

Energy Economics, Winter Semester 2021-2

Lecture 8: Support for Renewables

Prof. Tom Brown, Dr. Fabian Neumann

[Department of Digital Transformation in Energy Systems](#), Institute of Energy Technology, TU Berlin

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1. Why renewables require support
2. Policies
3. Support mechanisms
4. Green hydrogen

Why renewables require support

- Why do renewables require support?
- Why can't solar and wind survive from electricity market revenue alone?
- What types of support are there?
- What are the pros and cons of direct payments, premiums, taxes and quotas?
- What should support look like once wind and solar are mature?
- What is the most efficient way of reaching greenhouse gas reduction targets?

- reducing carbon dioxide emissions
- reducing air pollution (particulate matter, NO_x, SO₂ from fossil fuel combustion)
- reducing dependence on finite resources (fossil fuels, uranium)
- creating energy system with decentralised structure and ownership (reduces market power)
- reducing cost through knowledge spillovers (leading to lower overall cost energy system)
- developing an export industry by early specialisation
- energy security: limiting dependence on fossil fuels imports
- ancilliary benefit: generating employment

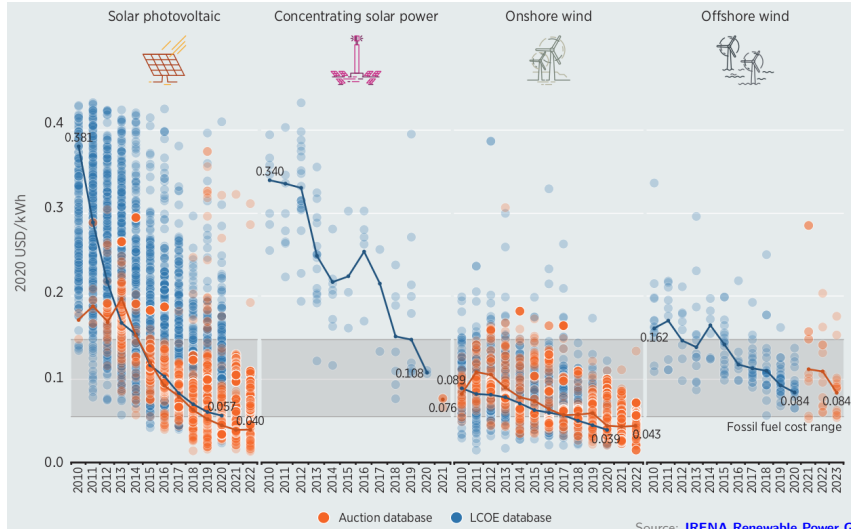
Why not just rely on **market revenues**?

Or on **carbon pricing** to make low-carbon generation attractive?

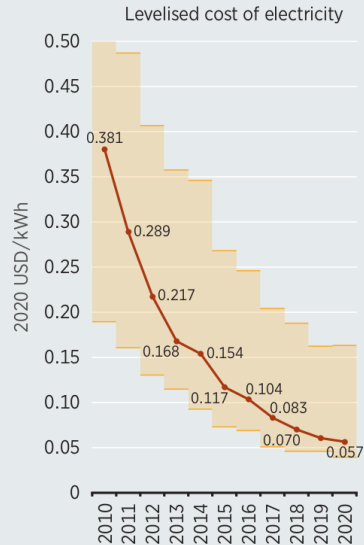
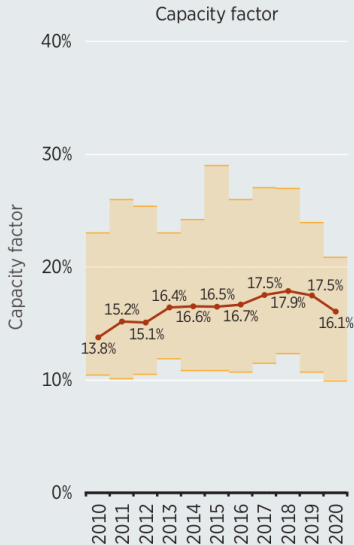
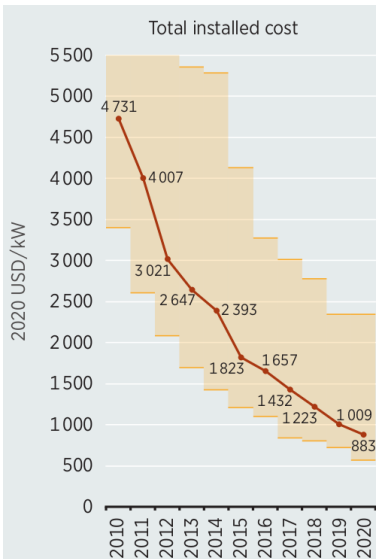
The reasons for support are varied, depend on technology, maturity and the penetration of the technology in the market.

- The technology is at the beginning of its learning curve and is **expensive** but there is an **expectation of cost decline** that will make it competitive in the future
- The technology is competitive but not being built because of **price risk**
- The technology penetration is so high that in the absence of other policy (e.g. carbon pricing) there is **cannibalization of market value**

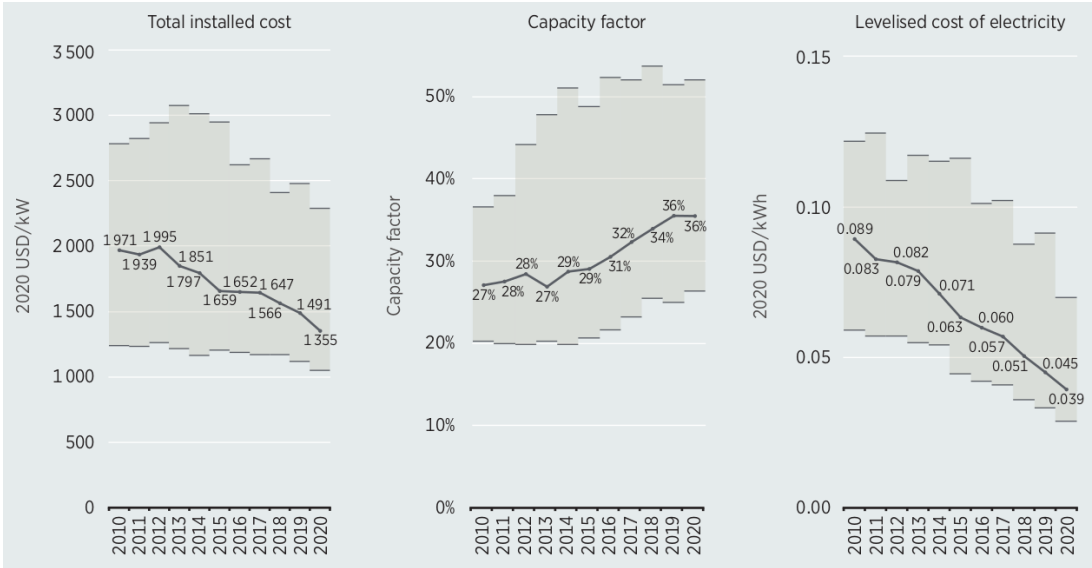
Project and global weighted-average LCOE and PPA/auction prices for 2010-2023:



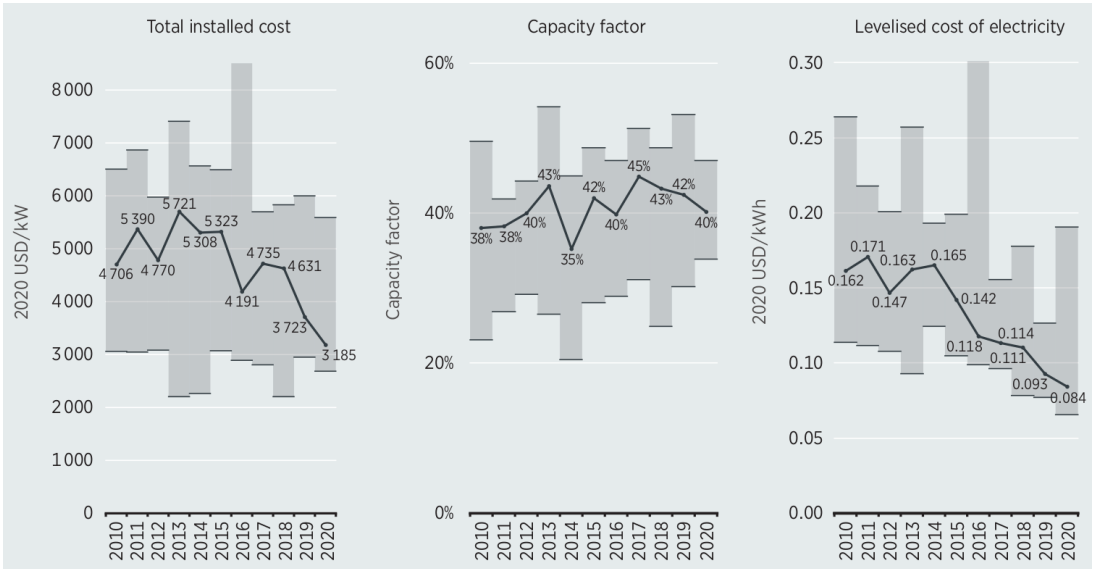
Global weighted costs for solar PV



Global weighted costs for onshore wind



Global weighted costs for offshore wind



VRE have the property that they cannibalise their own market, by pushing down prices when lots of other VRE are producing through the **merit order effect**.

They reduce their own revenue by producing in a correlated way.

To quantify this effect, we can define the **market value** of a technology by the average market price it receives when it produces, i.e. for technology s and production at time t of $g_{s,t}$ MWh when the market price is p_t €/MWh:

$$MV_s = \frac{\sum_t p_t g_{s,t}}{\sum_t g_{s,t}}$$

We can compare this to the average market price, defined either as the simple average $\frac{1}{T} \sum_t p_t$ or the demand-weighted average $\frac{\sum_t p_t d_t}{\sum_t d_t}$.

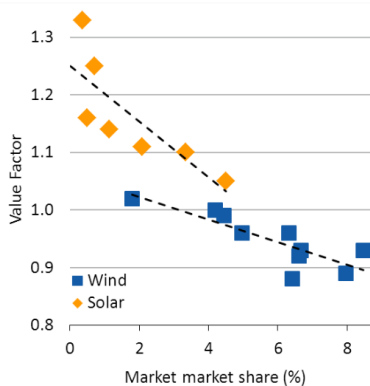


Figure 6. Historical wind and solar value factors in Germany (as reported numerically in Table 3).

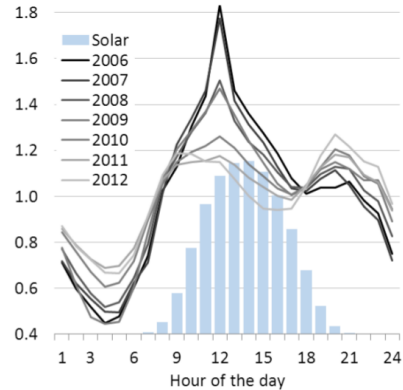
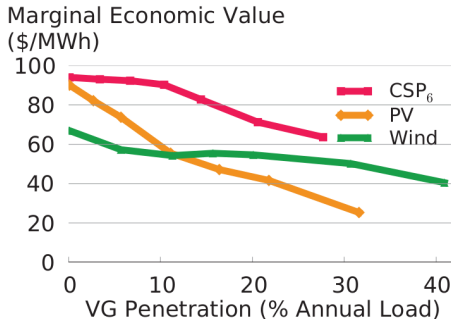


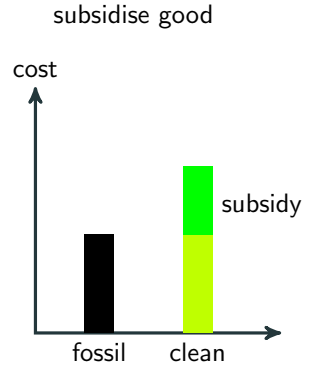
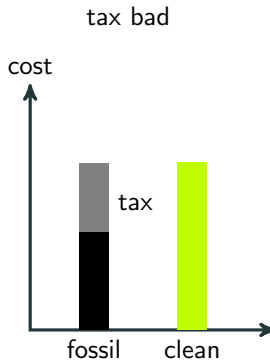
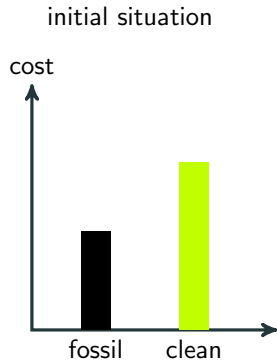
Figure 7. The daily price structure in Germany during summers from 2006 – 2012. The bars display the distribution of solar generation over the day.

At low shares of VRE the market value may be higher than the average market price (because for example, PV produces a midday when prices are higher than average), but as VRE share increases the market value goes down.



The effect is particularly severe for PV, since the production is highly correlated; for wind smoothing prevents a steeper drop off. The bigger the catchment area, the longer wind preserves its market value.

In general if you have two competing technologies and you want to encourage the more expensive one, you can either **tax** the disfavoured technology until the favoured technology is preferred, or you can **subsidise** the favoured technology.



To encourage electric vehicles (EV) over internal combustion engine vehicles (ICEV), we do both in Germany:

- **energy tax** and **CO₂ tax** on diesel and petrol
- **vehicle sales tax** (Pkw-Steuer) only applies to ICEV
- **subsidy** (Elektro-Kaufprämie) for electric vehicles of up to €9000
- **state regulatory and financial support** for charging stations

Alternative to taxes and subsidies: set target for **volume** instead of **price**, e.g. fixed **quotas** (e.g. for biofuels in transport fuels, renewable power in generation, maximum emission standards) or regulation banning technologies (coal exit, ban on gas boilers).

Example 1: to limit carbon dioxide emissions: set **volume limit** then trade certificates for this emissions volume (like EU Emissions Trading System (ETS)) OR set **carbon price** determined administratively.

Example 2: to raise share of renewables: set **renewable share target** with tradeable certificates for generation (like Renewable Portfolio Standard (RPS) in some US states) OR set **feed-in tariff** determined administratively.

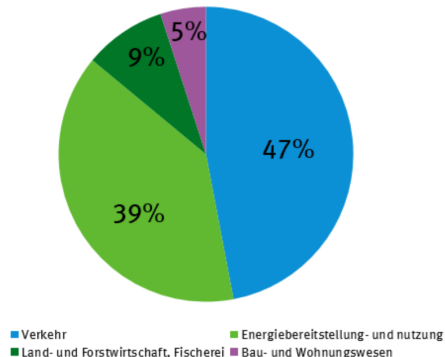
- **Public financing** - public investments, loans, grants
- **Corporate financing** - Power Purchase Agreements (PPAs)
- **Fiscal incentives** - subsidies and tax reductions for RES or taxes on carbon
- **Quotas for consumers** - required shares for renewables or clean energy

The Federal Environmental Agency (UBA) estimates that in 2018 in Germany there were environment-damaging subsidies of €65.4 billion, of which €60.6 billion damage the climate.

Major factors include EEG exceptions, lower tax on diesel relative to petrol, energy-tax-free kerosene for aviation, VAT-free international flights, commuter tax allowance, subsidies for coal, lower VAT for animal products, free distribution of ETS CO₂ certifications.

NB: This does NOT include indirect subsidy of not taxing fossil fuel externalities for climate and air pollution.

Abbildung 17: Aufteilung des Subventionsvolumens nach Sektoren



Policies

As of mid-Nov 2021 (after COP26 in Glasgow) 74 nations have net-zero emissions targets.

By What Year Have Countries Pledged to Reach Net-Zero Emissions?

Already Achieved

Bhutan

2030

Barbados
Maldives
Mauritania

2035

Finland

2040

Austria
Iceland

2045

Germany
Sweden
Nepal

2050

| | | |
|--------------------|------------------|----------------|
| Andorra | Jamaica | Slovenia |
| Argentina | Japan | South Korea |
| Australia | Laos | Spain |
| Brazil | Latvia | Switzerland |
| Bulgaria | Liberia | UAE |
| Canada | Lithuania | United Kingdom |
| Cape Verde | Luxembourg | United States |
| Chile | Malawi | Uruguay |
| Colombia | Malta | Vatican |
| Costa Rica | Marshall Islands | Vietnam |
| Cyprus | Monaco | |
| Denmark | Montenegro | |
| Dominican Republic | Nauru | |
| European Union | New Zealand | |
| Fiji | Panama | |
| France | Portugal | |
| Hungary | Rwanda | |
| Ireland | Seychelles | |
| Israel | Solomon Islands | |
| Italy | Slovakia | |

2053

Turkey

2060

Bahrain
China
Kazakhstan
Nigeria
Russia
Saudi Arabia
Sri Lanka
Ukraine

2070

India
Mauritius

2nd half of
21st century

Malaysia
Namibia
Singapore
Thailand

Several design choices impact the rigor of these targets.
Read our paper *Designing and Communicating Net-Zero Targets*

Net-zero target set in law or policy

Political pledge to reach net zero

10/15/21



WORLD RESOURCES INSTITUTE

Source: [World Resources Institute, 2021](https://www.wri.org/publications/2021/11/designing-and-communicating-net-zero-targets)

2030 energy and climate framework

Key targets for 2030 in 'Fit For 55' programme:

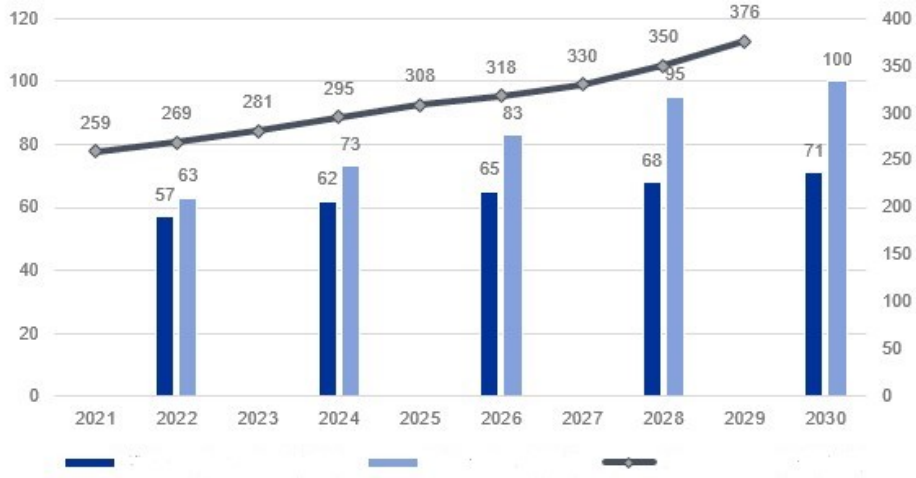
- At least 55% cut in greenhouse gas emissions (from 1990 levels; NB: not just CO₂, also other five Kyoto GHG)
- At least 40% share of renewables in final energy consumption (proposal from Commission)
- At least 32.5% improvement in energy efficiency

European Green Deal

- carbon-neutral economy by 2050 (i.e. net-zero greenhouse gas emissions)

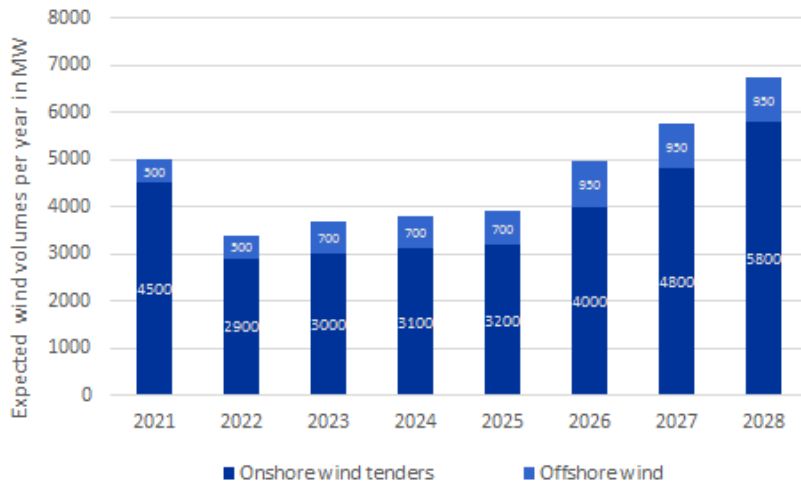
EEG 2021 has targets:

- At least 65% share of renewable energy in gross electricity demand in 2030
- 100% CO₂-neutral electricity generation and consumption by 2050
- Continuous, cost-efficient and grid-adjusted RES expansion.



For offshore wind, yearly auction volumes are determined by BNetzA to ensure synchronisation with required grid expansion and reach 20 GW by 2030 and 40 GW by 2040.

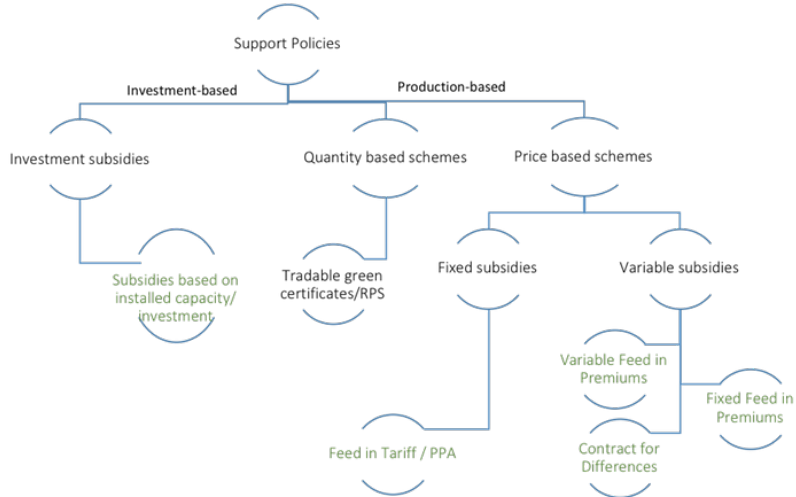
Additional capacities of onshore and offshore wind



The coalition agreement raised the ambition of previous targets.

- electricity consumption to rise to 680-750 TWh in 2030
- 65% → 80% renewable electricity target by 2030
- 100 GW → 200 GW solar PV target by 2030
- 20 GW → 30 GW offshore wind target by 2030
- around 100-120 GW onshore wind by 2030
- 50% climate-neutral heating
- coal exit ideally by 2030
- need hydrogen-ready gas turbines
- 10 GW of electrolyzers
- abolish EEG-Umlage from 01.01.2023

Support mechanisms



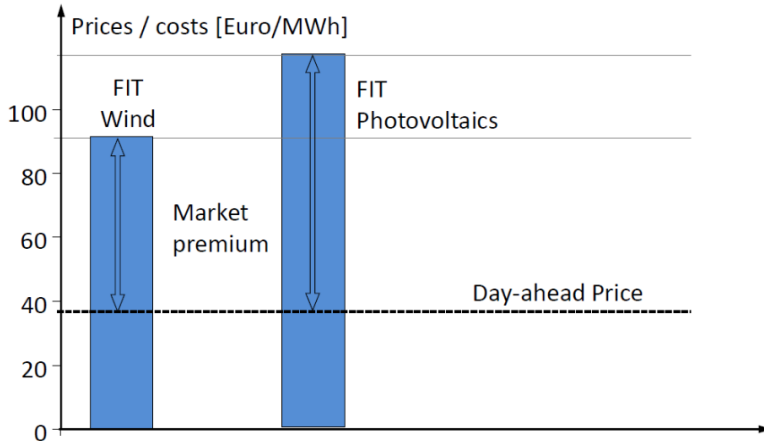
Note: Support levels in these schemes can be set both using auctions or administratively

EU Clean Energy Package (2018): binding target of 32% for renewable energy sources in EU's energy mix by 2030.

| | | |
|----------------|---|--|
| Price control | Obligation of grid operators (or ISO) to purchase all offered renewable electricity at legally defined (and technology specific) fixed feed-in payments | Dominant model but challenged by the EU Commission |
| | Legally defined and technology specific market premium (on top of the market price) granted to renewable generators that have sold the electricity | Similar to Contract for Differences |
| Volume control | Obligation of retailers to hold a minimum number of Renewable Electricity Certificates (RECs) issued by registered renewable generators | |
| | Renewable portfolio standard (retailers must physically purchase a minimum share of renewable electricity) | Do retailers have the capacity to comply? |
| | Renewable investment tenders (government defines the renewable capacity additions and selects the investors that ask for the lowest market premium) | Model preferred by the EU Commission |

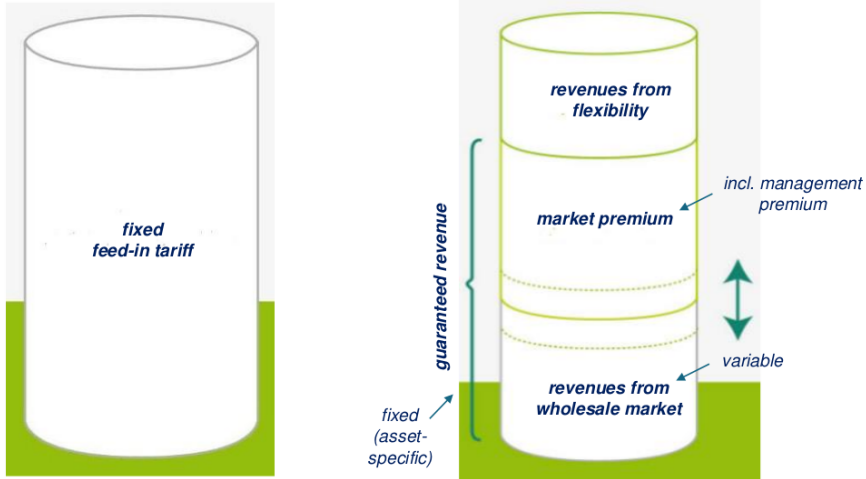
- The government fixes the price for each MWh produced or injected into the grid from RES.
- Normally, the fee depends on renewable source and size of power plant.
- **Feed-in tariff (FIT)** provides fixed amount of money per produced MWh.
- A **market premium** pays the difference between the market price and a strike price, giving incentives for selling RES output directly on the wholesale market.
- If the premium or tariff is coherent with the production cost, the government's RES output target can be met; otherwise it would be not reached or exceeded.
- The charges linked to the support system are paid by final electricity customers.

Market premium covers difference between average monthly **market value** of technology and pre-determined strike price, so that total payment is the same as the FIT for average generator. Direct marketing provides an incentive to produce more during times of high prices.

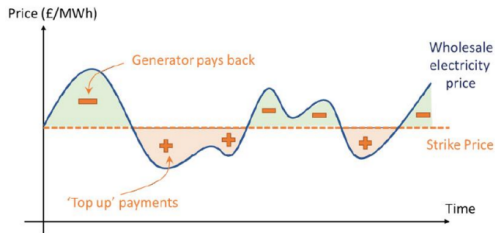


Feed-In Tariff versus market premium

The market premium includes a fee for management costs.

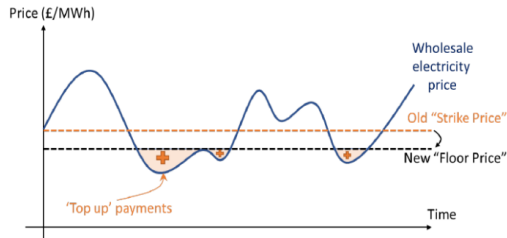


With a **contract for difference** (CfD), left picture, as used in the UK for nuclear and offshore wind, the state pays the generator when the market price is below the **strike price**, and the generator pays back the state when the market price is higher than the strike price.



Current CfD Mechanism

The German **market premium**, right picture, only provides a **floor price**, i.e. the generator does not pay back when the market price exceeds the strike price, which leads to a lower strike price. The generator is incentivised to feed in power when prices are high.



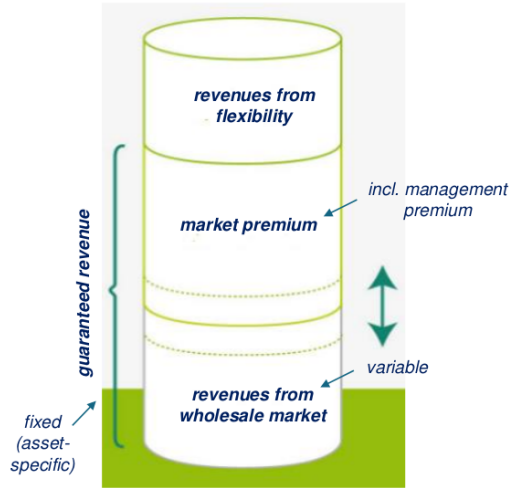
Floor-Price CfD Mechanism

EEG 2017:

- Predetermined auctioned capacity for RES new build
- Prequalified projects bidding their reference value (guaranteed revenue)
- Installation-specific reference value

Auction requirement for

- Offshore wind
- Onshore wind and solar PV from 750 kW
- Biomass from 150 kW



| Market integration objectives | Dimensions of achievement of objectives | Contributions to overarching objectives |
|---|---|---|
| Demand-oriented generation of RES electricity and increased flexibility of RES plants | Prevention of surplus supply situations via voluntary curtailment in times of negative electricity prices | Contribution of RES to security of supply is increased; |
| | Shift of feed-in to times when demand is strong and prices are high: | Costs of RES promotion are reduced through an increase in RES market value; |
| | <ul style="list-style-type: none"> • Intermittent RES: Maintenance planning, installation design oriented towards market value and system requirements • Dispatchable RES: targeted load shifting | Cost reductions in the overall system (e.g. lower balancing energy prices and system integration costs) |
| | Increased remote controllability of RES installations | |
| Efficient marketing of RES electricity | Participation of RES installations in the balancing energy market | |
| | Reduced transaction costs of marketing RES electricity | RES promotion costs are reduced |
| | Increased forecasting quality and reduction of costs of procuring balancing energy | |
| Market-driven production and investment decisions | Competition for efficient marketing forms | |
| | Competitive determination of RES remuneration | RES expansion costs are reduced |
| | RES producers become regular market players | |

Renewables support levy levied on customers (like German EEG-Umlage)

$$\text{RES levy} = \frac{\text{RES support payments} - \text{RES marketing revenue}}{\text{Adjusted non-preferred final electricity consumption}}$$

Adjusted final electricity consumption is equal to total final electricity consumption minus:

- Share of electricity consumption of energy intensive industries, which are exempted from the levy
- Own generation (self-consumption), which is partly exempted from the levy

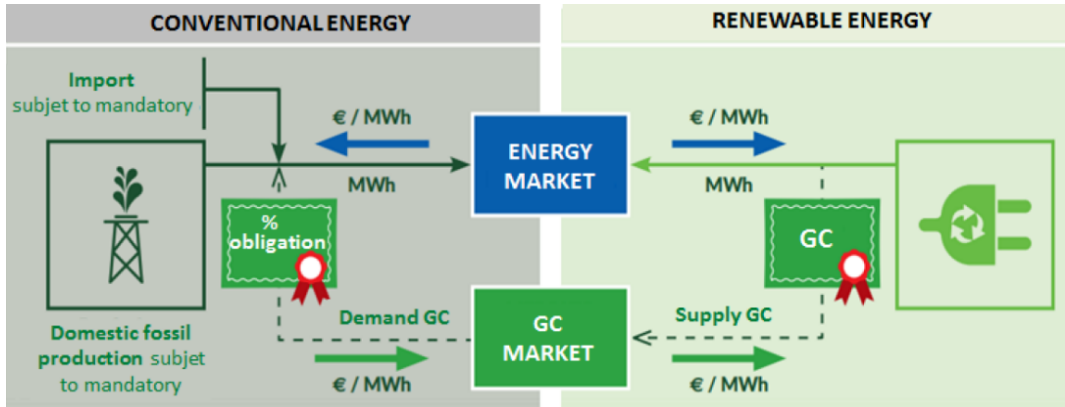
In 2020 €29.6 billion was paid in subsidies in Germany for RES.

| Final user expenditures in Germany | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|--------------------|-------------|-------------|-------------|-------------|
| | Billion Euros p.a. | | | | |
| Total domestic expenditures | 60.9 | 63.6 | 64.3 | 71.0 | 70.3 |
| Expenditures induced by the government | 17.2 | 23.0 | 23.3 | 30.0 | 32.3 |
| Electricity taxes | 6.4 | 7.2 | 7.0 | 7.0 | 6.6 |
| Concession fees | 2.1 | 2.2 | 2.1 | 2.1 | 2.0 |
| Renewable electricity levy | 8.3 | 13.4 | 14.0 | 19.8 | 22.3 |
| Combined heat and power Levy | 0.4 | 0.2 | 0.3 | 0.4 | 0.5 |
| Offshore grid levy (§ 17F ENWG) | - | - | - | 0.8 | 0.8 |
| Expenditures regulated by the government | 16.9 | 17.6 | 19.0 | 21.2 | 21.4 |
| Fees for the transmission grid | 2.2 | 2.2 | 2.6 | 3.0 | 3.1 |
| Fees for the distribution grid | 14.7 | 15.4 | 16.4 | 18.2 | 18.3 |
| Expenditures driven by the market | 26.8 | 23.1 | 22.0 | 19.8 | 16.6 |
| Market value of renewable electricity | 3.5 | 4.4 | 4.8 | 4.2 | 4.1 |
| Conv. generation, marketing, sales | 23.3 | 18.6 | 17.2 | 15.6 | 12.6 |

For countries with quotas for RES share (either government mandated like the Renewable Portfolio Standard (RPS) in the US) or voluntary corporate targets), they can trade **green certificates (GC)** or **guarantees of origin (GoO)**.

- Fossil fuel-fired generators are required to replace every year a certain percentage of their energy production with RES or to purchase GC from suppliers with excess RES.
- The balance between demand (from generators and importers under the GC obligation) and supply (RES generators) determines the GC price.
- The charges linked to the GC are translated to the final customers through the electricity price (on wholesale or retail market). NB: No external subsidy required!

Guarantees of Origin are a certificate or a piece of paper, that provide proof that electricity has been generated from renewable energy sources. It specifies the generation type, the year it was produced, the location and type of the asset and country and date of issuance. Typically one GoO corresponds to 1 MWh.



For corporate buyers who want to show they cover their demand with green or clean energy, they can purchase **guarantees of origin** for green electricity and show they cover their demand.

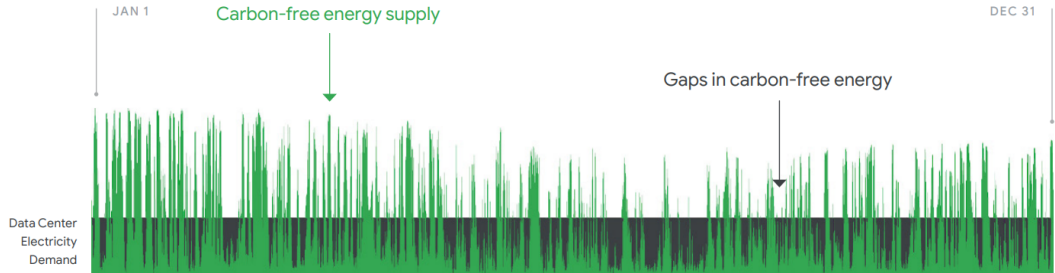
But this doesn't necessarily lead to new capacity being built - they could just relabel electricity that is otherwise subsidised.

For true **additionality** they can buy **Power Purchase Agreements (PPAs)** where they either build their own plant or offer a wind or solar developer a fixed €/MWh price for their electricity, removing the generator's price risk (like a CfD or swap).

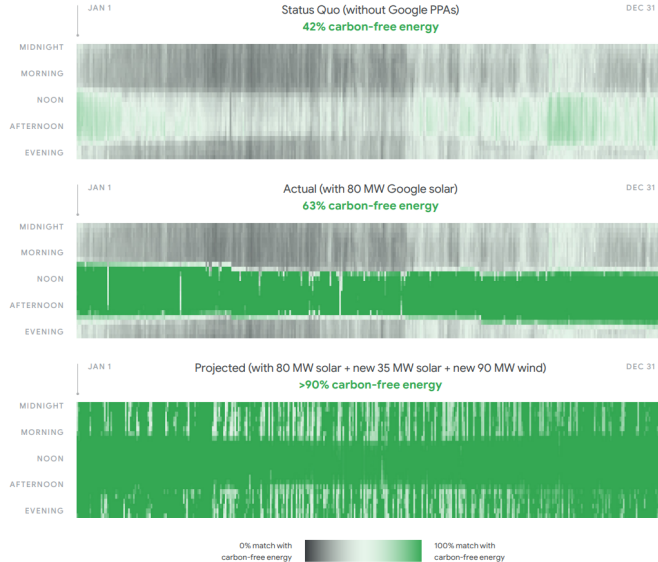
But this only meets demand on an **annual basis** and might be in a different grid.

New ideas circulating for **local, hourly matching**, e.g. with wind, solar and storage/CCS/geothermal. Would lead to **hourly guarantees of origin**.

For example, internet firm Google currently matches their data centre demand on a **yearly** basis with renewable energy, but on an **hourly** basis they still have hours when they rely on the fossil-powered grid.

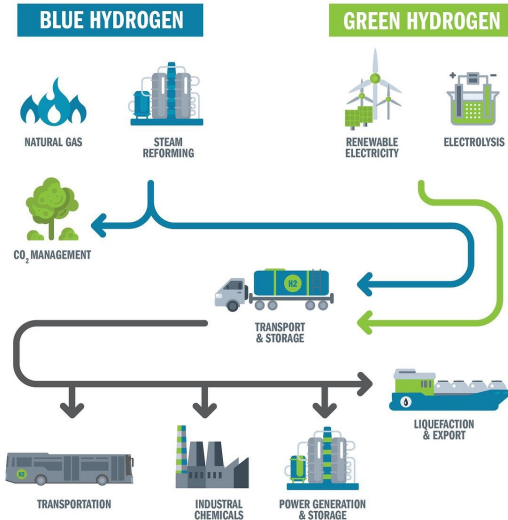


Yearly versus hourly matching



By combining wind and solar, or using storage or dispatchable low-carbon resources, they can improve the hourly matching.

Green hydrogen



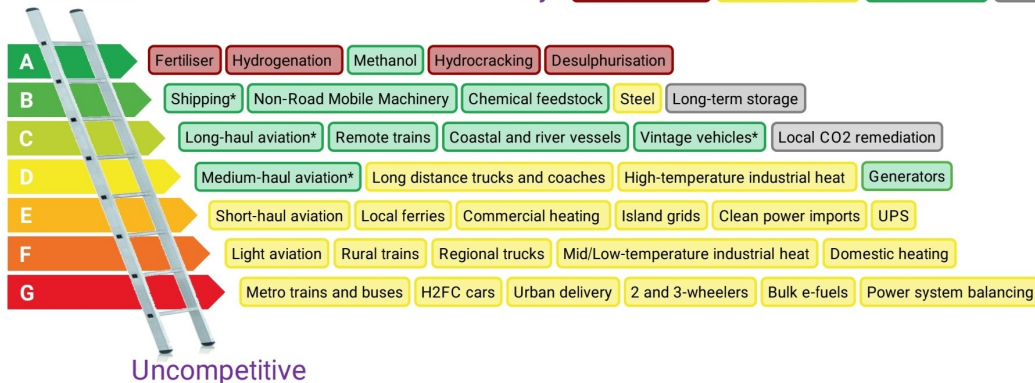
- Almost all hydrogen today is **grey hydrogen** produced by steam reformation of methane or coal, releasing CO₂ into the atmosphere.
- If the CO₂ is captured and sequestered we have **blue hydrogen** (methane leaks and imperfect capture still mean there is a greenhouse impact).
- Hydrogen produced by electrolysis of water with electricity from renewables is called **green hydrogen** and has no greenhouse emissions.

Hydrogen: the backstop of the energy transition

Hydrogen could help decarbonise sectors where direct electrification is difficult. Some say **champagne of energy transition**; could also say **backstop** for what efficiency and electrification don't reach.

Unavoidable

Key: No real alternative Electricity/batteries Biomass/biogas Other



* Most likely via ammonia or e-fuel rather than H2 gas or liquid

Source: Michael Liebreich/Liebreich Associates, Clean Hydrogen Ladder, Version 4.1, 2021. Concept credit: Adrian Hiel, Energy Cities. CC-BY 3.0

In 2020 the European Commission introduced a target for 40 GW of electrolyzers for producing green hydrogen by 2030, both to decarbonise hard-to-abate sectors like steel and heavy-duty transport, and to stimulate Europe's worldwide-leading electrolyser producers.

In 2021 the Commission proposed a reform of the Renewable Energy Directive II (RED II) with 'a new sub target for renewable fuels from non-biological origin (RFNBO) of 2.6% (single counted), and a new target for a 50% share of renewables in hydrogen consumption in industry - including non-energy uses' by 2030.

But how do we define green hydrogen?

There are several factors that have to be addressed in the definition:

- **Renewable:** What do we define as renewable generation?
- **Additionality:** Should the renewable generation be newly built, or can we use capacity built in the past that has already been subsidised? What about generation that has fallen out of subsidy period (like wind and solar older than 20 years in Germany)?
- **Location:** Do the electrolyser and renewable generation have to be co-located, at same grid node, same bidding zone, same country or just same continent? What if there is congestion in the grid?
- **Timing:** Does the electrolyser only consume the same energy as the renewable generation supplies per hour, month or year? Is it sufficient that they just run at the same time?

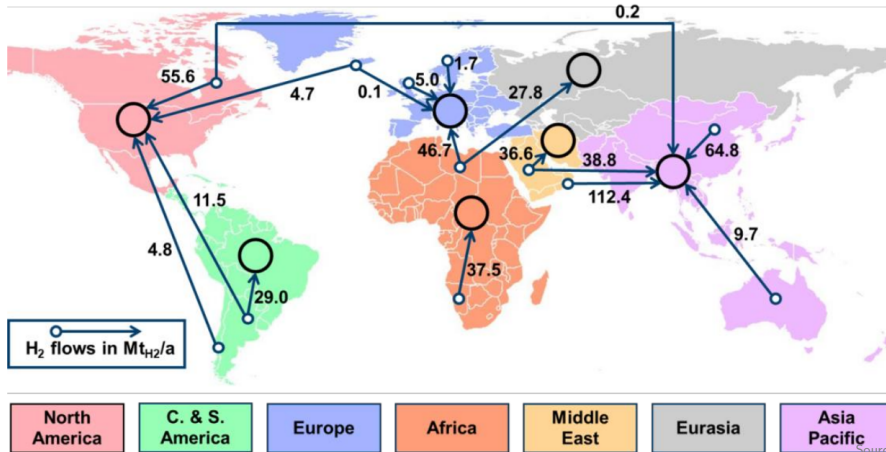
There is a **big debate** about the definition of green hydrogen, with environmental NGOs on one side and renewable and gas lobbyists on the other.

If the definition is too **loose**, then some hydrogen could be produced from fossil generators, leading to an increase in emissions compared to hydrogen reformed from fossil gas.

If the definition is too **tight**, green hydrogen installations will be expensive and take years to get built.

Possible **compromise**: for first 5 years allow to co-locate in bidding zones, allow wind and solar from outside subsidy regime, for timing allow it to be green if they run simultaneous and there is monthly energy-matching. Then tighten!

Today fossil fuels are traded across the globe. Electrolytic-hydrogen-based synthetic fuels (e.g. hydrogen, ammonia, methane, liquid hydrocarbons and methanol) could also be piped/shipped worldwide. Possible future scenario for hydrogen trade from Helmholtz colleagues at FZJ IEK-3:



The German H2Global scheme provides support for the production of renewable hydrogen in non-EU countries, to be imported and sold in the EU.

It makes available €900 million over 10 years to cover the difference between production costs and what consumers are willing to pay.

This difference is determined by a double auction: producers bids for **hydrogen purchase agreements (HPA)** that run for 10 years, providing investment security, while consumers bid for hydrogen service agreements (HSA) of duration one year.

H2Global was approved by the European Commission to comply with EU state aid rules in December 2021.

See [H2Global website](#).