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Green energy could kill Britain's economy

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George Osborne needs to act fast if we are to benefit from falling gas prices in the rest of the world

The Chancellor is to knock £50 off the average energy bill by replacing some green levies with general taxation and extending the timescale for rolling out others. On the face of it, the possibility that global energy prices may start to fall over the next few years might seem like good political news for him, and some of the chicken entrails do seem to be pointing in that direction. There is, however, a political danger to George Osborne in such trends .

For Government strategists reeling from the twin blows of Ed Miliband's economically illiterate but politically astute promise of an energy bill freeze and the energy companies' price hikes, the prospect of lower wholesale energy prices might seem heaven sent. But in many ways it only exacerbates their problems, for the Government is right now fixing the prices we will have to pay for nuclear, wind and biomass power for decades to come. And it is fixing those prices at quite a high level.

The more that oil, gas and coal prices drop, the worse these deals look and the more they threaten our economic competitiveness. The Liberal Democrats have not allowed the Chancellor to cut subsidies for the renewable energy industry, the most regressive redistribution of wealth since the Sheriff of Nottingham was in his pomp.

They argue that what has driven energy bills up threefold in ten years is mainly an increase in the wholesale price of energy, rather than any great lurch towards subsidising renewables. True, but most of the lurch is yet to come and as wind power capacity quadruples by 2020, it will add £400 to average bills — not to mention driving up the price of energy to industry, which will pass it on to consumers.

"There is not a low-cost energy future out there," said Ed Miliband when Secretary of State for Energy and Climate Change in 2009, at the time an enthusiast for discouraging energy use by price rises. It even became fashionable to argue, when Chris Huhne filled that post, that higher prices would cut bills (yes, you read that right) by encouraging people to use less power.

Anyhow, the forces that have driven energy prices up in recent years appear to be fading. Consider some of the reasons that oil and gas prices rose in 2011, the year energy companies pushed up prices even more than this year. Japan suffered a terrible tsunami, shut down its nuclear industry and began scouring the world for gas imports to keep its lights on. At about the same time Libya was plunged into civil war, cutting off a key supplier of gas. Add in simmering

tension over Iran, Germany's sudden decision to turn its back on nuclear power, the legacy of a couple of cold winters and the lingering depressive effect on oil and gas exploration of low energy prices from much of the previous decade, and it is little surprise that oil and gas producers pushed up prices.

Contrast that with today. Several years of high prices have driven a surge of new exploration. Deep offshore technology is advancing rapidly and huge gas fields have been found in the Mediterranean and in the Indian and Atlantic oceans. In the United States, the shale revolution has glutted both gas and oil markets, displacing imports. Iran is coming in from the cold, Libya is back on stream and Australia is preparing to export huge volumes of gas. Should the rest of the world start producing shale gas — China, Argentina, Poland and others are on the brink, even Britain might one day deign to join them — that would further add to supply.

A decade is a long time in energy policy. Ten years ago, no less an oracle than Alan Greenspan told Congress: "Today's tight natural gas markets have been a long time in coming, and distant futures prices suggest that we are not apt to return to earlier periods of relative abundance and low prices anytime soon." Abundance and low prices are exactly what America now has: so much so that it is using gas instead of coal to provide base-load electricity, investing heavily in manufacturing and chemical industry, and shifting some of its road transport from oil to gas. By 2020, shale gas will have boosted the American economy by £500 billion, 3 per cent of GDP and 1.7 million jobs, according to McKinsey Global Institute.

Meanwhile, the argument that the running out of fossil fuels is what has been driving up prices has been proven once again, for the third time in my lifetime, to be bunk. America, the most explored and depleted oil and gas field in the world, is now increasing its oil and gas production at such a rate of knots that it is heading towards self-sufficiency. If an oil field as gigantic as the Eagle Ford can be found (through technological innovation) in Texas, think how much awaits explorers in the rest of the world. Even five years ago, gas was thought likely to be the first of the fossil fuels to run out. Nobody thinks that now.

At least nobody outside Whitehall. As Professor Dieter Helm told a House of Lords committee last month: "I think one should be very sceptical about this Government and the last Government embarking on policies that require them to assume that the oil and gas prices are going to go up and then pursuing those policies and not being willing to contemplate the consequence of that not being the case." According to Peter Atherton of Liberum Capital, the recent "strike price" deal with EDF to build a nuclear power station at Hinckley Point in Somerset will only look good value to consumers if gas prices more than double by 2023.

Suppose, instead, world energy prices come down, even as the cost of subsidising renewables and nuclear starts to bite. We will have rising energy bills while the rest of the world has falling ones. That is a recipe for job destruction.

One of my favourite charts – I know, I should get out more – comes from Professor Robert Allen of the University of Oxford. It shows the cost of energy, as measured in grammes of silver per million BTUs, in various world cities in the early 1700s. Newcastle stands out like a sore thumb, with energy costs much lower than London and Amsterdam, and far lower than Paris and Beijing. The average Chinese paid roughly 20 times more for heat than the average Geordie. This meant that turning heat into work (via steam engines) throughout the north of England was profitable. In China, by contrast, it made more sense to employ lots of people, on low wages . The result was an industrial revolution in Britain with innovation and rising living standards and an "industrious" revolution in China (and Japan) with falling living standards.

Affordable energy is the indispensable lifeblood of economic growth. Back in 2011, David Cameron was warned by an adviser that electricity, gas and petrol prices were of much greater concern to voters than any other issue, including the NHS, unemployment, public sector cuts and crime. If subsidies for windmills prevent us from passing on any future falls in gas and oil prices, and jobs flee to lower-cost countries, the voters will not be forgiving.