SCOTLAND's ECONOMIC FUTURE POST-2014

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Key Points:

- An integrated GB wholesale market after independence is likely
- EU law provides the mechanism for joint support across member states, but a shared subsidy regime may be politically problematic
- A Strategic Energy Partnership, as envisaged in the White Paper, may impose constraints without significantly enhancing influence

Energy and devolution

Scotland is recognised within and beyond the UK as a leader in renewables, hosting 38% of the UK's installed capacity of sites generating renewable electricity in 2012, including almost 90% of the UK's hydro capacity and 44% of onshore wind.[1] These achievements in part reflect a government-led drive to promote renewables in spite of having very little constitutional competence. The Scotland Act (1998) reserved to Westminster most areas of energy competence, including the generation, transmission, distribution and supply of electricity, the regulation of the energy market, and the regulation of energy efficiency. The Scottish Government has had to utilise 'soft power' to attempt to influence the shape of UK energy policy and market reform, with only limited success. Independence would see a transfer of these competences to the Scottish Parliament, but if it entailed continuity of the GB market to the extent envisaged in the White Paper, the capacity for Scotland to develop distinctive energy policies may be constrained.

Competing perspectives on independence and energy

The Scottish Government's White Paper on independence envisaged a GB-wide market for electricity and gas '***reflecting the integrated transmission networks between Scotland and the rest of the UK***' and the '***common interest***' in sharing energy resources.

The UK Government's Scotland Analysis paper on energy recognises that '***in the event of independence, there would be a mutual benefit to Scotland and England and Wales from continued cross-border trade in electricity***' but it insists that '***the current GB energy system could not continue as it is now***'.

Prospects for a common energy market under independence

The single GB market in electricity was established in 2005 with the introduction of the British Electricity Trading Transmission Arrangements (BETTA). As a wholesale market between electricity generators and suppliers, it was intended to encourage competition, efficiency and value for consumers. The UK also operates an integrated system for subsidising electricity generation within the GB market, with support mechanisms for electricity generation and transmission financed by GB consumers.

[1] DECC, 2013. *Energy Trends,* December; Scottish Government, 2014. *Energy in Scotland 2014. A Compendium of Scottish Energy Statistics and Information*.

Reflecting on whether GB market integration could survive a transition to Scottish independence, we should separate wholesale market trading from issues of financing and incentivising the renewables industry and the grid.

An Integrated GB market for buying and selling energy seems a likely prospect after independence:
There are many successful examples of trading within integrated markets in Europe:

- The Nordic countries brought their individual deregulated markets together in the 1990s, creating a cross-border power exchange which now includes Estonia, Lithuania and Latvia. There is significant cooperation between transmission operators and energy agencies across the Nordic countries.
- The European Power Exchange – Epex Spot – serves as a wholesale market for members buying and selling electricity in Germany, Austria, France and Switzerland, including through cross-border trade. It has been formed by the gradual integration of national power exchanges, supported by EU directives on internal energy markets.
- The Single Electricity Market on the island of Ireland was negotiated between the UK and Irish governments to support efficient and effective security of supply. It provides a mandatory pool into which all generators producing electricity above 10MW must bid.

Given that the trend within the EU – fostered by successive directives and the Third EU Energy Package – is towards market integration, continuity of at least a wholesale GB market seems unproblematic.

Independence would not change geography:
- The UK and Scotland would continue to share an island and an island grid, facilitating market integration and necessitating some co-operation.
- Many generators and suppliers operate and trade across the border and could be expected to lobby both governments toward maintaining an integrated energy market
- The GB market currently has a low level of external interconnection - links to France, Ireland, the Netherlands and the Isle of Man amount to around 5% of capacity.[2] This reinforces the incentive to maintain strong interconnections on the British mainland.

A shared GB subsidy regime may be more problematic
More controversial may be the Scottish Government's preference to continue a GB system for subsidising renewable energy generation and upgrades to the grid infrastructure. It argued recently that '***Scotland makes a significant and reliable contribution to the security of power supplies across these islands - helping to keep the lights on and bills down***.'

But UK Government ministers have been vocal in voicing their doubts about such arrangements. Launching the Scotland Analysis paper, the Secretary of State Ed Davey said: '***So let me be crystal clear… in the event of independence there would be no need for the continuing UK to support an independent Scottish state's energy costs to ensure its own security of supply***.'

Fuel bills and the costs of subsidising renewable energy are highly politicised north and south of the border, and are likely to play a role in the forthcoming UK General Election. It

[2] Royal Academy of Engineering, 2014, *Wind Energy. Implications of Large-scale deployment on the GB electricity system*. p.28

may be politically difficult for the UK Government to deviate from its stated position in the event of a Yes vote even if it were minded to do so.

BUT:

- Though relatively unusual, cross-border subsidies are not unprecedented. Since 2012, Sweden and Norway have shared a Joint Green Certificate scheme which operates in a similar way to the Renewables Obligation. (Denmark decided against joining because - as a technology neutral scheme - it supports the cheapest forms of renewable energy and so would be detrimental to Danish ambitions for more expensive offshore wind.)
- The EU Renewable Energy Directive 2009/28/EC established a set of co-operation mechanisms to help member states meet their 2020 targets. These included joint support schemes, joint projects and statistical transfer. To date, the Swedish-Danish certificate scheme is the only co-operation mechanism to be implemented.
- The UK government and the Irish government had signed a Memorandum of Understanding with a view to setting up a joint project to help meet the UK's 2020 obligations and broader capacity constraints. However, the planned wind farm in the Irish Midlands – which could have seen 8 GW of power exported directly into the UK network – has just been shelved.
- Co-operation mechanisms should be easier to maintain where they already exist, as would be the case with Scotland and rUK, than to design anew. Electricity exported from Scotland *could* contribute to the UK's EU energy obligations, though how the obligations are apportioned between Scotland and rUK may be subject to renegotiation with the EU.

Governing energy interdependence

The White Paper suggests that an independent Scotland would seek to form a Strategic Energy Partnership with the Westminster government. This, it is argued, would help to address the failings of the current system of market regulation and ensure that Scotland had a bigger role in influencing and steering the system to match the needs of Scotland as well as the rUK: "***as a substantial supplier to the rest of the UK, an independent Scotland will require a far greater degree of oversight of the market arrangements for energy and firmer safeguards over Scottish energy security***."[3]

However, there is very little detail about the form such a partnership would take, or how it would work to the mutual benefit of both governments. There are no existing intergovernmental forums which could adequately serve such a partnership – a new forum would have to be established, with guiding principles for joint working and dispute resolution.

Formal partnership with rUK would constrain capacity for autonomous decision-making within Scotland. Even if there was a will on both sides to form such a partnership, it is not clear how a Scottish Government would be able to exert sufficient influence in overseeing the electricity market to enable it to address the perceived failings of the current system. Nor is it clear that such a partnership would be viable should the two governments diverge further in their energy policy preferences.

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[3] Scottish Government, 2014, *UK Energy Policy and Scotland's Contribution to Security of Supply*