

Cold Death by Neoliberalism

The Political Economy of Fuel Poverty

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Scotland has some of the worst statistics in Europe for winter deaths among older people. Most of these deaths do not happen dramatically. Hypothermia cases are rare. But many result indirectly. Strokes occur when the body compensates for lowered temperatures by concentrating the blood in the main organs – which are less able to cope when people are old. Bronchial illnesses are also much more prevalent. In the UK, “last winter, more than 25,000 older people died as a result of cold-related illnesses.”¹

Why should this be when Scotland has milder winters than the rest of the Europe? There are two immediate reasons.

The first is the poor standard of housing. The second is fuel poverty. The 2002 Scottish House Condition Survey found that 76 per cent of houses in Glasgow failed to meet housing quality standards. In ex-council stock the figure was 86 per cent. On top of this people are increasingly unable to afford to heat these houses.

Already in 2002, when gas and electricity prices were at a historic low, the Scottish Executive Fuel Poverty Statement found that 55 per cent of all older people were in fuel poverty – that is, having to spend more than 10 per cent of all income, including housing benefit and their winter fuel allowance, to heat their homes adequately. Excluding pensioners, 55 per cent of other households on benefits were also in fuel poverty.²

Since then fuel prices have increased by 77 per cent and the number of households in fuel poverty has risen from 282,000 in 2002 to 646,000 at the end of 2006. One third of all Scottish homes is now affected.

To adequately heat their houses, single pensioners dependent on pension credit have to spend 16 per cent of their income – in reality much more as their housing benefit goes direct to their landlord. Additionally, housing benefit is effectively capped with any shortfall having to be met by the individual. A single pregnant woman dependent on income support would have to spend 42 per cent of their disposable income.³

This is because energy is more expensive in the UK. Electricity users pay 75 per cent more than consumers in Finland or Spain, 55 per cent more than in Sweden and Austria, 46 per cent more than in France and 24 per cent more than in Germany.⁴

So, again, we have to ask why this should be – when the North Sea provides over 90 per cent of the UK’s gas consumption and gas is a main source of its electricity generation?

It is this question which is the focus of this article. Our answer has a number of different layers but all ultimately come to the same thing: The UK’s energy prices are far more exposed to market forces than those elsewhere in Europe and these market forces, especially in their current guise, are geared to profit maximisation over very short periods.

There are three main causes. The first is the privatisation of energy sources and their distribution. The second is the liberalisation of the energy market. The third is the deregulation of financial markets. All these have been carried much further in Britain than elsewhere and it is their interaction that has produced the current crisis.

Privatisation of energy sources and their distribution

The UK’s energy sources were privatised between 1984 and 1990. These included coal, hydroelectric generation and the very considerable public

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assets in North Sea oil and gas. BP, 51 per cent state-owned, was the biggest producer. Britoil operated as the state-exploration and production firm. British Gas produced the bulk of gas output in the southern North Sea. The British National Oil Corporation created in 1976 had overall powers to purchase 51 per cent of all oil produced in the North Sea and, from 1982, would have had powers to impose depletion controls over private oil companies similar to those in Norway. Had these been used, the UK would still have had comparable reserves of oil and gas. All were privatised.

As a result, oil was pumped out of the North Sea quite profligately during the battle to break the power of the third world producers in the Organisation of Petroleum Exporting Countries in the 1980s. Much of the gas was just flared off. After that investment fell quickly and from the 1990s the big US and UK companies used their income from the North Sea to invest in the much more productive oil fields now available in the Middle East, Central Asia and elsewhere. Significant amounts of oil and gas remain but current investment levels make it unlikely that it will be fully extracted. Output is due to fall to half its peak level by 2012.⁵

However, the big oil companies continue to benefit. Global pressures on oil and gas supplies have made North Sea production almost uniquely profitable compared with other industrial sectors in the UK. This is shown in the figures released by the Office of National Statistics in January 2007. In 2006, while pensioners faced a 30 per cent increase in energy costs, the North Sea operations of UK companies yielded a 42.9 per cent return on capital.

Turning to the power industry, privatisation took place somewhat later, between 1988 and 1990. Here privatisation involved breaking up integrated gas and electricity systems into regional companies and separating the national grid from distribution.

Electricity privatisation was later described by a Department of Trade and Industry investigation as grossly favourable to the new private owners. The main academic study describes the profits of the new private companies as “massive” and far above the average for stock exchange quoted companies through the 1990s.⁶ The new companies achieved this by selling off property assets, liquidating reserves and cutting the industry’s overall workforce from 142,000 to 72,000.

It was the loss of these workers that did the most damage. If they had been simply surplus to requirements, then long-run efficiencies would have resulted. But this was not the case. They were the employees who possessed the knowledge and skills essential for maintaining the infrastructure – and also included a large slab of the research staff.

The 2004 Commons Select Committee on Trade and Industry concluded that there was now a “real danger” that the electricity infrastructure was deteriorating to a level where, as in the privatised railways, “it would take several years to repair”. Professor Robin Maclaren, Chair of the Electricity Association Networks Board, told the committee that it had been company policy to “sweat” the gold-plated assets inherited from the publicly owned industry and to undertake only minimal maintenance. The Select Committee entertained serious doubts as to whether sufficient levels of skilled personnel remained within the industry to undertake the work now required.⁷

Levels of research and development also plummeted far below other comparable countries. In 2002 the UK was spending \$68m on energy research and development against \$70m by Norway, \$89m by Finland, \$336 by Germany, \$523m by France, and \$4,524m by Japan.⁸

The long-term result for the UK’s gas and electricity industries has been under-developed and damaged infrastructures, high levels of energy loss, weak placement in renewable technologies and by 2006 inadequate generating capacity in electricity and inadequate storage capacity for gas.

Privatisation has, however, been very profitable for the investors, and remains so, and this brings us to the second strand of explanation: the impact of energy deregulation.

Liberalisation of the energy market

The neoliberal justification for privatisation is that it maximises consumer choice, ends state monopoly control and frees market forces to drive down prices through competition.

The problem in public utilities like energy supply is that such a market does not exist naturally and the government has to create it artificially and expensively. In the UK, this meant separating the ownership of the grid from generation and distribution and regulating both prices and investment. The regulator, Ofgem, assesses proposals for investment and then agrees to a proportionate price rise – calculating the return on capital very lucratively on the same basis as private finance initiatives.⁹

This, however, still leaves a quasi-monopolistic relationship with the consumer and this is compounded by another factor neo-liberal ideologists tend to forget, the tendency to monopoly in the private sector.

Throughout the last decade utility companies have returned a consistently higher operating surplus than the services industry generally and far more than manufacturing industry. This has had two consequences. The companies themselves have expanded very quickly into other areas and have themselves become targets for take-over. Their high and relatively risk free revenue stream is very attractive to big investors.

Scottish Power provides a typical example. Its asset base at privatisation was the generation and distribution network servicing central Scotland. Within a decade its profits had enabled it buy into power franchises across England, Ireland, Asia and particularly in the United States. By 2004, within a decade and a half of privatisation, over two thirds of its capital and employees were outside Scotland. Some of its more speculative investments in the US failed and its big investors started looking for a buyer that would maximise the value of their holdings. In November 2006, Scottish Power was sold to Iberdrola, the Spanish energy and real estate conglomerate.¹⁰

Scottish Power’s story demonstrates the degree

to which the income which should have been re-invested in Scotland's energy infrastructure and in developing new forms of carbon free energy went elsewhere. Today the eighteen energy companies created at privatisation have been reduced to six. Only two, Scottish & Southern Energy and Centrica (British Gas), remain as British companies.

So the net result of privatisation has been to create semi-monopolistic companies which are unaccountable to government while operating, to their own considerable benefit, within a government imposed framework which guarantees income but which also fragments energy supply, control of the grid and generation.

Deregulation of financial markets

The third strand of explanation concerns the impact of financial deregulation on how these companies operate and the way energy is traded.

In the decade after 1979 the UK lifted all controls over the movement of capital and today the City of London is the world centre for trading in shares, currencies and commodities. Much of the capital comes from elsewhere, mostly the United States, and the operation of the City of London as a world financial trading centre has had a profound effect on the UK economy.

The ownership and control of British companies has always been somewhat exceptional. Elsewhere in Europe, as in Germany and France, the typical pattern is for one or two shareholders to control dominant blocks of shares in major companies, to hold these long term and to oversee long-term investment programmes. Often these shareholders are state governments and sometimes banks, often in turn part owned by the state or local government. Long-term, interlocking shareholdings, generally with a degree of regional accountability, tended also to lead to synergies with other regionally based companies.

The high productivity and success of French and German energy companies, like the state-owned Electricite de France or E.on and RWE of Germany, rest on these foundations.¹¹

By contrast shares in British companies have always been far more actively traded on the stock exchange. Financial deregulation intensified this. Over a third of shares are now owned from overseas – most by US financiers and investment companies. Typically these investors will review their portfolios monthly. At any one time a company will have five or six big investors looking to the maximisation of investor value over the next twelve months.

Before it was sold Scottish Power went through two chief executives in as many years. They had no specialist knowledge of energy. Their training was as accountants and they had to respond to a handful of often very belligerent big investors wanting quick results.

However, in terms of the recent spikes in energy prices, it is another aspect of financial deregulation that has probably done most damage. The same financial institutions that speculate short-term in shares also do so in commodities. Increasingly they do so by betting on both future prices and derivatives that insure against risk. Recent studies indicate that the fourfold spikes in energy prices in 2001 and again in 2006 were significantly worsened by a flood of speculative money into the market.¹²

Elsewhere in Europe energy suppliers were far less vulnerable. France and Germany had integrated power companies with their own generating capacity. Usually these also have long term contracts for energy feed stocks. In Germany a big proportion is produced directly from renewables. The fragmented structure of the British industry left it much more vulnerable to market fluctuations. The separation of the grid from generation, and generation from retailing, amplifies market exposure and in part accounts for the scale of the price increases to consumers.

California experienced some of the more extreme consequences of a similarly liberalised energy structure in 2001. As in the UK, liberalisation was meant to guarantee maximum

efficiency through full competition. But it was not proof against private monopoly power. One of the biggest generating companies, Enron, bought up many of the others. It then decided to take a big slab of its generating capacity out of commission for maintenance and bet heavily on electricity futures. Unfortunately for Enron, as the price of electricity shot up and parts of California suffered blackouts, the state governor imposed a price freeze and the company's debt overload took it into bankruptcy.

As far as Scotland is concerned, therefore, the fuel crisis seems to have three origins. Privatisation of oil and gas wasted the long-term potential of North Sea reserves and did considerable damage to the efficiency of energy production and distribution. Energy liberalisation intensified tendencies to monopoly and made the industry more vulnerable to energy price fluctuations. Finally, financial deregulation put the UK at the centre of speculative activity by capital on a global scale.

This seems to be the reason why, despite the UK's unique possession of its own large gas and oil reserves, energy prices are today so much higher than elsewhere in Europe.

Are things likely to get better?

Current projections do not look good. Retail fuel costs in Scotland are likely to come down somewhat from their current highs over the next few months and liquid gas imports from the Middle East may ease shortages by the end of 2007. But over the medium run, world energy reserves will come under extreme pressure. The current world output of 85 million barrels of oil a day is unlikely to increase much above 90 million (some commentators say it has already peaked). Yet the US government expects its domestic consumption to rise from 20m to 26m barrels over the next decade. The combined demand from India and China has doubled from 4m to 9m over the past five years and is likely to continue to increase at the same rate.

In these circumstances price spikes of the kind experienced in 2006 are bound to recur. The UK will be particularly vulnerable. By 2020 the government estimates that there will be a 75 per cent dependency on imported supplies of energy of which the biggest part will be gas.

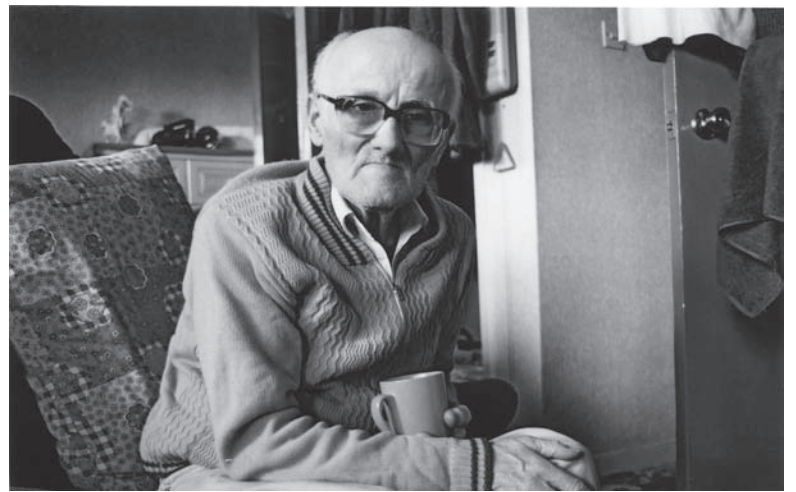
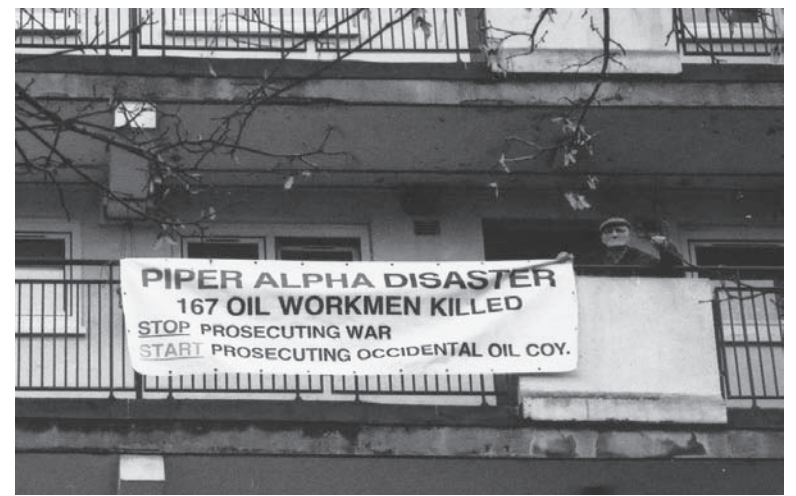
Nor does it seem likely that the control of energy will become any less monopolistic. The British government is pushing strongly for the full implementation of the EU directive on energy that would dismantle state owned companies across the continent and again split control of the grid from generation and distribution. This is likely to intensify the growth of pan-European monopolies.

The government's main response to the crisis is to push for more nuclear power stations to replace those that will be phased out in the 2020s. But again the controlling companies have been privatised – the research and development arm as recently as two years ago – and a heavy price will have to be paid by consumers to subsidise what is a very expensive form of energy and to meet the costs of nuclear decommissioning.

As far as Scotland is concerned, the Scottish Executive's June 2006 Response to the UK Energy Review stresses its commitment to renewables. It expresses the hope that the British government will increase the financial incentives for companies to expand their renewable portfolios from wind power to marine power, biomass and clean coal technologies. It also details its steps to combat fuel poverty by insulation programmes and the installation of central heating – so far extending to about 10 per cent of homes.¹³

But it does not state the obvious. Privatisation in energy has failed about as disastrously as it has in transport – and with probably far more lethal consequences for the future. If policy continues to rely on very large private companies with increasingly remote ownership, the problems can only get worse.

Tackling fuel poverty is best done locally. It requires community energy provision: combined heat and power plants, heat pumps (only really



efficient on a combined locality basis) and micro-generation systems. To tackle the overall problem of ensuring cheap sustainable energy for the next generation, there needs to be massive planned investment immediately in research and development that can maximise the efficient and clean use of Scotland's remaining fossil fuels and harness its renewable energy.¹⁴

Neoliberal economics cannot do this – although it will certainly continue to deliver very high profits and more cold deaths for pensioners.

The late Gavin Cleeland, a campaigner and father of one of the victims of the Piper Alpha disaster.

Notes

- 1 <http://www.helptheaged.org.uk>
- 2 Scottish Executive Fuel Poverty Statement, 2002: paragraphs 3.3, 5.6, 5.9: some of the flaws in the government's approach to fuel poverty are outlined in Brenda Boardman, 'New Directions for Household Energy Efficiency', *Energy Policy*, vol. 32/17, November 2004
- 3 Energy Watch press release, 6 December 2006
- 4 Energy Advice, November 2006
- 5 Energy White Paper 2003, HMSO; OILC published a study in September 2006 based on data from 600 wells warning of rising water content and a much faster level of decline *Sunday Herald* 10 September 2006. The wider political economy of North Sea oil is examined by Charles Woolfson, *Paying for the Pipe: Capital and Labour in North Sea Oil*, Mansell, 1996
- 6 Massimo Florio, *The Great Divestiture: Evaluating the Welfare Impact of British Privatisations*, MIT, 2004
- 7 House of Commons Select Committee on Trade and Industry, Third report Session 2003-04, The Resilience of the National Electricity Network, 2 March 2004
- 8 International Energy Agency website.
- 9 Dieter Helm pointed out these problems shortly after privatisation 'British Utility Regulation Theory', *Oxford Review of Economic Policy*, 1994, 10/3
- 10 Sandy Baird et al., 'Ownership and Control in the Scottish Economy', *Red Paper on Scotland*, ed. V. Mills, Glasgow Caledonian University, 2005
- 11 Bruno Amable, *The Diversity of Modern Capitalism*, Oxford University Press, 2003
- 12 Jeremy Grant, 'How Traders May Distort Energy Costs', *Financial Times*, 25 January 2007
- 13 *Scottish Executive Response to the UK Energy Review*, June 2006
- 14 Some these issues are examined in J. Foster, 'Scotland's Energy Crisis', *Red Paper on Scotland*, ed. V. Mills, 2005