European Enterprise Alliance

Position Paper on Energy Price Increases

Background

Media outlets, research bodies and national organisations have been observing the vast increases in gas and energy prices (and in coal, crude oil, and CO2 emission allowances) that have occurred across Europe and most of the world at an enormous pace since the Autumn of 2020. For example, in Poland the average price of hedging and annual contract in 2020 was PLN 69.90/MWh, while currently, this same contract costs approximately PLN 500/MWh. In electricity, the average price of hedging an annual contract in 2020 was 232.74 PLN/MWh, and currently it is trading at 1000-1200 PLN/ MWh. Some European countries have experienced even higher increases. In Germany, the wholesale price for electricity more than tripled in 2021 to an average of 97 EUR/MWh compared to the previous year, reaching the highest level in 20 years.[1] It seems that it was only the beginning of increases, as the same annual contract is currently trading at approximately 230 EUR/MWh.

The Covid-19 crisis caused a historic drop in global energy consumption in its early months, driving the prices of many fuels to their lowest levels in decades. However, since then, these prices have bounced-back strongly as a result of rapid global economic recovery. Gas prices have seen the biggest increase, with European and Asian benchmark prices hitting an all-time record. Gas in Europe cost as much as 150 EUR/ MWh. US natural gas prices have more than tripled since October 2020 to reach their highest level since 2008. On average, gas prices in 2021 were approximately 49 EUR/ MWh higher, and five times as high as in 2020.[2]

International coal prices are around five times the level they were last year, with prices for imported coal increasing to over 30 EUR/ MWh due to higher demand for coal-fired power and to supply bottlenecks. Hard coal prices were driven up by natural disasters in China, Australia, and the U.S., by the increased demand as the economies recover, and by the high

[1] Fernandez Alvarez, C. and Molnar, G. (2021) 'What is behind soaring energy prices and what happens next?' IEA. Accessed: https://www.iea.org/commentaries/what-is-behind-soaring-energy-prices-and-what-happens-next
[2] Noucier, A. and Piebalgs, A. (2021) 'Some reflections on current gas market price trends.' EUI Florence School of Regulation. Accessed: https://fsr.eui.eu/skyrocketing-energy-prices/#_ftn1

gas prices. The higher gas and coal prices, combined with rising European carbon prices, have resulted in higher electricity prices, increasing by more than eighteen percent[3] - between 2020 and 2021, the year-on-year increase in the price of electricity, along with gas and heating oils was the highest on record.

Current market dynamics suggest that European benchmarks for gas (TTF) and coal (ARA Amsterdam – Rotterdam - Antwerp coal) will remain high. Economic recovery increased demand in Asia and deliveries through Russian pipelines to Europe were reduced, leaving Europe's gas shortage facilities at the lower-than average level before the winter of 2021-2022. The pre-winter gas storage levels in the EU had been at seventy-seven percent of capacity, whereas they usually stand at around ninety percent.[4]

In such a dynamically changing price environment, energy-intensive industries, as well as all other economic activities using over 100 MWh/y, are beginning to worry if they will be able to conduct their business. Many businesses are likely to face the double impact of rising energy costs, paired with a potential decline of consumer spending due to household's increased energy-related expenses. It is unclear where the ceiling is, as this uptrend has been going on with no sign of stopping for nearly two years. Direct users of oil, gas and power are not the only ones dealing with soaring energy prices. If higher energy prices are sustained, they may eventually result in second-round effects as energy-intensive companies pass on price increases to clients.[5] Thus, clients will also be faced with raising costs. Production of energy-intensive products could also become unprofitable at high energy prices, and increasing unemployment on top of this may cause shortage in demand. Producers might lower production levels which could create shortages further up the supply chain.

Factors behind Price Increases

Multiple factors lie behind the hike in energy prices: most recently, the war in the Ukraine has cut-off many of Europe's energy sources from Russia, contributing to pre-existing problems with energy prices. With regards to the war, Kristian Ruby, secretary general and Eurelectric, which represents the European electricity industry, has claimed that "what we have seen is that withholding big volumes of gas has been part of a clearly orchestrated military strategy to paralyse the EU and make it harder for us to react appropriately to Russia's invasion of Ukraine."[6]

[3] Fernandez Alverez, C. and Molnar, G. (2021) Ibid.
[4] Appunn, K. (2022) 'The energy crunch – what causes the rise in energy prices?' Clean Energy Wire. Accessed: https://www.cleanenergywire.org/factsheets/energy-crunch-what-causes-rise-energy-prices
[5] Van Sante, M. and Hieminga, G. (2022) 'The ripple effects of soaring energy prices.' ING. Accessed: https://think.ing.com/articles/the-ripple-effects-of-soaring-energy-prices
[6] Keating, D. (2022) As Ukraine war rumbles on, EU looks to turn energy promises into actions.' Energy Monitor. Accessed: https://www.energymonitor.ai/ukraine-crisis

However, the price hike has not been the result of a single 'shock event' on the demand or supply side. Rather, it has resulted from a combination of supply and demand factors that gradually tightened markets over the course of several months, and even years. For example:

- an increase in CO2 allowance prices,
- a crisis in the coal market,
- pressure on gas prices,
- and growing demand for power, among other reasons.

Bottlenecks in energy supply at the same time that the European economy picked-up after the lockdowns of 2020 also contributed to high prices. A prolonged and cold winter in both Europe and Asia between 2020 and 2021 caused gas shortages. Additionally, high demand for liquefied natural gas (LNG) from Asia (which offered higher prices) has led to lower LNG shipments to Europe.

The volatility of the energy market in Europe has caused some EU member states - such as Spain, Portugal, France, and Italy - to call for changes to the EU's electricity market design. Meanwhile, some EU capitals have initiated their own measures to address the ongoing market volatility, such as clawbacks of windfall profits or energy price caps. Experts have warned against change to EU energy market rules or to the single European electricity market.[7] They argue that the current conditions are abnormal and mainly driven by Russia's behaviour in the gas market. A report on the wholesale EU power market in November 2021 by the Agency for the Cooperation of Energy Regulators (ACER), which unites national energy regulators in Europe, concluded that, while the EU energy market model was not 'fully future-proof', it is better equipped to shield EU consumers from high volatility than other forms of market design.[8] Experts have voiced equally weary concern over uncoordinated measures being taken at the national level, claiming it is extremely unclear, if national governments make individual responses, what the impacts will be on the market structure, and what the investment signals are going to be - that essentially the crown jewel of EU energy policy could be lost, which is the internal energy market.

Problems for CEE Countries

CEE countries, which have had many trade relations with Ukraine, Belarus, and Russia, are now entering into a difficult period in the face of divestment, the disruption of intricate supply chains, large-scale production shutdowns, and the threat of gigantic stagflation. The biggest way in which the war in Ukraine is hitting the region, along with food prices, is through

[7] Gumbau, A. (2022) 'Energy price crisis: Is the EU's power market design to blame?' Energy Monitor. Accessed: https://www.energymonitor.ai/policy/market-design/energy-price-crisis-is-the-eus-power-market-design-to-blame
[8] ACER (2021) 'ACER's Preliminary Assessment of Europe's high energy prices and the current wholesale electricity market design. Accessed: https://www.acer.europa.eu/events-and-engagement/news/acer-submits-european-commission-its-preliminary-assessment-europes-high

these sharply rising energy prices, squeezing real household income and reducing private consumption. The World Bank has warned that food and energy price shocks from the Ukraine war could stretch on and have implications for many years. The increase in energy prices over the past two years have been the largest the region has seen since the 1973 oil crisis. In addition, price increases for food commodities - of which Russia and Ukraine are large producers - and fertilisers, which rely on natural gas as a production input, have been the largest since 2008. The World Bank estimated that energy prices are expected to rise by more than fifty percent in 2022, before easing in 2023 and 2024.[9]

Cumulatively, there may be a shortage of various types of products across the region - adding to the shaken logistics caused by the pandemic for several months. The spectre of mass bankruptcies is also present, which would cause collapse that would not be easy to rebuild. While speculation that much of the energy price crisis experienced across the world has arisen from transitions to renewable energy, Fatih Birol, executive director of the International Energy Agency (IEA), stated: "Unfortunately, we are once again seeing claims that volatility in gas and electricity markets is the result of the clean energy transition. These assertions are misleading to say the least. This is not a renewable or clean energy crisis; this is a natural gas market crisis."[10] However, in the face of current and ongoing difficulties, it is important that the EU re-evaluate Fit for 55[11] - a plan for transition into the green economy, working on the revision of its climate, energy, and transport-related legislation, maybe an unfit policy tool to deal with the immediate and long-term problems of the region. It is crucial to think about the 2023-2024 perspective before reaching plans for 2030, as there is a possibility that many CEE players may no longer have the capacity to reach the finish line, unless new and suitable policy is drawn-up and implemented. A report published in May 2022 found that despite measures planned in the Fit of 55 package, forecasted gas consumption in 2030 could cost the EU €250 billion more than anticipated by the Commission in its impact assessments when drafting the package.[12] The report also found that the only way to considerably reduce this cost was to roll-out renewable energies more rapidly and on a larger scale than planned in the package, while simultaneously increasing energy efficiency.

Following a trip to Hungary on May 9th, Commission President von der Leyen and EU officials announced that the Commission was considering offering certain CEE member states (Hungary, Slovakia, Czech Republic) additional funding to improve oil infrastructure and connections with other Member States, to convince them to endorse a ban on Russian oil, as they are landlocked with fewer options than other member states for alternative supplies.

[9] World Bank (2022) 'Food and Energy Price Shocks from Ukraine War Could Last for Years.' Accessed: https://www.worldbank.org/en/news/press-release/2022/04/26/food-and-energy-price-shocks-from-ukraine-war
[10] Birol, F. (2022) 'What does the current global energy crisis mean for energy investment?' IEA. Accessed: https://www.iea.org/commentaries/what-does-the-current-global-energy-crisis-mean-for-energy-investment
[11] European Council (2022) Fit for 55: The EU's Plan for a Green Transition. Accessed: https://www.consilium.europa.eu/en/policies/green-deal/fit-for-55-the-eu-plan-for-a-green-transition/
[12] Brown, S. (2022) 'The EU's €250 billion gas gamble.' Ember Climate. Accessed: https://ember-climate.org/insights/research/the-eus-e250-billion-gas-gamble/

This has been proposed as part of a sanctions package against Russia and must be approved unanimously by Member States. The Commission has additionally agreed to grant Hungary, Slovakia and Czechia longer transition periods for phasing out crude oil and refined oil imports.[13]

In March 2022, the Commission set out ideas for collective European action to address the root causes of the energy price crisis and ensure security of supply as reasonable prices for next winter and beyond. Tabling a legislative proposal, the Commission introduced a minimum 80% gas storage level obligation for next winter to ensure security of energy supply, rising to 90% for the following years. A new mandatory certification of all storage system operators will avoid potential risks resulting from outside influence over critical storage infrastructure, meaning that non-certified operators will have to give up ownership or control of EU gas storage facilities. Further, the Commission adopted a communication setting out the options for market intervention at European and national level, assessing the pros and cons of potential options. The Commission intends to create a task force for common gas purchases, inspired by vaccine purchasing during the pandemic, by pooling demand, the task force would facilitate and strengthen the EU's international outreach to suppliers to help secure well-priced imports ahead of next winter. Additionally, the Commission is considering providing guidance to Member States on how to make best use of targeted country-specific derogations under the Energy Taxation Directive. The Commission notes that there is no single easy answer to tackle high electricity prices, given the diversity of situations among Member States in terms of their energy mix, market design and interconnection levels.[14]

[13] Dr2 Consultants (2022) 'Fit for 55 Policy Updates.' Accessed: https://dr2consultants.eu/work/fit-for-55-services/fit-for-55-policy-update/
[14] European Commission (2022) 'Commission outlines options to mitigate high energy prices with common gas purchases and minimum gas storage obligations.' Accessed: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1936