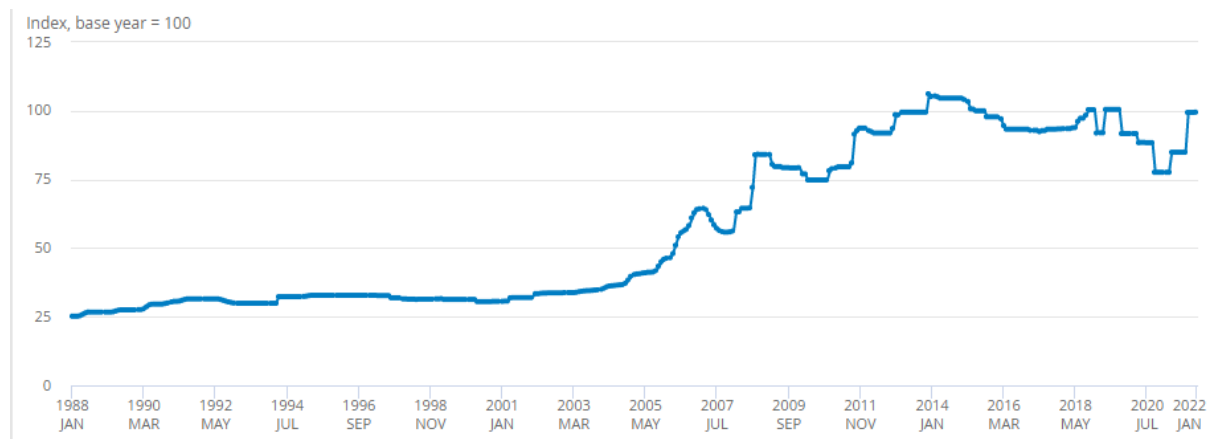


## The Energy Crisis: Rising prices and the government's response

According to Ofgem the energy price cap will increase from April for almost 22million customers. Those on default tariffs paying by direct debit will see an increase of £693 or 54% from £1,277 per year to £1,971 per year. <sup>1</sup> The price we pay for our energy is dependent on a number of things. For example about half of what we pay is the wholesale cost of gas and electricity, but there is also the energy company's operating costs, VAT, and the environmental and social obligation levy which puts 25.5% on our electricity bills and 2.5% on our gas bills. <sup>2</sup>

As the chart shows Britain experienced a period of steady and/or falling gas prices from the mid-1980s until 2004/05. <sup>3</sup> That was the year that Britain first started importing more gas than it produced itself. Since 2005 the gas prices being paid by British customers have been much more unstable, with the general trend being decidedly upwards. On the basis that 2015 represents 100, the price in 2005 was 40.6. By 2008 it had more than doubled to 84.1. After falling slightly to a low of 74.8 in 2010 it rose again reaching a peak of 105.2 in 2014. By 2019 it was 100.5 and in January 2022 it stood at 99.5.



Around 40% of the gas consumed in the UK comes from the North Sea. A similar proportion comes from Europe mostly through a pipeline direct from Norway across the north sea. The Netherlands and Belgium also supply significant amounts. The remaining roughly 20% comes in the form of liquified natural gas (LNG) shipped in mainly from Qatar and the USA. Although we have left the EU we are still part of the north-west European gas market and the price we pay is determined by the events influencing supply and demand in Europe and beyond. <sup>4</sup> As a recent National Grid report makes clear: *"the underlying market arrangements in the UK are predicated on the basis that the market will provide and that the market will balance itself"*. <sup>5</sup>

Another reason for the UK being so exposed to price fluctuations relates to the lack of storage facilities. The UK's stores hold enough gas to meet the demand of four to five winter days or just 1% of Europe's total available storage. The Netherlands has storage capacity of more than nine times the UK's and Germany has 16 times more. In 2017 the Rough storage facility, a depleted gas-field in the North Sea, was closed, having been assessed as too expensive to refurbish. The Centrica-owned service *"was the largest gas storage facility in Great Britain, used by market participants to store gas in the summer and deliver that gas to meet peak demand in the winter."* It had provided 70% of the UK gas storage capability for over thirty years. <sup>6</sup>

The recent rise in the wholesale price of gas is due to a number of factors. Firstly, the UK was until recently experiencing less wind than usual – this lowered the output from wind turbines and led to increased demand for gas for electricity generation. Secondly, Europe has been suffering from a reduction in supplies from Russia possibly in an attempt to force the opening up of the controversial Nord Stream 2 pipeline to Germany. This drop in supply led to consumers across Europe seeking alternatives which pushed up demand and therefore prices. Thirdly, higher demand from Asia's manufacturing sector post-lockdown has resulted in more supplies of liquified natural gas being shipped there and consequently less than expected has been reaching Europe. 7

On 3<sup>rd</sup> February 2022, the Chancellor of the Exchequer announced a package of measures to reduce the impact of higher gas prices on UK households. In April a £150 Council Tax rebate will go to households in Bands A to D - around 80 per cent of UK households. This will not need to be repaid. Second, an upfront payment of £200 will be discounted from energy bills – this will be directly applied by energy suppliers in October and paid for by the government. However the government intends to recoup the £200 upfront payment by adding £40 instalments to household bills over five years starting in April 2023. 8

Despite the £200 payment low-income households will still see a large rise in their energy spending. As a share of their total spending low-income households will see their energy bills rise from 7 per cent in 2019-20 to 10 per cent in 2022-23 - it would have been 12 per cent without the £200 payment. Middle and higher-income households will also see the share of their spending on energy rise, but by far less than low-income households. 9 When other government changes are included along with the increase in the energy price cap - the rise in National Insurance Contributions and the freezing of income tax thresholds - the overall help being offered by the government *“will still leave households on average some £1,000 per annum worse off.”* 10

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