MEMO TO THE NEW COMMISSIONER FOR ENERGY

GEORG ZACHMANN

Highlights

- European energy policy has had mixed fortunes in recent years: complex but ambitious compromises (greenhouse gas reduction targets), clear and feasible compromises (renewables), unhurried but steady progress in some areas (internal electricity market), no breakthrough in other important fields (internal gas market) and a dangerously passive stance in crucial subjects (research and development).
- While liberalising energy markets and combating climate change will remain top priorities, securing energy supplies and energy price issues might temporarily lose some appeal due to the crisis-induced energy demand dip.
- The Commission should not spend valuable financial and human resources on: investments in generation, attempting to control energy price levels, changing the settlement currency for oil imports or securing foreign energy resources. Functioning markets will get all of these right.
- However, in some key energy policy areas, markets alone will fail. Thus, mitigating climate change, directing investments in network infrastructure and creating a single energy market should be the three interlinked priorities for your term of office.

This policy contribution is a supplement to 'Bruegel memos to the new Commission: Europe's economic priorities 2010-2015'

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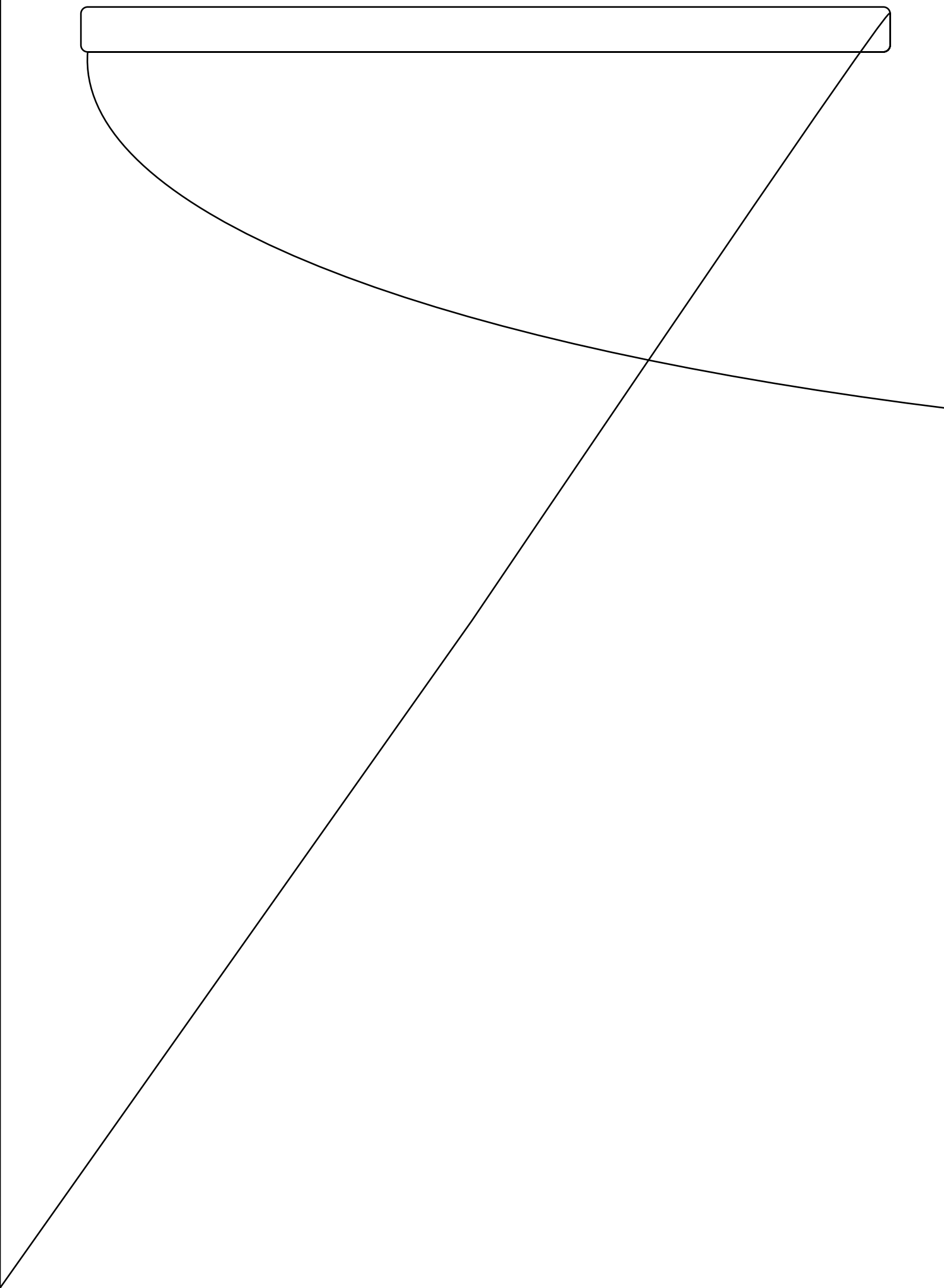
GEORG ZACHMANN, DECEMBER 2009

STATE OF AFFAIRS

Energy was one of the key economic policy issues before the financial and economic crisis hit the world economy. In particular, (1) securing the fossil fuel supply in the near future, (2) reducing energy-related greenhouse gas emissions, and (3) containing the level and volatility of energy prices were high on the agenda of all European energy policymakers. The means to achieve these common goals were often controversial, with differing conflict lines between the actors involved (27 member states, at least four EU departments, companies, NGOs). As well as these three major shared goals, one important issue, where not only



to climate change. From the European perspective, the results of the European Emissions Trading System (ETS), which began operations in 2005, have been especially interesting. Significant windfall profits to the power sector, high volatility of carbon prices, full pass-through of the carbon price to consumers as well as low investments in carbon-saving R&D and RES in some member countries came somewhat unexpectedly for many observers.

Based on these outcomes, in April 2009 the EU

price shocks of the 2000s were much milder. Models suggest that, given technological advances and the substitutability of oil as a production factor, crude oil price increases do not necessarily lead to dramatic negative long-term output effects.

Second, the recent discoveries of huge oil and gas fields off the coast of Africa and Brazil, as well as the proven capacity of producers of non-conventional oil to come in as soon as prices are high enough, have demonstrated that overall oil production can still be increased. Furthermore, even though global natural-gas demand will increase at 1.5 percent per year between 2007 and 2030 in the reference scenario of the IEA, sufficient reserves for 60 years are proven (estimated reserves are almost 300 years).

Third, in addition to the general doubts about the advantages of playing the 'great game' in pipeline politics, the pressure to diversify natural gas supply to Europe has diminished significantly recently. As the present increases in the produc-