

This is Mr. Seppanen's letter to the editors of The European Voice and The Financial Times answering to the letter written by Mr. Matthes et al. and published in both papers on 11.9.2008.

The writers were right in their assessment that "the soaring Polish power prices are due, fundamentally, to liberalising the electricity system", but they are wrong in their assessment that the auctioning or alternatively free distribution of emission allowances has "little or nothing" to do with power price impacts.

The liberalisation through harmonisation of the electricity market includes the aim to make electricity prices equal in all EU countries and make them independent of the general or average cost in electricity generation. This "liberal, competitive system" does not result in lower prices in all member states but increases the prices in the countries where energy is cheaper than in the EU on the average. Liberalisation and harmonisation, as such, increase prices in the Nordic countries, and if the prices go down somewhere, it happens at the cost of the Finnish and Swedish consumers.

The price formation system of electricity is the main source of windfall profits of the power companies, and not only auctioning or not auctioning of the emission allowances.

In the price formation in the energy exchanges the power plants are not paid according to their own bid but according to the bid of the marginal producer with the highest variable costs. Thus, the price system brings windfall profits to all the companies which produce electricity at the lower cost than the highest variable cost. The system is the profit automatic for the hydro and nuclear power plants - and their windfall profits explode in the ETS. The price formation system allows these companies to include the price of emission allowances in the price of all electricity even though they do not need them for their electricity generation. The high price of the allowance is the gift from the system to them.

There are some built-in problems in the ETS due to the speculative elements knit into the net of auctions and the secondary market.

Auctioning means securitisation of the emission allowances and they will be financial products. When all the interested parties, including the financial speculators, are allowed to participate in auctions, the price of the allowance (= security) may be speculatively high - and the speculative part is added in the price of all electricity.

The same happens in the energy exchanges, where the securitisation of emission allowances leads to a possibility to trade them as financial derivatives with very unstabling effect on both the price of allowances and through them on the electricity price. There are many proven speculative wrongdoings in such a trading especially in the over-the-counter trade which is free of any public supervision and control.

My first conclusion is that liberalisation and harmonisation of the energy markets, as such, increase electricity prices in many low-cost countries and are the automatic of huge and growing windfall profits of big companies.

Another conclusion is that auctioning and speculative secondary markets increase electricity prices through the price formation system and the trading of emission allowances as financial products.

In the price of electricity (and gas), the households and industries should pay only for climate pollution but not for financial speculation. In that respect, we have just received a clear message from the USA of the ruthless thrive for profits.

By benchmarking the allowances according to the best available technology instead of obliging the European industries to buy their allowances in auctions and energy exchanges we can make sure that the ETS does not punish the environmentally advanced European enterprises. The caps can be maintained also in such a system without the negative impact on the European product prices.

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