Europe’s energy security crisis: Outlook and responses

Market Report

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Rāpopoto - Summary

- The European Union (EU) is accelerating its efforts to address the ongoing energy security crisis. The crisis is attributable to Russia’s escalating restrictions on the supply of natural gas to Europe. Those restrictions are in retaliation against Western sanctions on Russia for the illegal and unprovoked invasion of Ukraine. Energy will remain at the top of the EU’s agenda over the coming months, as European leaders grapple with managing demand reduction, spiralling energy prices, the challenges of sourcing alternative gas supplies, and a cost of living crisis – with inflation having increased to nearly 9 percent.
- Major efforts are under way both to secure the EU’s energy supply to keep households warm and industry operating over winter, and to limit the cost of that supply to consumers. The energy crisis will have major impacts on the EU’s economic policies, and potentially on other areas, such as climate policy and the response to the invasion of Ukraine.

Pūrongo - Report

The EU is facing an unprecedented energy security crisis as Russia continues to constrain natural gas supply. Since its invasion of Ukraine on 24 February, Russia has halted or drastically reduced exports to a significant number of Member States. Characterised as “energy blackmail” by European Commission President von der Leyen, Russia’s systematic reduction of energy exports to Europe has contributed to skyrocketing wholesale gas prices. Households and industry are experiencing substantial increases in their costs, given the linkage between gas and electricity costs in Europe. The situation is expected to worsen as Europe enters winter, when energy demands increase.

Proposed new measures

Addressing high energy prices, and taming demand, is at the top of the EU’s agenda over the coming months. President von der Leyen announced a range of energy proposals on 14 September, including electricity demand reduction measures, a revenue cap on electricity generated by renewables, coal and nuclear (“inframarginal producers”), and a windfall charge on the fossil fuel sector.

The proposed **electricity demand reduction measures** include a requirement to reduce electricity consumption by 5% during peak hours, and an overall reduction of 10% until 31 March. The **temporary revenue cap** on “inframarginal producers” will see revenue earned above cap collected by EU Member State governments, and applied to reduced consumer energy bills. The windfall charge (or “temporary solidarity contribution on excess profits”) will be a one-off levy on profits from the oil, gas, coal and refinery sectors. Profits more than 20% over the average profits of the past 3 years will be re-directed to energy consumers.

These EU-level measures are in addition to the interventions that individual Member States have announced. Almost all Member States are implementing some form of support for households, including price subsidies to mitigate public discontent.

EU efforts to diversify supply

EU leaders continue to develop relationships with other energy-rich countries so as to ensure the EU’s energy security (primarily the supply of gas). While Russia’s illegal invasion of Ukraine is a major contributing factor in the EU’s energy crisis, it is not the only one. It also reflects investment decisions that have favoured fossil fuels rather than renewables; reductions in French nuclear energy production; and recent droughts in Europe that have hampered hydropower output and coal transport.

The impact on consumers and households remains unclear and will vary across the bloc. Observers suggest that the main issue will be affordability of energy, rather than supply. Widespread or major black or brownouts, or energy rationing, are considered to be unlikely.

Outlook

The energy crisis has been brewing for many months, and coincides with a range of other economic pressures including elevated inflation, supply-chain problems, and exchange rate challenges. To date most of Europe's policy responses to high energy costs have been made by individual EU Member States. France, Germany, Spain and Italy, for example, have all announced measures to reduce the financial burden on consumers. The proposals announced by Ursula von der Leyen on 14 September are the European Commission's attempt to address the crisis on a bloc-wide level. The very different size, resources and circumstances of the 27 Member States means that the proposals might change in the course of negotiations.

The EU's successful response to the Covid-19 crisis is an example of its capacity to innovate and act collectively in a crisis. The EU's evolving response to the energy crisis will have implications for its future economic growth and its ambitious climate change agenda. The proposals are intended to build on the EU's existing "RE-PowerEU" strategy. They are also intended to reinforce the Commission's "Fit for 55" proposed de-carbonisation programme, which includes a wide-ranging reform of the EU's carbon market, such as the phase-out of pollution subsidies under a Carbon Border Adjustment Mechanism (or "CBAM"), and banning the sale of combustion engines vehicles from 2035.

The complexity of Europe's energy markets and infrastructure, and the very different energy profiles of the EU27, mean that the Commission will have its work cut out in achieving an effective and coherent bloc-wide response to the crisis.

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