Energy & Climate Change Committee inquiry Leaving the EU: implications for UK climate policy - August 2016

MAKE uk
The Manufacturers' Organisation

INQUIRY RESPONSE

Summary

1. Following the EU referendum it is essential for the UK Government to act swiftly but methodically to set out a clear agenda for the development of a new relationship with the EU. We need a comprehensive deal with the EU which takes account of the specific relationship between the EU and the UK; not a Swiss, Norwegian or even Canadian model, but a UK model.
2. In terms of climate change policy specifically, any negotiation must look to ensure that areas of close cooperation which are mutually beneficial to both parties such as the United Nations Framework Convention on Climate Change (UNFCCC) process endure. Furthermore, if UK industry remains intertwined with the EU's climate policies, such as the EU Emissions Trading System (EU ETS) it is vital that the UK continues to have an active and formal role in their future development.
3. While the UK's path to decarbonise has generated many opportunities for our low carbon economy, it has also provided significant challenges. Particularly to our foundation industries such as the steel industry who operate under intense international competition and with limited ability to reduce emissions and energy usage, without significant and costly development in new technologies. Therefore, the UK's approach to these negotiations and post-departure must be informed by a truly integrated climate and industrial policy which reflects this reality and helps enable all our manufacturers to best compete on the global market.

The future of the UK's participation in the EU's climate change policies and obligations

EU Emissions Trading System

4. In the short term, while there is uncertainty concerning the UK's longer term participation in the EU ETS following the result of the referendum, we believe that it is absolutely crucial that the UK Government remains an active participant in the post-2020 reform negotiations currently taking place (also known as Phase IV – covering the period 2021 to 2030). The government must continue to ensure that the views of the UK's manufacturing sector are represented and strongly advocated for.
5. In the longer term, it is understood at this time that any decision concerning the UK's participation in the EU ETS post-departure is dependent on whether the UK continues to be part of the European Single Market within the European Economic Area (EEA) as it is a condition of membership. However, while this is likely to cause the least disruption for covered installations, such an arrangement (often referred to as the 'Norway model') is far from ideal as the UK Government will have no formal role in shaping and reforming the system.
6. The UK's ability to even influence the key decision makers will be severely weakened despite being the second largest emitter in the system behind Germany. In addition, the dynamics post-departure within the EU and its

impact on the direction of the EU ETS may also not be in the interests of UK industry. Under this scenario, taking measures to address this imbalance between participation with no formal representation in the decision making process must be a key priority for government.

7. While we support the fundamental aims of the EU ETS of driving the decarbonisation of industry in the most cost-effective manner, the system is in need of significant reform. In particular, it needs to more comprehensively take account of both the technical and economic realities faced by energy intensive industries (EIIs) in decarbonising. This only reinforces the importance of the UK Government's active role in the current Phase IV negotiations if the UK does indeed remain in the system but has no means to directly influence its outcomes in the future.
8. If the UK were to negotiate an arrangement with the EU outside of the EEA, whether as part of the European Free Trade Association or another Free Trade Agreement model, it should not be automatically assumed that establishing our own ETS and linking it to the EU ETS is the best course of action. In such an instance, government and industry should work collaboratively to assess all options which could provide the most cost-effective manner to meet our legally binding carbon targets for all sectors of the economy. Any future scheme should look to better incentivise industrial decarbonisation, reflect the different abatement potential between sectors (such as process emissions) and the impact of embedded emissions in our imports.
9. If the UK were to leave the EU ETS, the timing of the departure is of critical importance. The current phase does not end until 31 December 2020 so it be would logical that the end of Phase III would mark the end of the UK's participation. This date also coincides with the end of the second compliance period under the Kyoto Protocol and the expected start date for obligations under the Paris Agreement.
10. A departure from the EU ETS mid-phase, whether in Phase III or IV, would likely cause severe disruption to the UK's covered installations. It would negatively impact the managing of compliance deadlines and create uncertainty for the allocation of free allowances, and could also have wider implications on the system such as how the Market Stability Reserve would operate for Member States.

EU Effort Sharing Decision

11. Last month, the European Commission published its proposal for the second phase of the Effort Sharing Decision for the period 2021 to 2030. Effort Sharing covers sectors of the economy that are not within the scope of the EU ETS such as transport, agriculture and non-energy intensive industry. The proposal commits the UK's non-ETS sectors to a 37% emissions reduction by 2030 below 2005 levels which was very much in line with EEF's expectations and which we believe in itself should not post a threat to our international competitiveness.
12. However, due to the outcome of the EU referendum, the proposal presents the UK's non-traded sector with much uncertainty as to whether they will be obligated to play a part in achieving these targets. If the UK is no longer to be bound by the EU's Effort Sharing agreement in the future, it will be the sole gift of the UK Government as to how to best set and implement carbon targets for these sectors. It must be noted though,

that these proposed non-ETS sector targets for the UK closely align with our already agreed to domestic targets as set out in the Fifth Carbon Budget (2028-2032). In this respect, if the UK were to no longer participate in the EU's Effort Sharing Decision the impact on UK industry is likely to be limited.

13. The current first phase of the EU Effort Sharing Decision covers the period 2013 to 2020. As such if the UK were to end its participation doing so at the end of this phase, and in line with the end of the Phase III of the EU ETS, would seem sensible. Such timing would also avoid the European Commission having to revise the current arrangements already agreed to by Member States.

International climate change obligations and on-going negotiations

14. The UK Government has long been a leading voice within the EU for internationally ambitious climate change targets supported by strong, transparent and binding rules. While the French received much of the plaudits for the success of COP21, and deservedly so, the role and reach of the UK's climate diplomacy cannot be underestimated. Furthermore, built on the back of the UK Climate Change Act 2008, with an 80% emissions reduction target by 2050 and even talk of a zero carbon emissions target[1], the UK Government led attempts to increase the bloc's 2030 climate target of at least 40%.
15. While these were actions taken under a different set of Ministers (and Department), there is no reason to suggest at present that the UK's climate ambition following its departure from the EU would materially change. However, it could place in jeopardy the level of the EU's climate targets in the future, as coal dependent and less ambitious Member States, such as Poland, gain greater influence with the UK's departure.
16. This would be a serious cause of concern to industry, particularly EIIs, as the UK's climate targets are already far more ambitious than many European countries. No matter the outcome of the negotiations, the UK Government must be flexible and ensure that our targets and related policies do not undermine the UK's industrial competitiveness and are calibrated with those of our nearest neighbours.
17. Turning to the UNFCCC process and the ongoing international negotiations, following its departure from the EU, the UK should be in a strong position to contribute to this process in its own right. The UK Government's climate diplomacy is rightly respected within the international community and has a global reach well beyond that of many European countries. It could be argued that forging our own path may be beneficial, as on some occasions the UK's direct influence within the UNFCCC process can be diminished as it participates under the EU's banner.
18. Notwithstanding this, any successful international climate change agreement reached post-departure would still require both parties working in tandem. It would be detrimental to the UNFCCC process and the global efforts to tackle climate change if the UK and the EU were not to do so. Using their combined expertise and experience to help align all countries' climate commitments over time would serve the mutual interests of both parties and should not be put at risk.

[1] Harrabin, Roger. 2016. Climate change deal: 'Zero carbon' laws promised by government. Available at: http://www.bbc.co.uk/news/uk-35809144

19. Finally with respect to the specific pledges made in Paris last December, it is not yet clear what implications the UK's departure will have for both the EU's and the UK's committed obligations. The UK's pledge was part of the EU's Intended Nationally Determined Contributions (INDCs) submission, and therefore did not submit its own. While EEA countries such as Norway and Iceland expect to meet their 2030 targets as part of collective efforts with the EU and its Member States, they did in fact submit their own INDC prior to COP21.
20. Given the UK is likely not to be a member of the EU when obligations under the Paris Agreement are expected to commence in 2021, consideration will need to be given to do likewise in due course – this will also involve the EU reassessing and possibly even reducing their overall level of ambition. In addition, and again depending on the date of departure from the EU, the UK may have specific obligations under the second compliance period of the Kyoto Protocol to meet which will also need to be considered.
21. Clarity on these matters from government as soon as possible would be most welcome to ensure industry best understands the possible implications.

Research, development and demonstration funding for low carbon technologies

22. The cross-sector Industrial Decarbonisation and Energy Efficiency Roadmaps to 2050 which the government published last year, clearly set out the challenges and potential opportunities the UK's EIIs face in decarbonising while maintaining their international competitiveness. These industries such as steel and cement require significant capital investments in an array of innovative low carbon technologies in order to undertake the major transformation that the UK's climate targets require.
23. However, faced with a scarcity of available capital, uncertain financial returns and fierce competition from overseas, many EIIs require access to public research, development and demonstration (RD&D) funding to help put them on the path to do so. At present though, public funding for such projects including carbon capture, utilisation & storage (CCUS) technologies are heavily reliant on EU funding streams.
24. For example, linked to the EU ETS under Phase III, NER 300 is one of the world's largest funding programmes for Carbon Capture and Storage (CCS) and renewable energy technologies. In 2014 the White Rose CCS project in Yorkshire was awarded €300m from the fund before it was later withdrawn, as the funding was linked to the government's £1bn CCS demonstration programme which was scrapped last year.
25. The European Commission's successor to NER 300, the proposed Innovation Fund to commence under Phase IV of the EU ETS is to have an increased funding pot, possibly over €6bn depending on the carbon price, along with a broadened scope of eligible projects to include industrial carbon abatement technologies. In addition to these EU ETS support mechanisms, there are also other applicable EU funding streams which UK industry can and have benefited from. Such funding is a critical part of industry and government working together to find practical and lasting solutions to combat climate change.
26. The UK's planned departure from the EU casts much doubt over industry's ability to have continued access to these funding streams. While some non-EU member states can still access forms of EU funding, it is often limited and with little ability to influence where the money should be spent. In terms of the funding directly

linked to the EU ETS, EEA members are already eligible to apply for funding which may be applicable to the UK post-departure.

27. Therefore, the government must either ensure that industry continues to have access to these EU sources of funding, or provide assurances that alternative and commensurate funding will be made available while still encouraging close collaboration with our European partners post-departure. To do otherwise would not only put at risk reaching our 2030 and 2050 climate targets but also the UK's longer term industrial competitiveness.

Make UK would be more than happy to also provide oral evidence for this committee inquiry.

Make UK

Make UK champions British manufacturing. We are powerful voice at local, national and international level for small and medium sized businesses and corporates in the manufacturing and engineering sectors.

We're determined to create the most supportive environment for UK manufacturing growth and success, and we present the issues that are most important to our members, working hard to ensure UK Manufacturing remains in the government and media spotlight.

Together, we build a platform for the evolution of UK manufacturing.