Four keys to facing the energy crisis

While the price of energy continues to rise, the European Union should think carefully about its short- and long-term energy strategy and decide if subsidizing fuel prices is really a good idea.



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Energy prices had already begun to rise before war broke out in Ukraine. The reasons for this included surging prices for natural gas and CO2 — which is paid for in some industries — coupled with supply pressures on wind energy due to meteorological factors (there was not enough wind). Bottlenecks in the supply chains of energy producers such as Gazprom also played a role. And policies to promote the green energy transition, which put expiry dates on

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fossil fuels, led to reduced investments in some energy projects.

All these factors have led to an energy crisis that is particularly acute in Europe, which is highly dependent on external energy sources. How might the European Union deal with the situation?

Here are four ways Europe can deal with the energy crisis:

1. **Plan the green energy transition carefully**. Which energies will be needed for the transition? We need to think carefully about what's needed and how best to incentivize and invest in these technologies. A key question, for example, is what role nuclear energy should play. Nuclear, along with gas, has gone from being seen as "dirty" to being considered clean energy. Meanwhile the goal of zero emissions set for 2050 seems unlikely, but we need to keep it in mind. This, of course, requires resources. And as always, bear in mind the global nature of the problem: it won't do much good for Europe to honor its commitments if the United States and China fail to reduce their emissions; it would simply lead to Europe becoming less competitive. However, if Europe does decide to move in this direction, it should adopt certain measures, such as imposing tariffs on high carbon products from abroad.
2. **Develop a European energy policy.** European countries need stronger interconnections. Europe can demand better prices when it negotiates and purchases as a bloc. Likewise, energy diversification policies need to be coordinated among member countries.
3. **Reform the wholesale energy market**. Energy is a market with marginal pricing, where the highest marginal cost — usually gas — sets the price. This works when companies are competitive and there is freedom of entry and exit from the market. But, for regulatory reasons, there is no freedom of entry in either the nuclear or hydroelectric sectors. Renewable energies, meanwhile, have high fixed costs but low variables. To find investment incentives that work, it's important to analyze how the market is structured and how the basic wholesale price is formed.
4. **Subsidize only where it's really needed**. Governments don't have the power to stop the price of oil or gas from rising. In the short term, they can subsidize the cost to alleviate the effects of price increases, but that ends up translating into higher demand. Nonetheless, some countries have recently adopted such measures. The promises of the [then] UK prime minister Liz Truss, now withdrawn, could have cost the taxpayer 150 billion pounds. Such a policy was not sustainable. Though energy

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prices have a ruinous affect upon some segments of the population, this is not the case across the board. Those who are comfortably off should pay the real price, while families living in precarity should receive direct aid. Anything else distorts the real price of goods and reduces incentives to save energy.

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