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How not to run an energy policy: the lessons from three decades



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Making a difference to policy outcomes locally, nationally and globally

OCCASIONAL PAPER

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How not to run an energy policy: the lessons from three decades

Brian Wilson, Visiting Professor, Centre for Energy Policy

I stand here as a layman in a room full of experts; as someone who, for a few years, tried to steer the United Kingdom's energy policy in a safe and sustainable direction and now retains involvement as occasional participant and commentator. But none of that – or even the title of Visiting Professor at the University of Strathclyde - makes me an expert. The only defence I can plead is that, sometimes, you need non-experts making decisions because the one certainty about experts is that their expertise will not all point in the same direction. That is where politicians have come in; balancing the arguments – against cost, against benefits, against ideological objectives, against common sense. Not always successfully.

If that process is to succeed, the most desirable ingredient is continuity. The same minister, the same advisers, the same intellectual challenges, the same objectives. On that basis, it just might be possible to steer a path that follows a consistent route, albeit with twists and turns along the way. Unfortunately, these conditions bear little relationship to the realities of how energy policy has evolved. In the absence of continuity, we have lived with a procession of compromises, delays and short-term fixes. At the end of the day, it has not been a disaster because the lights are still on and the wheels of industry – or what is left of it – continue to turn. But that is setting the bar rather low and also begs the question of what we are handing on to the next generation, a quarter of a century after the state-owned industries passed such a handsome legacy to those who succeeded them.

Ideology has driven UK energy policy

If we look back over the past 30-odd years, ideology has driven policy but has failed to deliver satisfactory answers. Ideology dictated the break-up of the great state utilities, the destruction of the coal industry and the political influence associated with it. Just when that triumph had prevailed, along came a very different ideology which required a response to climate change and rejection of fossil fuels. The first ideological wave demanded that the market should be left free to determine the course of energy policy. That produced short term gains but failed to guarantee investment. Then along came the ideology of carbon reduction and the façade of non-interventionism collapsed so that we now have a profit-driven system expected to deliver a range of outcomes which depend on state interventionism and public subsidy. The results, not least here in Scotland, are decidedly mixed.

The three imperatives of energy policy are security of supply, affordability and carbon reduction. The job of government is to serve all three masters without any one of them achieving such dominance as to damage the other two. There is no point having the most virtuous energy mix that humanity can devise if few can afford to pay for it. And nobody will thank a government for environmental virtue if nothing happens when the switch is flicked. These three imperatives require a constant balancing act and it is the politicians who will, quite rightly, be held responsible when that balance fails.

Security of supply

So how are we doing? The current security of supply position in electricity is, by most accounts, worryingly tight – with the margin at between two and six per cent, down from almost double that a decade ago with the mildness of recent winters the saviour of the system. The average domestic bill in 2016 was 56 per cent higher than in 2003 while British industry has the most expensive electricity in Europe. As for carbon reduction, targets are set at such a distance that measuring progress is a highly selective art. What is generally agreed is that the costs of reaching the more ambitious targets are impossibly high.

So, yes, the lights are still on but the report card scarcely inspires confidence in the future. In the absence of clear strategies, we constantly fall back on default positions. Currently, there is massive reliance on old plant – coal, diesel, nuclear – while almost nothing new is being built. That is scarcely a strategy for the future. In other words, we muddle through because there is no other option in a world where public interest objectives often conflict with the commercial interests on which they depend for delivery.

The gas and electricity networks in the United Kingdom were built up over decades through public investment, to reflect the country's industrial, economic and social needs. The electricity network was brought together as a public enterprise in the 1920s and the gas network was nationalized in 1949. It was the responsibility of government to provide the generating capacity which would serve the network and because its primary interest was in security of supply it did so without too fine judgments about balancing output against demand. In that rational world, too much was self-evidently better than too little. The system correlated to the demands of a coal and steel economy which suited Scotland very well. There was also a social dimension. In the north of Scotland, we were blessed with the great programme of hydroelectric schemes, which no private system would ever have delivered, bringing power to the remotest islands and glens. Never let it be disputed that the United Kingdom as a whole, and Scotland in particular, were exceptionally well served by the state owned energy system. And that was the legacy which the private sector inherited.

What now? There has been no new thermal generation capacity created in Scotland since privatisation. On the other hand, Cockerzie has been closed with the promise of a gas-fired replacement quietly dropped. Longannet has been closed prematurely for the commercial convenience of its operators. While new nuclear power is banned in Scotland as if it was akin to the Black Death, our status as an exporter of electricity is marginally retained most of the time entirely due to the fact that two nuclear power stations, Hunterston and Torness, continue to generate far beyond their original life expectancy. The moment they stop doing so, Scotland will become a net importer of electricity on a large and growing scale.

Nor will it stop there. The Scottish Government's own Draft Climate Change Plan states that: "In 2030, Scotland's electricity system will be wholly decarbonized and will supply a growing share of Scotland's energy needs. As well as lighting our buildings and powering our appliances, electricity will be increasingly important as a power source for keeping our homes warm and our vehicles on the move". That's what it says – so, in other words, electricity is not only going to perform its present role in the Scottish energy mix, it is also going to push out gas – which four out of five Scottish homes rely on as their main source of domestic fuel – and also the petrol and diesel we put in our tanks. The obvious question is: "Where is all that electricity going to come from".

Lognannet no more, Cockerzie no more

By that time, it will be a case not only of Longannet no more, Cockerzie no more, but also Peterhead no more, Hunterston no more and Torness no more. For reasons I will come to later, it is completely unrealistic to suppose that renewables are going to fill the void that these closures will have left, far less provide the additional power required for a decarbonized energy system. All of this points in only one direction – southwards and towards imports. Fortunately, interconnectors operate in both directions. Thirty years of public policy and sometimes overblown rhetoric, doing battle with a system run on market principles, will have the net effect of turning Scotland into an importer of power rather than an exporter and, unless they get a move on, may well have the same effect for the United Kingdom as a whole. And let's not ignore the immediate economic effects of that trend - the more we import power, the more we export jobs and the industrial supply chain.

The Thatcher/Lawson era

Gas and electricity privatisation were the ideological flagships of the Thatcher era with Nigel Lawson as admiral of the fleet. It was the heyday of popular capitalism with large numbers of small investors enticed into buying shares which the vast majority of them quickly converted into profit. The ideological commitment to breaking up the state monoliths coincided closely

with the political objective of ending dependency upon coal and eliminating the power of its trade unions. In 1993, it was John Major's government and the White Paper on The Prospects for Coal which sounded the death-knell. It said that coal must take its place in a competitive energy market and that what remained of the industry would be privatised. With the dash for gas well underway as a result of North Sea developments, that was a formula for coal-fired generation to be steadily squeezed out. Nuclear, on the surface at least, and gas were cheaper sources of generation. According to the 1993 White Paper, the aim was "to ensure secure, diverse and sustainable supplies of energy in the forms that people want, and at competitive prices". The White Paper emphasized that "Government should not attempt to impose all-embracing plans about how much energy of what kind should be produced or consumed by whom". Such tasks were to be left to the invisible hand of the market.

New Labour, new approach?

If only life was so simple. In the run-up to the 1997 General Election, the story that dominated the headlines was not about the efficiencies delivered by a privatised system even though average household electricity bills had fallen. Rather, the focus was on the gargantuan profits of the privatised utilities and eye-watering salaries for those who had found their way into running them – the fat-cats, as they became known in popular lore. So extreme were these concerns that the incoming Labour government was able to impose a windfall tax of £5.2 billion upon the privatised utilities to fund its Welfare to Work programme, with barely a whimper of protest, and even that sum represented no more than a blip of temporary inconvenience. Part of the industry's new profitability stemmed from the continuing move away from coal and availability of cheap North Sea gas. Between 1991 and 1997, the proportion of UK electricity generated from gas increased from zero to 27 per cent, mainly at the expense of coal and this prompted the incoming government to launch a Review of Energy Sources for Power Generation.

By then, the break-up of the power industry was so far advanced and other priorities for public spending so pressing that any return to a state-owned system was impossible. That bird had long since flown. So the policies which the Labour government adopted were geared to creating more competition and protecting the interests of consumers through regulation. To this end, the regulators for the gas and electricity industries were merged in 1999, to form Ofgem. This was roughly where I entered the scene as Energy Minister in the Department of Trade and Industry.

On the surface, there was a good story to tell. Between 1991 and 2003, the average domestic electricity bill fell from £489 to £333. Competition appeared to be working. What I spent much of my time pointing out was that this had happened largely because the market was over-

supplied as a legacy of the state system. The interest of the generators lay in forcing capacity out, in order to push prices up, rather than in the vital longer term investment in new generating capacity. All of this came to a head in 2002 with the virtual collapse of British Energy, the nuclear generator. Whereas other generators could survive low wholesale prices, by cross-subsidising through their supply arms, British Energy had no such option. Neither could they close power stations down for a few months till things improved. I well remember the day this crisis hit as I had just landed in the giddy heights of La Paz and was sitting in the back of a car with our Ambassador to Bolivia when the phone call came suggesting that I get back to London as quickly as possible, as British Energy was on the brink of collapse.

Maybe I should have stayed in La Paz for the formula imposed by the Treasury for saving it was not one with which I agreed. If British Energy's output had been subsidized until prices rose by a few pounds, as they did, the company could have continued to operate and meet its long-term obligations as before. Instead, the taxpayer took on liabilities later quantified at £5.3 billion and British Energy was sold off a few years later to the French state company EDF. This episode left a continuing mark on UK energy policy. First, it played into the hands of the very active anti-nuclear lobby within the Labour government, which regarded nuclear power as the devil incarnate. Second, it guaranteed that any future investment in new nuclear would have to be underwritten by government. Given that a short-term fluctuation in the wholesale price of electricity had brought British Energy to its knees, nobody was going to invest in new nuclear power stations – with no knowledge of what the market might look like in 15 or 25 years time – without that risk being underwritten. Therein lay the enigma with which we still live.

A few years later, the Labour government accepted the need for nuclear new-build when brief events in Ukraine finally persuaded them that future dependence on Russian gas wasn't really such a sound energy policy after all, but still wouldn't will the means to make new-build happen. The Coalition government carried on in the same vein and added the stupid mantra that nuclear new-build would have to be without any form of subsidy, actual or potential. All the time, the clock was ticking and the longer this posturing went on, and the greater the failure on other fronts to secure investment in new baseload generation, the stronger the hand of EDF and other nuclear developers. That is what took us to the Hinkley Point deal which has been widely criticised as too generous. I don't know the answer to that but I do know that the UK government's hand has been weakened by a decade and more of delay. Hinkley Point is due to deliver seven per cent of the UK's electricity output by 2025 and as a House of Lords Select Committee report pointed out last week, it is a matter of some urgency to say what the alternatives are if, even now, Hinkley Point does not proceed. I doubt if anyone knows and that in itself represents a significant failure of policy and planning.

The benefits and costs of the Renewables Obligation

By the time I was Energy Minister, the drive for decarbonisation was in full swing and I have been blessed and cursed in equal measure for the introduction of the Renewables Obligation. The case in its favour was that it carried the renewables contribution to our energy mix from virtually a standing start – less than five per cent - to its present position of significance, accounting for 30 per cent of UK generation. Very little of that would have happened without the Renewables Obligation and the subsidies it provided. Before anyone says that hydro-electricity was already there, I will point out that one of my modest contributions to the common good was to bring Hydro into the renewables obligation, in return for undertakings of investment in prolonging the life of these plants. The downside of the Renewables Obligation was that it was open-ended and simply added revenue, paid for by consumers, to the wholesale price of electricity. In other words, it was unsustainable. While the Renewables Obligation was certainly motivated by environmental objectives, my own commitment to it also included the belief that it would create a great new manufacturing industry for the UK, and Scotland in particular. On that front, I think our faith and trust have been badly let down by the big utilities, who have milked the system very efficiently but found it more profitable to import than to manufacture in this country.

At that time, I expressed concern about the balance between decarbonisation and affordability. Electricity was cheap and our target for 2010 was going to put eight per cent on the price of electricity. Nobody noticed. But as wholesale costs rose and other environmental impositions bore in, there was bound to be a backlash both from domestic and industrial consumers. According to the House of Lords Economic Affairs Committee report, climate change-driven costs will account for a quarter of domestic electricity bills by 2020. The position for industry is worse. Already, the figure is at 13 per cent and the UK has gone from being one of Europe's lowest energy cost environments in 2003 to being the most expensive in 2015 with significant implications for investment and employment. As the Lords Committee concluded, it is unrealistic to keep adding to environmentally-driven costs without regard to affordability or other implications.

Ofgem and 'independent' regulation

A third area of policy of which I had experience that left its mark was in dealing with Ofgem which had been established under my predecessor and given the status of independent regulator. Suffice to say that its first chief executive, Callum McCarthy, was very good at pointing out its independence; in other words, that he was not going to be told by anyone what to do. Callum went on to be chairman of the Financial Services Authority at the time of the 2008 crash, so clearly he had a successful career in ignoring warning signs. We thus had a situation

in which the regulator was more ideological than the politician, and Callum was an unshakeable believer in the untrammelled power of the market to deliver efficiencies through competition. In the case of domestic consumers, the right to switch suppliers was to be the answer to everything. But, of course, the vast majority of consumers had no interest in switching and thus became sitting targets, particularly in Scotland, for whatever price rises the utilities cared to heap upon them. Even when I insisted on taking action against blatant mis-selling by the big utilities, Ofgem bristled with indignation. For them, conning old ladies into signing up to dodgy deals was all part of the market at work. It was an experience that left me with severe doubts about the role of market regulators. Sometimes politicians have a responsibility to make decisions for which they, and not regulators, will be held accountable. Nothing that has happened in the intervening years, in any sector where regulation is supposed to be the safeguard against exploitation of the system by commercial interests, has diminished that view.

Scotland's energy policy: imports not renewables

Let me say a word about the Scottish energy mix, particularly in the light of the consultation that has now been launched by the Scottish Government on their strategy up to 2050. As I mentioned earlier, and has been highlighted by Alf Young in an excellent blog post for the Institute¹, there is a gaping hole in the middle of this strategy. It envisages a vastly greater role for electricity not only in respect of its current functions but also as a replacement for fossil fuels in heating and transport. The unanswered question is where that electricity is going to come from. The political answer, if pressed, would doubtless be “renewables” but the more realistic one is “imports” – without any control over how the power is generated.

The Scottish Government's much-heralded renewables policy has always been a bit of a con, based more on press releases than anything more substantial. The clue to this lay in their persistent refusal to break down targets into technologies. Wind, wave and tidal were airily grouped together as if they were all players in the same game. Nothing could have been further from the truth and, in reality, the growth of Scottish renewables has depended overwhelmingly on onshore wind and subsidy provided by consumers throughout the United Kingdom. That gravy train has now, rightly, ended. It should have been done with greater sensitivity to outstanding issues and legitimate claims. For example, there is still the unfinished business, which has now been dragging on for 17 years, of recognising that the Scottish islands should be treated as a separate category – neither onshore, because they require interconnectors, nor offshore, because they are made of dry land. I hope that this anomaly can finally be addressed through the current consultation and that the Scottish islands are allowed to make their disproportionate

¹<http://www.strath.ac.uk/research/internationalpublicpolicyinstitute/ourblog/february2017/scotlandandenergystrategyambitiontoofar/>

potential contribution to renewables targets while at the same time benefiting their local economies.

Wave and tidal, I regret to say, have failed to deliver anything. There should continue to be modest investment in them and in other promising technologies but it is delusionary to assume that the challenges which have proved so resilient will be overcome any time soon. Offshore wind, contrary to all the talk about us being the Saudi Arabia of renewables, is largely a mirage as far as Scotland is concerned – not because of politics but simply due to geology. There are few sites in shallow waters where the economics would stack up. We currently have two legacy projects – Beatrice and Trump's favourite off the Aberdeenshire coast – but little to follow. The Scottish Government delayed consenting Neart na Gaoithe off the Fife coast, which had secured Contracts for Difference approval, to such an extent that it has now been stymied – at least for the time being - by the RSPB and unless that project can be rescued from the current legal impasse there is nothing else in the pipeline. So again, I ask, where is all this electricity going to come from – other than through an interconnector from England or elsewhere? If anyone here knows the answer, I will be interested to hear it.

An impoverished energy legacy?

So I finish where I started by asking what we will be handing on to the next generation, compared to what the state owned system bequeathed to us? Scotland as a net importer of power rather than an exporter. The UK winging it at the margins of security of supply. A massively reduced industrial base associated with power generation. And fuel bills which leave a distressingly high proportion of the population in fuel poverty.

Neither the market nor politicians have been very good at providing answers. So I rather like the recommendation from the House of Lords Select Committee that the government should establish an Energy Commission to provide continuity and strategic thinking by advising on all aspects of the energy market and providing greater scrutiny of energy policy decisions. When, translated, I suppose that means we should after all, leave it to the experts. In Scotland, my expectations for concessions to reality are modest but maybe some committee of Holyrood could summon all its courage and carry out a serious investigation, free from political spin, of where current policies are leading us, what the implications – both economic and political - are of becoming heavily import dependent and if it's really not time to stop banning technologies that might make a significant difference.

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Since leaving politics in 2005, he has written extensively on energy issues. Brian and his family live on the Isle of Lewis. As chairman of Harris Tweed Hebrides, he was named UK Global Director of the Year by the Institute of Directors in 2012.

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