

Getting the Supply Side Right: Is Carbon the Driver?

Keynote by Dr. Johannes Teyssen at EURELECTRIC Annual
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Ladies and gentlemen,

first of all I thank Commissioner Hedegaard for trying to reconcile the different targets we are facing in the European energy and climate discussion. Indeed the **picture energy companies and investors face in Europe is quite mixed** and this picture in sum does neither fit together nor does it give any clear investment signal.

The **European power industry is ready** to follow the path of far-reaching **decarbonisation of its sector by 2050**. It is prepared **to invest** a total of **3 trillion euros by 2035** in this huge restructuring. But at present it is **not in a position to bear entrepreneurial responsibility for those investments** and to mobilise the necessary capital because it is completely uncertain whether the future framework will allow an adequate return.

One thing is certain: no private energy company can invest in an energy future in which the state wants to regulate everything down to the last detail – with increasing volatility in regulatory frequency. **Nobody will invest in a foreseeable failure. In a long-term business nobody will submit to changing unstable political moods.**

Companies and investors are **uncertain because they cannot make out a long-term regulatory framework for European energy supply.**

There are lots of market intervention and special national approaches – which would easily fill a keynote by its own. A Citibank study launched last September counted 27 political interventions since 2010. They added up all costs to 200 bn euros and titled the study “A Very Hostile Political Environment”.

These interventions show that Europe is pursuing **two energy strategies in parallel**: in the short term, **the single energy market is to be completed by 2014**, as decided by the European Council. At the same time, the **Roadmap 2050** is being

pursued as a long-term strategy for largely decarbonising European energy supply.

How can the two - the competitive market for energy and the administrative reorganisation of energy structures - **be merged into a single coherent strategy?**

My reply is this: by resolutely strengthening the European emissions trading system, the ETS!

Both approaches – the Roadmap 2050 and the single European energy market - fit in the end very well together since they relate as cook and waiter. A political decided Roadmap 2050 delivers the strategically target, or as you may call it - the menu for the cook. The most efficient instrument to deliver this menu is the single European energy market that consists next to price incentives coming from energy or capital markets also on reliable price signals for CO2 efficient investment from the CO2 market - the ETS.

The ETS is genuinely European because it is designed for the single European market in energy. The ETS is **in line with market principles** because it lets companies choose the most efficient climate protection measures. And it is **open to all technologies** because it gives every technical solution a fair chance in competition – leaving aside countries like Germany that want to dispense with nuclear energy.

In other words, the ETS is the cornerstone of efficient European climate policy.

But the **current status of ETS is devastating**. ETS is bust, since it does not produce any investment signals. In an economy with overall deflation investors do not have any interests investing since there is no real return for their investment and in such a situation prolonging investments might be the best decision. So investors don't spend money in equipment, they prefer cash. **The ETS market is also market in deflation**. The CO2 price is not determined by the most cost-efficient technology in the market but determined by external market interventions coming from the various European support systems. To give an example: In Germany in cold, sunny February during midday PV – the currently most expensive CO2-abatement technology we have in our portfolio - is determining the CO2 demand by squeezing efficient gas fired power plants out of the market through its privileged market access. So PV is pressing the CO2 price in the power market with abatement costs of several

hundred euros per ton. Or take the UK floor price for CO₂ which is just not only destroying the single European CO₂ price signal, it also shifts emission allowance supply from Britain to the Continent thus pressing the price here further.

If we are not capable to establish a clear hierarchy of the different energy and climate instrument with the ETS a cornerstone, the CO₂-price would deteriorate to a residual – determined by subsidized instruments like the renewables support systems or command and control systems – just to mention here the currently discussed energy efficiency directive. There would neither be any price signal for investment nor any reliable and substantial source for public finance from CO₂ auctions – which is also an important issue these days.

So, in its present form the ETS is of less use, it is just an appendix to already existing administrative support schemes. Due to numerous cases of direct market intervention, **it has become merely a residual element of climate policy.** Originally it was created as a market instrument to replace such direct market intervention and the resulting inefficiency. However, **policy-makers left the ETS to its own devices, perhaps even undermining it by promoting counterproductive instruments.**

The results are sobering: **given the present carbon dioxide price of clearly under 10 euros per ton, nobody is investing in CO₂ abatement.** The European Commission once expected roughly 30 euros per ton. Nothing illustrates the loss of emission trading's function more clearly than the fact that **lignite is again at the forefront of power competition** in Germany. Last year this resulted in **additional carbon dioxide emissions** amounting to **roughly 6 million tons.**

This price collapse is not just due to the recession in Europe, as a result of which energy demand has fallen significantly. Recessions come and go - I hope this will be the case in Europe, too. But what will remain, if we do not take counteraction, is a **structural erosion of the ETS by the parallel development of subsidies for renewables** in EU countries. **The increase in renewables planned in Germany alone is estimated to lead to 1.8 billion tonnes of carbon dioxide being avoided between 2008 and 2020** - this is roughly equivalent to the surplus allowances that the EU has as a whole or almost the annual quantity of emissions trading.

If the ETS is not revamped and renewables are not integrated, the two systems might destroy each other – the renewables generate exploding costs – the ETS implodes. We now have to muster **the courage for a general overhaul. What would be the alternative?** – emissions trading that nobody takes seriously both inside and outside Europe and subsidisation of renewables as permanent roadworks in energy policy. This is the surest way of making the energy turnaround - the bold target for 2050 - prove to be a failure.

Furthermore it would deliver a bad example of climate policy. The Durban climate conference in 2011 demonstrated that international climate policy is at a very critical junction. No major emitter so far follows the EU climate road since we didn't yet prove that economic growth and climate protection fit together. EU believes to be frontrunner, but without realising that there are very few runners behind. Therefore **in order to promote international climate policy we in the EU have to prove that a market-oriented instrument is not harming economic prospects, but also promoting climate friendly investment.** The ETS serves this target.

In the global context a long-term decarbonisation strategy not only follows climate protection requirements, a decarbonisation strategy might also be useful with respect to our vanishing energy resources in Europe resulting in a higher energy dependency. From a global competitiveness point of view a well-functioning ETS supports to deliver a more energy efficient production stock thus increasing security of supply.

To sum it up: It is time to act now. And we need two types of immediate actions to reanimate the patient ETS:

First as a kind of emergency aid we have as soon as possible to remove significant amounts of certificates from the market in order to **rebalance supply and demand** and to highlight again what a price of carbon dioxide was designed for: a price of scarcity.

Second as the patient ETS stabilizes we need to start long-term therapy by launching legislation **to repair the ETS by adjusting its targets to the carbon roadmap 2050**. There 2030 should be taken as milestone.

A revamped ETS would also significantly improve the competitiveness of renewables in relation to conventional power generation. This alone ought to be enough to enable onshore wind farms to do without subsidies. Though offshore wind farms are even more expensive, we see in our own plants a cost reduction of 40 % in the coming years. It is generally expected that solar energy will achieve grid parity in the next few years, meaning that it will be competitive with grid electricity for residential customers.

With respect to the different European targets we need to establish a better coherence in EU energy and climate policies:

- **We need coherence in scope**, so implement ETS as the cornerstone; it provides an EU-wide level playing field and a least cost approach delivered through markets.
- **We need coherence in time**, so decide soon on a 2030 target.
- **We need coherence in hierarchy**, so integrate RES-support under ETS.

Strengthening emissions trading makes it **possible, with the aid of a few political decisions, to lay the regulatory tracks in the direction of the marketplace.** This would be a strong impetus for a market-oriented change of course in all European energy and climate policy.

The stage has to be set in this direction now. Europe cannot lose any more time.

Thank you for your attention.