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Energy costs widen gap in competitiveness

By Guy Chazan

Powerful combination: wind turbines in front of an RWE Power brown coal plant near Cologne, Germany

When Ed Miliband, leader of the UK's opposition Labour party, promised in September to freeze energy prices if he won the country's next general election, it caught Britain's business elite by surprise. It should not have done.

In stark contrast to the US, where gas prices fell to 10-year lows last year, the question of rising energy costs is coming to dominate the political agenda in Europe. It is an equally hot topic in Japan, which is having to rely on expensive imported gas as it shuts down its nuclear reactors. In many countries, it is becoming one of the defining issues of our time.

It is a problem that not only affects hard-pressed consumers struggling to pay their bills amid recession and economic hardship. It is also hurting European industry, which is becoming increasingly outspoken on the subject. Business leaders blame the growing burden of environmental levies and renewable energy subsidies.

Jim Ratcliffe, chief executive of Ineos, one of the world's largest chemicals groups, says the danger is that some companies, especially manufacturers, will move to places where energy is cheaper.

"It's fine being very, very green, but not if you're interested in manufacturing," he says. "The UK is already disadvantaged on the wholesale cost of energy, and then it puts taxes on it. Anybody who's an energy user is just going to disappear."

European companies say high energy costs mean they are less competitive than their counterparts in the US, where the shale boom has led to lower natural gas prices and heralded an industrial renaissance.

The gap in competitiveness was the central theme of a summit of EU heads of government in Brussels in May, when the European Commission revealed that gas prices for industry fell by 66 per cent in the US between 2005 and 2012, whereas they rose 35 per cent in Europe.

That price difference is leading to some doom-laden pronouncements.

"There is no near-term cure for Europe's energy price gap with the US – be it in shale gas, liquefied natural gas or US imports," says Johannes Teyssen, chief executive of German utility Eon. "Companies will continue to move overseas as a result." European policy makers should "focus not on correcting the situation but [on] not making it worse", he adds.

Japan pays about five times more for its natural gas than the US and has become a lot more dependent on the fuel since it started shutting down its nuclear reactors after the 2011 Fukushima disaster.

Its utilities rely on expensive imports of LNG, crude oil and coal to replace nuclear, which once accounted for 30 per cent of electricity generated in Japan. The government has allowed them to pass some of the extra cost to consumers. In August, the price of electricity in Tokyo was 15 per cent up on a year earlier.

In Europe, the debate centres on the so-called energy "trilemma". European energy policy has been designed to pursue three objectives:

mitigating climate change by reducing carbon dioxide emissions, achieving security of supply and making sure energy is affordable to consumers.

In the years before 2008, the imperative of preventing global warming loomed largest. The EU adopted ambitious goals for cutting carbon and sourcing more and more energy from renewable sources such as wind and solar.

The world is different now. The 2008 financial crash, the ensuing eurozone debt crisis and the weak recovery that followed have changed the parameters of the debate and made it harder for policy makers to balance what are often mutually conflicting goals.

“There’s been a tangible shift in Europe,” says Roger Reynolds, a utilities specialist at Exane BNP Paribas in London. “The balance has now moved away from reducing emissions at any cost to the question of affordability.”

That shift has happened despite any softening in the scientific consensus on global warming. Indeed, opinion has, if anything, hardened.

The latest report by the UN’s climate panel said global warming on the ground, in the air and in the oceans was “unequivocal”. The panel added that scientists are 95 per cent certain that humans are the “dominant cause”.

There is little evidence that the public is becoming more sceptical about climate change, certainly in Europe. What has changed is that consumers are less willing to foot the whole bill for policies to mitigate global warming.

The shift in the debate is most conspicuous in Germany, where the Energiewende – Chancellor Angela Merkel’s historic drive away from polluting fossil fuels and nuclear power towards wind and solar – has left German consumers with among the highest prices for electricity in Europe.

Germany plans to raise the percentage of renewables in the electricity mix to 35 per cent by 2020 and 80 per cent by 2050. This compares with 23 per cent last year. But there is a huge price tag. The cost of the renewable energy surcharge, which is placed on all consumers’ bills, is expected to jump this year from €14.1bn to €20.4bn euros, according to one estimate.

The German environment ministry says the total cost of the Energiewende could reach about €1tn.

Some big energy-intensive companies have managed to win exemptions from the surcharge. But much of Germany’s Mittelstand – the network of family-owned businesses that are the bedrock of the economy – are required to pay.

Peter Atherton, utilities analyst at Liberum Capital, says: “Modern industrial economies are predicated on robust, affordable and competitive energy and you mess with that at your peril.”

Germany’s big power suppliers, such as Eon and RWE, are also suffering from the alternative energy boom.

Germany’s renewable energy law, the EEG, prioritises solar and wind power over coal and gas in the grid, which means that the many conventional power stations that have nothing to do on sunny and windy days are no longer profitable to operate.

In one of the most perverse outcomes of the Energiewende, Germany’s CO_2 emissions actually rose last year. That is because the shale gas boom in the US prompted many local power generators to switch from coal to gas as a feedstock, leading to a huge influx of cheap North American coal into Europe.

As a result, coal plants have become cheap to operate and modern, efficient gas-fired power plants have been shuttered. The failure of the EU’s carbon-emissions trading system has not helped.

Gérard Mestrallet, chief executive of GDF Suez, says over the past five to six years about 50,000MW of gas-fired capacity in Europe – equivalent to 50 nuclear plants – have been closed down or mothballed by 10 of the continent’s biggest utilities.

That, he adds, has “implications for energy security”, namely there may not be any gas plant available to provide peak power in northern Europe when the wind is not blowing and the sun is not shining.

GDF Suez is one of nine big European utilities that recently appealed for a complete rethink of European energy policy. Europe, argued Mr Mestrallet, was “destroying its energy industry through a lack of consistency, coherence and wrong decisions by the European Commission and by individual governments”.

He called for a reduction in subsidies for renewables, saying they should be limited to “technologies that are not mature today – such as tidal and wave power”.

It is not such an outlandish idea. Spain has cut its non-fossil fuel subsidies and other governments are thinking of doing the same.

“There have been a lot of good intentions,” says Eon’s Mr Teyssen of Europe’s energy policy. “But things are now getting out of control.”

Eon and other European utilities have been lobbying Brussels to ease state aid rules so that governments can provide “capacity payments" – effectively a subsidy for gas-fired plants. This would allow power companies to keep such plants as back-up for calm grey days.

Such an approach has plenty of opposition and the likelihood is that the energy policy debate will continue to rage for years to come.

"The cost of energy is becoming a key battleground for policy makers, utilities, renewables developers and consumers," says Mr Reynolds at Exane BNP Paribas.

"It's becoming a real struggle to strike the right balance."

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