The ominous parallels between finance and energy

The current economic crisis is providing new insights into the global financial and energy systems that the world economy runs on.
Those who, a year ago, dared to warn about the proliferation of high risk financial products and predict the demise of financial institutions, were not taken seriously. It was also emphatically denied that politicians had completely lost control of capitalistic banking systems. We know better now. In his only admission of guilt to date, Alan Greenspan, the previous chairman of the American Federal Reserve Bank, stated that he had (completely) overestimated the self-cleansing ability of a capitalistic financial system.

In the past few months two events occurred in the energy sector, which point up interesting parallels with the situation in the financial sector. The first is the announcement of Shell's withdrawal from wind energy. The second is the take-over of Hungary's Mol by Russian Surgutneftegaz.

Shell has announced, without entering into details, that it will withdraw from wind energy. Shell's justification for this did not go much further than the statement that the company had to set priorities. The underlying reason, however, is simple: Shell's financial performance requirements are based on a high risk profile and a correspondingly high return on investment. Shareholders are rewarded with this princely return on an annual basis. The returns in the wind energy sector are too low to keep shareholders happy. In fact, Shell is opting for the same route as Exxon, which took the same decision many years ago.

Some parallels with the latest insights into the mistakes in the financial sector are evident here. Financial institutions were driven by commercial objectives only and their facilitating role in keeping the economy going became subordinate. They became so powerful and strong, that governments no longer dared to intervene. It now turns out that the same applies to energy companies. The commercial (shareholders') interests have priority, the rest is subordinate. And governments dare not expand their regulations in the energy sector either.
There is a lesson to be learned here. The commercial interests of energy companies will prevent them from cooperating with a politically motivated energy transition, unless they are offered comparable returns on investment through subsidy schemes.

Then the take-over of Hungarian oil company Mol by Russian Surgutneftegaz. It is an illusion to think that Russian oil companies will not try their hardest to penetrate the European market. The weak brothers on the fringes of Europe will be their first prey. No doubt, the Russians have already lined up their take-over candidates and are waiting for the right moment to pounce. Obviously, it's all about money, power and politics, not about ensuring security of supply in an affordable manner.
This is a nightmare scenario for politicians in Brussels, who dream of a collective European approach to future energy supplies.

These two events, plus the shocking demise of the financial sector, must raise all the alarm bells in the capitals of European member states and in Brussels. After all, the populations of Europe, as well as those on other continents, must be able to count on affordable energy today and in the future. They will, however, get no help whatsoever from the parties engaged in the conventional supply of fossil-fuel based energy. These parties are, apparently, only interested in a high return on investment.

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The world economy has two lubricants: the financial system and the energy system. There are important parallels between the two. The financial crisis might trigger politicians to act more decisively when it comes to financing the energy transition.

One thing seems certain: if regulators (politicians) allow the sector to do its own thing, things may turn out as badly as they have for the financial sector, with dramatic consequences for the economy.

How can governments solve this problem? It certainly seems out of the question that the private energy companies will be nationalised. Banks may be nationalised in case they are threatened with bankruptcy, but this will hardly be an option for energy companies. Furthermore, there are also many state-owned energy companies that are just as profit-driven as their private counterparts.

One obvious option is to subsidise new energy projects to the extent that the established companies can continue to generate their customary high returns. Governments rightly have not decided to take that route. But then who is going to finance sustainable, secure and affordable energy?

In Germany, which has a system of feed-in tariffs, it is the consumer who ultimately pays. This system is a great success. Established energy companies are pulling out all the stops to convince the public that they can produce cheaper energy with nuclear and coal. The very fierceness of their claims proves the success of the system. The big advantage of the German approach is that it leaves no unpaid bills.

Another option is for governments themselves to invest in energy production, financed for example by inflation-indexed bonds. Sufficient pension capital is available to collect large amounts of money in the market, possibly up to €100 billion on a European scale. Financing would no longer be a problem, although to make consumers ultimately pay for the expenses might be more difficult. Are consumers prepared to pay the price? Germany has proved that they are. Consumers would rather pay extra for a transition to green energy and a secure energy supply than for a tax on archaic fossil-fuel based energy.

One major hurdle remains: governments profit handsomely from taxes on fossil fuels. They charge pollution taxes, fuel taxes, emission taxes, etcetera, and they get income taxes from energy multinationals. All in all, we are talking about tens of billions of euros per year in Europe alone. How are governments going to compensate for losses in tax income as a result of the transition to green energy and low-profit energy projects?

Wisdom and a long-term vision are required. Unaffordable energy as a result of insufficient investments in alternative energy will lead to stagnation of the economy. It will cost a lot more in the long term to fix this than to invest today in a transition to green energy and later collect income taxes in a healthy economy running on affordable energy.

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