



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

Michael Pollitt

*IEA-Marketforce Conference, London
12th October 2009*

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?

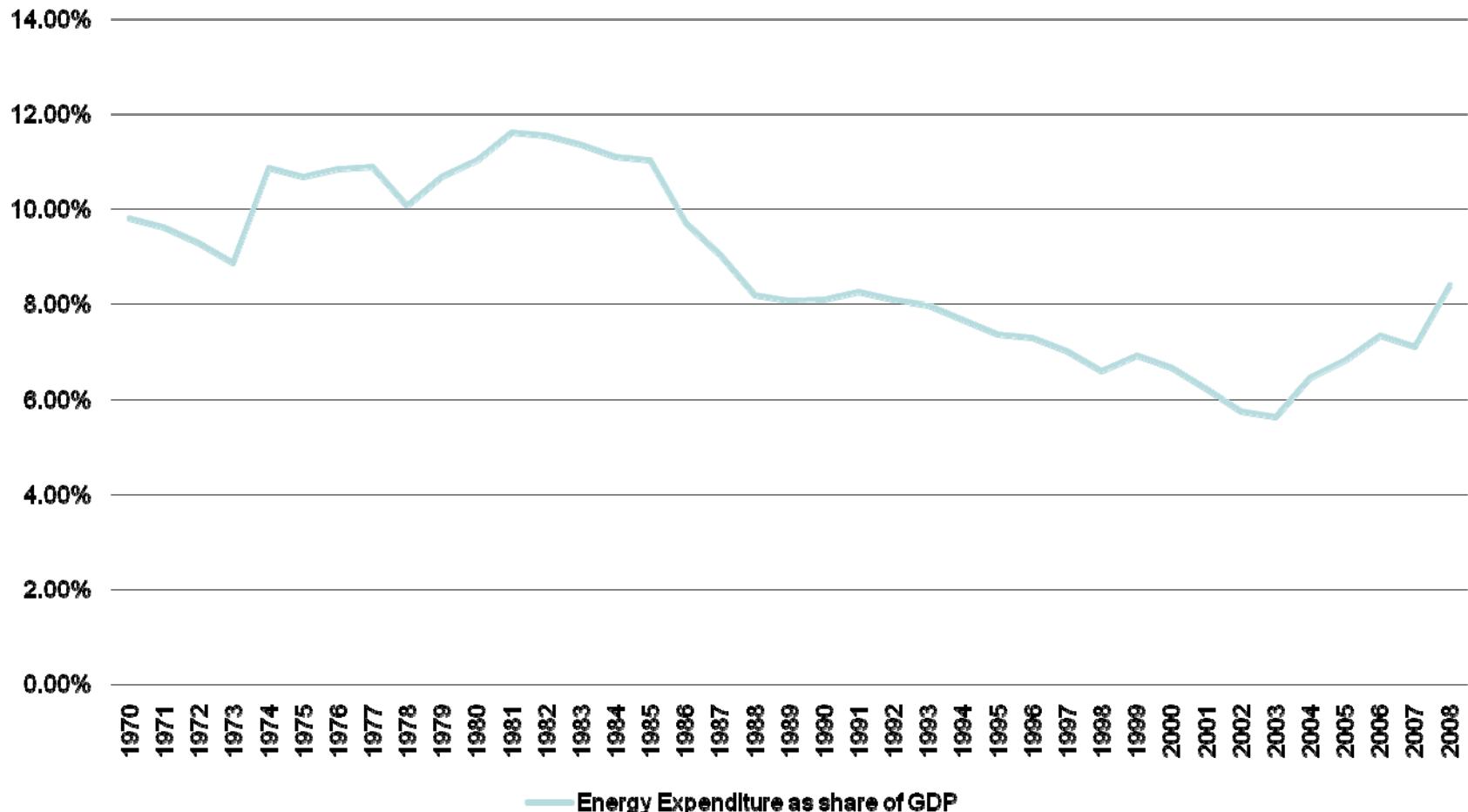
- *Secure*
- *Affordable*
- *Low Carbon*
- *Energy*



UNIVERSITY OF
CAMBRIDGE | Electricity Policy
Research Group

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)
- Energy Security Directive, Energy Services Directive etc...
- 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

- Jamasb, T. and Pollitt, M. (2005), ‘Electricity market reform in the European Union: review of progress toward liberalization and integration’, *Energy Journal*, Special Issue on European Electricity Liberalisation, pp.11-41.
- Keay, M. (2006), *The Dynamics of Power: Power Generation Investment in Liberalised Electricity Markets*, Oxford: Oxford Institute for Energy Studies.
- Pollitt, M. (2009a), ‘Evaluating the evidence on electricity reform: Lessons for the South East Europe (SEE) market’, *Utilities Policy*, 17 (1), pp.13-23.
- Pollitt, M. (2009b), ‘UK Renewable Energy Policy since 1990’, *mimeo*.
- Pollitt, M. (2008), ‘The Future of Electricity (and Gas) Regulation in Low-carbon policy world’, *The Energy Journal*, Special Issue in Honor of David Newbery, pp.63-94. Available at
<http://www.ofgem.gov.uk/Networks/rpix20/forum/Documents1/1a.pdf>

