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# energy perspective

## Budget 2009—Chancellor finds large crumbs of comfort for energy sector

Over recent weeks there has been an unprecedented level of speculation about what the Budget would mean for the energy sector, and what any new green deal might mean in practice. In the event the chancellor's Budget speech on Wednesday 25 April and the supporting Treasury report *Building Britain's future* detailed a wide range of measures aimed at accelerating the UK's shift to a low carbon economy, although the calls for an aggressive new green fiscal stimulus package went largely unheeded.

Within the wider political and media context most expectations following Alistair Darling's statement were, frankly, not met, and the overall sense of the dense coverage was either lukewarm at best or hostile at worst. The *FT* and the *Guardian* (among others) both issued full supplements, but the focus perhaps understandably was on recession, deficits and tax increases. Energy managed a modest page or so in both newspapers, at pages 8 and 13 respectively. But there were some particular winners within the energy sector—notably certain renewables technologies, combined heat and power and CCS—as the Government made some surprise moves to protect energy investment.

### No new green deal

The Government has itself been talking up the importance of an economic recovery driven by low carbon policies for some months. Expectations were heightened by various recent statements from ministers about new industrial strategies and investment in green jobs. In the event the Government said little new in terms of tangible investment proposals. It made clear existing policies were already enabling £50bn<sup>1</sup> worth of low carbon investment in the British economy over the three years to 2011 “helping to support 900,000 jobs”. Indeed, the Treasury estimated that the low carbon and environmental sector could be worth some £150bn in the UK alone by 2015.

The Budget added £1.4bn more and specifically offered £405mn for low carbon energy and “advanced green manufacturing” in Britain. “In particular, this will help us strengthen the supply chain right across these sectors, and build on the expertise we already have in this country”, the chancellor said. There was also £535mn of accelerated capital spending and resources to promote environmental objectives and support low carbon growth, though this includes increased funding already announced for Warm Front and Decent Homes programmes. But these monies should be seen as additive, and they increased to £10.4bn the amount committed since the autumn to stimulate “a low carbon recovery”, including the measures already set out in the December pre-budget report.

These and other measures impacting on the energy sector are summarised below (see *Box 1*).

### First carbon budgets flatter to deceive

The Budget did set out the UK's first carbon budgets under the Climate Change Act 2008 (p6) committing to slightly deeper emission cuts than those recommended by the Government's Committee on Climate Change (CCC) last December. The Government is now budgeting for UK emissions to fall by 34% over the period 1990 to 2020, and the significance of the commitment, which is now a cornerstone of policy, should not be underestimated. The target is now a fundamental and non-discretionary element around which the annual fiscal round must be structured. And not only does the target go well-beyond the EU's commitment to cut emissions by 20% by 2020, the target is also legally binding.

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<sup>1</sup> A summary is provided at page 135 of the Budget report, and comprises in summary £8.9bn on energy efficiency, £6bn on renewables support, £1.7bn on technology support (including funding for the Carbon Trust and Energy Technologies Institute), £2.4bn on reducing green house gases from waste, £7.6bn on electricity network infrastructure and £23.3bn on public transport and electric vehicles.

## Muted reactions

The Environmental Industries Commission and the Aldersgate Group, a coalition of businesses and environmental groups pushing the green agenda, both quoted by the *Guardian* expressed disappointment with the outcome. “This Budget fails to include an ambitious green economic stimulus that would have supported job creation, economic development and environmental protection “The extra £1.4bn ... is timid and inadequate—and puts the UK at a competitive disadvantage,” said Adrian Wilkes of the Environmental Industries Commission.

### Box 1—Budget 2009 headlines

**Chancellor Alistair Darling said last week’s Budget would help pave the way for future industrial growth with a strong focus on a low carbon economy.**

Darling claimed existing Government policies were already enabling £50bn of low carbon investment over the three years to 2011 and helping to support 900,000 jobs. This Budget he said provided over £1.4bn of extra targeted low carbon support.

The chancellor said meeting the targets represented by the carbon budgets would require a transformation of the way the UK met its energy needs and the Government’s existing framework would enable a ten-fold increase in renewable investment by 2020. To protect investment and jobs in low carbon energy and strengthen the long-term framework he announced:

- an additional £375mn to support energy and resource efficiency in businesses, public buildings and households over the next two years, and £70mn for decentralised small-scale and community low-carbon energy. He said these measures would save £60mn in energy bills a year;
- £405mn to support low carbon industries and advanced green manufacturing;
- up to £4bn of new capital for UK renewable and energy projects from the European Investment Bank;
- an uplift in support for offshore wind investments that reached financial close between now and 2011 through the Renewables Obligation, which was expected to support £9bn of investment;
- extending support for CHP through continuation of the Climate Change Levy and associated exemptions beyond 2013 “helping bring forward £2.5bn of investment and 3GW of capacity by 2015, and supporting employment”;
- a new funding levy mechanism to support up to four CCS demonstration projects, including post- and pre-combustion technology and £90mn to fund detailed preparatory studies; and
- incentives to encourage investment in small and technically challenging North Sea oil and gas fields to unlock 2bn barrels of reserves and measures to help asset trades. He also announced reforms to remove barriers to projects that reused North Sea infrastructure for other activities, including gas storage, CCS and wind energy.

Other measures announced included:

- additional Winter Fuel payments this year of £100 for households with someone aged over 80 and £50 if over 60;
- an increase in fuel duty of 2p a litre on 1 September 2009, and 1p a year in real terms each year from 2010 to 2013, saving 2mn t CO<sub>2</sub> a year by 2013-14;
- a temporary vehicle scrappage scheme worth £300mn offering a discount of £2,000 to replace new vehicles;
- an increase in the standard rate of landfill tax by £8/t on 1 April each year from 2011 to 2013 to encourage investment in alternative waste management; and
- 10% of the 100,000 new jobs via Local Authority funding to be targeted at employment in green industries.

The Government also published on 23 April a document *Investing in a low carbon Britain* setting out a programme of investment to provide help for businesses and households to create and sustain jobs “that will contribute to the UK’s prosperity in a new low carbon world.”

The Aldersgate Group gave qualified support for the budget, but said it did not go far enough “The chancellor should be commended for outlining the world’s first carbon budgets but there is a real risk these will not be met without further commitments for environmental technologies,” said its chairman Peter Young.

The economist Lord Nicholas Stern, whose thinking triggered the establishment of the carbon budget has separately recommended 20% of all new spending be devoted to green measures, commented. “The additional expenditure [...] must be the initial step along the path towards a major structural shift in policy which we trust will follow over the coming decade”, implying that he at least did not occur that such a shift had been made yet. Indeed most commentators felt that the budget had not provided the “tough policies and strong leadership from government” that Lord Turner, chairman of the CCC, had called for. In fact much of the necessary detail on measures to deliver the target was still missing from the Budget, and much more is expected from DECC later in the year presumably once the energy and climate change road-map is issued for consultation in the late spring/early summer.

## Read the small print

But an important theme running through the document was how to secure energy investment in the current environment. “Falls in carbon and energy prices, tight finance conditions and exchange rate fluctuation create risks

renewables and infrastructure development”, the Budget report noted. It concluded that the Government needed to act “to help protect investment in energy and infrastructure projects”. These measures received a predictably more upbeat response from many in the energy sector (see Box 2).

### **Additional temporary support for offshore wind**

Against a background of sustained lobbying across the industry and the need to stimulate orderly development of Round 2 schemes, it came as no surprise that Darling pointed to the need to boost the economics of offshore wind projects that have been halted as a result of the credit crunch. Additional funding is to be made available to new schemes from the Renewables Obligation (RO) until 2011. This is to be effected by raising the subsidy levels for offshore wind from 1.5 Rocs/MWh to 2 Rocs/MWh for new orders made in 2009-10, and then 1.75 Rocs/MWh for orders placed in 2010-11. “The credit squeeze is holding back major offshore wind projects”, said the chancellor. “I want to lift the barriers—through £525mn of new financial support over the next two years for off-shore wind, funded through the RO. The potential is enormous.” The Government said it expected the move to free up £9bn of investment presently at risk. Costs of offshore wind projects have continued to rise because of sterling’s slide against the euro, which has more than offset reductions in equipment costs following depressed demand.

“I am confident that this [initiative] will lead to major projects getting the go-ahead quickly, providing enough electricity to meet the needs of up to 3mn households,” said the chancellor. “We must build on Britain’s status as the world leader in offshore wind power generation,” he added. And given the expected shortfall against RO targets, the extra awards will effectively be funded by other renewables developers as they will receive a lower recycling value on their Rocs than would otherwise be the case. The change should benefit consumers as they will receive more electricity from renewables for the same RO payments.

Direct funding is also to be provided, though it is unclear where a possible £4bn of new funding from the European Investment Bank on offshore wind and other low carbon technologies also mentioned by the chancellor fits, as this will be allocated on a scheme-by-scheme basis rather than jurisdictionally. But many in the industry are expecting a reasonable chunk of this project support to be earmarked for the London Array, which the Prime Minister has separately talked up recently in the hope of some capacity being commissioned in time for the 2012 London Olympics.

### **CHP support regime extended**

The Chancellor announced at long last that combined heat and power plants (CHP) would be made exempt from the Climate Change Levy (CCL) from 2013 when the current arrangements expire—extending them to 2023 subject to state aid clearance.

The Government said it expected this move to bring forward £2.5bn of new investment in CHP projects, and Darling suggested 3GW of CHP capacity could result by 2015 from the extension of the Levy exemption. By 2020, the Government said a further 7GW of CHP capacity could be in place. Meanwhile the CCL will remain at current levels in 2010-11, the Budget report added. And the chancellor also committed to continuing other existing exemptions for CHP.

The long-term strategy to support CHP will be set out in the heat and energy saving strategy later in 2009.

### **Deeper foundations for energy efficiency**

Darling promised £365mn of additional funding for energy efficiency measures for households and businesses, with a boost to the Decent Homes programme, more energy efficient homes and new funding for low carbon loans via the Carbon Trust. Some £70mn of additional funding will go to decentralised small-scale and community low carbon energy, including £45mn for the Low Carbon Buildings Programme to help 13,000 installations and “prepare the renewable energy supply chain”. Put another way it should address real risks investment might dry up ahead of the implementation of as yet undefined incentives for small scale renewable electricity and renewable heat in 2010 and 2011 respectively.

A further £25mn will go towards low carbon community heating schemes, which will be available for 10 communities.

### **U-turn on CCS**

The Government said it wants to fund three more CCS projects for coal-fired power stations, beyond the one it has already committed to (see p7 for more on this). The four projects will now include post-combustion as well as pre-combustion technologies, reversing the self-inflicted limitation the Government imposed on itself in 2007 when it said it had decided to focus its competition only on post-combustion schemes. A new funding levy mechanism to support the demonstration projects, was also announced, as well as a further £90mn to fund detailed preparatory studies.

## North Sea stimulus

A clear message from the Budget was the Government view that the long-term prospects for the North Sea are deteriorating, with a corresponding decline in tax revenues, being £1-5-2bn a year lower than previously expected. Accordingly the Budget announced reforms to remove fiscal barriers to projects that reuse North Sea oil and gas infrastructure for other activities, potentially benefiting gas storage, CCS and offshore wind energy projects.

### Box 2—What they said...

**The energy industry and key stakeholders generally gave a warm welcome to last week's Budget, with renewables and CCS participants being particularly enthused.**

REA director general Philip Wolfe said the Government had sought to respond to "areas we identified as critical and these measures should help prevent contraction in the renewables industry." He said the three main measures that would benefit the industry were: the £4bn in European Investment Bank finance; the increase in the number of Rocs allocated to offshore wind; and the £70mn of new grants for the decentralised renewables sector ahead of the introduction of feed-in tariffs. But he said, while these matched the key proposals in the REA's pre-budget submission, they provided "less hard cash" than desired and warned many of the provisions had pre-conditions and eligibility criteria that needed "to be spelt out before industry can be sure these measures will bite."

BWEA chairman Adam Bruce said the Budget addressed the short-term economic hurdles linked to sterling weakness and a lack of project finance. Chairman of the Government's Renewables Advisory Board Alan Moore said the £405mn for low carbon technologies would speed "progress towards exploiting our massive indigenous wave and tidal energy potential."

E.ON UK chief executive Paul Golby said the Rocs change would "help transform wind power in the UK from a business into an industry" while the enhanced incentives would "clearly help the economics of offshore wind proposals such as London Array." Overall, he commented: "The Government has clearly realised we're at a tipping point with energy policy [...] If we get it right then we can look forward to a secure, low carbon energy future for the UK."

The CBI said: "With many big energy projects, especially in renewables, being shelved or delayed because of funding problems, the provision of European Investment Bank loans will help get these schemes moving again."

The CHPA welcomed the announcement to extend the CCL exemption for indirect sales of CHP electricity. It said this together with increased funding for low carbon community heating schemes were "important advances" noting that the CCL exemption was expected to cost the Exchequer annually around £100mn in foregone revenue, something "even more remarkable given the present economic conditions."

Oil and Gas UK said incentives to extract a possible 2bn barrels of oil equivalent from the North Sea showed the "Government's commitment to the future of this industry", but chief executive Malcolm Webb warned further measures to help existing fields were also required urgently.

Consumer Focus highlighted the lack of action on fuel poverty, referring to the "pitiful energy efficiency measures announced" and warned the cost of meeting the new carbon budgets could push 2mn more pensioners and families into fuel poverty. It was disappointed there was no increase to the grant and overall funding for Warm Front and that there were no VAT reductions for energy efficient products. But this was prior to DECC announcing on 23 April changes to Warm Front following a review with EAGA.<sup>2</sup>

Greenpeace described the Budget as "a mixed bag, with a few positive announcements that were more than outweighed by a striking paucity of ambition". But it welcomed the support for renewables projects and CHP, although it was less confident about CCS. It also said the EIB funding meant there was "now no excuse for the energy companies holding back on a huge increase in wind power projects" adding E.ON UK should now approve the London Array.

Reaction from opposition parties was muted with hardly any reference from the Tories to the energy and climate change measures, while the Lib Dems referred briefly to "ineffective" energy efficiency plans and "contradictory proposals" particularly relating to coal and nuclear.

DONG Energy announced straight after the Budget that it would build a second offshore wind farm, Walney II, in the Irish Sea "as a result of the British Government's increase in funding." The farm will be affiliated to Walney I, which has already received planning. The new project will cost DKr9.7bn and will take total capacity at both sites to 367MW with 102 turbines. Walney I is due for completion in early 2011 with the new project expected one year later.

### Overall a good budget for the sector

As ever, the Budget needs to be assessed as part of a much more complex policy development process that is now almost continuous in nature. But, while those calling for a silver (or green) environmental bullet will be disappointed, there was much that builds on previous actions. In the case of offshore wind and CCS, the industry seems to have got more or less what it wanted. What we now need to address is what this all means for the consumer—as in the main it is not the taxpayer—who will be called on to underwrite many elements of these programmes. And of course the devil is always in the detail.

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<sup>2</sup> The Government said on Thursday that households connected to the gas grid were now eligible for grants of up to £3,500, up from £2,700, while those in off-gas areas could apply for funding up to £6,000, up £2,000 reflecting rising costs of installing heating and insulation measures. It said funding had increased by £174mn since September bringing total cash to £959mn for the three years to April 2011.