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a mortgaged future?

the consequences of UK energy policy

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Energy Policy and Environmental Impacts

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He has advised government and industry in the UK, USA, New Zealand, Japan, the Czech Republic, Hungary, Ireland, Argentina, Germany and France, and was a member of the French Government's Champsaur committee on electricity tariffs.

Dr Helm's publications include *British Energy Policy in the 1990's: The Transition to the Competitive Market*, *British Utility Regulation: Principles, Experience and Reform*; *The Assessment: Environmental Policy-Objectives, Instruments and Institutions*; *Oxford Review of Economic Policy*; *Environmental Policy: Objectives, Instruments and Implementation* (editor).

Dr Helm has presented *UK Plc*, a BBC Radio 4 series, and is currently completing a major study of British energy policy since 1979.

I want to set out some current problems in energy policy, then to discuss the environmental issues involved and draw attention to longer term issues than whether or not we happen to meet the Kyoto targets. I will conclude that we need a quite fundamental look at energy policy and, in particular, to shift its focus from competitiveness to the environment. I'm going to be pretty critical so it's only fair to add that my remarks are as much directed to the last government as to the current one.

Policy is about getting to where you want to be, not setting up a wish list. Current energy policy is a messy collection of objectives. We are, for instance, supposed to be interested in energy security and diversity of supply but nobody has thought through the nature of long term gas supply contracts. California's current troubles reveal the impact of this kind of thinking. It's convenient to blame the regulators rather than pointing to circumstances where very large companies end up being punted on the difference between a regulated and a spot price. Some people believe that prices can only go down and that we will never need any future contracting base. None of these issues were addressed - or addressed seriously - in the 1998 White Paper on energy policy.

All governments have conflicting energy policy objectives. No government ever defines the trade offs between them very clearly but we now have a set of inconsistencies sufficiently great to require a return to the drawing board.

- Protection of the coal industry is a central goal of government policy. One of the great myths is that coal has been driven out of the market by gas. Yet in 1990, and again in 1993, the coal industry was awarded contracts at higher than market prices. This was done in part to protect security of supply. But the only serious interruption to energy security have come from coal miners. Protecting coal for security of supply reasons is a very odd thing to do.
- Government policy towards the nuclear sector has been decidedly odd too. Privatisation moved liabilities into the private sector but there is no strategy for long term waste management.
- Renewables policy is really about picking winning technologies. There needn't be anything wrong with that but it's inconsistent with claims that we want market based solutions.

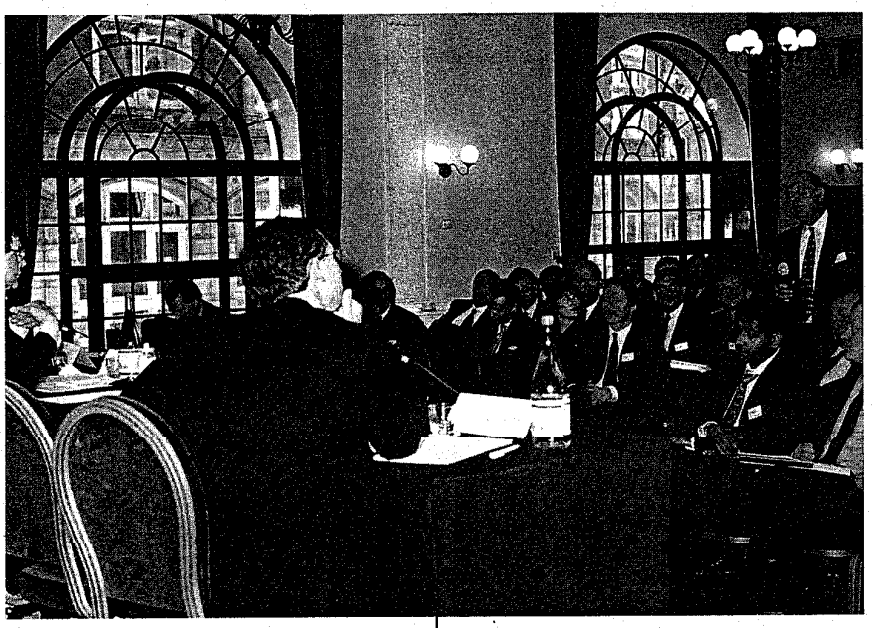
And, of course, all of this mustn't put energy prices up, only decrease them and the "fuel poor" must be looked after in this process.

The Price of Inconsistency

Some of these inconsistencies have led to serious biasing in carbon and climate change policy. Of course, the climate change commitment (the 12.5% carbon emissions reduction for example) doesn't scratch the surface of the problem the scientists tell us we have. If you want to deal with that we should start thinking seriously about the 60% reduction in carbon emissions proposed by the Royal Commission. Much of the 12.5% Kyoto commitment and the Government's own 20% target have been already achieved by closing down most of the coal industry. It's going to get a lot tougher after 2010 as nuclear power declines, there's little left of the coal industry to close, gas use grows and renewables struggle to meet their 10% target.

There is, of course, no evidence whatsoever that economic growth can be met by reducing energy demand. We can move from inefficient use of energy to efficient use but energy demand will march ever upwards. The only solution to the long

term problem of climate change has to be via a switch from carbon intensive fuels to carbon non-intensive ones. There has to be a substantial increase in the price of carbon if you're going to get a supply side shift. Any economic instrument or policy which fails to distinguish between the two is at best neutral in effect and probably counter productive. Whether we use permits or a carbon tax is a nicety. I happen to prefer a tax, but if we're going to try permits they must adjust prices to reflect the marginal cost of pollution.



The panel in discussion with the audience

The Climate Change Levy (CCL) could be seen as counter productive. It creates a huge amount of hostility, which in turn creates problems for negotiated agreements. It is based on the implicit assumption, never stated publicly, always privately known, that we can't have a Levy based on carbon use because that would disadvantage the coal industry. The cheapest way to reduce emissions is by reducing emissions from the power generation sector and that means targeting coal. The current CCL sends no supply side signals to develop non-carbon technologies. And because it would have fallen heavily on large industrial companies they were allowed to negotiate agreements. But you can't promote the steel, chemical and glass industries and at the same time create an instrument to change carbon emissions.

More worrying is the idea that consumers don't have to do anything about climate change - only big bad business has to address the issue. A great deal of public education is required to persuade people that they too must make their contribution to combating global warming. The hostile political reaction to VAT on domestic fuels and, of course, the needs of the coal miners, blunted the CCL and prevented it doing what it claims to do.

All governments have conflicting energy policy objectives but current inconsistencies require a return to the drawing board.

Cost-Efficient Carbon Reduction

Both permits and a carbon tax offer the opportunity of using the market to find the least cost solution to an environmental problem. The tougher the environmental requirements, the more the efficiency of achieving them matters because the costs are going to be very, very large and every marginal additional to them is going to be harder and harder to adapt to. All policies have price effects but some are much more inefficient than others.

The Climate Change Levy is not based on carbon use because that would disadvantage the coal industry.

Let's be honest about why people want emissions trading. A carbon tax takes the money from industry and domestic users and gives it to the Treasury. The permit system grandfathers the existing levels of pollution and only takes revenue from companies with respect to their emission reduction targets. From an industry point of view it makes sense to be in favour of emissions trading permits, provided they're grandfathered, rather than a tax. So how do you get companies to reduce emissions below the level they need to? The Government pays them to reduce pollution. That's quite an important departure.