



EPRG Policy Brief: **A Note to the New Commission on the Way Forward to 2030**

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Debates over the 2030 European framework on climate and energy policy come amidst greater concerns over competitiveness and energy security and so laudable efforts to increase Europe's ambitions with respect to climate change policy will require that the most cost-effective measures be employed. The new State Aid guidelines already take an important first step in encouraging greater market orientation and reliance on economic principles, as does the Commission's proposal to make emissions reductions central to the 2030 efforts. We believe still more needs to be done to ensure an adequate, credible and durable carbon price, address carbon leakage and encourage other major emitters to act, bring on additional interconnection capacity, build up integrated capacity markets, and invest more in RD&D into immature low-carbon technologies.

Existing EU Climate and Energy Policy Frameworks

The European Union will meet its 2020 targets of a 20% reduction in greenhouse gas (GHG) emissions (below 1990 levels), 20% share of renewables in the energy mix and an increase in energy efficiency by 20% by 2020. EU-28 GHG reductions were already 19.2% below 1990 levels at the end of 2012, driven primarily by the recent economic downturn and major shifts in the UK and Germany in the early 1990s. As part of the 2020 package, the Renewables Directive required member states to set out a National Renewable Action Plan and they have used a wide variety of measures to meet their specific national targets, most commonly feed-in tariffs. In response to the economic downturn, a number of countries, as most dramatically seen in Spain, have backed away from their commitments to renewable deployment subsidies.

More emphasis is now being placed on tenders and encouraging technology neutrality in government support. Guidelines on State Aid for Environmental protection and Energy 2014-2020' came into effect on 1 July, 2014 and require that member states use clear economic reasoning to identify the specific market failure(s) that justify intervention. From 2016, the guidelines require that all new aid be provided in the form of a premium above the market price or a green certificate and that electricity is sold directly in the market. The guidelines also require that generators assume responsibility for balancing (unless no liquid intra-day markets exist). Further, from 2017, aid must be granted in a competitive bidding process based on 'clear, transparent and non-discriminatory criteria' unless the member state can demonstrate that such an approach is either not feasible or would produce an undesirable outcome. Including all renewable electricity generators on a non-discriminatory basis will lead to a presumption that the aid does not pose a threat to competition.

Tensions between environmental protection and other two pillars of EU's energy policy

Inevitably, efforts to increase environmental protection will raise tensions with the other pillars of the energy policy 'trilemma', namely competitiveness and security of supply.

Competitiveness

The global economic crisis of 2008 followed by the Eurozone crisis, which saw the slowdown of industrial output in Europe also led to a withdrawal of renewable support in member states such as Greece, Italy and Spain. Other countries have adjusted their support for renewables and low-carbon technologies to varying extents. The 2014 European Competitiveness Report highlighted that the EU's industrial competitiveness has been hurt by not only the financial crisis but also by rising energy costs. For example, European electricity prices are currently twice that of the United States and higher costs are having a significant impact on competitiveness of energy-intensive industries in particular.

Security of Supply

As the Ukrainian crisis unfolds, energy security has moved up the political agenda. In the near term, we note the importance of the interim deal proposed by Commissioner Oettinger during trilateral talks in Berlin in September and without it, Europe risks a repeat of the 2009 gas supply disruption this coming winter. Ukraine's desire to import gas from Central Europe can only happen with a review of Europe's regulatory regime, particularly the gas target model, governing wholesale gas trade and investment in transport capacity within Europe. For electricity security of supply, many proposed interconnectors remain unrealized and member states are independently exploring possible capacity markets, but, left uncoordinated, this diversity would erode the internal market for energy.

The proposed 2030 framework and criticism

Following the perceived success of the 2020 package, the European Commission proposed an integrated policy framework for the period to 2030. Its key features are: (a) GHG emissions targets of 40% reduction from 1990 levels, in line with a desired 80-90% reduction by 2050, (b) increasing the share of renewable energy in the EU to a minimum of 27%, but without country-specific targets, and (c) an increase in energy efficiency by 30%. The proposal has received criticism from industry, governments, NGOs and the European Parliament. Some criticise the lack of binding national RES targets or that the GHG targets are not stringent enough, while others express concerns that unilateral action that would raise energy prices and further undermine competitiveness or energy security.

Our assessment of the 2030 proposal

- (i) The proposal is an important step in placing GHG emissions reductions at the centre of European policy and would likely result in a much higher carbon price, but is still unlikely to provide a sufficient long-term, credible signal needed for many low-carbon investments.
- (ii) Unilateral action by the EU may impact competitiveness, which would need to be addressed (e.g. through border tax adjustments failing wider international agreement).
- (iii) There is no mechanism to stimulate additional R&D investment in low-carbon technologies, the focus remains entirely on near-term deployment subsidies; and
- (iv) Going into major international climate negotiations in Paris in late 2015, nothing is being done to explicitly encourage actions by other major emitters.

Recommendations for action

To encourage more effective EU energy and climate policies, we propose the following:

- (i) *Build a more complete internal market.* Additional interconnection capacity can help address energy security concerns, and new capacity markets will need to be better integrated into cross-border capacity allocation and market coupling platforms to address security of supply issues raised by high levels of intermittent generation. There is urgency in addressing planning for transmission lines and cross-border transmission will need a more carefully designed financing mechanism. Completing the agenda of efficient cross-border capacity and balancing should be a high priority.
- (ii) *Tackle competitiveness concerns.* Problems of carbon leakage need to be addressed, both within the EU and internationally, if necessary through border tax adjustments, so that all business faces the same effective carbon price in the EU, although at the international level, any unilateral measures could possibly raise concerns over trade disputes.
- (iii) *Reduce deployment support and increase RD&D.* Instability in renewable support schemes has created credibility concerns. Auctions for long-term contracts should alleviate this problem, with gradually tightening restrictions on the amount of subsidies available for particular technologies. EU-wide competitions for RD&D into immature low-carbon technologies (the 'Strategic Energy Technology' plan) financed by member state contributions are needed to address the current imbalance between deployment support and RD&D.
- (iv) *Reform the ETS.* The EU ETS was an impressive initial achievement but has failed to deliver an adequate, credible and durable carbon price, partly because member states overstated their allocation needs, but more recently because of the 2008 financial crisis. If trading, rather than fixing a carbon price trajectory, is to remain central to the EU approach, then the budget will need to be tighter and longer (i.e., extend beyond 2030 but with clear, binding milestones along the way), underwritten by mechanisms that enhance its credibility, and arguably supplemented by caps and floors.
- (v) *Link EU actions to international negotiations.* Proposals for contingent reduction in GHG emissions (akin to the 30% target offered in the 20-20-20 package) could encourage others to take action. China and the U.S., the two largest emitters, are currently experimenting with local carbon markets and adopting domestic regulatory measures, but in both countries (and the EU) there are concerns about impacts on competitiveness, so the possibility of more aggressive reductions should be explicitly tied to progress in the major economies.