

UK EMISSIONS TRADING SCHEME

Welsh Government Integrated Impact Assessment – Summary

Copies of the full assessments are available upon request

WHAT ACTION IS THE WELSH GOVERNMENT CONSIDERING AND WHY?

The proposed UK Emissions Trading Scheme (UK ETS) policy framework and associated legislation will establish a UK-wide carbon market, to encourage cost-effective emissions reductions from the power, industrial and aviation sectors. This is a policy replacement for the UK's participation in the EU Emissions Trading System (EU ETS), which will cease at the end of the Brexit Transition Period. The proposed UK scheme also allows for a potential link between a UK ETS and the EU ETS in due course, subject to negotiation between the UK Government and the EU.

Emissions trading systems ensure the 'polluter pays' principle is adopted by deploying a 'cap and trade' mechanism, where a cap is set on the total amount of certain greenhouse gases that can be emitted by installations and flights covered by the system. Within the cap, participants receive or buy emission allowances which they can trade with one another as needed. This cap is reduced over time, so that total emissions fall.

The proposed UK ETS sets out the scope of participants, the environmental ambition as indicated by the cap and trajectory of allowances, requirements for monitoring, reporting and verification, charging, compliance and enforcement, penalties and appeals, and scheme reviews.

Long Term, Prevention and Integration

Climate change is a serious and global threat to the wellbeing of current and future generations. The associated environmental, ecological, economic, health and social impacts are well documented. The current EU ETS participants within Wales account for around 46% of Wales' total emissions. Hence this policy is a crucial part of the Welsh Government's efforts to achieve its climate change ambitions and statutory targets.

The first phase of the UK ETS is set for 10 years from 1 January 2021 to 31 December 2030. This provides long term certainty for scheme participants, supporting informed investment decisions.

Collaboration and Involvement

The development and future governance of the proposed UK ETS are being managed through a collaborative 'Common Framework' approach between all four governments across the UK nations and their regulators.

The proposed UK ETS will decarbonise those sectors of our economy responsible for the greatest carbon emissions. The four governments must ensure this is achieved in a way which retains and strengthens industry in the UK and does not simply result in industry facing insurmountable economic headwinds. The scheme seeks to avoid the risk of closures and associated regional economic shocks, as well as the risk of 'offshoring' emissions.

Working with the industries targeted by the policy is crucial. A 10 week consultation ran from 2 May 2019 to 12 July 2019, setting out the preferred approach to UK carbon pricing and seeking views on the design of a future scheme. In addition to UK Government run events, two stakeholder events were held in Wales – one in Swansea and one in Llandudno.

Following publication of the Government response and further to a UK wide event, a Wales event with industrial stakeholders was held on 16 June 2020 to discuss the results of the consultation.

The joint government response to the consultation, which includes a summary of the consultation responses, is available at <https://gov.wales/future-uk-carbon-pricing> .

Stakeholder engagement between policy teams, regulators and future scheme participants is ongoing. On a practical basis, this includes stakeholder testing of the new IT systems, support to ensure the required registrations and permits are in place and assistance to ensure a smooth transition from the EU ETS to the UK ETS. Additionally, we will be seeking stakeholder input into future ad hoc and whole system reviews of the scheme.

Impact

The Welsh Government's Explanatory Memorandum to The Greenhouse Gas Emissions Trading Scheme Order 2020 includes a Regulatory Impact Assessment on the proposed UK ETS. Overall, the analysis concludes that a standalone UK ETS design would be expected to deliver significant decarbonisation benefits, with minimal impacts upon industry and business competitiveness when compared with continued participation in the EU ETS. A linked scheme could provide a wider carbon market, which would be likely to result in reduced costs for businesses.

A number of reviews of the UK ETS will be conducted following the launch of the scheme. The aim of the reviews will be to ensure the UK ETS continues to be fit for purpose and meet its policy objectives.

Costs and Savings

The main additional costs of the UK ETS, compared with the current EU ETS arrangements, are the administrative costs to Government in setting up the UK ETS (in particular the IT systems), the cost of amending or issuing permits, and additional resource costs to scheme participants due to the risks of higher carbon costs under the standalone UK ETS.

The IT systems being developed for the UK ETS are a registry to hold emissions allowances and a system for permitting, monitoring, reporting and verification (PMRV). Both systems will replace

the corresponding EU systems which the UK currently access. The estimated costs are £3.45 million for the registry and £3.25 million for the PMRV system. There will be additional costs in the event of a linking agreement, to facilitate interaction with the EU systems. The majority of the cost for both systems is funded through the UK Government's EU exit funding pot. However, from 2021/22 it is anticipated the Welsh Government will contribute to the PMRV development costs, and future enhancements of both systems. An estimate of costs for 2021/22 is £80,000 - £120,000. Thereafter, costs are projected to be significantly lower.

Mechanisms have been introduced into the scheme to manage extremes of carbon prices, ensuring the incentive to decarbonise remains while protecting businesses against extremely high costs. This includes an auction reserve price (ARP) of £15 per allowance. Additionally, free allowances are allocated to some industrial installations to ensure they remain globally competitive.

The degree to which these costs are significant to individual businesses will depend on a wide range of factors and will vary depending on the characteristics of the business affected and the amount of free allocation that they receive. However, higher carbon costs in the short term could also increase the sustainability of our industrial base through an increased incentive for more innovation and investment in low-carbon technologies, which will improve their long-term competitiveness.

CONCLUSION

How have people most likely to be affected by the proposal been involved in developing it?

The proposed UK ETS applies directly to particular energy intensive installations and sectors of industry. There are no anticipated significant impacts upon individuals or particular groups of people.

The development and future governance of the proposed UK ETS are being managed through a collaborative 'Common Framework' approach between all four governments across the UK. The environmental regulators and those who will be responsible for managing the IT systems are also collaborating on the scheme design, bringing with them valuable experience of working within the EU ETS regime.

Industry stakeholders have been, and will continue to be, consulted on the development and operation of the scheme. A 10 week consultation ran from 2 May 2019 to 12 July 2019, setting out the preferred approach to UK carbon pricing and seeking views on the design of a future scheme. This included stakeholder events held in Wales.

The UK ETS has no direct links with the Welsh Government's Cymraeg 2050 strategy but Welsh Language provisions are included in all stakeholder engagement and communications, in compliance with the Welsh Government's Welsh language Standards.

What are the most significant impacts, positive and negative?

The main (beneficial) impact of the proposed UK ETS will be to reduce emissions from particular energy intensive installations and sectors of industry. The ‘traded sector’ to which this carbon-trading scheme applies accounts for around 46% of Wales’ total carbon emissions. As such, the benefits of the scheme will be highly significant in meeting Wales’ overall emissions reduction targets. The design of the scheme provides for maximum overall emissions reduction while minimising impacts upon business competitiveness as far as possible. Furthermore, it seeks to avoid undue shock to scheme participants by maintaining arrangements that are as close as possible to the existing EU ETS arrangements (which the UK will be leaving at the end of the Brexit Transition Period), and through specific pricing control mechanisms built into the scheme.

The potential long-term impacts of climate change are far-reaching and highly significant. The UK ETS will contribute to minimising the associated long-term impacts on climate, natural resources and society.

No significant negative impacts have been identified. There may be marginal additional costs to business compared to the counterfactual, remaining in the EU ETS.

In light of the impacts identified, how will the proposal:

- **maximise contribution to our well-being objectives and the seven well-being goals; and/or,**
- **avoid, reduce or mitigate any negative impacts?**

The UK ETS is designed to provide a replacement for the EU ETS. It will play a significant part in meeting Wales’ emissions reduction targets. In so doing, it will be contributing to the Wellbeing of Future Generations in the following ways:

- A prosperous Wales – ensuring a low carbon society which recognises the limits of the global environment and therefore uses resources efficiently and proportionately (including acting on climate change). This includes developing frameworks which both incentivise decarbonisation, but do so in a way which strengthens industry in Wales and protects employment.
- A resilient Wales – Limiting additional impacts upon biodiversity and the natural environment associated with long-term emissions.
- A healthier Wales – Avoiding the impacts of climate change upon health and wellbeing.
- A more equal Wales – Avoiding wider, secondary, impacts of climate change upon society.

Climate change has been shown to impact disproportionately on disadvantaged sections of society. The contributions this scheme makes to decarbonising Wales will ensure these

impacts are not exacerbated further. The scheme will also compliment work done elsewhere to create equality in Wales by protecting jobs

- A Wales of cohesive communities – Supporting local economies and communities by providing a sustainable approach towards decarbonisation of industry and supply chains.
- A globally responsible Wales – Contributing to global emissions reduction, policy designed to protect against offshoring of emissions.
- A Wales of vibrant culture and thriving Welsh language – all stakeholder engagement to follow Welsh Language policy guidelines by ensuring the sustainability of natural resources within our communities and living environments this proposal indirectly also support the sustainability of Welsh speaking communities.

How will the impact of the proposal be monitored and evaluated as it progresses and when it concludes?

The Greenhouse Gas Emissions Trading Scheme Order 2020 specifies two major, whole system reviews during the 10 year phase. An initial review of the UK ETS to be conducted from 2023 to assess whole system performance during the first half of the phase (2021-2025) with any necessary changes to design features implemented by 2026; a full review from 2028 onwards to assess whole system performance across all of Phase I (2021-2030) with any update to the UK ETS rules implemented for 2031 (Phase II). These reviews are aligned with the EU ETS Phase IV reviews and Paris Agreement Global Stocktake efforts.