BURSON-MARSTELLER INSIGHT
EU Energy Policy: Now What?

INTRODUCTION

Investors are worried. Companies and stakeholders in European energy markets need to rethink their interests and strategies. Here's why.

Increasing political and regulatory uncertainty across the spectrum of power generation and transport fuel technologies has reduced confidence and dampened Europe's ability to attract long-term private-sector investments on the scale necessary to meet the EU's oft-stated energy policy objectives. Europe's shopping list includes the further development and deployment of a broad array of renewable power and transport technologies, together with the "smart" new infrastructures necessary to exploit them.

The IEA's latest estimate puts the price tag for all that at about €4 trillion. At the same time, EU (especially Eurozone) governments are being driven toward historic public sector austerity under the German whip. Far less of that €4 trillion than had been expected will henceforth come from the public purse. So where do we go from here? Good question.

A FRAGMENTED EU ENERGY POLICY

From an investment point of view, it is difficult to see the European Commission's keenly awaited new energy strategy as anything more – at least pending the promised follow-on "roadmaps" and legislative proposals - than an eloquent testimony to the increasingly confused – not to say random – real world interplay of forces unleashed by a decade of ambitious EU energy rhetoric and piecemeal policy.

To be fair, much of the blame for this state of affairs can be laid at the door of the EU member states, particularly their insistence – led by France and Germany - on the designation of energy policy as a "shared competence" in the Lisbon Treaty. In so doing, they have reserved many difficult market and industry-shaping decisions and choices for themselves, while leaving their EU-level obligations deliberately ambiguous. Exhibit A is the Renewable Energy Directive, a veritable Bermuda Triangle of constitutional confusion over the enforceability of its single market aspirations. And even where EU gas and electricity market legislation is firmly rooted in the internal market provisions of the treaties, the Commission is fighting rear-guard action on a broad front, with over 40 infringement procedures underway on the second (2003) internal energy market package alone.

The bitter irony is that member states themselves now appear increasingly confused as they struggle to put in place their own national energy strategies and regulatory rules, with greater or lesser concern for compatibility with either their EU obligations – such as they may be - or each other.

Let's be clear: this path may reflect today's political realities, but it is ultimately a dead end for Europe's energy and climate change ambitions. Only a determined effort to build continental-scale markets for low-carbon energy technologies can attract the necessary risk (and human) capital to Europe in competition with the rest of the world. As the Commission itself reports, the US and China are already considered the best investment opportunities for renewable energy, while new research puts China at the head of an emerging "new world order" in low carbon energy.

None of this is – or should be – news to European leaders. In a non-paper prepared for the European Council devoted to Energy in February 2011, EU Council President Herman Van Rompuy himself stressed that, "The very foundation for a European energy policy is an integrated European market. It is key to assure the competitiveness of Europe's economy, security of energy supply and sustainable development."

The fragmentation of Europe's energy policy and regulatory environment is clearly reflected in the reactions to the Commission's strategy paper of the many highly-mobilised industry and stakeholder interests active in the EU energy lobby. Industry groups no less than NGOs are increasingly promoting their own narrowly-defined interests and agendas without taking the bigger picture into account – concerned that there is no bigger picture, but rather a market-by-market, zero-sum, winner-take-all game. Every interest seems to have its own agenda, its own designs on the public purse, its own allies and its own adversaries. One lobby's renewable power generation solution is another's pipe-dream dependent on unsustainable public subsidies, while you cannot find an emissions-reducing energy technology without its virulent NGO detractors stoking the fires of political and public concern.

NOW WHAT?

Little wonder then that would-be investors in European energy sectors are reluctant to commit long-term money in the face of such volatile political - and often reputational - risk. Moreover, the higher the perceived risk, the higher the potential return demanded – a vicious circle that can only be broken by lowering the perceived risk.

Is there a way to turn this around? Three observations:

It is vital to ground European energy policy going forward in the recognition of two interlocking realities:

Like it or not, the supply and demand for natural gas in Europe will be the primary driver of power market conditions for decades to come, conditioning perceptions of the role and viability of all other power generation alternatives. This reality has immediate significance for policy in view of a foreseeable global gas glut over the next 10 years – with the vast potential of shale gas increasingly over-hanging much longer-term perceptions.

There will not be enough public money to go around. This has three self-evident consequences:

- Policy-makers at all levels in Europe will have to decide where to concentrate the public support they control;
- Those sectors and technologies which cannot expect new or continued public support will have to devise new models for long-term financial viability that depend not on subsidies but competitiveness;
- The greater the alignment and stability of support policies across the continent, the greater the leverage on private sector investment (for better or for worse, depending on where you sit).

Europe's perceived determination to spend what it takes to meet its GHG reduction commitments (relative notably to "energy security" objectives) is what has driven the willingness of investors to invest in Europe across the spectrum of low-carbon energy technology innovation and deployment. Inevitably, the twin prospect of cheap gas for decades and shrinking public purses will now severely test both that political determination and consequent investor willingness - particularly because gas itself is a low-carbon alternative relative to coal.

Under these circumstances, the attraction of regulatory measures – particularly those conditioning market access - will inevitably grow. Even impoverished governments can force consumers to pay for low-carbon solutions by adopting mandatory standards or taxes. Growing uncertainty over the ability of the EU Emissions Trading System to deliver Europe's emissions reduction commitment all by itself will further feed this trend. And here again, the greater the harmonisation, the greater the leverage.

CONCLUSION

There is no prospect of amending the shared competence for energy policy now enshrined in the EU Treaty. That means quite simply that bringing greater clarity and single market leverage to bear on energy investors' perceptions will require political consensus that can only emerge from decisive joint leadership at the top of the three major EU institutions. Of the three, the European Parliament now looks most able to play a leadership role – a necessary and welcome but entirely insufficient condition for progress.

For now, the ball remains in the Commission's court as it pursues member state infringements and as the promised 2050 "roadmaps" and associated legislative proposals take shape internally, with considerable internal horse-trading between the DG Energy/DG Move axis, and the DG Climate Action/DG Environment axis. Futurology has its place in Europe's energy policy debate, provided it helps clarify today's policy choices and drive a consensus that investors can rely on. That moment of truth looks like arriving in 2011.

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