Four Criteria for Fighting the Energy Crisis
By Geoff Gottlieb and Krzysztof Krogulksi

In recent weeks, energy prices in Europe have fallen due to a warmer than expected autumn and countries' significant progress on building energy reserves. However, we expect this reprieve to be temporary and policymakers must be prepared for the energy crisis to persist. Specifically, energy consumption cannot continue as if the Russian war on Ukraine has not happened. The best path forward protects the most urgent energy needs of today while investing in abundant energy for the future.

As in much of Europe, Poland's energy market is changing rapidly because of Russia's war against Ukraine. Poland is no longer importing natural gas or coal from Russia and has substantially reduced oil imports. To give a sense of magnitude, this drop in Russian-supplied energy corresponds to about 30 percent of Polish energy consumption.

Fortunately, Poland has been able to switch to alternative sources. Thanks to forward-thinking decisions taken well before the recent war, Poland's near-term gas demand is likely secure because of the recently operational Baltic Pipeline and previously built LNG terminal. Moreover, though bottlenecks are still a risk, Poland has access to international oil and coal markets via existing port infrastructure.

Nonetheless, Poland is still facing unprecedented spikes in wholesale energy prices because of developments in international markets. In the most recent data, wholesale prices for gas and electricity in Poland have risen by 130 and 40 percent, respectively, since the start of the war. This is more modest than price increases seen elsewhere in Europe but still very significant for the Polish economy.

Amid such a price shock, governments across Europe have understandably taken urgent short-term measures to cushion the impact. The primary policy response in Poland has been cuts in taxes on energy to help hold gas and electricity prices constant for all households, regardless of income. The government also introduced income support for households which rely on other types of energy (e.g. coal for home heating) as those prices have moved more with market fundamentals.

However, it is important to update this policy mix. Tightness in European energy markets is likely to persist into 2024, meaning that high wholesale prices and the risk of energy shortages will remain. As a result, it is critical that policies in Europe to support households and firms continue to address urgent social needs but in a more economically and environmentally sustainable manner.

Policies should aim to pass four tests:

- Are those households most in need adequately protected? No household should forgo critical heat and electricity needs because energy is unaffordable or unavailable. There is a particular risk of increased reliance on toxic forms of energy which endanger long-term health.
- Do the measures incentivize the conservation of energy? To minimize the risk of shortages, overall reductions in energy consumption will be essential. The most effective way of achieving this is to allow prices to rise to reflect the new energy reality (while helping the vulnerable cope with them).
- Does the support create other macroeconomic problems? The fiscal response to the energy shock must avoid adding to aggregate demand (which would counter efforts to contain inflationary

pressures) or unnecessarily adding to public debt. This means that fiscal support should be well-targeted, temporary, and carefully financed.

- Do the policies help maintain and increase the supply of energy? Policies should not undermine the viability of existing energy suppliers. Moreover, they should aim to remove short-term bottlenecks and incentivize new investment in medium term-supply and distribution, including renewables.

Policies recently announced or under consideration in Poland are a step toward addressing many of these concerns. But their effectiveness in ensuring energy security, social protection, and macroeconomic stability will ultimately depend on important design considerations. For example:

- Block pricing – Introducing larger price increases on household electricity use above a basic level will help with conservation. But to have an impact, it is critical that this "subsistence" threshold is not set too high and the price increase on non-essential levels of consumption is not too low. The scheme could also be extended to non-household energy users and more types of energy.

- Fiscal support for households – Policy makers should avoid granting sizable net transfers and tax cuts which benefit all households, regardless of income. Targeting the support to vulnerable households allows more generous help while avoiding pressure on broader economic stability.

- Fiscal support to energy intensive firms – Providing temporary support to energy intensive firms that are hit hard by the spike in prices will help avoid unnecessary contractions and loss of capacity in the industrial sector. But the support should be contingent on explicit progress on energy efficiency.

- Revenue cap on energy producers – Though broad-based solidarity surcharges on income tax can be more efficient, a revenue cap on energy suppliers can help offset the budgetary cost and inflationary impact of other support measures. However, caution will be needed on the design: in addition to potential legal challenges, there is a risk the cap will dissuade future investment in the sector if it does not allow for adequate profits.

Russia's war in Ukraine represents a sharp and likely persistent fall in the existing sources of energy for Europe. There are no easy near-term solutions. Nonetheless, careful policy choices can both protect citizens through the current crisis while preserving the needed resources for a more secure energy future.