

## Rising energy prices, consumer protection and decarbonisation: markets can help

20 October 2021

### Current context

Rising gas, electricity and carbon emission allowance prices pose challenges for consumers, the European economy and governments. EFET recognises that governments are expected to provide support for vulnerable consumers and find ways to maintain industrial competitiveness while making progress with decarbonisation and expanding renewable energy sources.

In this short paper we argue that:

- ❖ National governments have a range of tools available to them to ensure help is given to vulnerable residential consumers and to afford relief to industrial and commercial users of energy.
- ❖ Measures which moderate bills, while maintaining the integrity and functioning of the EU internal energy market, are most likely to ensure continuity of competition and security of supply. Thus, to be in the best interests of consumers of all types over time.
- ❖ On the other hand, measures which distort price signals or adversely affect the operation of markets may jeopardise competition, discourage investment, reduce innovation, and thereby increase the cost of the European transition to net zero carbon.

EFET therefore urges the EU as a whole and individual European governments to balance the needs they see for short-term action to keep energy costs in check with a longer-term perspective on competitiveness, security of supply and a carbon neutral economy.

### Rely on markets to decarbonise cost-effectively

Well-functioning markets are not an end in themselves. They rather create pressure for energy producers and suppliers to operate efficiently, to respond to customer needs and to invest in innovative and cost-effective technologies. In this way liquid markets in gases, electricity and carbon emission allowances, underpinned by healthy competition, ensure security of supply and lead to other outcomes which are good for society. By way of example:

- Electricity markets ensure that energy is generated using the available technology with the lowest running cost, wherever in Europe that might be (as long as there is transmission capacity to get it to where it is consumed).
- Price signals in natural gas markets direct flows to where they are most needed across the European interconnected transmission system, attract imports when necessary and stimulate either injection into or extraction from storage facilities.
- A developing market in hydrogen could function in much the same way as the current market for natural gas.
- Putting a price on carbon emissions introduces a clear incentive for power generators and industry to switch away from relatively more carbon intensive processes or technologies and encourages them to find the lowest cost way of substituting them

with green alternatives. The EU Emissions Trading System has created a uniform carbon abatement price signal across most of Europe to help make switching and substitution a reality.

If prices in any of these types of wholesale market rise, that enhances a signal for users and/or producers of energy to make new investments using innovative technologies – a crucial incentive for a faster and more efficient energy transition.

Markets across Europe in energy commodities and related contracts therefore contribute solutions for each aspect of the so-called energy trilemma:

- Affordability
- Security of supply
- Decarbonisation

Europe possesses a proud track record of developing pan-European markets in products and services. Full assessments of benefits are relatively infrequent, though the Commission suggested in 2016 that the potential increase in social welfare of fully integrating Europe's electricity markets could lie in the range of €16 billion to €43 billion annually by 2030<sup>1</sup>.

### **Some energy consumers will need help**

The price of any commodity, such as gas, electricity or carbon emission allowances, is fundamentally driven by supply and demand. This means prices fluctuate – over years, over periods of the year and within weeks and days depending on local, national and global factors. Big, corporate users of energy employ sophisticated 'hedging strategies' to buy energy over varying periods, so as to smooth out fluctuations in their input costs. Retail suppliers of energy to smaller consumers may also hedge their purchase costs, so that they are able to insulate those consumers to an extent from changes in wholesale prices<sup>2</sup>.

Unfortunately, fuel poverty remains a significant problem across Europe. In 2018 over 34 million European citizens said they couldn't adequately heat their homes<sup>3</sup>. It is a matter of fact that when prices rise, people find it harder to pay their bills and many face choices about whether to heat their homes or cut back on other essentials. Equally, higher prices can damage industrial competitiveness. It is absolutely right that Governments and regulators act to help households and/or businesses who need assistance.

### **If government interventions distort markets, the cost to everyone can rise**

Attempts to reduce prices in the short term, particularly those that involve a direct intervention in markets, may have a detrimental impact on all consumers in the long-run, The negative impact may transpire in a number of ways:

- *Damaging investor confidence:* The scale of investment needed for Europe to become carbon neutral is vast. The Commission's communication on the Sustainable Europe Investment Plan also says: "achieving the 2030 climate and energy targets will require

---

<sup>1</sup> [https://eur-lex.europa.eu/resource.html?uri=cellar:e4c834ae-b7b8-11e6-9e3c-01aa75ed71a1.0001.02/DOC\\_3&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:e4c834ae-b7b8-11e6-9e3c-01aa75ed71a1.0001.02/DOC_3&format=PDF)

<sup>2</sup> Some end users opt for contracts which are directly based on the wholesale price and therefore their bills change as the wholesale price changes.

<sup>3</sup> [European Commission – Energy poverty](#)

additional investments of EUR 260 billion a year by 2030<sup>4</sup>. This relies on attracting large volumes of private capital – ideally seeking relatively low rates of return. These investment decisions are based on an assessment of returns that can be earned through energy markets, prices they expect to see in carbon markets, and revenues received through support schemes. Unexpected changes make investors wary and increase the return they need to invest – a cost ultimately paid by customers.

- *Reducing innovation:* As the Commission’s System Integration Strategy stresses, the so-called demand side of the market (i.e. customers changing when and how they use energy) will play an ever more important role in the energy system of the future. Demand side technologies and flexible solutions haven’t developed as quickly as many would have liked. They will get a direct boost from relatively higher prices, which will spur innovation and speed up the transition to a more flexible system.
- *Slowing down decarbonisation:* As the bulk of energy investment is in renewable technologies, any damage to investor confidence – by reducing market revenues or carbon prices - will reduce the speed at which this is rolled out. This may mean that fossil fuelled, carbon emitting technologies are required for longer. Technologies such as hydrogen will need relatively high carbon prices (or sizeable state subsidies) to be competitive and uncertainty may reduce the speed at which these technologies are taken up.
- *Making markets work less well:* Generally speaking, bigger and more liquid markets (those involving a large number of buyers and sellers executing hundreds or thousands of transactions each day) lead to the greatest benefits to consumers. If barriers to entry, such as differential national rules are erected, it becomes harder to flow power or gas freely around Europe and the operation of the overall energy market become less efficient – with a corresponding risk that prices rise when they otherwise would not.

### **Policy options, which help consumers, but maintain market efficiency and facilitate the Green Deal, are available**

There is a real risk that a measure conceived to help consumers in the short-term will have unintended long-term consequences. Hence, there are compelling reasons to opt for policies which focus on helping the most vulnerable in society and preserve industry competitiveness, but which don’t reduce the effectiveness of markets. This was summed up recently by Commissioner Simson who said: “*There are tools that the Member States can use to address the situation immediately: VAT and excise policy, targeted measures for energy poor and vulnerable consumers or temporary measures for households and small businesses, as well as direct support to consumers are all steps that can be taken, fully in line with the EU rules.*”

The Commission’s 2020 report on energy prices and costs in Europe reported that taxes and levies account for 41% of a household electricity bill and 30-34% of industrial electricity prices, respectively. In gas, the figures are 32% and 13-16% respectively<sup>5</sup>. On top of this, there are tariffs for the use of both power and gas transmission networks. In the case of electricity, network charges represent a further 30% of an average electricity bill.

---

<sup>4</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020DC0021&from=EN>

<sup>5</sup> [https://ec.europa.eu/energy/data-analysis/energy-prices-and-costs\\_en](https://ec.europa.eu/energy/data-analysis/energy-prices-and-costs_en)

Reducing the impact of taxes and levies on energy bills, using receipts from carbon emission allowance auctions to help the poorest consumers, providing energy vouchers to, or introducing targeted regulatory measures in favour of, such consumers are all measures worthy of consideration. They have the potential to provide short term relief to consumers who need it while preserving the long-term benefits of a market-based energy economy.

For the European Green Deal to be a success, a balance must be found. Price signals sent by energy and carbon markets need to deliver incentives to innovate, invest, become more energy efficient and switch away from carbon intensive fuels. If allowed to do so, the probability that Europe will find a least cost decarbonisation pathway increases. In tandem, the wider regulatory and policy framework can be used to protect those who most need shelter from high prices. These objectives are not mutually exclusive.

Thus, EFET calls on EU institutions and national governments to opt for policies, which may reduce bills for those most in need, while preserving the operation of the EU internal energy market.