

Council for Economic Renewal

Energy Prices and Energy Intensive Industries in Wales

Purpose

1. To provide an update to the Council for Economic Renewal on the impact of energy pricing on energy intensive industries in Wales.

Action

2. The Council for Economic Renewal is asked to note the content of the Paper.

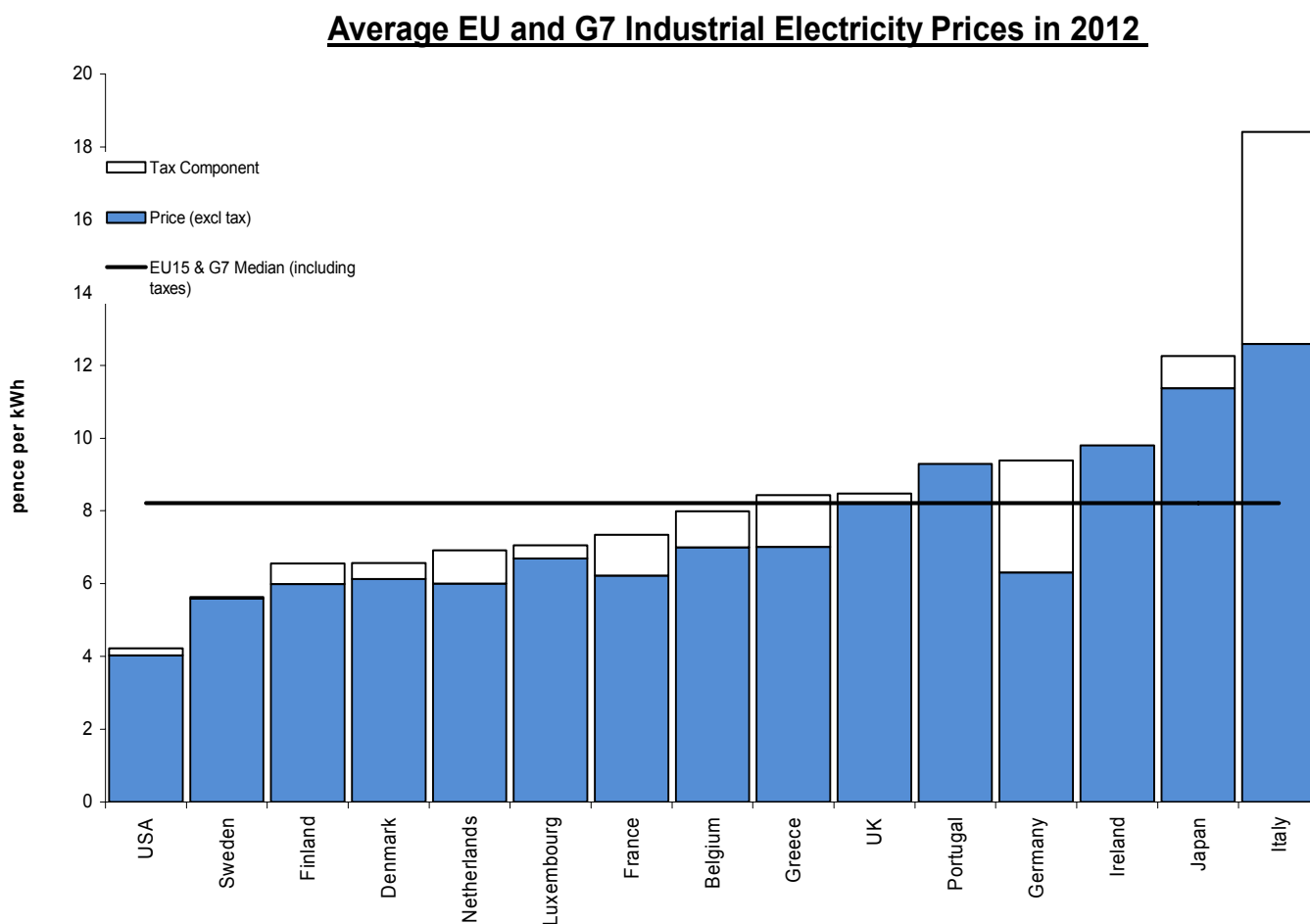
Background

3. The Welsh Government recognises the valuable contribution of energy intensive industries (EII) to the economy of Wales and the significant role that they play in providing the products to aid the transition to a low carbon economy. It is important that the competitiveness of these industries is safeguarded during this transition and that Governments, at all levels, effectively address the risk of carbon leakage.
4. Cabinet recently agreed to take the forward a green growth approach for Wales (the Council for Economic Renewal endorsed the green growth approach in June 2013), accepting that it is a key part of ensuring economic growth in Wales in the long term. The Welsh Government's drive to steer the Welsh economy on to a green growth trajectory will be an essential element to safeguarding the competitiveness of these energy intensive industries. This is because green growth is in essence a means to making the growth process:
 - Resource efficient,
 - Supporting of increased resilience in natural systems we depend on and
 - Low carbon where economically feasible.
5. EIIs are often defined on a sectoral basis, with sectors ranked according to the size of their electricity costs as a percentage of gross value added (GVA). Those industries or sectors with an energy intensity of 10% or more are often considered to be EIIs.
6. The Welsh Government works with Wales-based EIIs to understand the particular concerns of the respective sectors. It is clear that there remains concern about the impact of energy prices on EIIs and the UK Government's approach to supporting EIIs in the move to a low carbon economy.

Industrial Electricity prices in the EU and the G7 countries

7. The UK Government publishes comparisons of industrial energy prices by consumer size against other EU and G7 countries, using data from both Eurostat and the International Energy Agency (IEA). In 2012, the average UK industrial electricity price including taxes were the seventh highest in the EU15, fourth highest in the G7, and were 3.1 per cent above the EU15 and G7 median (see Figure 1). Prices in the UK excluding taxes were the sixth highest in the EU15, third highest in the G7, and were 19.8 per cent above the EU15 and G7 median.

Figure 1. Comparison of Industrial electricity prices in the EU and the G7 countries in 2012

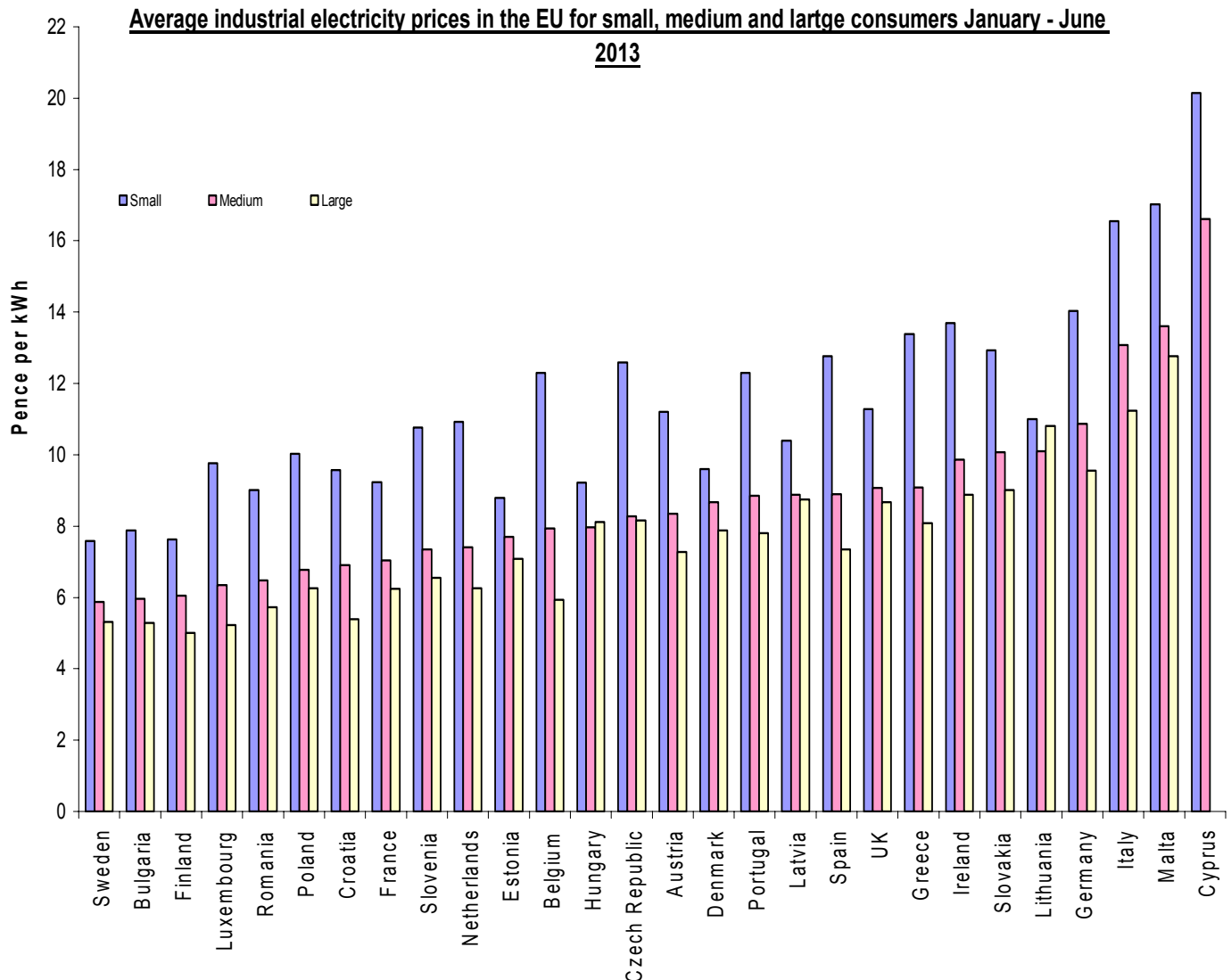


8. The UK Government estimates Industrial energy prices by size of firm: small, medium and large and very large. The definitions they use are as below.¹

Industrial Electricity	Eurostat size band	Annual consumption (MWh)
Small	Band IB	20 – 499
Medium	Band ID	2,000 – 19,999
Large	Band IE	20,000 – 69,999
Very Large	Band IF	70,000 – 150,000

¹ A change in methodology after 2008 means that these bands have changed.

Figure 2. Average industrial prices for small, medium and large customers in January-June 2013.



9. Average industrial electricity prices including taxes in the UK for medium consumers for the period January to June 2013 were the fifth highest in the EU15 and were 4.6% above the estimated EU15 median.
10. For large consumers the UK's prices were the 4th highest of the EU 15 with an industrial energy electricity price of 8.67 pence per kwh. This is 18.1% higher than the EU15 average of 7.34 pence per kwh.

Existing Policy Interventions

EU ETS Compensation Scheme and Welsh EU ETS installations

11. The European Union's Emissions Trading Scheme (EU ETS) places a cap on greenhouse gas emissions (GHG) from energy intensive installations. Installations must purchase GHG allowances which represent the right to emit a certain volume of emissions. The UK Government has previously estimated that energy and climate change policies could add up to 28% to the average electricity prices paid by large businesses in industries such as steel, chemicals, paper and cement by 2020. Following representations from industry and others, including the Welsh Government, the UK Government decided to introduce a scheme to compensate those electricity-intensive industries whose competitiveness may be most at risk to help offset the indirect cost of the EU Emissions Trading System, in line with the European Commission's published guidelines.
12. Under the compensation scheme only companies that manufacture goods that correspond to set European Commission categories will be eligible to claim compensation. Manufacturers of basic steel and iron, man-made fibres, paper and leather clothes are among those who will be eligible to claim.
13. Businesses involved in the manufacturing of the categorised items also, generally, will need to pass a '5% test', which involves them demonstrating that they are sufficiently exposed to electricity price increases in order to merit being awarded compensation.
14. The purpose of the 5% test is to ensure that the limited amount of compensation available is targeted at those businesses whose competitiveness will be most affected by an increase in the price of electricity – i.e. those businesses who operate in internationally competitive markets and which are electricity intensive.
15. It has been possible to submit applications to the compensation scheme since June 2013.
16. Alongside the EU ETS compensation scheme, there are 40 installations (not including energy generators) in Wales (held by 32 companies) which will receive free allocation in Phase III of the EU ETS (2013-20). Free allocation is granted to all industrial (i.e. non-electricity generating) installations, either on a transitional declining basis or in full to protect them from the risk of carbon leakage. In Phase II of the EU ETS (2005-2012) there were 56 permits held by 47 companies (including generators).
17. As well as consulting on the EU ETS compensation scheme in 2012, the UK Government also sought views on a Carbon Price Floor compensation scheme. The Carbon Price Floor is another form of levy on the supplies of fossil fuel used in electricity generation. It is designed to provide an incentive to invest in low-carbon power generation by providing greater support and certainty to the carbon price in the UK's electricity generation sector. Subject to EU approval having considered state aid rules, we understand that the UK Government will aim to introduce compensation plans for industry in relation to costs faced as a result of implementing the Carbon Price Floor.

Discounts for Bulk Buying of Electricity

18. In terms of issues around the bulk purchase of energy, it should be noted that Ofgem does not regulate end user prices, and unlike Ofgem's Retail Market domestic policies, there are no specific rules on discounts for the bulk-buying of energy. Prices for non-domestic customers, and particularly the largest, will be negotiated individually between the supplier and the end-user.

Welsh Government Support for the EII Sector

19. Whilst energy policy is a non-devolved matter, Welsh Ministers have raised with the UK Government on a number of occasions the high energy costs faced by EIIs in the UK compared with those of other European countries and the consequential impacts on EIIs in Wales, particularly in terms of future investments.
20. The Welsh Government has stressed the importance of the UK Government delivering on its commitment to compensate key electro-intensive businesses to help offset some of the indirect costs of energy and climate change policies and to ensure they are able to compete on a level playing field internationally. We have also highlighted the importance of agreeing the various approaches to Electricity Market Reform in a timely manner so as to provide certainty for the energy generation sector and consumers more generally. Long term certainty on EMR will help to reduce risks and costs faced by energy consumers.
21. The Welsh Government's Department of Economy, Science & Transport provides tailored flexible support for EII in Wales to enable long-term business development, for example through using the Environmental Protection scheme to assist companies in increasing their energy efficiency.
22. Officials in the Energy & Environment Sector Team work with industry to seek solutions for high and increasing energy costs and to this effect are working in collaboration with Sustainable Futures on the scope of future support to business on energy efficiency. The Welsh Government has reviewed the provision of energy efficiency advice to all sectors, and is establishing a well integrated service capable of providing a range of resource efficiency support that will meet current and future needs.
23. A rare opportunity exists for Wales in the transition to a green growth economic pathway. In the future, energy generation will likely be a blend of large scale strategic infrastructure and on-site medium scale commercially owned generation, as innovation makes smaller scale generation increasingly effective at lower cost. The possibility of on-site energy generation may help reduce the exposure of EII's to wholesale energy generation costs and hence help with their global competitiveness.

Recommendation

24. The Council is asked to note the content of the Paper.