



Electricity Association

European Commission Green Paper on EU Security of Supply

Electricity Association Response

General Comments

The Electricity Association welcomes the publication of the Green Paper on Security of Supply. Given the recent rises in oil and gas prices and the severe electricity supply problems in California, it is timely to examine the energy challenges facing Europe.

Europe's energy policy in recent years has been based on the three "pillars" of competitiveness, security of supply and environmental protection. However, the Green Paper does not fully reflect the right balance between the objectives, in placing relatively little emphasis on competitiveness and economic reform. The California crisis, in our view, does not demonstrate the failure of liberalised markets but shows the importance of a favourable investment climate and a carefully planned transition to competition. It is important that Europe continues its recent progress towards liberalised energy markets and maintains a stable policy framework.

We would also like to see greater clarity in the discussion of the security of supply and Kyoto themes. Some sections of the Green Paper appear to make the case for a European energy policy on the basis of Europe's growing supply dependency; other sections seem to place greater emphasis on the need for an ecologically sustainable policy. The Association's responses to the Commission's thirteen questions are given below.

1. Import Dependency

The Electricity Association does not believe that import dependency per se represents a problem – the EU imports many other commodities and there is no reason why it should not import energy. Trade in energy should be driven by economic principles within the framework of world trade agreements.

The key to security is diversity of fuels and supply sources. Free trade and competitive markets are likely to promote diversity, and so priority should continue to be given to liberalising energy markets both inside and outside the EU. The main threats to supply security are political disruption and politically-based restrictions on fuel sources, not a shortage of resources. The Electricity Association does not support a prescriptive framework policy for energy imports, which would be likely to undermine trade and distort the market.

It must be borne in mind that other EU policies, notably environmental policy, can impinge on supply security. For instance, coal can play an important role in fuel diversity, but its future as a generation fuel is threatened by EU environmental measures. Current drafts of the Large Combustion Plant and National Emission Ceiling Directives are likely to result in the early closure of much UK coal-fired plant, without producing any significant environmental benefit. It is important that a balance is struck between security of supply and environmental objectives.

2. Liberalisation and a Coordinated EU Energy Policy

Liberalised markets will promote better use of capacity and more integrated European energy networks, thus enhancing security of supply. Market players will have an incentive to diversify supply sources and transmission routes in order to manage their risks. Liberalisation should therefore be speeded up, with the electricity and gas markets being opened in parallel. Governments should avoid undue interference in markets and should aim to remove artificial barriers, e.g. lack of access to gas storage.

The record of coordinated policies at EU level is not particularly good and central policy direction could undermine the natural energy diversity which exists within the EU. Coordination should be achieved through the uniform introduction of competitive markets throughout the EU.

3. Energy Taxation and State Aids

Taxes and subsidies distort the allocation of scarce resources and can result in inefficient investments. State aids and high energy taxes compared with other trade blocs, particularly North America, have both had an adverse effect on Europe's competitiveness. Taxation is an area where some competition between Member States is desirable. We would not therefore support the harmonisation of energy taxes at European level. This would be likely to produce a ratcheting-up of tax rates, thus undermining the position of European industry.

Voluntary and market-based approaches, such as emission trading, are more effective than energy taxes in reducing emissions at least cost. Energy taxes are a blunt instrument which should only be used when other methods have failed. Given the low price elasticity of electricity, the pursuit of energy efficiency and cleaner fuel sources is more likely to reduce environmental impact than taxation. If environmental taxes are introduced, the revenue should be devoted to particular purposes, e.g. the promotion of renewables.

4. Relations with Producers e.g. Russia

Because the main risk to supply security is political disruption, the EU bodies have an important role to play in maintaining good relations with energy producing countries. It is essential that a favourable climate for investment is maintained and that uncertainties due to different legal regimes are reduced. The Energy Charter provides an important framework for promoting free

trade, and it is to be hoped that Russia will soon ratify the Charter Treaty. Once this happens, priority should be given to resolving the transit problems which have occurred within some of the new independent states.

Notwithstanding the above comments, the Electricity Association believes that the Green Paper over-emphasises dependency on Russia and the potential difficulties in ensuring reliable energy supplies to the EU. Free trade in energy and stable commercial relationships are in the interests of Russia as well as the EU countries. The EU institutions should focus on promoting economic reform throughout the former Soviet Union and providing an overall framework for trade. Individual transactions should be left to commercial contracts and market forces.

5. Strategic Storage

Coal is a widely traded fuel available from many sources. While there are some concerns about the consolidation of the international coal trade and its potential impact on prices, there does not seem to be any need to impose storage requirements at European level.

The transportation of natural gas is expensive and consequently a small number of producing countries have the major share of the European market. Even so, the Commission's own recent Communication on the Security of Gas Supply has confirmed that Europe's supply picture is satisfactory and that national storage facilities are adequate for all but the most extreme cases of disruption. Gas storage is expensive to provide and we do not see any need for additional reserves to be stockpiled or for the Community to take on a greater role in this area. The Commission should instead focus on securing competitive access to gas storage throughout the EU. This will help to optimise the use of existing storage facilities.

6. Energy Transport Networks

Energy liberalisation with open network access and transparent pricing will promote free trade. This in turn will result in a better use of Europe's energy infrastructure and stimulate the reinforcement of networks. To achieve these goals, a proper framework for cross-border charging, interconnector access and congestion management should be established at EU level. Commercial solutions should be used to handle constraints where possible. Network operators should have commercial incentives to develop their networks and to optimise the management of congestion. The EU bodies can also play an important role by creating a favourable climate for investment and where appropriate by providing direct financial support.

7. Renewable Funding

The UK electricity companies believe that renewables can make a valuable contribution to meeting both environmental and energy security objectives, and therefore support the objective of increasing renewable energy use. However, any attempt to fund renewable development from other "highly

profitable” energy sources is likely to reduce investment in these sources, thus impairing security of supply, and to produce large market distortions.

Given the general societal benefits of promoting renewable resources, there is an argument that society as a whole should finance the additional costs associated with renewables. However, if this is not possible, the best approach is to establish support schemes which drive down renewable costs over time and spread the burden across all energy customers. Detailed promotion of renewables should be a matter for Member States, with the European Union institutions setting the overall framework

8. Nuclear Issues

Nuclear power is a key component in the energy diversity of the EU and plays a major role in maintaining supply security. Nuclear power stations within the EU have an excellent safety record and existing nuclear plant is generally competitive with other plant. Moreover, nuclear stations are making a major contribution to reducing CO₂ emissions and, if existing stations were closed prematurely, it is unlikely that the EU would meet its Kyoto targets. However, in many EU Member States there is considerable opposition to nuclear power, which means that it will be difficult to maintain the current share of nuclear generation.

The EU should aim to keep open the options for the continuation of nuclear power within the overall programme to address climate change. As public opinion is a major stumbling block, the EU institutions should promote an objective debate on nuclear issues, highlighting the adverse economic and environmental impact if nuclear units were forced to close prematurely for political reasons. The EU should continue to support research into nuclear waste and promote a coordinated approach to waste disposal.

9. Kyoto Targets

Europe’s Kyoto targets are challenging and can best be achieved through a combination of more competitive markets, increased energy efficiency and the use of lower carbon fuels. National governments have responsibility for meeting the targets and should develop programmes for doing so at least cost.

On the demand side, energy efficient electrotechnologies can make an important contribution to reducing CO₂ emissions. Within the electricity sector, improved efficiency in conventional power stations, the replacement of coal by gas, a continuing role for nuclear power, more use of cogeneration and the development of renewables can all play a role. However, it is essential that all sectors play their full part in achieving the targets, and this must include the transport and domestic sectors. The public needs to understand that individuals and households also have responsibilities in relation to climate change; business and industry cannot meet the challenge alone.

The Green Paper lays considerable emphasis on the use of taxation, and in particular on the upward harmonisation of energy taxes, as a means of achieving the Kyoto targets. The Electricity Association, however, believes that taxation is a very inefficient and blunt instrument for changing energy use behaviour and that other mechanisms, such as emissions trading offer far more cost-effective ways of achieving environmental objectives. Several EU Member States are developing national emissions trading schemes and the EU should be defining a coherent framework of general principles within which the national schemes can operate equitably and transparently.

10. Alternative Fuels

Biofuels offer the promise of a substantial contribution to renewable energy resources in the medium term, and would benefit from greater EU support for development and demonstration to complement national initiatives. The hydrogen economy is a longer-term prospect and we regard a 20% target for the year 2020 as very ambitious. This objective can only be achieved with the support of the oil companies in providing infrastructure and with the development of a substantial renewable electricity base. Again the EU should promote research in this area, but as agricultural production is largely dependent on climatic conditions, national initiatives are likely to be the most cost-effective route to developing biofuels.

11. Energy Saving in Buildings

There is considerable scope for increasing the energy efficiency of buildings through improved insulation and appliance standards. In such a diverse area, improvements can be made through both regulation, e.g. building insulation standards, and through market-based measures, e.g. building and appliance labelling. Even so, it has historically proved difficult to realise the potential for energy saving on the demand side, and so targets should be realistic.

The role of the Member States is crucial in achieving energy efficiency gains, and any European initiatives should therefore be sufficiently flexible to allow national variations. There is also an urgent need for greater public understanding of the potential benefits to be gained. In the business sector, the introduction of emissions trading could provide a necessary incentive for motivating energy efficiency improvements.

12. Energy Saving in Transport

It is essential that the upward trend in transport emissions be reversed. A shift from private to public transport is highly desirable and the opening-up of public systems, particularly the railways, to competitive pressures should improve these prospects. However, the shift away from private transport is unlikely ever to be more than marginal in a free market economy, so it is necessary to address the emissions from private transport at source. Further tightening of vehicle emission limits by both regulation and tax breaks will be important in the short term.

EU support should be provided for the longer-term development of alternative fuel systems, using biofuels, hydrogen and electricity. Electric propulsion can improve overall emissions from most forms of transport, but is particularly valuable for rail transport and for road transport in city areas.

13. Collaborative and Long-term Visions

Cooperation between Member States may be helpful but an approach based on an interventionist EU energy policy is unlikely to succeed. In particular, we would not advocate the setting of a target fuel mix either by the Commission or Member States. The consistency between national energy policies is best obtained by the liberalisation of the market in accordance with the Treaty Rules. Priority should be given to market mechanisms, which themselves are likely to promote diversity.

The EU institutions, particularly the Commission, do have a role in promoting good relations with producing countries and thus helping to manage the global interdependence of energy supply. Energy trends should also be monitored at EU level to allow for more informed decision-making both by the public authorities and market participants. In short, the EU bodies should have an enabling role.

7th March 2001