Response to the consultation on reforms to the tax treatment of red diesel and other rebated fuels

2 October 2020

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering almost all (90%) of both the UK's power generation and energy supply for over 27 million UK homes as well as businesses.

The energy industry invests over £13.1bn annually, delivers around £85.6bn in economic activity through its supply chain and interaction with other sectors, and supports over 764,000 jobs in every corner of the country.

Executive Summary

Energy UK supports the intention of the proposed reforms in helping Government meet its climate change and wider environmental targets, including improving the UK's air quality. Since 1990 the energy sector has reduced its greenhouse gas emissions by over 60%[1] and will be a key enabler for the UK's transition to a net-zero economy by 2050.

While we welcome the direction of travel towards reducing the use of diesel and its associated environmental impact, we have three main concerns with how the reforms within this consultation propose achieving this:

1. There are unintended, adverse environmental outcomes of implementing a hard deadline of April 2022 for utilising stocks of red diesel for electricity generation. This would only result in increased emissions in the run up to the deadline as generators would be forced to use up their remaining stocks.
2. Changing the eligibility for red diesel will add unexpected costs to committed low carbon infrastructure projects under construction with no environmental benefit, as there is a lack of ready-to-deploy low-carbon alternatives to replace the use of red diesel in generators on construction sites for the next 3-5 years, let alone from 1 April 2022.
3. There needs to be a more consistent approach to reducing red diesel use, where an expectation is placed on all sectors to reduce their use of red diesel as soon as low-carbon alternatives are available. As it stands, the proposed reforms allow certain sectors to remain exempt with no long-term financial incentive in place to reduce diesel use, even when alternatives are available.

We provide more detail around each of these points in our main response below.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/875482/2019_UK_greenhouse_gas_emissions_provisional_figures_statistical_summary.pdf

Response to consultation

The role of diesel in the power sector is predominantly to serve as standby generation for the electricity networks or back-up generation for power systems at large thermal combustion plant. As such, these generators will only be running for very limited hours each year, in some cases less than 5 hours per year. To be prepared for any unexpected events (e.g. a system stress event caused by extreme weather) our members will hold a relatively high volume of fuel stock to be able to generate electricity for an extended period, but this is not a regular occurrence. Fuel stocks are usually subject to relatively low usage and therefore can have a very slow turnover. The proposed reforms therefore create a perverse incentive for generators to use extra fossil fuel to unnecessarily dispose of existing stock and then replace it with chemically-identical fossil fuel (other than the red dye). This is an unintended consequence which is at odds with government's intention to create positive environmental outcomes.

To avoid this cliff-edge deadline and resulting peak emissions, we would suggest an alternate transitional approach whereby delivery of red diesel to generation sites is prohibited from 1 April 2022, but existing stocks are allowed to remain for electricity generation. These stocks may still take several years to deplete; however, this approach would ensure a gradual phase-out of red diesel with a preferable environmental impact in terms of emissions.

Another use of red diesel is on construction sites, which for our sector largely concerns sites for the construction of new low carbon generation projects. While we understand the general direction of travel towards creating a price signal to incentivise the switch to low-carbon alternatives, we consider the proposed 2022 implementation to be too early given that the greener alternatives mentioned in the consultation (electric solutions, hybrid technologies or liquefied petroleum gas) are not yet ready to deploy for these purposes. Switching to the use of low-carbon hydrogen or hydrogen-based fuels could potentially provide a very good solution over the longer term and our sector is investigating avenues for this, however, low-carbon hydrogen is still in the early stages of development and could not yet be deployed as a realistic large-scale replacement for diesel. We expect that over the next decade, the parallel development of low-carbon hydrogen production facilities and of end-user markets for low-carbon hydrogen, including the availability of Non-Road Mobile Machinery (NRMM) capable of using low-carbon hydrogen and hydrogen-based fuels, will gradually make this a realistic option. This will also require the right Government support measures for the development of low-carbon hydrogen; we look forward to the publication of the Government's Hydrogen Strategy in the next few months.

Therefore, considering there are no alternatives available for construction sites, including construction of new low carbon generation projects, it is our view that it would be more appropriate to defer the removal of red diesel eligibility increase for a number of years, or more gradually increase it such that the full higher rate does not apply until later in the 2020's when low-carbon alternatives are more widely available. Until there are other options to switch to from diesel, the tax increase will not effectively operate as a switching incentive and should therefore be deferred to a later date.

Similar challenges in finding alternatives to diesel apply to projects that are decommissioning and demolishing redundant infrastructure. For this reason, we recommend that deferral or other measures applied to construction sites are also extended to decommissioning and demolition sites.

As a point of principle, we consider that the approach for applying exemptions across various sectors, as detailed in the consultation, is rather inconsistent. We note that HMT is proposing to exclude agriculture, forestry, horticulture, fish farming, railways and non-commercial heating systems from the tax increase. While we recognise some of the rationale for excluding these sectors from an immediate large tax increase, it remains the case that all sectors of the economy will need to decarbonise over time if net-zero emissions are to be achieved. It is also the case that low carbon alternatives are potentially available in these sectors, but will need regulatory and fiscal encouragement if they are to penetrate into these new markets.

Therefore, in the longer term, we would encourage HM Treasury to plan for the long-term removal of diesel tax subsidies from all sectors of the economy. In line with our proposals for the construction sector outlined above, we consider this should be done in a phased and gradual manner, giving time for sectors to adjust and new markets for low carbon alternatives to develop. In the meantime, in order to support the UK Government's plan to "Build Back Better" from COVID-19, it seems inconsistent to burden construction activities that are "building back" the UK, and allow other sectors to continue to use red diesel at the lower rate. The Green Recovery from COVID-19 should encourage all sectors to decarbonise if we are to achieve net zero by 2050.

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