FINANCIAL TIMES

"Without fear and without favour"

Wednesday January 22 2014

High energy prices hold Europe back

US gains huge competitive advantage from EU muddle

Europe is slowly emerging from the crisis and economic growth is picking up. But the sluggish nature of the recovery means governments cannot ease up in the pursuit of reforms that boost investment and jobs. Much of the discussion about improving competitiveness revolves around labour market reforms and reductions in red tape. But far too little attention is paid to what has become a significant burden on European growth: the high cost of energy in Europe when compared with the US and other markets.

Yesterday the European Commission published a report setting out in alarming detail the difference in energy costs between the EU and its main trading partners. The report notes that electricity prices for industrial consumers are more than double those in the US, and 20 per cent higher than in China. The situation on gas prices is worse. These are three to four times higher than comparable US and Russian tariffs.

This gap creates a problem for the EU as it tries to attract – and retain – investors who are big energy users. Last weekend Paolo Scaroni, chief executive of Italian oil and gas company Eni, warned that the energy price differential was creating a "massive competitive advantage for the US" and a "real emergency for Europe". Lakshmi Mittal, chairman and CEO of ArcelorMittal, declared yesterday that lower prices would encourage energy-intensive industries to shift to the US. "If we paid US prices at our EU facilities," he wrote in the FT, "our costs would drop by more than $1bn a year".

Why are European energy prices so much higher? To a large degree, it is because of differences in supply. Europe has, over time, allowed gas to become its fuel of choice. With its indigenous reserves in decline, the continent increasingly relies on costly imports from Russia, Algeria and Norway. By contrast, the shale gas revolution in the US means Americans enjoy much cheaper gas supplies. US prices are therefore much lower than in Europe, where shale is not yet being significantly explored in any state, except Poland.

Supply is only part of the picture, however. Regulation also has a part to play, not least in relation to EU climate policies. In 2007, EU member states set legally binding commitments to be reached by 2020. States must cut greenhouse gas emissions by 20 per cent from 1990 levels. Governments must also use renewable sources to supply 20 per cent of Europe's energy. These latter measures have bumped up the fuel bill for companies and households to pay for wind farms and solar panels.

What can the EU now do to reduce this price disparity? One idea would be to pursue shale exploration with greater vigour. Euro-shale gas will never be as cheap as its US counterpart. The cost of fracking in Europe would be much higher than in the US, partly because of the continent's greater population density. Still, Brussels and national regulators should encourage shale development.

The differential in energy prices with the US is creating 'a real emergency for Europe'

Europe must also beware of adopting policies that add unduly to costs. Today the commission will unveil its energy and climate policy package for 2030. Some states – among them Britain, France and Germany – want a binding cut of 40 per cent in greenhouse gas emissions when compared with 1990. But the commission must not opt for a target that is so far ahead of other countries that it drives industries based in Europe to the higher-emitting economies.

It is also essential that Brussels does not impose binding targets on the proportion of energy that each state must generate through renewables. This will not only force consumers to subsidise yet more relatively inefficient technologies. It will also push up energy prices. That is something Europe does not need.

Germany cautions on impact of green energy

Minister urges focus on cheapest sources

Reforms to subsidy system outlined

By Jeevan Vasagar in Berlin

Germany's transition to renewable energy has strained Europe's largest economy to its limit, a leading minister said yesterday as he outlined reforms to a subsidy scheme that costs business and consumers €24bn a year.

Sigmar Gabriel, the economy and energy minister, said Germany had to focus on the cheapest sources of clean energy in order to rein in costs or risk losing public support for such policies.

Mr Gabriel also said he would begin talks with utilities about special payments designed to ensure that they maintained gas power plants and other conventional sources of energy that have suffered because of the emphasis on renewables.

"For a secure transition to renewable energy, we don't just need economic success – we need the support of the population. With rising energy prices, we will lose that," Mr Gabriel said, adding: "We have reached the limit of what we can ask of our economy."

The minister's comments on energy policy reform were the most detailed since a new coalition government was formed in Germany late last year. They came a day before the European Commission is set to unveil a climate and energy package that will shape EU energy policies up to 2030.

The debate over that package, which will include binding targets for greenhouse gas emissions and new targets for renewable energy, has proved highly contentious, raising fresh questions about Europe's energy prices.

Speaking at an energy industry conference yesterday, Mr Gabriel promised to fight for German industrial interests against an EU investigation into special exemptions that have shielded the country's manufacturers from the full cost of its high energy prices.

Old and new: a coal-fired plant stands near a wind turbine in northern Germany Getty

"Europe is not an island," Mr Gabriel said. "European climate change targets should not lead to disadvantages for energy intensive and internationally competitive industries."

The minister added that Germany had been "financing the learning curve" on renewable energy for other European countries. "The costs of the learning curve must be bearable for our industry," he said. "This country does a great deal for European development."

Some utilities, their profits dented by the preferential treatment given to renewable energy, have been lobbying for payments to cover the cost of maintaining conventional generating capacity.

Eon and RWE, for example, have been shutting down or idling conventional energy plants because they claim policies that favour renewables have made them no longer viable.

Mr Gabriel opposed subsidies for all conventional power plants because the costs would be too high. But he was prepared to discuss smaller and more regional solutions to prevent a loss of capacity.

Mr Gabriel will seek to limit subsidies paid to operators of new onshore wind turbines to no more than €0.09 a kilowatt-hour in 2015 and limit new construction of onshore wind to about 2,500 megawatts a year, according to a ministry document prepared for a meeting of the ruling coalition today and tomorrow.

That would essentially cap the industry's annual growth at last year's level, which was the highest since 2003.

'We have reached the limit of what we can ask of our economy'

Sigmar Gabriel, economy and energy minister

According to the draft, Germany will cut feed-in tariffs paid to renewable power generators to an average across all technologies of €0.12 per kilowatt-hour by 2015, down from a current average of €0.17/kWh, by concentrating on cheaper means of clean energy generation.

Mr Gabriel said energy generated from biomass was too expensive, implying it would no longer be promoted. Calculations by McKinsey, the economic consultancy, suggest there is little the government can do to bring down the immediate costs of subsidies.

Long-term contracts with renewable energy producers mean that even if there was to be a complete halt in the construction of new renewable energy plants, surcharges on customers' bills would barely decrease, McKinsey say.

The new German government has pledged to present a bill reforming the renewable energy law by Easter.

Editorial Comment, Page 8