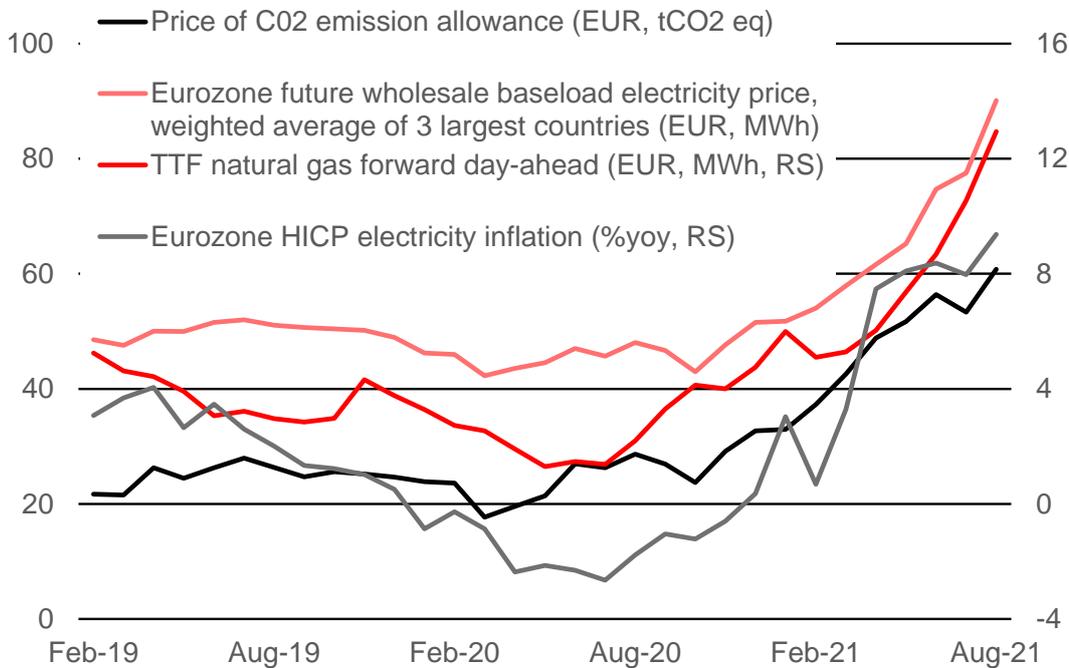


Soaring wholesale electricity prices heat up debate on cost of green transition



Source: Bloomberg, Eurostat, UniCredit Research

- Eurozone wholesale market electricity prices have hit an all-time high this week. This is primarily due to the steady increase in the price of natural gas (used by power plants for electricity generation) amid persistent supply shortages and bottlenecks in alternative renewable energies. It also reflects, albeit to a lesser extent (EU Timmermans said by 20%), the rise in the price of greenhouse gas emission allowances related to Europe's greater ambition for emission-reduction targets (by 55% compared to 1990 levels by 2030 from 40% previously). The latter has contributed to an increase in the cost of electricity generation for those plants using (more polluting) fossil-fuel technologies whose production is still needed to meet electricity demand.
- Eventually, the increase in retail electricity prices is probably accounted for to only a small extent by the rising price of gas emission allowances via the pass-through of changes in wholesale electricity prices to retail ones (which, in turn, varies depending on each country's price-setting mechanism). Still, the recent increase in wholesale electricity prices has sparked a heated debate across Europe about the cost that consumers will have to bear to support the green transition and how to avoid a backlash. It has also raised fears of a repeat of the yellow-vest protests that raged in France at the end of 2018, albeit they were not primarily about climate action.
- The transition to a greener economy will inevitably imply an economic cost of adjustment. This is also the main reason why a shift in climate policies towards less-polluting energy sources has been postponed for so long. The main challenge for policymakers is to ensure that the cost of the adjustment is fairly redistributed and that the most vulnerable groups do not bear an excessive burden, which is a condition to make sacrifices more acceptable. In the face of the recent sharp rise in electricity prices, using part of the revenue derived from the emission trading system to help protect the purchasing power of low-income households represents an appropriate policy. The budgetary cost of these mitigation measures could eventually turn out to be relatively contained if inefficient government-sponsored bans and subsidies, which often concur in the formation of retail electricity prices, were financed in a more appropriate and visible way. This is also a proposal currently being debated in Italy.

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