

UK energy policy is failing. Electricity and gas prices have tripled – security of supply has deteriorated – and emissions of CO<sub>2</sub> are rising. Consumers currently face the highest industrial energy prices in Europe and the risk of interruptions to their gas supplies, threatening the viability of our manufacturing industry.

How did we get into this mess – and what can we do to get out of it?

Three years ago, before the government published its Energy White Paper, consumers benefited from secure, competitive energy supplies achieved through liberalised energy markets and an efficient system of economic regulation. Electricity prices had reached a low following a series of market reforms. Gas prices had risen, but remained below continental oil-indexed levels. Oil prices, set in the international market, had started to rise but remained below \$15bbl – still relatively low by historical standards. To some, the threats to the security and competitiveness of our energy supplies may have appeared remote.

The Energy White Paper was supposed to put the UK on a path to a low carbon economy. Consumers, especially in the industrial sector, would bear the brunt of the costs arising from the EU emissions trading scheme (to encourage efficient reductions in CO<sub>2</sub> emissions), the Renewables Obligation (an annually escalating subsidy to renewable generators) and the Climate Change Levy (an energy tax). Energy policy would remain market based, but subject to interventions to promote uneconomic renewables. Gas would remain the fuel of choice – imports from liberalised continental gas markets would replace the output of the UK's declining sources. Electricity would become heavily gas dependent, coal plant would be retired in response to increasingly costly emissions constraints, so CO<sub>2</sub> emissions would fall. Nuclear (the principal source of zero emission power, then providing nearly a quarter of the UK's electricity) would be progressively replaced by renewables, which would account for 10% of electricity generation by 2010. The nuclear option would be kept open but the sensitive issue of new build could be safely postponed for another electoral cycle. Emissions would be cut, security of supply would be maintained, and yet prices would remain competitive as countries in Europe and beyond followed the UK's great leap forward.

Unfortunately, since this policy was implemented, fuel prices have rocketed. Oil prices have quadrupled to over \$60bbl. Gas is so expensive that generators have switched back to coal, despite being exposed to unexpectedly high carbon costs under the EU trading scheme. Renewables are growing much more slowly than planned despite massive subsidies (the National Audit Office recently estimated the Renewables Obligation will cost consumers more than £1bn pa by 2010 – others think it will be even worse). Whilst consumers suffer, oil and gas producers are making windfall profits but so too, ironically, are carbon-intensive power generators (due to the way the EU trading scheme is implemented).

The net result has been that emissions and energy costs have both gone up – the worst possible outcome, whether viewed from an environmental or economic point of view.

As if this was not bad enough, industry now faces the risk of its gas supplies being cut off. Gas production from the North Sea has declined faster than expected and supplies will remain tight for at least two years until new import facilities are completed. The increase in import capacity will improve security of supply but will not resolve the pricing problem, since gas prices will remain linked to oil until continental markets are fully liberalised, which will take many years. Even then, there is no prospect of gas prices returning to previous levels. According to DTI, a third of the UK's gas supplies will come from shipments of liquefied natural gas (a relatively expensive source) which will increasingly set the market price.

High gas and carbon prices make conventionally generated electricity uncompetitive, whilst wind power (the least expensive renewable option that can be deployed on any scale) is inherently incapable of providing a secure supply. There is no credible alternative to nuclear power if we wish to cut emissions whilst retaining competitive electricity supplies and the sooner this is acknowledged the better.

To its credit, the government has already admitted that the UK's emissions and energy efficiency targets will not be achieved by 2010, and is close to doing the same for the renewables target. What is missing is an acknowledgement that prices have already become uncompetitive and will get worse without a change in policy. Countries like France and Finland have made sure their industry has access secure, emission-free electricity supplies at predictable, competitive prices. We need to learn from their example – and quickly – before the damage to UK industry becomes permanent.

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