Office for Official Publications of the European Communities, Luxembourg, 2002, pp. 51, 53.

TABLE 2.2.1. Primary Energy Consumption in the EU (2001)

	Solid Fuels	Oil	Natural Gas	Nuclear	Renewables			TOTAL	
					Hydro	Biomass	Other	per cent	Quantity (Mtoe)*
Germany	24.4	38.0	21.7	12.7	0.5	2.0	0.3	100.0	348.8
Austria	12.2	41.9	23.1	-	11.9	9.9	0.3	100.0	30.3
Belgium	12.8	39.0	23.7	21.6	0.0	1.3	0.1	100.0	55.6
Denmark	21.1	45.2	23.1	-	0.0	9.0	2.1	100.0	19.9
Finland	18.4	26.8	11.1	17.8	3.3	19.3	0.3	100.0	33.2
France	4.8	36.1	12.9	41.4	2.4	4.6	0.1	100.0	262.3
Nether.	10.7	37.9	45.7	1.3	0.0	1.9	0.2	100.0	77.6
England	17.0	34.1	37.3	10.0	0.1	1.0	0.0	100.0	232.5
Ireland	18.1	55.6	25.0	-	0.7	1.4	0.0	100.0	14.4
Spain	14.6	52.4	13.0	13.0	2.8	3.3	0.5	100.0	126.3
Sweden	5.4	29.3	1.6	36.0	13.2	15.7	0.2	100.0	51.6
Italy	7.6	49.4	32.9	0.0	2.3	3.5	1.8	100.0	176.6
Lux.	2.6	63.2	18.4	-	0.0	0.0	0.3	100.0	3.8
Portugal	13.2	63.6	9.5	-	5.0	8.7	0.3	100.0	24.2
Greece	32.2	56.7	5.9	-	0.7	3.5	0.3	100.0	28.9
EU-15 (per cent)	14.6	40.3	23.1	15.5	2.0	3.8	0.4	100.0	
Quantity (Mtoe)	216.6	598.9	343.7	229.9	29.1	56.6	6.2		1486.2

* Million tones of oil equivalent.

Source: European Commission, Directorate-General for Energy and Transport (in cooperation with Eurostat) *EU Energy and Transport in Figures: Statistical Pocketbook 2003* (Luxembourg: Office for Official Publications of the European Communities, 2003)

When we look at the final energy consumption by sector in the EU, we see that domestic and tertiary sector has the largest share of 40 per cent, followed by transport sector with 32 per cent and industrial sector with 28 per cent, which means that the share of small consumers is relatively higher than the industrial and commercial ones. (Table 2.2.2.)

³² Data about the new member states are not included in Table 1.2.1.

TABLE 2.2.2. Final Energy Consumption by Sector in the EU (2001)

	Industry	Domestic and Tertiary	Transport	Total (per cent)	Quantity (Mtoe)
Germany	25.8	44.2	30.0	100.0	214.9
Austria	26.7	43.6	29.2	100.0	23.6
Belgium	36.3	38.2	25.3	100.0	37.2
Denmark	20.4	49.0	30.6	100.0	14.7
Finland	47.0	34.8	18.2	100.0	24.7
France	23.9	42.8	33.3	100.0	155.7
Netherlands	27.2	44.8	28.0	100.0	50.7
England	23.2	43.2	33.6	100.0	151.9
Ireland	18.7	41.1	40.2	100.0	10.7
Spain	32.7	26.3	41.1	100.0	83.3
Sweden	38.3	35.8	25.9	100.0	33.2
Italy	31.3	36.3	32.4	100.0	129.7
Luxembourg	24.3	21.6	54.1	100.0	3.7
Portugal	32.2	29.9	37.4	100.0	17.4
Greece	23.6	38.2	38.7	100.0	19.1
EU-15	27.8	40.1	32.1	100.0	970.3

Source: European Commission, Directorate-General for Energy and Transport (in cooperation with Eurostat) *EU Energy and Transport in Figures: Statistical Pocketbook 2003* (Luxembourg: Office for Official Publications of the European Communities, 2003)

2.3. Evolution of CEP

The course of official energy policies and the balance of other policies affecting energy sector have changed over the decades. During the post-World War II period, energy had been an important tool in the post-war reconstruction. From 1950s onwards, there have been a massive increase in energy consumption and a decrease in energy production.³³ Policies about the energy sector in the post-war environment were essential to accomplish the economic objectives like the development of new technologies, control of balance of payments, inflation and achieving the social welfare. Thus, developing common policies in the field of energy has gained importance in Europe.

³³ H. Çaha, 'Avrupa Birliği Enerji Politikaları', *Yeni Türkiye*, 36 (2000), p. 1544.

In 1951, Treaty of Paris created the ECSC³⁴, which aimed at developing a Common Coal Policy for Western Europe. In 1957, with the Euratom Treaty, which created European Atomic Energy Community, the aim was to promote technological researches to end the monopolistic power of United States in nuclear power industry. But it failed due to the differences in the national policies. For example, while France and United Kingdom preferred using a technology based on natural uranium, West Germany preferred reactors using enriched uranium technology.³⁵ During that period, governments were able to play an influential role in the sector through outright ownership or through giving special privileges to some groups within energy markets, like monopoly franchises.³⁶

During 1950s and 1960s, efforts for developing common energy policies were disregarded or refused by member states, who wanted to keep control over their energy sector. The reason for the resistance towards a common policy can be explained with the unequal allocation of energy resources at the Community level (concentration of oil and natural gas reserves at the North Sea side) and differing interests of the member states.³⁷ Although in 1957, Treaty of Rome founded the European Economic Community (EEC), which laid down the basics for the common market, a common market for the energy sectors other than coal and nuclear power was addressed in the Rome Treaty.³⁸ Even though the Community has no specific competences on energy matters, the European Commission has relied on the Article 235 of the Treaty, which says;

*if action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.*³⁹

³⁴ The ECSC was inaugurated in 1951 and ended in 2002.

³⁵ Čaha, *op.cit.*, p. 1544.

³⁶ McGowan, *op.cit.*, p. 2.

³⁷ Čaha, *op.cit.*, p. 1544.

³⁸ McGowan, *op.cit.*, p. 14.

³⁹ P. K. Lyons, *EU Energy Policies Towards the 21st Century: A Business Intelligence Report* (United Kingdom, 1998), p. 5.

However, it was obvious that there was not an effective common energy policy of the EC between 1958 and 1972, although the need for an integrated energy market was underlined in the 1957 Treaty.⁴⁰

Industrial Revolution of 20th Century was largely depending on oil reserves rather than coal reserves of 19th Century. But this has constituted a big problem, since the oil reserves of Europe were scarcer than its coal reserves. In terms of energy production, EU has not been self-sufficient. It largely depends on foreign suppliers. Presently, almost half of the fuel consumption is met by imported fuel in the Union, although the degree of dependence changes from region to region. Table 2.3.1. gives the historical development of energy balances in the EU since 1960. In the world market, Europe did not have a dominant position in terms of oil industries, since the market was largely dominated by United States.⁴¹ Until the Oil Crisis of 1973/4, access to the energy resources was easier and the prices were quite cheaper for the European countries. But with the crisis, the prices of oil and other fuels increased enormously, which led to an increase in the prices of all the other commodities and services accordingly.⁴² Member states, who are largely net importers of energy resources, understood how vulnerable they were to the external energy crises.⁴³ Increasing political turmoil in the Middle Eastern region make vulnerable the European countries, which were largely dependent on Middle Eastern and African energy resources.⁴⁴ This crisis demonstrated that neither the European Community nor the governments had economic security and paid special attention on developing common policies on energy before.

⁴⁰ Deketelaere, *op.cit.*, p. 8.

⁴¹ Çaha, *op.cit.*, p. 1544.

⁴² In 1970, the cost of one barrel of oil was 0,89 US dollar. In 1975 it raised to the amount of 10,12 US dollar. (Çaha p. 1544)

⁴³ For more details on European Energy Dependence, see Table 1.1. European Energy Dependence, 1960-90 (m.tonnes oil equivalent) (McGowan, p3)

⁴⁴ In 1972, the dependence on oil resources, imported from Middle East and Africa was 52 per cent of the total energy need of Europe, whereas this ratio in the United States was only 2.8 per cent. (Çaha, p. 1544)

TABLE 2.3.1. Historical Development of EU Energy Balance (Mtoe)

	Production	Net Import	Gross Inland Consumption
1960	360.3	206.2	551.4
1970	408.1	650.2	1015.0
1980	584.3	687.6	1218.1
1990	708.9	642.1	1318.6
1995	740.1	651.1	1364.2
2001	761.2	765.9	1486.2

Source: European Commission, Directorate-General for Energy and Transport (in cooperation with Eurostat) EU Energy and Transport in Figures: Statistical Pocketbook 2003 (Luxembourg: Office for Official Publications of the European Communities, 2003)

From the crises onwards, energy has begun to be seen as a strategic element. Member States have focused on more protecting their national interests. Since they realized how vulnerable they are in crisis-like situations. This crisis led to a major structural change all over Europe. Diversification of energy resources and investment in the energy saving field had become high priorities for most of the member states. In addition, member states had to invest in the services and commodities, which were formerly imported from oil-producer countries to maintain the balance of trade in the long-run. It was understood that there was an urgent need for a CEP for Europe to ensure security of supply and prevent crisis-like situations. Although this seemed as a good opportunity for the EC to develop a CEP at the Community level, it failed to manage a policy for Europe during that period. Since the member states preferred developing their own policies in the energy sector. Each member state wants to hold the control of its energy sector especially in crisis-like situations, since, as it was mentioned in the introduction of this study, energy has a direct impact on the growth of economy and its competitiveness. For that reason public control over the sector is seen as a must by most of the member states, which want to gain competitive advantage in the market. In addition, each member state has its own market conditions and primary energy consumption structure. On the other hand, every sub-energy sector has its own characteristics and problems. In light of this reality, it was believed that urgent solutions to the crisis-like situations could only be found through national policies.

As another attempt, a new strategy, "New Energy Policy" was agreed on with the Council Decision of 17 April 1974. The strategy envisaged a plan, which should have been implemented until 1986. The new energy strategy aimed at restricting fuel imports to ensure economic and political security in the Community. It also foresaw the import of fuels from different regions. Besides, it aimed at encouraging the exploration facilities of new oil, gas and coal reserves within the Community. Furthermore, efficient use of energy was encouraged. Finally the strategy envisaged the endorsement of R&D facilities concerning alternative energy resources.⁴⁵

Main concern of the member states was to find alternative energy resources to the Middle Eastern and African energy resources. At the same time, they gave importance to stimulate technological research so as to increase energy saving. Coal mines regained their importance as an alternative resource to oil. Moreover, member states began to encourage their national oil companies to increase their oil and gas exploration activities in the secure parts of the North Sea Region. Even though the price of oil in the North Sea is more expensive than the price of oil in the Middle Eastern Region, it was believed that with the increased competition in the North Sea, the prices would fall to the level of oil prices in Middle East and Africa.⁴⁶

After the oil crisis, electricity generation from nuclear power has gained impetus in the European Countries as a measure to decrease dependence on imported fuel. After World War II, France and England paid special attention to nuclear research not for military but for civil reasons. However United States has enjoyed a monopolistic power in the nuclear field, which made the member states vulnerable to United States this time. In order to prevent the monopolistic power of United States in the nuclear sector, France and Germany began to collaborate to accelerate R&D facilities in the nuclear field. Nuclear policies were considered as crucial part of national policies.

For most of the governments, energy has been too crucial to leave to the international market forces or to give up too much coordination within intergovernmental

⁴⁵ Çaha, *op.cit.*, p. 1545.

arrangements.⁴⁷ Growing import dependence, risk of fuel shortage by the mid-1970s, regime of obligatory oil stocks, distinct Member States' policies were the impediments in front of the attempts for market integration.⁴⁸ Nationalization trend got strengthened during that period. In 1981 Communication, Commission expressed its disappointment at the lack of progress for an energy strategy for the Community.⁴⁹ Member States preferred following their own policies or work through the IEA.⁵⁰

Following these failures, the Commission attempted to develop a different approach to manage the energy supply and demand, involving the setting of target objectives such as decreasing the energy imports or the improvement in energy intensities. Nevertheless, in these cases the main concern was to alter the structure of energy balances rather than the structure of energy markets.⁵¹ The main objective of the member states was to ensure security of energy supply. The issue of how far supply security can be associated with self sufficiency and how far countries need to be self-sufficient in terms of energy resources is questionable, but for countries, which are more dependent on external resources, decisions about those resources (whether fossil fuels, nuclear power or renewable energies) will most likely be more sensitive than in a country with substantial and different resources.

We see that there was a tremendous change in the energy balances due to the measures taken by the member states between 1972 and 1986. In this context, energy intensity has increased about 25 per cent and the energy dependence has decreased from 65 per cent to 45 per cent. While the oil consumption was 63 per cent in 1973, it reduced to a level 47 per cent in 1986. The ratio of oil and gas usage in the electricity generation diminished from 40 per cent to 15 per cent. Throughout that period, there has been more than 70 per cent increase in the energy production. The increase in the energy production can be explained with the extensive use of nuclear and oil resources. Nuclear resources provided more than one third of the electricity

⁴⁶ Ibid.

⁴⁷ McGowan, *op.cit.*, p. 2.

⁴⁸ Deketelaere, *op.cit.*, pp. 7-8.

⁴⁹ Ibid., p. 9.

⁵⁰ McGowan, *op.cit.*, p. 14.

generation during that period. Nuclear energy amounted to almost 13 per cent of total energy consumption.⁵²

Since 1980s, the strategic importance of energy has fallen behind with the radical changes in the energy markets. The rationale behind this shift may be explained with the drop of energy prices in the mid 1980s and the more positive supply-demand balance in global energy resource markets and technological and political changes. All the EC Countries have considered free market understanding in the energy sector, although they interpret it differently. Energy sector has been one of the few elements of a planned economy in most of the capitalist countries. Throughout the post-war period, the need to deal with uncertainty in energy markets help to explain the main energy policy concerns. Market disruption and a view that energy import dependence leaves economies out, have been influential incentives for most governments in making energy policy.⁵³ But in late 1980s, policy concerns like environmental protection, encouragement of competition have overcome the earlier concerns. These changes have also altered the interest definitions, involved in the energy policy-making. The large consumers, producers, environmentalists have begun to influence the priorities of energy policy.⁵⁴

By the mid-1980s, the Commission had begun to play a partial role in energy policy-making, although it was far from being central to member states' energy policy agendas. Since then, the scope for a wider Community role in energy policy began to increase. This change was to some extent a result of changes within the Community itself.⁵⁵ Such changes are in parallel with global trends towards a market-based economy. In the EU, such changes have occurred within a special institutional context, which at the same time strengthen, elaborate and adapt such external influences.⁵⁶ In this context, a number of important EU initiatives have been introduced to reinforce the supranational control over the energy sector. On 16 September 1986, the European Council adopted a Resolution, which put the targets

⁵¹ Ibid.

⁵² Çaha, *op.cit.*, p. 1546.

⁵³ McGowan, *op.cit.*, p. 5.

⁵⁴ Ibid., p. 2.

⁵⁵ Ibid., p. 14.

concerning energy sector for the year 1995. In this context, the targets were set as follows;

- Development of the Community's own energy sources,
- Diversification of external sources of supply,
- Improved flexibility of energy systems,
- Common crisis measures,
- Energy saving,
- Diversification between the diverse forms of energy.⁵⁷

With this Resolution, the aim of the Community was to guarantee a sufficient amount of energy supply; control energy prices and encourage research on energy resources, which are environmentally friendly.⁵⁸

The Community had planned decreasing the use of oil and natural gas under 15 per cent until the year 1995. It also aimed at protecting the ratio of oil use in the total energy, which was 40 per cent and it intended to keep the ratio of imported oil, which was one third of total oil demand and keep the ratio of imported natural gas at the same level.⁵⁹ Energy policy agenda of the Commission has also encompassed other aspects like supporting energy efficiency and use of renewable resources through research budgets and other measures. In this perspective, Community gave special attention to improve energy technologies through some projects like JOULE, THERMIE, SAVE, ALTENER and VALOREN.

Single European Act, which was signed in 1987 by the member states, was a turning point for the Community. The Act has stipulated the free movement of goods, labour and capital in the EU. With the enactment of SEA, the Commission has become more active particularly in the areas of market liberalisation and environmental protection. These areas were matching well with the policy techniques of the Commission and the competences and obligations of the relevant Directorates (DG 4

⁵⁶ Andersen, *op.cit.*, pp. 1-2.

⁵⁷ Lyons, *op.cit.*, p. 5.

⁵⁸ Çaha, *op.cit.*, p. 1546.

⁵⁹ *Ibid.*

and 11). The Act modified the three Treaties. The amendments in the EEC Treaty can be summarized as follows;

- Setting up an Internal Energy Market (IEM) by the end of 1992
- Introduction of qualified majority legislation
- Basis for the Commission for legislative initiatives in the electricity and gas sector and more efficient enforcement of Treaty rules on competition and free movement of goods
- Inclusion in the EEC Treaty of provisions designed to protect the environment, calling for a cautious and rational utilization of natural energy resources.⁶⁰

These Single Market policies have had a more strong impact on the energy industries than the former policies about ensuring security of supply.⁶¹ With the signature of the Act, the Commission was able to play more and more visible role in proposing policy and regulating the Community economy as well as the energy sector.⁶²

Gulf War and the internal energy market developments have enforced the Commission to start a new energy policy exercise at the beginning of 1990s.⁶³ The Commission sought to join the International Energy Agency and play a more active role in crisis management to enlarge its role in the area of security of supply.⁶⁴ In that period, energy matters were included to the internal market programme of the EU where competition policy was playing a key role. The most significant changes are associated with the internal market directives on the electricity and gas markets.

Another attempt of the EU was the signature of the European Energy Charter Treaty, which aimed at creating international market regimes that could support reform in the Eastern Bloc, and by this means protect EU's energy supplies.⁶⁵

⁶⁰ Deketelaere, *op.cit.*, pp. 10-11.

⁶¹ Lyons, *op.cit.*, p. 5.

⁶² McGowan, *op.cit.*, p. 14.

⁶³ Lyons, *op.cit.*, p. 5

⁶⁴ McGowan, *op.cit.*, p. 15.

⁶⁵ Andersen., *op.cit.*, p. 2.

In the Treaty of the EU of 1992 (Maastricht Treaty), there were still no explicit provisions on energy, with the exception of the mentioning of *measures in the spheres of energy, civil protection and tourism* as one of the Community's policy areas and the enclosure of the competences on Trans-European Networks to the Treaty.⁶⁶ But the attempts of the Commission and the Parliament to convince the member states for the inclusion of a specific energy chapter to the Treaty were failed.⁶⁷

The Commission issued two policy papers on energy policy; a Green Paper "For a European Energy Policy"⁶⁸ and a White Paper "An Energy Policy for the EU"⁶⁹. It is understood from the policy papers that Community's energy policy was centred on three basic aims; sustainable development, security of supply and competitiveness, although search for competitiveness is seen as the main driving force for the Community Energy Policy.⁷⁰ In the Green Paper, the Commission stressed that with the enlarged integration of the European energy market, new concerns would emerge. To protect the consumer rights, the Commission emphasized the cooperation between the regulatory authorities of the member states, network management and it called for the harmonization of the competition rules by making the distinction between those, which concern the Community, and those which concern a limited number of Member States.⁷¹ There was a widespread debate on the Green Paper between the interested parties.

In October 1995, the Parliament issued a Resolution and drew more attention to environment and cohesion concerns than the Green Paper.⁷² Whilst it accepted the significance of the internal market, it stressed the financial harmonization, consumer rights and respect for general economic interests as well.⁷³

⁶⁶ Deketelaere, *op.cit.*, p. 12.

⁶⁷ Lyons, *op.cit.*, p. 5.

⁶⁸ This first substantial policy document was issued by the Commission in January 1995.

⁶⁹ The second policy document was issued by the Commission in 1995.

⁷⁰ Lyons, *op.cit.*, p. 5.

⁷¹ *Ibid.*, p. 6.

⁷² *Ibid.*

⁷³ *Ibid.*

In November 1995, the Council adopted a Resolution concerning Green Paper which was tense with compromise between States insisting on liberalization and States worried about the need for long-term planning. It concluded that;

(The Council) considers that the operation of the internal market requires the strengthening of consultation and cooperation between the Member States within the Community and the development of Community methods of analysis, in particular with respect to the functioning of the market mechanisms, which could enlighten the Community decision-making process.⁷⁴

In the second part of the Resolution, a set of energy policy objectives was enclosed.

The energy policy goals were set as follows;

- Completion of the internal market in natural gas and electricity
- Regular review of the existing EC legislation in the energy sector and repeal of the rules that are not necessary any more
- Better configuration of energy and environmental goals
- Development of the necessary energy infrastructure, mainly the Trans-European networks
- Strengthening relations with the third countries in the field of energy
- Improvement of energy efficiency and conservation
- Assessment of existing measures and consideration of prospective measures to ensure security of supply
- Diversification of supplies and taking all kind of energy production into consideration that is in line with the provisions of the Treaty regarding safety, security and environmental protection.⁷⁵

After getting feedbacks about the Green Paper from the relevant circles, the Commission introduced the second policy document, the White Paper “An Energy Policy for the European Union”. This Paper embraces a number of key parameters on the energy use in the future. According to the Paper, dependence on imported energy will rise enormously; gas will become the rival of oil in the fuel mix; the European consumers will rely on more grid-supplied energy and lastly there will be substantial flexibility over the future fuel mix, depending on the climate change policy,

⁷⁴ Ibid.

technological effects, renewables and liberalization of the market. In the section of “Guidelines for Energy Policy Implementation” of the White Paper, there was a brief discussion on energy policy at the Community level. It was stated that the energy policy must aim to reconcile contradictory objectives like competitiveness, security of energy supply and environmental protection. The Paper stresses that social and economic cohesion should not be undermined, especially in a competitive market.

Completion of the single energy market, managing external dependency, sustainable development and energy technology research were considered as four future policy areas in the White Paper. All these areas were summarized in an action plan with the target dates for the proposals.

At the end of the White Paper, there was emphasis on the subsidiarity principle. It said that there was a need for harmonizing national policies and a sound Community Strategy.

In order to improve the dialogue between the various actors, the Commission proposed setting up a programme to monitor the energy trends in cooperation with Member States, industry and other bodies. It also called for the establishment of an Energy Consultative Committee under the Commission, consisting of representatives of economic and social actors in the energy sector. So as to accomplish the rules of good governance like transparency, the Commission thought that establishment of such kind of a Committee would be essential. Thus, the final proposal of the Commission was to contribute to the organization of the cooperation between Member States on agreed energy objectives.

In July 1996, the Council adopted a Resolution on the White Paper, stating that the White Paper recognizes the need for bringing the aims of competitiveness, security of supply and environmental protection together and takes the subsidiarity principle and economic and social cohesion into consideration. Member States strengthened their statement on energy policy by saying it “*considers that the agreed common*

⁷⁵ Ibid.

energy objectives identified in the Resolution on the green paper should be implemented at the Community level". The Council also called the Commission for creating a cooperative environment between Community and the member states to assure that the Community and national energy policies are well-matched with the objectives.⁷⁶ Promotion of renewable energies and guaranteeing the transparency of economic indicators were also underlined in the Resolution. In the final paragraphs, it is also understood that member states support the idea of issuing a periodic "*report on the development of energy policy at Community level in relation to agreed energy objectives*".⁷⁷

In a detailed Resolution, the Parliament showed its agreement with the Commission's White Paper but demanded the strengthening of the EU's policy on renewables, the organization of an energy panel for nuclear safety actions in Eastern Europe and the enclosure of an objective to decrease import dependency. Just after the Council Resolution, the Commission submitted a proposal on common energy objectives and founded the Energy Consultative Committee in 1996. It also put forward a proposal for an Energy Framework Programme in 1997 to monitor the future energy trends.⁷⁸

In August 1998, under the amended draft Council Decision with the Parliament's opinion, a set of common energy objectives were agreed by the member states and a framework for energy cooperation between the Community and the member states was called for. The amended draft Council Decision contained three articles.⁷⁹ The possible objectives were presented with an annex list. The objectives were as follows;

- Energy policy objectives should be in line with the objectives of market integration, sustainable development, environmental protection and security of supply.
- Energy market integration should base on the principles of openness and competitiveness to achieve flexibility, energy efficiency and security.

⁷⁶ Ibid., p. 8.

⁷⁷ Ibid.

⁷⁸ Ibid.

Integration should take the diversification of the energy sources and economic and social cohesion through trans-European networks into consideration.

- Transparency in the energy prices should be ensured for the efficient functioning of the market on the basis of fair competition.
- Reconciling sustainable development, energy, and environmental goals is of key importance to accomplish the Treaty objectives. Taking this into account, the full cost of energy production and consumption should be reflected in the price. Renewables and nuclear, but with the highest safety standards, are important economic non fossil fuels in this respect.
- Reinforcing security of supply through enhanced diversification and flexibility of domestic and imported supplies and by developing environmentally friendly indigenous energy resources.
- Ensuring free and open trade and a secure framework for energy investments, which contain environmentally sound technologies and enhancing cooperation with non-member countries to improve energy security and achieve environmental objectives.
- Encouraging energy production by renewable energy sources through supportive measures both at the Community and national levels and increasing the share of these sources in the primary energy production by 2010.
- Improving energy efficiency through coordination of national and Community measures by 2010.⁸⁰

In Article two of the amended draft Council Decision, the roles of the Commission in achieving the energy objectives were laid down. In this context, the Commission has to monitor the energy policy developments and the impacts on the member states. Besides, it should follow the energy trends in the global context. It has to examine the actions of the Community and the member states in the field of energy and the exchange of information between member states. It should contribute to the improvement of the cooperation in the energy field. Furthermore, the Commission

⁷⁹ Ibid.

should develop taxation or an incentive system matching with sustainable energy policy objectives.⁸¹ Final role given to the Commission was to examine the EC actions to support measures taken in the member states.⁸²

Article three called for the Member States to report to the Commission every year about their progress in implementing the measures and it also required the Commission to use the information to prepare a Communication every two years “*on the compatibility of energy policies in the Member States and Community actions in the energy field with the agreed energy objectives*”.⁸³

Although the European Parliament approved the draft Decision with some amendment proposals, the Council was not able to proceed on the dossier, since the Member States did not support it and the legal service of the Council refused the use of a formal Decision, by saying that;

*The above proposal for a Decision does not comply with the Treaty provisions concerning the transfer of implementing powers by the Council to the Commission and is not covered by the proposed legal basis. It must therefore, be re-examined by the Commission in order, particularly, to determine the need for a legislative act and, if necessary, to define the basic rules to be implemented by the Commission.*⁸⁴

With a Commission Decision on November 1996, the Energy Consultative Committee (ECC) was established in line with the foreseen actions in the White Paper. ECC is made up of members representing energy industry, energy consumers, unions, environmental protection organizations and the Commission. The reason for the establishment of the ECC is to get advice from the relevant organizations on the basis of participatory understanding. The Commission may require reports on some energy-specific issues from the Committee and consult on energy policy proposals.⁸⁵

⁸⁰ Ibid., pp. 8-9.

⁸¹ This action was put in the Article 2 of the amended proposal with the suggestion of the European Parliament (Lyons, p. 9).

⁸² Lyons, *op.cit.*, p. 9.

⁸³ Ibid.

⁸⁴ Ibid.

⁸⁵ Ibid.

In 1996, a new Regulation on monitoring the energy investments in the member states was approved by the Council. The aim with the Regulation was to get information on investment projects on the generation, transport, storage, and distribution of petroleum, natural gas or electric power. The required information is about the defined purpose and nature of the investment; the planned capacity or power; the probable commissioning date (or decommissioning), the type of raw materials to be used and the undertakings.⁸⁶ However the member states were quite anxious about the confidentiality of the given information about the investment projects and particularly undertakings.

Such a variety of activities show that the Commission still waited for a formal European competence in energy policy. Its initiatives to formalise its role in the Treaty on European Union were ineffective. The attempts for introducing an energy chapter to the EU Treaty failed, although the Commission submitted a proposed chapter on energy policy before the intergovernmental conference (IGC) that was lead to the Maastricht Treaty. But it was totally dropped, except the enclosure of a Declaration (No. 1) on a common energy policy to the Maastricht Treaty.⁸⁷ The Council and most of the lobby groups rejected the idea of an energy chapter, saying that inclusion of such kind of a chapter was unnecessary indeed.⁸⁸ On the other hand, EP and the Economic and the Social Committee (ESC) were in favour of an energy chapter. For that reason, in 1994, ESC created an own initiative Opinion with a specific proposal for a draft chapter, which started out a framework where public service obligations, concerns about cohesion, harmonisation of financial and environmental actions would all be recognized as legitimate energy policy issues.⁸⁹

1995 Resolution of the EP on the Green Paper included a paragraph, which stated the enclosure of an energy chapter was necessary;

(The EP) stresses that the energy policy aspects of the ECSC and Euratom Treaties and other energy considerations should be integrated within a common energy framework, helping to ensure overall cooperation with regard to security of supply and environmental

⁸⁶ Ibid. p. 13.

⁸⁷ Lyons, *op.cit.*, p. 13.

⁸⁸ Ibid., p. 14.

⁸⁹ Ibid.

*protection, and requests the Commission to include in its forthcoming white paper a draft proposal for an energy chapter to be tabled at the 1996 IGC for inclusion in the Treaty.*⁹⁰

In its proposal as a response to Declaration (No. 1), attached to the Maastricht Treaty, the Commission stressed that the three Treaties must be made simpler and combined, since despite the common coal and nuclear policies under ECSC and Euratom Treaties respectively, neither is necessarily in harmony with the policies on other types of fuels.⁹¹

Even though some member states like Ireland, Italy, Belgium, Greece, Austria and Portugal were in favour of an energy chapter, most of the member states like UK, France, Germany, the Netherlands, and Spain preferred protecting the status quo. Finally in June 1997, no alteration was made in terms of energy policy to the Amsterdam Treaty.⁹²

Although it is highly debatable whether the Commission is successful in securing a formal competence in energy policy, it is obvious that it will continue to develop policies which act as constraint on the policies at the national level. It is argued that the growth of this “regulatory” role is expected to remain the Commission’s most effective means of influencing member states.⁹³ The increasingly regulatory role of the Commission in energy matters has strengthened its position. Lobbying activities towards Brussels, particularly from energy industry circles have gained momentum, which shows that EU institutions are increasingly playing influential role in policy formulation. The formation of specifically European associations for electricity, gas, oil, renewables and conservation industries, the foundation of European branches in large energy firms’ government affairs departments, and the increase in complaints and cases on energy matters taken to the Commission and the Court are indicative of the increasing attempt to influence European institutions in the policy-making process.⁹⁴

⁹⁰ Ibid., p. 13.

⁹¹ Ibid., p. 14.

⁹² Ibid., p. 15.

⁹³ McGowan, *op.cit.*, p. 15.

⁹⁴ Ibid., p. 16.

Although the national authorities still hold their decision making power and abstain from devolving their rights to Brussels, today, governments can no longer discount the role of the Commission in the energy sector. For instance, the British has sought to have an approval for its privatisation plans, the Germans have been negotiating on Commission's objections to coal subsidies or the French and Italians have been defending themselves against accusations of anticompetitive behaviour in the electricity sector. It is becoming clearer that member state authorities have to consider the European dimension in almost all aspects of energy.⁹⁵

The competition rules are a source of greater restriction when there is larger competence given to the Commission in determining how far national means are in line with the Treaty. The Commission is intervening more and more on issues of market structure and the conditions of government support in the energy sector albeit limited. Some of these policy actions have a rather long history (the attempts to restrict subsidies to the coal industry and the reform of oil monopolies).⁹⁶ In the last decade, the extent of Commission activities has increased noticeably and it is largely the result of the desire to develop the internal energy market. In some cases like British electricity privatisation, energy subsidies, application of competition and environmental protection, the Commission has showed its willingness and capacity to intervene. But, the results of these interventions were changeable. In many cases, it has been clear that the Commission has been under substantial political pressure. In fact, it would not be true to say that the regulatory activities of the Commission are not restricted by the member states.

Energy policy in Europe continues to be a national concern and important differences between national policies endure, in spite of the fact that most of the member states meet generally similar problems and challenges. Even though member states are vulnerable in terms of energy dependence and committing to integrate within the EU, governments are still trying to preserve their independent position in the policy-making process because of the very important interests at stake in the energy field

⁹⁵ Ibid.

and the power of the interests involved in the energy sector. Yet the strengthening role of EU institutions - the activism of the Commission and the increasing role of European law - can no longer be neglected by member states: governments have to take more account of the European dimension in energy matters and appoint a regulatory body at the European level –can be European Commission- which will act as the Commissar of the energy market and ensure fair competition among the member states. Nevertheless, today, although the restrictions imposed upon national policies are likely to increase, they hardly constitute a coherent EU energy policy.

2.4. Evolution of an Internal Energy Market in Europe and Role of the European Commission

In Europe, energy markets were dominated by national or regional monopolies, which are vertically integrated electricity companies generating, transmitting and trading electricity to the end users. This has been widely the case for the gas markets as well. In the past, energy utilities were usually under public ownership. Cross-border energy trade was restricted with wholesale transactions among utilities. Cross-subsidies between different groups of national consumers were tolerated. There was no rivalry among utilities and no choice for consumers; national decisions had no direct impact upon utilities or consumers in other countries. The European Community Project aims at freeing the industry from the direct government control in member states and completing the internal market process⁹⁷ particularly after the Cold War Period in line with the political changes in the international arena. Energy sector has become one of the key areas in the European Community Project since the mid-1990s as well. The efforts to privatise and liberalize the energy markets⁹⁸ have gained impetus during that period. The motive behind the efforts for liberalizing the energy markets in the European Union forms part of a greater global process of liberalisation and deregulation. It is believed that the creation of a single electricity and gas market may provide economic benefits in terms of increasing the efficiency

⁹⁶ Ibid., pp. 16-17.

⁹⁷ Internal market process was initiated by the former President of the European Commission Jacques Delors in 1986.

⁹⁸ Internal Energy Market Programme of the EU covers only the electricity industry and natural gas market.

of electricity and gas production. Also, it is believed that increasing competition between producers and suppliers should result in innovation and the transmission of energy to end-users in a more efficient way and contributing to the welfare of European citizens. It is believed that while EU is transforming to an economic, monetary and political union, it has to have a common energy policy for the member states, which is a strategically important issue. According to Andy Klom⁹⁹ first of all, it is necessary to understand the reasons behind the energy liberalization, which are political, economic and legal in essence.

From political standpoint, while countries like United States, Britain, Norway, Argentina, Chile, Australia, Japan and New Zealand had already liberalized their electricity and gas markets and opened them up to competition, the trend was more new for Europe. Efforts for energy liberalization were inescapable in the EU since it had to compete with the reformist countries in global trade and the world economy. Energy industries have been privatised, deregulated and liberalised to improve efficiency; set up a more energy-producing industry; ensure security of supply; attract new foreign investors and largely to split the State from over-regulated, heavily indebted public utilities. According to modern school of thought, these utilities were deemed to be market actors like others but with probably a special role to play in terms of the general public interest.¹⁰⁰

From economic point of view, it is evident that the EU has played a central role in global trade, which means that European companies have to compete with other market players in the world, operating on the basis of different economic factors and inputs. As a result of innovative changes in information and process technologies, many industries are required to compete in a global marketplace. European industries have to cope with severe competition from the economies of East Asia, Central Europe and North America. The competitive advantage of the industries usually depends on energy supply costs. Therefore, European energy consuming industries

⁹⁹ He worked in Unit A3 (Internal Energy Market) of Directorate-General XVII for Energy of the European Commission in Brussels until autumn 1996. He was then posted to the Commission's Directorate-General for External Relations.

¹⁰⁰ Andy Klom (2000), "Electricity Deregulation in the European Union" accessible at <http://www.europa.eu.int/en/comm/dg17/27klom.htm>, p. 8.

need to improve their competitiveness to survive in the world markets. It is believed that free and open access to energy sources should be warranted through competitive market structures to race against the competitive price conditions. From a macro point of view, it is also believed that reinforcing the competitiveness of the energy producing companies will create economic growth and employment, and accordingly augment the level of prosperity. The White Paper on Energy Policy considered industrial competitiveness as one of the key objectives of a common European Energy Policy and it underlined the need for the completion of the internal energy market in Europe. Another document, Ciampi Report on Competitiveness of 1995 argued that unless energy liberalization is maintained, this might have a negative impact on the overall European economy. All these economic concerns put the EU under great pressure.¹⁰¹ However search for an internal energy market in the EU has been from time to time discouraged by a combination of political and market forces due to differences in member state energy markets and protection of national monopolies.

According to Klom, there are also legal reasons for energy market liberalization. The European Community Treaty makes the definition of internal market as *"an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty"*. The aim with the internal market understanding is to create better opportunities for trade, employment and economic growth all over Europe. The internal market covers a number of principles that are significant for economic activity, such as the free movement of goods, the free provision of services and the right of establishment. In this context, electricity is taken as a commodity and selling it is a service and installing a power plant anywhere in the EU is getting the right of establishment according to the Treaty. There are no exceptions for the energy sector in the Treaty in spite of the separate treaties for coal and nuclear. Thus, the EC Treaty provisions entail that other forms of energy (oil, gas, electricity, natural gas) are subject to the general rules enclosed within. The European Commission is empowered to complete the internal

¹⁰¹ Ibid., p. 9.

market process for all the economic areas including energy sector in line with the EC Treaty provisions.

The European Commission gives special attention on four general principles at the European level for the establishment of internal energy market. First, an approach should be developed to enable industry to adapt to the new competitive environment. Secondly, Member states should have the opportunity to choose the best option that suited to their system. Third principle is to avoid excessive regulation and the last principle is to consider a legislative approach involving a democratic dialogue with all the institutions of the EU such as the Council of Ministers, the European Parliament and the Economic and Social Committee.

The Commission's proposal for a single market in energy dated back to its 1988 Green Paper on the internal energy market, which stated that the main impediments to this aim are structures and practices in the member state energy markets that protected the industry from competition. Although the White Paper on the single market in 1985 kept out gas and electricity along with other utilities, these two sectors were placed on the single market agenda by 1988. The Commission envisaged setting up a single regulation model, which guaranteed third party access to the Member State gas and electricity distribution networks. Although the early focus fell on enabling transit between utilities across networks, the Commission's intention in late 1980s was establishing 'common carriage'¹⁰² across the EU.¹⁰³

In 1990 and 1991, the Council of Ministers adopted two Directives on electricity and gas transit¹⁰⁴ and another Directive on price transparency for gas and electricity.¹⁰⁵ In 1994, a Directive on the liberalization of the market for the exploration and production of hydrocarbons (gas and oil) and a Directive on public procurement in

¹⁰² 'Common carriage' means third party access, enabling suppliers free access to gas pipelines and electricity grids through paying the tariff that is set by an independent authority.

¹⁰³ Nick Sitter, "The Liberalisation of European Union Energy Markets: Common Policy and Plural Institutions", paper presented for the Political Studies Association-UK 50th Annual Conference, London, 10-13 April 2000. p.14.

¹⁰⁴ Directives 90/547/EEC, OJ L 313, 13.11.90, P. 30 and 91/296/EEC, OJ L 147 of 12.06.91, p. 37.

¹⁰⁵ Directive 90/377 EEC, 29.06.90, OJ L 185 of 17.07.90, p. 16.

the excluded sector¹⁰⁶ that brought the upstream part of the natural gas market within the scope of the internal market were adopted. Despite the adoption of these Directives, there have still been only trade relations between monopolistic networks and utility companies, which meant that the problem of third party access to electricity and gas networks had still to be solved.¹⁰⁷ The solution of third party access issue is crucial, since it is the essential part of internal market. The Commission's proposals were adopted and entered into force by 1992, albeit the opposition from German and Dutch gas suppliers. The Commission's proposal on a directive liberalising gas and electricity markets, based on Article 100a, calling for a Council approval by Qualified Majority Voting (QMV), was highly resisted by some of the member states because of the 'common carrier' principle and regulated third party access to networks. The energy companies, which own the electricity and gas networks, resisted the third party access principle strongly, because they saw it as a kind of unfair intervention in their industrial activity. Also, the reasons behind these objections can be described with the security of supply concerns; the fear that small consumers might bear the costs of the competition and the arguments that liberalisation would necessitate a large degree of regulation. The Commission accordingly gave in an amended proposal in 1993 in the form of two separate proposals for gas and electricity taking into account their difference.¹⁰⁸

The Council firstly concentrated on the electricity proposal. The debates were centred on the objections of the monopoly utilities to third party access to networks and managerial unbundling, which aimed at separating vertically, integrated utilities' network and trading divisions. Both elements were weakened during negotiations with the strong opposition from utilities, with more focus on negotiated TPA¹⁰⁹ rather than regulated TPA and replacement of 'managerial unbundling' to 'accountancy unbundling'. Throughout 1994, the question of network access couldn't be solved. Since while UK and the Competition Commissioner van Miert pushed for 'regulated third party access', German Presidency insisted on 'negotiated third party

¹⁰⁶ Directive 93/38, 14.06.93, OJ L 199, 09.08.93, p. 84 and COM (95) 107 final, OJ C 138, 03.06.95, p. 49, to amend this Directive and Directive 90/531/EEC, OJ L 297, 29.10.90, p. 1.

¹⁰⁷ Klom, *op.cit.*, p. 10.

¹⁰⁸ *Ibid.*, p. 15.

access' in the second half of 1994. Then the Presidency was handed over to two more reluctant liberalisers, France and Spain, which favoured a 'single buyer model'¹¹⁰ (as an alternative to TPA) that would protect the exclusive rights of utility monopolies of purchasing and selling electricity in the state.¹¹¹ In 1995, French Presidency proposed the 'Single Buyer Model'. This proposed system allows a low degree of market opening for new producers; but it gives much more choice and better efficiency savings for the consumers. With this proposal, a kind of planned economy approach was tried to be introduced for the countries, which were more cautious about the liberalization process.¹¹²

On March 1995, the Commission acknowledged the theoretical compatibility of a modified 'single buyer' system and negotiated third party access. However, the possible consequences for the market of the three systems (NTPA, RTPA and Single Buyer Model) have to be parallel. This necessity brought the principle of reciprocity into question. In this context, the economic outcomes; the degree of market opening and the degree of access to the network have to be equivalent. Further, all three approaches have to be compatible with the provisions of the EC Treaty. However, the Commission argued that single buyer model is not in conformity with the Treaty provisions and does not produce similar results with the NTPA. Moreover, the definition of the eligible consumers is different in the two proposed systems, which is also contradicting with the Article 30 of the EC Treaty.¹¹³ In fact the problem occurs while some countries try to liberalize their markets, some still favour a closed system. Government protection lets the industry increase its competitive advantage, so that it can compete effectively in the global markets, without having the threat of competition in its home market. For example, EdF has an important share in the Argentinean, Australian, Swedish and English power markets, while protecting its

¹⁰⁹ In NTPA, there is the direct sales by the producers to the eligible customers, where the producer has to negotiate with the network operator to gain network access for its supplies.

¹¹⁰ In this kind of system, only one entity can buy and sell electricity within the given area. So all the producers have to sell their electricity to the single buyer and all the customers have to buy it from this entity. Besides, the single buyer controls the calls for tender and would only permit some consumers to make contract for the supply of power from abroad.

¹¹¹ Klom, *op.cit.*, pp. 15-16.

¹¹² A. Johnston, 'Maintaining the Balance of Power: Liberalisation, Reciprocity and Electricity in the European Community', *Journal of Energy & Natural Resources Law*, Vol. 17, No. 2 (1999), p. 126.

¹¹³ *Ibid.*, p. 127.

monopolistic structure in the French power market without any effort to open up its home market to outsiders.¹¹⁴ So, it is understood that the problem here is the lack of reciprocity of access in electricity trade. To reduce the fears of the more liberal states, that are in fact being incapable of avoiding imports from closed systems into their own more liberal structures, the French proposed the principle of reciprocity to protect their single buyer model in the negotiations for the directive. Hence, the outcome was the enclosure of Article 19(5) in Directive 96/92/EC, the 'reciprocity provision'.¹¹⁵ The Commission saw reciprocity as a way to reinforce the Europe wide trading system particularly where yet no multilateral rules existed in a particular sector. Although the European Court of Justice found the reciprocity principle incompatible with the Community legal order, the Community has allowed a degree of reciprocity to promote more Europe wide liberalisation, while giving itself a certain degree of protection against the undertakings from less liberalized countries.¹¹⁶ In order to prevent the market distortion and to meet the reciprocity principle, the Commission proposed some amendments to the single buyer model concerning the degree of choice available for eligible consumers, the import and export regime, the full unbundling of the different functions of the single buyer.¹¹⁷

In 1994, new cases had been brought against France, the Netherlands, Italy and Spain over import/export monopolies in electricity (and gas too in the French case) under limitations of trade between Member States (articles 30, 34 and 37). Although these were in time to fail, decisions against the four states would have damaged the single buyer model.¹¹⁸ In May 1995, opposition groups under the leadership of utilities like Electricité de France and the Netherlands' Gasunie and 30,000 French energy and communications workers protested against liberalisation of electricity and gas markets. In June, Member States decided to accept the Commission's view of the theoretical compatibility of the single buyer model and negotiated third party access. A key compromise was achieved on the issue of network access. This was seen as a big concession on the side of Commission and a victory for French. However there

¹¹⁴ Ibid, p. 128.

¹¹⁵ Ibid, p. 129.

¹¹⁶ Ibid, p. 148.

¹¹⁷ Ibid, p. 127.

¹¹⁸ Klom, *op.cit.*, p. 16.

were still problems on the speed of liberalisation and the qualitative and quantitative thresholds such as target percentages of market opening and definition of eligible customers.¹¹⁹

The European Council maintained the final compromise with the 'Common Position' of 20 June 1996. This compromise was seen as the success for the supporters of limited liberalisation, which considers a single buyer model and imposition of 'public service obligations' and relatively high thresholds. Nevertheless the principle of reciprocity and revision clause restored the balance to some extent, as industry, the Commission and the liberalising states foresaw more liberalisation.¹²⁰

On the gas side, negotiations started during the Irish and Dutch Presidencies in 1996-1997 after the Member States had achieved the compromise on the Electricity Directive. In the case of gas, the single buyer model was opposed and only regulated or negotiated third party access to networks was permitted, although there was the fear that third party access would weaken long-term stability of supply as customers would be unwilling to enter into long-term contracts if the production and transportation of gas were to be decoupled. French and Belgian stress for import monopolies that would in fact provide for a single buyer were questioned by the Council's legal service and then rejected. To ensure third party access in both electricity and gas sectors, first of all grid owners would be permitted to access to other networks; then third parties could be included. The Commission should be informed about the requests for access and monitor the process. The Commission has the right to intervene when necessary through invoking Article 86 or 90, the Treaty of Rome, which let the Commission to take action against the state-owned monopolies that hamper competition.¹²¹

As in the electricity talks, quantitative and qualitative levels of market opening and definitions of eligible customers were the second debated areas among the Member States. In the spring of 1997, the Dutch Presidency discarded its proposed figures on

¹¹⁹ Ibid., p. 17.

¹²⁰ Ibid.

¹²¹ Matlary, *op.cit.*, p. 48.

rapid and comprehensive liberalisation, setting the scene for further weakening of the process of market opening. However there was a considerable market pressure in the gas sector, pushing for more liberalisation. The surplus in the post-Soviet market as demand fell down with the collapse of communism was compounded by a substantial growth of pipeline capacity during the 1990s, including new ways to Russia, Norway and North Africa. Interconnection of the competitive UK market and the continent was also expected to add further downward pressure on prices and increasing industrial consumers' demand for liberalisation.¹²²

Despite the threat of a QMV that had been invoked by the Luxembourg Presidency, a Common Position on Gas Liberalisation was adopted unanimously on December 1997. The agreement envisaged a partial and slow market opening with some scope for temporary derogations¹²³ and Member State discretion in implementation.

Within this context, two Directives 96/92/EC (electricity) and 98/30/EC (natural gas) were adopted by the EU. These two directives are based on the grounds for establishing common rules for the establishment of an internal electricity and gas market. Some of the main features of the electricity and gas directives are as follows:

- Gradually opening the energy markets for gas and electricity¹²⁴,
- Setting the rules for third party access to the transmission and distribution network,
- Setting up a national dispute settlement authority,
- Considering two alternatives for the building of new generating infrastructure: tendering and authorisation procedure,
- Guaranteeing management unbundling of the transmission system operator and account unbundling of transmission and distribution activities from the other rest of the activities.¹²⁵

¹²² Klom, *op.cit.*, p. 18.

¹²³ It permitted temporary derogations over take-or-pay contracts, upon decisions by states or their regulatory authorities depending on established guidelines and possible amendment by the Commission, as well as temporary derogations for growing markets or markets with only one external supplier.

¹²⁴ The liberalisation process focuses particularly on the development of demand side rather than supply side. For instance, liberalisation is measured in terms of market opening by defining the percentage of total consumption accounted for by the end-user free to choose the supplier.

With these directives, eligible consumers are becoming free to choose their electricity or gas supplier in any Member State of the EU. Energy undertakings are free to trade and to invest in all Member States, which signals the opening of national energy systems. Political, legislative or regulatory decisions about energy investment and trading frameworks in one Member State have a potential impact on all EU energy markets. These Directives are not trying to create a homogeneous system throughout Europe; the Commission invokes the principle of subsidiarity¹²⁶ and flexibility for Member States when transposing these directives into their national legislation. Member States have the right to choose the most suitable model for themselves from the Directives. Another principle was that the Commission would stay away from 'excessive regulation', which was a kind of appeasing the member states, which fear that the Commission will set up a major regulatory role for itself.¹²⁷

Although it is believed that the Internal Energy Market provides new opportunities to energy consumers and energy companies, it is still far from being a reality. It is believed that with an internal energy market, economic and technical efficiency as well as security of supply can be enhanced and accordingly European welfare and the competitiveness of the European industry may improve. Furthermore it may contribute to the strengthening of political and economic links with Eastern European and South Mediterranean countries. On the other hand, according to the Council of European Energy Regulators, if the IEM is not well organized and the increasing political, economic and institutional interdependence is not taken into account, it may lead to inefficiencies, high-energy prices and poor quality of service and even endangering security of supply.¹²⁸

¹²⁵ S. Speck and M. Mulder, Competition on European Energy Markets: Between policy ambitions and practical restrictions (CPB Document No 33, July 2003) p. 11.

¹²⁶ Since the Treaty of Maastricht, the principle of subsidiarity is part of the Treaty on the European Communities (Article 5 TEC, formerly Art. 3b TEC). Article 5 TEC refers to the exercise of the shared competencies. The European level can interfere only if the aims cannot be achieved by the Member states individually and that an action by the European Union guarantees more efficiency.

¹²⁷ Matlary, op.cit., p. 49.

¹²⁸ Council of European Energy Regulators (2003), "Completing the Internal Energy Market: The Missing Steps", accessible at http://www.autorita.energia.it/wfer/ceer_internalmarket.pdf

Some circles argue that these directives are incompatible with EU law, since they reflect the efforts to combine diverse institutional and policy preferences of member states, which thus lead to different interpretations by member states.¹²⁹ The intellectuals try to examine this pressure for change to EU-level regulation in the energy markets; on one hand there is an agreed compromise on the liberalisation of energy markets, on the other hand still protectionist behaviours are prevalent. Although, there is a successive process of putting the legislation into effect, it is debatable how far member states transpose these directives and implement them. Completion of the IEM is a difficult and quite slow process. It is strongly influenced by the different speeds of national legal, institutional and industry developments. Some scholars answer these questions with the approach, seeing EU as a plural system in which there is the integration of different member state institutions.¹³⁰

While the liberalisation of the EU electricity and gas markets characterizing the expansion of the Single European Market to the energy sector, both the legal basis for proposals and the 'thicker' norms for decision-making remained a bit uncertain during the process.¹³¹ As with all other SEM legislation, Article 100a² allowed a qualified majority voting in the Council of Ministers to make ineffective the objections of a coalition of member states that benefited from less than 23 weighted votes. This agreement was designed to avoid the more protectionist states from using their veto power. On paper, therefore, only if the European Parliament agreed, a substantial degree of liberalisation could be expected. However these 'thin rules' were compromised by 'thick' norms that reflected the Council's unwillingness to make ineffective a member state on a major issue. Although the co-decision procedure was designed to take the place of the Luxembourg Compromise, which has long protected member states by providing an informal veto to be raised only in cases of 'vital national interest', its status in the 1990s had been controversial. Taking into account the importance of energy in member state industrial policy and the dominance of

¹²⁹ N. Sitter, *op.cit.*, p.1.

¹³⁰ *Ibid.*

¹³¹ *Ibid.*, p. 2.

monopoly operators in the gas and electricity sectors, ministers have abstained from invoking qualified majority voting.¹³²

For some intellectuals, it is clear that there is an ambiguity in terms of institutional rules, which leads to debates over the applicability of comparative political analysis to the EU especially in the energy field. In the 1990s, the EU institutions have begun to play an 'autonomous' role in restraining member states. They are more than simple frameworks within which policy is made, but are seen as "intervening rather than independent variables".¹³³ The preferences of member states are to a certain extent depending on the influence by expert argument, for example from the Commission, or may be shaped through negotiations or a learning process.¹³⁴ In terms of liberalisation of electricity and gas markets, this debate pointed out potential limits to a rational member state driven process, partly through institutional uncertainty and institutional bias. For some intellectuals, the free market orientation of the EU and the SEM project are evidences for an institutional bias on the side of liberalization.¹³⁵ In any adopted approach, actor driven policymaking is restricted not only by institutions, but also by the need to bring different policy making regimes together. For these intellectuals, it is not wrong to say that the EU policy making is somewhat the product of competition between member states, which try to impose their own institutional structure on the EU level. Therefore, despite the agreement on a SEM, the differences in member state regulatory regimes were likely to create conflict over its implementation.¹³⁶ However, for some industry analysts, the actual extent of liberalisation would owe more to a market-driven process and member state government policies than to the provisions of the EU directives.¹³⁷ In this context, it is not wrong to say that the intergovernmental vetoes of the member states confirm the weakness of the EU regulations.

After the entry into force of the directive on electricity liberalisation, questions were centred on its implementation. Several potential problems are found out in the

¹³² Ibid., p.3.

¹³³ Ibid.

¹³⁴ Ibid., p.4.

¹³⁵ Ibid.

¹³⁶ Ibid., p.5.

directives. The difficulties of creating such competitive markets became clear while adopting these directives into domestic national laws, and implementation of the legal and economic requirements of these directives. In March 2000, France and Luxembourg had yet to transpose the directive into domestic legislation, and at the Lisbon Summit, French Prime Minister gave the signals of their opposition to full liberalisation. The main problems were the delays in the implementation of the Electricity Directive. In December 1999, the Commission issued 'reasoned opinions' against France and Luxembourg and the latter was taken to the Court. The reason behind the delays was the governments' difficulties in transposing the new legislation through parliament for domestic reasons: for example, in the French case, the two legislative chambers opposed its transposition; in Luxembourg there were national elections. The Dutch government called upon the reciprocity clause, blocking network access for customers from the less liberalised states consuming less than 100 GWh/y.

In March 2001, the Commission proposed a new Acceleration Directive, which is a renewed version of the electricity and gas directives, taking into account their deficiencies after the first assessment of the implementation of these directives through a benchmarking report¹³⁸, which was published by the European Commission in 2002 with the request of European Council at Stockholm. As a result of weaknesses identified in the evolution of the market and obstacles put out by the benchmarking reports, amending legislation was proposed by the Commission. The new Directives on electricity and gas were adopted by the Council and Parliament on 16th June 2003. The following chapter briefly reviews the results that were underlined in the benchmarking reports and look at the recent developments in the reform of electricity markets in the EU in a detailed manner.

The completion of the internal market for energy is accompanied by measures to reinforce economic and social cohesion, such as the formation of trans-European energy networks. Legislation on Community guidelines in this field and on measures

¹³⁷ Ibid., p. 7.

to create a favourable context for the trans-European networks was adopted during 1996. The decisions on the guidelines include a list of projects of common interest in the trans-European electricity networks. The funding of these projects is principally the responsibility of the transmission system operators in this sector. However, these priority projects are tackling with the administrative, financial and environmental problems which are slowing them. There is still a lot to be done to eliminate the bottlenecks in the networks and improve the interoperability of them.

After all the aim of the EC is the progressive creation of an integrated energy market not only within the Union but also with the neighbouring countries. Surely, such a wider European energy market should be based on common standards about market opening, environmental protection and nuclear safety. The principles governing EU relationships with its neighbours regarding energy policy are set out in the *Communication from the Commission to the Council and the European Parliament on the Development of Energy Policy for the Enlarged European Union, its Neighbours and Partner Countries*, declared in May 2003.

The Document declares that enlarging the benefits of the Internal Market is part of the projection of stability to the countries that surround the Union and is essential for the Union. It also recognizes that the neighbouring countries are crucial to EU energy policy as suppliers and transit countries.

The Communication does not imply adopting all standards and regulatory frameworks to neighbouring countries, but rather similar levels of market access and adoption of equivalent standards.

In June 2003, after a long period of negotiation, it was agreed that all commercial and industrial energy users in Europe should have been awarded as eligible consumers by 1st July 2004 and the member states should fully open their energy markets to competition by 2007, which means all households will become eligible in

¹³⁸ The report was prepared with the information gathered from market actors and government agencies following a detailed survey. Besides, several individual studies were conducted by DG Energy and Transport and external consultants.

mid-2007. However, only very few member states open their markets for commercial and industrial consumers according to the deadline, 1 July 2004. The United Kingdom (UK), Germany, Spain, Austria, Norway, Denmark, Sweden and Finland in theory all have 100 per cent market opening, even if only the UK and the Scandinavian countries are regarded as fully-functioning competitive markets. It is believed that the opening of the markets will pave the way for a single European energy market, offering consumers access to competitively priced electricity across Europe. In practice, it is witnessed that there are still many obstacles to full competition.

The electricity and gas sectors have exceptional situations, which are nationally-oriented segmentation and monopolies. In order to realize the internal market programme, the Commission's approach is to put an end to the monopolies and to put these different national market segments under a European-wide regulatory framework. It tries to perform these changes on the basis of its own competences under European competition law, as a way to put some pressure on the member states to go for harmonisation in the Council, whereas in doing that, it fails to a great extent. It is not wrong to say that intergovernmental elements are prevalent in the case of electricity sector regulation. Despite the supranational competences of the EU institutions, it is observed that most of these competences were not used or only taken up with unwillingness and delay due to pressures coming from different interest groups.¹³⁹ Finally some would argue that the single competitive market will remain doubtful in the long run.

¹³⁹ S. K. Schmidt, 'Sterile Debates and Dubious Generalisations: An Empirical Critique of European Integration Theory Based on the Integration Processes in Telecommunications and Electricity' (MPIFG Discussion Paper 96/5, max Planck-Institut für Gesellschaftsforschung), p. 23.

CHAPTER 3

AN INTERNAL ELECTRICITY MARKET FOR EUROPE

Electricity is a crucial part of our everyday lives. Changes in political and economic philosophy have required greater study of this sector and its structure. In a sector historically, politically and economically sensitive for many years calls for reform and liberalization met with considerable resistance. Since the original economics of creating a national system required a monopolistic structure in the field of network construction, given the substantial economies of scale involved and the advantages to be gained in coordinating production, transmission and distribution facilities. After all, since electricity cannot be stored, available supply and thus production capacities must match with the fluctuations of demand, which was usually best provided by coordination between these functions and planning, or often integration of them in a single, usually state owned entity.

Due to the above-mentioned reasons, the negotiations on liberalization of electricity markets in the EU have been difficult and long-lasting. The requirements of this new phase of liberalisation bring uncertainty with it as well. However widespread belief in the Western world is that liberalizing the electricity markets at the European level is necessary to stimulate competition and economic growth. Presenting its strategic objectives for 2000-2005 (COM (2000) 154 final, 'Shaping a new Europe'), the Commission pointed to energy to be a key factor for Europe's competitiveness and economic development. As it was stated in the previous chapters, the basic aim of the EU's energy policy, as set out in the November 2000 Green Paper on the security of energy supply, is to ensure the supply of energy to all consumers at affordable prices while respecting the environment and promoting healthy competition on the European energy market. Creation of a single electricity market (SEM) is part of the

energy policy and has long been a priority of the Community. The creation of the SEM, which is still under way, has proceeded in stages. Before examining the development of SEM, first of all the provisions of 96/92/EC Electricity Directive will be taken into consideration, which ensures the free movement of electricity within the Community. The new Electricity Directive and its provisions will be handled under another sub-title within this chapter, followed by the implementation of the Directives across the EU and the main impediments in front of the SEM.

3.1. The Electricity Market Directive 96/92/EC

The Electricity Market Directive (96/92/EC) ushered in a wave of liberalisation across the EU. EC points out that for a healthy SEM, it is necessary for the member states to transpose the electricity directive into their national laws. It argues that introduction of competition into the electricity markets might increase efficiency. Accordingly, increase in efficiency might lead to a downward trend in electricity prices. Furthermore, it is believed that creation of a single electricity market is of utmost importance to prevent the imbalances in electricity prices between member states, which are important barriers in front of effective competition. Also, EU has felt the need to increase its competitive power against United States and Australia, which have had relatively low electricity prices than EU. It was believed that deregulation and liberalization of electricity markets would give consumers greater choice in supply and improve sales, marketing schemes and customer services. The Commission also believes that an interconnected market calls for less reserve capacity, which is in fact expensive.¹⁴⁰ In addition, electricity producers will have to use resources better in the electricity production process to evade waste of resources, since wasting resources is both expensive and polluting. Last of all, the fall in electricity prices may result in lower production costs for all European industry. However, it is debatable how far the Commission has achieved these objectives through the electricity directive. In the final part of this chapter, this issue and the impediments in front of the SEM will be scrutinized in detail.

¹⁴⁰ Speck and Mulder, *op.cit.*, p. 12.

Although it took so long for the EC to turn its attention to the electricity industry, an Electricity Directive was enacted by EP in 11 December 1996 and formally adopted on 19 December by the European Council. The text of the Directive laying down common rules for the internal electricity market was published on 30 January 1997 and came into force on 19 February 1999. Member states had to transpose the directive into their national law at latest 1999, although Belgium, Ireland and Greece would transpose it after a short transition period due to the technical restrictions in their systems. The directive concerns access to the grid, mechanisms for entry into power generation and access by some end-users to alternative EU power generators or suppliers.

The provisions in the Electricity Directive 96/92/EC can be summarized as follows;

- The liberalization of generation to spur competition either by establishing an authorization procedure or tendering procedure for the installation and operation of new generating capacity,
- An independent transmission and distribution system operator that are appointed by each member state for operating, maintaining and developing the transmission system,
- Unbundling and transparency of the accounts of the vertically integrated electricity companies to hinder cross-subsidization, market distortion and discrimination. Besides the unbundling of the account, unbundling of management is required where a vertically integrated company is also having the role of single buyer.
- Non-discriminatory access to the network systems should be ensured by the member states through either negotiated third party access (NTPA) or regulated third party access (RTPA)¹⁴¹ or single buyer (SB) model,
- Initial amount of 26 per cent market opening (calculated on the basis of the Community share of electricity consumed by final consumers who consume more than 40GWh annually); an amount of 27 per cent for the market opening (with the consumption threshold of 20GWh) and 33 per cent market opening six years after the date of implementation with a consumption level

of 9GWh per year. Table 3.1.1. indicates the required market opening levels in the electricity directive. Besides the eligibility thresholds mentioned above, the directive had left each member state free to establish additional criteria to identify the eligible customers who could freely negotiate with the electricity suppliers. According to the Directive, each state had to define its eligible customers by 31 January each year.

- Non-discriminatory and clearly-defined security and public service obligations should be ensured by the electricity companies to guarantee security of supply, regularity and environmental protection.
- Establishing requirements for national dispute settlement authority but not as an independent regulatory body.
- Adoption of the principle of reciprocity, which refers to equivalent or 'reciprocal' market opening.

TABLE 3.1.1. Market Opening Levels

Threshold level	40GWh	20GWh	9GWh
Market opening (per cent)	per cent ²⁶	per cent ²⁷⁻³⁰	per cent ³³
Implementation date	19-Feb-99	19-Feb-00	19-Feb-03

Source: Datamonitor

3.2. The New Electricity Directive

After the entry of the Directive 96/92/EC into force, there have been some positive developments in the EU electricity market such as increase in efficiency, certain price reductions. But surely the progress was not sufficient and there were problems in the functioning of the market such as market concentration. Since the Directive's

¹⁴¹ In RTPA, the regulatory authority of the member state sets fixed tariffs, that have to be applied by the vertically integrated companies and their competitors.

entry into force on 19 February 1999, changes have been implemented at an unexpected speed, and generally far beyond the targets. In March 2001 the EC issued a proposal on a draft Directive setting 'common rules for the internal market in electricity and gas' (COM (2001) 125 final) to complete the liberalisation of the EU energy markets. The aim with a new Electricity Directive (2003/54/EC) was to eliminate the deficiencies of the first Directive.

The key points in the new Electricity Directive are as follows;

- Establishment of a national body to function as a regulatory authority in each member state. (The Authority has to be separate from industry but not necessarily from government.)
- All reference to the single buyer model is removed.
- Authorisation procedure becomes essential in controlling the establishment of a generating plant.
- Compliance programmes within network operators to show non-discrimination is compulsory.
- Negotiated third party access is no more allowed; access has to be by published network tariffs. The new Directive only allows for 'regulated third party access' to ensure fair access to the network.
- Rules and tariffs governing network access and the balancing market become more objective and transparent.
- Member states are permitted to examine the accounts of supply activities.
- Public service obligations are more strengthened, specifically for vulnerable customers.
- To eradicate discrimination in network access (New Directive requires that all electricity companies separate their transmission and distribution activities from all other activities and create specific legal entities in charge of each of these network activities. This 'legal unbundling' requirement will be added to the existing accounts and management unbundling, which requires companies to keep separate accounts for network and competitive activities and to

manage them separately from one another, with separate staff and separate decision-making procedures.¹⁴²⁾

The new Electricity Directive has become part of Community law with the main provisions entering into force on July 2004. This event together with the enlargement of the EU to twenty-five Member States means that the electricity market has begun a new stage of development. It is believed that this reform helps to create a more efficient and dynamic energy sector offering high standards of public service by means of encouraging competition and cross border transactions.

The proposal has foreseen the opening of the market to all non-household customers by 1 July 2004 and to all customers by 1st July 2007. Although this is now a part of Community law only very few countries have opened their markets according to the deadline, envisaged by the new Electricity Directive. Also, most of the new member states fell short of reaching these targets for market opening.

For the electricity exchanges, a Regulation governing cross-border trade in electricity was passed in 2003, which envisages establishment of a regulatory committee to decide on guidelines on costs of transit flows, on coordination of national transmission tariffs and on distribution of cross-border interconnection capacity.¹⁴³

3.3. The Florence Forum

Significant contributions have been made to the development of internal electricity market in Europe through Florence and Madrid Forums. The Forums discuss aspects of the creation of an internal energy market that are not fully addressed in the Directives.

¹⁴² MEDA – Regional Energy Project under the Framework of the MEDA Regulation, Reform of the Legal and Institutional Energy Sector Framework: Study on Structural Obstacles and Reform Challenges, 3rd Draft, 17 March 2003, p. 9.

¹⁴³ Europe and MED Desk EURELECTRIC, Electricity Sector Reform: the pan-European, CIS and Mediterranean Dimension (Brussels, June 2003), p. 18.

Florence Forum was founded in 1998. It convenes twice a year and comprises national regulatory authorities, member states, representatives of the EC, TSOs, electricity traders, consumers, network users and power exchanges.¹⁴⁴

During the meetings, cross border trade, tariffs, management of interconnection capacity and technical and commercial obstacles in front of the IEM are the main issues of interest.

3.4. Implementation of the Electricity Directive across the EU

After the first Electricity Directive had entered into force, the Commission has begun to concentrate on the adoption of the Directive into national laws. In order to follow up the implementation process, DGXVII came together with the member state officials regularly in 1997 and 1998. Later, DGXVII created a follow-up group consisting of member state officials for the exchange of ideas.¹⁴⁵

The Commission first announced its appraisal of market opening in November 1997 in the Official Journal, stating that the degree of market opening was higher than the amount envisaged in the Directive. In a report of 1998, the Commission evaluated the progress in transposing the Directive by member states quite satisfactory.¹⁴⁶

Establishment of an internal electricity market brings new questions into mind concerning how the rules of international trading would be set and how the interoperability of the systems would be maintained.¹⁴⁷

As it was mentioned in the previous chapters, the Electricity Directive is a compromise. It does not create a homogeneous system. A measure of subsidiarity is provided with the Directive, so that member states choose the best option that suits their national structure. Thus, each member state has the right to choose a different liberalization model.

¹⁴⁴ Ibid, p. 10.

¹⁴⁵ P. Lyons, *op.cit.*, p. 32.

¹⁴⁶ Ibid., p. 33.

The timetables for market opening vary from country to country. For instance, Belgium was given an extra year to transpose the Directive. But the Belgian government decided to open the 45 per cent of the market, which was in fact over the amount of 26 per cent market opening, required by the Directive. Ireland had also one year derogation from the Directive and therefore began to apply the commitments of the Directive in February 2000. Similarly, Greece benefited from the Article 27(2) of the Directive by having an extra two years of derogation from the Directive.

While, some countries like UK and Sweden had already liberalized their electricity markets, some member states like France and Greece act cautiously during the adoption of the new legislation. Spain and Netherlands opened up their electricity markets ahead of the Directive. Germany, had already 100 per cent opened up its market, which means that all consumers are eligible.

Due to the political problems (strong resistance from the Communist Party), France opened its electricity market a year later than the deadline in the Directive unlike the other member states. For that reason, she was taken to the court by the European Commission for violation of EU law. Most of the member states and especially UK and Germany have complained about the behaviour of France, since while Electricité de France (EdF) can enter the other markets, it was not such that easy for the companies of the other member states to enter into the French electricity market.¹⁴⁸ Electricity market of France is one of the major markets in Europe. France has opted to keep market opening at the minimum level required by the Electricity Directive. In recent months, the French Regulator, CRE, has been tougher in its efforts to advance liberalisation. However, the opening of the industrial and commercial market does not show its effect in the market. Despite the limited generation capacity sales, the electricity market is still dominated by state-owned electricity company Electricite de France (EdF). EdF has total domination of the wholesale market as well as a strong brand and financial power. Despite the liberalization efforts, it is believed that most

¹⁴⁷ L. Nardoni, The European Electricity Markets, Reuters, p. 8.

of the industrial customers have found it difficult to get better deals from suppliers other than EdF. Also it is believed that this has been also especially the case for the smaller consumers.¹⁴⁹

Unlike France, the German electricity market has been opened to competition in 1998 and all consumers have become free to choose their suppliers. The direct impact of liberalisation was a rapid fall in electricity prices to end consumers. However, there are still impediments in front of the new market entrants. The main problem in the market is the dominion of two German utilities, RWE and E.ON, which controls the 60 per cent of the whole generation. However, there are some efforts to decrease the supremacy of these two utilities over the others in the market. For example, a new regulator is assigned to monitor the market functioning and ensure fair competition among the market players. Other problems in the market are the absence of regulated third party access; lack of unbundling; widespread price-matching and high transmission charges for electricity.¹⁵⁰

Like most EU power markets, the Italian electricity industry is undergoing restructuring and deregulation to enhance competition. Unlike France, Italy has gone beyond the minimum requirement concerning market opening that is set by the EU Electricity Directive although it had to tackle with bureaucracy and local resistance to new ideas. Today the Italian electricity market is one of the high priced electricity markets in Europe. Supply is not enough to meet the high demand, for the reason Government introduced a new Law to attract the private investors for investment in the power generation sector and there, now, exists a strong political dedication to further liberalization.

Table 3.4.1. contains an assessment of the current position in the electricity sector. This table demonstrates the progress that is made in developing a successful framework for competition in the electricity sector. It shows that, in 2003, market opening has been extended and the unbundling strengthened in many member states,

¹⁴⁸ Ibid., p. 9.

¹⁴⁹ S. Roth, 'Europe: One Market? Not Quite', *Energy Markets*, Vol. 9, No. 8 (2004), p. 39.

¹⁵⁰ Ibid, p. 40.

for instance, Belgium and the Netherlands. Plans are also being made to reinforce the role of regulators in, for example Germany and some of the acceding countries.¹⁵¹

TABLE 3.4.1. Implementation of the Electricity Directive

	Declared Market Opening (per cent)	Unbundling: TSO	Unbundling: DSO	Regulator	Balancing conditions favourable to entry	Biggest generator's share of capacity (per cent)
Austria	100	Legal	Accounts	Ex-ante	Favourable	6
Belgium	80	Legal	Legal	Ex-ante	Unfavourable	59
Denmark	100	Legal	Legal	Ex-ante	Favourable	0
Finland	100	Ownership	Accounts	Ex-post	Favourable	11
France	37	Management	Accounts	Ex-ante	Moderate	78
Germany	100	Legal	Accounts	Planned	Unfavourable	23
Greece	34	Legal/Mgmt	Accounts	Ex-ante	Unfavourable	85
Ireland	56	Legal/Mgmt	Management	Ex-ante	Moderate	80
Italy	66	Own/Legal	Legal	Ex-ante	Moderate	43
Lux.	57	Accounts	Accounts	Ex-ante	Unfavourable	0
Nether.	63	Ownership	Legal	Ex-ante	Favourable	n.k.
Portugal	45	Ownership	Management	Ex-ante	Moderate	59
Spain	100	Ownership	Legal	Ex-ante	Favourable	37
Sweden	100	Ownership	Legal	Ex-post	Favourable	16
UK	100	Ownership	Legal	Ex-ante	Favourable	16
Norway	100	Ownership	Accounts	Ex-ante	Favourable	12
Estonia	10	Accounts	Accounts	Ex-ante	Unfavourable	15
Latvia	11	Legal	Legal	Ex-ante	n.k.	0
Lithuania	17	Legal	Legal	Ex-ante	Moderate	0
Poland	51	Management	Accounts	Ex-ante	Moderate	4
Czech Rep.	30	Legal	Accounts	Ex-ante	Unfavourable	43
Slovakia	41	Legal	Legal	Ex-ante	Moderate	29
Hungary	30	Accounts	Accounts	n.k.	Moderate	5
Slovenia	64	Legal	Accounts	Ex-ante	Unfavourable	16
Cyprus	0	Management	None	Ex-ante	Not decided	100
Malta	0	Derogation	None	n.k.	Not decided	100

Source: European Commission, DG TREN Draft Working Paper: Third Benchmarking Report on the Implementation of the Internal Electricity and Gas Market (Brussels, 1 March 2004)

¹⁵¹ European Commission, DG TREN Draft Working Paper: Third Benchmarking Report on the Implementation of the Internal Electricity and Gas Market, Brussels, 1 March 2004, p. 5.

3.5. Obstacles in front of the Internal Electricity Market

The main obstacles to competition in the first Benchmarking Report were summarized as follows:

- *Excessively high network tariffs, which form barriers to competition by discouraging third party access, and may provide revenue for cross subsidy of affiliated businesses in the competitive markets,*
- *a high level of market power of existing generation companies combined with a lack of liquidity in wholesale and balancing markets which is likely to expose new entrants to the risk of high imbalance charges,*
- *network tariff structures which are not published in advance or subject to ex-ante approval, this may lead to uncertainty and create costly and time consuming disputes unless combined with full ownership unbundling,*
- *insufficient unbundling, which may obscure discriminatory charging structures and lead to possible cross subsidy.*¹⁵²

According to the Report, in many respects, there has been more rapid progression than expected. In terms of market opening, some member states have gone further than the minimum requirements of the electricity and gas directives. On the other hand, some have inadequate market opening than that was foreseen.

With the request of the European Council in Barcelona Summit in March 2002, the Commission issued the Second Benchmarking Report on the progress of the implementation of the directives in October 2002. In the Second Benchmarking Report, following points were underlined;

- *differential rates of market opening continue to reduce the scope of benefits to customers from competition, leading to higher prices than otherwise to small businesses and households, and also promote distortion of competition between energy companies by allowing the*

¹⁵² European Commission, Implementing the Internal Energy Market: First Benchmarking Report (Luxembourg: Office for Official Publications of the European Communities, 2002) p. 2.

possibility of cross-subsidies at a time when companies are restructuring themselves into pan-European suppliers;

- *disparities in access tariffs between network operators which, due to the lack of transparency caused by insufficient unbundling and inefficient regulation, may form a barrier to competition;*
- *the high level of market power among existing generating companies associated with a lack of liquidity in wholesale and balancing markets which impedes new entrants;*
- *insufficient interconnection infrastructure between member states and, where congestion exists, unsatisfactory methods for allocating scarce capacity.*¹⁵³

So it is not wrong to say that the key barriers in front of the market evolution are the broad range of secondary legislation which was enacted to impose the directive and the lack of transparency concerning the rules on market access.

Limited interconnection capacity is one of the important obstacles in front of the internal market evolution. There are no rules concerning the allocation of capacity to competitors. This poses a great challenge for the functioning of the market. The limited interconnection capacity is usually reserved by a small number of suppliers in the market with long-term contracts. In this case, rather than the directive, the EU competition rules have to be applied to solve the problem. However, in such cases, the application of competition rules about the restricted access to interconnectors falls under the area of national authorities, as stated in the Article 20/3 of the directive. So, each national authority finds a different way to solve the problem.¹⁵⁴

Even though non-discriminatory, transparent and objective behaviour of each market participant is quite necessary, it seems that the rules concerning third party access refusal and tariffs are not clear and this leads to lack of transparency and discrimination among the market players. Companies might use their dominant position, trying to keep their competitors out of their markets. In order to prevent such kind of a market abuse, it is believed that the third party access has to be regulated. In Europe, only Germany considers negotiated third party access, which means that industry participants agree on the third party access to the grid. The

¹⁵³ Commission Staff Working Paper, Second Benchmarking Report on the Implementation of the Internal Electricity and Gas Market, Brussels, SEC(2002)1038.

¹⁵⁴ Ibid., p. 10-11.

problems of the NTPA can be summarized as follows; higher prices relative to other European countries distance based tariffs and lack of transparency.¹⁵⁵ For example US-based Enron stated its complaint against Elektromark (a local distribution grid operator) to the German Federal Cartel Office, stating that Elektromark refused Enron Energie access to its network on the grounds of shortage of capacity. Federal Cartel Office put its position on the side of Enron, stating that the access refusal could be, by no means justified, Elektromark had used its dominant position against the other players. Similar complaints have been forwarded to the Federal Cartel Office, which shows that unclear rules on TPA pose a great challenge for the functioning of the market.¹⁵⁶

Although, Article 82 of the Rome Treaty forbids the companies' exploitation of their dominant positions in the market, it is widely believed that in order to create national champions in the EU member states, most of the competition authorities have eased their controls over the concentrations in the market and permit dominant positions. In the short run, it is foreseen that the mergers in the wholesale electricity market will endure in the EU. The increasing market concentration has led to the withdrawal of many medium and small sized firms from the market. Companies, which are called as 'national champions' such as EdF, Enel, Rwe, Eon and Vattenfall have begun to dominate the market. The shares of these companies in the EU electricity market are as follows;

¹⁵⁵ Ibid., p. 13-14.

TABLE 3.5.1. Shares of Companies in the EU Electricity Market

Name of the Company	Origin	Shares in the EU Market (per cent)	Structure of the Company
EdF	France	17.0	per cent 100 Public Ownership
ENEL	Italy	8.0	per cent 100 Public Ownership
RWE	Germany	7.0	Private Ownership
Eon	Germany	7.0	Private Ownership
Vattenfall	Sweden	3.2	per cent 100 Public Ownership
International	Britain	2.7	Private Ownership
Electrabel	Belgium	2.7	Tractabel per cent 40 Communes per cent 5 Tractabel Suez
British Energy	Britain	2.6	Private Ownership
Iberdrola	Spain	2.3	Private Ownership EdP per cent 2
EnBW	Germany	2.0	EdF per cent 34
PowerGen	Britain	2.0	Private

Source: C. Turmes, MEP of the European Parliament, (2003), 'Briefing on the Directive on the Liberalisation of the Electricity Market', accessible at <http://www.eu-energy.com/fs-MarketConcentration-final.pdf>

This increasing market concentration has added much to the Eurosceptic views, which see the EU as a platform of pursuing national self-interests. The inadequacy of EU regulations and institutions has led to mistrust among the member states, which have relatively low competitive advantages.

Another obstacle in front of the internal electricity market is the "stranded costs"¹⁵⁷. Although there is not an explicit definition of stranded cost in the Directive, in Article 24/1 of the Directive, it is stated that *"the existence of commitments or guarantees of operation given before the entry into force of the directive may not be honoured on account of the provisions of the directive itself"*. According to this

¹⁵⁶ Ibid., p. 14-15.

¹⁵⁷ Stranded costs are defined as the market value of a firm's assets minus their historical, depreciated book value. For details, see L. Nardoni, p. 15.

provision, stranded costs can be defined as the "costs of liberalization".¹⁵⁸ So in order to protect the companies from the costs of liberalization, companies should get some kind of reimbursement for the costs caused by the beginning of competition. In order to cover the "costs of transition to competition" (CTC), Spain envisages a transitional regime in its Electricity Act. The aim with CTC is to give partial compensation to each electricity generating plant for a period of 10-15 years, because of a likely decrease in the spot market prices. However, in July 1999, European Commission rejected Spanish allegations that the CTC should be examined under Article 24 of the directive and stated that CTC should be covered under state aid rules. There are also other questions concerning compensation schemes such as whether the companies, which get such compensation, might have an unjust competitive advantage over their competitors and whether prices can fall to a real market level despite the compensation schemes and if not, who will have to uphold such a burden.¹⁵⁹

Lack of common rules for taxation and the unclear electricity costs and prices are other impediments in front of the internal electricity market.

The electricity trade between member states was made to balance the efficiency of neighbouring systems in the short term, rather than the trade in the traditional sense. Distinct national policies on the industry, especially on the issue of the construction of new capacity, created a new trade environment, in which countries with important excess production capacity began to sell their excess capacity to their neighbours, where the national requirements could not be met. For instance Italy became a significant net importer of electricity from France. These new trade patterns have brought new problems together. For example, France with its excess production capacity due to its over investment in nuclear power in 1970s and 1980s, EDF was forced to find a place in the foreign markets to trade the over capacity. Due to the low operating costs of the French nuclear power plants, EDF could offer the best prices in the market especially to the neighbouring countries like Italy. But, when non-neighbouring countries want to import electricity from EDF, the question of transmission across the immediate neighbouring member state was raised. Such kind

¹⁵⁸ Ibid., p. 15.

of problem occurred between Portugal, France and Spain. Portugal wanted to import electricity from France but the neighbouring country, Spain wanted an extra charge for its intermediary role. The threat of EC intervention made them reach to an agreement.¹⁶⁰ Another problem had occurred when the large German consumers would like to import electricity from France. Local utilities in Germany strongly resisted to this, since they saw this as a reliable customer is defecting to another supplier to prevent the local utilities' comparatively high charges. These examples show that France had proved a major means in creating a political reaction to the internal electricity market ambitions of the European Commission, which turned out to be more favourable than might have been expected.¹⁶¹

Under an integrated system, the prices are usually expected to be similar, whereas the price of electricity differs markedly among the member states. This points out that the process of market integration has not been completed yet. The determining factor here is the distances between the areas of production and consumption and the degree of integration.

The current situation also shows that there is still lot to do for the member states to form an EU-wide electricity market. Although the legislation says that all European member states have to open their industrial and commercial markets to full competition, only two European member states had adopted the new EU gas and electricity directives before the 1 July 2004 deadline so far. Only Slovenia and Netherlands transposed the directives and a small number of member states out of 25, Denmark, Hungary and Lithuania have adopted most of the measures. The EC is now looking for considering legal action against the member states that have not transposed the directives.¹⁶²

Some analysts see Western countries as copying the policy models of Britain and the United States, which were the first nations to adopt liberal reforms; others see

¹⁵⁹ Ibid, p. 16.

¹⁶⁰ Johnston, *op.cit.*, p. 124.

¹⁶¹ Ibid, p. 124-125.

¹⁶² S. Roth, 'Competition Delayed', *Energy Markets*, Vol. 9, No. 8 (2004), p. 11.

European Union and North American Free Trade Agreement countries as subjected to regional electricity sector integration by supranational regional agreements. However, the current situation in the EU demonstrates that national interests have limited domestic electricity market reforms in most of the member states despite their participation in regional electricity market integration projects. The international energy system is characterized by a rivalry between different markets with different features ranging from liberalized to regulated/monopolized markets and from market prices to regulated subsidized prices. Although the main task of the supranational authorities is to manage and rule the flows of energy trade and investments between these different market fragments, governments generally want to hold their controlling influence on issues of energy industry activities, even if the industries have been privatized. National interests are preferred to be pursued in an intergovernmental formulation and most of the member states want to implement their own domestic electricity policies. As a result, multilateral governance faces challenges on the international and domestic levels, since these different levels have mutual impact on each other.

CHAPTER 4

ELECTRICITY MARKET IN BRITAIN

Energy policy of Britain has undergone some remarkable changes over the last two decades. The government has begun to support market-oriented understanding against statist understanding in the energy sector. This change in policy has taken place after an impressive change in the energy balances of Britain. These market oriented policies coincided with Britain becoming self-sufficient in energy, which was not the case anywhere else in the European Community. Some have argued that these two changes are connected, since only a self-sufficient country in terms of energy resources could meet the expense of a market-driven energy strategy, reducing the traditional concern of policy makers with supply security in favour of other objectives.¹⁶³ On the other hand, although there was a clear shift in policies, the government's overall approach to energy has not been undermined. In this chapter, firstly the energy balances of Britain and the development of British energy policy will be examined in depth. Then, the chapter will focus on the policies of privatisation and liberalisation particularly in the electricity sector, which were introduced with the acceptance of market-driven strategies. The chapter also examines how the energy policy of Britain has been affected by the policies of the EU and their relationships on energy matters.

4.1. Energy Balances in Britain

United Kingdom (United Kingdom of Great Britain and Northern Ireland) is a major political power, which has the world's fourth largest economy (according to 2003 nominal gross domestic product). The country has been a member of EU since 1973.

¹⁶³ McGowan, *op.cit.*, p. 130.

Before examining the energy policies of Britain, it is necessary to go over the basic features of British energy sector and the energy balances.

In terms of primary energy resources, Britain played a pivotal role in the industrial field during nineteenth and twentieth centuries due to the availability of cheap coal. Nearly 70 per cent of coal is produced in England, followed by Scotland and Wales, which have 25 per cent and 6 per cent shares in coal production respectively.¹⁶⁴ Although UK was an important exporter of coal historically, it has become a net importer of coal since mid-1980s. Today it imports coal from South Africa, Australia and Russia.

The sector was under the auspices of British Coal, which was formerly named as National Coal Board. Then it was nationalized in 1947. It was responsible from deep-mined production and marketing coal. In 1995, the sector was subject to privatisation scheme like the other industries.

The significance of coal has been going down over the past decades. Coal production in the UK fell from 119 million short tons (Mmst) in 1986 to 32.6 Mmst in 2002. Like production, UK demand for coal has decreased drastically, from 123 Mmst in 1986 to 64.3 Mmst in 2002. The reason behind this fall is explained with the increased use of natural gas for thermal electric generation. Invention of potential oil and gas reserves in the North Sea has augmented the fall of coal. Retreat of coal has required some protective measures such as subsidies to the National Coal Board, prohibition of coal imports and taxation of petroleum products. However large increases in the wages of coal miners impeded the retreat of coal. Instead, new coal mines were added to the old ones in 1985.¹⁶⁵ After 1986, coal production and consumption has seen a dramatic downturn following a year-long strike, the establishment of pollution-abatement goals and disintegration of the Central

¹⁶⁴ Energy Information Administration, United Kingdom Country Analysis (April 2004), accessible at www.eia.doe.gov/emeu/cabs/uk.html

¹⁶⁴ Ibid.

¹⁶⁵ G. Carmoy, Energy for Europe: Economic and Political Implications (Washington D.C.: American Enterprise Institute for Public Policy Research, 1977), p. 40.

Electricity Generating Board.¹⁶⁶ While in late 1980s, the two thirds of UK's thermal electric generation was provided by coal-fired power plants, its share has dropped to 32 per cent in 2002.¹⁶⁷

According to some circles, despite the downward trend, coal-fired generation may increase up to the new circumstances in the energy balance. For example, high natural gas prices in 2001 and 2002 led to an increase in coal consumption. It seems that the power sector continues to be the largest end-user of coal in the UK in the coming years. According to some projections, all coal-fired electricity generation may end by the year 2016. Since new EU environmental directives, such as Directive 2001/80/EC, seek to limit nitrogen oxides and sulphur dioxide emissions produced from large combustion plants. Furthermore as a party to Kyoto Protocol, UK has to comply with the targets that are set by the Protocol and has to decrease its CO₂ emissions. This commitment has also a restrictive impact on the coal's role in the country's fuel mix. In order not lay the coal industry aside; the UK government is supporting the research projects concerning the development of cleaner coal technologies, carbon capture and storage. In addition the government has launched a program, called "Coal Investment Aid" to protect the social rights of the workers in the coal industry through stimulating coal producers to invest commercially viable projects that preserve access to reserves.¹⁶⁸

Since the 1970s, UK has begun to put special emphasis on oil rather than coal for its economic growth. Today, UK is the largest petroleum producer and exporter, as well as natural gas producer in the EU. Today, UK's proven oil reserves stood at 4.7 billion barrels, which is the largest amount in the EU. Much of the raw material has been produced on the UK continental shelf in the North Sea. It is expected that the UK's onshore reserves will increase in the coming years as well. In terms of oil production the record of 2003 was 2.38 million barrels per day (bbl/d), which was 7.5 per cent lower than the amount in 2002. According to the official estimates, oil

¹⁶⁶ PennWell, *op.cit.*, p. 79.

¹⁶⁷ EIA, *op.cit.*

¹⁶⁸ *Ibid.*

production in the UK will decrease to a level between 1.38 million bbl/d and 1.59 million bbl/d by 2009.¹⁶⁹

The country has become a net exporter of crude oil since 1980s. Much of the crude oil production is exported to United States, the Netherlands, France, and Germany. The remaining crude oil production is taken by the UK's refineries. On the other hand, UK imports oil from Norway (73 per cent), Russia (nine per cent), Algeria (five per cent) and the Middle East (three per cent).

Formerly, oil exploration and production was carried out by a mixture of public and privately owned companies, after the privatisations in 1980s, all these facilities have begun to be carried out under private ownership. Downstream activities have been controlled by the private sector; whereas the government had a major stake in British Petroleum (BP) for many years. And this shareholding was steadily privatised. Today, despite a large number of smaller companies, main producer companies in the oil market are BP, Royal Dutch/Shell, ExxonMobil, TotalFinaElf, Chevron Texaco and Amerada Hess.

UK has also invested in the Middle Eastern oil through Royal Dutch Shell Group and Anglo-Iranian Company, which was later named as BP as well. Britain has taken a pro-Arab stand in the Middle East conflict since 1967, when the government supported Resolution 242 of the United Nations, advocating the withdrawal of Israel from occupied territories. On the specific matter of the Euro-Arab dialogue, Britain adopted a cautious attitude towards US policy. Britain's generally favourable attitude toward the Arab cause is linked to its oil and industrial interests in the Middle East and to the role of the London money market in conjunction with oil. Before and after the 1973-1974 crises, a large portion of the surplus funds of the oil producing countries was directed either to the money market or to the Eurocurrency market in London. Nevertheless, Britain's financial difficulties have induced several oil-

¹⁶⁹ Ibid.

producing countries of the Gulf to discontinue their short-term investments in London.¹⁷⁰

In 1975, the British National Oil Corporation was founded, to produce, refine and market North Sea oil and state participation in offshore fields. However, British industry failed to provide new technology for offshore oil developments. The pipelines were supplied by US and European companies. Also, the British Government's attempts to have maximum autonomy of action in terms of production volume and of prices for North Sea oil in the international arena, failed.¹⁷¹ In this context, the UK Government has launched a Pilot Program in 2000 to ensure long-term production of oil and natural gas from UK continental shelf.¹⁷²

Britain began its oil and gas exploration facilities in the North Sea in the early 1960s, resulting in major gas discoveries in the southern part of North Sea in the mid-1960s. It was believed that with the potential reserves in the North Sea, Britain could be self-sufficient in terms of energy resources. Today the proven natural gas reserves of UK are estimated as 22.2 trillion cubic feet, a 9.8 per cent decrease over 2003. Much of the gas fields are located offshore in the North Sea. As oil, UK natural gas production seems to decline in recent years after peaking 2000. In order to meet the demand in the future, UK has been lining up potential international natural gas supplies via liquefied natural gas (LNG) and pipelines.¹⁷³

The development of natural gas from production to final supply was run by British Gas a single nationalised entity, which replaced the municipal and privately owned local utilities in the late 1940s. British Gas has enjoyed a monopolistic position in purchasing, marketing and transmitting gas. It also had considerable interests in gas and oil exploration and extraction, though other companies engaged in exploration and extraction facilities as well. In 1981, the privileged position of British Gas was removed and it was privatised in 1986 and the restructuring of the UK natural gas

¹⁷⁰ Carmoy, *op.cit.*, pp. 45-46.

¹⁷¹ *Ibid.*, p. 44.

¹⁷² EIA, *op.cit.*

¹⁷³ *Ibid.*

market began.¹⁷⁴ In 1986, the Office of Gas Supply (Ofgas), now Office of Gas and Electricity Markets (Ofgem) was founded to regulate the industry and safeguard the rights of the customers. In 1992, industrial and commercial customers were awarded as eligible customers, which led to the entering of alternative suppliers to the natural gas market. However, British Gas remained the only gas supplier to the rest of the market (mainly residential) until the enactment of 1995 Act, which envisages the opening up of the whole natural gas market to competition. In the end, the whole market was opened to competition by 1998.

The UK has large coal, natural gas and oil reserves with the gas and electricity industries contributing £ 15.8 billion (\$25.2 billion) annually to gross domestic product. However, it is projected that UK oil and gas production will go down sharply over the next decade as reserves are low. By 2006, the UK is likely to import up to 15 per cent of its gas compared with 2 per cent now and by 2006-2007, it is prone to be a net oil importer.¹⁷⁵

As of December 2002, the installed electricity generation capacity was 77.0 gigawatts, of which were per cent 80 thermal, per cent 16 nuclear, per cent 2 hydropower and per cent 2 other resources. UK has the third largest power market in Europe after Germany and France. In terms of net power generation, the country produced 360.8 billion kWh electricity in 2002. Electricity consumption was 343.9 billion kWh in that year.¹⁷⁶ The UK is estimated to see a 25 per cent increase in electricity demand by 2020 with the grid operator planning on annual growth of 1.7 per cent over the next seven years. A diversified fuel mix in generation currently provides security of supply though much of the electricity is obtained from fossil fuels with a growing dependence on natural gas.¹⁷⁷ Potential reserves in the North Sea lessened the need for development of nuclear power as well. Nuclear power accounted for 22 per cent of electricity production in 2002 but this will reduce since the reactors are becoming old and will be retired in 2011. UK is a net importer of

¹⁷⁴ McGowan, *op.cit.*, p. 133.

¹⁷⁵ PennWell Global Energy Group, Global Power Review 2003: A Snapshot of the World's Top 30 Electricity Markets (Essex: PennWell House, 2003), p. 79.

¹⁷⁶ EIA, *op.cit.*

¹⁷⁷ PennWell, *op.cit.*, p. 79.

electricity (10.4 TWh in 2001) with the mainland having power grid interconnections with France and Northern Ireland.¹⁷⁸ The UK's electricity industry structure and the policies concerning the liberalization of the electricity market will be examined under another subtitle within this Chapter.

4.2. Energy Policy of Britain

From post-war period till the election of Margaret Thatcher in 1979, British energy policy was largely carried out by the publicly owned firms which dominated the energy sector following the nationalisation of the coal, electricity and gas industries in the late 1940s. The key industries were under the control of public ownership, thus the state could directly influence the policy-making process.

Before World War II, the energy industries were under municipal or private ownership. However, there were substantial attempts to bring these sectors under public ownership. Nationalisation was seen as a way of coordinating the energy utilities, particularly in the electricity sector. An attempt in 1926 to form a publicly owned company to build and own a high voltage transmission grid and to coordinate power supply was seen as only a partial success.¹⁷⁹ In order to eliminate the problems in the energy sector during wartime, it was believed that the sector had to be coordinated by a centralized ownership. The energy industries were the key players in economic reconstruction throughout the period of public ownership. During this period energy policy was discussed in various governmental committees. But an explicit declaration of energy policy could be made after 1960s. Before that period, energy policies were relying on post-war economic reconstruction and promotion of new resources and technologies.¹⁸⁰

The first White Paper on energy policy was published in 1965 by Labour Government. The Paper put some goals concerning supply security, consumer choice and national competitiveness. In order to meet these goals, the government set up an

¹⁷⁸ Ibid.

¹⁷⁹ McGowan, *op.cit.*, p. 134.

¹⁸⁰ Ibid, p. 135.

Energy Advisory Committee and a Coordinating Committee. The White Papers were published after a series of important initiatives in the energy sector over 1950s and 1960s. Governments of both the left and right wings took key decisions on nuclear industry development, coal industry nationalisation and North Sea oil and gas exploration, which were determining the priorities of UK energy policy for the following decades. Throughout that period, British energy policy was shaped by the interests of the government and mainly by the interests of public sector energy industry.

The oil crises of the early 1970s showed the weakness of British economy to supply disruption and price fluctuations in the energy sector. A series of damaging strikes in the coal industry made the miners oppose to the future energy policy and, by contributing to the end of the Conservative Government in 1974, created a climate of hostility between that party and the coal industry which was to finish in further conflict ten years later. The energy policy was usually dominated by the policies concerning self sufficiency, the development of North Sea oil, nuclear power and the prospective role of coal.

The next formal declaration of energy policy was the 1978 Green Paper based largely on an Energy Commission Paper which had proposed the development of nuclear power in the country. The Paper underlined the necessity of research for medium to long term technologies for the development of indigenous energy sources as well. These official energy policy statements were quite effective, particularly in the development of North Sea resources over 1960s and 1970s.¹⁸¹

The mix of government ownership and clear objectives worked well in developing oil and gas reserves and in building a national network for natural gas. But from 1970s onwards, there appeared some problems, especially in the coal and nuclear sectors. Over this period, energy policy was centred on two main issues: the development of North Sea resources and the future of electricity supply. The shifts in UK energy policy to some extent were the reflections of the changes in overall

¹⁸¹ Ibid., pp. 136-137.

energy balances over the post-war period. From being self sufficient and coal-based, the UK became gradually more dependent upon imported energy, largely oil. The market for coal became increasingly focused on the electricity industry with the becoming of UK economy less energy intensive. On the other hand, coal's share in electricity generation had begun to be threatened by oil and nuclear from the 1960s onwards: by the end of the 1970s in power generation, the share of nuclear had reached to 13 per cent.¹⁸²

The other major change in UK energy balances was the development of offshore resources and the increased use of natural gas. By the end of 1970s, North Sea oil production was beginning to reach to significant levels and exceeding the imports for the first time in 1979. With these developments in the North Sea, UK, for the first time, diminished its dependence on imported fuel to the levels of 1950s.

UK energy policy before 1979 was centred upon the development of British energy resources to meet domestic energy needs and to pursue economic objectives in developing high technology industries, supporting the engineering sector and promoting regional and social policies. In fulfilling these goals, the publicly owned enterprises which dominated the energy sector played a crucial role.

Although there is a clear shift in the energy policies of UK, it is wrong to think that there was an overnight transformation of energy policies during Thatcher government. In fact the first energy policy of the Thatcher government was about nuclear power. In the beginning of 1980s, the government made most of the controls on nationalised industries much more aggressively than the former governments.¹⁸³

Until the 1990s, the energy system in the UK was largely owned and controlled by the Government. The most important change was the increasing importance on the market-based understanding in the energy sector. At the centre of this change, there were the policies of privatisation and liberalisation. For McGowan (1996) although there was a considerable change in energy policies and these changes had important

¹⁸² Ibid, p. 138.

effects on the British energy sector, the nature of those changes seemed to be the outcome of short-term political calculations and they were not always about the characteristics of that period. But surely the characteristics of that period had had a great impact on the strengthening of the privatisation and liberalisation efforts as well with the fall of Keynesian economic policies.

In 1982, in line with the privatization attempts, the government issued the Oil and Gas (Enterprise) Act to separate British Gas from its oil interests, moving them to private sector and opening up the British Gas pipeline system to let other suppliers compete with British Gas for final customers. However, the status of British Gas did not change.¹⁸⁴

With the Energy Act of 1983, the government extended its liberalisation policy to the electricity sector. The Act stipulated the abolishment of electricity companies' monopolistic position and obliged them to publish the terms for the purchase and transmission of electricity. However, this legislation met with only a little interest than the previous year's initiative. The competitive advantage of the incumbents discouraged the new market player candidates. The electricity companies enjoyed their privileged position in determining the conditions for purchasing the electricity. Central Electricity Generating Board (CEGB), which was a vertically integrated production and transmission company, exploited its position through its structure in England and Wales. It is not wrong to say that the government was to a certain extent unsuccessful in implementing its market oriented energy policy in the beginning.¹⁸⁵

It is believed that regulation is necessary in cases of privatisation to encourage the entry of new participants to the market and to stimulate competition. Before privatisation, the option of restructuring the utility was usually rejected. This failure to take apart the incumbent firms was the result of a number of factors, particularly the vagueness of new firm structures and competition slowing down the process of privatisation and decreasing the returns from the sale. Therefore, in 1986, British Gas

¹⁸³ Ibid., pp. 140-141.

¹⁸⁴ Ibid, p. 142.

¹⁸⁵ Ibid, 142.

was privatised as a monopoly utility with a regulatory agency (Ofgas), which was in fact widely believed to be too weak. Pragmatism in protecting the best economic and political outcomes was superior to the government's expressions of competition and the market.¹⁸⁶

In line with the liberalisation efforts, the government set its energy policy goals in 1993 as follows:

- to stimulate competition between the energy producers
- to establish a regulatory framework to ensure well-functioning of the markets
- to commercialise energy markets in which the full costs of energy were borne by customers
- to privatise the energy industries
- to consider the environmental impact of the energy sector and meet international commitments
- to promote energy efficiency.¹⁸⁷

Today, UK, as one of the pioneers of liberalization efforts, has become one of the most open and liberal energy markets in the world. Since 1990s, the Government's responsibility has been determined as to set the overall goals for UK energy policy and to guarantee that the energy markets of UK and the other policies meet these goals. Since 1998, all natural gas consumers have become eligible consumers and free to choose their suppliers. Since 1999, all electricity consumers have also become eligible consumers.

The British gas and electricity industries have gone through a phase of restructuring in these last years. There evolved new acquisitions, mergers and de-mergers, which were the results of commercial considerations, since the industries are almost exclusively privately owned. The only exception to this is BNFL Magnox Generation, a state owned company that keeps hold of the magnox nuclear power plants. The restructuring also has resulted in incorporation of the gas and electricity markets, as gas suppliers increasingly began to sell electricity as well. As the

¹⁸⁶ Ibid, 144.

outcome of this trend, the separate regulatory authorities for electricity (Offer) and gas (Ofgas) were merged under the Utilities Act 2000 and the Office of Gas and Electricity Markets (Ofgem) was founded. The merging of the two former regulators reflected the convergence of the two markets – most suppliers offer both fuels and in electricity generation, gas is more and more preferred.

The critical breakthrough towards a fully competitive electricity generation market was achieved through the introduction of the New Electricity Trading Arrangements (NETA) in March 2001. NETA superseded the Electricity Pool, the compulsory electricity trading mechanism, which had been at the centre of the power market in England and Wales for ten years since the first reforms in 1990/91. With the NETA, a flexible and voluntary mechanism for electricity trading was introduced, which had provided the fall of electricity wholesale prices by 20-25 per cent.¹⁸⁸

Liberalisation of gas and electricity markets was very successful and almost completed. Industry restructuring is in the hands of private sector decisions, whereas a few areas require attention for the deployment of liberalisation in whole Kingdom. For instance, the electricity markets in Scotland and Northern Ireland are not as competitive as the market in England and Wales.¹⁸⁹

The key responsibility for the development of national policies concerning all forms of energy supply in Great Britain is in the hands of the Department of Trade and Industry (DTI). It is responsible from the government's relations with the UK Atomic Energy Agency, British Nuclear Fuels plc, the Coal Authority and the government interest in the development of the oil and gas resources of the UK. In addition it contributes to the development of environmental and energy efficiency policies.

¹⁸⁷ Ibid, p. 140.

¹⁸⁸ International Energy Agency, Energy Policies of IEA Countries: The United Kingdom 2002 Review (Paris: Head of Publications Service, OECD, 2002), p. 5.

¹⁸⁹ Ibid.

The Gas and Electricity Markets Authority (GEMA) and its executive arm Ofgem are responsible from supervising day to day regulation and secure the interests of consumers.

The Government's overall energy policy in general is '*to ensure secure, diverse, sustainable supplies of energy at competitive prices*'. Competitive markets and the companies are necessary to pursue this goal. In this context, the Government's role is to set the frame by providing the suitable legal structure for competitive energy markets and the economic development of energy resources compatible with the safety and environmental standards. It also provides for regulation in the consumer interest to watch over the transition to competition and to control the monopoly activities left behind. Another duty of the Government is to monitor the wider public interest. The Government has to warrant that energy plays a crucial role in sustainable development. The UK Government is subject to a binding international target under the 1997 Kyoto Protocol and the EU's internal burden sharing agreement of 17 June 1998, calling for a 12.5 per cent reduction of greenhouse gas emissions compared with 1990 levels by 2010.¹⁹⁰

In 1998, with the introduction of devolution legislation, Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly were established as the devolved administrations. In the devolution process, although the UK Government protected most aspects of energy policy, some issues were devolved such as renewable energy, energy efficiency to the above-mentioned devolved administrations. The departments responsible for energy policy keep contact with the devolved administrations over issues of importance to them and the UK remains as a single market.¹⁹¹

The Government declared on 25 June 2001 that the Performance and Innovation Unit (PIU) under the Cabinet Office performed a review of the strategic energy policy issues for UK. The review was laid down in the framework of meeting the climate change problem, at the same time ensuring secure, diverse and reliable energy

¹⁹⁰ Ibid, p. 27.

supplies with affordable prices. The main aim of the review was to put out the objectives of future energy policy and to develop a strategy, which guarantees that current policy obligations are consistent with longer-term economic, environmental and social goals. The Review took into consideration the role of coal, gas, oil and renewables in the UK's future energy balance plus combined heat and power and the improvement of energy efficiency. It considered the role of nuclear industry in meeting the environmental and security of supply goals as well. The Review also gave its support to the Renewables Obligation, which is put into practice by the Government presently and noted that more efforts were needed to lower the cost of new renewables and to set up new alternatives.

The PIU Review stated that security and diversification of energy supply were crucial issues for several reasons. The Review called attention to the growing security concerns referring to the Californian Crisis, which led to a series of electricity blackouts in 2000-2001, the increasing political anxieties because of the 11 September 2002 terrorist attacks in the USA and the UK's future need to import gas. The Review discarded the idea that self-sufficiency is essential for security of supply with the idea that the government should decide on the future fuel mix in the electricity supply industry. The Review recommended that security should be ensured through the use of competitive markets; creating a more durable and flexible energy system and using international action to tackle global threats to energy security.¹⁹² The Review concluded that the liberalisation of EU gas and electricity markets is of utmost importance for energy security. Since it is believed that liberalisation would bring strength to European energy markets and increase the flexibility of the energy system to a large extent. The Review also noted that the processes of privatisation and liberalisation in the electricity and gas markets seemed to have succeeded well.¹⁹³

¹⁹¹ Ibid, pp. 13, 26.

¹⁹² Britain became an active member of International Energy Agency in 1974. It has played a powerful role in both IEA and European Economic Community (EEC) in relation to the development of its domestic oil and gas resources.

¹⁹³ Ibid, pp. 29-30.

Following the PIU Review, a White Paper on energy, entitled 'Our Energy Future – Creating a Low Carbon Economy' was presented to the Parliament by the Secretary of State for Trade and Industry to embark a strategy for the long term sustainable energy policy on February 2003,.

In the foreword of the White Paper, it was stated that combating climate change problem and having competitive markets to reduce the costs are of high priority for the well-being of the economy by Tony Blair, the Prime Minister of UK. The Paper also draws attention to the implications of reduced UK oil, gas and coal production, which will make UK vulnerable to outside energy resources. Thirdly, the Paper underlines the necessity to replace or upgrade much of the UK's energy infrastructure over the next twenty years. The Paper, which is a landmark in the energy policy of UK, relies on four mainstays *of the environment, energy reliability, and affordable energy for the poorest and competitive markets for our businesses, industries and households*. The aim of this White Paper is to address these issues.

It was mentioned that the goals of the UK Government's new energy policy was to make a 60 per cent reduction in the CO₂ emissions from 1990 levels by 2050 and to maintain the reliability of energy supplies. The Government also puts emphasis on encouraging research and development activities in the areas like fuel cells, offshore wind and tidal power in order to ensure low carbon economy and compensate for the decline of UK's indigenous energy supplies. Another commitment, highlighted in the White Paper was that no household in Britain would face with fuel poverty by 2016-18.¹⁹⁴

The Paper sets the target of doubling the share of renewables in electricity generation by 2020, which is a quite ambitious target. About nuclear power, it emphasizes that in the future, if it will be necessary, new nuclear plants can be commissioned so as to meet the carbon targets.¹⁹⁵ Finally, for coal fired generation it says that they will

¹⁹⁴ Department for Trade and Industry, Energy White Paper: Our Energy Future – Creating a Low Carbon Economy, (London, February 2003)

¹⁹⁵ For some circles, renewable sources and conservation will be insufficient to meet the targets set out by the UK Government in the White Paper. Thus there is a need for replacing the existing nuclear

stimulate research projects concerning cleaner coal technologies, carbon capture and storage.

With the Paper, the aim was to set a clear, long-term framework for the energy producers, investors and consumers, who are acting in the energy market. It was written with the aims of achieving the economic, social and environmental targets at the same time.

Although it is too early to comment on the results of the policies, determined in the White Paper, we see some negative developments in the UK energy market. The White Paper states that;

We do not propose to set targets for the share of total energy or electricity supply to be met from different fuels. We do not believe Government is equipped to decide the composition of the fuel mix. We prefer a market framework, reinforced by long term policy measures, which will give investors, business and consumers the right incentives to find the balance that will most effectively meet our overall goals.

Even though it is understood that the expectations from the market mechanism to determine the fuel mix, it is understood that electricity production is largely dependent on natural gas, which is in fact highly affected by the fluctuations in the oil prices in the world markets. It is obvious that it is wrong to wait from the market mechanism to balance the share of total energy or electricity supply from different resources. Diversification in energy resources still have to remain the key variable in the formula for the energy security for the UK. Even though the government promotes the competitive markets to ensure the flexibility of invention of energy resources, it is of paramount importance to have alternatives to fossil fuels. However, rather than diversification of the energy resources, there is an increasing reliance on natural gas sources. Most of the investments are just designed to diversify and secure the supply of gas.

The negative impacts of relying on natural gas resources to a large extent have shown itself nowadays with the increase in natural gas prices, which means increase

stations with the modern ones to achieve these goals. For more information see

in energy prices. Due to the increase in oil prices, natural gas prices have increased its highest level since the very beginning of deregulated market in 1990s.¹⁹⁶ The political turmoil in the international arena (i.e. US-Iraqi War) led to a significant increase in the oil prices and accordingly gas prices. Even though the core of liberalization is to sell the concept of cheap energy to consumers, the gas and electricity prices are unlikely to decline for the end-users in UK. It is not a coincidence that the electricity and gas prices to end-users had raised in many liberalized markets in the same way. Although UK has the leading deregulated market and has been shown as a good example in this respect, some see these price hikes for specifically the end-users as the problem of liberalization process. Despite the full market opening in the gas market, a few number of consumers switch from British Gas to alternative suppliers. For some, competitive pressure may force suppliers to decrease their prices. On the other hand, some see this as the wrong policies of the Government. In order to examine these price hikes, the UK Parliament has initiated an investigation about the high electricity and gas prices.¹⁹⁷

Some incentives, subsidies and a degree of governmental intervention seem necessary to achieve a degree of balance between the different policy areas such as economic, social and environmental, especially in such kind of sectors which are quite sensitive in meeting the general public obligations.

Besides the negative developments, the First Annual Progress Report on Implementation of the White Paper points out some significant achievements in the year 2004 such as the Government's initiatives for increasing the renewable capacity; submission of the UK's draft National Allocation Plan (NAP) to the European Commission to encourage least cost abatement of carbon dioxide and to attract investment to the UK; agreement on principles for a new Framework Treaty for the construction of a new pipeline from Norway to UK to meet the 20 per cent of UK annual gas demand and launching of energy efficiency programmes.¹⁹⁸

http://www.bnes.com/addn_content/WhitePaperResponseII-Mar03.htm

¹⁹⁶ S. Roth, 'Is the Honeymoon Over?' *Energy Markets*, Vol. 9, No. 10 (2004), p.7.

¹⁹⁷ Ibid.

¹⁹⁸ Department of Trade and Industry, *First Annual Report on Implementation of the Energy White Paper*, (London, April 2004), p. 5.

British energy policy has gone through radical changes in the last two decades. From being a policy largely dominated by publicly owned enterprises and government funding seeking to develop long term strategy, energy policy is currently determined by private firms competing in relatively open markets without the interference of the government. Government continues its activities in the energy sector albeit much less than the past. The Government has begun to play the role of regulator to ensure fair competition, well-functioning of the market and to monitor how the public service obligations are met.

The widespread belief is that the new energy policy relying on liberalisation and privatization is effective in UK. Since the beginning of efforts for privatisation, the market value of the electricity industry has increased to a great extent. However the consumer, the supposed beneficiary of larger competition, has seen only a little price change. Besides, the narrower focus of policy has partly been restricted by the increasing of environmental concerns. Nevertheless, in spite of some problems, it seems that there is unlikely to be major changes in British energy policy in the near future. Even the political opposition groups in the UK are not pushing for returning the sector to public ownership. For instance the Labour Party has discarded any plans to take any part of the energy sector back into the public ownership and their statements on economic policy show that they recognize the merits of competition even in the utility sector. In fact, as in the post-war years, when nationalisation was acknowledged by all major political actors, the market-based energy policy is part of the neo-liberal consensus that at present characterises the UK.¹⁹⁹

4.3. History of Electricity Industry Reform in Britain

The UK is an interesting case study in the process of electricity industry restructuring, privatization and regulatory reform. It was one of the first nations that began extensive privatization of its electric utilities. The UK's electricity privatization reform efforts have been among the world's most ambitious ones. A

¹⁹⁹ McGowan, *op.cit.*, p. 161.

number of nations have later followed the UK example, using its experience as a policy guide in their own electricity restructuring, privatization and regulatory reform efforts. Turkey is one of these countries, which has adopted a UK model in its electricity sector.

Surely, the privatization of the UK electricity industry was a product of a process, which began with the period of nationalization and continued up to the current period of industry restructuring, regulatory reform and privatization. In this context, the history of electricity industry in Britain can be divided into four phases. The early period municipal ownership depending on loose regulation lay down by law. Despite some important private sector success examples during that period, the industry largely fell behind the practices abroad. Central Electricity Board in 1926, which was a public corporation, was established to build transmission network. This marked the start of the second phase, which gathered some of the benefits of coordination by public ownership, with mixed ownership in generation and distribution. In 1947, the fragmented and largely municipally owned local distribution undertakings have begun to be coordinated by a central public ownership as part of the nationalization policies of the UK's post-war Labour Government.

The role of the state in Britain was devastating. Coal, distribution of industrial and natural gas, and the generation and distribution of electricity were nationalized under the British Gas Corporation and under the auspices of the Central Electricity Generating Board (CEGB)²⁰⁰ respectively; whereas distribution and supply were under the control of twelve Area Boards (ABs)²⁰¹, which bought electricity from CEGB under the bulk supply tariff. Both CEGB and ABs were represented in the Electricity Council, which was the coordinating body. Although this period had its technical successes, it was argued that the regulatory system was not efficient enough.

During the period of nationalization between 1947 and 1990, the two major rival political parties followed various and conflicting energy policies. Most of the time,

²⁰⁰ Supplies in Scotland and Northern Ireland were carried out by vertically integrated companies.

some dominant macroeconomic goals directed the electricity policy directives. For example, during the 1970s, the ruling Labour Party put pressure on the electricity industry to control prices to reduce general inflation. During the 1980s, after the Conservative Party took power, the industry was urged to increase prices to diminish public borrowings. Several currency crises and two oil price shocks pushed the electric industry to rely more heavily on domestic coal and to promote the development of nuclear power.²⁰²

In the 1960s and 1970s, government had several initiatives for reforming the electricity industry. But these initiatives had failed because of the lack of commitment and political returns. By 1970s, the UK experienced several economic problems, many of which were seen as the result of the increasing role of the State in the economy. There were also growing dissatisfaction with the general quality of services provided by nationalized companies; the increasing financial burden on the nationalized companies and the decreased UK public perception of the feasibility of several state-run industries.

The privatization of the industry was instigated after a conservative government came to power in the UK in 1979 under the leadership of Margaret Thatcher. The election of Thatcher Government was a major turning point in British politics and economic policy. Privatization became an important factor in the Thatcher Government's overall economic program. The main aim of the new government was to diminish the role of the government in the economy.

The wave of privatisation in the coal, gas and electricity industries in England demonstrated how much the politico-economic balance of interests had changed in 1990s. It is not surprising that the development of industry is subject to historical, technological and politico-economic factors. According to the intellectuals, rather than asking which one, public or private ownership is the best, it is better to determine the circumstances under which public ownership has competitive

²⁰¹ In England and Wales.

²⁰² Energy Information Administration, Electricity Reform Abroad and U.S. Investment (Washington D.C., September 1997), p. 15.

advantage and circumstances under which private ownership is preferable.²⁰³ Public ownership is preferred when coordination and restructuring are necessary, at least in the type of British Economy. On the other hand, for some, private ownership may have the ability to avoid the inefficiencies through introducing a competitive environment, which are the results of unclear objectives under state ownership due to differing balance of interests.²⁰⁴

The target of privatization has been achieved despite the difficulties in the electricity industry. The difficulties were due to the sui generis character of the electricity industry, which strongly reflects the features of a natural monopoly. Therefore electricity was among the last and more controversial privatizations. Electricity privatization and reform got off to a relatively late start in the UK, having its origins in the passage of the UK's Electricity Act of 1983, which was enacted by Thatcher Government. The Act was designed to endorse the entry of independent power producers to the market. Before the Act, it was prohibited for the industry to access to the national grid. Act stipulated that the Central Electricity Generation Board (CEGB) had to buy electricity from private producers at reasonable costs. However, due to the low rates of return that the CEGB authorized incumbent power producers prevented the new entrants and the Act fell short of removing the unjust access of the incumbents to the grid over new entrants.²⁰⁵

Six years later, another Act, the UK Electricity Act of 1989 was put into force. With this Act, priority was given to the restructuring of the market. In this context, CEGB was unbundled into two power producer companies (National Power and Powergen), a transmission company (National Grid), and a distribution network breaking up into 12 regional companies (RECs), which were created out of the former Regional Area Boards. The distribution and marketing segments under RECs were separated and auctioned off to the public by the UK Government. They were sold on December 1990. Shares in the two generating companies were also sold to the public in the

²⁰³ Gilbert, *op.cit.*, p.26.

²⁰⁴ *Ibid.*

²⁰⁵ Energy Information Administration, *op.cit.*, p. 16.

following year.²⁰⁶ The reason behind the Government's restructuring was the idea that electricity generation and marketing could be made competitive industries, whereas transmission and distribution needed to be treated as natural monopolies. All segments were initially under public ownership and privatization was realized in transitional stages.

At that time, the electricity markets of Northern Ireland and Scotland were also subject to reform process as the industries in England and Wales. However the reforms were more modest than the reforms in England and Wales. Northern Ireland and Scotland comprises 12 per cent of the whole UK electricity market. In this study, the reforms that were carried out in the electricity markets of England and Wales will be taken into consideration to a large extent.

Although the widespread belief is that the liberalization brought customers more choice, better service quality and more competitive prices, for the well-being of the market and fair competition, it is believed that there was a need for a regulator to monitor the market activities. In this context, Office of Gas and Electricity Markets (OFFER) was founded with the mandate of setting the pool prices and supervising the National Power and Power Gen in its operations to preclude any monopolistic attempt.

During that period, the major impediment in front of the electricity reform was how to allocate the financial burdens related to stranded costs.²⁰⁷ Another barrier was the eruption of mergers and acquisitions, which pose a great threat to the functioning of a fair competitive electricity market. The Government was anxious about the growing vertical market concentration between generation and distribution companies. Thus, since the commencement of the new electricity industry on 1 April 1990 (Vesting Day), the Government had put restriction on the private enterprises' ownership, which might have a maximum share of 15 per cent. The Government had continued to hold a big stake in the two power generation companies.

²⁰⁶ Ibid, p. 17.

²⁰⁷ Stranded costs in the UK resulted largely from earlier investments in nuclear power and high-priced coal contracts.

With the commencement of new electricity industry, privatisation had begun in that year. The privatisation has altered the industry, breaking up the CEGB into separate production and transmission companies in England and Wales while competition in production and the supply of final customers has also increased. The current phase of private ownership has led to important changes in the structure and operation of the industry.²⁰⁸ The distribution companies have been permitted to buy generation assets with the restriction that no REC generation facilities account for more than 15 per cent of their individual electricity sales.²⁰⁹

The Electricity Act of 1989 permitted the opening of market for the industrial consumers, while still the other consumers had to buy their electricity from their local RECs.

With the electricity reform, a national wholesale electricity pool was also created to balance electricity supply and demand. This electricity pool, which functioned as the wholesale market for power in the UK established electricity prices for the 48 half-hour periods for the following day and bring the generating capacity and forecasted demand into line. In practice, electricity prices in the England and Wales electricity pool have proven to be very unstable and dependent on manipulation. Over time there have been several claims that, due to their dominant position in the pool, National Power and PowerGen have been able to manipulate the pool prices.²¹⁰ Later in March 2001, this system was replaced by New Electricity Trading Arrangements (NETA), which was designed to bring greater competition in the generation market consisting of futures and a forward market covering power from 24 hours to four hours before real physical transmission begins, and a final balancing market for the national grid.²¹¹ Its impact has been limited with England and Wales. Scotland holds a separate system which is connected to the English grid through an interconnector. In order to create a single electricity market in Great Britain, a new mechanism called British Electricity Trading and Transmission Arrangements (Betta) was

²⁰⁸ Gilbert, *op.cit.*, p. 26-27.

²⁰⁹ Energy Information Administration, *op.cit.*, p. 18.

²¹⁰ *Ibid.*, p. 19.

formed. The aim of Beta is to eliminate the barriers and enhance competition in the wholesale market through the integration of Scottish generators.²¹²

When we look at the general assessments about the performance of the current electricity industry, it is not wrong to say that in terms of energy efficiency, the reform has been succeeded. However, it is argued that a large share of the industry's efficiency increases was realized through substantial workforce reductions. Another opinion is that the new market form is noticeably more efficient than the old structure before privatization. Nevertheless, in some cases, the industry reforms have been contentious. For instance, the system has been criticized for unjustly benefiting industry shareholders and corporate executives over consumers and electricity industry employees. While there are many companies that are licensed to supply electricity, the number of companies actively engaged in supplying the market, especially the residential market has fallen to a great extent. According to the data of Electricity Association, among 27 licensed electricity suppliers, only six of them share the market with 99 per cent of the residential market, with the top two suppliers, PowerGen and British Gas own almost half of the market.²¹³ Another contentious issue is about the prices. Even though electricity prices have been generally subject to inflation in the years prior to privatization, since the electricity reforms in 1990s, small electricity consumers have often felt less well treated themselves than industry shareholders.

4.4. British and EU Relations in the Case of Electricity Market Reform

UK energy market has been at the forefront of privatisation, deregulation and liberalisation of electricity and gas markets. Britain feels that it has largely succeeded in creating a competitive market and being a good example for its European neighbours. It shares its experiences from liberalising its electricity market with other EU member states. It is one of the pioneers of the thought of market liberalisation. The United Kingdom of Great Britain and Northern Ireland, comprising England,

²¹¹ Y. Yazoğlu, 'Opportunity in the UK', *Energy Markets*, Vol. 9, No. 9 (2004), p. 38.

²¹² United Kingdom: EU Energy Country Supplement, *Platts* (25 April 2003), p. 9.

²¹³ *Ibid.*, p. 12.

Scotland, Wales and Northern Ireland joined the EU in 1973, with a confirmation by referendum in 1975.

In terms of energy market liberalization, UK has been not only supportive of Commission proposals but also has acted as a good example in this respect. The Commission's attempts for liberalizing gas and electricity markets have been marked by substantial debates and opposition from many member states. It is not wrong to say that the UK has been useful to the Commission both as an example, showing that liberalization could be done and as a supporter of Commission's actions within the Council. In the earlier debates, it was supporting the idea of putting emphasis on the role of the private sector and markets to encourage energy industry development. The UK had also played an active role in order to endorse the idea of a European Energy Charter as a market-based initiative.²¹⁴

On the other hand, the European Union was largely perceived as a constraint upon British energy-policy making as for all the member states. As the only member of the EU, that is self-sufficient in energy resources, UK has seemed reluctant to give up its sovereignty over those resources to the Brussels. Despite the increasing emphasis on competition and liberalization, reduction in public funding for energy research and the ignorance of energy planning and forecasting in the 1980s, the British Government has still play an active role in determining the traditional energy policy agendas, techniques and environmental activities. Therefore UK opposed any attempt by the Commission to develop a common energy policy. Moreover, the UK has the concern that real competition cannot be achieved if other member states consider policies that favor the protection of national electricity utilities, which are called as 'national champions'. It criticizes the policy of 'national champions', which is in fact not also in favor of consumers. UK is critical about the slow progress in competition and the passive role taken by the EC. Therefore, maybe due to its mistrust to Brussels and not to lose its power on a very strategically important area, Britain abstains from devolving its decision-making power to Brussels. The Report of the Committee of House of Lords, published in 12 February 2002 is a good example of the British

²¹⁴ McGowan, *op.cit.*, p. 159.

Government's reluctance in this context. In the Report, the Committee agrees that there is no need to empower the Commission with new significant powers or there is no need to enclose an Energy Chapter in the Treaties of the EU. It recommended that the Commission had to concentrate on the completion of a single, liberal energy market in Europe and make easier the energy interconnections between Member States and endorse firm investment conditions for producer countries.²¹⁵

For McGowan it can be perhaps paradoxical that the privatization of the British Electric Industry was to provide the Commission with an opportunity to interfere in national energy policy-making. However, dealing with an industry that is subject to change is from the Commission's stance much easier than addressing the much greater forces which are not changing. For example, after privatization, the Commission has required key changes in the planned support of the nuclear industry, imposing limited financial support and protection regime that is in force presently. Such moves have not close the Commission up to the UK in spite of the parallel goals. Thus, the British has continued to be the firm supporters of subsidiarity even where it limits the extent of liberalization.²¹⁶ Although the British Government's stress on liberalization is corresponding to European Commission proposals, the general approach to energy policy remains much more limited than that foreseen by Brussels. For that reason, UK is likely to remain on the outer edge of European energy policy in more senses than one.²¹⁷

It is obvious that UK was among the first countries that started deregulating its energy sector in 1980s. UK, the world's oldest and perhaps the most liberal energy market has two decades of experience in an area where most of the other member states have come to a standstill. Even though UK has a market that is matured enough compared with the other member states. Today, ensuring sustainability and security of supply in a completely free market are the new obstacles in front of the UK's energy market. With increasing pressure from the EU to decrease its carbon emissions, UK has considered a policy shift, relying more on environmental

²¹⁵ House of Lords, Fourteenth Report, 12 February 2002, paragraphs 11-17.

²¹⁶ McGowan, *op.cit.*, p. 159.

²¹⁷ *Ibid*, p. 161.

considerations. With the final White Paper, UK proved its willingness to balance its power supply to ensure reliability and meet its carbon reduction commitments. Although UK is reluctant to give up its sovereignty over energy issues, the impact of EU regulations shouldn't be also undermined during the policy formulation process in UK. The last White Paper demonstrates that not only national but also supranational forces are becoming increasingly effective in national policy-making process.



CHAPTER 5

ELECTRICITY MARKET IN TURKEY

Turkey stands at a very strategic location for energy trade, at the crossroads of Europe, the Middle East and Central Asia. For the last two decades, Turkey has been one of the fastest growing power markets in the world, with an average annual growth rate of 9 per cent. Despite the decrease by 1 per cent in 2001 due to the economic crises, this trend is estimated to continue till 2020 at an average increase of 8 per cent per year.²¹⁸ Official projections indicate that rapid growth in electricity consumption would continue over the next fifteen years. Still, the government anticipates the need for significant increases in power generating capacity as well as the necessity of upgrading transmission and distribution systems, requiring an average \$ 3.5 to \$ 4 billion investment a year in the power sector during 2004-2010. This makes it the third largest area of investment in the global market after China and India.

Until only a few decades ago, Turkish Government was playing an active role in the Turkish economy. Although the energy policy is still largely centrally-driven and overseen by the Ministry of Energy and Natural Resources, it is transforming into a liberalized market so as to attract foreign investment and to restructure its market in parallel with the energy policy of the EU. In this context, Turkey has begun to pursue new rules and policies to liberalize its energy market to meet its increasing demand through diminishing the government intervention. It has ratified the international Energy Charter Treaty and introduced laws that will break up the government's monopoly in the energy sector and set up a regulatory body to supervise the market activities.

²¹⁸ Europe and MED Desk EURELECTRIC, *op.cit.* p. 71.

5.1. Energy Overview of Turkey

Turkey enjoys diverse natural energy resources. The country has rich coal reserves with lignite estimated at over 8 billion tonnes, the seventh largest in the world although only a small part of these reserves can be utilised as an energy source. One of the significant points about the lignite reserves is the improvement of their quality and the extent to which new technologies can help. Environmental considerations are also highly relevant in this context.²¹⁹

Unlike coal, oil and gas reserves are limited in Turkey. Oil provides 42 per cent of Turkey's energy needs, around 90 per cent of which is imported. Construction of a major oil pipeline linking Azerbaijan to the Turkish port of Ceyhan is a significant achievement for Turkey's position as a transit for oil and energy in general. The cost of the 'Western Route' pipeline is estimated at \$ 2.8-\$ 2.9 billion and is expected to be completed in 2005. This, together with a proposed gas interconnection with Greece will make the country a central transit way for oil and gas supplies to European markets.²²⁰

Natural gas is an important part of Turkey's energy sector today. It is understood that the availability of natural gas together with environmental considerations makes it Turkey's preferred energy source for growth of electricity generation in the future. Demand for natural gas increased by 14 per cent for each year between the years 1989 and 2002. Turkey is the seventh largest natural gas consumer in Europe and its consumption is 5 per cent of the European sum. However Turkey's own natural gas production is very limited, thus supply is primarily met by imports. It seems that large contracts to import gas over the coming years to meet industry's needs and the requirements of gas fired power stations will continue to be the case in the coming future. It is expected that the contracted amounts will rise from 29 Bcm to 60 Bcm in

²¹⁹ Y. Isik, *Turkey's Energy Prospects in the EU-Turkey Context* (Center for European Policy Studies, EU Turkey Working Papers, No. 9/ October 2004), p. 8.

²²⁰ PennWell, *op.cit.*, p. 76.

2010.²²¹ Turkey is importing its natural gas from Russia, Iran, Turkmenistan, Algeria and Nigeria. Almost half of the contracted amount is imported from Russia through Blue Stream Pipeline project.

The Turkish electricity market is one of the fastest growing power markets in the world. The reasons behind this strong electricity market growth can be explained with its young and growing population, low per capita electricity consumption, rapid urbanisation and strong economic growth. By 2002, the electricity consumption in Turkey per capita is 1,653 kWh (5,232 kWh in Spain, 4,985 kWh in Italy and 4,575 kWh in Greece). By 2003, total installed capacity of Turkey has risen to 35.502 MW. 64.7 per cent (22.974 MW) of the installed capacity is thermal and the rest (12.528 MW) is hydroelectricity and renewables. In power generation the share of natural gas has been increased remarkably to a level of 45 per cent in 2003. The current data with regards to the electricity generation and installed capacity by fuel in Turkey is as follows;

TABLE 5.1.1. Electricity Generation By Fuel (Million kWh)

	2002 per cent	2003 per cent
Natural Gas	52.497 41	63.536 45
Hydro	33.684 26	35.330 25
Coal	32.149 25	32.253 23
Other	11.070 9	9.462 7
Total Electricity Generation	129.400	140.581

Source: Accessible at www.teias.gov.tr

²²¹ Y. Isik, *op.cit.*, p. 7.

TABLE 5.1.2. Installed Capacity By Fuel (MW)

	2002 per cent	2003 per cent
Natural Gas	9.472 30	11.510 32
Hydro	12.241 38	12.579 35
Coal	7.293 23	8.239 23
Other	2.840 9	3.260 9
Total Installed Capacity	31.846	35.587

Source: Accessible at www.teias.gov.tr

Neighbouring countries are linked to Turkey's electricity grid although not set up for synchronized operation. Imports of electricity in 2000 rose to 3.8 TWh with exports at 437 GWh.

About renewable energy sources, a draft law has been prepared including a series of effective incentives in the field of renewable energy sources. It is argued that Turkey has a significant potential of wind, geothermal and solar energy sources. The efforts for exploring the potential reserves are continuing. About nuclear, the Justice and Development Party (AKP) declared its intention for building up nuclear power plants and now it has revived the prospect of developing a nuclear power plant under state control.

5.2. Electricity Market Reforms in Turkey

The Government's overall macroeconomic stabilization program puts special emphasis on strengthening the private sector activity in Turkey's economy. The privatization program was inaugurated in 1983 and accelerated with the Privatization Law No 4646, introduced on 23 November 1994.²²²

²²² Taboğlu Law Offices, Energy Regulation in Turkey (Istanbul, 7 September 2002), p. 2.

Despite the increasing role of the private sector in recent years, there are some chronic problems in the sector that prevent the well functioning of the market. In 1984, the government enacted Law No 3096²²³ Regarding the Authorization of Enterprises other than the Turkish Electricity Authority for the Generation, Transmission, Distribution and Trading of Electricity, which let private firms build, generate, distribute and trade electricity. Until the enactment of Law No 3096, the services in the electricity sector were only carried out by the Turkish Electricity Agency (TEK), which was then separated into two companies; Turkish Electricity Generation and Transmission Co. (TEAŞ) and Turkish Electricity Distribution Co. (TEDAŞ).

TEAŞ is the sole owner and operator of the transmission network in Turkey and still under public ownership to guarantee sustainability of supply and fair access to the national grid. Now it is subject to restructuring to ensure its adaptation to the new market conditions. After the privatisation of the Distribution regions and the development of a liberal market, TEAŞ will serve to a much more diversified customer base and increased number of producers.

EÜAŞ and Affiliated Partnerships of EÜAŞ own 28 thermal and 100 hydroelectric plants which all together accounts 60 per cent of the country's electric generation capacity. The rest is provided by the privately owned power plants and industrial power plants. The small concessionary companies are authorized to generate, transport, distribute and trade electricity in geographically isolated areas.²²⁴

Distribution is owned by TEDAŞ, which is publicly owned company supplying electricity for residential and industrial users. The privatization of distribution is on the way now. Presently, only one distribution area has been transferred to the private sector for operation and maintenance.

²²³ Published in the Official Gazette on 19 December 1984.

²²⁴ Europe and MED Desk Eurelectric, op.cit., p. 72.

With the enactment of Law No 3096, private companies including foreign investors have been granted the right of build and operate the power plants under 'Build Operate Transfer' (BOT)²²⁵, 'Build and Operate' (BO), 'Transfer of Operating Rights' (TOOR)²²⁶ and 'Autoproduction' Models. BOT along with BOO have achieved partial success in attracting investment in generation and have left large contingent liabilities for the Treasury through the guarantees given to the private investors.

The fast economic growth in Turkey has augmented the demand for energy. Huge investments both from local and foreign investors have to be realized to meet this increasing demand. Therefore the Government felt the need of encouraging private investors through paving the way for them with a new law based on liberal means. Within this context, a new Electricity Market Law No 4628 was put into force on 3 March 2001 by the recommendations of IMF and World Bank, which envisages the opening of the electricity market to private companies. With this Law, the aim was to restructure and deregulate the market in line with the EU norms to attract domestic and foreign capital to privatisations. With similar aims, Natural Gas Market Law No 4646 was enacted in the same year.

The objectives of Law No 4628 is to ensure development of a financially sound, constant and transparent electricity market, operating in a competitive environment in line with private law provisions, and to provide for an autonomous regulation and supervision in such market.²²⁷ Law No 4628 regulates generation, transmission, distribution, wholesale, retailing and retailing services, import and export of electricity and rights and obligations of real persons or legal entities directly engaged in these activities. Law allows privatization in generation and distribution areas; however, transmission activities are still under public monopoly. It also covers the privatization methods to be utilized for generation and distribution assets, principles relating to tariffs and provisions concerning Treasury guarantees applicable to energy

²²⁵ With BOT Model, private investors were entitled to operate the plants they built for a number of years before transferring the ownership to the State.

²²⁶ TOOR Model has been used by the Government to try and sell existing assets in the generation and distribution fields.

projects. A preparatory period of 18 months starting as of 3 March 2001 was specified to complete the anticipated transition in the sector.

The final aim of the liberalisation efforts is to create a free market based on the agreements between buyers and sellers, matched by a balancing and reconciliation mechanism.

The adopted electricity law includes the following key elements;

- An independent Energy Market Regulatory Authority (EMRA), governed by the Board,
- A new licensing structure for market participants,
- An energy market, to be based on bilateral contracts between market participants,
- Eligible consumer concept, to ensure freedom for eligible consumers to choose their suppliers.
- Unbundling of TEAŞ into transmission, generation and trading companies.

EMRA is an autonomous public institution, founded in November 2001, represented and executed by a Board. EMRA regulates the electricity, gas and downstream petroleum industries. In electricity, it is responsible for issuing licenses for electricity market activities to be carried out by the legal entities. It monitors the market performance and implements the electricity market activities and ensures fulfilment of license owners with Law No 4628 and license conditions. In addition, it approves tariffs and amendments and adjustments to the Law and ensures the compliance of the market behaviour with the provisions of the Law. It has also the role of settling disputes arising from connection and system usage agreements regarding transmission or distribution systems and arbitration of disputes under BOT, BOO and TOOR contracts before beginning of formal dispute settlement procedures specified in those contracts.

²²⁷ Enerji Piyasası Düzenleme Kurumu, Elektrik Piyasası Uygulama El Kitabı (Ankara, Nisan 2003), p. 1.

The Ministry of Energy and Natural Resources (MENR) is responsible for the development of energy policies and programs in coordination with the relevant governmental institutions and other key sector actors. It is also responsible for the coordination, supervision, assessment, implementation and management of international relations concerning cross border energy transportation projects.

As a candidate country of the EU, Turkey has prepared Law No 4628 in line with the EU Electricity Directives. In this context, it is committed to an ambitious privatization program in its energy sector, which is a crucial step for the liberalization of the market. Law No 4628 also enables privatization in generation and distribution areas. High Planning Council announced the 'Electricity Strategy Report' on 21 March 2004, setting out the basic principles and a detailed action plan for the privatization in the electricity sector. As for the privatization strategy, priority will be given to the thermal power plants and distribution zones. The Paper has drawn a road map, setting the mile stones for the privatization. Privatization of electricity will begin with the offer for sale of distribution assets in 2005. Presently, only one distribution area has been transferred to the private sector for operation and maintenance.

The Privatization Strategy also envisages privatization of state owned generating units after successful completion of privatisation of distribution network. The tender for the privatization of the public generating units, which has a share of approximately 84 per cent in total electricity generation, will begin in 2006. Currently the portfolios for the generation assets are being determined. Up to now, only two power plants, Çayırhan Lignite Fired Power Plant and Hazar Hydropower Plant were sold.

The current data concerning the installed capacity and electricity generation by generation companies in Turkey is as follows;

Installed Capacity by Generation Companies²²⁸:

Electricity Generation Company (State Co.)	: 20.909 MW (59.8 per cent)
Power Plants under Privatization Program	: 1.680 MW (4.7 per cent)
Autoproducers & Private Generators	: 4.695 MW (13.2 per cent)
BO-BOT-TOR Power Plants	: 8.303 MW (23.3 per cent)
Total Installed Capacity	: 35.587 MW (100 per cent)

Electricity Generation by Generation Companies:

Electricity Generation Company (State Co.)	: 65.085 GWh (46.3 per cent)
Power Plants under Privatization Program	: 2.591 GWh (1.8 per cent)
Autoproducers & Private Generators	: 23.318 GWh (16.6 per cent)
BO-BOT-TOR Power Plants	: 49.586 GWh (35.3 per cent)
Total Installed Capacity	: 140.580 GWh (100 per cent)

Although it is estimated that there is no need for new capacity until 2006-2007, the projections of the Government say that there will be a need for significant new capacity by 2009. As a result, large new investments will be required to deal with the growth in demand. However, due to the uncertainty in the Turkish power market, private sector abstains from making large energy investments in the sector. During this transition process, the key challenges in front of the Turkish power sector cannot be discarded. The 1990s have been a period in which Turkey's public finances have generally showed a poor performance, with increasing deficits and public debt, and deterioration of fiscal structure. There are still serious deficiencies in good governance, which lead to the mistrust of private investors.

Another significant challenge in front of the market is the power plants that were built on BOT basis, with the Treasury guarantees for the payments of purchased energy. These projects are a significant financial burden on TETAŞ, which is obliged to buy the energy from these power plants. The price of the energy produced in these

²²⁸ This information is accessible at www.teias.gov.tr

power plants is comparatively higher than the energy prices of EÜAŞ. This problem hinders the evolution of a competitive electricity market.

Another problem in the energy sector is the increasing dependence on imported fuels like natural gas in electricity generation. The share of natural gas in electricity consumption has increased markedly every year. Although Turkey has sufficient domestic hydro and lignite potentials, these potentials are not utilised efficiently and security of supply is threatened by too much relying on imported fuel like natural gas, which is highly sensitive to the oil prices in the world.

Although the aim is to set up a liberal electricity market in Turkey through giving roles to the private market actors, during the planning and restructuring process, their contributions and ideas are usually neglected.

There are also significant technical problems in the market. High loss and theft rates in electricity distribution are another crucial problem that has to be addressed by the authorities. To save energy and reduce the tariffs, necessary precautions for decreasing the loss and theft rates need to be taken. Furthermore, there are problems with the current electricity tariff system, which does not work in favour of the industrialists.

Finally and maybe the most important problem, which drags the liberalisation process into a chaotic situation is the unclear roles of the relevant institutions. It seems that there is a clash of interest among the institutions. The authorities like Ministry of Energy, State Planning Organisation and TEAŞ, TEDAŞ were playing the primary roles in policy-making, planning, investment, operating and setting tariffs until the enactment of Law 4628. However, with the adoption of the Law, there emerged new authorities like EMRA, Privatisation Authority with special competences. The uncertainty in the restructuring process has created a serious consensus problem among the authorities in the sector. These problems in competence sharing have slowed down the process through liberalisation.

5.3. Turkey and EU Membership

While the process of EU market integration continues, a similar effort has been undertaken by countries aspiring for membership of the EU. In order to achieve the 'acquis communautaire' in the field of energy, following three main objectives of Community energy policy have to be pursued by the candidate countries; ensuring security of supply, improving competitive power and environmental protection.

Taking into consideration the acquis, candidate countries were asked to²²⁹:

- agree on an energy policy with clear timetables for restructuring the sector,
- adopt the Gas and Electricity Directives and the other relevant directives into their national laws,
- prepare for crisis situations, mainly through the creation of 90 days of oil stocks,
- waste less energy and enhance the use of renewables such as wind, hydro, solar and biomass in energy production,
- improve the safety of nuclear power plants,
- ensure that nuclear waste is handled and prepare for the implementation of Euratom Safeguards on nuclear materials.

Candidate countries have made substantial progress through adopting these measures into their legislations. Most of them have already gone further than the current minimum requirements.

Turkey, as one of the candidate countries, is also trying to implement a free market understanding in the electricity sector to come in line with EU policy and deal with a rapidly increasing demand for power. In this context, Electricity Market Law No 4628 was passed on 3 March 2001. All the provisions of the Electricity Market Law are harmonized with that of EU Acquis.

²²⁹ Europe and Med Desk Eurelectric, op.cit., pp. 21-22.

In terms of market opening, all consumers that have direct link with the transmission network and the consumers, whose annual consumption is over 7.8 GWh are awarded as eligible consumers. Till the completion of the infrastructure for shorter periods, balancing and settlement mechanism was established for 8 hourly periods. About the access to the network, third party access is foreseen by Law without discrimination between the parties. As it is foreseen in the EU Electricity Directive, Turkey has set up its regulatory authority for the supervision of the performance of Electricity Market Law. With the Law, at the generation side, licensing procedure is foreseen by Law, which is also in line with the EU Directive. In terms of unbundling, generation, transmission and trading segments of the electricity industry have already been separated. Finally, as for the transmission system operation, an independent Transmission System Operator is foreseen in the Law, which will be TEİAŞ, the publicly owned generation company.

Ankara Agreement (1963), Additional Protocol and EC-Turkey Association Council, which constitute the basic legal documents of the Turkey-EU relations do not cover any special regulation about the energy sector. On the other hand, the regulations concerning free movement of goods, competition, state subsidies may have impacts on the energy market indirectly. In order to be a member of the EU, Turkey is obliged to harmonize its legislation with the EU Acquis. Therefore, Turkey considers energy policies that are compatible with the EU energy policy objectives.

The EC underlined the necessary steps that have to be taken by the Turkish Energy Authorities in order to be got prepared for the EU membership in the Accession Partnership Document on 14 April 2003.²³⁰ In the Accession Partnership Document, the short and medium term priority areas in the energy sector were determined that need to be addressed by the Commission. The short term priorities are as follows;²³¹

- Establish a programme for the adoption of the energy acquis, particularly that concerning issues other than the internal energy market.

²³⁰ Council Decision of 19 May 2003 on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with Turkey (2003/398/EC)

²³¹ Ibid., p. L145/48.

- *Ensure independence and effective functioning of the regulatory authority for the electricity and gas sectors; grants the authority the means to carry out its tasks effectively.*
- *Ensure the establishment of a competitive internal energy market, in compliance with the electricity and gas Directives.*
- *Ensure further alignment with the energy efficiency acquis and enhance the implementation of energy conservation practices.*
- *Design and start to implement a programme to reduce the energy intensity of the Turkish economy and to increase the use of renewable energy sources.*

And the medium term priorities are put as follows;²³²

- *Restructure energy utilities and open up energy markets in conformity with the acquis; further strengthen administrative and regulatory structures.*
- *Remove restrictions on the cross-border trade in energy.*
- *Complete alignment of national legislation with the acquis.*
- *Promote the implementation of projects in Turkey listed as projects of common interest in the European Community TEN-energy guidelines.*

After the announcement of Accession Partnership Document, Turkish Government has declared its National Program for the Adoption of Acquis in the Official Gazette on 24 July 2003.²³³ The National Program states that the Electricity Market Law, which entered into force on 3 March 2001 was prepared in line with the Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity. The Program was prepared with the aim of determining the priority areas and action plans for the sectors like energy, transportation, agriculture etc.

Priority areas in the National Program were set as follows;²³⁴

PRIORITY 14.1 Full alignment with the internal energy market

Task 14.1.1 Ensure independence and effective functioning of the regulatory authority for the electricity and gas sectors; grant the authority the means to carry out its tasks effectively

Task 14.1.2 Remove restrictions on the cross-border trade in energy

Task 14.1.3 Ensure the establishment of a competitive internal energy market, in compliance with the electricity and gas directives

²³² Ibid., p. L145/53.

²³³ National Program for the Adoption of Acquis, Official Gazete dated 24 July 2003 No. 25178 bis.

²³⁴ Ibid., p. 519.

PRIORITY 14.2 Establish a programme for the adoption of the energy acquis, particularly that concerning issues other than the internal market

Task 14.2.1 Harmonization with EU legislation imposing an obligation to maintain minimum stocks in crude oil and petroleum products

Task 14.2.2 Harmonization with EU legislation in the field of energy efficiency

Task 14.2.3 Establish a programme to increase the share of energy produced from renewable sources

Task 14.2.4 Harmonization with EU legislation in the field of nuclear energy

PRIORITY 14.3 Promote the implementation of projects in Turkey listed as projects of common interest in the European Community TEN-Energy Guidelines

Despite the commitments given to the EU with the National Program, Turkey has faced difficulties in implementing the Law. As mentioned in the previous section, there are still important problems in front of the Turkish Electricity Market that have to be addressed. Although Turkey harmonized its legislation with that of EU Acquis, there exist so many problems during the implementation process of the Law. These problems are also criticized in the EU's final Regular Report on Turkey's Progress towards Accession on 6 October 2004. The Progress Report states that;

Although Turkey has made progress with respect to adopting the Community acquis and is trying to accelerate its effective implementation, its overall alignment remains limited and uneven across the different areas of energy policy. Further efforts are necessary, throughout the sector, to align with the acquis and to ensure effective implementation and enforcement of the legislation. Sector restructuring including privatisation and the elimination of price distortions, should continue with a view ultimately to achieving competitive energy markets, in line with the acquis. Turkey will play a pivotal role in diversifying resources and routes for oil and gas transit from neighbouring countries to the EU. Further efforts are needed to ensure completion of alignment, effective implementation and enforcement of the national legislation and strengthening of administrative capacities in the nuclear field.

In the short run, it seems that it will not be very easy for Turkey to implement the Law No 4628. Although Turkey has moved forward in adopting the EU Electricity Directive, it comes to a deadlock now. While designing a free market system, the differing conditions of Turkey are neglected to a great extent. Although the electricity market of Turkey is not matured enough, the regulations of the developed countries like Britain are taken into account while setting the rules for the market.

Firstly, Turkey should prepare the necessary regulations and institutional background before giving start to the liberalisation process. For the sake of the EU membership, Turkey has harmonized its legislation with the Electricity Directive of EU, even though it has to pass through a smooth transition process like all the EU member states did. The introduction of liberal policies was nearly two decades ago in Europe whereas this process is quite new for Turkey. When we look at the initial stages of this process, we see that most of the EU member states and even the candidate countries are acting cautiously while transposing the electricity and gas directives and still most of them are resisting to opening up their electricity markets fully to competition. These developments demonstrate that there is a lack of common energy policy at the European level, which is binding for all the member states. There are only the appliances of small number of member states within the framework of EC regulations. Thus, while determining policies, Turkey should take into account the experiences of the member states, which derive from the attempts for the establishment of a common European energy policy.

As a result, a model, which seems appropriate for a country may not be appropriate for another country. In this case, Turkey rather than taking the British case as a model it should take into account its own market conditions, which are not yet matured enough like the British electricity market. While determining a strategy for the reformation of the electricity market, it should be noted that the political, economic, structural, legal characteristics and the sectoral conditions of a country normally differ from the other country's conditions. Therefore, if these points are disregarded by the authorities, the quoted applications may cause serious problems in the sector and drag the system into a standstill. This situation especially shows itself in the comparison between the applications of the developed and developing countries.²³⁵

²³⁵ G. Öz, 'Avrupa Birliği ve Türkiye'de Enerji Piyasalarında Rekabet Hukukunun Uygulanması' in AB'nin Enerji Politikası ve Türkiye (Ankara: Ulusal Politika Araştırmaları Vakfı, Mayıs 2004), pp. 68-69.

CHAPTER 6

CONCLUSION

Today, we cannot ignore the impact of international and supranational factors in the formulation of energy policies of the countries. World countries (STATES) have to take into account the international trends and developments more than before while developing their energy policies. Restructuring and regulation facilities in the post-1980 period, that are necessary for implementing the liberal policies, have augmented the impact of international factors in the formulation of energy policies. The mainstay of the liberal thought was to change the role of state in the economic field, to eliminate the barriers in front of the capital movement in the world and to give floor to the private ownership rather than public ownership in the fields where state had protected its position for many years. In parallel with these policies, sectors like infrastructure, energy and electrical energy, which were regarded as natural monopolies before, were also subject to this restructuring process.

As it was mentioned in the introductory part of this study, electrical energy has some genuine characteristics, which distinguish it from other sectors. Economically, electrical energy cannot be stored. Therefore, supply and demand has to be balanced at the real time basis. Besides, demand may vary according to the seasonal, monthly, daily and even in hourly basis. Consumers can utilize the electricity if they have a connection with the network. There is no technical solution that provides the flow of energy between the source of production and the consumer. The energy that is produced in a power plant flows through the transmission or distribution network. The consumer takes the energy from the network. For that reason, it is significant to effectively coordinate and plan the different sources of production for the well-

running of the system. In order to ensure supply security and in case of any power failure, it is crucial to have enough reserve capacity to use when necessary. Thus it is understandable that this can only be achieved with a good planning and coordination.

On the other hand, when we look at the characteristics of the network system, we see that transmission and distribution systems usually have high sink costs and have the feature of economics of scale, which means that it is not always economic to establish a second transmission and distribution network for the reasons of creating a competitive environment.

Such genuine characteristics of the electricity sector make it a unique case in the process of restructuring and liberalization. The EC has initiated its liberalization policies in the electricity sector with the aim of creating a single electricity market in Europe. It is believed that with a single electricity market that is fully open to competition, the competitive advantage of the European economy can be improved. After long-lasting and controversial negotiations between the member states, an Electricity Directive, which envisages common rules for the member states on the generation, transmission and distribution of electricity, was put into force in 1996. As it was examined in the previous chapters, the stipulations of the Directive were market opening for all consumers according to the determined timetables; unbundling of generation, supply, distribution and transmission facilities to prevent cross-subsidization and discrimination; and to ensure third party access to the transmission and distribution grids. Besides these, the Directive lays down the social targets concerning the security and quality of supply, price reductions and environmental protection that have to be met by the private enterprises in order to protect the public service obligations in a competitive environment. According to the assessments of the EC, the initial stage of liberalization process had showed a positive impact on the European economy.

Although most of the member states went beyond the minimum requirements in terms of market opening, there were big differences among the member states' market opening levels. With regards to the third party access, it is noted that

discrimination could hardly be prevented in most of the member states. Due to the lack of a standard published tariff for the third party access, this problem seems to continue in the coming days. Another problem, that couldn't be solved, was the ineffective unbundling of generation, distribution and transmission assets. Taking all these problems into account, the EC repealed the 96/92/EC Electricity Directive and a new Directive was put into force on 1 July 2004.

Although a number of important EU initiatives have been taken to strengthen the supranational influence on the energy policy since late 1980s, the current developments in the EU showed that the EU is still an arena of political rivalry for member states, which try to pursue their national self-interests. In such a sensitive sector, surely, member states struggle for a system, which answers the needs of their domestic system. The best explanation of the current process in the EU can be made by intergovernmentalist premises, which involves bringing the conflicting interests together, that are coming from different energy perspectives and infrastructures in the member states, and the wish to protect the national energy policies, which are contradicting with the internal market principles. For that reason, the Commission seeks to balance the interests of the member states in the energy sector to reach a compromise in the Council of Ministers for the purpose of passing EU regulations or directives in the energy field. But it has failed to a great extent, since the differing interests of the Member States are almost impossible to compromise at the domestic, intergovernmental and sectoral levels.

The failure of the EU in creating a single electricity market has led to mistrust over any plans to hand more power to Brussels. For example EU has failed to intervene in key European events, such as the merger of two giant companies E.ON and Ruhrgas. This has decreased its credibility and reinforced Eurosceptic views that Europe benefits some countries far more than it does others.

It remains difficult to imagine how supranational elements will advance in the new enlarged EU as well, as up until now the 15 old members have been unwilling to give up their sovereignty in particular sensitive areas for them and now there are 10 new

members, who have different priorities and are likely to strongly defend them. Besides, there is a huge economic and numerical gap among the member states. The enlargement of the EU to 25 member states has amplified the challenge that is faced by the member states.

In the electricity sector, we see that ten years of liberalization have transformed a fragmented industry dominated by a small number of regional state utilities into a European market ruled by an oligopoly of powerful privatized energy companies. The Third Benchmarking Report of the EC concerning the implementation of electricity and gas markets also states that many markets remain dominated by a limited number of suppliers, which discouraged the entry of new market players. Also it notes that they don't tend to compete with each other. This increasing market concentration has added much to the Eurosceptic views, which see the EU as a platform of pursuing national self-interests. The failure of EU regulations and institutions has led to mistrust among the member states, which have relatively low competitive advantages.

The British experience also demonstrates that there is concentration of a number of firms in the distribution field. Before liberalisation, there were 12 regional electricity companies, but with the liberalisation, number of companies has reduced to five with mergers and acquisitions. Such market concentration gives floor to the dominance of some companies over the others and hampers competition. In order to ensure fair competition, the market players, who are acting freely in a liberal market, should be monitored by an impartial regulatory authority. Thus the regulation of the electricity market by a fair Authority will ensure the well-functioning of the market in favour of every market player including the consumers.

A unified electricity market is necessary for the well-functioning and success of the EU. However the failure by a majority of European member states to implement the European electricity directive by July 1, 2004 proves that there is still much to do. The reason behind this failure can be evaluated as the result of continuing tensions within the member states; between the member states and between the member states

and the EC. Domestic tensions are also important factors in the failure to transpose the legislation. For instance, Germany and UK have struggled to bring together environmental aims with the desires of industry and industry's fear of losing competitive advantage to other European states. Member states are not giving away too much power to the supranational authorities in Brussels. The process by which implementation of key legislation is devolved to member states and subject to voting rules means it is almost impossible to get anything done efficiently.

The opening of the markets, in theory, will pave the way for the pan-European energy market, offering consumers access to competitively priced electricity. In practice, it is understood that it is not such that easy to achieve the target of cheap electricity prices and efficiency through following liberal policies as well. It is apparent that there are still many obstacles to full competition, which lead to the questioning of liberal policies. For example, most of the costs on the large consumers are transferred on to the small consumers with the consideration of liberal policies. Large consumers have relatively higher bargaining power in the market than the small consumers because of their high electricity consumption. Therefore retail suppliers are usually targeting large consumers. However, under a monopolistic structure, we cannot talk of discrimination between the large and small consumers. A competitive market model is not always advantageous; this model brings extra costs on to the consumers. For instance in Britain, as mentioned in Chapter Four, market opening did not bring benefit to the small consumers, who were awarded with choosing their suppliers in 1998, even though the role of Regulatory Office was to prevent discrimination between the consumers.²³⁶ The rationale behind the full market opening is to give all the consumers the right to choose their suppliers freely and accordingly to increase the competition among the suppliers. Nevertheless the number of consumers that are switching to other suppliers is quite limited in the EU. This was also the case for the consumers in Britain. Most of the consumers buy their electricity from only six suppliers and British Gas, although British Gas offers relatively high prices in the market. Since consumers usually prefer buying

²³⁶ Steve Thomas, 'Why Retail Electricity is Bad for Consumers: British Experience', paper presented to the conference on Restoring Just and Reasonable Electricity Rates, Washington D.C., 28-29 September 2002.

electricity from the supplier which has credibility in the market. Moreover, number of new entrants to the market is quite low. The strategy of this small number of suppliers is usually to protect their high price policies in the market in order to prevent any competition on prices. Consequently, despite the fall in the wholesale electricity prices, the small consumers cannot benefit from this fall in the prices. This requires effective regulation by the Regulator and more involvement of the Government to protect the rights of all the consumers. Paradoxically, despite the negative consequences of the liberalisation process, the UK and the Scandinavian countries are regarded as fully-functioning competitive markets in Europe and given as best examples by the authorities in the EU.

When we look at the impact of liberalisation process on the employment in the electricity sector, we see that the competitive pressure enforces the companies to restructure themselves through mergers or acquisitions. This restructuring has led to the following of downsizing policies by the companies in the market. According to a Report, written by a Consulting Firm on the 'Effects of the Liberalisation of the Electricity and Gas Sectors on Employment' of 1998, in the last decade, most of the job losses were seen in the electricity and gas sectors. According to the statistics, 250,000 job losses were recorded in European electricity and gas sectors between the years 1990-1998. Unions predict that with the increase in market concentration and mergers, the job losses would reach to 25 per cent in the coming five years. However, despite the general tendency of increasing unemployment in the European electricity sector, the ratio of unemployment differs among the member states. According to the ILO Report, most of the job losses were occurred in the UK. On the other hand in the member states where still public ownership is essential, the ratio of unemployment in the electricity sector is only three per cent. With these indicators, it may not be wrong to come to the conclusion that liberalization process has led to an increase in unemployment.²³⁷

²³⁷ Ecotec Research and Consulting Ltd, The Effects of Liberalisation of the Electricity and Gas Sectors on Employment, (Birmingham, 1998), pp. 7-8.

The experiences in the EU confirm that even in the developed countries, there have appeared so many problems while adopting the EU Acquis into their legislation. Most of the member states are reluctant to meet the requirements, which are foreseen in the Electricity Directive. Due to the differing economic, political and market conditions and law systems of the member states, the state authorities do not want to devolve their rights to the EU institutions in this highly sensitive area. So today, we can hardly talk of a single electricity market for Europe.

The experiences also show that an electricity market, which functions on a liberal basis, has to be regulated effectively to prevent market distortions, price hikes and to ensure security of supply. In this context, the regulatory authorities have quite important roles. Unless the market is regulated, the market concentration cannot be prevented and the rights of the consumers (especially the domestic ones) cannot be safeguarded. If the aim is to strengthen the European economy, then a regulator at the European level has to be appointed. But, firstly, the questions of what is meant by liberalization and what is expected from the European energy market, has to be answered. If the main goal is to provide cheap energy for all the consumers and to ensure long-term investment, then an effective regulation is of crucial importance at the European level. However it is debatable how far nations are ready to surrender their powers to the EC. The EC should play the role of mediator among the regulators in the 25 member states and encourage them for cooperation. Since there is a risk that national regulators may focus too much to their national concerns. However there is a need for an agreement on common principles to make an EU-wide electricity market work such as the harmonization of transmission grids and agreements on tarification. Although it seems that it is not possible in the short run for the EC to play the role of European Energy Regulator, it is clear that there needs to be harmonization among the various national regulatory regimes, plus regulatory bodies outside the EU. In order to prevent the oligopoly of strong European suppliers, a single Energy Regulator seems necessary at the European level.

Liberalisation process, which has started in 1980s, has witnessed both successful and unsuccessful experiences in the world. For some, if the process is not regulated well,

it may have higher costs than the previous systems that were under public ownership. For Europe, the energy liberalization process, as set out in the European directives, is only a start and full market opening in 2007 will not be the end of this process.

Turkey is also one of the countries, which starts implementing these liberal policies in its electricity sector with the credits given by World Bank in 1980s. In last two decades, in the framework of the policies that are shaped in line with the World Bank and International Monetary Fund's policies and the efforts for harmonization with the EU, Turkey has achieved a new stage in the restructuring of its electricity sector. For the future of the Turkish electricity sector, it is of utmost importance to make realistic assessments, while taking into account both the distinctive conditions of its home country and the developments in the international arena.

In the developing countries like Turkey, it is understood that the transition process is not very easy with their institutional structure, less developed private sector, weak politics and the legal status. Especially, the characteristics of the electricity sector and the institutional capability of the countries are important factors in the restructuring process.

In the National Program of 2004, it was stated that Turkey even goes beyond some of the member states in adopting the requirements of EU Electricity Directive. However, it should be examined whether the legislation is in conformity with the real situation of Turkey. There are important shortcomings in the functioning of the market, such as the effectiveness of regulation, price trends and high loss rates. As stated in the previous chapter, Turkey should have considered its own market conditions, economic, social political and legal structure, before adopting the EU Electricity Directive.

In this study, British and Turkish cases were taken into consideration. Turkey has adopted a Model similar to UK Model, while drafting its Electricity Law, which is also in line with the EU Acquis. UK has successfully adopted a privatization model in its electricity sector in the initial stages of the liberalisation process. Taking the

success of UK model into account, Turkish authorities had passed the Law No 4628 quickly from the Parliament without making any observations about its consequences in the UK electricity market. As it was mentioned above, the cost of liberalisation process was high for UK despite the success of privatization model. The liberalisation process has had some negative consequences in the market like price hikes, unemployment and market concentration. If such problems occur in a market, which is regarded as fully competitive, then it is necessary for Turkey to draw lessons from the experiences of UK and other countries' especially in the EU before adopting the Law. It should be noted that UK has had the capability of tackling these problems with its strong economy. Besides, it has been working for a liberal electricity market since two decades and it met with many challenges and is still facing. But for Turkey the beginning of the process is quite new. It enacted its Law that envisions a liberal electricity market in 2001, only three years ago. Last but not least, there are significant differences in law-making processes and institutional capabilities of the two countries. Thus, about the costs of liberalisation process, it is not wrong to say that the burden of it on the Turkish economy, which is still in the transition process, will be tremendous. All these prove that Turkey should be careful while adopting policies to ensure its security of supply and take realistic examples into account. Finally, while determining a strategy for the restructuring of the electricity market, it should be noted that the political, economic, structural, legal characteristics and the sectoral conditions of a country are usually different from the other country's conditions. Therefore, if these points are disregarded by the authorities, these applications may cause serious problems in the sector and drag the system and accordingly the economy into a standstill.

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