

## **Annex 2C: International comparisons of gas and electricity prices**

- Wholesale gas prices in the UK have risen in 2006. This has caused industrial and domestic gas prices to increase and the UK's position relative to the EU average to worsen.
- UK gas prices in January 2006, including tax, are, however, still below the EU average for domestic users by between 35 and 45 per cent depending on consumption level, with estimates for medium consumers for July 2006 still indicating UK prices are significantly below the EU average. Estimates for July 2006 indicate that industrial gas prices for small and large consumers are around the EU average, while prices for medium consumers are above the EU medium price by around 20 per cent.
- Wholesale electricity prices in the UK have been on an upward trend since 2003. This has caused industrial and domestic electricity prices to increase and the UK's position relative to the EU average to worsen.
- UK electricity prices in January 2006, including tax, remain at or below the EU average for domestic consumers, with estimates for medium consumers for July 2006 still indicating UK prices are around or below the EU average. Estimates for July also indicate that industrial gas prices are above the EU average for all consumption levels except small consumers, by between 2 and 13 per cent depending on consumption level.

### **Introduction**

2C.1 Prices in Europe are an important comparator to prices in the UK. For industrial prices, these show whether the price of energy increases or decreases the competitiveness of UK enterprises relative to other European enterprises, while in the domestic sector they show whether the competitive market in the UK has delivered lower prices to customers. Special emphasis in this annex is given to comparisons to Germany and France, as well as relative to the EU average. On most domestic measures, the UK still remains at or below the EU average, despite recent price increases. However, prices in 2006 to industrial consumers have increased above the EU average price for many consumption levels.

## Gas prices

### Background

2C.2 As described in Chapter 2, gas prices for domestic consumers between 2000 and 2003 were at their lowest levels over the period 1970 to 2003 in real terms, but increased to around 1998 levels in 2004. Prices in real terms for 2005 are at around 1995 levels. Industrial gas prices have increased from their low point in 2000, and 2005 industrial gas prices in real terms including CCL are around 1988 levels.

### Wholesale gas prices

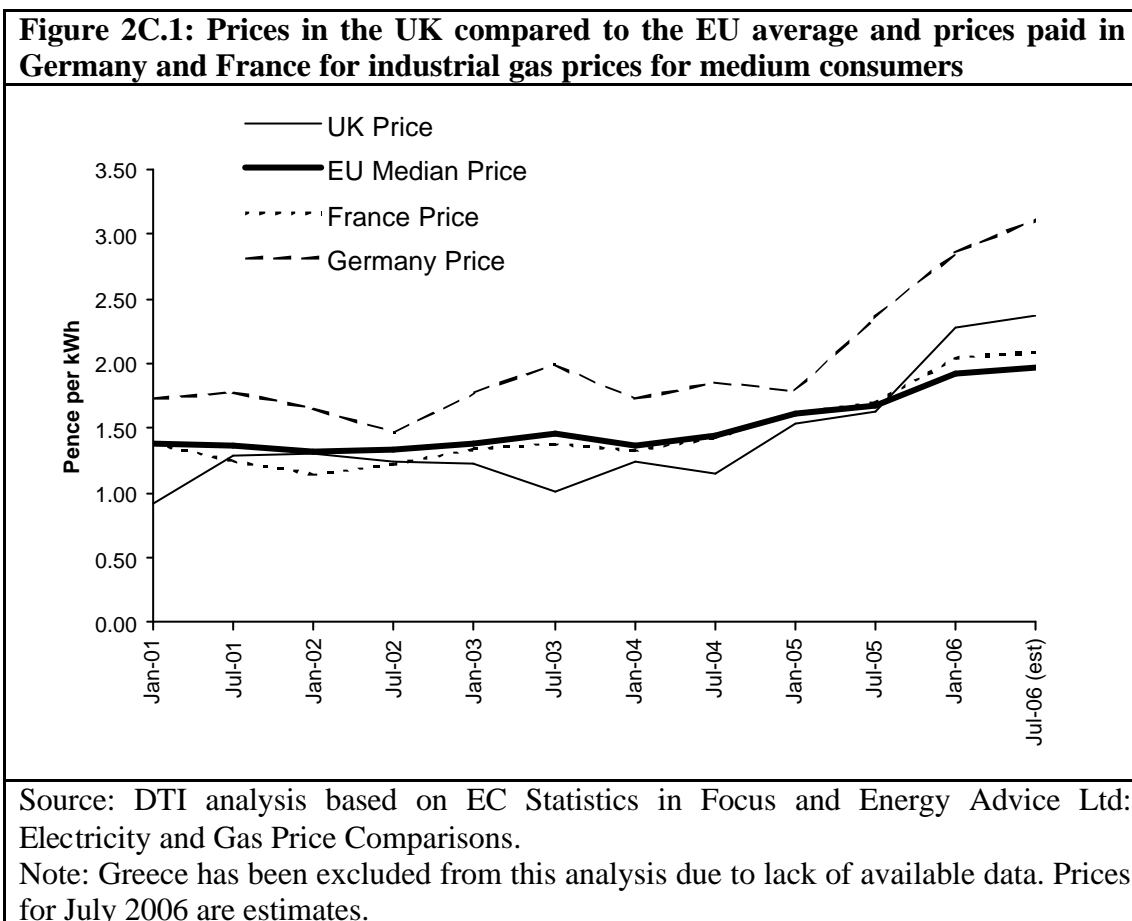
2C.3 Wholesale prices for gas are normally about the same at the Great Britain national balancing point (NBP) and the Zeebrugge hub in Belgium, because of the presence of the interconnector between the UK and Belgium. In theory, were the price in the UK to exceed that of continental Europe for a period of time, imports would flow into UK until the prices are balanced again. However, if the interconnector is in full export mode in either direction, no more imports are possible, and UK and Continental prices diverge.

2C.4 In the last year, wholesale gas prices in the UK have increased from around 31p/therm in gas year 2005 (which runs from October 2004 to September 2005) to 51p/therm in gas year 2006, or by 65 per cent. Much of this increase in spot outturn prices can be explained by the increase in oil prices, to which Continental prices are contractually linked, in the corresponding period from \$51/bbl to \$66/bbl, or by 28 per cent. The UK gas price was also affected by the tightness in the UK market over the winter period.

2C.5 Looking forward to gas year 2006/07, average wholesale price (using the expiry price at the end of September 2006 for the forward gas contract 2006/07) predict a similar outturn of around 51p/therm. For the corresponding period, using month-ahead contracts, (forward) oil prices have increased slightly to \$67/bbl. It should be noted though, that gas forward prices are not necessarily a good predictor of actual outturn gas spot prices in winter.

## Industrial gas prices

2C.6 Between January 1998 (the start of this survey) and July 2005, average UK prices have generally been within the seven lowest prices for countries in the EU, and were within the lowest three prices between January 2000 to January 2001, and January 2003 to July 2004. The largest prices have tended to be in Germany and Sweden, at around 40 and 60 per cent higher than those in the UK respectively. In July 2006, estimates for medium consumers suggest that UK prices have increased above the EU average price by around 20 per cent.

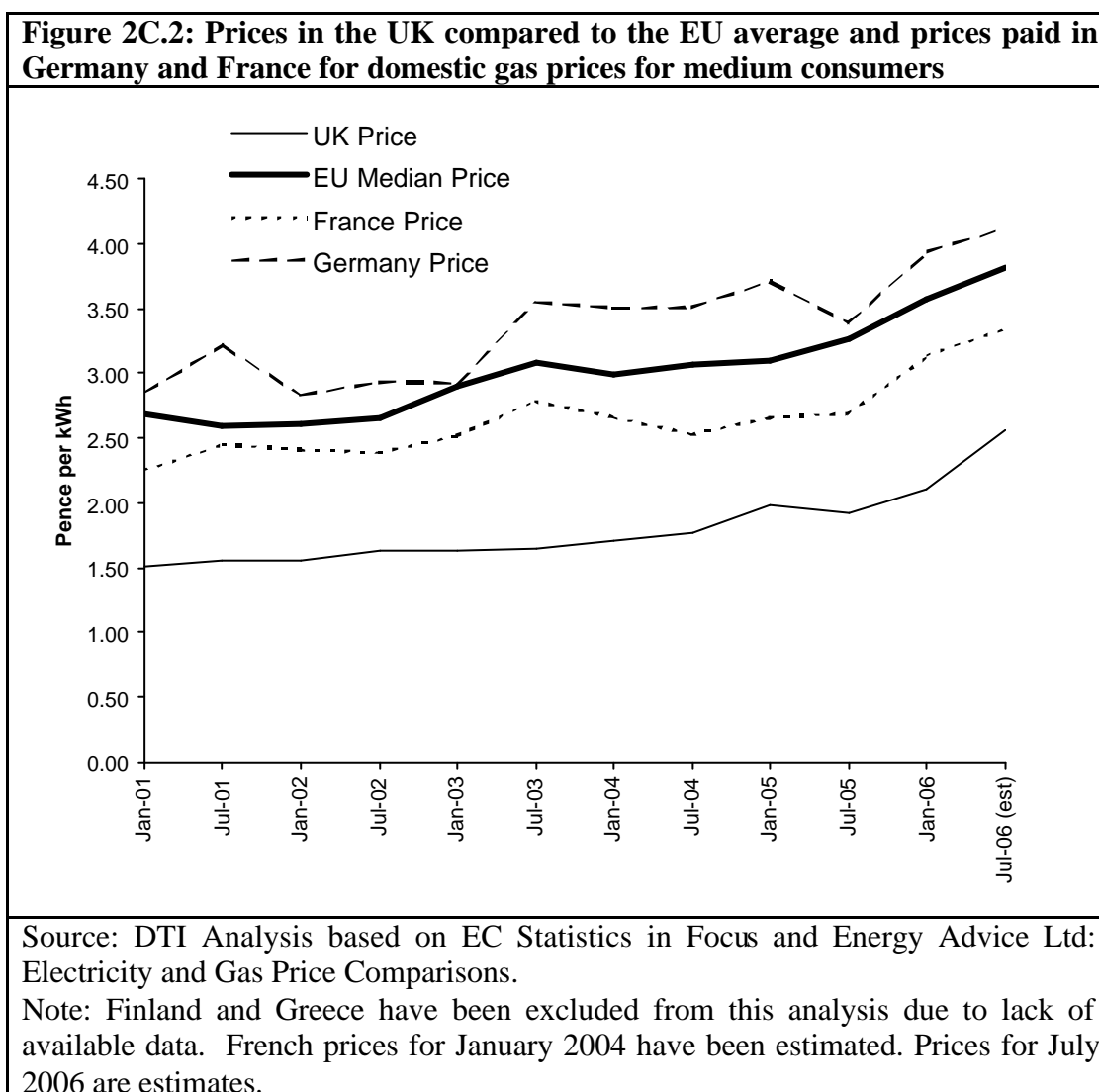


2C.7 The position in terms of gas prices in the UK compared to the other nations in the EU has worsened from 2005, with UK gas prices rising faster than those in other EU countries. As described above, wholesale gas prices have increased and forward prices (which are often used as the basis for contracting) in the UK are now above those on the Continent.

2C.8 In the UK, gas suppliers have limited ability or incentives to absorb wholesale price increases, which therefore tend to get directly passed through to industrial user prices. The combination of these drivers, i.e. higher wholesale prices and faster pass-through, will mean that UK industrial gas prices are less competitive than in the past. Estimates for July 2006 based on EC Statistics in Focus and Energy Advice Ltd data, however, show the UK price for industrial users is below the EU average price for small and large size bands.

## Domestic gas prices

2C.9 Average UK domestic gas prices for medium consumers, including taxes, have consistently been within the three lowest priced countries in the EU since the start of this survey in January 1998. In recent years, prices in Denmark and Sweden have tended to be approximately three times higher than the UK price, whilst those in the Netherlands tend to be approximately double those in the UK. Since January 2001, UK prices have been around 40 per cent lower than the EU average price.



2C.10 Increases in wholesale prices tend to have a larger lag in terms of the pass through of prices to domestic customers, compared to industrial users. This is due to the fact that wholesale costs only make up about 50 per cent of domestic costs, compared to a much higher proportion of industrial costs. Prices are now increasing in the UK for domestic customers, although estimates for July 2006 based on EC Statistics in Focus and Energy Advice Ltd data suggest that prices for medium domestic consumers of gas remain significantly below the EU average.

## **Electricity prices**

### **Background**

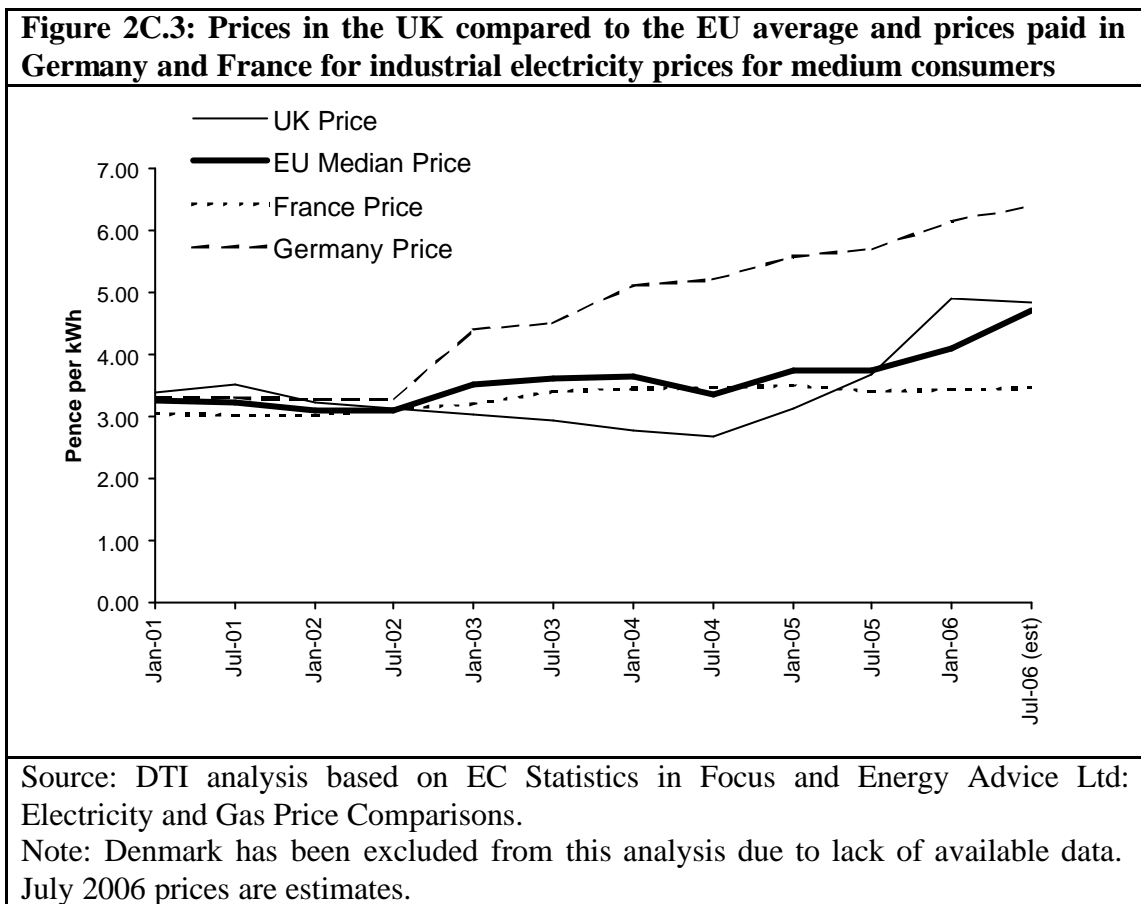
2C.11 Electricity prices in 2003 for both domestic and industrial customers were at their lowest level in real terms since 1970. There have since been increases in prices to both the industrial and domestic sector. Domestic prices in real terms for 2005 are at around 1999 levels, and Industrial prices in 2005 in real terms including CCL are around 1997 levels.

### **Wholesale electricity prices**

2C.12 Evidence suggests that forward wholesale electricity prices for the UK have been higher than France and Germany since late 2003. Gas is a substantial component of the UK fuel mix in electricity generation and gas price rises are the largest factor behind recent wholesale electricity price increases, but electricity price increases also reflect the fact that wholesale prices had reached historically low (and essentially unsustainable) levels in 2002, leading to greater industry consolidation and the exit of some firms.

### **Industrial electricity prices**

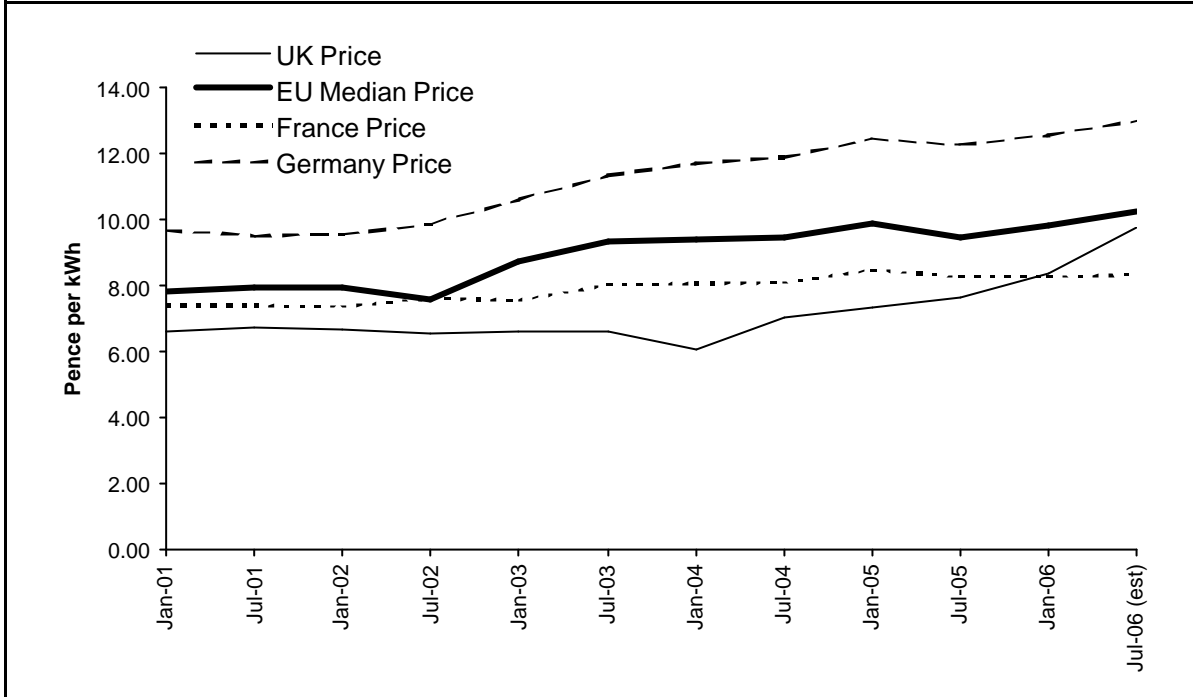
2C.13 The average UK electricity price is normally slightly below the average level for the EU, although estimates suggest that prices are slightly above the average in July 2006. Sweden generally has a lower industrial price for electricity (normally close to the lowest in the EU). The largest prices have tended to be in Italy, Ireland and Germany. Estimates for July 2006, derived from EC Statistics in Focus and Energy Advice Ltd, show that the UK international position has slightly worsened, with medium, large and extra-large UK consumer size band prices including tax now above the EU average. However, small consumers are estimated to be around the EU average.



### Domestic electricity prices

2C.14 Average UK domestic gas prices, including taxes, have been below the average price for countries in the EU since the start of the survey in January 1998. In the past five years the UK has consistently been within the five cheapest countries in the EU. In recent years, prices in Greece, Finland and Spain have tended to be lower than the UK price, whilst those in Denmark tend to be approximately double those in the UK. In the last five years, UK prices have been between 10 and 30 per cent lower than the EU average price.

**Figure 2C.4: Prices in the UK compared to the EU average and prices paid in Germany and France for domestic electricity prices for medium consumers**



Source: DTI analysis based on EC Statistics in Focus and Energy Advice Ltd: Electricity and Gas Price Comparisons.

2C.15 There is a lag between rising in the wholesale price of electricity and the passing on of this increase to domestic customers, however prices are now increasing in the UK for domestic customers. Estimates for July 2006, derived from EC Statistics in Focus and Energy Advice Ltd data, show that UK prices remain below the EU average for the medium domestic consumer size band.