

## **Stern Review on the Economics of Climate Change**

### **Submission by EEF, the manufacturers' organisation**

**16 December 2006**

#### *Introduction*

EEF, the manufacturers' organisation, has a membership of 6,000 manufacturing, engineering and technology-based businesses and represents the interest of manufacturing at all levels of government. Comprising 11 Regional Associations, the Engineering Construction Industries Association (ECIA) and UK Steel, EEF is one of the UK's leading providers of business services in employment relations and employment law, health, safety and environment, manufacturing performance, education and skills, and information and research.

We welcome the opportunity to contribute to the Stern Review on the economics of climate change. Undoubtedly, climate change is one of the most pressing concerns facing today's society, and the manufacturing sector has played – and will continue to play – a key role in tackling emissions and improving energy efficiency.

Of the individual points raised within the review's terms of reference, the first, third and fourth are of most relevance to EEF as an organisation representing manufacturing companies. Therefore, we have attempted to bring together our views on the climate change debate – encapsulating the key points that fall under these three bullets – within the body of this document.

#### *Emissions Reduction must be a Multinational Approach*

Our key message is that the tackling of emissions has to be a *multinational* approach. EEF remains committed to working towards reductions in emissions – both through helping to ensure manufacturing becomes a cleaner industry and also through working with government to deliver greater energy efficiency and a more sustainable and competitive solution to energy supply. However, the fundamental point is that the gains from a substantial reduction in UK emissions will be wiped out by the rising emissions which will result from strong economic growth in countries such as China and India, unless significant action is taken to encourage the take up of low carbon technologies in the developing world.

Amongst the key mechanisms to achieve this are the 'project credits' under the Joint Implementation Schemes and the Clean Development Mechanism, stemming from the Kyoto protocol. These project credits, which can be used within the EU ETS, will facilitate international action on climate change mitigation and support sustainable development in both developed and developing countries by helping to reduce emissions at the lowest cost location. However, the principle of complementarity potentially acts as a barrier to maximising CO2 emission

reductions because effectively it increases the cost to companies of achieving emissions reductions where lower cost opportunities could be exploited.

We must also remember that manufacturing is a globalised industry, with many companies taking day-to-day decisions about the movement of production capabilities around the world. Companies are increasingly moving some lower value added production into low cost locations and refocusing in developed countries on activities such as design, innovation, marketing, niche production and new revenue streams from services. In many cases, the low cost location will be in countries such as China where emissions are substantially less constrained. However, this will not always be the case, given that the importance of being close to the customer will sometimes favour 'near shoring' over 'offshoring'. Nonetheless, the essential point is that we need to think carefully about policies that may unintentionally raise global emissions by pushing activities out of countries such as the UK.

### *Emissions Trading System (ETS) and Climate Change Levy*

EEF has supported the EU ETS as a market-based mechanism to encourage reductions in carbon emissions. In practice, we have raised concerns relating to the UK's leadership role and the consequent lack of a level playing field across the EU and the inadequate lead times that allow the firms involved to plan ahead. In addition, the UK's more liberalised energy market means that UK energy prices are more likely to result in higher carbon prices associated with EU ETS. These issues are important for manufacturing at a time when the inability to pass on higher costs to customers means margins are getting squeezed.

In addition, the EU ETS is an immature scheme. The short duration of the phases and the widely-held perceptions that many European governments lack the political will to meet the commitments that they have made, means that it fails to send out clear signals to companies on what they need to do, and to potential investors in low carbon energy sources. This is important given that the UK has a market-based energy policy, from which it has largely benefited. A more mature and credible EU ETS would remove the need for the existing Renewables Obligation. We would also not need to look at mechanisms such as a Low Carbon Obligation, as proposed to encourage investment in capital intensive low carbon energy sources such as nuclear power.

EEF has also campaigned for reform of the climate change levy. Our joint survey with the CBI showed that companies within climate change agreements were significantly more likely to have invested in energy-saving equipment and to have achieved reductions in energy use. A combination of carrot and stick is far more effective in achieving results. This approach is reflected in the proposals made just last week by the Carbon Trust to extend the focus of measures to encourage greater energy efficiency and reduced carbon emissions beyond energy-intensive manufacturing sectors. Concerns over state aid have often been raised as an obstacle to going down this route but we believe that the importance of this issue means greater effort should be invested in finding ways round it. In this respect, we support the

recommendations of the Office of Fair Trading to the European Commission that state aid rules should focus more on tackling major market distortions rather than relatively small measures that could promote outcomes such as increased innovation or environmental benefits.

### *Energy efficiency*

Action on energy efficiency must be a key part of addressing climate change. In some cases, this can actually help companies to improve their competitiveness and profitability by identifying areas of waste in their business. Already, many of the heavy energy users have dramatically tackled emissions and become more efficient users of energy. The potential for further gains amongst these firms may therefore be limited. Greater attention therefore needs to be focused on other areas such as smaller firms, other parts of manufacturing, and public and private service sectors. The Carbon Trust is starting to focus more on some of these sectors – a trend that we welcome. However, we believe that we should explore the potential of the Manufacturing Advisory Service to help business to address energy efficiency more effectively. EEF also believes that policy makers need to devote more attention to the reduction of carbon emissions from the transport sector, and in improving energy efficiency amongst domestic users.

### *Decisions on energy supply will also play a critical role*

Our final point is that decision on our future energy supply will have a critical influence on our ability to tackle climate change. It is essential that we develop a balanced energy strategy in which renewable energy, clean coal and nuclear power all play a role in generating low carbon forms of energy. Our thoughts on this issue are summarised in an EEF report *Sustainable Energy – A Long-Term Strategy for the UK*, a copy of which we have attached for your information. We hope that you will find this of use to your review.