

# Energy Economics, Winter Semester 2021-2

## Lecture 1: Organisation & Introduction

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**Prof. Tom Brown**, Dr. Fabian Neumann

*Department of 'Digital Transformation in Energy Systems', Institute of Energy Technology*

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1. Administration
2. History and Definition of Energy Economics
3. Introduction to Energy Transitions

# Administration

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Prof. Dr. Tom Brown

Department of 'Digital Transformation in Energy Systems', Institute of Energy Technology

I specialise in the modelling of energy systems to meet strict greenhouse gas emission targets. I work at the intersection of engineering, economics, informatics, mathematics & meteorology.

Dr. Fabian Neumann is a scientist in the group and will lead the tutorials; he can also answer any organisational questions ([fneum@mail.tu-berlin.de](mailto:fneum@mail.tu-berlin.de)).

Group website:

<https://www.ensys.tu-berlin.de/>

Personal website: <https://nworbmot.org/>



You can find lecture notes, exercise sheets and all other information on ISIS:

<https://isis.tu-berlin.de/course/view.php?id=25940>

Course abbreviation: EnEE WiSe 21/22

Password: MeritordeR21

Announcements will also be made there, and you can ask questions in the discussion forum.

Lecture slides will be available shortly before each lecture and online until after the exam.

Video recordings of the lecture will be available for six days after each lecture.

The course has 6 ECTS.

Registration:

- Qispos (once it's working...)
- Freie Wahl oder Zusatzmodul: Prüfungsamt und "gelber Zettel"
- Erasmus: Email

- 90-minute online exam (via ISIS) in February/March
- Open book exam (i.e. you can use whatever materials you want)
- Sample exam in the last week of lectures
- Content: as in lecture and tutorials
- Voluntary group project (six unsupervised study periods in Jan/Feb) can boost grade by 7 points (7% of total)

Available as stand-alone (3 ECTS) or as module in Energy Systems (9 ECTS)

- Students analyse a current topic in energy markets, prepare a presentation and present it for discussion
- Presentations as a block at the end of the lecture-free period
- Supervision and discussion led by Prof. Erdmann, Prof. Grübel and scientific employees of the department
- Students work on topic with a supervisor during semester
- Topics will be presented in November 2021, presentations in April 2022
- Example topics: market reform, EEG, European Green Deal, e-mobility, hydrogen economy, industrial decarbonisation, flexibility markets, etc.

Due to the novel corona virus, this lecture course will take place online on [Zoom](#).

Day	Time	Event
Monday	1600-1800	Lecture
Tuesday	1600-1800	Tutorial
Thursday	1600-1800	Lecture

First lecture: Monday 18th October 2021, last lecture: Thursday 17th February 2022

Some of the exercises will require you to program in **Python**, so please do an online tutorial in Python if you don't know it. We will help you to install Python and the requisite libraries.

- Voluntary group work (up to 5 students)
- 6 study periods instead of lectures and exercises
- Probably starting 17.01.2022
- Report and presentation
- Rewards: Deeper understanding of the topic, methodological competence and extra bonus points for the exam

There is no book which covers all aspects of this course. The world of renewables also changes fast...

The following are concise:

- G. Erdmann, A. Praktiknjo, P. Zweifel, "Energy Economics - Theory and Applications," Springer, 2017
- M. Grubb et al, "Planetary Economics," Routledge, 2013, [available online](#)
- S.C. Bhattacharyya, "Energy Economics. Concepts, Issues, Markets and Governance," Springer, 2011
- D.R. Biggar, M.R. Hesamzadeh, "The Economics of Electricity Markets," Wiley, 2014
- C.A. Dahl, "International Energy Markets: Understanding Pricing, Policies, and Profits," PennWell, 2004
- S. Stoft, "Power System Economics: Designing Markets for Electricity," IEEE Press. 2002

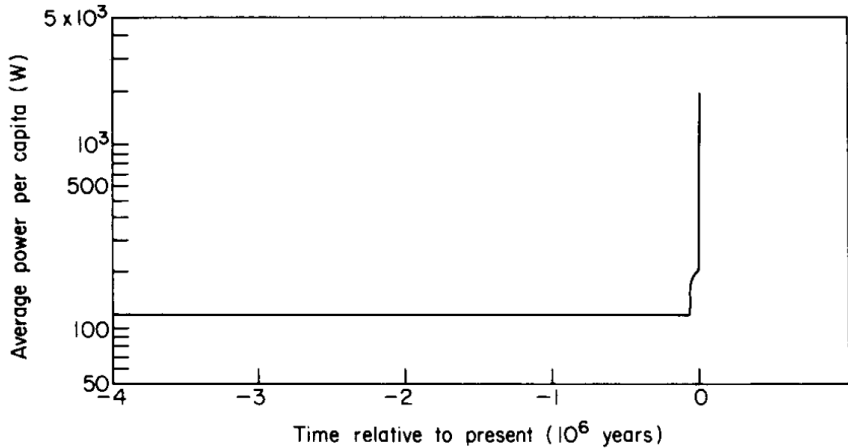
- Measuring energy, energy balances
- Basics of microeconomics
- Financial management
- Electricity markets
- Electricity grids
- Supporting renewables
- Emissions markets
- Resource management
- Oil markets
- Gas markets
- Learning curves and long-term dynamics
- Sector coupling
- Climate economics
- Current research topics



# History and Definition of Energy Economics

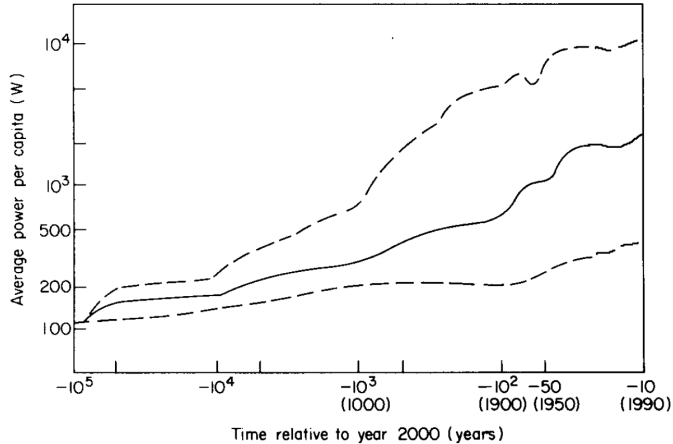
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It is hard to exaggerate the historical discontinuity of modern energy consumption.

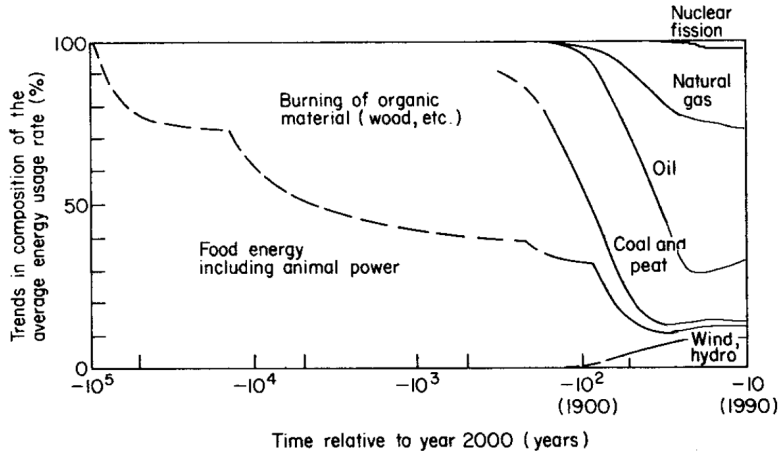


# Average energy use over time

A logarithmic time axis is necessary. Solid line is world average, dashed lines show societies with highest and lowest energy use.



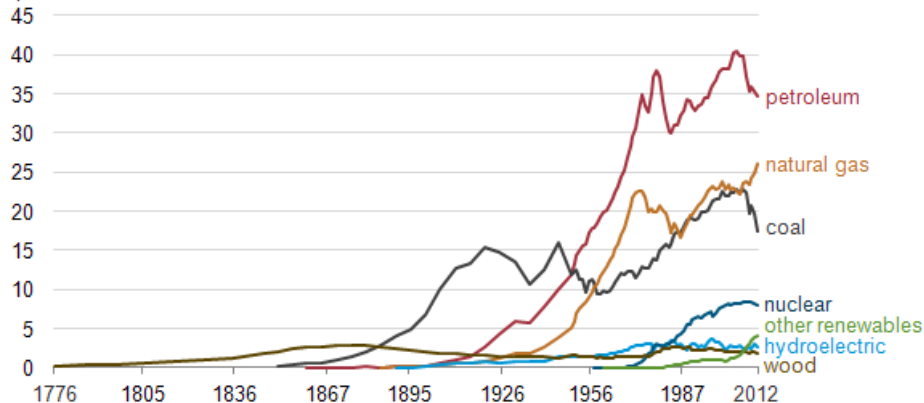
Energy transitions from muscle to biomass to coal to oil and gas, next: low-carbon electricity?



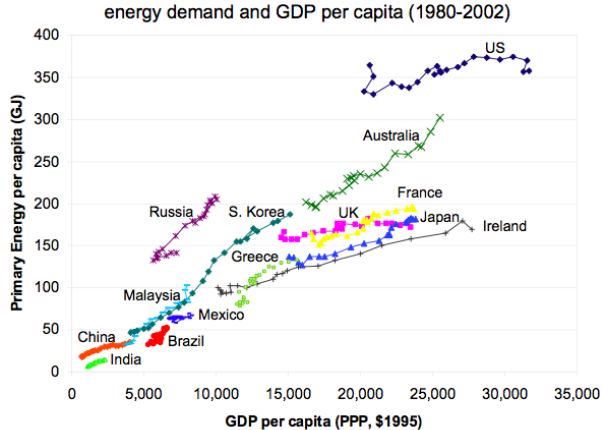
Focus on United States since independence. Notice non-hydro renewables.

History of energy consumption in the United States (1776-2012)

quadrillion Btu



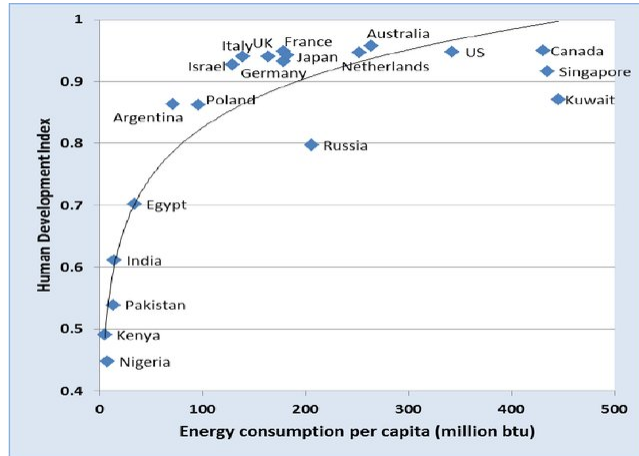
Energy demand versus GDP over time for selected countries.



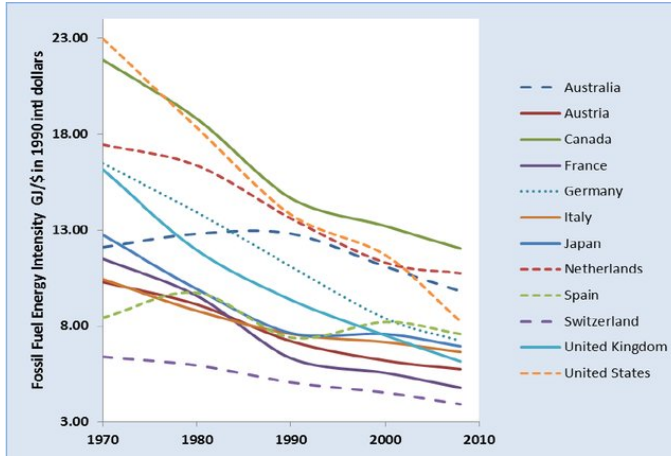
Source: UN and DOE EIA

# Economic development and energy use go together

Modern prosperity depends on a functioning energy supply for electricity, warmth/cooling, mobility and energy-intensive food and products.



# Fossil-fuel intensity is decreasing





Like any area where there are diverse uses for a good with different value to consumers, as well as scarcity on the supply side leading to different supply costs, markets can play a role in allocating goods. Economics is the study of this allocation.

This raises further questions:

- What makes energy different to other goods?
- Why a whole subject 'energy economics'?
- Why is energy politically so important?
- How does energy influence geopolitics?
- What questions does 'energy economics' try to answer?

The unique features of energy are numerous:

- **Essential for modern life:** for farming, cooking, lighting, comfort in buildings (heating and cooling) communication, mobility, production of most goods. This makes it a **political concern**.
- **Essential to all economic activity.** Cf. negative economic consequences of electricity blackouts in South Africa, gas shortages in UK in 2021.
- Reserves of fossil fuels and production capacity/minerals for renewables & storage are **concentrated in a few countries**. Geopolitics!
- **Large externalities:** most greenhouse gas emissions come from use of fossil fuels in energy, leads to climate breakdown; air pollution leads to widespread health impacts; for nuclear in meltdown and waste risk; for renewables in landscape impact.
- **High potential for innovation and cost reduction:** wind, solar, batteries, electrolyzers.

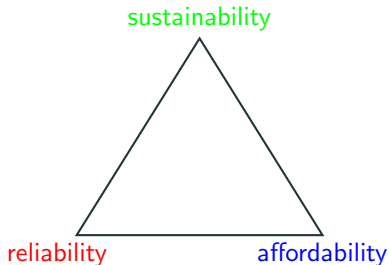
# What makes energy economics different from regular economics?

- Energy is **abundant** in nature, but mostly not immediately available for doing useful work.
- Infrastructure (transmission, generators) requires **long periods** of planning, investment and operation. Leads to slow change - inertia!
- In many markets there are **monopoly structures**, which are resistant to market solutions and need regulation (e.g. transmission networks, but also vertically-integrated utilities in some regions).
- Infrastructure **property rights** (e.g. underground, hydro) are sometimes with public rather than private sector.
- Some **risks are diffuse and widespread** (nuclear, hydro, landscape impact of wind).

Here is a typical selection of energy economics questions:

- How do we allocate consumption and production of energy by existing assets (short run)?
- How do we decide investment in energy consumption and production assets in the long run?
- How can we most efficiently reduce greenhouse gas emissions and air pollution from the energy sector?
- Wind and solar power are low-cost, but how do we efficiently deal with their variability?
- How do we design markets for variable renewable energy?
- Is a decentral system design better than a centralised one?

What should a well-functioning energy system look like? We design with respect to three goals:

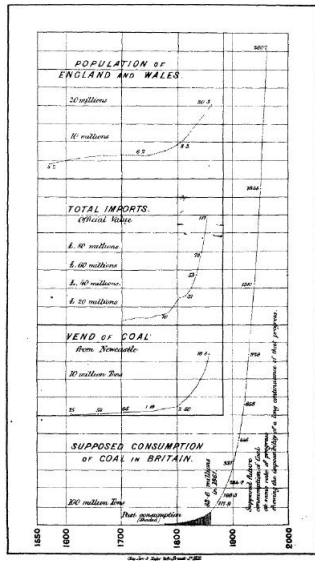


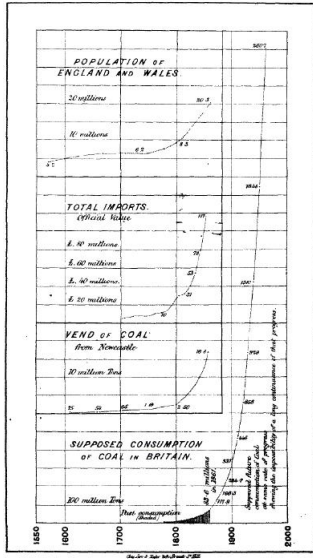
- **Sustainability:** Respect environmental constraints (greenhouse gases, air quality, preservation of wildlife), as well as social and political constraints (public acceptance of transmission lines, onshore wind, nuclear power)
- **Reliability:** Ensure energy services are delivered whenever needed, even when the wind isn't blowing and the sun isn't shining, and even when components fail
- **Affordability:** Deliver energy at a reasonable cost

Some of these policy targets can come into **conflict** - an **energy trilemma**.

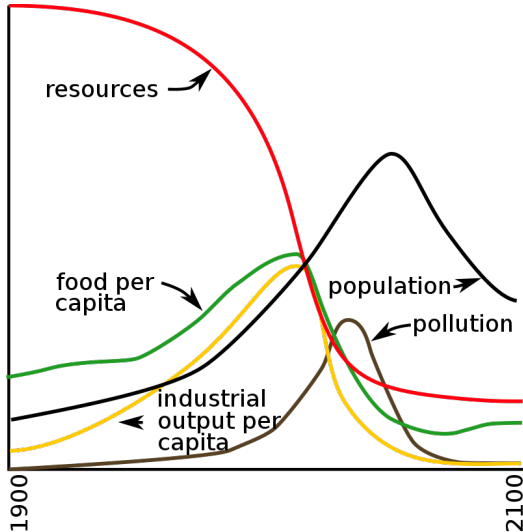
In 1865 William Stanley Jevons published **The Coal Question**, whose concern was the exhaustion of coal reserves in Britain giving exponentially rising demand.

- “With coal almost any feat is possible or easy; without it we are thrown back into the laborious poverty of early times.”
- “I must point out the painful fact that such a rate of growth will before long render our consumption of coal comparable with the total supply. In the increasing depth and difficulty of coal mining we shall meet that vague, but inevitable boundary that will stop our progress.”
- He reviews renewables, including wind used to pump water up into reservoirs, and also green hydrogen, before dismissing them all.





- **Jevons' Paradox:** "It is wholly a confusion of ideas to suppose that the economical use of fuel is equivalent to a diminished consumption. The very contrary is the truth...Whatever, therefore, conduces to increase the efficiency of coal, and to diminish the cost of its use, directly tends to augment the value of the steam-engine, and to enlarge the field of its operations."
- "If we lavishly and boldly push forward in the creation and distribution of our riches, it is hard to over-estimate the pitch of beneficial influence to which we may attain in the present. But the maintenance of such a position is physically impossible. We have to make the momentous **choice between brief greatness and longer continued mediocrity.**"



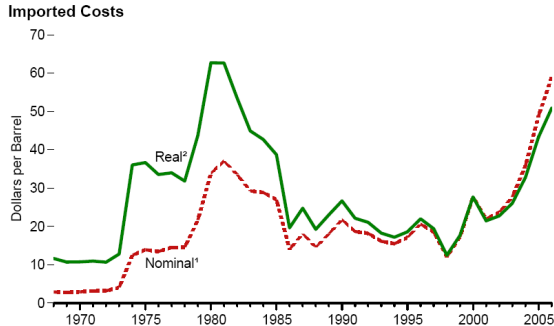
1972 report **The Limits to Growth**, commissioned by the Club of Rome, examined consequences of exponential economic and population growth with a finite supply of resources with a computer simulation.

- Conclusion: “the most probable result will be a rather **sudden and uncontrollable decline** in both population and industrial capacity”.
- But ignores role of technological progress.
- Growth versus limits versus progress: debate continues today.



In 1973 OPEC led by Saudi Arabia embargoed oil in response to the Yom Kippur War. Oil price jumps from 4 to 12 USD/barrel, before rising further in 1979 crisis following Iranian Revolution.

Fossil fuels are intimately tied to **geopolitics**. Triggered blooming of energy studies.



In 1972, 92% of Denmark's energy consumption came from imported oil.

Catalyst for many people (mostly physicists - that's another story) to rethink energy supply: Amory Lovins ('Soft Energy Paths' 1976-7); Art Rosenfeld on Energy Efficiency; Union of Concerned Scientists report 'Energy Strategies: Toward a Solar Future' (1980); Bent Sørensen; Swedish Secretariat for Futures Studies; Le Groupe de Bellevue, ALTER: A Study of a Long-Term Energy Future for France based on 100% Renewable Energies (Paris, 1978); Wolf Häfele, Jeanne Anderer, A. McDonald and Nebojsa Nakicenović, Energy in a Finite World (Cambridge, MA: Ballinger, 1981), many others...

# 1975: Bent Sørensen: 1st consistent 100% RE scenario

In 1975 Bent Sørensen published a scenario for 100% renewable energy in Denmark. He dealt with the variability of wind (with hydrogen) & solar thermal (with TES).

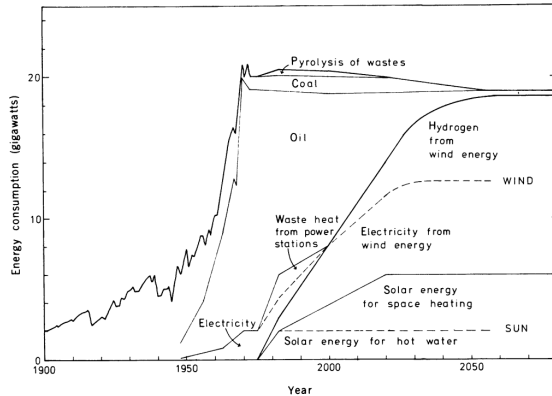


Fig. 4. Net energy consumption in Denmark, shown according to sources. Up to 1974, actual data are shown (14); data after 1974 indicate the proposed plan. The relative weighting between solar and wind energy shares might be altered, for example, if a major breakthrough occurred in the development of solar cells, making them competitive to wind-produced electricity under Danish conditions. The heavy, solid line indicates the proposed total share of solar and wind energy.

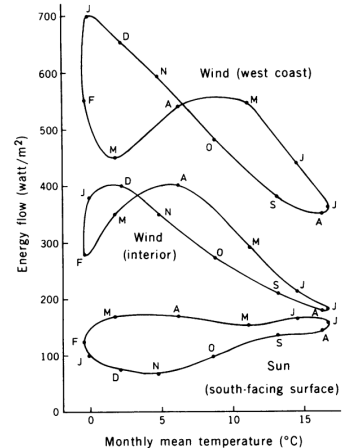
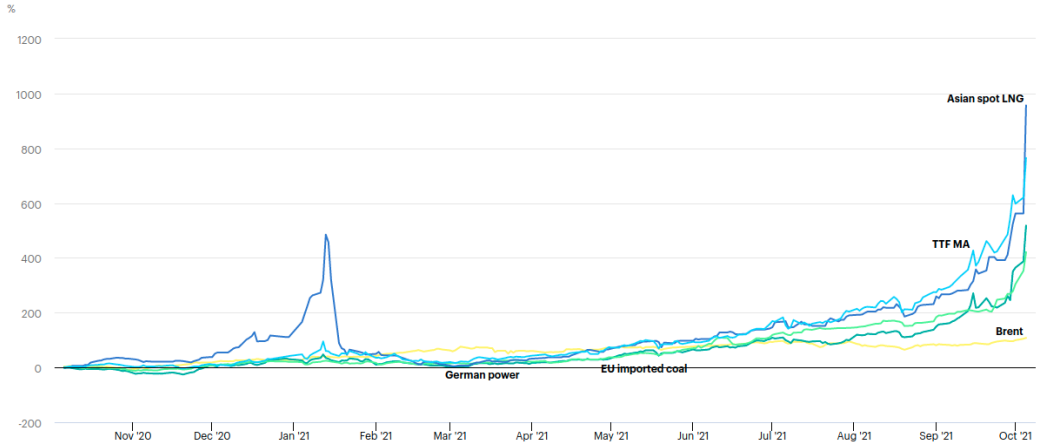


Fig. 2. Monthly average energy flow from continuous sources through a vertical square meter in Denmark as a function of the monthly mean

Evolution of energy prices 2020-2021 (TTF is Dutch gas month ahead (MA), Brent is for crude oil, LNG = Liquified Natural Gas):



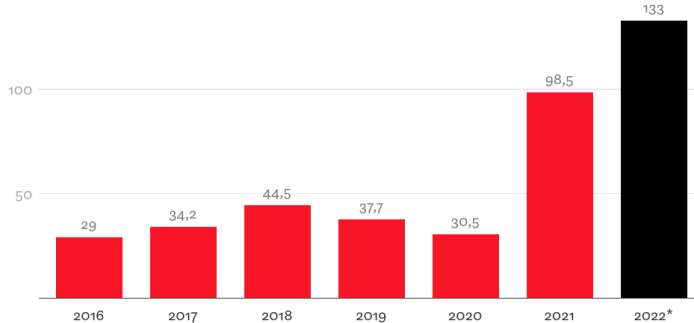
# Today: Gas prices exploding

Diverse reasons: cold winter 2020-2021, post-covid maintenance, competition for LNG with Asia, reduced production in Europe (e.g. Groningen field), Russian supply restrictions, high CO<sub>2</sub> price pushing out coal, etc.



## ■ TEURES NEUES JAHR

Jahresmittel der Strom-Spotmarktpreise (in Euro pro Megawattstunde)



\* aktueller Durchschnitt der Preise am Terminmarkt für Strom, den man in einem Jahr abrufen will : **Quelle:** Eigene Recherchen : **Grafik:** Carsten Stollmann

■ Wirtschafts  
Woche

The list of necessary reforms is long and diverse:

- Current tax and subsidy structure: e.g. electricity heavily taxed compared to gas and oil for heating, hindering switch to heat pumps (solutions: reduce EEG-Umlage/Stromsteuer, raise CO<sub>2</sub> price on fossil fuels, subsidise heat pumps)
- Insufficient incentives for flexible demand and storage
- Expansion of wind and solar too slow in many regions
- More locational signals for demand and supply coordination
- Need more incentives for building renovations
- Further digitalisation of energy use and supply
- Investment incentives for decarbonisation of industry, hydrogen infrastructure

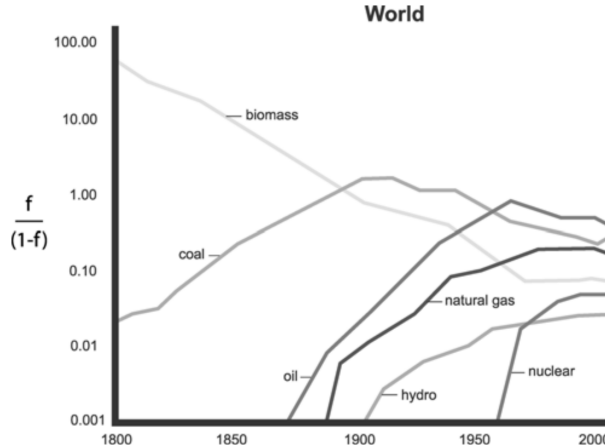
# Introduction to Energy Transitions

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# Historic Energy Transitions: Biomass to Hydrocarbons and Electricity

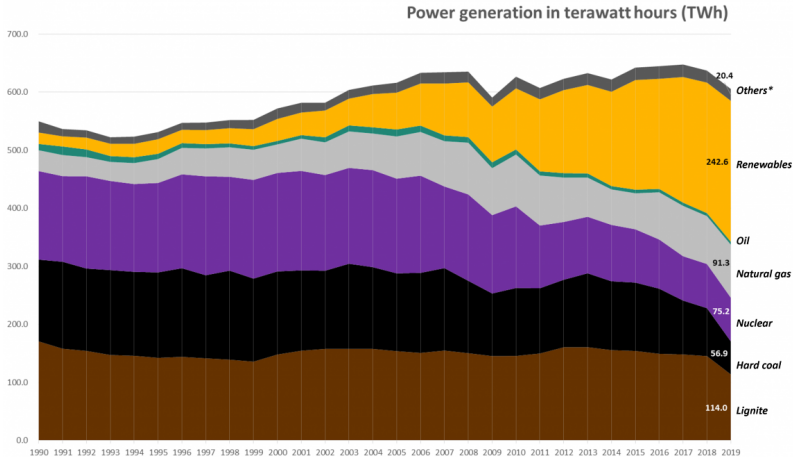
From 1800 to 2010 biomass dominance replaced by hydrocarbons and electricity. Fossil fuel shares steady since 1970.  $f$  is fraction of primary energy supply.



# Renewables reached 40% of gross electricity in Germany in 2019

## Gross power production in Germany 1990 - 2019, by source.

Data: AG Energiebilanzen 2019, data preliminary.



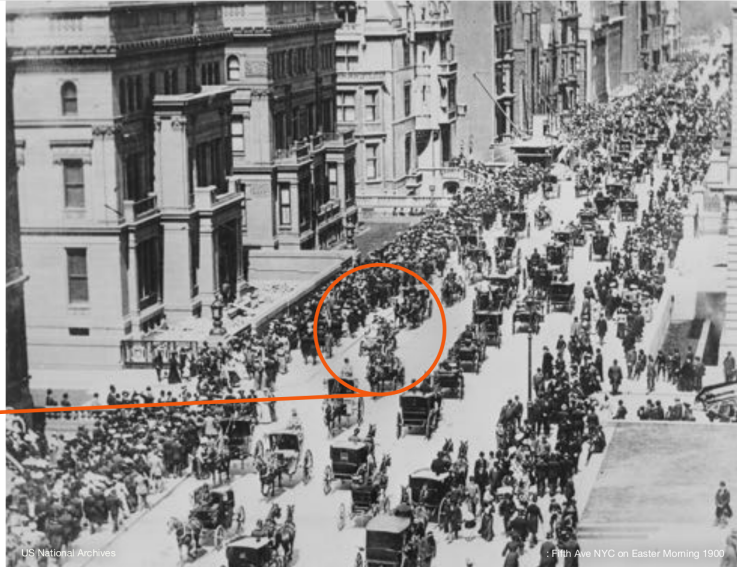
\* Without power generation from pumped storage.

# 1900: Where's the car?

5<sup>th</sup> AVE NYC

1900

Where is  
the  
car?



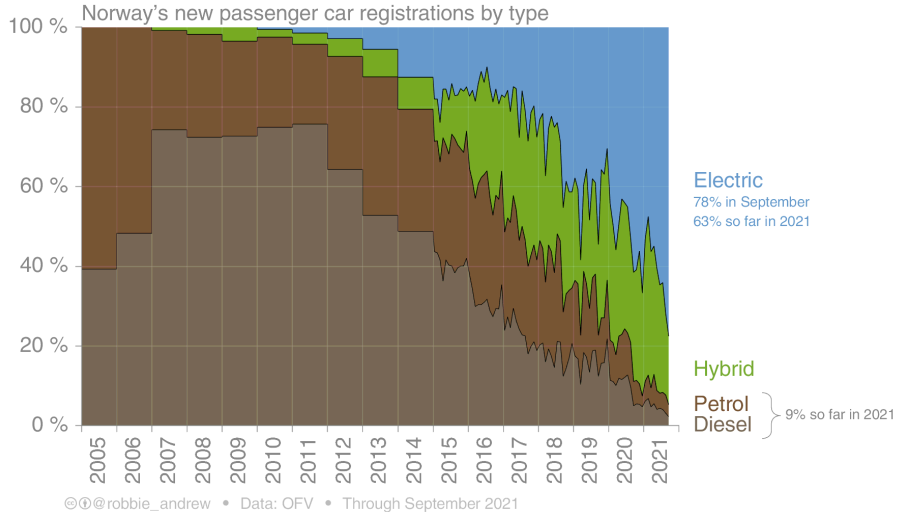
# 1913: Where's the horse?

5<sup>th</sup> AVE NYC  
1913

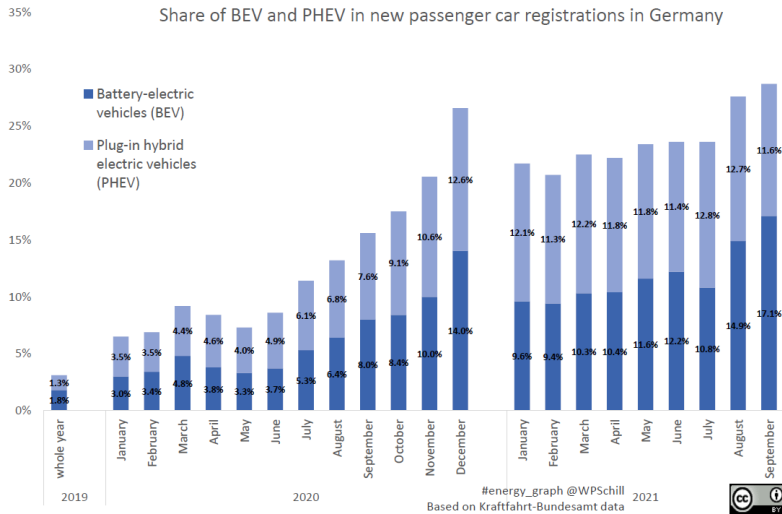
Where is  
the  
horse?



# Electric vehicles take off, first in Norway

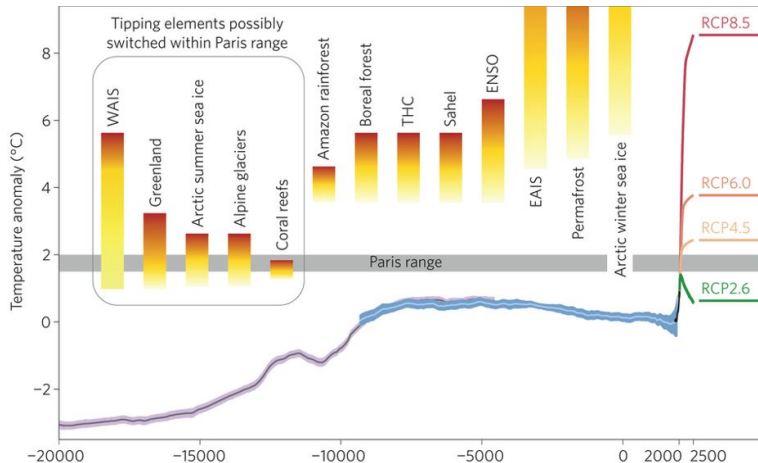


# Electric vehicles: Germany catching up



# Climate Breakdown: 2015 Paris Agreement

The 2015 Paris Agreement pledged its signatories to 'pursue efforts to limit [global warming above pre-industrial levels] to **1.5°C**' and hold 'the increase...to **well below 2°C**'. These targets were chosen to avoid potentially irreversible **tipping points** in the Earth's systems.



WAIS: West Antarctic Ice Sheet ( $\Rightarrow$  5m sea level rise)

Greenland (7m)

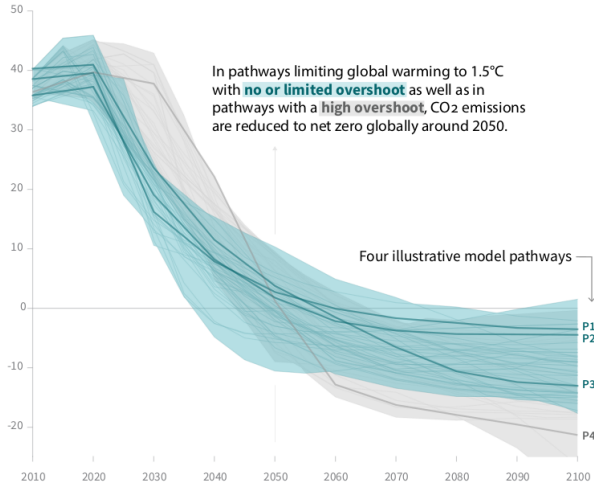
THC: thermohaline circulation (warms Europe)

ENSO: El Niño–Southern Oscillation (extreme weather)

EAIS: East Antarctic Ice Sheet ( $> 50$  m)

## Global total net CO<sub>2</sub> emissions

Billion tonnes of CO<sub>2</sub>/yr

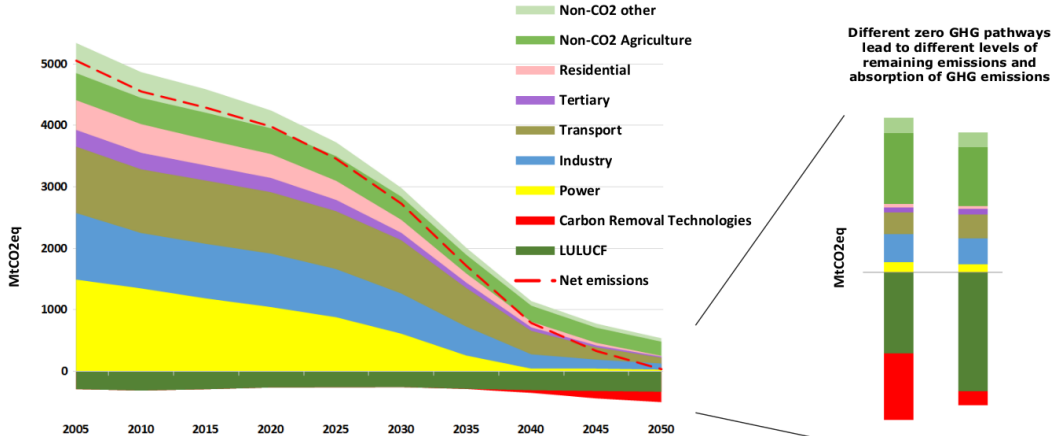


- Scenarios for global CO<sub>2</sub> emissions that limit warming to 1.5°C about industrial levels (**Paris agreement**)
- Today emissions **still rising**
- Level of use of negative emission technologies (NET) depends on rate of progress
- 2°C target without NET also needs rapid fall by 2050
- Common theme: **net-zero by 2050**



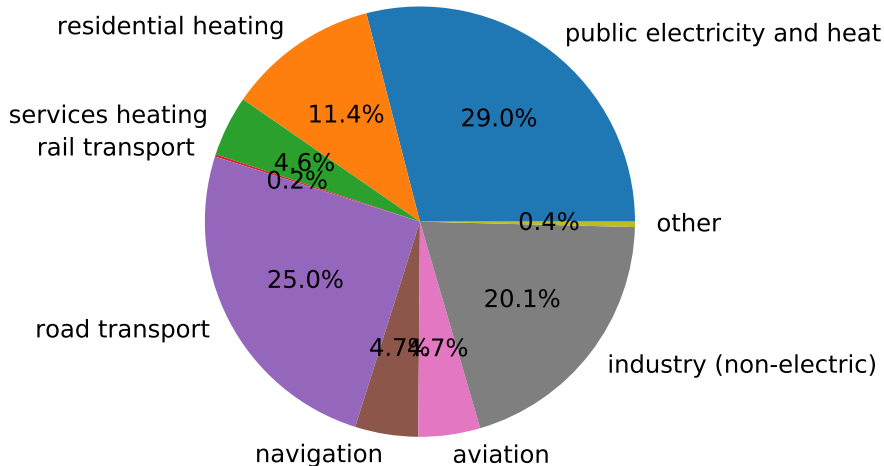
# The Greenhouse Gas Challenge: Net-Zero Emissions by 2050

Paris-compliant 1.5° C scenarios from European Commission for **net-zero GHG in EU by 2050**. This target has been adopted by the EU and enshrined in the **European Green Deal**.



# It's not just about electricity demand...

EU28 CO<sub>2</sub> emissions in 2016 (total 3.5 Gt CO<sub>2</sub>, 9.7% of global):



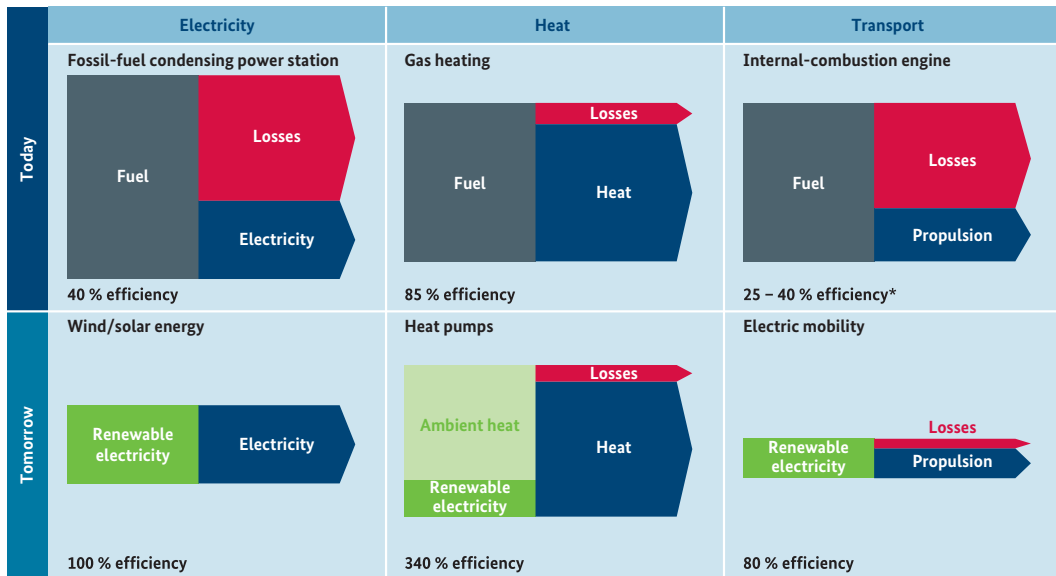
## ...but electrification of other sectors is critical for decarbonisation

**Electrification is essential** to decarbonise sectors such as transport, heating and industry, since we can use low-emission electricity from e.g. wind and solar to displace fossil-fuelled transport with electric vehicles, and fossil-fuelled heating with electric heat pumps.

Some scenarios show a **doubling or more of electricity demand**.

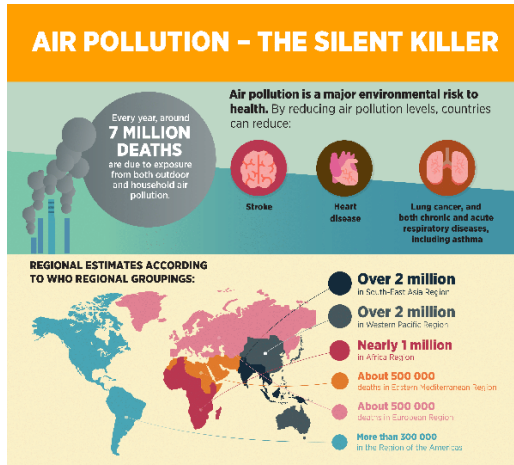
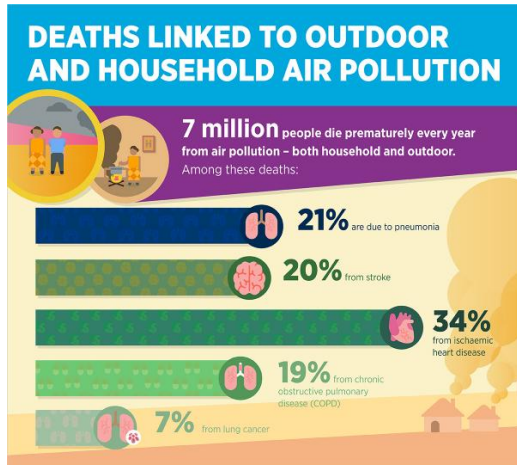


# Efficiency of renewables and sector coupling



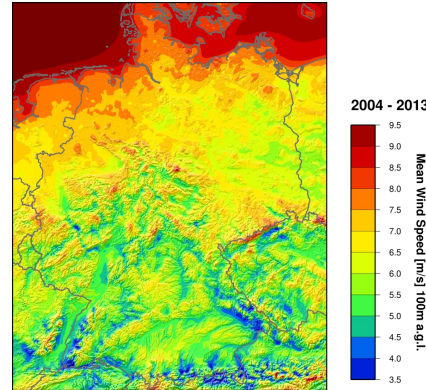
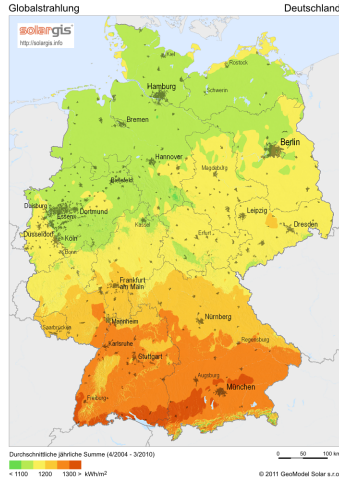
# Not just climate change: air pollution is a silent killer

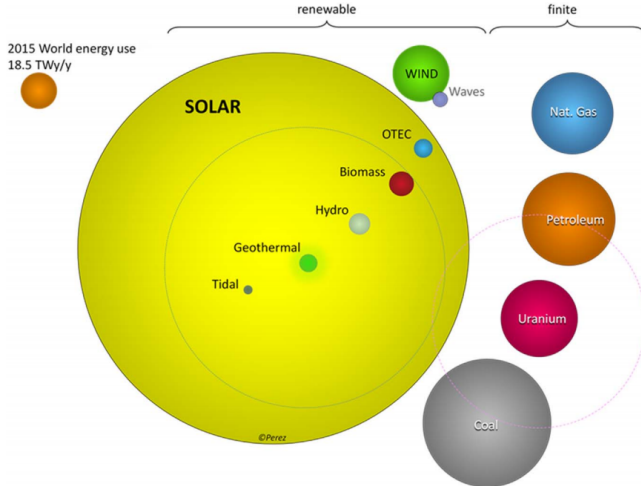
Air pollution from fossil fuel burning is linked to higher mortality (deaths) and morbidity (diseases, e.g. aggravation of asthma).



# Why focus on wind and solar for electricity generation?

- construction and operation have low greenhouse gas emissions
- good wind and sun are available in many parts of the world
- worldwide potential that exceeds demand by many factors
- rapidly falling costs





## RENEWABLE

Solar	23,000 TWy/y	Biomass	2-6 TWy/y
Wind	75-130 TWy/y	Hydro	3-4 TWy/y
Waves	0.2-2 TWy/y	Geotrm	0.2-3++ TWy/y
OTEC	3-11 TWy/y	Tidal	0.3 TWy/y

## FINITE

Nat. Gas	220 TWy
Petroleum	335 TWy
Uranium	185++ TWy
Coal	830 TWy

- Potentials for wind and solar exceed current demand by many factors (ignoring variability)
- Other renewable sources include wave, tidal, geothermal, biomass and hydroelectricity
- Uranium depends on the reactor: conventional thermal reactors can extract 50-70 times less than fast breeders

# Low cost of wind & solar per MWh in 2017 (NB: ignores variability)

$$\text{LCOE} = \text{Levelised Cost of Energy} = \text{Total Costs} / \text{Energy Output}$$

Selected Historical Mean LCOE Values<sup>(2)</sup>



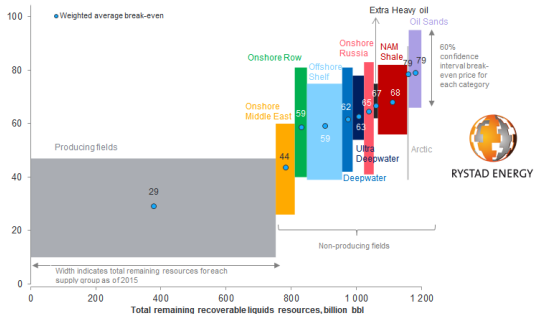


# Fundamental shift from scarce exhaustible to renewable energy

Fossil fuel costs rise with exploitation (can also drop with innovation)

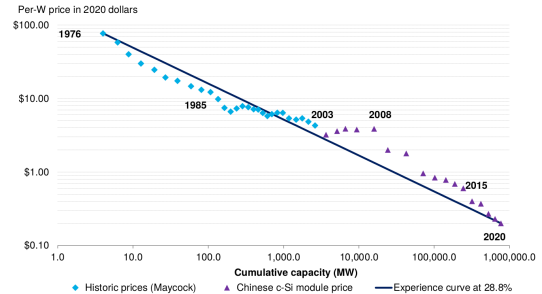
Solar and wind costs drop with innovation (can rise locally where land is scarce)

GLOBAL LIQUIDS COST CURVE\*  
Real Brent USD/bbl



\*The break-even price is the Brent oil price at which NPV equals zero using a real discount rate of 7.5%. Resources are split into two life cycle categories: producing and non-producing (under development and discoveries). The latter is further split into several supply segment groups. The curve is made up of more than 20,000 unique assets based on each asset's break-even price and remaining liquids resources in 2015. Source: Rystad Energy UCube September 2015

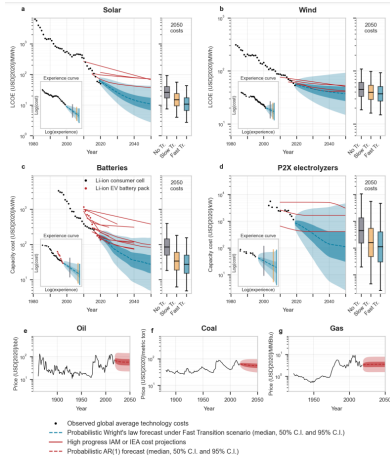
PV module experience curve (2020\$/W, MW)



(1 TW of solar generates  $\sim 1200$  TWh/a compared to global electricity demand of  $\sim 24,000$  TWh/a)

(2019 consumption was  $\sim 37$  billion barrels)

# 4 critical technologies: wind, solar, batteries, electrolyzers



All the critical technologies for the energy transition share a small unit size, enabling fast production and installation, economies of scale in manufacturing and learning-by-doing.

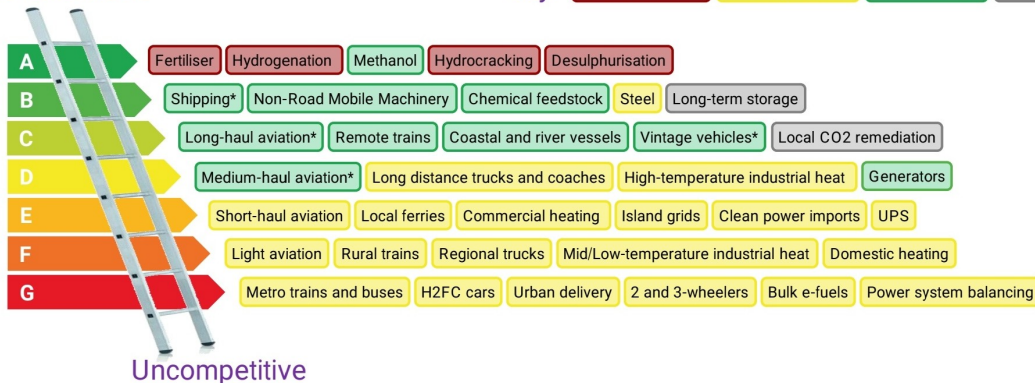
- **Low-cost electricity** from wind and solar.
- **Batteries** for mobility and balancing applications.
- **Electrolytic hydrogen** (splitting water) for everything else: long-duration storage, aviation, shipping, industry.
- **Heat pumps** (missing from graphic) for building comfort and some low-temperature industry applications.

# Hydrogen: the backstop of the energy transition

Clean hydrogen can do almost everything, but competes with direct electrification. Some say **champagne of energy transition**; could also say **backstop** for what efficiency and electrification don't reach.

Unavoidable

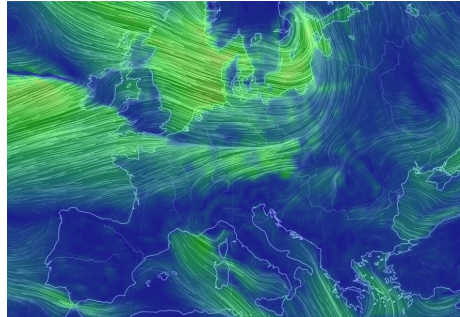
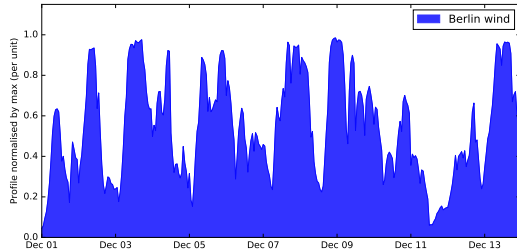
Key: No real alternative Electricity/batteries Biomass/biogas Other



\* 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

## But must take account of variability...





Sustainability doesn't just mean taking account of environmental constraints.

There are also **social and political constraints**, particularly for transmission grid and onshore wind development.



**Energiewende:** The Energy Transition, consists of several parts:

- Transition to an energy system with low greenhouse gas emissions
- Renewables replace fossil-fuelled generation (and nuclear in some countries)
- Increasing integration of international electricity markets
- Better integration of transmission constraints in electricity markets
- Sector coupling: heating, transport and industry electrify
- More decentralised location and ownership in the power sector