Position Paper

European Union Emissions Trading System post-Brexit

This statement complements the CPI Position Paper on EU ETS.

Background

One of the opportunities presented by Brexit is a chance to review climate change related policies to ensure they deliver the intended outcomes and don't result in unintended consequences. High costs for carbon and energy put UK industry at a competitive disadvantage if competitors in other countries don't face broadly equivalent costs. The long-term consequences of such cost disparity can only be carbon leakage, where production is relocated away from the UK to places with lower carbon and energy costs, with carbon emissions simply moved from one place to another.

EU ETS is established through European Directives, meaning that Brexit will break the legislative link, and, because the trading activity fundamental to the operation of the scheme requires continued access to EU registries and accounts, the EU Withdrawal Bill cannot simply mandate that EU ETS continues unchanged post-Brexit. Accordingly, EU ETS is a topic that will required detailed consideration before Brexit.

Policy Review

The UK has been at the forefront of leading global efforts to reduce the emissions of Greenhouse Gases linked to climate change. The UK was the first country to set itself legally binding emission reduction targets through the 2008 Climate Change Act, and, politically there remains a strong consensus that the targets should be retained and even tightened. With the United States withdrawn from the Paris Climate Agreement, Europe seems minded to signal its commitment to the Agreement possibly by further tightening targets.

For the UK Government, EU ETS is a major instrument within the policies to deliver national carbon reduction targets. EU ETS caps (and reduces over time) total emissions from heavy industry and the power sector across the EU, with the trading aspect ensuring reductions are achieved at the lowest cost.

CPI and UK Papermakers have supported the general principles of EU ETS, and UK paper mills continue to act to reduce emissions of fossil carbon. Between 1990 and 2017, emissions of fossil carbon (both direct and indirect) have been reduced by 54% per tonne of production.*

Hard Brexit

In the event of a Brexit with no deal, then the UK could leave the EU as early as 29 March 2019; the dates for 2018 verification have been brought forward so everything will be completed by this date. However, such a situation would still leave UK installations in an uncertain legal position for the first part of 2019, potentially with legal obligations that could not be actioned. Likewise, the legal status of UK held or issued EU ETS allowances would be unclear, meaning a risk that the complete system across the EU could be compromised.

With EU ETS being so central to climate change related policies, then CPI urges that an orderly withdrawal is enacted – and given the lack of time until March 2019 and the fact that this date is in the middle of a compliance year – this means a transition period is needed. The end of Phase III (31 December 2020) would be the most appropriate date.

Accordingly, CPI supports the Government proposal that the UK should remain in EU ETS until the end of 2020 and the conclusion of Phase III.

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Alternatives to EU ETS

The UK Government has stated that post-Brexit, the European Court of Justice can have no role in regulating UK schemes – if this red line is fixed, then the UK cannot stay in EU ETS after a transition period. However this position may be changing and remaining in EU ETS in the long-term may be an option.

Assuming that the UK does indeed leave EU ETS, then the Government could review present policies and develop new strategies that best deliver the twin objectives of reducing UK emissions while also supporting the manufacturing sector to help deliver a rebalanced economy.

Any UK specific scheme would need to deliver a number of objectives:

- **Avoiding further carbon leakage.** Protection from carbon leakage remains essential to protect UK industry from importers providing similar goods made in overseas locations that don't face the same costs. Any UK scheme need to be designed from inception to equalise these costs, either by providing exemptions from costs for domestic producers or adjusting the cost of imports to better reflect the cost of embedded carbon.

- **Not impose additional costs on industry.** The UK already has a unique carbon price floor that when instigated proved to be so damaging to energy intensive industries that a compensation scheme had to be urgently developed to avoid causing plant closures – there's a similar story around the Renewables Obligation and Feed in Tariffs. **These lessons must be learnt, and support for Energy Intensive Industries built into schemes from day one.**

- **Energy taxation causes industrial damage.** The UK cost for grid electricity is already much higher than in other major European nations, and while industrial gas is relatively competitively priced (compared with other places in the EU) it's a much higher cost than in many other parts of the world.

  If the UK is serious about a series of trade deals, then expecting UK industry to be competitive when domestic energy costs are much higher is naïve – it's more likely the UK will be opened to even more imports. **The Government cannot view energy as an easy target for tax raising.**

- **Schemes should not overlap.** UK papermakers are already obligated under a number of overlapping schemes including EU ETS, CCA and ESOS and the opportunity should be taken to simplify the situation. Specifically monitoring, reporting and verification should be as simple as possible; current schemes can be needlessly over-complicated – especially for smaller scale emitters such as the majority of paper mills.

Potential UK Schemes - Options

A simple carbon tax. Such a scheme would be blunt and unsophisticated and would deliver carbon reductions at a higher cost than trading schemes. While superficially attractive, support and exemptions for energy intensive installations would be critical from the start of the scheme.

UK ETS identical to and linked with EU ETS. Such a scheme would be reasonably straightforward to develop in the first instance, though if a mirror to the European scheme, there would be little opportunity to fine tune and adapt for UK purposes. Two-way linking would require support from the European Commission, though it may be possible for the UK to set up a one-way link by accepting EU ETS allowances for UK compliance.

UK ETS not linked to EU ETS. Such a scheme could allow the UK to develop a simplified and more effective scheme with support and exemption targeted to support Government policy. However, the relatively small size of the market may limit liquidity and result in a higher compliance cost.

Enhanced Climate Change Agreements. The UK already has its own successful scheme that pre-dates EU ETS. CCA are agreements between individual companies and Government through which operators agree bespoke and challenging energy efficiency targets and in return companies receive a discount on Climate Change Levy taxation. Targets are reviewed on a regular basis to ensure they remain challenging but realistic, and properly reflect the technology opportunities available to the sector.

In a post-Brexit context, enhanced CCAs offer a number of important advantages over other policy options:

- EU ETS objectives could be integrated within an enhanced CCA, so removing duplication;
- Carrots could be offered for efficiency gains and/or carbon reductions;
- The trading element could be reintroduced to deliver overall savings at the lowest cost;
- Targets would be installation specific and set to be challenging but achievable;
- The scheme would be much simpler to understand and use.

For these reasons CPI urges the Government to develop an enhanced Climate Change Scheme to replace EU ETS from January 2021.

Further Information

Further information is available from Steve Freeman, Director of Environmental and Energy Affairs, on 07775 696514 or email sfreeman@paper.org.uk.

Confederation of Paper Industries

- The Confederation of Paper Industries (CPI) is the leading trade association representing the UK's Paper-based Industries, comprising paper and board manufacturers and converters, corrugated packaging producers, makers of soft tissue papers and collectors of paper for recycling.

- CPI represents an industry with an aggregate annual turnover of £6.5 billion, 25,000 direct and more than 100,000 indirect employees.

- For facts on the UK's Paper-based Industries please visit: www.paper.org.uk.

*Source of data is Climate Change Agreement & EU ETS reporting data held by CPI.

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