



Rising Energy Prices, Non-Functioning Markets, Worsening Energy Poverty: Are we prepared for next winter?

Key Points

- **Energy prices** in the EU have been **rising sharply** since autumn 2021 and are becoming a threat to more and more people. **Energy poverty** is suddenly no longer an abstract phenomenon, but a **tangible reality for ever more households**.
- These **uncontrolled price rises** are not just a result of the Russian war of aggression in Ukraine, but also an **indication of the currently non-functioning energy markets**.
- **An end to the high price situation is not in sight**. Calculations by the European Commission and European regulators show that electricity prices will remain high until 2025 and these high prices are increasingly becoming a serious economic problem. High inflation is becoming permanent and there is a risk of a prolonged recession leading to deterioration in the competitiveness of European industry.
- Therefore, **strong policy responses are needed** on European level but also within the Member States – this applies both to short-term and long-term measures. The Commission addressed these problems over the last months by presenting three toolboxes which include different measures to protect all consumers, especially energy-poor households, but also the European industry.
- **More importantly, however, the structure of energy markets as a whole is to be called into question**. EU-Commission President Ursula von der Leyen stated in her speech on Wednesday, 8 June 2022 in Strasbourg that “this market system does not work anymore. We have to reform it.” This is an urgent but not an easy task. We have to think out of the box to obtain affordable prices for all – otherwise, our successful way to climate neutrality is in real danger.

Background

Prices for electricity and gas are currently at an **unprecedented level**. Since the beginning of 2021, the exchange prices for gas and electricity have risen rapidly. **The reasons are manifold**. One reason for the gas price increases is the harsh winter last year, leading to below-average gas storage levels throughout Europe. Normally, these storage facilities are filled up for the next winter during the warm season – when less gas is consumed directly and is therefore cheaper to buy. Due to a high demand of gas from Asia, caused by the economic upswing after the first year of the Covid-19 pandemic, this market mechanism did not work as usual last summer. At the same time, Russia and Norway, two of the most important gas exporting countries for the European market, exported less gas to the EU.

However, the **current price rally can only partly be explained by fundamental developments in supply and demand**. It is to be feared that financial market players are also **driving up prices through speculative transactions**. Since February 2022, when the Russian war of aggression against Ukraine began, it can be seen that not all actors involved adhere to the market rules of rational actions that have been enshrined in neoliberal thinking for decades. How the development will continue in 2022 depends primarily on the geopolitical situation.

The price increases for electricity are linked to those for gas. Lower production (and thus less available electrical energy) from renewable sources such as wind, water or photovoltaics lead to an increased use of coal and gas-fired power plants instead. In the electricity market, the most expensive power plant needed to produce the required demand of electricity determines the prices for all. Due to the low renewable generation and the therefore necessary increased use of expensive gas in generation, the price spiral began.

Main Findings

In general, the price increases both for electricity and gas are not a temporary phenomenon: energy production – and thus energy prices – are becoming more and more volatile. Therefore, consumers are also increasingly confronted with unpredictable price fluctuations. This problem is even more severe for people experiencing energy poverty.

Developments on the Stock Exchange are increasingly having an impact on the Energy Bills of End Customers

Electricity and gas are traded on the stock market, and „the market“ does not handle uncertainty well; **price swings are multiplying**. A stabilisation of the energy markets is therefore closely linked to ending the Russian-Ukraine war. But even then, it can be assumed that energy will no longer be as cheap as it was a few years ago. Prices for electricity and gas were already at unprecedented levels before the Russian invasion in Ukraine, and exchange prices, especially for natural gas, have climbed to even greater heights. According to the European Commission and the International Energy Agency, high prices are also expected the coming years.

Although energy suppliers with power plants generate electricity themselves or typically have long-term supply contracts for gas, developments on the stock exchange increasingly affect the energy bills of end customers. The reason for this is that **more and more contracts are linked to the development of indices**. In Austria, for example, these are the electricity wholesale price index ÖSPI or gas wholesale price index ÖGPI, calculated and published by the Austrian Energy Agency. The stock market developments then also have an effect on the customers' energy bills. In the case of so-called „floater“ contracts, the energy prices are even directly linked to the stock market's price developments and change monthly.

Energy poverty is becoming a severe problem even for middle-class households

Especially for energy-poor households, the current price explosion is hard to bear. Where financial difficulties due to low income meet high or rising energy prices, precarious housing conditions and poor thermal housing standards or outdated appliance equipment, the situation is already precarious.

Affected groups can no longer use energy to the extent they would like to – or if they do, their energy consumption very soon leads into a debt trap.

Often, affected households struggle with energy debt - despite energy-saving behaviour – for example

because their living spaces are poorly insulated, or heating systems and electrical appliances are outdated and inefficient. These households are then twofold disadvantaged: the flat is still cold and the energy debt has to be paid as well.

In Austria, low-income households already pay a higher share of their disposable household income for energy than average Austrian households. **Before the Covid-19 crisis, energy-poor households in Austria already spend more than 20% of their income on energy to keep their homes warm.** An above-average number of these households uses electric heating or does not have a permanently installed heating system in their home at all. Gas is also frequently used by the poorest of the poor; around 30% of these households heat with gas. **Electricity poses an even greater challenge for energy-poor households in Austria.** If the electricity bill can no longer be paid, this means the end of electricity-powered heating, even if a radiator was used. But these devices are usually also real power guzzlers and set the downward spiral of high costs, cold living spaces and inefficient devices in motion.

Price increases, such as those we are currently experiencing, do not only pose major problems for energy-poor households. The **increased cost burden of electricity, gas and heating is also becoming an increasingly noticeable problem for middle-income earners and pensioner households**, for whom paying energy bills has so far never really been a problem. This is a clear indicator that the welfare state and social security needs to be poverty-proof to prevent a broader population of becoming poor.

Targeted market interventions are necessary and useful to obtain more affordable prices

Since an improvement regarding the price situation on the energy markets is not expected in the near future, **interventions in the energy market are necessary.** This has to be done in addition to an **increase in social benefits and transfers**. For particularly affected groups, such as energy-poor households and new customers, **a cap on electricity, gas and district heating prices is needed**, as already proposed by the EU-Commission. **Speculations on the energy stock market must be made unprofitable** through a financial transaction tax and the exclusion of non-market players is also necessary as energy, seen as a service of general interest, shall not be used as an object of speculation.

In addition, the effects of the Russian war of aggression against Ukraine on the energy markets must be contained. A crucial measure is the

decoupling of electricity prices from gas prices.

Spain and Portugal can serve as models in this regard. By introducing a gas price cap for gas-fired power plants that generate electricity, the price of electricity for all consumers (industry, commerce and households) is significantly reduced. This, in turn, has the potential to dampen prices overall. A gas price cap or a similar model would also work in the rest of Europe.

The gas price cap for electricity generation in power plants has another effect: windfall profits for renewable energy producers are significantly reduced.

These are crisis-related surplus profits that arise due to the merit order effect: Because the generation costs of plants that produce electricity based on renewable energy sources have hardly changed, massive surplus profits arise as the energy produced at the same cost is now sold at a much higher price. But the mineral oil industry also profits from the current crisis and is earning record profits. The International Energy Agency (IEA) estimates windfall profits at over 200 billion euros annually across the EU. The IEA and the European Commission propose to skim off these excess profits and use the revenues to relieve the burden on households.

The gas price cap would only have to be introduced **for a small number of price-determining gas power plants**. The cost of this could be **financed by a special tax** affecting those companies that continue to make high excess profits due to the crisis, energy companies such as those in the oil and gas sector. The advantage would be enormous: a fixed gas price as in Portugal and Spain of 40-50 €/MWh for gas-fired power plants would reduce the electricity price by at least 50% to around 100 €/MWh. This is still high enough to create sufficient incentives for investments in renewable energy – even if the electricity price is half as high, investments in renewable energy would pay off, even without subsidies. All electricity consumers – industry, commerce and private households – would benefit from lower electricity prices. Overall, **inflationary dynamics would decrease noticeably**, with corresponding positive effects for the entire economy. **The effects on climate policy would also be positive**: for investments in heat pumps, electric cars or the production of green hydrogen to be worthwhile, (renewable) electricity must remain affordable.

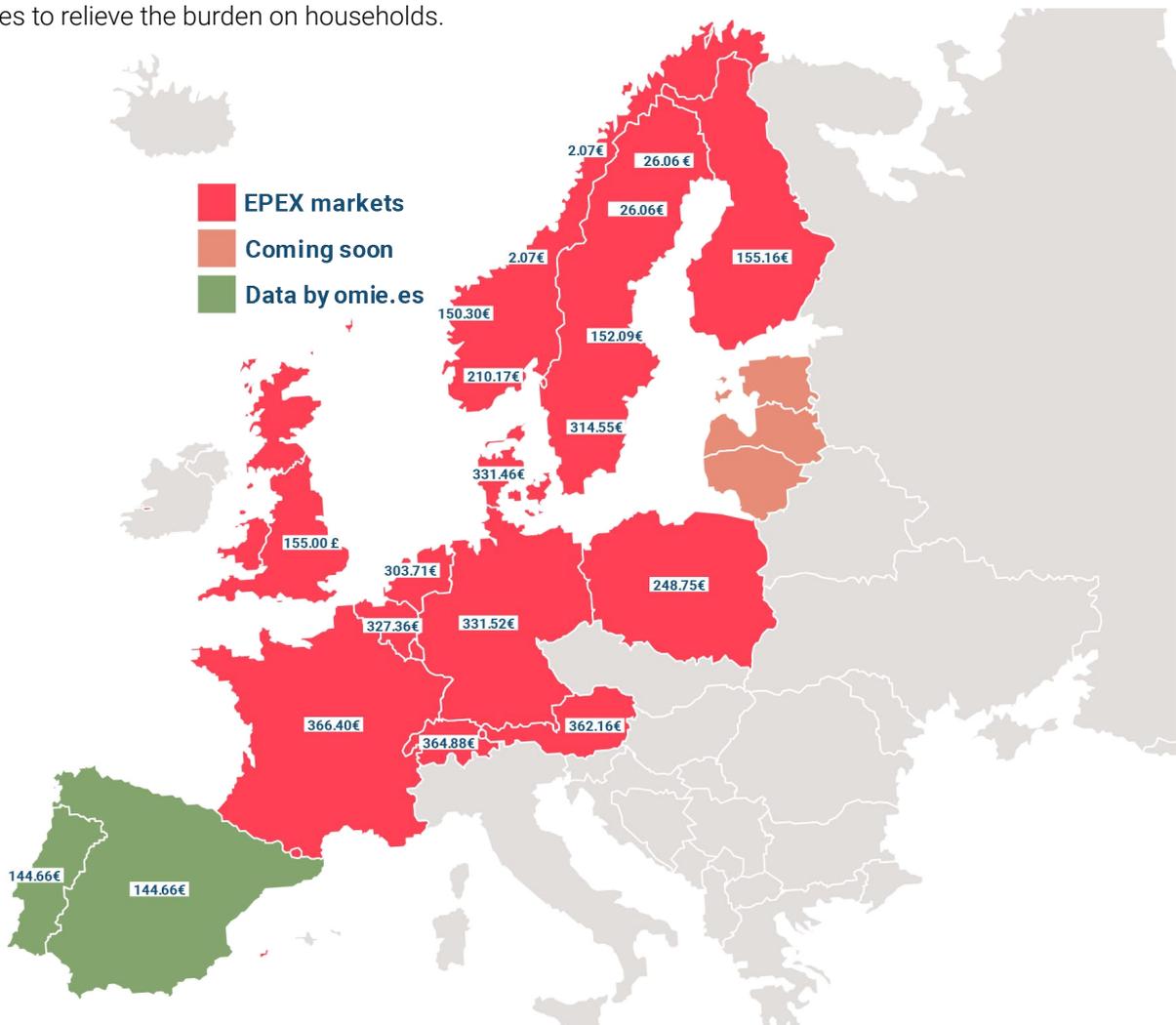


Figure 1: EPEXSPOT Market Data, Trading Day 27/6/22, Delivery date 28/6/22

Source: epexspot.com, omie.es

Demands

The Austrian Chamber of Labour demands the following measures to obtain affordable prices for all – households, commerce and the industry:

- In the short term: A **decoupling of the electricity price from the gas price** is necessary; a gas price cap should be considered. Spain and Portugal can serve as examples.
- In the medium term: A **reform of the energy market design** is needed. The electricity market design is not fit for a high share of renewables. Also in a decarbonized electricity system, flexible power plants, probably gas-fired power plants, will be needed and therefore determine the price of electricity. This would make the most important renewable energy source, electricity, unnecessarily expensive.
- We need **action against financial speculation in the energy sector**: a competition law review of the energy stock market is needed. Additionally, a ban on high-frequency trading and the introduction of a financial transaction tax is necessary.
- Also, **windfalls profits have to be skimmed off** by a tax, regarding profits of all energy companies, i.e. power generators and the fossil sector.
- And of course, we have to **protect those who really need it**: regulated tariffs for vulnerable and/or energy-poor households are clearly needed in addition to an increase in social benefits and transfers.

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