Environmental Audit Committee inquiry – Energy Intensive Industries Compensation Scheme

Memorandum from the **Energy Intensive Users Group**, 23rd November 2012

1. The Energy Intensive Users Group (EIUG) represents the UK's energy intensive industries including producers of steel, chemicals, paper, mineral products, glass, ceramics, aluminium 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 225,000 workers directly and contribute over £15 billion to UK GDP.

2. EIUG supports the long term goal of shifting to low carbon energy supplies, although our members have become increasingly concerned about the mounting cost of the UK's unilateral climate change commitments, their cumulative impact when considered in addition to UK and EU taxes on direct emissions on trade-exposed energy intensive industries, and the consequent risk of carbon leakage. We note that the carbon leakage risk is explicitly recognised within European climate legislation, and has also recently been recognised by the government with respect to UK-only climate policies.

3. EIUG welcomed the announcement of a compensation package in the Chancellor's 2011 Autumn Statement. We noted at the time however that the proposed £250m funding would be insufficient to ensure full mitigation of the indirect effects of EU Emissions Trading (EU ETS) and the Carbon Price Floor (CPF) on the UK's energy intensive industries, and firm measures had yet to be proposed to address the equally significant impact of renewable subsidies. We would like to see flexibility between the relative amounts available in the EU ETS indirect compensation and Carbon Price Floor funds, currently set at £110m and £100m respectively, allowing them to properly reflect the relative burdens of these two policies at the time the compensation is applied. In addition, this compensation is only proposed at present for the current spending review term, whereas the taxes will persist well beyond this: manufacturers need to be able to plan on a longer term basis. In this regard, EIUG would like to see a firm commitment to a second phase of more comprehensive compensation with an adequate budget to address the risk of carbon leakage from a broader range of trade exposed electro-intensive businesses.

4. EIUG also welcomed the publication by BIS in July of an independent consultant's report: *'An international comparison of energy and climate change policies impacting energy intensive industries in selected countries'*. The report confirmed EIUG's earlier assertion that UK intensive industries already face higher electricity prices than competitors in Germany, France, USA, China and India. The report also confirmed that the expected uplift in UK electricity prices by 2020 as a result of climate policies (£28.3/MWh) will be higher than in any other country surveyed. The findings of this report underline the need to mitigate the equally significant impact of renewable subsidies from the RO and EMR on EIIs, in addition to the indirect costs of ETS and CPF.

5. In line with Commission guidelines for EU ETS compensation, the government proposes that aid intensity must not exceed 85% of the eligible cost increase in 2013-15, 80% in 2016-18 and 75% in 2019-20. While we disagree with economic logic of the Commission's capping EU ETS compensation at 85-75%, we recognise that it is pragmatic for government to propose similar capping for CPF compensation in order to optimise the chances of getting state aid approval. We note however that even under the maximum level of CPF compensation, UK industry will be

exposed to an increase in electricity prices reflecting the uncompensated 15-25% of CPF impact that will not be experienced anywhere else in Europe.

6. We agree with the government that CPF compensation should be available for ***all*** vulnerable energy intensive industries, not just those in sectors previously deemed eligible for EU ETS compensation, and support the potential eligibility of electro-intensive processes or products outside these sectors where robust evidence is available to justify their inclusion. We note that many electro-intensive products and processes will not receive EU ETS indirect compensation if they are outside sectors previously deemed eligible for EU ETS compensation, leaving them especially under-compensated.

7. We profoundly disagree with the government's arbitrary and technically unjustifiable proposal to use an unrealistically low emissions factor for EU ETS and CPF compensation purposes. The Commission's guidance states that the UK may use a maximum figure of 0.58t/CO_2/MWh, reflecting the average carbon content of electricity from UK fossil fuel plants. We are aware that a number of countries such as Germany and the Netherlands intend to compensate at their maximum level, and we believe the UK should do likewise in order to preserve a level industrial playing field. The current proposals, for example, would mean the level of ETS compensation for UK industry will only be 50% of the level available in Germany. Even if one accepts the government's argument that the CO_2 emissions factor should be consistent with that of the marginal generator, their proposal to use a figure of 0.411tCO_2/MWh, representing gas fired generation, is clearly inappropriate as there are occasions when the marginal plant is coal, oil or indeed gas in open cycle. We strongly suspect government has proposed a lower figure simply because there is not enough to go round in the compensation fund. If so, the solution is to ensure adequate funding is available, not to fiddle the emissions figures and leave vulnerable electro-intensive industries under-compensated.