UK Emissions Trading Group

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By email

Could you please reply by email to the ETG Secretariat at john.craven@etg.uk.com

Charlie Lewis
Deputy Director, Emissions Trading
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London SW1H 0ET

Dear Charlie,

Re: BEIS Free Allocation Review – Call for Evidence

The UK Emissions Trading Group (UK ETG) recently wrote to the Minister of State at BEIS asking that the UK government demonstrate its serious consideration agreed under the terms of the 2020 EU-UK Trade and Cooperation Agreement and commit to negotiations now with the European Union with a view to linking UK ETS with EU ETS. Linking is strongly favoured by UK ETG, and it is important that the free allocation review considers how far UK ETS can diverge from the EU scheme without impacting the ability to link. It should be noted that while the two schemes remain separate, an increase in carbon price in the UK compared with that of the EU, reduces the competitiveness of UK industry with EU competitors and increases the risk of carbon leakage. Linking the two schemes will remove this carbon price divergence and help to maintain competitiveness with the UK's closest neighbours.

It is important to note that UK industry has been facing considerable uncertainty over carbon pricing for some time. Although the decision to implement a UK ETS was welcome, there is now huge uncertainty and concern regarding the carbon price level, particularly for 2021, and its trajectory. This uncertainty is compounded by no announcement on the level of free allocation to installations, and the potential changes resulting from the free allocation review and the anticipated consultation on the cap. All this uncertainty does not help attract investment to the UK. Investment leakage is often the precursor to carbon leakage, and it is important that UK ETS participants are provided with visibility over the full scheme rules and especially aspects like carbon leakage mitigation as soon as possible. Visibility of the scheme rules is also required to provide investors with confidence that the UK is an investable proposition and the place to implement first of a kind decarbonisation investments.

Sectors that are vulnerable to carbon leakage cannot pass the cost of carbon onto consumers without putting their international competitiveness at risk. Many of these sectors have already taken early action to decarbonise, and remaining decarbonisation opportunities are financially and technically challenging. Furthermore, many industries will rely on regional infrastructure such as CO_2 transport and storage and hydrogen production and distribution to be able to decarbonise. There is likely to be a phase over the short to medium term where the ability of sites to decarbonise is linked to their geographical location and in particular their proximity to industrial clusters. This also extends to clusters that are not chosen as “Track 1” or “Track 2” clusters in the Government approach to sequencing. Carbon leakage mitigation will continue to be necessary until such a time as all UK industry wherever it is located, can operate and decarbonise at both an actual and a policy cost that is comparable to that faced by international competitors.

Any carbon leakage measure must provide adequate mitigation and not be undermined in any way, whether through introduction of a cross sectoral correction factor (CSCF) or an ‘in phase’ reduction in the cap. This can be simply done by defining auctioning quantities of allowances as being the residue AFTER free allocation is made. This system of free allocation first with auctioning of the residual fractions second would also allow for the abolition of the NER since there would be no need to ring-fence free allocation to new entrants. UK ETG’s greatest concern is that free allocation in UK ETS could continue to be undermined as it was in EU ETS via implementation of a CSCF. Any such measure that exposes UK industry to a higher carbon cost than competitors in the EU and elsewhere in the world will expose UK industry to carbon leakage. Once the methodology has been determined to calculate the required level of free allocation for an installation, it must not be undermined. If adequate protection cannot be given through free allocation then alternative measures must be considered to mitigate the competitiveness impacts of any asymmetry in carbon pricing with international competitors.

As part of the broader review of UK ETS, consideration should be given to effort sharing of decarbonisation across the UK economy. Industry is often an easy target for decarbonisation because it is viewed as a relatively small collection of large greenhouse gas point sources. However, industry has already taken early action and made considerable decarbonisation progress. Remaining emissions are those that are technically and financially challenging to reduce and decarbonisation of these emissions must not be at the expense of moving UK manufacturing overseas.

The decarbonisation of industry will not be achieved through increasing the carbon price alone, this will simply result in deindustrialization and the offshoring of UK industry. Support to decarbonise is also required at a level that is at least equivalent to that provided to power generators.

We hope these comments help prioritise action for UK ETS and we would be happy to answer any questions or discuss further.

Yours sincerely,

D Casey

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