

About populism and economic ignorance: all the mistaken myths about the gas and electricity prices in Israel - Globes (Eli Zipori)

Natural gas is responsible? The price of gas can be cut by 50% and thus reduce electricity prices by 20% - it's all so simple, so easy and also populist and simplistic up to being ridiculous



The hike in the electricity prices was also the time of rejoice for all the populists who immediately penned this event as their usual discovery of some hidden treasure, and they blamed the price of natural gas.

So many inexact numbers and figures were floated into the air, including the simplistic ordainment and determination which turned into a real slogan, also used by senior politicians: the gas price can be cut by 50% and in this manner reduce the electricity price by 20% - its so simple to do, so easy and also populist and simple up to be ridiculous.

The subjects of gas and electricity are so complex and so complicated that there are very few journalists who can really understand the intricacy of these obscure facts and anyone who tries to present himself as though he can, is not true to reality. Therefore, each time that an important issue arises on the matter of gas or electricity I go to the experts whose honesty and professionalism I trust. As people who represent energy companies, as well as consumers and financiers, they are automatically regarded as “suspect” and in the Israeli public debate that has arisen, their views are thus discarded by those who don’t want to know. But this is the major mistake in this debate that is based on feels and on facts, or rather on fictive facts. In fact, the fictive fact that gas represents 40% of the electricity tariff - is fake news - and this can be checked not from those “who are suspect” but rather with the PUA or IEC. You are all already familiar from my column with Gina Cohen a global expert on natural gas and a lecturer at the Technion, and she was joined in this interview with Miki Korner a well-known economist and engineer in the sector.

You must have heard all the “festival” surrounding the electricity tariff and the final decision not to increase the tax on coal. At the end of the day, it was

declared that the electricity tariff would increase by 2.9%. Were you surprised by the original rate of the hike?

“Like all the other citizens, we were not happy at the electricity tariff hike that was supposed to increase by 6.3% and even more, but we knew this was about to happen for a very simple reason: in 2017, 45.2% of IEC’s electricity generation was still based on coal, a figure which remained high also for the first 9 months of 2019 at 42.9%. The price of coal according to IEC’s financial books increased in 2017 from 299 to 393 NIS a ton, a 31% hike. According to the estimates published this month by the PUA, the price in 2019 will be 499 NIS per ton, a further 14% increase.

In order to reflect some of the environmental harmful costs of coal, the Finance Committee of the Knesset decided in March this year, to increase the excise tax on coal from 46 NIS to 102 NIS a ton. The price of global LNG also increased this year by 37% compared to last year. In addition, the increase in the amount of renewable energy was imposed on the electricity tariff. Therefore, when the components that affect the price to generate electricity increase, so too the tariff is due to go up and so there was no great surprise here”.

But the issue that made the most noise in the media was in fact the price of natural gas that became the main “culprit” in the hike of the electricity tariff

“We were in shock when we saw the sweeping blame accusing the price of gas for the current hike in the electricity tariff in particular and even the cost of living in general. The biggest farce took place in the debate in the Economic Committee of the Knesset on 18th December, when the chairman of the Committee, Eitan Cable opened the debate with the following declaration: ‘the corrupt contract of the gas monopoly is the original sin and was a death blow to the cost of living’.

“These words can easily be rebutted with facts from IEC’s reports for the first nine months of 2018. In IEC’s table that provides the details of the changes in fuel prices one can see that the cost of coal increased from 224 million NIS, that of LNG increased by 49 million NIS whilst the cost of natural gas only increased by 9 million NIS. Namely, the contribution of the hike in the gas price to that of the total cost of IEC’s fuels is small and the impact of the gas price hike on the price hike of electricity is really negligible.”

“The lack of correlation between Cabel’s claims and the facts, can also be seen from the 2017 reports. The cost here of the change in coal cost was another 768 million shekels, whilst the cost of natural gas fell by 184 million shekels (!) despite higher consumer. This was mainly because of the fall in the dollar exchange rate”.

Some of the speakers in the Knesset debate claimed that the cost of gas production in Israel amounts to 30 cents per unit of energy and that this is being sold by the gas companies to IEC at \$6 per unit of heat

“Firstly, one has to calculate both the cost and the final price averaged over 30 years, over the life span of the gas field.”

“Then, one has to remember that the cost of operating the platform is not the only cost of production. One has to calculate all the expenses: the exploration and development

costs (\$4.5 billion), the need for more development/investment over the years, the state royalties based on revenues without being able to offset the costs, opex + insurance, the Sheshinski tax which is not yet being paid, financing costs and corporate taxes from which expenses are deducted. All these expenses must be divided up over the full volume of gas throughout the whole period of the field's lifespan".

Avi Gabbai said during the same debate that the electricity tariff could be cut by 20% if the gas price is drastically cut. Yaron Zelikha also repeated this claim

"This is a ridiculous contention because the payment on the gas from the Tamar field represents 16% of IEC's power generation costs and therefore even if the gas was given away for free it would not be possible to reduce the electricity price by 20%. In order to meet the expectations of the chairman of the Zionist Camp to reduce the electricity tariff the gas suppliers and the infrastructure transmission companies would have to pay IEC to consume the gas.

On a more serious note, and once again we are referring to figures and facts from IEC's reports that show the minimal impact that the natural gas price has on the price of electricity. For example, according to the 2017 reports, the price of gas was 1,208 NIS per ton compared to 1,258 NIS per ton in 2016 (IEC shows the cost per ton with 1 ton being 52.4 MMBtu). This was a decrease of 4% in the gas price, stemming mostly to a lower dollar exchange rate compared to the shekel, but it didn't lead to a fall in the electricity price at that time. The PUA estimates that in 2019 the gas price will increase by 1% linked to the US CPI, all this of course depending on the volatility of the currencies. In any case, these changes have only a marginal impact on the electricity tariff."

You talk about the past. What will be the price of natural gas in the future and what will be the state's influence, if any, on determining the tariff?

"Past experience in Israel shows that the state should not decide what will be the price of gas and not set a price indexation mechanism that is not what is the accepted norm in the world. After all, all the fuss is because the state did not accept the proposal reached between the gas companies and IEC to link the price of gas as is the norm to global energy prices and wanted instead to establish stability in the price and by doing so distorted the price in Israel. Beyond being responsible for the construction of supply and transmission infrastructure, the state should enable the conditions for and ensure that a competitive gas market develops and/or ensure there are a number of supplies with different ownership, and this has been achieved. The state must determine that the natural gas prices in Israel are linked to global energy prices - namely to oil or to gas hub prices of a number of countries, or any other international index that cannot be manipulated".

I followed the debate in the Knesset, and I didn't see you speak up or even notice that you were present during the debate. Why did you not fulfill your civic duty, go to Jerusalem and why did you not participate in the democratic process by contributing to the debate?

Cohen: "the economic committee prevented us from participating in the committee's debates. The manageress of the committee, Lea Varon, on behalf of MK Cabel,

rejected my request to participate in the meeting and wrote to me: “we had to reject a number of other professional people who approached us with a request to participate in front of the committee’s members because of a lack of physical space (instructions given by the Knesset’s security office determine the number of people who can enter the Knesset rooms)... and therefore you cannot come to the committee”.

Korner: “I came to the Knesset as the representative of the Manufacturers’ Association and the Gas Forum, but at the entrance of the Committee’s room I was told by the security guard, repeatedly, that the chairman ordered “not to let anyone in except for the government representatives and the representatives of the social organizations”. I understood that Cable wanted to be heard and not listen. Shame”.

I presume you saw Prof. David Gilo’s response to me on the issue of the Most Favored Nation’s clause that was not allowed to be included at the end of the day in IEC’s gas contract because of his objection. Gilo claimed that an analysis by the antitrust authority showed that since IEC was a very big client, that if this clause had been allowed to be included, then the gas monopoly would not have agreed from the beginning to give any client a lower price”.

“Prof. Gilo is not precise. The antitrust authority cancelled the MFN clause that would have ensured that IEC could always pay the cheapest gas price sold by the Tamar field. The antitrust authority’s commissioner’s objective in this case, as the ATA declared at the time, was to support the private power generation sector which had not even yet been established at the time. The results of this decision is that IEC, a government company and the largest electricity generator and biggest supplier to the market is paying today a gas price that is higher than paid by a growing number of IPPs. The gas prices that the IPPs pay is connected to IEC power generation cost (and the latest hike in tariff proposed by the PUA increased the ‘system’ costs and not the power generation costs). Moreover, in 2018, half of the gas from Tamar is sold to IEC so that the claim of 2012 is no longer correct”.

“In this matter, we have to point out that the gas companies were not interested to link the gas price to the CPI but this was a decision taken by the PUA and the MOF - which demanded it. Their concern was in 2002 that the electricity price in Israel would increase sharply in accordance with the global oil price that is affected by extreme changes either on the political or climatic scene or because of global fundamentals. Therefore, the PUA/MOF preferred stability that the US CPI would provide. The oil prices however did not go up as they had feared, but instead fell sharply in 2014 whilst the gas price in Israel remained stable. Two years later, when the oil price started to increase, the gas price in Israel did not increase with it”.

“Had the PUA and MOF not intervened in the market, IEC’s gas price would have been linked to a basket of fuels and would in any case have fallen automatically (rather than increase) as global oil prices towards the end of 2014 fell. Today, IEC is paying more for its gas than all the small IPPs whose gas price is linked to IEC’s power generation costs (which the PUA has reduced), which enables them to in turn sell cheaper electricity to a limited number of industrialists.”

“Had the antitrust authority not intervened, IEC would have had the fall-back MFN clause (see explanations further on) which would have remedied the distortion and

IEC would have had a lower gas price which would have enabled them to sell lower price electricity to the public at large”.

“It is important to explain the concept of MFN clauses: this is a mechanism designed to increase efficiency in contracts by introducing price flexibility in long term contracts, as indeed a primary limitation of long-term contracts with inflexible prices is that it isolates the parties to the exchange from market-determined opportunity costs. MFNs help to facilitate efficient price adjustment in extended relationships.”

“The linkage however of the IPPs price is severed from global energy or gas prices and thus also from alternative fuels. This formula also fails to take into consideration the costs of further exploration and development of new gas fields nor does it take into consideration extraneous market costs, such as damage caused to the environment (on the negative side) or state revenues from taxes (on the positive front). “

What else contributed to the hike in the electricity tariff besides coal and natural gas?

“Over the last decade, the government and the Knesset took a number of decisions to support the use of renewable energy - and there was a price to pay with the implementation of these decisions: according to reports published by the PUA, the total payment made for renewable energy in 2019 is expected to amount to 2.7 billion NIS compared to 2 billion NIS in 2018. Two-thirds of this cost is a premium over and above the cost of conventional generation. Government support for this comes with a price tag, which will also be reflected in an increase in the electricity tariff.”

The main claim is that the Tamar field is so very lucrative and so there is room to reduce the gas price

“The Tamar field is indeed profitable, but not like described. Let’s look at it also from a wider angle. When the wells were drilled, the cost of each one is about \$100m, other fields were also discovered - Dalit and Dolphin in Israel and Aphrodite in Cyprus - none of these have hitherto been developed. The Karish and Tanin fields were sold as required by the government as part of the gas outline at cost price and the Leviathan field which is currently under development, 9 years after it was discovered, is moving ahead based on an uncertain market and without any government support”.

“Lets also look at the picture from the point of view of the field’s ownership. If the Tamar field was so phenomenally profitable as is claimed, then it is not clear why the companies which had to reduce their holdings as required by the gas outline, were unable to find even one international or for that matter local company that was willing to buy holdings in the project - and were forced in this case to sell at a relatively cheaper price on the stock market”.

The festival has faded out, the hike in the electricity tariff is now conditional on cancelling the hike in the excise tax on coal and elections are around the corner. What do you think will have from now going forward?

“The result of this onslaught on the gas companies will be more use of coal and a fall in investment in renewable energies. This could mostly lead to hurting the public’s health and damages to the market and the environment, because in addition to the

financial costs of using coal there is also an environmental cost that is estimated at 2 billion NIS per year (to use the scrubbers). This move will also hurt the attempts to interest international companies to participate in the new exploration tender published by the Ministry of energy for 24 new gas exploration blocks.”

“The public discourse in Israel is based on partially mistaken data and facts and this has also affected the Economic Committee of the Knesset. In our view, the committee must act transparently and enable professionals to express their views also if these differ from the opinion of the committee’s chairman. If MK Cabel wants to win the public’s trust he must act with impartiality, to allow well-founded and grounded claims to be expressed and sometimes also to listen”.