



Will the governance of energy policy ensure the achievement of ambitious goals?

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Audit report

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Performance audit “Does the energy policy governance established in Latvia ensure effective decision-making for the development of the energy sector?”

The audit was performed based on audit schedule No 2.4.1-22/2023 of the First Audit Department of the State Audit Office of Latvia of 30 May 2023.

The cover design includes an image from the website www.depositphotos.com, *Lightbulb and crumpled white paper balls*, author *Khakimullin*.

Dear Reader,



Latvia has committed to achieving very ambitious energy policy goals by 2030, which stem from our international commitments. We are close to the midpoint of the implementation period

of the National Energy and Climate Plan 2021–2030 (NECP) currently, so it is useful to assess how the governance of energy policy has progressed so far, as there is not much time left until the 2030 deadline to achieve the goals.

During the audit, we have concluded that an effective system and prerequisites for the successful implementation of energy policy have not been established despite the goals of energy sector have been set in Latvia. Although deadlines have been set for achieving the goals, mainly 2030, there is a lack of intermediate indicators that would allow for regular assessment of progress and making necessary adjustments. In addition, two years after the establishment of the Ministry of Climate and Energy, it still lacks effective tools for implementing the energy policy, and the Ministry of Economics still plays a significant role in the performance of certain energy functions. When analysing the activities of the Ministry of Economics and the Ministry of Climate and Energy, we concluded that irregularities in the management of energy policy had contributed to the adoption of ineffective and uneconomical decisions in some cases, which created additional expenses for the state budget and affected the national economy negatively.

If the governance energy policy is not significantly improved, including effective monitoring of the implementation of planned activities and achievement of indicators, and a clear framework for attracting private financing

is not created, the goals set in the NECP for 2030 will not be achieved.

Following the audit, we have called on the Ministry of Climate and Energy to improve the governance of energy policy including identifying responsible state institutions for the implementation of measures and developing proposals for attracting additional public and private financing. There is little time left to achieve the goals, while funding is not enough to implement all measures. Therefore, identifying priority measures and making the most effective investments that would ensure a greater impact on achieving the goals, as well as providing a clear signal to businesses operating in the energy sector about development opportunities, which is currently lacking, are essential. We have also called on the Ministry of Economics to take steps to ensure more active involvement of state-owned enterprises in the implementation of the NECP goals and the development of renewable resource capacities in the territory of Latvia.

At the same time, one should emphasise that achieving the goals of energy policy, in accordance with one's competence, should involve not only the responsible policy makers of the sector but also all involved institutions, including local and regional governments, social partners, the non-governmental sector, businesses and the public at large.

We would like to thank the employees of the Ministry of Climate and Energy, as well as the Ministry of Economics for the information provided and constructive cooperation in the audit. We also express our gratitude to the energy sector experts who provided significant input into the audit process.

Respectfully
Mr Mārtiņš Āboliņš
Department Director

Summary

Main conclusions

In line with the common EU frameworkⁱ, which aims to ensure the implementation of the commitments undertaken by EU Member States in the context of the Paris Agreement - UN Framework Convention on Climate Changeⁱⁱ, Latvia has committed to achieving ambitious energy policy goals by 2030. The objective of this audit was to examine whether the governance of energy policy established in Latvia ensured effective decision-making for the development of the energy sector and progress towards achieving the set goals.

Although a number of policy planning documents and information reports are in force in Latvia that address energy and climate change mitigation issues, a long-term policy planning document for the energy sector is only at the development stage in Latvia. The basic principles, goals and directions of action of the Latvian National Energy and Climate Policy 2030 are determined by the basic development planning document for the energy sector, that is, the National Energy and Climate Plan 2021–2030. The initial version of the NECP was approved on 4 February 2020ⁱⁱⁱ, and the energy policy based on this version of the NECP was implemented for three and a half years. The initial version of the NECP has expired with the approval of the updated NECP on 12 July 2024^{iv}.

In Latvia, the NECP has been developed taking into account the provisions of the EU Regulation^v. The Plan was drafted following the energy policy and legislation developed by the EC and is aimed at achieving the EU climate goals, taking into account the division of dimensions determined by the EU: (1) decarbonization, (2) energy efficiency, (3) energy security, (4) internal energy markets, (5) research, innovation and competitiveness. In each of the dimensions, the NECP determines the values of the target indicators that Latvia must achieve by 2030. The NECP also defines the actions to be taken to achieve the goals and provides for monitoring and reporting measures for the implementation of the NECP, as well as periodic updating of the NECP.

To safeguard progress towards the achievement of the planned energy policy goals given the diverse impact of energy policy and the numerous policy planning and regulatory documents affecting the direction of energy policy, effective policy governance plays a decisive role. We are now close to the midpoint of the NECP implementation period, as more than four years have passed since the NECP was approved, and, in the auditors' opinion, it is useful to assess how the governance of energy policy has been progressing so far, as there is not much time left until 2030 and the deadline for achieving the energy goals.

The audit assessed the energy policy framework, the institutional system, and we have examined whether the established governance of energy policy system has effectively contributed to the achievement of energy policy goals by assessing individual examples selected in the audit.

The audit has concluded that the governance of energy policy established in the country does not ensure targeted progress towards achieving the ambitious goals set out in the NECP, nor does it provide a clear vision of how to finance the measures necessary to achieve the goals. Without significantly improving the governance of energy policy including by safeguarding

effective monitoring of the implementation of planned activities and achievement of indicators and providing a clear vision of the priority measures to be taken and their financing sources, the goals set out in the NECP for 2030 will not be achieved.

- ❖ *In Latvia, energy sector-related goals and indicators have been set in the NECP, however, a system has not been established and prerequisites for effective energy policy implementation have not been created, as the Ministry of Climate and Energy needs to improve the system for interim assessment and ensure high-quality monitoring of the implementation of the NECP. To achieve the energy sector goals, both the energy policy framework and the institutional system must be improved.*

The NECP is a planning document that sets out the goals of energy policy; it has been elaborated following the principles set out in the EU Regulation. However, it cannot be considered a full-fledged energy sector strategy that would balance the goals set by the EU with the needs of the Latvian economy, security aspects and the conditions for affordable and competitive energy prices determined in the most appropriate manner for the situation in Latvia. For the effective development of energy policy, specifically defined development directions are also important to promote investment attraction and provide businesses involved in the energy sector with a clear signal about development opportunities, which is currently lacking.

During the audit, energy policy makers have also defined the need to develop a long-term energy policy document. The updated NECP stipulates, *in order for Latvia to move towards achieving climate neutrality in 2050, the Ministry of Energy and Climate shall develop an Energy Strategy 2050 in 2024 with the aim of assessing scenarios for the decarbonisation of the energy sector, energy security and independence.* The conclusion is: although belated, there is now an opportunity for politicians and the industry to elaborate an energy strategy that will guide the industry not only towards achieving the NECP goals set by the EU but also towards the overall development of the industry.

The audit has concluded that although the goals of the NECP are set in accordance with the goals set in other policy planning documents, the NECP does not include information on how and whether the measures and activities planned in the NECP will ensure the achievement of the goals. The impact of the measures and activities planned in the NECP on the achievement of the targets cannot be tracked, and the necessary resources and their sources for the planned activities are only partially identified. Most of the goals can be achieved only by carrying out additional activities and attracting additional funding. The amount of additional investment calculated by the Ministry of Finance on the basis of the information included in the NECP in the updated NECP is at least 13.1 billion euros^{vi} to achieve the goals of the NECP.

There is a following audit conclusion: despite the risks related to the lack of funding required for the implementation of the NECP and problems with attracting funds have been identified, the issue is still mainly being addressed in the form of future actions at present by starting to identify needs, seeking solutions in conditions of limited time and human resources, etc. Given that four years have passed since the approval of the NECP and six years remain until the results should be achieved, the auditors are not sure that attracting funding is possible at all. One should remember that without attracting funding, the NECP goals cannot be achieved, therefore there is a significant

risk of not achieving the goals and, accordingly, being subject to sanctions from the EC. The EC has the right to refer Latvia to the Court of Justice of the European Union for failure to meet the goals, as failure to meet the goals is perceived as failure to comply with EU law. The Court of Justice of the European Union may impose financial sanctions on a Member State both fines and late payment fees; and it should be noted that payments will have to be made until the goals are fully met, as the application of sanctions does not relieve a Member State from its obligations.

When updating the NECP, the effectiveness of previously implemented measures and progress in achieving the goals have not been assessed. The Ministry of Climate and Energy, as the implementer of sectoral policy, has not followed the progress of the implementation of the measures set out in the NECP, whose implementation deadlines were until 2023 by leaving this to the competence of the sectoral ministries. Thus, in the auditors' opinion, the Ministry of Climate and Energy does not ensure coordinated monitoring of the implementation of the NECP measures. When assessing the existing monitoring system, the auditors have found that the Ministry of Climate and Energy has not created the prerequisites for ensuring substantive monitoring of the implementation of the planned measures. There are basically set deadlines both for the goals and the planned measures, that is, 2030 in most cases. Consequently, there is a lack of intermediate values for ensuring interim monitoring that would allow assessing progress. In its turn, without a qualitative assessment of the progress of achieving interim goals, a qualitative update of the NECP and specification of the measures to be taken are not possible. The auditors conclude that the existing monitoring system has not used all the tools for effective progress towards achieving the planned goals.

The Ministry of Climate and Energy, as the leading state institution in the field of climate policy and energy policy, began its operations in January 2023 after the reorganization of the Ministry of Economics and the Ministry of Environmental Protection and Regional Development. The audit has concluded that the current institutional system has not achieved the goal of reducing the duplication of competencies of the two ministries – the Ministry of Economics and the Ministry of Climate and Energy because the energy function has been removed from the regulations of the Ministry of Economics but its responsibility for the energy sector remains at present. The Ministry of Economics safeguards the implementation of sectoral policy in the institutions subordinate to the ministry (State Construction Control Bureau, Latvian Investment and Development Agency) and state-owned enterprise “*Public Asset Manager Possessor*” Ltd, which performs tasks related to the energy function, among others. At the same time, the Ministry of Economics is the holder of state capital shares in one of the largest energy service providers and electricity producers in the Baltics, JSC *Latvenergo*.

The audit has found that the implementation of certain tasks related to the implementation of energy policy is not ensured in accordance with the NECP and other laws and regulations, and these tasks have an impact on the implementation of the measures planned in the NECP, including:

- The implementation of the NECP planned measures under the responsibility of the Ministry of Economics and the Ministry of Climate and Energy with a deadline of 2023 has been ensured only partially;
- The elaboration of the updated NECP project was delayed;

- The terms and conditions for targeted support to compensate for the increase in energy prices were developed with a delay;
- The studies planned by the Ministry of Climate and Energy, including in the field of energy, are not implemented consistently although funding is provided for this purpose in the budget;
- The development of documents regulating the activities of the Ministry of Climate and Energy has not been provided on time and in accordance with the legal framework.

In fact, neither the planned permanent monitoring of the implementation of the NECP nor the oversight, which was planned as a tool for the effective implementation of the NECP, has been provided and the latter is not functioning:

- The monitoring and reporting system required for the implementation of the NECP has not been established for more than four years, as its development will continue until May 2025;
- The planned energy policy oversight body, the National Energy and Climate Council, which was established to ensure a coordinated, integrated and sustainable state policy for addressing energy and climate issues, has only operated until 2021;
- the Energy, Environment and Climate Committee (thematic committee of the Cabinet of Ministers), established in December 2023, which is intended to assess progress in achieving the NECP among other things, is already not meeting every month, as provided for in the Prime Minister's Order.

In general, one can conclude that by defining goals and indicators, but not improving the system for interim assessment and not safeguarding effective and high-quality monitoring, Latvia needs to improve the NECP implementation monitoring system and it is necessary to improve the prerequisites for effective energy policy implementation. The auditors consider that it is crucial both to implement and update the planned NECP monitoring and assessment measures, and to ensure their high-quality implementation.

❖ ***The examples selected in the audit show that ineffective and uneconomical decisions create additional expenses for the state budget and adverse consequences for both the beneficiaries and JSC "Sadales tīkls" (Distribution grid).***

In the 2021/2022 heating season, the Ministry of Economics had established a compensatory mechanism to mitigate the negative social and economic impact of high energy prices on the well-being of the population and economic growth. However, the period of application of the support was not based on electricity market trends. As a result, households were not provided with support during the period when electricity prices were highest (from July to September 2022). In its turn, support was paid out in 2023 (from January to April) even though the electricity price on the Nord Pool Exchange was already below the threshold set by the Ministry of Economics for the application of support of 160 euros/MWh. In addition, the dynamics of prices set by electricity traders indicated a risk that the application of support payments regardless of the electricity price on the Nord Pool Exchange did not contribute to a faster revision of electricity traders' prices in line with market price trends.

The decision of the Ministry of Climate and Energy to switch from a net accounting system to a net settlement system had a negative impact on one of the initially set goals of the support measure for households for the installation of solar panels, id est, to avoid unpredictable fluctuations in

energy prices because the net settlement system involved the transfer of financial risks from the distribution network operator to households. It was partly caused by the fact that the previously set conditions for granting support to population for the purchase of solar panels did not provide for precise prerequisites and measures to promote the consumption of electricity produced in households primarily during its production, which was one of the most important conditions for promoting the effectiveness of the support provided to population. Moreover, by not coordinating the deadlines for the adoption of decision (support measure for the installation of solar panels for households and the transition to a net settlement system), the Ministry of Economics and the Ministry of Climate and Energy (as the successor of the Emission Allowance Auctioning Instrument measures from the Ministry of Environmental Protection and Regional Development in early 2023) created the need to set a longer deadline for the transition to a net settlement system. According to auditors' estimates, it will create an additional financial risk of 741,809 euros for the distribution network operator each year until February 2029. Such hasty and mutually uncoordinated decisions both undermine citizens' trust in the sustainability of energy policy and cause losses for industry participants.

- ❖ *The current energy policy has not facilitated a clearly understood and targeted sustainable development of the energy system including investments by certain state-owned enterprises in the development of energy infrastructure that are based on business interests primarily with insufficient involvement in achieving the energy goals set by the government.*

State-owned enterprises take into account the goals and directions of action set out in existing energy policy planning documents when planning their future investments and infrastructure development. However, a common trend can be observed in investments to focus on maintaining existing infrastructure.

Investments and the pace of development related to new energy generating capacity and storage solutions should be assessed more critically. The portfolio of generating capacities of neither Latvia nor JSC “Latvenergo” has changed significantly in the last 15 years. Electricity generation is still based on natural gas (TEC-1 and TEC-2) and hydropower (Daugava HPP cascade). The installed RES capacities (solar and wind energy) in Latvia in 2024 were 2.5–5.5 times smaller than in Estonia and Lithuania. One should note that a number of administrative obstacles (for example, a lengthy environmental impact assessment process and connection capacity reservation rules) have hindered the more rapid development of renewable energy capacity in Latvia, for the reduction of which JSC “Latvenergo” has submitted proposals to the Ministry of Economics and the Ministry of Climate and Energy.

From 2022, the focus of the development of new electricity capacities of JSC “Latvenergo” is on solar power plants and wind farms. However, the results achieved currently do not change the portfolio of existing generating capacities significantly. JSC “Latvenergo” has a significant impact on the national decarbonization goal (reduction of energy GHG emissions), as natural gas consumption by JSC “Latvenergo” accounts for an average of 38–47% of all natural gas consumption in Latvia. To ensure efficient load on the electricity infrastructure and make economically sound decisions on investments in the development of electricity infrastructure, determining an optimal structure of energy generation sources for the Latvian situation is crucial (cogeneration plants, hydroelectric power plants, wind, solar, etc.) taking into account the existing

structure of generation capacities, local advantages and specifics, optimal loading of the transmission system, expected electrification and the necessary flexibility services (balancing, energy storage, etc.) and their volume. Yet, no such structure is specified in any development planning document of energy sector at present, and the Ministry of Climate and Energy relies on self-regulation of the energy market.

As the number of non-permanent sources of electricity generation increases, the need for various flexibility services or base powers increases significantly. Currently, the position of the Ministry of Climate and Energy regarding the development of flexibility services is cautious, which is justified by the lack of experience of market participants and potential risks associated with it. At the same time, measures are taken at the Baltic regional level to determine the regulation of ancillary services in the electricity market (for example, the introduction of a 15-minute trading interval and the start of operations of the single balancing reserve market platform). Consequently, the flexibility services market is developing slowly, and its more rapid development is expected from 2025 when significant additional information will be obtained about the operation of the electricity system and the expected demand volume and price formation of the ancillary services market in it after the Baltic States join synchronous operation with the continental European electricity system. At present, it is not determined what the desired structure of electricity generation, including flexibility services, would be and what the achievable goal would be (e.g., demand response service, energy storage service, balancing service). Energy market participants need to send a clear signal about their role in the energy market so that market participants can plan investments, develop the necessary areas and cover demand. Therefore, in accordance with the conclusions drawn in 2025, the stakeholders (transmission system operator, the Ministry of Climate and Energy and the Public Utilities Commission) must ensure a high level of readiness to make the necessary adjustments to the legal framework to safeguard the development of various ancillary services, as well as flexibility and demand response services markets if necessary.

Key recommendations

Following the audit findings, there were three recommendations issued to improve energy policy governance. The implementation of the recommendations is expected to:

- Improved energy policy governance measures:
 - Improved monitoring of energy policy implementation, including the establishment of responsible institutions for the implementation of measures set out in policy planning documents, intermediate targets and progress in achieving goals;
 - The current system for attracting public and private funding to achieve energy policy goals has been assessed and a proposal has been drafted for attracting additional public and private funding;
 - When planning the next National Energy and Climate Plan, a system has been improved in which the ambitions proposed by the EC for achieving climate neutrality, the impact on the Latvian economy and end consumers are assessed, as well as sectors, potential measures and the necessary funding to achieve the goals have been identified;
 - The operation of the established monitoring system has been ensured in accordance with the plan;

- Priority measures in the energy sector have been determined, which have the greatest impact on the energy goals set out in the National Energy and Climate Plan.
- Actions have been taken to ensure more active involvement of electricity producers in reducing administrative obstacles hindering the development of the energy sector to promote the implementation of the NECP objectives in the development of RES capacities in the territory of Latvia.
- Actions have been taken to include an electricity generation structure suitable for Latvian conditions in the Latvian energy planning documents by assessing capacity adequacy and electricity consumption forecasts in various energy sector development scenarios.

References

- i Regulation [2018/1999](#); EU legislative package "[Ready for the 55% target – EU Green Transition Plan - Consilium](#)". Resource viewed on 16 December 2024.
- ii https://unfccc.int/sites/default/files/english_paris_agreement.pdf, resource viewed on 6 September 2023.
- iii Cabinet Order No. 46 on the National Energy and Climate Plan of Latvia for 2021-2030 of 4 February 2020 (expired on 12 July 2024).
- iv Cabinet Order No. 573 "Updated National Energy and Climate Plan for 2021-2030" of 12 July 2024.
- v Regulation [2018/1999](#).
- vi Section 5 of Informative Report "Fiscal Risk Declaration" by the Ministry of Finance (adopted for consideration at the Cabinet meeting of 20 August 2024).