Autumn Statement 2016 – submission from the Energy Intensive Users Group

The Energy Intensive Users Group (EIUG) represents the UK's energy intensive industries (EIIs) including the manufacturers of steel, chemicals, paper, glass, cement, lime, ceramics, aluminium and industrial gases that compete in global markets and depend on secure, internationally competitive energy supplies to remain in business. These foundation industries employ 200,000 people directly, support 800,000 jobs including their supply chains, and make a £15bn pa contribution to UK GDP.

<u>Carbon Price Floor</u>

HMT will recall from previous correspondence that EIUG has opposed the Carbon Price Floor from its inception and repeatedly called for its abolition at the earliest opportunity. HMT may also be aware from external representations, as well as its own analysis, that this tax has disadvantaged consumers, damaged international competitiveness of *all* trade-exposed manufacturing industries (but especially EIIs), distorted trade in power between GB and continental power generators and eroded the value of carbon allowances in the EU Emissions Trading Scheme. It has simultaneously failed to do anything to reduce power sector emissions overall, since these are capped at an EU level. It has therefore given the illusion of encouraging emissions reduction as a result of fuel switching between existing power stations *within Britain*, whilst reducing the emissions reduction required from every other EU member by exactly the same amount – i.e. it has delivered no net benefit as far as climate change is concerned. It has however succeeded in increasing the proportion of EU decarbonisation costs that are borne by British electricity users, whilst correspondingly reducing them for our EU competitors.

EIUG was grateful therefore that HMT recognised the damage the CPF was causing to electricity users, that the tax was capped to prevent further damage from the rising trajectory initially proposed, and that a partial compensation scheme was introduced to mitigate its impact on some, but not all especially vulnerable EIIs. It should be noted however that the compensation scheme is inadequate to provide a level playing field with respect to EU EIIs. First, EU state aid rules prevent EIIs in certain sectors receiving aid for indirect carbon costs (in contrast with the less rigid and more recently agreed guidelines on renewable costs) even where there is clear evidence on a sector or company basis of high electricity intensity, high trade exposure, and hence high risk of carbon leakage. Second, EU state aid rules limit the proportion of the tax cost for which compensation may be paid, and on a declining basis, so that companies benefitting from relief still face a significantly higher carbon impact on the price of their electricity supplies than EU competitors, and one that will carry on growing towards the end of the decade. Furthermore, unlike a properly functioning EU (or UK) emissions trading scheme, the CPF does nothing to support industrial decarbonisation. So long as the CPF remains in place, and the UK remains subject to current EU state aid rules, these problems cannot be resolved satisfactorily.

Whatever claims might be made in defence of the CPF in terms of GB fuel switching (subject to the caveats noted above), it has proved to be an failure as an investment signal. Hardly any new gas fired capacity is being built to replace retiring coal plant, and almost all the alternative capacity that is being built (wind, solar and in due course nuclear) is entirely dependent on RO/FIT or CFD support, not CPF. In fact, the CPF is now becoming a barrier to investment in gas fired power stations at precisely the time when the UK, increasingly dependent on intermittent renewables and shortly about to lose its remaining coal fired power stations, desperately needs to stimulate investment in dispatchable capacity in order to ensure security of supply. EIUG therefore believes that the CPF should be phased out at the very latest by 2025, when coal will no longer be generating in the UK and fuel switching to gas is no longer an issue, with no further increases in the interim.

EIUG would also urge HMT to consider the following issues of concern to EIIs:

Levy Control Framework – it is clearly important to investors to have clarity about future subsidy levels as far ahead as reasonably practical, but also to energy users in order to understand the likely impact on their future energy costs. It is also important to have clarity on the timing envisaged for the next and future rounds of CFD and Capacity Market auctions. EIUG therefore hopes the Autumn Statement will include specific details on whether the Levy Control Framework will be extended beyond 2020/21 and/or other measures HMT might be considering to constrain the impact of low carbon energy costs on the international competitiveness of industrial energy supplies.

Government-backed infrastructure bonds – EIUG believes there is merit in considering whether infrastructure bonds (as suggested in a recent speech by the Prime Minister) could lower financing costs for essential energy infrastructure and deliver long term benefits to energy users in terms of energy price competitiveness and/or security of supply.

Energy efficiency, CCS and R&D support – the Government will need to develop support mechanisms analogous to those in power sector if EIIs are to decarbonise as envisaged in the 2050 Roadmaps that BEIS has been developing in conjunction with industry. EIUG fully supports the bid by BEIS for up to £100 million over the course of the Parliament to be set aside as an energy efficiency fund for EIIs covered by the 2050 Roadmap process, which would enable them to unlock substantial investment in additional energy efficiency measures. It will also be important to replace EU funding streams for industrial decarbonisation such as Horizon 2020 if these reduce or cease as expected following the UK's exit from the EU.

EII compensation package – EIUG believes HMT must give a commitment to continue and consider extending the compensation for EII RO/FIT costs if exemption is not approved by Commission by April 2017, and to fund compensation in Northern Ireland for the limited number of affected companies if exemption by April 2017 is not forthcoming. There is also an opportunity to broaden this relief, at no cost to HMT, by lowering the business test threshold as GB moves to an exemption in April 2017.

EIUG also believes the compensation package will need to be extended to cover escalating Capacity Mechanism costs, transmission and balancing services that have arisen as a consequence of the Government's renewable policies to ensure a level playing field for UK EIIs in terms of international electricity supply costs. These costs are already significant and rising – e.g. the Capacity Mechanism alone is set to cost users around £7/MWh by 2017/18.

EIUG would be keen to discuss any of these issues with HMT ministers or officials at the earliest opportunity. In the meantime, we trust the concerns we have raised will be given serious consideration, and that announcements to address them will be included in the forthcoming Autumn Statement.