Opinion of the Chief Economist of the Union of Entrepreneurs and Employers on rising prices of raw materials for energy

Prices of raw materials used for energy production have increased drastically over the last year. It was all the more dramatic as the recession that took place due to the COVID-19 pandemic lowered those prices “temporarily” to their lowest levels in more than a decade. Over a dozen or so months, prices rose from exceptionally low to extremely high. The global law of one price does not apply to natural gas and prices are still regionally shaped. In this case, price increases in Europe proved to be particularly steep. In Poland, the severity of high prices of some of these raw materials is further exacerbated by the unfavourable situation on the foreign exchange market.

The price increase in energy raw materials significantly impacted the inflation dynamics through rising costs of electricity, transport, and heating. In Poland, this is partially neutralised by the national coal policy. State-owned mining companies concluded some time ago long-term contracts for the supply of hard coal to Polish energy producers. Back then, it was supposed to protect, at least on a basic level, the interests of the hard coal sector. Last year, it meant the cost of coal was several dozen percent higher than market costs. This year, however, coal prices at least twice as low as in Europe.

Should prices of energy raw materials stabilise at an elevated level, this would result in a relatively short-term inflation spike. However, should the growth trend in this sector turn out to stay with us in the medium-term (which is hard to imagine today at the current prices), it will result in constant inflationary pressure. Already today, in the context of inflation caused by both internal factors and the external pressure on prices of energy raw materials (and consequently on prices of energy in various forms), there is talk of a social inequality becoming more severe. We are approaching the point where an increase in nominal wages will be tantamount to a decline, not an increase in real wages. This will be a mighty blow to the lowest-income groups who spend a major part of their salaries and wages on goods and services whose prices are particularly sensitive to energy prices and transport costs, such as food.

The sources of this increase are diverse. The increase in demand compared to the previous year due to economic growth (recovery after the deep slump the year before) played a critical role. Supply chains becoming longer or broken as well as the cold winter in the northern hemisphere contributed to this too. It seems, however, that one of the most principal factors in this case turned out to be the green policies for preventing climate change and limiting greenhouse gas emissions.

One must stress the fact that the challenge of rising prices of energy raw materials in Europe is not a short-term one. Apart from global factors, the increase in prices is influenced by regional conditions, including a high degree of monopolisation of supplies and climate policies. These policies, based on ambitious plans for a rapid reduction of emissions (as provided for in EU's strategic agendas: European Green Deal and Fit for 55), are to bring about swift results in the most emission-intensive sectors of the economy, e.g. transport, energy and heavy industry. Natural gas, until recently considered a transitional fuel, plays a key role in European energy transformation (and in achieving the EU's goal of climate neutrality). As Europe is dependent on natural gas imports, and the energy transformation is driving demand for gas, its suppliers gain strong political leverage. This applies particularly to Russia's policy, although the uncertainty (expected and unassumed) of supplies from North Africa also raises concerns. Moreover, growing demand for gas in Asia has made Europe (and especially the EU) compete directly with Asian buyers. Since demand in Asia in recent years has started to exceed that of Europe, we are slowly becoming, to a certain degree, the price taker. This is also due to the development of maritime transport of LNG, as well as investments in a network of gas pipelines connecting Russian deposits with recipients in Asia.

Europe has been hit awfully hard this year by the crisis on the market of energy raw materials. Technological conditions and political choices mean that we can expect long-term problems due to soaring prices of fossil fuels and the ability of safely meeting the demand. These problems can significantly affect the quality of life of Europeans. First of all, directly through the price mechanism: increases in energy prices in various forms (electricity, heating, or fuel) may become gut-wrenching and indirect, because they will further boost inflation. Then, there is the risk of temporary shortages of fuel (which we have seen take place recently in the UK, already outside the EU) or gas or electricity (in the form of blackouts). An additional consequence may be such a high increase in production costs in the manufacturing sector that it will affect the development potential of European industry. We would then have to give up our dreams of a European re-industrialisation.

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Such a negative impact on the quality of life (and possibly the dynamics of development), should this process prove to be permanent, may in turn spark a redefinition of the European political scene. It is therefore worth paying attention to the situation, because the mixture of (excessively?) ambitious climate policy goals, dependence on external gas suppliers, and unexpected turbulences in global markets may affect not only the fate of climate policy in Europe, but also the internal cohesion of the entire community.

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