CHEMICAL INDUSTRIES ASSOCIATION

CIA Spring Budget Representation 2023

Executive Summary

We are calling for action in five areas:

1. **Energy:** Increase the Energy Intensive Industry (EII) exemption aid intensity to 100%, pursue Review of Electricity Market (REMA) reforms, ensure Climate Change Agreement (CCA) reform does not remove carbon leakage mitigation, launch consultation on UK Carbon Border Adjustment Mechanism (CBAM).
2. **Investment incentives:** Compete with US' Inflation Reduction Act (IRA) and EU's soon to be confirmed response. To follow the Super Deduction - full expensing of main rate plant and machinery in the first year and a 50% first year allowance for special rate plant and machinery.
3. **REACH:** A more cost-effective UK registration system, revision of GB REACH fees so that they are proportionate rather than identical to EU REACH.
4. **Sustainability / net zero:** Streamline sustainability reporting, establish a UK ETS innovation fund from its auctioning revenue, provide a clear signal for deploying hydrogen and CCS infrastructure in the remaining cluster.
5. **Business Taxes:** Focus on improvements to simplicity, generosity and scope of the apprenticeship levy, R&D tax credits and business rates.

The UK may well have avoided entering a recession in the final quarter of 2022 however, looking forward, we are far from out of the woods. This year will be tough but there are green shoots to be optimistic about, but in the mid-to-long term there are some major concerns. The UK is on the precipice of being left behind by the international field, energy prices are already significantly higher than in North America and the Far East, penalising manufacturers and making the country poorer, and the US's IRA and EU's imminent response is already dragging away much needed investment that could have been undertaken in the UK.

In 2016 the UK received the second largest flow of inward Foreign Direct Investment (FDI) out of any country, behind only the US. In 2020 we'd slipped to 7th on the list, and just one year later we were 15th, behind European countries including Germany, France, Poland and Sweden. Without Government action now, we will continue dropping down the list.

No major economy functions without a manufacturing sector. Data from the World Bank shows that the manufacturing sector makes up an average of 13.1% of the G7 economies, 14.7% of European Union member economies, 27.4% of the Chinese economy, however just 8.8% of the UK economy. The UK Government needs to decide now if it wants a manufacturing sector, at the heart of which is the chemical industry, providing vital raw materials and innovative breakthroughs crucial for the net zero transition.

There is clearly one answer to the question posed above, and to deliver it we need the Government to show the world that the UK is open for business and the place to invest. To this end, we need stability – stability on energy prices; stability on industrial action; stability of regulation and stability of the political machine.

CIA CHEMICAL INDUSTRIES ASSOCIATION

UK CHEMICAL INDUSTRY 2023 IN NUMBERS

4,415 businesses directly employing 151,000 people while supporting over 500,000 jobs in the economy

17.5% of total UK business R&D spend

Salaries over 33% higher than, manufacturing and 45% higher than the whole economy average

Highly productive sector with £203,000 GVA* per employee, 280% higher than whole economy average 148% higher than manufacturing

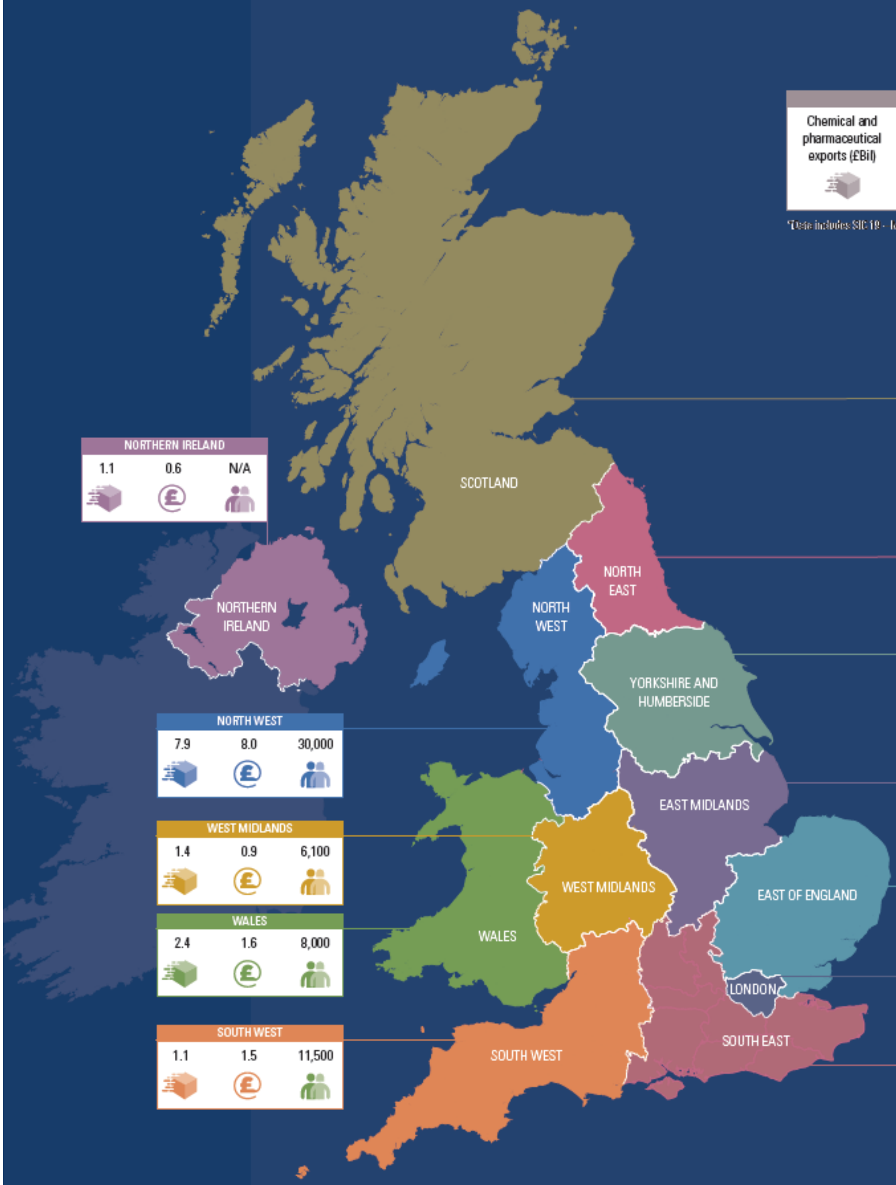
One of the UK's largest exporters of manufactured goods with annual exports of over £54bn

* Gross Value Added

CIA CHEMICAL INDUSTRIES ASSOCIATION

MADE IN THE UK, SOLD ACROSS THE WORLD

Our Chemical Industry



KEY	Chemical and pharmaceutical exports (£Bil)	GVA (£Bil)*	Employment
NORTHERN IRELAND	1.1	0.6	N/A
SCOTLAND	3.0	2.4	10,500
NORTH EAST	2.8	2.1	9,500
NORTH WEST	7.9	8.0	30,000
YORKSHIRE AND HUMBERSIDE	3.0	3.3	16,500
EAST MIDLANDS	1.7	1.4	10,000
WEST MIDLANDS	1.4	0.9	6,100
WALES	2.4	1.6	8,000
EAST OF ENGLAND	7.6	3.2	15,000
LONDON	5.3	0.7	2,500
SOUTH WEST	1.1	1.5	11,500
SOUTH EAST	9.5	5.4	13,500

*Data includes SIC 19 – Manufacturing of coke and petroleum

Figures correct as of Q1 2023.

Source: ONS

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Who we are and why is the chemical industry important to the UK?

The Chemical Industries Association (CIA) is the UK's trade association representing and advising chemical and pharmaceutical companies located across the UK. Our core membership is a diverse mix of chemical and pharmaceutical companies operating within the UK.

The graphics on the two previous pages highlight clearly the importance of the chemical industry to the UK. With a combined annal business investment and R&D spend of over £10 billion, £30 billion of value added for the economy, £50+ billion of exports, and the supporting of hundreds of thousands of high paying jobs in all regions of the country, the industry is pivotal to the Government's Levelling Up, Global Britain, Scientific Powerhouse and Net Zero ambitions.

No major economy functions without a manufacturing sector and at the foundation of manufacturing is a chemical industry. Not only does the chemical industry contribute key raw materials to all manufacturing industries, it will be vital in creating the next generation of materials and innovations required for the net zero transition.

What are we calling for?

In the CIA's latest business survey of membership which was conducted between the 9th and 20th of January 2023 and received responses from almost 50% of CIA membership, respondents were asked what topics they would like represented in the CIA's budget submission. The results were as follows and were used to guide the CIA's submission.

Energy prices and security	88.4%
Investment incentives	65.1%
UK REACH	46.5%
Apprenticeship levy / skills	41.9%
Sustainability / net zero	39.5%
R&D tax relief	37.2%
Business rates	20.9%

The CIA's representation is therefore broken down into five sections with the apprenticeship levy, R&D tax incentives and business rates covered under section 5 – 'Business Taxes'.

1) Energy

CIA members have repeatedly reported over the last 18 months that energy prices are the biggest challenge facing the industry. However, even before the onset of the European energy crisis, industrial energy prices in the UK were significantly higher than in the European Union, North America and Asia, a fact set out clearly in BEIS' '*Energy Intensive Industries Review - Review of the scheme to provide relief to energy intensive industries for a proportion of the indirect costs of funding renewable electricity policies'.* For this reason, industrial energy prices have been, and continue to be, a priority for the CIA as they pose a serious risk to the international competitiveness of the UK chemical industry.

The CIA is calling for:

1. Government to follow through with reform of EII exemption, to increase the aid intensity to up to 100%, as per the British Energy Security Strategy. The CIA would like Government to go further, by reducing the burden of energy network charges on UK manufacturers to bring us in line with competitor economies.
2. REMA reforms that will bring down the wholesale, network and policy costs of UK energy, as a matter of priority.
3. Assurance that any reform of the CCA scheme does not remove vital carbon leakage mitigation for manufacturers struggling under high energy cost, and that it does incentivise net zero investment.

2) Investment incentives

With the US' IRA providing a $369 billion green subsidy package over the next 10 years and the European Union's imminent response, the UK is on the precipice of being starved of international investment in an industry vital for the net zero transition and future prosperity. The CIA appreciates that the UK Government cannot compete with the magnitude of the US and EU27's programmes, after all, their economies are 7.4 and 5.5 times larger than the UK's. However, we need to utilise our regulatory freedoms, as well as our manufacturing and scientific knowledge base, to compete with these packages.

Moving away from the international view, the CIA estimates that capital allowances in the chemical and pharmaceutical industry were £3.2 billion with a larger dependency on non-Annual Investment Allowance (AIA) than the average manufacturing industry. It is therefore clear that capital allowances provide significant support for the industry and, if designed correctly, with a generous allowance outside of the AIA, can further motivate multinational chemical and pharmaceutical companies to invest in the UK.

In early 2021, after the announcement of the Chancellor's Super Deduction, the CIA polled its members to see how the policy would impact investment plans over the following two-year period. Most respondents – 59% – felt that there would be no impact to levels, however they would enjoy the tax relief; 18.9% reported that it would motivate them to bring work forward whilst 5.1% reported that it would lead to new investment. The remaining 17.9% reported that it would have no impact on them. The reason that only 5.1% of respondents said that the Super Deduction would lead to new investment is because investment decisions in the chemical industry are often made on a multi-year basis and therefore a two-year relief window is hard to utilise.

The CIA surveyed its membership regarding the five follow on options to the Super Deduction proposed in the 2022 Spring Statement and used the insights that were collected to guide the requests laid out below. Although an increase in the AIA is clearly beneficial for the industry, since the chemical and pharmaceutical industry has a greater proportion of larger business compared to the remainder of manufacturing, greater 'bang for buck' would be generated by a more generous non-AIA deduction.

The CIA is calling for:

1. A green strategy to compete with the US's IRA and EU's imminent response.
2. Full and uncapped expensing of main rate plant and machinery in the first year and a 50% first year allowance for special rate plant and machinery.
3. Cashflow support for companies who undertake business investment but are loss making. A system similar to SME R&D tax relief where loss making companies can choose to give up the right to offset losses equivalent to 100% of qualifying plant and machinery expenditure (or its total losses, if these are smaller) against future profits in return for a cash payment from the government of 14.5% of the losses given up.
4. Any change made to the current capital allowance regime is long term, allowing business to accurately forecast their business investment intentions opposite relief levels.

3) REACH – Regulatory red tape and related costs

The duplication of existing EU REACH legislation is estimated to cost the UK chemical industry and many of its key UK customer industries between £1 - 3 billion, according to Government estimates. This cost does not improve operations, increase productivity or strengthen health and environmental protection. It is instead a cost for companies to simply duplicate data previously submitted to the EU and largely available on public databases. This cost reduces the competitiveness of the UK chemical industry and deprives funds for business investment and research and development.

UK businesses looking to place a new or indeed an existing chemical on the market are subject to GB REACH fees of up to £29,000 per substance for a much smaller market size. In the EU that same £29,000 give access to 30 markets (including EEA countries). Looking to the other countries who have a more comparative market size to the UK, the maximum fees under similar regulations is £1,500.

Like EU REACH, UK companies have similar concerns around the proposed HSE charging scheme for active substances for Biocidal Products, with EU costs again being duplicated for a significantly smaller market size than the EU27.

The CIA is calling for:

1. Government to support the industry with this cost, delivering a more cost-effective UK registration system that enables UK chemical companies to direct their investment towards new capital, R&D and digitisation to further drive productivity and international competitiveness.
2. Revision of GB REACH fees so that they are proportionate rather than identical to EU REACH fees. The UK fees need to reflect the smaller market size companies will be paying for.

4) Sustainability / net zero

There is an extensive catalogue of reporting methods for sustainability. These are often unclear and, in some cases, overlap occurs causing a great administrative burden for companies—especially SMEs who have a smaller pool of resources to draw upon. For example, the UK BAT scheme reporting requirements are incredibly similar to that of the Transition Plan Taskforce's mandatory transition plans. The challenge is that companies will not have the time nor patience to navigate the complexities inherent in the different reporting schemes and consider them suboptimal due to the seemingly unnecessary duplication of data. This may result in the submission of inadequate data or a complete lack of compliance. The transition to net zero is not going to be an easy one and the current reporting landscape is making this more difficult.

Planet Tracker recently produced a report which delved into the concept of 'Greenwashing'. Greenwashing is the result of companies promoting themselves or their products using misleading language. The term 'greenwashing' is not new, however neither are phrases like 'sustainability', 'green', 'SDGs', etc. The general public are familiar with these terms and when making consumption decisions will inadvertently take these things into account. However, if these claims are not well substantiated or cannot be verified by a third party then they are employing this language for their own benefit, and not for the benefit of the environment. We are aware of the FCA's proposed sustainable disclosure requirements and sustainability labels, however for these to be effective Government must enforce stricter monitoring and verification.

The – UK only – Carbon Price Support (CPS) rates at £18/ tCO_2 has led to one of the world's highest combined carbon prices on the power sector, a cost which is passed through in electricity bills to consumers when coal or gas-fired power is in demand. CPS is now unnecessary. It was designed to supplement a weak EU ETS price signal to push coal off the grid. The price signal is now high enough to be effective without supplementary support and the UK is also now fully in control of its own price signal through the UK ETS. The CPS inflates UK industrial electricity prices (against competitors in the EU and elsewhere) with no environmental or economic benefit.

The CIA is calling for:

1. The Government to focus on streamlining reporting to make the transition to net zero as simple as can be for business and industry.
2. Government bodies to converse to see where different reporting schemes overlap and whether exemptions can apply if a company is already reporting the required data (albeit in different format) under a different scheme.
3. Government to provide further clarity on their reporting schemes, as well as internally compare and contrast schemes to encourage compliance and obtain the most effective data.
4. Government to enforce stricter monitoring and verification of sustainability labels to prevent greenwashing undermining well acting parties.
5. The set-up of a UK ETS innovation fund from its auctioning revenue to support low carbon manufacturing in the UK.
6. A clear signal for deploying hydrogen and CCS infrastructure in the remaining clusters. This will enable business to take efficient investment decisions. Whilst the cluster sequencing process has already identified clusters successful for track 1, government should take a pragmatic approach and take forward all advanced clusters to progress net zero more quickly.
7. Abolishment of Carbon Price Support
8. UK ETS: Launch public consultations on the UK Carbon Border Adjustment Mechanisms and reform of free allocation in the UK ETS, as soon as possible. Clarity is required by business on future cost and competitive position so as to justify new investment.

5) Business Taxes

Apprenticeship levy

In a recent CIA business survey (Q2 2022) only 33% of respondents reported that they used 100% of the apprenticeship levy entitlement, 39% use under half with over 12% using none.

How the tax is gathered and the size of it doesn't feel punitive, the issue is how you can then access and use the funds.

The CIA is calling for:

1. More flexibility, covering shorter courses and other financial costs relating to hiring apprentices rather than solely the courses they go on.
2. Added simplicity and flexibility regarding how it's accessed and what it can be spent on.

R&D

In a recent CIA business survey (Q2 2022) 44% of respondents reported that they used the R&D Expenditure Credit (RDEC) whilst a further 13% use the SME R&D relief scheme. Only 17% of respondents who use either of the schemes felt that they were fine in their current form and therefore did not need any changes.

The CIA appreciates that since the undertaking of this survey the Government has increased the generosity of the RDEC from 13p to 20p, a measure we strongly welcome. However when asked about what changes CIA members would like to see to the scheme, the most popular answer, with 59% of respondents requesting it, was to increase the scope of the RDEC to include capital investment. Improved simplicity was also requested from 55% of respondents.

The CIA is calling for:

1. A broadening of the scope of the RDEC to cover aspects of capital R&D
2. A reduction in the admin burden required when using the RDEC
3. A re-increase in the generosity of the SME R&D scheme

Business rates

Prior to the pandemic and subsequent energy crisis, business rates was consistently reported by CIA members as one of the biggest issues for the industry.

The CIA appreciates the Government's fundamental review of business rates however is calling on them to go further. Business rates are still a tax that disincentivises investment. The UK government collects the equivalent of 1.5% of GDP in recurring tax on non-residential property. This is significantly higher than the G7, EU and OECD averages, e.g. France's is 0.6%, Germany 0.2% and the US doesn't have any.

The CIA is calling for:

1. A reduction in the multiplier so that the total tax burden on non-residential property is aligned with international averages.
2. The multiplier to rise annually by a local property index and not by inflation.
3. More frequent valuations and a smaller gap between the valuation year and year of implementation.
4. A consultation into the logistics and feasibility of moving to a land tax rather than a property linked tax.

The CIA is realistic in its belief that the measures called for in this Budget representation are not a silver bullet and will not solve all the challenges currently facing the UK chemical industry. However they are a stride in the right direction and would constitute an important signal from Government that they listen to business concerns and are pro-British industry.

Moreover, the CIA is not calling for an unprecedented spending boom and bonfire of regulation – quite the opposite. We appreciate the difficult financial position that Government has found itself in and, in turn, are calling for important fiscally small measures. The requests set out above pose a minimal cost to the Exchequer yet have the potential to deliver stability and growth in an industry that is the foundation of UK manufacturing.

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