Manufacturing NI Response to the Price Control for Northern Ireland’s Gas Transmission Networks GT17

Introduction

Manufacturing NI represent some 550 manufacturing businesses across every constituency represented in the NI Assembly.

Background

Manufacturing makes a substantial difference to the Northern Ireland economy. In 2015 the sector directly provided 85,200 jobs and made a Gross Value Added contribution of £4.7 billion to GDP (measured in 2012 prices). This is equivalent to more than 10 percent of all jobs and 14 percent of total economic output in the region. Manufacturing is the third largest employer and the second largest sector in terms of economic output. It accounts for a larger proportion of the economy in Northern Ireland than in the UK as a whole reflecting the strong manufacturing base that has existed there since the nineteenth century.

Manufacturing supports jobs and economic growth across all Northern Ireland and in rural and urban areas alike. In Mid Ulster and Mid and East Antrim, manufacturing is the largest employer and accounts for more than a quarter of the economic output. Even in Belfast, which has seen significant economic restructuring in recent decades, the sector provides 11,000 jobs.

The impact of Northern Ireland's manufacturing sector is strongly felt throughout the economy. The contribution that the sector makes extends significantly beyond the jobs, economic activity and wages directly associated with the sector. There is an additional indirect impact which encapsulates the activity and employment supported in the supply chain as a result of the manufacturing sector's procurement of goods and services from other parts of the Northern Ireland economy. In addition, there is a further induced impact, comprising the economic benefits that arise as the people employed in the manufacturing sector and its supply chain spend their wages in the local consumer economy, for example at retail and leisure establishments.

Including all three channels of economic impact—direct, indirect and induced—the total contribution of manufacturing to the Northern Ireland economy was £9.9 billion in 2015. For every £1 billion of economic output produced by the sector, a further £1.1 billion is created elsewhere in the Northern Ireland economy. In 2015, on top of the £4.7 billion direct GVA contribution that the sector made, it also supported a £3.5 billion contribution to GDP through its supply chain activities and a £1.6 billion wage expenditure GVA contribution, spread widely throughout the Northern Ireland economy. In total, we estimate that in 2015 the sector sustained 214,000 jobs; amounting to a quarter of all jobs in the Northern Ireland economy. For every manufacturing job in Northern Ireland, another 1.5 are supported elsewhere in the economy. By sustaining this level of employment, manufacturing directly contributed £2 billion in wages to its own staff, and a further £2.2 billion in wages through jobs supported outside the sector itself.

An Oxford Economics forecast shows that over the next 10 years manufacturing will grow faster in Northern Ireland than in any other region in the UK but it also faces a substantial challenges from competition from abroad and rising costs. Sustaining these levels of growth will be achieved through increased investment into new technologies and processes that will boost productivity and will be a function of the extent to which the cost base of the sector remains stable relative to its competitors. Any further pressure on costs risks exacerbating the challenges the sector already faces, leading to slower growth in the sector, and with a knock-on impact for economic output and jobs all across the Northern Ireland economy.

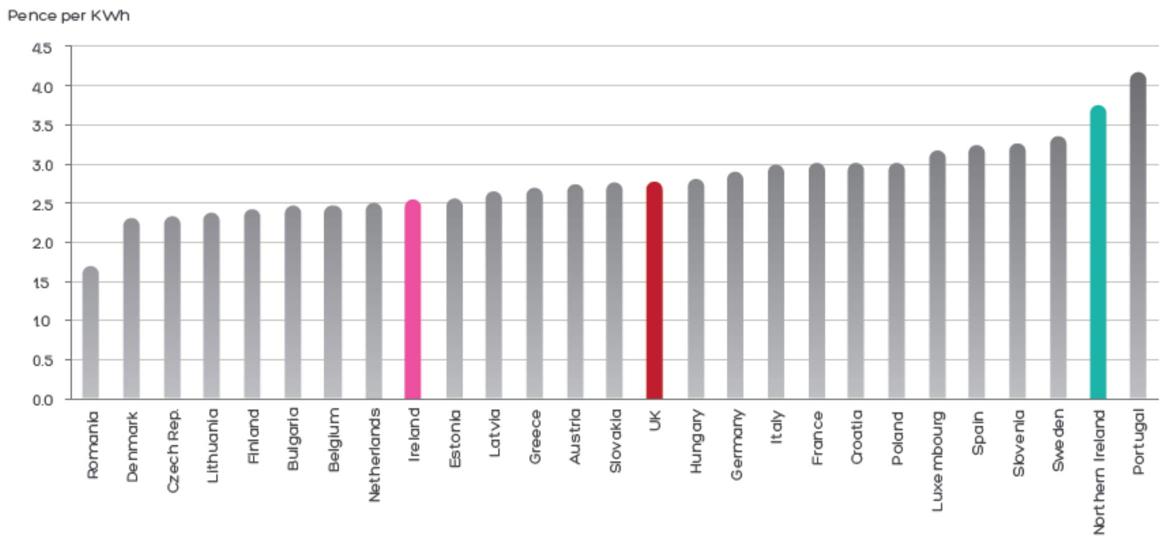
Gas Costs

Energy represents a significant cost for almost all businesses, but is particularly important for an energy-intensive industry such as manufacturing. Surveys conducted by the Northern Ireland Chamber of commerce show that energy costs are a major concern for businesses in Northern Ireland. Over 60 percent of businesses cited energy costs as the most burdensome on business, with a significant proportion reporting that they felt energy costs were a potential deterrent to future investment decisions.

The price of gas is also an important factor in determining energy costs in Northern Ireland, not least because it is an important input into the generation of electricity. Therefore higher wholesale gas prices push up the price of electricity that businesses face, as well as the retail cost for I&C customers that use gas for general industrial purposes.

Gas prices in Northern Ireland have been higher than the UK as a whole due to a lack of competition and the fact that the gas supply largely comes from Great Britain (Figure 35 below). Oxford Economics have estimated that the average unit cost of Gas for a typical industrial and commercial user is the second highest in the EU, 35 percent higher than the equivalent cost in the UK and 47 percent higher than the cost in Ireland.

Fig. 33. Industrial gas prices in the EU for small consumers, ex Vat, H1 2015



Source: Decc, Firmus Energy
Data not available for Malta or Cyprus

Manufacturing Costs

The latest, January 2017, report from the Office of National Statistics spells out the significant cost inflation pressures being endured by manufacturers in the UK.

UK, August 2016 to January 2017

Percentage change

		All materials and fuels purchased		Imported materials and fuels purchased	
		1 month	12 months	1 month	12 month
2016	Aug	0.3	7.8	0.3	9.2
	Sep	0.4	7.6	0.2	8.9
	Oct	4.4	12.4	4.5	14.0
	Nov	-0.6	13.5	-1.4	14.7
	Dec	2.7	17.0	1.8	17.6
2017	Jan	1.7	20.5	2.1	20.2

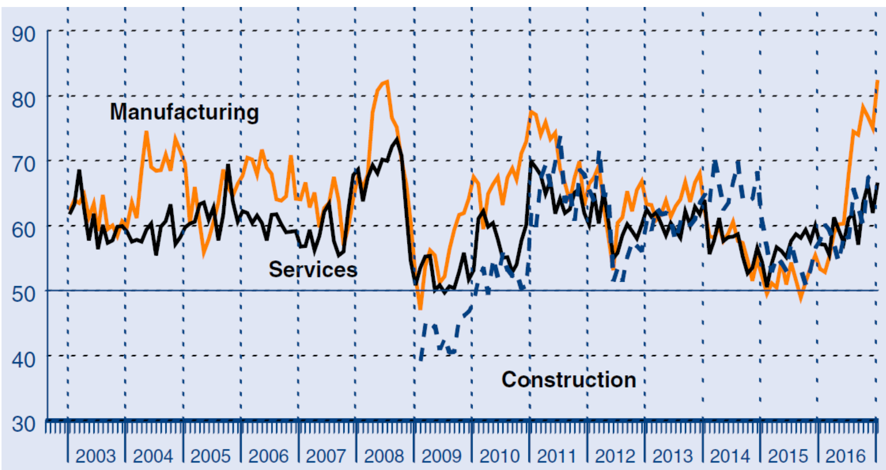
Source: Office for National Statistics

These costs are not being reflected in output prices which saw just a 3.5% rise in the 12 months to January 2017.

Northern Ireland's manufacturers are already a significant cost disadvantage over and above cost pressures endured by the UK as a whole – our geography alone means they are at the physical end and the beginning of the supply chain which brings costs others do not face.

The latest Northern Ireland PMI figures below (from Ulster Bank and Markit) also demonstrate the significant cost inflation being endured by the sector here (see chart below). Firms are already in a cost crisis with consumer and customer prices rising at a rate up to 6 times less than the rise in input costs.

	Construction	Manufacturing	Services
November 2016	52.0	**60.6**	51.3
December 2016	56.5	**58.4**	51.2
January 2017	58.0	**63.1**	52.5



Specific Responses to the Consultation

Mutual Energy Review

We are aware of the purpose, ownership and financial arrangements around of Mutual Energy (MEL). However, we would like the Utility Regulator in this Determination to ensure that there is greater transparency and ensure that the Final Determination secures a greater emphasis on representing consumer interests from the MEL Board.

Whilst the company is there to operate in the consumer's interest, the potential to simply wave through increased operating costs which are then passed through to consumers is real. There is a requirement to put in place checks, from the UR, to ensure that best value is being achieved.

Any incentives should be aligned to interests of consumers. We believe it is critically important that a governance review is undertaken.

Transparency

Our understanding is that whilst there are 'expected' costs, that these do not have a cap applied (unlike other Price Controls). On that basis, the introduction of RIGS are critical. Collecting, analysing and benchmarking cost and output data will provide more transparency for consumers.

Contractual Joint Venture

We support the use of the CJV as a means of ensuring efficient levels of cost.

Opex

We agree with the UR that there was sufficient allowances for Opex in the previous price control and that there has been no significant evidence provided to prove otherwise.

In addition, the Gas to the West project had a successful bidder very recently. We see no justification in providing additional allowances when this successful bid remains contemporary. In addition, to adjust now would be unfair on the other unsuccessful bidders and could lead to legal challenge.

Capital and Replacement Expenditure

We fail to see any justification for the requested, significant, spend by GNI. Indeed, in the last Price Control a similar tactic was deployed whereby lots of money was requested but as has been proved it wasn't required. We believe a similar tactic is at play here – inflating the requirement beyond what is needed. We support pegging this expenditure back to as little as possible.

WACC

It is our view that the market for borrowing money for these types of investments remains incredibly cheap. Gas networks are viewed as safe businesses to invest in and this is reflected in the available rates. Indeed, with no revenue risk and no requirement to spend capital there is an appetite and offers for low costs of borrowing.

There is a considerable body of evidence to back this up both from the markets but also, significantly, from the companies as evidenced in the Determination published. On that basis we support the UR pegging WACC rates to those proposed.

Scottish Connection

We are deeply concerned about the application of future costs from any works on the connection through and with Scotland. We firmly believe that consumers here need advanced warning of any prospect of additional charges in order to provide an opportunity to get consumer interests here represented. Much more transparency is required.

Adjustment Mechanism

We do not believe there is any need for an adjustment mechanism.

Consumer Impact

As previously evidenced, we have the 2nd most expensive gas in Europe.

We understand that Transmission equates to c10p per therm. We also know that around 2/3rd of the total £50m costs on this Price Control will be borne by the 2 gas power stations in Northern Ireland. Every 1p per therm adds 40p per mwh to power prices. The impact of this Determination goes beyond simply the Gas Network and will impact on electricity consumers who already endure some of the highest costs in Europe. We would ask that the UR does all it can to avoid unnecessary additional costs being applied.

We are happy for this response to be published.

Stephen Kelly
Chief Executive
14 February 2017