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EIUG Response to the Green Paper on the UK's Modern Industrial Strategy

Introduction

1. The Energy Intensive Users Group (EIUG) is an umbrella organisation that represents the interests of energy intensive industrial (EIIs) consumers. Its objective is to achieve fair and competitive energy prices for British industry. It represents manufacturers of steel, chemicals, fertilisers, paper, glass, cement, lime, ceramics, and industrial gases. EIUG members produce materials which are essential inputs to UK manufacturing supply chains, including materials that support climate solutions in the energy, transport, construction, agriculture, and household sectors. They add an annual contribution of £29bn GVA to the UK economy and support 210,000 jobs directly and 800,000 jobs indirectly around the country.

2. These foundation industries are both energy and trade-intensive and continue to invest in the UK. To compete globally, EIIs need secure, internationally competitive energy supplies and measures to mitigate the risk of carbon leakage. However, inward investment, growth and competitiveness have been hampered for years by UK energy costs being higher than those abroad. This has increased the risk of carbon leakage and deterred investments in decarbonisation. In some cases, investment, economic activity, emissions and jobs have relocated abroad, leading to a subsequent increase in imports, decrease in productivity and reduction in UK GDP.

3. This response focuses on those questions from the consultation of most interest to EIIs.

How should the UK government identify the most important subsectors for delivering our objectives?

4. The key structural challenge with the UK economy that many analysts and commentators – and the green paper identifies – is the relative slowdown in productivity increase compared to other countries. Many analysts and commentators have pointed to possible causes and solutions to address this productive gap as well, such as low public and private investment, lack of house-building, infrastructure falling behind and relative high electricity prices. A focus

on eight growth-driven sectors proposed in the green paper will not address the UK's productivity challenge.

5. The more horizontal policies to create a pro-business environment, such as people & skills, innovation policy and energy and planning reform better address it, but do need a targeted focus.

6. The green paper identifies economic security and resilience as one of the objectives of the industry strategy and propose to "reduce supply chain and other vulnerabilities in growth-driving sectors which could harm their long-term growth or ability to deliver critical outputs". Reducing supply chain vulnerability should apply to the whole economy, instead of only to growth-driving sectors.

7. Key to making the UK economy less vulnerable to external trade shocks is the role of critical materials in supply chains. Various Departments should have a reasonable understanding of their role following (unpublished) external research for Government to analysis the risk of interruption to trade in critical materials during the Covid-pandemic and Brexit discussions.

8. Those analyses will show the role foundation industries play in the supply of critical materials to the UK economy, including those sectors the paper identifies as high-growth sectors. These foundation industries manufacture materials crucial for the supply chain of other sectors. They also manufacture materials for new infrastructure and housing and manufacture materials crucial to decarbonising the UK economy. Foundation industries not only supply materials for advanced manufacturing but are also part of advanced manufacturing.

9. The green paper recognised this as well, up to a point, when it states that "*The Sector Plans will also include policies for those subsectors on which the growth-driving sectors have critical dependencies. To that end, value chain analysis is being progressed, to identify subsectors within 'foundational' sectors*". As the criticality of materials manufactured by foundation industries for those sectors the green paper prioritises is pretty obvious, it seems peculiar to exclude them from the focus sectors.

10. Furthermore, these subsector also contribute to the following Government objectives:

    - **Net zero**: all foundation sectors deliver products that are essential to our everyday lives and to the transition of the whole economy to net zero;
    - **Regional growth**: foundation sectors are spread up and down the country and not just focussed in one area of the country;
    - **Employment**: foundation industries often provide well-paid employment in those areas with a lower than average incomes, both directly and indirectly.

11. Government should also heed the approach in industrial strategies of other countries to inform its approach, in particular the policies in the EU, US and China.

How should the UK government incorporate foundational sectors and value chains into this analysis?

12. In incorporating foundational sectors into its analysis, the UK Government should map and recognise the criticality of certain materials for supply chains across the economy. Understanding the linkages between upstream and downstream supply chains is vital for assessing the broader economic impact of supporting any particular sector. Again, departments will have already partly done this as part of the Covid-19 response and Brexit preparations.

13. Furthermore, Government should assess what impact foundation industries have on those growth sectors it has identified and what dependencies there are between them for these sectors to thrive.

What are the key enablers and barriers to growth in these sub sectors and how could the UK government address them?

14. One of the major barriers to growth for foundation industries in the UK is the significant policy incoherence and uncertainty, in particular relating to climate pricing and energy policies. Government has not provide clarity about some of these key policies and foundation industries in the UK see investments go elsewhere that could have gone to the UK. This is not a pro-business environment.

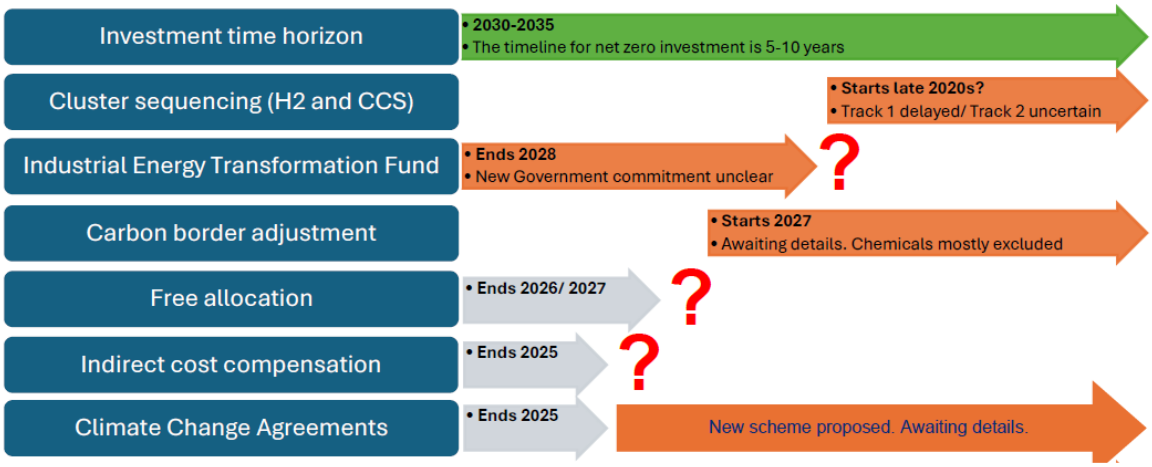
15. As foundation industries tend to be energy-intensive, one of the key barriers to their growth is relatively high industrial electricity prices in GB. The green paper recognises that these high electricity costs are a major barrier to growth and investment. It says that "*on average, very large UK energy users face relatively high electricity prices compared to EU competitors (£228/MWh in 2023, compared to £108/MWh in France and £148/MWh in Germany) although about 400 of the most electricity- and trade-intensive UK industrial users benefit from lower electricity prices due to Government policies".* Though these policies reduce the electricity price differential, they do not remove it.

16. UK Steel's analysis finds that steel producers in the UK typically face an average electricity price in 2024/25 of £66/MWh, compared to the estimated German price of £50/MWh and French price of £43/MWh. This means UK steelmakers still pay up to 50% more than their main counterparts in Europe, even after the Government's policies to reduce industrial electricity prices.

17. The risk of carbon leakage is another significant barrier for foundation industries. HMT's Net Zero Review defined this risk pretty well and recognises that it poses a threat to jobs, economic growth, and the UK's decarbonisation goals. The

Government will therefore introduce a carbon border adjustment mechanism (CBAM) to reduce the carbon pricing differential between UK manufacturers exposed to carbon prices and those outside the UK who do not and not at all. However, the EIUG does not believe that the design of the CBAM, as set in HMT's consultation response, is as effective as it should be. A more effective CBAM is important to mitigate the risk of carbon leakage and ensure the success of the UK's Industrial Strategy. The EIUG would also like to refer to the response by the Commission for Carbon Competitiveness.

18. Furthermore, the various Government policies to mitigate the risk of carbon leakage and support foundation industries to decarbonise are not well aligned. The figure below shows the timetable of key policies to mitigate the risk of carbon leakage and support industrial decarbonisation – without electrification – relative to an average large investment time horizon of foundation industries. This misalignment is a significant barrier to investment in the UK.



19. The EIUG recommends that Government assesses how these policies interact, including the CCUS and hydrogen business models and support for industrial electrification, and identifies the policy that is on the critical path – CBAM from the EIUG's perspective – and align the timetable of the other policies with HMT's CBAM timetable, i.e. a far more holistic approach to its policy-making to provide more long-term visibility to business and achieve the overall goal of Net Zero.

20. The EIUG believes that linking the UK ETS and EU ETS at the appropriate time is in the best interest of the energy intensive industries in the UK. Linking different emission trading systems of similar ambition, would minimise competitive distortions due to different carbon prices, reduce price volatility and trading under separate CBAMs in the future. The aim should be a global carbon price in the long-term, but until then the ability of energy intensive industries to compete internationally should not be undermined by competitors who do not face an equivalent carbon price in their manufacturing process.

21. The EIUG sees linking the emission trading schemes as constituting an international trade mechanism that retains full use of revenues and the ability to

set the majority of the rules. Any linking agreement should benefit both the UK and EU economy whilst taking into account their specific sectoral circumstances.

What are the barriers to competitive industrial activity and increased electrification, beyond those set out in response to the UK government's recent Call for Evidence on industrial electrification?

22. The key barrier to increased electrification of manufacturing processes of the foundation industries is relatively high electricity prices in the UK, as set out above. The EIUG recognises the various policy changes Governments have made to reduce the cumulative impact of energy and climate change policies on industrial electricity prices, but so have other Governments across Europe. Electricity network charges still remain relatively high compared to France and Germany, even after taking the network charge compensation (NCC) scheme into account. The EIUG therefore urges Government to match their schemes by increasing the rate of the NCC from 60% to 90%.

What examples of international best practice to support businesses on energy, for example Purchase Power Agreements, would you recommend to increase investment and growth?

23. Government is a member of the International Energy Agency which has a database of support measures for business on energy. DESNZ also analysed international policies to inform the Industrial Decarbonisation Strategy published in 2021.

24. On power purchase agreements (PPAs), while some foundation industries have taken them up, it is not a common arrangement for these industries for a number of reasons:
    - **Volume:** the market for corporate PPAs is not yet mature enough to provide PPA to energy intensive industries (EIIs) for the volume of electricity they consume. Some EIIs will have struck a PPA but only for a small portion of their overall consumption.
    - **Counterparty risk:** Agreeing to a long-term PPA of, for example, 15 years does carry additional risks, as the counterparty may not be there in 15 years' time.
    - **Price volatility**: a PPA may provide a certain degree of price certainty, but the market price could drop below the agreed PPA price, exposing the EIIs to higher electricity costs which is significantly magnified by their large volume of consumption.

25. While PPAs have their place, potentially as part of the commercial hedging strategy for foundation industries, they are not a solution to relatively high industrial electricity prices in the UK.

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