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UNITED KINGDOM: Energy policy conflicts raise risks

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Abstract (summary)

UK energy policy conflicts.

Last week, the government announced a number of investments in, and funding of, low-carbon energy. This included the plan to proceed with the Hinkley C nuclear reactor as well as the possible reduction of 'green charges', which have supported programmes to develop renewable energy and energy efficiency. These announcements, and the increasingly politicised debate surrounding them due to growing public dissatisfaction over rising energy bills, reveal a contradiction at the heart of UK energy policy: a long-term commitment to the development of low-carbon options, which will address problems of energy security and climate change; and a short-term unwillingness to accept the upfront costs of such a strategy.

Full Text

SUBJECT:UK energy policy conflicts.

SIGNIFICANCE:Last week, the government announced a number of investments in, and funding of, low-carbon energy. This included the plan to proceed with the Hinkley C nuclear reactor as well as the possible reduction of 'green charges', which have supported programmes to develop renewable energy and energy efficiency. These announcements, and the increasingly politicised debate surrounding them due to growing public dissatisfaction over rising energy bills, reveal a contradiction at the heart of UK energy policy: a long-term commitment to the development of low-carbon options, which will address problems of energy security and climate change; and a short-term unwillingness to accept the upfront costs of such a strategy.

ANALYSIS: Impacts.

The Hinkley C decision may usher in a programme of investments to replace the existing fleet of nuclear power plants.

Such investments could also lead to the increase the current share of nuclear in the UK energy balance.

The prospect of cutting or even abandoning green charges would put paid to existing commitments to decarbonise the UK economy.

Politicisation of energy policy will increase uncertainty, raising the risk premium and reducing the attractiveness of the UK energy sector.

The government presented the announcement last week of an agreement on the terms for the construction of a new nuclear power station at Hinkley Point as a good deal for UK taxpayers and consumers: since construction of the plant will be wholly financed and undertaken by a private consortium (albeit one which currently consists of mainly state-owned enterprises from France and China), taxpayers will not be liable, with costs being recovered from a guaranteed price for the plant's electricity.

This 'strike price' is based on a wholesale electricity price of 92.50 pounds (149.50 dollars) per megawatt hour (MWh):

if the actual price is below this, the difference will be recovered from consumers; and

if above, the company will have to reimburse the surplus to consumers.

The agreed price is around twice the level of current prices (and will in fact be higher, since it is indexed to inflation and the plant will not begin operations before 2023 at the earliest). The government started the negotiations with a price closer to 80 pounds/MWh, while Electricite de France , which leads the consortium, wanted something in excess of 100 pounds/MWh.

Bad deal?.

Critics have argued that the government should have been able to secure a lower price, since the protagonists had few other opportunities on the horizon. Moreover, the price is well above the levels originally presented when the nuclear option was initially revived (under 30 pounds/MWh in current terms).

However, the escalation reflects the cost of additional safety requirements since Fukushima (see EUROPE: Fukushima crisis sparks nuclear review - March 17, 2011), but also the experience of rising costs and delays at the two plants of a similar design which are under way in Finland and France, where costs and construction times have more or less doubled from original estimates (see FRANCE: Nuclear shows signs of growing vulnerability - September 28, 2012).

It is unclear who bears the risk of the project prior to completion: while the government has been keen to assert that the taxpayer will not be responsible for any excess costs, it is underwriting much of the finance for the project and the details of liability for overruns are reportedly ambiguous.

History of tensions.

The deal also marks a tension with the overall orientation of UK energy policy in the last 30 years, a period in which governments of all hues have argued in favour of a market-driven energy policy both in terms of the principles governing the sector and the profiles of potential investors. While the government's decision seems to be a vindication of the latter (by delegating ownership and operation of such a strategic resource to a fully foreign-owned enterprise), the mechanisms for doing so (guaranteed prices backed by government underwriting) seem to be at odds with market principles.

Price hikes.

The government's announcement coincided with a series of announcements by major energy companies of

significant increases in electricity and gas prices for UK customers. The scale of the increases -- 8-10% for most of those who have so far indicated their new tariffs -- is highly controversial, with the government, opposition and senior politicians arguing over the causes of the increases and possible solutions:

Labour.Labour wants a price freeze from 2015, along with reforms of the market and the regulatory framework.

Conservatives.Prime Minister David Cameron has condemned Labour's price freeze plan as "socialist" and wants a mix of greater competition and a reversal of green charges. Cameron's position has been undermined by calls from Conservative politicians for more dramatic interventions, such as a windfall tax to recover the cost of helping those in fuel poverty as a result of the price rises.

Liberal Democrats.The junior coalition partner wants to maintain green charges either directly or by transferring them to general taxation -- thus contradicting Cameron's position.

Deeper problems.

The dispute exposes a contradiction over the long- and short-term dimensions of UK energy policy, illustrated by the government's willingness to agree to a very substantial price increase when Hinkley C begins operating and politicians' wariness of existing policy-led price increases to support renewables and energy efficiency (see EUROPEAN UNION: Germany may guide renewables revamp - September 3, 2013). With Hinkley C in mind, the government hopes that rises in fossil fuel prices and the cost of carbon will render the strike price a good deal, but carbon prices overall are languishing and even the UK 'floor price' (in effect a carbon tax that will increase the UK price of carbon well above current EU market prices) will not close the gap. However, even if wholesale prices converge over the next decade, retail prices will have to increase even more than they have already.

Trouble ahead.

The current row is symptomatic of deeper problems in UK energy policy. UK dependence on imported energy reached its highest level since the 1970s in the first half of 2013: net imports accounted for nearly 48% of total requirements, compared with 41% in the same period in 2012. Import shares were greatest for coal (77% of total requirements) and natural gas (50% of total requirements). Earlier this month, the National Grid announced that the margin of spare power capacity available at peak demand in cold weather would be around 5%, compared with 15% two years ago, and that it was likely to tighten further in the future, as a number of fossil fuel power plants are closed. This could give rise to power cuts, an even more serious political crisis than price increases.

CONCLUSION: The final decision on the Hinkley C nuclear reactor will be subject to EU approval. While very unlikely to block the project, the European Commission may add conditions that could force a reopening of negotiations between the government and investors, delaying the project and increasing its costs.

Indexing (details)

Subject	Economic conditions; Industry; Politics; Social conditions & trends; Coal industry; Electric utilities; Energy policy; Environment; Government;

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