HMT Consultation – Reforming the business energy efficiency tax landscape:

Response from the **Energy Intensive Users Group**

General comments

The Energy Intensive Users Group (EIUG) represents manufacturing sectors including steel, chemicals, paper, mineral products, glass, ceramics and industrial gases that operate in global markets and depend on access to secure, internationally competitive energy supplies to remain in business. These industries employ around 200,000 workers directly, providing indirect employment for over 800,000 workers, and contribute over £15 billion to UK GDP.

EIUG welcomes the opportunity to comment on proposals to improve energy tax efficiency. EIUG greatly appreciates the efforts of HMT, BIS and DECC officials to engage with EIUG and other business energy user representatives prior to the publication of this consultation, and recognising the need to take into account the concerns of vulnerable trade exposed energy intensive industries (EIIs) in framing these proposals.

Consultation questions

1. Do you agree with the principle of moving away from the current system of overlapping policies towards a system where a single business/organisation faces one tax and one reporting scheme? Please provide evidence on level and types of benefits of an approach like this.

EIUG supports the principle of moving to a single reporting system so long as it is no more onerous for EIIs than current arrangements, including Climate Change Agreements (CCAs) and exemptions for relevant energy-intensive, trade-exposed industrial processes. EIUG recognises there is pressure to reduce the number of sectors benefitting from CCAs (or any equivalent arrangements that might supersede them) for business energy users that are less clearly at risk of carbon leakage, but it is essential that any such changes do not affect EIUG sectors, where the risk is clearly established.

Government needs to work with industry during the consultative process to ensure there are no unintended increases in administrative costs.

2. Do you agree that mandatory reporting should remain as an important element of the landscape in driving the uptake of low carbon and energy efficiency measures? If not, why not?

EIUG does not object to the principle of mandatory reporting providing the requirements are not unduly onerous and do not materially increase the bureaucratic/ administrative burden on industry (or government, for that matter). There is a need to avoid duplication –EIIs already have reporting mechanisms and incentives for energy efficiency – CCA sectors should not need to report again through ESOS.

3. Should such reports require board level sign-off and should reported data be made publicly available? Please give your reasons.

Energy is already a board level issue for EIIs, for obvious commercial reasons, regardless of regulatory reporting requirements. EIUG recognises this may not be the case for most non-EIIs.

Where board level sign off is required on reported data, this should be at the level of the UK board to avoid any additional obligations on multinational companies to report on their global activities.

It is difficult to make reliable company comparisons based on published (or potentially publishable) data. There is also the issue of commercial sensitivity, e.g. if individual company data were to be made public on energy consumption, tonnage, etc. This is not a problem with data currently published under CCAs – future publication of reported data should not go beyond this.

4. Do you agree that government should develop a single reporting scheme requiring all ESOS participants (and potentially the public sector (see paragraphs 4.21 - 4.23) to report regularly at board level? If so, what data should be included in such a report?

It is not obvious what value would be added by mandating board level reporting for EIIs – they are doing this anyway.

There is an opportunity to simplify ESOS, which appears to be more burdensome for industrial energy users than equivalent regulations elsewhere in the EU. In this respect, whilst ensuring that the requirements of the Energy Efficiency Directive Article 8(4) are met, a review of ESOS should consider applying the best approaches to exemptions that exist in other EU countries, such as exemptions for energy efficiency agreements (at a site, company or a sector level).

5. The government recognises the importance of ensuring market actors have access to transparent, reliable and comparable information to support financing and investment in energy efficiency and low carbon measures. How best can a streamlined report achieve this? To what extent does your response apply to other large companies (as defined in the Companies Act) that are not listed companies?

No comment.

6. Do you agree that moving to a single tax would simplify the tax system for business? Should we abolish the CRC and move towards a new tax based on the CCL? Please give reasons.

EIUG has previously criticised the complexity and inefficiency of business energy taxation, along with many others, even though most of our members are not directly affected by CRC to any significant extent. EIUG supports the principle of abolishing the CRC and moving to a single tax based on the CCL, so long as no vulnerable, trade-exposed EIIs genuinely at risk of carbon leakage are disadvantaged by this change – i.e. current exemptions / discounted rates for EIIs are maintained. EIUG believes the net effect of changes to merge CCL and CRC should be revenue neutral for Treasury.

7. How should a single tax be designed to improve its effectiveness in incentivising energy efficiency and carbon reduction?

Environmental effectiveness could be improved by recycling revenue from energy taxation as grants, capital allowances or other tax breaks, etc., to support additional energy efficiency measures. EOIG would not support funding grants through an increase in the tax paid by EIIs.

8. Should all participants pay the same rates (before any incentives/reliefs are applied) or should the rates vary across different businesses? For example, do you think that smaller consumers and at risk Energy Intensive Industries (EIIs) should pay lower rates?

It is essential that EIIs' energy supplies remain taxed at the lowest rate permissible under EU Energy Taxation Directive (ETD) and exempted altogether where permitted, in order to prevent carbon/investment leakage.

Carbon leakage risk should be addressed by applying relief to EIIs to achieve a lower effective tax rate, <u>not</u> by retrospective compensation.

9. Do we currently have the right balance between gas and electricity tax rates? What are the implications of rebalancing the tax rate ratio between electricity and gas? What is the right ratio between gas and electricity rates?

EIUG has no specific recommendation on the 'right' tax rate ratio between electricity and gas, but we recognise this is a legitimate concern in terms of environmental efficiency.

EIUG has no objection in principle to rebalancing standard rates of gas and electricity tax provided appropriate exemptions/discounts remain available to vulnerable trade exposed EIIs address the carbon leakage risk, as mentioned above.

Industrial gas prices are relatively competitive (within the EU, at least) but additional taxation could undermine this position, damaging UK business competitiveness. Government needs to recognise that many non-EU competitors already benefit from substantially lower gas prices (e.g. Russia, USA) with no equivalent to the tax levied on industrial use in the UK/EU. It should also be recognised that there are no cost viable alternatives to gas use in some industrial processes (e.g. high temperature kilns). UK industrial electricity prices are fundamentally uncompetitive internationally, mainly because of policy costs, as HMT is well aware – and it would be damaging to manufacturing competitiveness if a similar situation were allowed to arise with industrial gas prices.

10. Do you believe that the CCA scheme (or any new scheme giving a discount on the CCL or on any new tax based on the model of the CCL) eligibility should only focus on industries needing protection from competitive disadvantage? If so, how should government determine which sectors are in need of protection?

EIUG agrees that the focus should be on protection from competitive disadvantage. This must include international energy price competitiveness, taking into account industrial energy prices in global markets, not just within the EU. Government should determine sectors in need of protection with reference to total energy costs, along the lines indicated in the ETD and/or sector Roadmaps.

EIUG has consistently argued that support, whether in the form of exemptions or discounted tax rates, should be focussed on the most energy intensive, trade-exposed industries for which uncompetitive energy prices pose the greatest risk. The CCA scheme (or any successor along similar lines) should therefore recognise the fact that the threat to these industries is ultimately global, but at the very least protective measures should ensure no such industry faces a competitive disadvantage with respect to their EU competitors.

11. Do you believe that the CCA scheme (or new scheme) eligibility should focus only on providing protection to those EIIs exposed to international competition and at risk of carbon leakage? If so, how should the government assess which CCA sectors are at risk of carbon leakage?

EIUG supports eligibility being focussed on EIIs most exposed to international competition, as mentioned above. Eligibility should include every sector or process listed in EU state aid guidelines (Annex 3 and Annex 5) as potentially eligible for EU ETS/carbon price support or renewable cost relief – and any company or sector that can demonstrate equivalent energy intensity and trade exposure.

It should be recognised that some companies register at Companies House under unexpected NACE codes reflecting broader manufacturing interests that may not be a reliable indicator of their energy intensity and/or trade exposure, and hence risk of carbon leakage.

In assessing carbon leakage risk, it must be acknowledged that current trade exposure may be significantly greater than indicated by past trade intensity, as recent evidence of rapidly increasing import penetration in a number of energy intensive sectors has demonstrated.

12. Do you believe that the targets set by the current CCA scheme are effective at incentivising energy efficiency? Do you believe that the current CCA scheme is at least as effective, or more effective, at incentivising energy efficiency than if participants paid the full current rates of CCL? How could CCAs be improved? Are there alternative mechanisms that may be more effective?

Energy efficiency is part of core business for EIIs, which have an impressive track record of continuous energy efficiency improvement over several decades. Energy costs are already a commercial driver for EIIs even in the absence of additional taxation. High taxes do not necessarily lead to energy efficiency improvements – they reduce the ability of companies to fund technological improvements.

EIUG agrees that the current CCA scheme is more effective at incentivising energy efficiency than participants paying the full rate of CCL. This can be shown by examining published evidence on energy efficiency improvement in sectors with CCAs compared with business in general that pays the full rate of CCL.

Whether within CCAs or otherwise, it should be recognised that arbitrary reductions in benchmarks are nonsensical – reductions in energy use in transformation of materials are limited by the laws of thermodynamics.

13. Do you believe that incentives could help drive additional investment in energy efficiency and carbon reduction? Please explain your reasons.

EIUG agrees that additional incentives could help drive additional energy efficiency investment across business as a whole. However, for trade-exposed EIIs, caution is needed – raising energy prices (which in the case of electricity to large users are already amongst the highest in Europe) simply raises the risk of carbon leakage in already comparatively energy efficient sectors, undermining the incentive to invest in further energy efficiency measures at UK facilities. The potential to continue receiving tax exemption for identified sectors (e.g. Min/Met) or discounts at no higher rate than at present (as is currently the case for sectors within CCAs) must be retained.

14. What is the best mechanism to deliver incentives for investment in energy efficiency and carbon reduction (e.g. tax reliefs, supplier obligations, grants, funding based on competitive bidding)? Are different approaches needed for different types of business? If so, which approaches work for which business types? What approaches should be avoided?

EIUG supports the principle of linking tax reliefs to energy efficiency investment, as is effectively the case with CCAs at the moment, and along the lines being discussed in relation to industrial sector 2050 decarbonisation Roadmaps.

Investments with longer payback periods are required in EII sectors if their energy efficiency potential is to be maximised, so incentives to increase deployment rates would be welcomed. For example, Enhanced Capital Allowances (ECAs) for a wider range of heat reduction technologies, Carbon Trust type interest free loans, etc.

Llessons should be learned from recent experience with Demand Side Response mechanisms which suggest a bidding process would be too burdensome for EIIs, especially SMEs.

15. What impact would moving to a single tax have on the public sector and charities?

No comment.

16. How should the merged tax be designed to improve its effectiveness in driving energy and carbon savings from the public sector and charities?

No comment.

17. Should a new reporting framework also require reporting by the public sector?

EIUG agrees that the public sector should be subject to similar reporting requirements and incentives to improve energy efficiency as those imposed on private sector businesses. The public sector is an energy extensive sector with significant overall consumption, and potentially greater opportunities for cost-effective energy savings than in some other parts of the business sector. All sectors of the economy will have to achieve significant efficiency savings if the UK's long term carbon emission targets are to be met, not just private industry.