BRITISH ceramic CONFEDERATION

Federation House, Station Road, Stoke-on-Trent. ST4 2SA
Tel: (01782) 744631 Fax: (01782) 744102
E-mail: bcc@ceramfed.co.uk
www.ceramfed.co.uk

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Rt Hon Philip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Chancellor,

CERAMICS REPRESENTATION FOR SPRING BUDGET 2017

The British Ceramic Confederation (BCC) is the trade association for the UK ceramic manufacturing industry, representing the common and collective interests of all sectors of the industry. Its 100 member companies (75% of which are SMEs) cover the full spectrum of ceramic products and comprise over 90% of the industry's manufacturing capacity. The sector in the UK employs about 20,000 people directly with at least as many in indirect jobs. Annual sales, including suppliers are around £2 billion with over £500 million exports. Members range from large multinationals to SMEs making a range of products that will contribute to the success of Brexit and improve the UK's balance of payments. Membership of the Confederation is extremely diverse - containing both foundation industries and advanced manufacturing / materials.

All energy-intensive industries (EIIs) face similar issues; and the **Ceramic EARTH campaign**[1] aims to ensure that this is recognised.

Our sector's full potential is not being realised because of a combination of policies. While ceramic exports have grown in recent years, the UK ceramic sector's overall trade balance stands at a deficit of almost £1 billion, and has grown steadily. UK Government can help reverse this trend, but we need a level playing field to compete internationally. We have five asks requiring urgent and decisive ministerial action including by HMT:

E	**Emissions Trading Scheme**. Whether part of the EU ETS, or as a separate scheme, the government needs to ensure all ceramic sub-sectors receive mitigation measures in full to guard against carbon, investment and job leakage risks to competitors outside the UK.
A	**Action to lighten the cumulative costs of UK energy, climate and environmental policies** which harm the sector's ability to remain internationally competitive.
R	**Reduce industrial CO_2 emissions** by developing a long-term partnership with co-funding assistance for the sector to accelerate the development and implementation of breakthrough technologies.
T	**Trade freely but fairly**. Ensure an adequate and comprehensive UK-EU trade settlement obtaining, if possible, tariff free access to the EU. New UK free trade agreements must support UK ceramic manufacturers. Develop adequate UK Trade Defence Instruments to protect UK manufacturers against dumped products. Reject unilateral EU and UK recognition of China as a Market Economy until it meets accepted criteria.
H	**Housing**. Achieve higher growth for the UK economy from government housing policy by enabling investment in the supply chain here rather than overseas.

[1] Ceramic EARTH Campaign – Update after Referendum
http://www.ceramfed.co.uk/download/key-topic-1156.docx

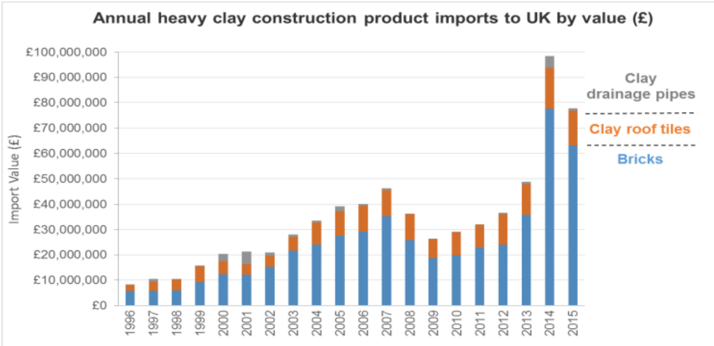
EU ETS

The UK needs to take a holistic approach on issues affecting energy-intensive industries, working jointly across Government departments including HMT to prevent carbon, investment and job leakage. A combination of current policies is deterring investment and is threatening business survival. Our members' businesses compete internationally and are at high risk from unilateral UK and EU climate policy costs.

The biggest deterrent for future investment to many of our businesses is the UK's policy support of 'tiering' of free allowances in the EU Emissions Trading Scheme (EU ETS) after 2020. Although both the European Parliament Industry (ITRE) and Environment (ENVI) committees rejected tiering of free allowances in Q4 2016, ENVI's formally-adopted position introduced an entirely new and equally-damaging proposal for a border adjustment mechanism (BAM) one day before the vote. This would apply to all energy-intensive sectors with trade intensity below 10% and would see the establishment of an 'import inclusion' scheme. Allowances would then be bought / surrendered for imported products; and EU producers in those sectors – including all our brick, roof tiles, clay drainage pipes, expanded clay and kaolin sites in the scheme - would receive no free allowances after 2020 (regardless of whether they meet any quantitative or qualitative metrics for determining carbon leakage risks).

The UK Government's tiering proposals would mean that world class new energy-efficient brick, roof tiles and clay pipe factories would have to buy almost all their carbon allowances after 2020. Under the ENVI committee's BAM proposal, they would need to buy all of their carbon allowances after 2020); making them hugely uncompetitive compared with overseas competitors. The projected costs of carbon for this sector are likely to exceed profits in the 2020s for most ceramic manufacturing sites in EU ETS. Investment is now stifled when there is a strong demand for these products for new homes.

We need UK Government to oppose both Border Adjustment Mechanisms and Tiering measures at the imminent Environment Council meeting. While HM Treasury does not lead on this policy, there is a responsibility to ensure the full economic consequences are understood on jobs, businesses, investments and costs if jobs are lost – and this has been lacking in work we have seen to date from any UK department.



Products where the UK has been largely self-sufficient for many decades are now seeing unprecedented levels of imports (source: HMRC UKTradeInfo).

The referendum outcome and the Prime Minister's intention to leave the Single Market represents a major opportunity for the UK to shift to a holistic, novel and fairer approach to delivering industrial greenhouse gas emission reductions whilst enhancing the UK's competitiveness, jobs, growth and investment. We want to work with Government, including HMT to explore a fairer approach and internationally competitive, including alternatives to the EU ETS.

Action to lighten the cumulative costs of UK/EU energy, climate and environmental policies

All UK ceramic businesses require secure and affordable energy. They all compete in fiercely competitive global markets. They all are at high risk of carbon, job and investment leakage. We need a level playing field on costs while we remain in the EU, yet are paying 80% more than the EU average costs for electricity. Given the Prime Minister's intention to leave the single market and therefore remove EU state aid requirements, the Spring Budget should set the scene for what will be done after we leave the EU to improve the competitiveness of the UK's energy-intensive industries, including ceramics, beyond those in the EU.

Divergence in energy and decarbonisation costs relative to competitors (both EU and non-EU) has already lead to some relocation of production, loss of jobs / skills, financial costs to Government (e.g. benefit payments, lost revenue to HM Treasury) and the potential for net increases in global emissions. The current cost of energy and climate policy regime is extremely challenging for the UK ceramic sector and threatens company viability in the medium-term. Action on the following is urgently required if the sector is to retain an internationally competitive position:

i) Adequate mitigation for the direct costs associated with greenhouse gas emission reductions.
ii) A complete overhaul of indirect cost compensation associated with greenhouse gas emission reductions to ensure all electro-intensive sectors, subsectors and installations are protected.
iii) Early repeal or phasing out of the 'UK-only' Carbon Price Floor (which is completely uncompensated for our sector). If this cannot be achieved, then the tax must (at least) be frozen permanently. We were very disappointed in the Autumn Statement there were no moves to announce the abolition of the tax, which

continues to undermine the competitiveness of UK industrial electricity users and hope the Budget addresses this issue.

iv) BCC remains concerned that the government has still not made any formal commitment to continue compensation for Renewable Obligation (RO) and Feed in Tariff (FIT) after April 2017 despite the fact that the delay in securing EU state aid approval means an exemption from these costs cannot now be in place by then, as originally planned. HMT should recognise that our members require this assurance immediately, and that further delay in providing this (e.g. on grounds of Budget purdah) is unacceptable. We would also like a statement in the Spring Budget about what measures will be taken to broaden relief as only seven (out of ~ 100) BCC member companies are compensated for some renewables costs, unlike many of their EU competitors (e.g. in Germany, Italy, Austria and France). There is an opportunity to broaden this compensation at no cost to HMT when GB moves to an exemption by lowering the business test threshold. This is an urgent requirement as UK industrial users continue to pay 80% more for their electricity than the EU average.

v) BCC recognises the importance to BEIS and to low carbon energy investors of having clarity about future subsidy levels for as far ahead as is reasonably practical. It is equally important for energy users in enabling them to understand the likely impact of subsidies on future energy costs in general, and the adequacy or otherwise of measures designed to prevent carbon leakage from trade-exposed EIIs in particular. We are open-minded about the precise form the Levy Control Framework (LCF) or its successor should take, so long as HMT continues to limit the total costs while promoting lowest cost electricity decarbonisation over the medium term, and also provides clarity on the likely impact over this period of those subsidies on energy prices to EIIs and other users. We trust that the Spring Budget will include specific details of how the LCF or its replacement will be implemented after 2020/21, together with a firm commitment that government will publish annual assessments of the aggregate impact on consumers in general, and on EIIs specifically, during the period covered.

Moreover, energy security is essential to maintain business operations and long term investment certainty. At times of energy shortages, industrial users are particularly vulnerable, both in terms of the exposure to higher / more volatile energy costs and the major damage that can be caused to continuously operating high temperature kilns if gas or electricity supplies suddenly cease. Successive Governments have concluded that the market will deliver the UK's gas security. However, with no significant new gas storage capacity constructed in recent years coupled with Centrica Storage's Rough facility (which accounts for around 70% of total UK gas storage capacity) ageing and operating at reduced capacity this winter, we feel Government urgently needs to reconsider the case for supporting new and existing gas storage facilities. One option for doing this, as the Prime Minister said in July 2016, is using "*more Treasury-backed project bonds for new infrastructure projects"* as the market is not delivering the necessary investment. Our calculations allowing for a 30 year life, cost of capital, finance and cushion gas indicate an additional cost to all consumers of 1p/therm. This is before factoring in the significant benefits of reduced energy price volatility and greater security of energy supply. Our members feel this is affordable for them. Government also needs to take urgent action to create a clearer pathway with timeframes / milestones for delivery of new electricity infrastructure.

Reduce industrial CO_2 emissions

We would welcome a range of measures to help boost investment in both proven and breakthrough technologies to ensure more energy / carbon efficient manufacturing, including:

i) The Government will need to develop support mechanisms analogous to those in already established in the power sector if EIIs are to decarbonise as envisaged in the 2050 Roadmaps that BEIS has been developing in conjunction with industry. We support establishment of an energy efficiency fund of up to £100 million over the course of the Parliament, enabling EIIs covered by the 2050 Roadmap process to unlock substantial investment in additional proven energy efficiency measures.

ii) We have developed costed plans for an extension of the Energy Technology List (ETL) / Enhanced Capital Allowance (ECA) scheme to cover a wider range of technologies relevant to heat-intensive sectors (covering; "ovens", "heaters", "control", "insulation" and "heat recovery"). The annual cost to government (over a 5 year Government term, but excluding interest costs) is approximately £3 million for the ceramics sector. BEIS and the Carbon Trust are supportive of this approach and we have previously taken your officials through our analysis.

iii) To develop new commercially viable "breakthrough" decarbonisation technologies we have been active in encouraging our members to apply for EU funding to deliver industrial decarbonisation, e.g. through Horizon 2020, SILC etc. However after the vote to leave the EU access to these substantial EU funding streams has already been made more difficult and could cease. It is imperative that similar UK funding is forthcoming applicable for a range of heat-using industries to meet our longer term emissions reductions targets. We stress that these must be grants and not loans.

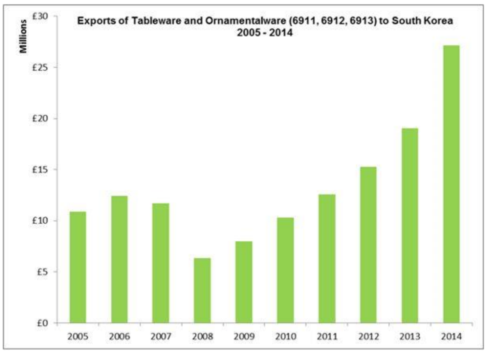
During the policy uncertainty as we leave the EU, temporarily raising Annual Investment Allowances to £1 million until 2019 would help boost capital investment (CBI previous cost estimate £1 bn pa).

Trade freely but fairly

UK Ceramic manufacturers make products heavily traded across the world. Free trade is welcomed by our members, provided it is fair. If trade conditions are right our sector is in a strong position to grow exports and fully contribute to a more even balance of trade. Three key areas are:

i) With half ceramic exports sold in the EU, it is of no surprise that our members are anxious to avoid any tariff and non-tariff trade barriers that could make their products less competitive in this crucially important market and we support a speedy comprehensive UK-EU Free Trade Agreement. If after Brexit, WTO Most Favoured Nation rates apply, these would be 5-12% to the EU for our most exported subsectors. If these costs were passed through to customers as UK manufacturers would find these difficult to absorb, this would make UK products much less competitive in the price-sensitive EU market. **The industry needs to keep tariff-free access to this market.** Some commentators have suggested that a list of possible policies, in combination with a weak pound, could fully offset tariffs; we have no confidence that this can be achieved as currency prices are often volatile and the required number of UK policy reversals required is unlikely. **The industry also needs to keep access to the EU single market free from non-tariff barriers (NTBs)**.

ii) At present British manufacturers benefit from Free Trade Agreements (FTAs) that the EU has negotiated with other countries to remove tariffs, making UK–manufactured goods more competitive in those markets. The importance of "good" FTAs to the ceramics industry is demonstrated by exports to South Korea. The EU and South Korea signed a Free Trade Agreement that came into force on a provisional basis on 1 July 2011. This reduced import duties on UK goods being sold to South Korea. The graph (HMRC UKTradeInfo) shows a rapid rise in exports of ceramic tableware to £28 million per year. This equates to about 200 extra UK direct jobs (mainly in the West and East Midlands) and indirect benefits to UK suppliers of clay (South West region), glaze, kilns etc. South Korea is now the second largest non-EU export market for ceramics (after the United States). **Transitional arrangements whereby the UK is able to remain party to the EU's FTAs until it is able to sign its own similar UK-third country agreements would be highly welcomed by our industry.**



iii) For genuine free trade there must be fair competition, without distortions, between domestic and foreign producers. The EU's system of Trade Defence Instruments (TDI), including a non-market economy methodology in dumping investigations when relevant, has been somewhat effective in 'levelling the playing field' where unfair trade practices have occurred. We concur with the House of Lords EU Committee's 5th Report of the 2016-17 Session which concluded:

> *"Whatever framework the Government adopts, it will also need to establish a domestic authority for trade remedy investigations, to replace the work currently undertaken by the Commission on behalf of EU Member States. This will require capacity-building in a specialised area of law. This may take a considerable time, and should therefore be an early priority in preparing for Brexit."*

Since the introduction of the anti-dumping tariffs by the EU covering imports from China of tiles (2011) and tableware (2013), UK-based producers have been able to stabilise, invest in their manufacturing facilities and start to reverse the trend of job losses. Employment in UK floor and wall tile manufacturers has increased by nearly 40% and in the tableware and giftware by nearly 20%. Employment has also increased in the UK supply chain. The risk is that if dumping was allowed to resume unabated after the UK leaves the EU, this progress would be lost. There needs to be a clear plan to manage the transition from EU TDIs to new UK trade remedies, with continuation of active measures for our sector until UK investigations are completed. This is not an area where the UK Government has had legal competence for many years and while we welcome the establishment of a DIT Trade Remedies team, this needs to be adequately resourced and responsive to the needs of UK manufacturers.

We recognise that HM Treasury does not lead on trade matters, but there is a responsibility to ensure impartial and fact-based analysis and objectivity is used in ascertaining, for example, whether China is or is not a market economy and not a largely political decision made without evaluating broader economic consequences on UK manufacturing and trade, both now and in the future.

Housing

There are opportunities to achieve higher growth for the UK economy from Government construction investment, by enabling investment in the supply chain here rather than overseas. Clearly more house-building is needed to meet UK need and we would welcome supply side measures in the Spring Budget bringing forward construction sooner. In order to meet medium and long-term UK housing stock needs, policies must take into account factors of quality and service life. It is important that Government does not distort the market by subsidising imported construction materials or untried technologies. UK-manufactured materials must not be disadvantaged.

There are significant economic benefits of retaining and growing UK production of construction products to meet a burgeoning housing need and maintaining alignment with the "UK Construction 2025 Industrial Strategy: Government and industry in partnership". More investment in new UK manufacturing capacity now needs to be made. This would also help boost productivity. A key target of this Government strategy is a 50% reduction in the trade gap by 2025 between total exports and total imports for construction products and materials[2.] If we get this right by working in partnership there is an opportunity to provide an additional 4,000 direct ceramic manufacturing jobs, mainly in areas of high unemployment, and £300 million per year for the UK economy as well as capital investment of approximately £800 million. Our members would welcome working across Government departments to help ensure the essential principle of "Government and industry in partnership" is followed.

BCC would be keen to discuss any of these issues with HMT ministers or officials at the earliest opportunity. In the meantime, we trust the concerns we have raised will be given serious consideration, and that relevant announcements will be included in the Spring Budget. We would be delighted if you would like to visit a ceramic manufacturing site so we can explain these issues at first hand.

Yours sincerely

Dr Laura Cohen MBE
Chief Executive
Tel: 01782 572845
Email: laurac@ceramfed.co.uk

cc

Rt Hon Greg Clark MP, Secretary of State for Business, Energy and Industrial Strategy
Rt Hon Sajid Javid MP, Secretary of State for Communities and Local Government
Rt Hon David Davis MP, Secretary of State for Exiting the European Union
Rt Hon Liam Fox MP, Secretary of State for International Trade
Rt Hon David Gauke MP Chief Secretary to the Treasury
Rt Hon. Lord Young of Cookham, CH, Commercial Secretary to the Treasury
Nick Hurd MP, Minister of State for Climate Change and Industry
Brendan Bayley, Rachel King, Lara Phillips, Alex Routledge, Nico Heslop - HM Treasury
Niall Mackenzie, Carolyn Campbell, Robin Webb, Andrea Whitworth, Dan Osgood, Paul van Heyningen, Anna Osborne, Amy Lilley, Carly McGurry - BEIS
Nick Tennant - DCLG
Rosa Wilkinson, Amanda Brooks - DfIT
MPs / MEPs with ceramic manufacturing interests
BCC Board; Brick Development Association
Trade union contacts – TUC, GMB, Unite

[2] Balance of Trade - Construction 2025: Industrial Strategy: government and industry in partnership (July 2013) https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/210099/bis-13-955-construction-2025-industrial-strategy.pdf (page 5)