HOUSE OF LORDS
European Union Committee

House of Lords
London
SW1A 0PW

Tel: 020 7219 4579
Fax: 020 7219 6715
euclords@parliament.uk
www.parliament.uk/lords

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The Rt Hon Claire Perry MP
Minister of State for Climate Change and Industry
Department for Business, Energy & Industrial Strategy
1 Victoria Street
London, SW1H 0ET

Dear Claire,

Post-Brexit carbon pricing

Thank you for attending our meeting on 27 February to discuss your plans for carbon pricing post-Brexit in both a 'deal' and 'no deal' scenario, following on from our evidence sessions on 13 February with climate experts and representatives from industry. We are also grateful to your colleagues Robert Jenrick MP, Anne-Therese Farmer and Dan Osgood.

We are grateful for the clarification you were able to provide. We do, however, have a number of outstanding questions and concerns. These are set out below.

In addition, on the matter of consultation, while we note the various topics on which you have sought stakeholders' views in this area, the fact remains that our earlier witnesses did not feel they received information from you in return. We therefore urge you to consider your approach to consultation to ensure that industry and others are receiving as much information and reassurance as you can provide.

Domestic ETS linked to the EU ETS

Thank you for setting out the steps you believe will be necessary to establish a domestic emissions trading scheme, namely carrying out a consultation and impact assessment, establishing an IT infrastructure, negotiations with the EU, and the passing of legislation. We particularly welcome your intention to conduct an impact assessment, and your recognition of the need for legislation to be passed in the devolved administrations.

You said during the evidence session that the Government spends "well in excess" of 50% of EU Emissions Trading Scheme (EU ETS) auction revenues on climate and energy, and Robert Jenrick stated that "there is no reason to believe that that will change". However, as Phil MacDonald from Sandbag pointed out when he spoke with us, as the EU ETS carbon price increases and revenues increase accordingly, that will become a more challenging target to meet.[1] There may therefore be some value in maintaining a similar obligation post-Brexit.

We asked whether you would be content with the balance of policy influence and constraints represented by the current EU-Switzerland arrangement for linking emissions trading schemes. You stated a view that the UK's negotiations would be "a lot shorter" than those that took place between the EU and Switzerland because "we start from a position of alignment", noted that we have a much larger market than Switzerland, and argued that "Scheme members would probably acknowledge that our contribution has been helpful in making the Scheme more effective". You did not, however, answer the question. We therefore ask again: would you be content with the balance of policy influence and constraints represented by the current EU-Switzerland arrangement, or will you be seeking a greater role in shaping the EU ETS if it is linked to a domestic scheme? Are there any constraints on Switzerland arising from their emissions trading scheme link that you would find unacceptable in a UK context?

Thank you for clarifying that, in your view, in the event a link with the EU ETS cannot be negotiated, a UK-only ETS would be viable in terms of both volumes and liquidity, and that this is based on your assessment of other international emissions trading schemes. In fact, you stated: "There is no evidence to suggest that it would not be effective." However, our other witnesses were not as confident about the effectiveness of a UK-only system. Adrian Gault, from the Committee on Climate Change, advised the Committee that a domestic-only scheme that is not linked to the ETS would be "getting on the margins of whether that by itself is really viable and produces much by way of cost-effective advantages within the UK",[2] while the LSE Grantham Institute argued that a domestic-only scheme would "almost certainly not be cost-effective".[3] And Phil MacDonald stated: "If the cap was tight enough to have a meaningful effect on bringing down carbon emissions with a small market, you might move into an area where the price was very volatile."[4] We therefore advise that you seek wider input on this matter as part of your consultation exercise.

We raised the question of whether the UK would continue to participate in the EU ETS for some or all of Phase 4 if the transition period were extended beyond 2020, but did not receive a clear answer from either you or your officials. The industry representatives we spoke with made it clear that they did not support continuing to participate in the EU ETS for only part of Phase 4,[5] but it is notable that the draft Withdrawal Agreement does not exempt the UK from EU ETS participation in the event of an extended transition period, as it does the Common Agricultural Policy. Can you therefore please clarify your understanding of whether the UK would participate in the EU ETS for some or all of Phase 4 if the transition period were extended beyond 2020?

We are encouraged that officials from across the UK are meeting frequently to work out the details of a domestic ETS that would be acceptable to all devolved administrations, and welcome your work with the devolved administrations to establish a governance structure and secure their input on the consultation document.

[1] Q 10
[2] Q 4
[3] BCP0001
[4] Q 4
[5] Q 17

Carbon Emissions Tax

Several times while discussing the potential Carbon Emissions Tax your colleagues from the Treasury stated that it is a contingency plan and not the Government's preferred option, and of course we acknowledge that point. However, there was an implication to several of those comments – for example in relation to the £16 Tax rate and consultation with the Committee on Climate Change (CCC) – that it is justification for plans for the Tax not being fully developed, and of course that would be unacceptable. The Tax may need to take effect from 29 March, so it is vital that the assessment behind it and plans for its implementation are robust and on-track.

It is helpful to understand that you chose £16 / tonneCO_2 as the level of the Carbon Emissions Tax on the basis of the prior six months and a forecast of the six months ahead. However, given the range of views regarding the trajectory of the EU ETS price in a 'no deal' scenario (for example that it could dip due to the UK's withdrawal, or continue to rise because of the recently-enacted reforms), the latter is potentially contentious. What assumptions did you make as part of that forecast?

In addition, Robert Jenrick stated that "[Government] could choose at the next fiscal event … to make a new forecast and set the price for the next fiscal year at that point". What would prompt a decision to make a new forecast, and what factors would you consider when setting the new Tax rate? Also, you did not answer our question of whether you would consider changing the Tax rate more frequently than once a year, for example in the event of a significant and extended change to the EU ETS price. Please address this point.

In the meeting we raised a concern that future decisions about the Tax rate could be based on political rather than decarbonisation drivers, and although we note your view that so far you have successfully balanced "different agendas", a more structured and transparent process would provide reassurance. For example, given that you are required to consult the CCC about the design of and cap for a domestic emissions trading scheme, it would seem reasonable for you to be obliged to consult the CCC about any changes to the Tax rate to ensure they are consistent with the UK's carbon budgets. Has any consideration been given to creating such an obligation?

On the issue of potential carbon price divergence between the EU and UK in the event the Carbon Emissions Tax is implemented, we are disappointed that you have not sought the Commission's view on whether that differential would be material, for example when deeming standards to be equivalent. Robert Jenrick stated that because it will only be implemented in a 'no deal' scenario, "it does not concern the Commission"; but this fails to acknowledge that if it is not accepted by the Commission, some of the Government's ambitions for a 'no deal' scenario – such as maintaining the Single Electricity Market on the island of Ireland – become significantly more challenging. We therefore urge you to seek the Commission's view on this as a matter of urgency, and to both inform us of the outcome of these discussions and factor them in to your consideration of a long-term plan for carbon pricing in the UK.

Thank you for explaining that, although both the Scottish and Welsh governments have objected to the proposed Tax, this was in part due to concern that it may pre-judge your long-term intentions for carbon pricing in the UK – which you have since assured them it will not – and that the devolved administrations will be involved in preparing the necessary guidance should the Tax be implemented.

Adrian Gault told us that if the UK were to leave the EU ETS, either the accounting of carbon budgets would need to change, to refer to actual emissions instead of net emissions, or the level of the budgets would need to change, to ensure that they retain their current level of ambition.[6] It was not clear from the evidence we heard from you that you were aware of this consideration. Do you have plans to take either of these actions in the event that the Tax is implemented?

Thank you for clarifying that, if the Tax were implemented, in deciding on a long-term carbon pricing approach you would take a view on whether the Tax was effective, the cost to businesses of a second system change, and whether there were widespread consensus that there is a better option than the Tax; and that you have not yet decided when that decision would be taken.

We look forward to a reply to this letter within 10 working days.

Lord Teverson
Chair of the European Union Energy and Environment Sub-Committee

Cc Robert Jenrick MP

[6] Q 11