

SUBMISSION BY PAUL HUNT¹ ON “TOWARDS A SUSTAINABLE ENERGY FUTURE FOR IRELAND”, Green Paper, Department of Communications, Marine and Natural Resources (DCMNR), 1 October 2006

1.1 Introduction

This submission has been prepared in response to the invitation by the Government to interested parties and individuals to comment on the themes and issues raised in the Green Paper.

The DCMNR has structured the Green Paper around three major themes:

- Security of energy supply;
- Sustainability of energy supply;
- Competitiveness of energy supply.

Under each of these major themes the DCMNR has framed a number of questions to solicit specific views.

In response to the DCMNR’s approach this paper is structured as follows. The next section presents some general observations and this is followed by three sections corresponding to the major themes identified by the DCMNR. Each of the three sections presents the Green Paper’s summary policy objectives, targets and actions followed by responses to the questions framed by the DCMNR.

1.2 General Observations

It is recognized there is a risk that any general comments or observations not linked to the specific questions framed in the Green Paper will be conveniently ignored. However, some of the responses to the specific questions refer back to these general observations as they provide the basis for the submission. It is hoped that these general observations will be considered in the same spirit in which this submission is being made. These observations may be made under the following headings.

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1.2.1 The Green Paper's Approach to Energy Policy

The Green Paper is welcome on the basis of “better late than never”. It demonstrates evidence of some sustained consideration of energy policy issues which has not happened during the last 15 years. Unfortunately, the general thrust of energy policy that emerges is driven by special interest group pressure to preserve the dominance of state entities, rather than by the best practice used in other jurisdictions, which is based on what has been found to be effective in practice together with detailed consideration of the theory.

This flawed approach elevates unexamined prejudice over rational analysis. It is evidenced by the sequence in which the Green Paper presents consideration of the major themes of energy supply security, sustainability and competitiveness. There is a wealth of international theory and practice that shows that establishing appropriate institutional arrangements and a competitive market structure is the best means of achieving the security and sustainability of energy supply.

As a result the major themes identified by the DCMNR have been re-sequenced and, in the responses to the 22 specific questions, the competitiveness of energy supply is addressed first.

1.2.2 The European Dimension

In its treatment of the European dimension to energy policy the Green Paper demonstrates the DCMNR's traditional approach of viewing Europe only in the context of transposing EU directives and initiatives into Irish law and policy. There is no serious consideration of the increasing integration of the gas and electricity market on these islands and in a European context or of how Ireland can promote energy policy at a European level in co-ordination with the other smaller Member States who share many of Ireland's concerns about the future shape of the European energy market. The only consideration offered is in the insular terms of interconnection.

Even more negligently, there is no consideration of the impact of the EU Electricity and Gas Market Inquiries being conducted by the Directorate-General for Competition (DG COMP) of the EU Commission and the Regional Energy Markets (REMs) initiative of the European Regulatory Group for Electricity and Gas (ERGEG). DG COMP has issued a preliminary report identifying the major market issues that require remedy. In addition, DG COMP has considerable powers to impose behavioural or structural remedies on gas and electricity market participants and it expects to publish its proposed remedies early in 2007. It beggars belief that the Green Paper is presenting such a dogmatic and prejudiced stance on the ownership and structure of the Irish gas and electricity industries while these European inquiries are taking place.

1.2.3 The Deloitte Report on the Electricity Sector in Ireland

Deloitte undertook a major review of the Irish electricity industry for the DCMNR between April and December 2005. Deloitte was explicitly prevented by the Terms of Reference (ToR) of the review from considering the role and functions of the Commission for Energy Regulation (CER). Given the role that the CER plays this was the equivalent of “ignoring the elephant in the sitting room”. It constitutes a major deficiency in the Deloitte Report, but which was beyond the power of Deloitte to remedy.

Deloitte put considerable effort into bench-marking Irish electricity supply costs and service provision against comparable businesses internationally. This exercise provided evidence that Irish electricity costs are considerably higher, and service provision poorer, than in other countries. As it was prevented from considering the role and functions of the CER which is statutorily empowered to regulate most of these costs and services, Deloitte was unable to pursue a detailed quantitative analysis or to consider evidence² that the regulatory approach to network asset valuation is generating final prices higher than they should be. As a result, Deloitte was compelled to fall back on banal and clichéd explanations in terms of a historical deficiency in network investment, rapid demand growth and growth in new connections.

Given the DCMNR's prejudices in favour of continuing State ownership of "strategic" energy infrastructure, Deloitte was compelled to perform remarkable intellectual contortions to justify the DCMNR's position.

In February 2005 the Minister announced that a comprehensive energy review would take place. Between the announcement of the review and the drafting of the Terms of Reference the scope of the review was restricted to the electricity industry. As a result there has been no corresponding review of the gas industry and the treatment of the gas industry in the Green Paper is cursory to say the least. This, of course, does not reflect on Deloitte's performance, but on that of the DCMNR.

Finally, in compliance with the ToR, Deloitte put considerable effort into specifying an industry structure that would have the potential to promote effective and sustainable retail competition and into presenting a transitional programme of industry restructuring. It is possible to have doubts about the feasibility and effectiveness of Deloitte's recommendations, but the effort is to be applauded. All this effort is ignored in the Green Paper despite the EU and statutory requirement to facilitate the introduction of full retail competition by 1 July 2007.

Once again, proposals for rational reform of the electricity sector have been sacrificed on the altar of unexamined prejudice.

² See reference to submission to CER in fn1. The CER sought to ignore the thrust of this submission and only gave it some consideration when the Joint Oireachtas Committee on Communications, Marine and Natural Resources took an interest in the case being made. Not surprisingly, it failed to acknowledge the validity of the points being made about the over-valuation of electricity and gas network assets.

1.3 Competitiveness of Energy Supply

COMPETITIVENESS OF ENERGY SUPPLY
<p>POLICY OBJECTIVES</p> <ul style="list-style-type: none"> Effectively liberalising gas and electricity sectors by implementing energy market mechanisms Enabling competition by reforming institutional arrangements and market structure
<p>POLICY TARGETS</p> <ul style="list-style-type: none"> Introduction of the Single Electricity Market in 2007 Full opening of Irish gas market will be achieved by 1 July 2007 Completion of legal unbundling of BGE DSO (Distribution System Operator) and TSO (Transmission System Operator) by end 2006 Legal and functional unbundling of ESB DSO by 1 July 2007
<p>POLICY ACTIONS</p> <ul style="list-style-type: none"> Retain a strong commercially viable ESB Strategic electricity assets, including networks and certain generation assets, to stay in State ownership in long run Reduction of market power held by any one player in price-setting generation plant Consideration of establishing a State-owned landbank of current and potential generating sites Real and effective competition in energy supply must be encouraged and facilitated in the interests of consumers Extension of SEI's Low Income Housing Programme Rationalisation of a number of fuel poverty initiatives under the Essential Repairs Grant scheme

17) Increasing Competition and Consumer Choice

In the context of liberalisation of the Irish energy market, what further actions should be taken to develop more fully competitive electricity and gas markets and what specific barriers need to be overcome?

This question, by focusing specifically on the liberalisation of the Irish energy market, betrays a strangely insular mind-set. Ireland is a Member State of the EU and the process of electricity and gas market liberalisation is being pursued at an EU-level to effect the completion of the internal energy markets in electricity and gas. It should be self-evidently obvious that the dimensions of the Irish gas and electricity markets – even of the much touted All-Ireland market – are not sufficient to generate and sustain the market mechanisms³ that are required to support the full development of competitive electricity and gas markets. Even if these dimensions were sufficient, the EU policy objective, to which Ireland has given its full consent, is to develop an EU internal market.

³ For electricity, it is possible to sustain the fiction of the potential to promote the emergence of a competitive market. For natural gas, however, it is more difficult to suspend disbelief as these market mechanisms comprise (i) a primary, regulated, market in transmission capacity; (ii) liquid spot and forward markets; (iii) a liquid secondary market in transmission capacity; and (iv) a futures market referenced to the most liquid spot market.

Three of the four policy targets specified by the DCMNR are requirements to comply with EU Directives. There is no doubt that EU directives and decisions will continue to set the agenda for Irish energy policy. It is expected that DG COMP's report on its EU electricity and gas market inquiries will be published in mid January 2007 and it is almost certain to present a combination of behavioural and structural remedies to address the clear failure to complete the internal EU market in electricity and gas. ERGEG is taking steps to implement its Regional Energy Markets initiative. And it is reported that the EU Commission will publish proposals on the "third wave" of electricity and gas market liberalisation early in the new year.

This is the context in which Irish energy policy should be formulated and implemented. In line with these developments Irish energy policy should focus on working with the UK to develop the institutional, regulatory and commercial arrangements to create single gas and electricity markets on these islands with a view to the development of single North West Europe markets as envisaged by ERGEG. The Irish gas market is effectively part of the British gas market, but it is not an integral part. The proposed East-West electricity interconnector will have a similar impact on the Irish electricity market. A fuller integration of these markets is the only means of generating the benefits of competition for Irish electricity and gas consumers.

18) Reforming Institutional Arrangements and Market Structure

What policy measures and targets should be introduced to reform institutional arrangements and market structure, particularly in the electricity and gas sectors?

As part of the process of engaging with the policy and regulatory authorities in Britain described in the previous response, there should be a comprehensive review of the performance of the CER to identify necessary changes in its powers, duties and procedures.

For example, under the legislation⁴ establishing the CER there is an imbalance in the assignment of legal powers between the Minister and the Commission and an asymmetry in the availability of appropriate statutory procedures to review the exercise of these powers. The imbalance in the assignment of powers may be justified on the grounds that it is required by the Commission to ensure its autonomy.⁵ But the asymmetry in the availability of review procedures means that a regulated entity is entitled to invoke an appeals procedure whereas consumers have no recourse to a review procedure.

There is a clear requirement to establish a statutory energy consumer protection body to protect the interests of electricity and gas consumers since the CER has signally failed to do so. Whether such a body would be established by creating a separate body or by extending the powers and duties of the Natural Consumer Agency is a matter for further consideration.

In addition, the CER frequently issues its proposed decisions on prices and tariffs one to two months prior to these decisions coming into effect and seeks the views of interested parties. The CER typically dismisses the submissions made by referring to arguments

⁴ Electricity Regulation Act of 1999 and Gas (Interim) (Regulation) Act of 2002)

⁵ It, also, has allowed the Minister to assign responsibility for politically unpalatable decisions to the Commission.

supporting its proposed decision and simply confirms its proposed decision as final. This makes a mockery of the regulatory consultation process and will need to be addressed.

19) Reducing Controllable Costs in the Electricity and Gas Supply Chains

While a significant proportion of our energy prices are determined by international oil and gas prices, what actions should be taken domestically to reduce the cost of electricity and gas to consumers?

A part of the performance review of the CER should focus on its approach to network asset valuation and the mechanism it applies to pass-through the cost of gas and the costs of fuels for electricity generation to final consumers.

20) Role of State-owned Enterprises

State-owned enterprises (e.g. ESB, BGE, BnM) have played a central role in the development of the energy sector. How should the role of State-owned energy enterprises respond to the challenges of meeting our energy needs in the future?

The network business units of the ESB and BGE should be completely separated from the commodity activities, established as separate companies and privatised. The remaining electricity and gas supply businesses of the ESB and BGE should be merged in a single company and privatised. This single company should have sufficient resources and capability to compete in integrated gas and electricity markets on these islands and internationally. Integrated markets on these islands will provide opportunities for suppliers currently operating in Britain and in the wider EU market to compete effectively with the merged electricity and gas supply company in Ireland.⁶

The announcement by the CER on 29 November 2006 that it has reached an agreement with the ESB whereby the ESB will divest 1,300 MW of its generating capacity by 2010 has the potential to alter the structure of the All-Ireland electricity market. The objective is to reduce the ESB's share of generation and supply to 40% in an All-Ireland context. While any measure of structural change is welcome, the effect of this change is unlikely to promote the degree of competition in the market that is required to generate long term and sustainable benefits to consumers. Insofar as it is possible the ESB will dispose of plants that are inefficient or close to retirement. These will hold no attraction for existing or prospective market participants.

⁶ Insofar as recent news reports are trustworthy, the reported attempt by the ESB to acquire Viridian, to create two all-Ireland generation and supply businesses (one of which would be sold off) and to establish the combined North and South electricity networks as a separate company conveys some evidence of appropriate strategic thinking on the part of the ESB that is in line with the likely future restructuring of integrated electricity and gas utilities throughout the EU. Unfortunately, the ESB had to be prompted into action by the proposed take-over of Viridian by a Middle Eastern investment fund, Arcapita. It then took too long to "wake up and smell the coffee" and the opportunity as envisaged no longer exists. However, Arcapita, whose purchase of Viridian has been approved by its shareholders, will be confronted with the requirement to restructure Viridian into separate network and generation and supply companies. Much depends on Arcapita's long term objectives. If it is investing in a "yield stock" it will retain the network business and divest the supply and generating business. On the other hand, if it has an appetite for more risk (and wishes to recover a large share of its initial investment) it will seek to sell off the network business. Either course of action will create opportunities for rational restructuring of the electricity industry in both the North and the South.

The CER and the DCMNR appear determined to ignore the fact that genuine competition in electricity and gas supply will emerge only on a pan-European basis – which is precisely what DG COMP and DG TREN are seeking to promote.⁷ Assisting the ESB to move to a reduced, but higher-value, plant portfolio may generate some activity, and convey the illusion of competition, in the short to medium term, but it will not generate long term benefits. Ironically, it may be sufficient to evade the implementation in Ireland of any remedies DG COMP might propose early in 2007 and, conceivably, could be seen as a cunning pre-emptive move.

21) Alleviating Fuel Poverty

What further action should be taken to alleviate fuel poverty?

Prepayment Meters (PPMs) provide a means of allowing gas consumers on low incomes and, in particular, older gas consumers on fixed incomes to budget their gas consumption effectively. They also provide the opportunity for consumers who wish to do so to “pay-as-you-go” in a similar manner to the supply contracts offered in the mobile phone market. However, PPMs are frequently installed and used as a means of debt recovery. The basic cost of gas for consumers with PPMs is higher than that for consumers on conventional credit meters.

The CER consulted on arrangements for PPMs in March 2006 in the context of full retail market opening on 1 July 2007 and received a number of responses. One response⁸ proposed an approach to PPMs that would allow a significant expansion in their use and, by using the most efficient metering technology and by excluding them from the resource-consuming processes of estimating, allocating and reconciling the consumptions at Non-Daily Metered (NDM) gas points and of charging for pipeline services at these gas points⁹, would allow a reduction in the basic cost of gas for PPM consumers. This approach, in addition, would facilitate an expansion in gas penetration, competition in gas supply to PPM consumers and allow effective targeting of winter fuel allowances.

It is understood that this approach is being given serious consideration in Northern Ireland, but so far, there is no evidence of similar consideration in the Republic. In so far as any consideration is being given to PPMs the CER is focusing on its powers and duties in the context of market opening. The protection of the interests of consumers does not seem to enter into its considerations. This is an area in which the Minister and the Department and an appropriately empowered energy consumer protection body should be involved, but the imbalance in Ministerial and Commission powers and the absence of an energy consumers’ protection body mean that sufficient consideration is not being given to this issue.

⁷ The following link provides an excellent overview of the reasons why competition is not emerging and of what needs to be done: <http://www.stockholm-network.org/downloads/publications/d41d8cd9-Power%20Failure%20-%20Single%20Pages.pdf>.

⁸ www.cer.ie/CERDocs/cer06181.pdf This document, apparently, was submitted anonymously.

⁹ A simplified charge for pipeline services would be included in the final price paid by PPM consumers.

22) Green Paper Policy Direction

Does the Green Paper generally set the right policy directions for enhancing the competitiveness of the Irish energy sector?

Despite framing 5 questions on specific policy areas in this section, the Green Paper has been drafted to convey the impression that these areas have received sufficient consideration and that no further policy action is required. The responses in this submission demonstrate that the proposed policy directions are entirely inadequate and wrong-headed.

1.4 Security of Supply

SECURITY OF SUPPLY
<p>POLICY OBJECTIVES</p> <ul style="list-style-type: none"> • Ensuring that energy supply can meet future demand • Ensuring the security of gas supplies to the country • Addressing the diversity of fuels used within the generation sector • Delivering electricity and gas to homes and businesses over networks that are adequate and secure • Encouraging investments in energy infrastructure by creating an attractive environment; and • Mitigating the impact of energy supply disruptions by ensuring that contingency measures are in place
<p>POLICY TARGETS</p> <ul style="list-style-type: none"> • Delivery of second North-South electricity interconnector by 2012 • Delivery of East-West electricity interconnector by 2012 • 15% of electricity consumption will be obtained from renewable sources by 2010; 30% to be achieved by 2020 • Co-firing up to 30% at peat fired generating stations by 2015 • The South-North gas pipeline is scheduled for completion by end 2006 • All-Island market progressed and Single Electricity market introduced in 2007 • Establishment of NORA as an independent statutory body
<p>POLICY ACTIONS</p> <ul style="list-style-type: none"> • Maintain prohibition on nuclear generation • Develop and support All Island energy framework and Single Electricity Market • Commission All-Island study to examine medium to long term gas security of supply on the island of Ireland (due for completion in 2006) • Undertake all-Island Grid study to support renewable growth (due for completion in 2007) • Ensuring an appropriate mix of baseload and flexible plant to allow for further renewable growth • Review case for allocation of National Development Plan 2007-2013 towards strategic transmission and interconnection projects • Commission a report in 2006 on security of oil supplies to Ireland • Review of National Oil Stockholding Policy completed by end 2006 • Maximisation of wholly-owned NORA oil stocks subject to NORA's financial resources, storage availability and value for money • Inaugural Handbook on Oil Supply Disruptions Contingency Measures published by end 2006 • Complete peer review of offshore fiscal regime study by end 2006 • Complete review of offshore licensing terms by end 2006 • CER Task Force on Emergency Procedures continue to monitor improvements to contingency plans

It is not possible to respond to these questions individually without employing needless repetition so the responses are combined in the response to Question 8) below.

1) Reducing Dependence on Oil and Gas

In addition to enhancing the contribution of renewable energy, what actions could be taken to further diversify the fuel mix for electricity generation and reduce dependence on oil and gas?

2) Generation and Transmission Adequacy

How can generation and transmission adequacy in the electricity sector be improved?

3) Gas Storage

What actions should be taken to create strategic storage capacity in the gas sector?

4) Barriers to Entry to Electricity Generation

What are the challenges to greater participation by new players in the development and operation of power generation plant - and how should they be addressed?

5) Interconnection with Europe

How, and over what timeframe, should Ireland pursue greater electricity interconnection with Europe?

6) Indigenous E&P

What measures could be taken to encourage the exploration and production of indigenous energy resources?

7) Fossil Fuel Import Contingency Measures

Given the existing level of dependence on imported fossil fuels, what needs to be done to enhance contingency measures?

8) Green Paper Policy Direction

Does the Green Paper generally set out the right policy directions for security of energy supply?

The official line for some time at the EU and Member State level is that properly functioning competitive markets combined with appropriate regulation will deliver significant benefits to European consumers and businesses while maintaining security of supply. Recently, however, the growing market power of Gazprom as the major external EU gas supplier combined with the increased integration and state control and direction of the Russian energy industry is causing concern and encouraging more policy intervention in this area. It is, of course, convenient for those who continue to be opposed to liberalisation of the EU electricity and gas markets to draw attention to these concerns.

Nevertheless, there are grounds for concern, but the correct response is not a retreat from the promotion of competitive markets and a rash of state intervention. The policy direction set out by the Green Paper conveys a sense of policy hyperactivity. The principal purpose of Government in this area is to create the environment in which rational and efficient investment decisions can take place. As discussed in the previous section, taking steps to achieve a fuller integration of the gas and electricity markets on these islands (with a view to further integration in North West Europe markets) and radically reforming the structure and ownership of the existing electricity and gas semi-state companies is the most effective use of Government resources in this area.

Taking these steps will provide the opportunities for market participants to address a number of the concerns raised in the Green Paper about the fuel mix in electricity generation, generation and transmission adequacy, barriers to entry in the electricity market, electricity interconnection with Europe and gas storage. Nor should nuclear

power be excluded permanently from consideration. Although it is accepted as unlikely that, for the foreseeable future, the genuine concerns of the Irish public about the economic, health and safety and environmental aspects of nuclear power will be resolved, it would make sense to keep the option under review. There is more than an element of hypocrisy in self-righteously maintaining a prohibition on nuclear power while promoting interconnection with electricity supply systems which include nuclear power stations.

The State has an important role to play in ensuring that its upstream fiscal terms are competitive with those in other oil and gas provinces and (in conjunction with other Member States) in maintaining strategic oil reserves. There may also be a role in strategic gas storage, now that an LNG importation project is beginning to take shape.

A more focused and resourced implementation of the EU's Neighbourhood Policy and its external co-operation policy could help to reduce the market power being deployed by Gazprom and is something Government could pursue with its European partners. Tackling these three issues (fiscal terms, strategic storage, EU external policy) combined with market integration on these islands and semi-state restructuring is a more than sufficient workload for this and succeeding governments.

1.5 Sustainability of Energy Supply

SUSTAINABILITY OF ENERGY SUPPLY
<p>POLICY OBJECTIVES</p> <ul style="list-style-type: none"> • Addressing climate change by reducing energy-related greenhouse gas emissions • Increase the level of renewable energy sources in electricity, heat and transport • Stimulating the development of alternative energy sources by providing incentives • Reducing demand by strengthening energy efficiency and conservation measures; and • Delivering a research and development programme supportive of technology breakthroughs in the sector
<p>POLICY TARGETS</p> <ul style="list-style-type: none"> • Defined renewable penetration as a proportion of electricity consumption will be achieved: 15% by 2010; 30% by 2020 • At least 2% biofuels penetration achieved by 2008 and 5.75% by 2010 • Heat market target of 5% renewable provision by 2010 • CHP target of 400MW installed by 2010 • 20% improvement in energy efficiency achieved by 2020
<p>POLICY ACTIONS</p> <ul style="list-style-type: none"> • Develop and implement National Bioenergy Action Plan • Implement excise relief programme for biofuels and capital grant aid programme for biofuels processing facilities • Deliver CHP grants scheme for small-scale CHP and large-scale biomass-fed CHP • Continue and extend SEI Greener Homes initiative • Implement REFIT scheme • Implement Ocean Energy strategy in four-phase approach to 2020 • Develop Action Plan on energy efficiency including: <ul style="list-style-type: none"> - implementation of EU Directives on energy performance in buildings and end use efficiency and energy services - provision of energy efficiency programmes into the Regional Operational Programmes 2007-2013 - building of research and development and innovation capability - delivery of progress on an all-island approach to energy efficiency - encouragement of Demand Side Management initiatives; and - launch of a major national energy efficiency campaign

Once again, it is not possible to respond to these questions individually without employing needless repetition so the responses are combined in the response to Question 16) below.

9) Delivery of Renewable Energy

What can be done to improve the pace and range of development of renewable energy resources for electricity generation on a sustainable basis?

10) Renewable Energy in Transport and Heat-raising

In addition to electricity generation, what actions should be taken to develop renewable energy usage in the transport and heat sectors?

11) New Energy Efficiency Initiatives

What significant new initiatives could be taken to increase energy efficiency across the economy and in particular in households, businesses, the public sector, the transport sector and the built environment?

12) Expanding RTDI

What additional policy measures should be introduced to significantly expand energy RTDI and what are the priority areas of research, which need to be targeted?

13) National Energy Research Capacity

In light of the Government's Science, Technology and Innovation Strategy, what needs to be done to radically expand the national energy research capacity?

14) BioEnergy

What are the key supply and demand questions to be addressed to underpin a fully cohesive National BioEnergy Strategy?

15) Mandatory Targets and/or Incentives

Do we need to choose between mandatory targets and better incentives for renewable energy and energy efficiency - or is a mix of both the best way forward?

16) Green Paper Policy Direction

Does the Green Paper generally set the right policy directions for energy sustainability?

Ensuring energy sustainability and tackling climate change are two sides of the same coin. The Green Paper focuses on the individual, local and national aspects, but these issues have to be tackled effectively at the EU and international levels as well. The Stern Report in the UK, received with widespread acceptance and acclaim, highlights the costs and benefits. In addition to concerted effort at the international level, national policy should focus on developing joined-up policy initiatives that reduce the barriers to entry of renewable sources of energy. For example, Ireland should have a comparative advantage in terms of wind power and planning regulations may require review.

However, the economic fundamentals of the energy market must be in place and, manifestly, they are not in Ireland. It will then be possible to reform the taxation system to capture environmental costs and to expand the use of tradable carbon (and other polluting) emissions without distorting investment and consumption decisions. Price signals conveyed by competitive market mechanisms provide far better incentives to alter behaviour in the desired manner than any number of policy initiatives and interventions.