HMT Carbon Price Support Consultation:
Response from the Energy Intensive Users Group

General Comments

The Energy Intensive Users Group (EIUG) is an umbrella organisation that campaigns for secure, internationally competitive industrial energy supplies. Energy intensive manufacturing sectors include steel, chemicals, paper, cement and mineral products, glass ceramics, industrial gases and aluminium smelting. These industries have a critical role to play in a rebalanced UK economy, directly employing 225,000 workers and contributing over £15 billion to UK GDP. They are at the head of many supply chains covering such important manufacturing sectors as automotive, aerospace, and low carbon generation technologies. Energy intensive sectors are highly exposed to international competition and consequently at risk of 'carbon leakage' if UK industrial energy prices are driven to internationally uncompetitive levels as a result of carbon taxation and other unilaterally imposed decarbonisation costs.

Our members appreciate the need to maintain diversity in the provision of new baseload energy generation capacity and that some assurance of an acceptable return is required for those forms of generation with very high initial investment costs which must be recouped over a lengthy future period. Indeed, our members are themselves faced with similar long-term investment decisions.

Our response to this consultation takes place in the context of escalating energy costs arising from existing UK and EU climate policies that are already eroding the international competitiveness of intensive manufacturing and deterring investment in these sectors that is necessary to assure their future. EIUG drew attention to the unacceptable cumulative burden of these policies in a report jointly commissioned with the TUC from independent consultants Water Wye Associates, which was shared with government and published in June 2010. One of the conclusions of this report – which appeared to have been accepted by government – was that future climate policy consultations should include impact assessments for intensive industrial energy users specifically, both with regard to the marginal impact of proposals *and* the cumulative burden in the context of existing policies.

Our members were understandably shocked therefore to see that, contrary to earlier assurances, Treasury had failed to publish an impact assessment of the Carbon Price Support (CPS) proposals for intensive energy users, let alone one quantifying the cumulative competitive burden in conjunction with existing climate policies. The suspicion has naturally arisen that Treasury refused to publish such an assessment for fear of publicly acknowledging the detrimental impact of the CPS proposals on industrial competitiveness.

In the absence of an adequate impact assessment, EIUG has commissioned an update report from WWA on the impact of climate policies (including the CPS and Energy Market Reform proposals) on energy intensive businesses, which is appended to this response.

EIUG strongly disagrees with Treasury's assertion (for which, revealingly, no evidence has been presented) that industrial energy users are able to pass on the costs of unilateral energy price increases. As Treasury ought already to be well aware, manufacturing businesses operate in an international market, so with the price at which energy intensive products are sold being set internationally – unlike for power generators – there is no ability to pass such costs on. The effect of the CPS proposals would simply to be to erode profit margins for UK-based manufacturers and hence, over time, to encourage carbon leakage. This fact has already been acknowledged by the government for intensive sectors covered by Climate Change Agreements, and at the European level for trade exposed sectors whose process emissions are covered by the EU Emissions Trading Scheme, so it should not be necessary to debate this matter yet again.

The effect of the CPS proposals would be to guarantee a higher carbon price impact on UK power prices than for any other EU state, which has obvious implications for intra-EU trade in energy intensive products. It cannot be acceptable for Treasury to disadvantage UK-based manufacturing in this way, tipping the playing field in favour of our European competitors. We note that no other EU government is making similar proposals – indeed, with respect to their energy taxation and renewable subsidy policies, many EU governments have taken steps to *reduce* their impact on trade-exposed industries precisely to avoid this problem.

We are also surprised that the consultation document fails to give sufficient weight to the impact of unilateral energy price increases on UK GDP. Given the expectations on industry to lead the UK out of recession, especially in the area of export led manufacturing, and the government's apparent recognition of the importance of UK manufacturing in delivering the materials and products necessary for green infrastructure investment, this is strange. The consultation document is unbalanced in this respect, overly focussed on the demands of low carbon generators and suppliers and insufficiently concerned about the needs of consumers.

It is also regrettable that the CPS proposals, along with those for Electricity Market Reform, appear to overlap both with one another. For example, if the proposals for a Feed in Tariffs for low carbon generation go ahead, it is not clear why a CPS mechanism is needed. An opportunity has been missed for the simplification and improvement in economic efficiency of climate policies – instead, the energy industry and its consumers are facing even greater complexity and policy overlap.

Absent measures to mitigate the cumulative impact of climate policies on industrial electricity prices, EIUG cannot therefore support the CPS proposals as currently outlined.

Responses to Specific Consultation Questions

Investment

EIUG supports the need to retain nuclear power within a balanced, low carbon generating portfolio and hence the need to encourage new nuclear investment.

EIUG would support reform of the Climate Change Levy so that differential rates were applied to electricity relating to the carbon intensity of the individual generators (provided that the full impact of CCL on all energy intensive sectors continues to mitigated through climate change agreements), but this proposal does not reform CCL – it merely imposes an additional tax.

Administration

The costs of the CPS mechanism, if it goes ahead, should be clear to consumers and an indication of its impact should be disclosed on their bills.

Imports and exports

The exposure of UK generators to additional carbon costs not faced by generators elsewhere in Europe will decrease the competitiveness of UK fossil-fuelled generation and (other factors being equal) tend to increase the UK's reliance on imported electricity.

Carbon price support mechanism

4.E1: How should the carbon price support rates be set in order to increase certainty for investors, in particular over the medium and long term?

The imposition of unilateral carbon costs passed on to electricity consumers will increase certainty in investors that the UK will be an increasingly unattractive place to site manufacturing businesses.

Future price of carbon

The carbon price target, should there be one, must be set at such a level that it does not materially disadvantage the competitiveness of the UK economy generally, and of trade exposed energy intensive manufacturing in particular.

Since new nuclear build cannot become operational until the end of the current decade, there is no reason for a CPS mechanism to take effect beforehand

Electricity price impacts

Individual EIUG members have shared information on their energy costs and purchasing strategy with Treasury in confidence. A copy of an update report from WWA on the potential impact of climate policies, including on profit margins, is appended to this response.