Current UK energy policy: Are all elements of policy pulling in the same direction?

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Outline

• UK Energy Policy
• European Context
• Gas Market Policy Success
• Electricity Market Policy to date
• Sensible Electricity Policy
• Is policy pulling together?
  – Renewables
  – Energy Poverty
  – Energy Security
What is UK energy policy?

- Secure
- Affordable
- Low Carbon
- Energy
Macro Context

Energy Expenditure as share of GDP

Source: ONS
European Energy Policy Context

- 20-20-20 Targets for 2020:
  - 20% reduction in CO2e (hard target)
  - 20% renewable energy (indicative target)
  - 20% reduction in energy intensity (aspirational target)

- Completion of Electricity and Gas markets (3rd Energy Package)


- Reality of patchy implementation
Gas Market ‘Policy’ a huge success

• Liquid, transparent wholesale market capable of handling supply and demand side shocks.
  – 2006 Rough incident
  – Now benefiting from falling commodity prices
• Demand responding to high prices
• Significant investment response to decline of UK production:
  – In LNG
  – In Storage
  – In UK continental shelf
• Norwegians and international LNG market love us (and we them).
Gas market ‘policy’ a huge success

- UK wholesale gas markets deliver:
  - Efficient prices (which are lower over long term)
  - Energy security (via market investment)
  - Lower carbon backstop option

- By contrast EU partners very confused (and wrong) on role of market in gas.

- Note to policy makers:
  - DO NOT MUCK THIS UP!!!
UK electricity market experience

• Electricity markets have delivered so far and can continue to do so.
• Regulation has kept network charges down.
• Privatisation of final price a prize worth having (as in gas).
  – Policy makers take ‘control’ of this price at their peril.
• No doubt short run security of supply issues do exist in electricity.
• These are well handled by incentive mechanisms:
  – Quality of service incentives
  – Auctions for peak capacity.
A sensible electricity policy?

- **Affordability:**
  - Only efficient markets (and tight network monopoly regulation) can keep the long run prices close to efficient costs.
  - Fuel poor customers should be handled outside of market via direct subsidy (efficiency and equity clearly separated).

- **Energy security:**
  - Competitive markets deliver over capacity in general.
  - It is only where markets not allowed to work that we see capacity ‘shortages’ emerging.

- **Low carbon:**
  - A high and stable (or low and credibly rising) carbon price throughout the economy.
  - Must recognise that incentives required on the demand and supply side.
  - Renewables subsidy can only be justified by learning benefits of deployment (not by reference to ‘green jobs’).
Is UK electricity policy sensible?

• Many of the elements are in place.
• However many of the core elements under threat:
  – Reliance on market for low prices
  – Incentivising security of supply directly
  – Emphasis on pricing carbon
  – Technology neutral subsidies to learning benefits.

• Many individual UK policies have a rationale but are poorly targeted…
Are policies pulling together?

• Lack of high and stable enough carbon price is number one source of policy confusion.
  – Inhibits demand response.
  – Has delayed nuclear investment (if truly efficient).
  – Has led to more coal and less gas being burnt (and more CO2).
  – Has slowed development of bio-fuels (land fill gas and co-firing) and prolonged their subsidy.

• As a result:
  – Mature low carbon technologies have not emerged strongly.
  – Large reliance has been placed on subsidies to less developed technologies.
  – General policy uncertainty has delayed investment and unnecessarily raised issues of ‘will the lights go out’.
Renewables support in the UK

- The general policy context has placed pressure on the ROC scheme to deliver.
- The performance of this scheme is poor.
- Currently this scheme costs £1bn p.a. and recycled £316m in 2007-08. Delivery was 64%.
- There are two scale-able renewable options:
  - Onshore wind where planning issues are key.
  - Offshore wind where cost issues are key.
- ROC scheme ok for onshore: just remove unnecessary revenue recycling.
- Offshore much better to move to annual auctions for capacity (as we have for transmission capacity to wind farm) to reveal true cost. Banded ROCs costly alternative.
Tackling energy poverty

• Least cost mechanisms for delivering low carbon supply essential, otherwise decarbonisation agenda will have to be abandoned.
• Democratisation of demand (via smart metering) will be key in longer run (and very popular).
• Vulnerable customers should be targeted for direct payments and for capital investment and indiscriminate subsidy should be avoided.
• More local initiatives emphasising low income households can play a role.
Energy Security Policy

- Long run energy security policy is often based on conceit that government can second guess all of the dimensions of an inherently uncertain future.

- The biggest energy security threat remains muddled government policy.

- Liquid commodity markets are the best humanly devised way of handling known or knowable energy security risks.

- Good international relations undoubtedly reduce costs however and are a legitimate role for government.

- (Don’t make the mistake of arguing that these markets behave in the same way as financial markets).
In closing

- Elements of good policy in place but there are obvious inconsistencies and a lack of intellectual coherence.
- Need to reemphasise commitment to markets *and* proper carbon pricing.
- Specific climate policy costs cannot be justified with reference to ‘green’ jobs relies on discredited industrial policy arguments.
- ‘Energy security policy’ is a misguided pre-occupation.
- Recession suggests re-emphasis of cost of policy.
- UK should reassert role in Europe as champion of competitive markets and argue against the even more muddled EU policy.
- **UK must support competition**, anti-competitive investigations and encourage new entrants.
- UK needs to treat incumbents arguments for more investment skeptically.
References