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**7 September 2018**

Dear Sir / Madam,

This submission was prepared by Citizens Advice. Citizens Advice has statutory responsibilities to represent the views of electricity and gas consumers in Great Britain. This document is entirely non-confidential, and may be published on your website. If you would like to discuss any matter raised in more detail please do not hesitate to get in contact.

We are sympathetic to the difficulties that some energy intensive industries face in maintaining international competitivity, but nonetheless have concerns regarding these proposals in a number of areas.

The proposals are inconsistent with polluter pays principles because they have the specific intention of exempting higher polluters from the costs incurred in decarbonising the economy, with the knock on effect that their avoided costs are smeared across lower polluters instead. Indeed, they may have the unintended and undesirable consequence of discouraging investments in energy efficiency in some cases, if this would result in the company falling below the exemption threshold.

They also fail to tackle one of the perceived deficiencies that is used to justify the possible need for change: that the current exemption regime may create competitive distortions between those firms who are eligible for the existing exemption and those who are not. While we agree that the current regime is likely to create a 'cliff-edge' at the exemption threshold, none of the proposals put forward would remove that cliff edge, all would simply move it.

While we note your analysis suggests that the volume of money recovered from over exempted EIIs may be reasonably nugatory, we do not agree with the proposal that it should not be redistributed to consumers without further evidence that the costs of doing so would be disproportionate. If those monies are simply recovered and kept by BEIS it would create an unhealthy precedent of government department activities being effectively part-funded by bill levies.

By helping businesses without reference to their profitability, these proposals come with risk of significant deadweight - that some businesses who may not need this financial assistance will be helped, or that others may receive help but still go bust. While the redistributive effect of the proposals on non-exempt industrial customers has been calculated as a £s/year increase in their bills at different consumption levels, no attempt has been made to gauge the impact that may have on their financial prospects. £30-110k/year added to the bill of a large non-exempt business customer may have an adverse effect on their own competitive positioning.

Before expanding the exemption regime, we would like to see BEIS undertake a fuller review of the effectiveness of the existing exemption regime. That review should take into account the potentially negative impact on non-exempt customers as well as the positive impact on exempt customers, and it should seek to test whether there is convincing evidence of the exemption regime making a critical difference to the competitiveness of exempt firms and not simply creating windfall winners and losers.

We also think BEIS should give more thought to funding the exemption through taxation rather than through bill levies. It is commonly understood that bills are a much more regressive way of funding energy policy than taxation, because they mean that a greater proportion of the costs will be met by those in lower income deciles.

I trust that this response is clear, but would be happy to discuss any matter raised within it in more depth if that would be helpful.

Yours sincerely

Rich Hall

Richard Hall
Chief Energy Economist

**Answers to consultation questions**

**1) Should the level of eligibility threshold for the exemption schemes be maintained at 20% electricity intensity?**

To the best of our knowledge, BEIS has never published a holistic assessment of the success or otherwise of the existing exemption scheme. While it has estimated its costs and redistributional effects in electricity price terms, this does not allow the reader to understand whether it has saved jobs, if so how many, its impact on the UK economy, and the impact on the global competitive positioning of both exempt and non-exempt companies.

As such, the case for even maintaining the current exemption is unclear.

While this consultation contains anecdotal assertions that the current threshold may be negatively impacting producers who fall below the current threshold, it does not evidence their claims.

**2) If the current 20% electricity intensity threshold is lowered, should it be set at 17%, 15% or 10%?**

As indicated above, no evidence has been presented that would justify a lowering of the threshold.

The proposals are inconsistent with polluter pays principles because they have the specific intention of exempting higher polluters from the costs incurred in decarbonising the economy, with the knock on effect that their avoided costs are smeared across lower polluters instead. Indeed, they may have the unintended and undesirable consequence of discouraging investments in energy efficiency in some cases, if this would result in the company falling below the exemption threshold.

Lowering the threshold would not remove the competitive distortion that currently exists between exempt and non-exempt firms, it would simply move the cliff-edge. In so doing, it is likely to create a slippery slope whereby the existing pressure for reform from those who are just below the 20% threshold is simply replaced by new pressure for reform from those who are just below the new 17%, 15% or 10% threshold.

**3) Do you agree with our proposal not to include options below 10% electricity intensity in the consideration of a lower eligibility threshold for exemption schemes?**

Yes. The consultation does not present convincing evidence to justify any reduction in the exemption threshold. No case has been presented for a reduction this severe.

We note that neither the consultation nor the impact assessment attempts to assess the distribution impact of a threshold below 10%. As such, were you to subsequently consider a lower threshold we think you would need to restart the consultation process.

**4) Should the aid intensity be reduced for EIIs in a lower tier of electricity intensity in order to manage costs for other consumers?**

Yes, for two reasons.

Firstly, for the one identified in the question: to manage costs for other consumers. While these may appear individually small in the case of household consumers, we are mindful that most policy costs appear individually small - but that in aggregate, they start adding up to significant figures. The National Audit Office has estimated that £132 (13%) of the average household bill in 2016 related to policy costs and that this figure would rise to £164 by 2020.[1] The EII exemption is simply one of a range of costs passed through to household consumers and it is important that BEIS keeps a lid on policy cost inflation in all areas.

In the case of non-exempt business consumers, the costs appear potentially significant. £30-110k/year added on to the bill of a large non-exempt business consumer is a large unwanted addition to their cost base and may, where that business is already struggling, adversely affect its chances of survival or employment plans. Non-exempt businesses will also suffer the uncosted consequences of reduced competitiveness against newly exempt businesses.

The second reason why we think reduced aid intensity in lower tiers would be appropriate is because it would soften the cliff edge that currently exists between exempt and non-exempt businesses. While there would continue to be jumps in the level of aid intensity that a business qualified for when it passed through an exemption threshold, it would not simply jump from 0% to 85% but would pass

[1] 'Controlling the consumer funded costs of energy policies,' NAO, October 2016. https://tinyurl.com/y89jzbzx

through intermediate tiers. This would not remove the competitive distortion that would exist between exempt and non-exempt firms, but should soften it.

**5) If the aid intensity is reduced for EIIs in a lower tier of electricity intensity, do you agree with the structure set out in paragraph 4.8. If no, please explain what structure you would prefer.**

No comment.

**6) Do you have any other suggestions for achieving the right balance between supporting EIIs and managing the cost to other consumers?**

We think that the government should consider whether the costs of the exemption could be met through taxation, and that it should narrow eligibility to only support those firms where it will genuinely make a difference to their prospects of survival.

It is commonly accepted that paying for policies through bill levies is regressive when compared to paying for them through taxation, as it results in a greater proportion of the costs being met by those in lower income deciles. Some energy policies, albeit a minority, are paid for through taxation and it would mitigate the detrimental distributional effect of this policy if BEIS were to add the EII exemption to that group.

The interests of household energy consumers in this decision are broader than simply in relation to the energy they use. They also have a stake in the prosperity of the country, and form the employee base and in many cases are shareholders (whether directly, or through pensions) of our industrial sector - the companies affected by these proposals. As such, we think that household consumers may have some sympathies with providing support to electrically intensive industries *if it will make a difference* to their survival and growth. In our view, there is a very significant difference between the likely social acceptability of providing aid that makes a crucial difference to the survival chances of major employers, which may be justified, and simply reducing the bills of already viable businesses (or ones that will go out of business whether with or without aid), which would simply provide an unjustified windfall gain at the expense of household and small business consumers.

Unfortunately, the framing of the exemptions policy does not allow this distinction to be borne in mind. In its current form, the exemption treats all companies above the exemption threshold for electrical intensity in defined sectors in the same way, and in need of support.  It is a very crude proxy for industrial 'vulnerability.'  We would like to see BEIS consider whether aid could be more targeted to take into account companies survival chances, with or without it.  The focus of the policy should be to only provide aid where it will materially affect the chances of businesses surviving.  This could perhaps take the form of a profitability test.  The benefits of narrowing down the focus of the exemptions scheme in this way would both be by reducing the cash spend and distributional effect (because fewer companies would be eligible), and maintaining public buy-in (because only businesses who genuinely needed support would receive it).  Without this, there is a risk that this policy is simply perceived as being, or actually is, free cash for heavy polluters.

**7) What was your company turnover in the last financial year?**

**8) What was your average electricity intensity in the last three financial years?**

**9) Are there any other competitive issues that ineligible businesses face from eligible EIIs? and**

**10) Do you have evidence which would help us to improve the estimated impact of each of the options for a lower electricity intensity threshold?**

No comment.

**11) Do you have any other comments on the Impact Assessment?**

As set out in our response to question 6, we think that this form of industrial aid may be more socially acceptable if it will make a genuine difference to the viability of the recipient firms.  The Impact Assessment does not provide any assessment of the number of jobs that may be saved at eligible companies, or that may be lost at ineligible companies who would face higher bills.  There is also no persuasive explanation of why BEIS is not choosing to take into account the impact that this measure may make on the profitability of eligible companies.  In our view, it would be unjustified to provide cash handouts to exempt companies, at the expense of non-exempt companies and households, where they are already viable businesses.

**12) Do you agree with the proposal not to redistribute the value of recovered over-exemptions back to suppliers of other consumers (who could pass on the savings to consumers)?**

No, we do not.

While we note your analysis suggests that the volume of money recovered from over exempted EIIs may be reasonably nugatory, we do not agree with the proposal that it should not be redistributed to consumers without further evidence that the costs of doing so would be disproportionate. If those monies are simply recovered and kept by BEIS it would create an unhealthy precedent of government department activities being effectively part-funded by bill levies.

**Questions 13-18:**

No comment.