HOUSE OF LORDS

Select Committee on the European Union

Sub-Committee on Energy and Environment

Corrected oral evidence: Post-Brexit carbon pricing

Wednesday 27 February 2019

11 am

Watch the meeting

Members present: Lord Teverson (The Chairman); Lord Cameron of Dillington; Viscount Hanworth; Lord Krebs; Duke of Montrose; Lord Rooker; Lord Selkirk of Douglas; Baroness Sheehan; The Earl of Stair; Viscount Ullswater; Baroness Wilcox; Lord Young of Norwood Green.

Evidence Session No. 2 Heard in Public Questions 23 - 36

Witnesses

I: Rt Hon Claire Perry MP, Minister of State for Energy and Clean Growth, Department for Business, Energy and Industrial Strategy; Robert Jenrick MP, Exchequer Secretary to the Treasury; Dan Osgood, Director, Heat & Emissions Trading, Department for Business, Energy and Industrial Strategy; Anne-Therese Farmer, Deputy Director Energy and Transport Tax, HM Treasury.

Examination of witnesses

Rt Hon Claire Perry MP, Robert Jenrick MP, Dan Osgood and Anne-Therese Farmer.

Q23 **The Chairman:** Before I start this public session, may I first go through the village hall messages? Could I ask all Members to declare any interests the first time they ask a question? I remind everybody that this is a public session. It is being webcast. We will also prepare a transcript, which will be distributed to our witnesses today, and if you see anything that is not right in that, please come back to us and we will correct it.

This is the second in our series of sessions looking at post-Brexit carbon pricing. Perhaps I could ask our witnesses, who we are very pleased to have here from BEIS and the Treasury, to introduce themselves.

Claire Perry: I am the Minister of State for Energy and Clean Growth in the Department for Business, Energy and Industrial Strategy.

Robert Jenrick: I am the Exchequer Secretary to the Treasury.

Anne-Therese Farmer: I am deputy director for energy and transport tax in the Treasury.

Dan Osgood: I am the director for heat and emissions trading at BEIS.

Q24 **The Chairman:** Thank you. As I say, this is the second session we have had on this particular subject. At the first, we had representatives from industry in particular, and one of the strongest criticisms about consultation that I think we have had in front of this Committee. We did not particularly seek it, but it came back as a message.

The particular feeling was that there had been a large degree of listening but not necessarily any engagement in debate in this area, which is very important for certain sectors of industry in this country—energy, major manufacturing, cement production; those sorts of areas—and they had been left not knowing what was going to happen in the future regarding any detail, or even strategy.

How do you react to that, and how do you feel it could be put right? As I say, it was a message that came over to us strongly.

Claire Perry: First, may I commend their Lordships on having paper cups? It is something we have yet to achieve at the other end, and perhaps we might follow your sustainable lead in this, as in so many other areas.

I am obviously very disappointed to hear that criticism. We will be publishing, in the week commencing 29 April, the documentation on which we have been doing very detailed consultation and analysis. One of the challenges is that we have had a multiway set of consultations and, indeed, explorations. We have been working hard with industry to understand its views.

There have also been the ongoing challenges with the current allowances scheme and we have been working hard on communications in that regard. We have been talking to the EU and have an outline, if you like, of its preferred option, and we have been working to prepare for negotiations on that. We have been working with the devolved administrations, because clearly their involvement in this is very substantial. Robert and I have been personally involved in those conversations, and they continue very well. We have also taken the opportunity to ask the Committee on Climate Change for advice on the level of any cap in a future scheme, which again is a really important part of ensuring that a scheme will work.

The preferred option, which has been communicated clearly to industry in line with the political declaration, is a linked ETS that delivers, as far as possible, the benefits that have started to emerge. The movements in the carbon price are very striking now. It is quite clear that our preferred option and the fallback options will deliver on our Clean Growth Strategy commitments.

Before I turn to Dan, we have also taken the opportunity to seek views on a couple of other things, such as how we reduce the administrative burden on ETS operators, which has been a long-standing criticism by some of the participants in the scheme. We have taken the opportunity to try to improve what we do and to consult on maintaining this desired alignment, but quite properly to look at fallback positions, because the ultimate result of this will be negotiated through the next phase of negotiations.

Dan Osgood: I agree with what the Minister has just said about the views that have been communicated to you. We have been doing a lot of listening and engagement with industry and other stakeholders. A very clear message has been coming back from that, in particular the desire from virtually all the current participants in the EU scheme for some degree of continuity as we move to whatever replaces it.

We have also been doing a lot of work on the practical side. The discussions with industry have been around the policy, but we have been doing a lot of work on thinking, for instance, about the IT infrastructure that will be needed to support any emissions trading scheme. As the Minister said, I have also been talking to the Committee on Climate Change, which would have a formal role in advising on the level of a cap in any emissions trading scheme. The formal request to it for advice will go out at the same time as we publish our consultation, but we have been talking to it in advance to ensure that it is ready for that request when it comes.

The Chairman: Thank you for that. I do not particularly want to go further into this, but I would just ask the Department to ensure that you really think about how you do this, recognising that there are one or two other things on your plate at the moment, apart from this. This is absolutely key to major sectors of our industry in this country.

Q25 **Lord Rooker:** We are ahead of the game, because we do not have any work representing constituents, so we can do things that the other place does not have time to do.

There was a time when the UK had its own emissions trading scheme. It is so long ago I can recall answering questions about it in the Lords, and I left Government 10 years ago. There might still be some policy expertise, but people also move around. Do you have a view about what you would be required to do to create a domestic scheme and the broad key decisions on the function and timing? Would you still adopt the idea of 50% of the auction price being used to deal with climate change and other issues? Have you given any detailed thought to that yet?

Claire Perry: I would feel very remiss if I blamed our constituents for our lack of progress on sustainability. I think it is more a short, sharp message from somebody, but I will come off that topic.

Thank you for asking an important question, and I defer to your knowledge. Of course, we were the original pilot for carbon trading. It was invented here and most carbon is traded in London. It is a great asset and we have been able to do some great structuring on the back of it.

I believe there are five steps that would be necessary to establish a domestic scheme. The first is clearly the consultation and an impact assessment associated with it. I mentioned the Committee on Climate Change, and we are asking for its always very helpful advice on the design and operational elements of the system. I will ask that that letter be published alongside the consultation. We have to have an IT infrastructure to support it. We will publish an invitation to tender for that in the Official Journal of the European Union in the week commencing 11 March, with a commitment that that service is through beta testing and ready to go live on 1 January 2021.

We then, of course, have to engage in negotiations on the future economic partnership, of which this will be an important strand, and, while we have not yet had those official negotiations, clearly there has been a lot of preparation work on both sides. I or another Minister will then have the delight of another Statutory Instrument to establish the scheme to be laid in 2020, and various pieces of legislation will have to be passed in the devolved administrations, because this is a devolved matter.

You asked a question, Lord Rooker, about the 50% hypothecation. You will know from your time in Government that we do not hypothecate spend, but I have looked at this and the ETS revenues are about £0.6 billion to £1.6 billion a year, so if you take that out over a Parliament it is £3 billion to £8 billion. We are spending far more than that already: we are spending £5.8 billion on international climate finance; £2.5 billion domestically in the R&D portfolio in my space; £0.5 billion on BEIS Energy Innovation; and another £1.2 billion going out to catapults. So we are spending well in excess of that level, and given the Government's commitment to clean growth being one of the four pillars of our industrial strategy and the very strong commitment from the current Prime Minister and Cabinet, we could only imagine that those numbers will continue to be exceeded.

Robert Jenrick: On that last point, Claire is absolutely right that we are spending significantly more than the 50% commitment today. That revenue goes to the Consolidated Fund, so we do not hypothecate it today, but we track how much we spend, and it is significantly more than that. There is no reason to believe that that will change. We have made clear that our commitment will continue. We do not intend to hypothecate it. It will continue to be paid into the Consolidated Fund, out of which we will fund the initiatives that Claire has outlined, and others in the future.

Claire Perry: May I have another go at this? Another really important point is that through the Industrial Strategy we are taking a much more joined-up approach to how we use this spending, not just to decarbonise but to drive down costs and to create a competitive advantage. There is a kind of triple test now for everything that we do in this space, including in the R&D space, which is really welcome and long overdue, and, arguably, we have not been able to do that through the EU auction revenue system.

Lord Rooker: In the end, I came to accept the Treasury view about hypothecation. It is good in practice as long as you can track the money. I think that is the point that you have made. As long as you can satisfy external surveillance of it and you can track the money, it is not strictly necessary.

Baroness Sheehan: Minister, I just want to clarify whether a stand-alone domestic ETS is still under consideration, or will it be linked to the EU ETS?

Claire Perry: It is under consideration, because it is a fallback option if we do not succeed in a negotiated outcome, along with other options which we would be happy to discuss. It is under consideration, and clearly there has been a lot of analysis to understand whether it would be viable, which it would be in terms of volumes and liquidity. I am very happy to discuss that further if that is of interest to the Committee.

We feel strongly that we need to analyse all these options, because the cap-and-trade system has been one of the most effective parts of decarbonisation policy and it is really important that we have a functional scheme, whatever the outcome of the negotiations.

Baroness Sheehan: A quick follow-up. You talked about viability. What work has been done in the Department on that?

Claire Perry: I will ask Dan to comment in detail. We are very pleased and proud of the work the civil servants have done on this. We have looked at what the characteristics of an effective system are and where they exist globally. A UK ETS, just to talk a little about that, with the same scope of industry reach as the EU scheme would have between 800 and 900 participants. That is significantly more than the number of participants covered by California and Quebec's joint cap-and-trade system or indeed the stand-alone system in South Korea. Emissions-wise, we are similar in volume of emissions to California and a much larger emitter than New Zealand.

Our work has been informed by the problems that some of those schemes have seen. For example, the South Korean scheme is very liquid and only 3% of allowances are auctioned, and the Swiss system does not have a functioning secondary market. That depth of liquidity in a secondary market is a hugely important point.

So there is no evidence to suggest that it would not be effective, but, equally, I am strongly of the view that a linked scheme would be even more effective, and that is obviously our joint preference.

Lord Krebs: Very briefly, the plans you have described so far are all predicated on there being a transition period and a deal. What happens if there is no deal in a month's time?

Claire Perry: We are working very hard to avoid that possibility. This is a somewhat hypothetical question, along with many of the other questions about what happens to other deal/no deal preparations should the transitional period not happen, or be extended, or various other things.

We would obviously remain committed to the delivery of a linked scheme, whether or not we are still in Phase 4. That would clearly be administratively complex but not unimaginably difficult. We are obviously thinking about that, but we have to plan on the most likely scenario. The most likely scenario is that we leave with a deal, but of course we have done the contingency planning to ensure we can leave and have a functioning market in the event of no deal.

Lord Krebs: So there would be a system in place on 30 March?

Claire Perry: Yes.

Robert Jenrick: Perhaps I can explain the system we have arrived at. We announced at the Budget that we would take contingency powers to implement a Carbon Emissions Tax in the event of no deal, but only in the event of no deal. We have now legislated for that. The Finance Bill now has Royal Assent, so the powers are there ready for us to use in the event of no deal. Clearly, as Claire says, it is not the outcome that either of us would wish, but the powers are ready to be used. We have discussed them with stakeholders in the industry so they are fully apprised of them. We have published a note alongside the Budget which set out in more detail how this would operate in practice.

We set the price at £16 per tonne in the Budget. It is not easy to forecast, because a traded system like the ETS is relatively volatile and has fluctuated from as low as £6 to over £20 per tonne in recent times. We chose £16 based on the prior six months and a forecast of the six months ahead, and that has turned out to be a reasonably accurate forecast. Today, the ETS is trading at around £17. That would come into effect on exit day, and HMRC would publish shortly thereafter further information as to how the tax would be collected. In that eventuality, which we do not want to face, we are actually well prepared.

The Chairman: Thank you, Robert. We will come to some of that later on. I do not want to exclude you from the second half of the meeting, having gone through it all now, but that is very useful.

May I ask two brief points? We often talk about the fact that we were ahead on emissions trading schemes prior to the EU ETS. Is there anybody in the Department who is still there from that time? Is there practical corporate memory, because that is what it often comes down to?

Dan Osgood: Yes, there is practical corporate memory within the Department. This is also an area where the conversation with stakeholders is beneficial, because many of the key contacts that we talk to in industry have had practical experience of the whole history of emissions trading over the last 15 years. Yes, there is memory both within the Department and out there for us to draw on.

The Chairman: Despite the warm words, what I am getting back from Robert in particular is the fact that no, there will be no formal commitment on the 50%, despite the fact that it is likely to happen anyway. We talk about no hypothecation, but we have the Landfill Tax, which is hypothecated. Can we not do the same here?

Robert Jenrick: As a member of the European Union we have never hypothecated this. We have obviously committed to spending the 50% and we have exceeded it. As far as I am aware, we have always exceeded it, and, as Claire outlined, we exceed it very significantly.

The Chairman: It is not a criticism. I am just trying to clear it up. There will be no commitment on that 50%.

Robert Jenrick: Obviously, the decision is one for future Budgets and for the Chancellor to make at fiscal events. We have no plans to hypothecate it. Equally, we have no plans to reduce our commitment. We have always said that leaving the European Union will not affect our commitment to climate change.

The Chairman: Thank you. That is very useful. Lord Selkirk.

Lord Selkirk of Douglas: Lord Chairman, I should mention that my interests are in the register of interests. I did mention in the past an interest in a possible wind turbine, but that has fallen through.

Claire Perry: I am sorry.

Q26 **Lord Selkirk of Douglas:** So to the best of my knowledge I do not have an interest relating to the questions I am about to ask.

In linking a domestic emissions trading scheme with the EU's, would you be content with the balance of policy influence and constraints represented by the current EU-Switzerland arrangement? You have touched on this, but if you could explain your thinking in a little greater depth, that would be very helpful. Have you had, for example, any discussions with the European Commission in detail on this subject for linking schemes?

Claire Perry: It is an important question, because this is one of the schemes that has ended up in the same place of being domestic but linked. It is a helpful precedent, but for us, given that we start, as in so many areas of regulation, in an identical place, the assumption is that our negotiations would be a lot shorter.

We have been an important part of the ETS and, to your point, Lord Teverson, the EU wants us to be involved in this because we are an important part of the Scheme. We are a big provider, if you like, of liquidity to the Scheme, and we have a much larger market. The UK represents about 10% of the current EU ETS versus less than 1% for Switzerland. There is a really strong political will to link. There is a blueprint, if you like, for one way of linking via the Swiss deal, but my sense is that we will be able to move faster and perhaps in a less constrained way towards a linkage.

To your second question about whether we have had any discussions, no, we have not had formal discussions as a work stream during the negotiations on the political declaration, but we have prepared extensively for the next stage of negotiations.

Robert Jenrick: The outline political declaration states that it is our joint intention to explore the possibility of a linked ETS scheme. Although there have been no formal negotiations, clearly we have agreed that text as the beginning of a future negotiation.

The Chairman: What we are trying to get at here, Ministers, is that when we looked at Brexit and energy, we had the Swiss energy ambassador in front of us, who was an excellent advocate for his country, but at the end of the day he said that despite Switzerland being at the absolute epicentre of European energy systems and interconnectors, it has absolutely zero influence on the internal energy market.

In a similar way, Switzerland has effectively become a rule-taker in the way the Emissions Trading Scheme works. Given that Brexit is very much about taking back control, does this not present us with a dilemma, because we are not going to be in the driving seat here?

Claire Perry: Perhaps there is a scale issue here. Switzerland has about 50 companies in its scheme with about 5.5 million tonnes of CO_2 emitted. We have 900 companies and 10 times that amount of CO_2. You cannot necessarily predict the future from the past, but because we have been so active in driving the reforms in this Scheme, which of course have led to the rise in the carbon price, which has been very helpful, I think the

Scheme members would probably acknowledge that our contribution has been helpful in making the scheme more effective, and given the scale of emissions that we could continue to trade and the liquidity that we could provide, the message has been very clear that they want to have close co-operation going forward on any changes in the rules.

I would say from my experience of negotiating some other packages in the EU that there is a very diverse range of opinions. We were negotiating the package on CO_2 emissions reduction from light commercial vehicles, and the UK, along with some of the Scandi countries and Spain, was absolutely in the forefront of ambition. There were a lot of laggards particularly from more coal-intensive countries. In a way, given the EU's ambition in this space, using the UK's progress and ambition is helpful to the net agenda. I have felt that very strongly. Of course, Norway is in a similar position to the one we will potentially be in by sitting in on part of the negotiations and not sitting in on the general debates. I do think it is possible to continue to be influential, because we have been really good at this.

The Chairman: Thank you. I like the upbeat tone.

Q27 **Viscount Ullswater:** Minister, this question is about leaving with a deal and is about the EU ETS phases. Phase 3 lasts until the end of 2020, which could be the same as the transition period, and would be followed by Phase 4. From what you are saying, it sounds as if we would wish to continue with Phase 3 until the end, and if there was a question of setting up a domestic ETS that could be a break point. When we talked to the industry, it said that if we were going to go into Phase 4, it would much prefer it if we went in for the whole of Phase 4 rather than going in and coming out shortly after its inception. What are your thoughts on that?

Claire Perry: I know we have discussed this before in the Committee, because there is a timing question. If you will allow me, I will ask Dan to answer, because he has been speaking to industry specifically on this point.

Dan Osgood: Obviously, this is speculating on how the future might turn out. At the moment in the Withdrawal aAgreement there is text that would mean that the UK would stay within the EU Emissions Trading Scheme until the end of the current Phase, so until 31 December 2020. In the work that we have been doing to develop potential successor arrangements, we are aiming for 1 January 2021. Our goal would be that this question simply does not arise, because in the Withdrawal Agreement it is agreed that we stay in Phase 3 until the end and then implement successor arrangements as soon as possible after that.

Obviously in a world where we are in negotiation with another party to try to secure a linked emissions trading scheme, the timescale for that is not entirely within our control. We understand that, but, as the Ministers have set out, we intend to be ready in all circumstances. Part of the reason why we are continuing to work on a number of fallback options is because one of the uncertainties here is how long those negotiations for a linked trading emissions scheme would actually take. We have a range of options that we can use in that situation, but our goal is to not find ourselves in that situation in the first place.

The Chairman: Coming back to the Switzerland example, Mr Osgood, was it 11 years that it took to negotiate that? I know we are already in the EU ETS, so it is a disaggregation as opposed to a coming together, but that particular statistic does not bode well, to my mind. Do you think it will take that long? Will it be easier, or is the relationship more difficult?

Claire Perry: It is similar to conversations about trade deals, I feel, and the Canada deal. In this case, because, as in that case, we start from a position of alignment rather than disaggregation, and given the strong political statements in the declaration about the desire to form an effective scheme, and given the value of the UK's emissions pool and desire for reform in this space—obviously, I cannot predict, and it is a negotiation—we would be extremely disappointed if it took anything like that time.

Equally, it is right, as we have done, to take a backstop position—and I hate to use that word—to make provisions and to explore opportunities as fallbacks if we cannot achieve what we think would be the best outcome.

The Chairman: I might come back to that, but we move on to the knotty question of devolution.

Q28 **The Earl of Stair:** Minister, looking at the ETS and the devolved Parliaments, both the Scottish and Welsh Governments have indicated an interest in taking part in an ETS, and certainly any planned consultations that you hold will bring their views into mind. What has been the reaction of the devolved administrations to a proposal for a domestic ETS linked to the EU ETS, and how do you intend to involve both the Scottish and Welsh Governments in the policy development?

Claire Perry: I want to put on record that we have had really excellent engagement on this issue with the two DA Executives and the NIO civil servants. All four nations are highly ambitious in their climate plans. Everyone sees the ETS scheme as being very important to the delivery. Rob and I have set up a regular series of quadrilateral conversations—in fact, we have had two in the last 10 days—and our officials are working very effectively on almost weekly technical meetings to thrash through the detail.

Effectively, we have a joint domestic ETS working group to deliver a UK ETS, whether it is stand-alone or linked. There are very good conversations about the detail of that. The issue with the ETS is one of governance going forward. We have some precedents that are out there across Whitehall, so we are working to establish what the governance will look like. All three DAs have also seen copies of the consultation document now, and we are working at pace to ensure that their contributions are included in the final version before we distribute it for comment.

Q29 **Viscount Hanworth:** I think my designated question about the provenance of the carbon tax at £16 per tonne has already been answered by Robert Jenrick. I have to worry this a bit more. I think it is clear that it was a backwards-looking average. After it was promulgated or proposed or suggested, the ETS carbon price departed from £16 and rose quite rapidly and has now fallen back again.

I suppose the first question is: do you see any great disadvantages in significant departures as between the carbon tax for the UK and the ETS price? Looking forward, how would you propose to accommodate predictions of future movements in the carbon price? What opportunities arise, and when could you make the changes to track the ETS price? That is a jumble of questions.

Robert Jenrick: I am happy to answer. The first thing to say is that we are only taking these powers on a contingency basis. This is not our preferred outcome. Inevitably, taking the powers to create a Carbon Emissions Tax means that we set the price at fiscal events. At the moment we only have one fiscal event a year, which is the Autumn Budget, so we have the task of choosing a price that will likely last until the next fiscal event. That will inevitably mean that there is some deviation from a traded system and one that in recent years at least has been relatively volatile.

As I said earlier in answer to your previous question, we looked at the six months prior to the Budget, forecast for the six months looking forward from the Budget and chose the £16 per tonne. Admittedly, as you say, the price has fluctuated in the period since the Budget, but it is at approximately the £16 level today, so that has not been an inaccurate estimate. If we have a no deal scenario, that will be the price upon exit day. As you say, we could choose at the next fiscal event, say at the Budget in the autumn, to make a new forecast and set the price for the next fiscal year at that point.

Viscount Hanworth: The central question is what the disadvantages would be of a radical departure as between the ETS price and this Tax. Supplementary to that is: can you really conceive of changing more rapidly than once a year when the fiscal event arises?

Robert Jenrick: Anne-Therese would like to come in at this point.

Anne-Therese Farmer: One thing that is worth noting is that we have a Carbon Price Support, so it has been the norm for quite a long time for us to have in effect a different carbon price from the rest of Europe. That has been key to the policy outcomes that we want to achieve regarding emission reductions. It is quite normal for us to have some divergence.

We picked the price to provide as much similarity as possible, bearing in mind the data that existed at the time and the inevitable difference between a tax and a traded system. You would have to see an incredibly radical rise in the ETS to put a carbon price higher than our carbon price with the CPS in it as well.

Robert Jenrick: Because the CPS is £18, plus the £16, so together our price in aggregate is usually higher than its equivalent in the ETS.

Viscount Hanworth: I think that is it. Thank you.

Q30 **Lord Krebs:** In a way, my question develops Viscount Hanworth's. Acknowledging that there would be occasions in future when there was a divergence between a carbon tax and the ETS implicit price—or explicit price—have you sought the Commission's view on whether that differential would be a significant issue for it? In particular, what about the impact on the Integrated Single Electricity Market in the island of Ireland if the Tax and the EU ETS price were to diverge significantly?

Robert Jenrick: I will ask Anne-Therese to answer that with respect to Northern Ireland. The short answer is no, we have not sought the Commission's advice, because we are only taking these powers in the event of us leaving the European Union in a no deal situation. This is not our preferred outcome and not the situation that would arise if we secured a deal and entered the implementation period. To that extent at least, it does not concern the Commission. Is there anything you would like to add on Northern Ireland, Anne-Therese?

Anne-Therese Farmer: As we said, we consciously tried to pick a price that was as similar as possible, bearing in mind the practical differences of the systems.

Regarding the Single Electricity Market, if we were in a world where we had to introduce this, the Government have been clear that they are committed to maintaining the Single Electricity Market, and we would want to do everything we could to ensure that the existence of the carbon tax as opposed to the ETS in no way hindered the function of that.

The Chairman: Robert, one of the things that I guess has been a feature of carbon pricing over the last few years is that the Carbon Price Floor has not changed, and I sometimes get the impression that that is a political decision rather than a climate change or decarbonisation decision. Is there not a real risk that the carbon price gets stuck because it is politically very difficult for the sorts of organisations looked after by BEIS and Claire's department if they suddenly, in times of difficulty, get a tax rise despite the fact the EU ETS price has gone up? Does it not launch all this rather strongly into the political field?

Robert Jenrick: I understand your point. I hope that is not the case. We have chosen to set a price that emphasises continuity. Of course, there were those who argued that you could go higher or lower, either to boost the competitiveness of energy-intensive industries or to improve on our environmental credentials, but we chose continuity. I think that has been well-received by all sides as a sensible way forward. We did not make a political choice in reaching that decision.

The Chairman: I understand that point about continuity.

Robert Jenrick: We did not take a political path but chose a price that would give the greatest level of continuity for all involved.

The Chairman: My question was more about the ongoing situation.

Claire Perry: If I may say so, it has been a highly effective policy. This has helped us to drive coal out of the generation mix. It has contributed to the very rapid decarbonisation of our energy system. We have taken steps through the EII allowances to ensure that those intensive industries that cannot decarbonise any further do not face undue competitive costs.

It is always a balance, but it is probably a fairly fruitful conversation between the two departments. Of course we are trying to counterbalance different agendas, but it is actually working. I think it was important in the latest Budget to be cognisant of some of the uncertainties which the whole industrial sector is facing as we go through the Brexit preparations. Equally, it has not stopped the decarbonisation of our energy system.

Robert Jenrick: Without speculating too much about what might happen in a no deal scenario, we are taking these powers for the Carbon Emissions Tax on a contingency basis, but it does not mean that that Carbon Emissions Tax, were it ever to come into force, would last in perpetuity. The same conversations would apply as to whether in future we could create a domestic system.

The Chairman: That is a very good point, which I take.

Robert Jenrick: This may not last for a long time.

The Chairman: That is a very well-made point. Lord Krebs, you wanted to come in on this.

Lord Krebs: I have a very small point. At the beginning, Claire Perry, you mentioned that the CCC had been consulted on the future of any UK or linked ETS, or will be consulted—I think you said you would ask them on 29 April. Is there a similar request of the CCC apropos a carbon tax even if it were an interim measure, as Robert Jenrick has indicated? Have you asked the CCC for advice on that?

Claire Perry: I do not know. I am looking hopefully at my official.

Dan Osgood: In a world where we were implementing a Carbon Emissions Tax, ultimately decisions on tax would be a matter for the Chancellor. In any case, the Committee on Climate Change already has the powers and a duty, in fact, to produce an annual progress report to Parliament on how it thinks the Government are progressing against our carbon budgets. It has an opportunity to comment across the policy landscape. I am sure that the Committee, whether or not Treasury Ministers formally asked it for a view on this, would want to consider whether it felt able to comment on it anyway.

Lord Krebs: I am taking that as no, you have not asked it.

Robert Jenrick: As far as I am aware, unless Anne-Therese can help, we have not asked it, but it is within the scope of its existing powers to comment should it wish to, and I suspect it will.

Anne-Therese Farmer: This all relates to the fact that the powers have only been taken as a contingency measure. We have done everything we can in designing it to ensure that there is no growth in our emissions as a result of having to make the switch in a no deal scenario. We have been focused on trying to keep the same incentives in place for emissions reduction.

Claire Perry: Thinking this through, it will also, I imagine, be interested in the consultation document and, given its assiduity in this space, may well write us a response.

Q31 **Baroness Sheehan:** My question is about the devolved administrations and some of their reservations about the proposed tax. On what grounds have the Scottish and Welsh Governments objected to the proposed Carbon Emissions Tax? What steps have you taken to address their concerns?

Robert Jenrick: As Claire has already described, we have a good relationship with the devolved administrations and with the civil servants who are able to support us from Northern Ireland. We have had a series of meetings now and have agreed to continue those conversations. Because tax is not a devolved matter, we legislated for this in the Finance Bill, as you would expect. I piloted those areas of it through the House of Commons, and this was debated, but there was not a high degree of dissent.

It was clear that in the event of no deal we had to take action to ensure continuity, and this was the logical way in which to do so. We chose not to consult on that matter prior to the Finance Bill, but that is not unusual, and in the interests of time we felt that was the right way to proceed. We published guidance from HMRC. Our officials have been in contact with their counterparts in the devolved administrations and they will be involved in the event that we have to implement the tax and will prepare further guidance which HMRC will issue after exit day.

Anne-Therese Farmer: To add to that, you asked about key concerns, and I think one of the key concerns was clarity on our part that this was not pre-judging a long-term future and was just a no deal contingency measure, which we have tried to continue to be clear is the case.

Q32 **Baroness Sheehan:** One of the concerns that they have raised is that the current devolved mechanism is collectively agreed by all four of the administrations but that a tax would be reserved to HM Treasury and the devolved administrations would have no involvement. It is not clear to me that you have addressed the concerns specifically of the Scottish and Welsh Governments, which were expressed in a letter to the Chancellor. Have those concerns been addressed?

Robert Jenrick: They have raised those concerns with us in the meetings that I have had and they were raised during the passage of the Finance Bill, although, as I say, I would not overstate them, because if you refer to the debates in *Hansard*, this was not an issue that was discussed at great length. I think that is because, being pragmatic, we have to accept that while we do not want a no deal outcome, we should prepare for it. If you care about this agenda and want to see continuity, you need to find a way through, and this is the most logical way of doing so.

Nobody has suggested to me a better way of doing this. This is the most logical way of preparing the country for a no deal outcome. It also has to be said that the areas of devolved responsibility which they have today, for example in monitoring carbon emissions, they will continue to have even under the Carbon Emissions Tax. Even in the event that we have to implement the Tax, the day-to-day work that the devolved administrations undertake in this area would continue.

Q33 **Baroness Wilcox:** I have two questions. The EU requires at least 50% of the revenues from the EU ETS auctions to be used for climate and energy-related purposes. Would you apply that requirement to the revenue from the Carbon Emissions Tax?

The second question is: would you apportion the tax revenue among the devolved administrations to replace the revenue they currently receive from the auction of the EU ETS allowances?

Robert Jenrick: I think we sought to answer that question earlier. The current system requires Member States to spend an equivalent sum of 50%. It does not require hypothecation and we do not hypothecate it. We spend, as we said earlier, significantly more than the 50% target anyway, and we have no intention of changing that. I hope that answers that question.

We have not made a decision with respect to the revenues from the Carbon Emissions Tax. We have made a decision in the sense that at least 50% would be devoted to the same areas as they are today.

Regarding the revenue feeding through the devolved administrations, that is a decision the Chancellor will have to take at a fiscal event, but today the revenues are Barnett-ed, so the devolved administrations get the advantage of that. In fact, by the nature of the Barnett formula, I think it is advantageous to them to stick to the current formula.

The Chairman: I am pleased to say this Committee has never got to the Barnett formula before and I have no intention that we go any further down that particular route.

Lord Rooker: I did a Joint Select Committee on it once. Do not go there.

Baroness Sheehan: Where can we see online today where the revenues go?

Anne-Therese Farmer: As the Ministers have said, the revenues go into the Consolidated Fund, because we do not do direct hypothecation. We spend far in excess of the 50% requirement on the areas the Commission says the revenue should be spent on.

Claire Perry: Some of that is done through reserved funds and some of it through devolved funds, and of course some of it goes in through things such as city deals, which are often jointly funded through reserved and devolved, so it is complicated. We know the aggregate number that we are spending in this area, and we are all very comfortable that it far exceeds the commitment.

Baroness Sheehan: Is it definitely marked as being climate and energy related?

Claire Perry: That is a good question. I would say yes. The Aberdeen city deal, which I have been very proud to be involved in, built a great big conference centre that is highly climate efficient. I do not know how we have scored that, but the bits we can score, and there may indeed be more than we are scoring, are scored as spending on climate and energy improvements.

Q34 **Lord Young of Norwood Green:** The Government adopt five-yearly carbon budgets that restrict the amount of greenhouse gas the UK can legally emit in that period. They are currently calculated on a net basis allowing for trading in the EU ETS scheme. I was also looking at a bit of evidence on this tax and I saw it was described as a Pigovian tax. I have to admit that, not being an economist, I had to look that one up, and apparently it is a tax that corrects a market distortion where the market has external effects. I am sure you are far more familiar with this than I am.

Somebody goes on to allege that it is not a revenue-raising tax. I did not quite understand that, because you are going to raise some revenue and it looks as though you are going to spend it as well. Do you envisage making changes to the UK's carbon budgets in the event that the Carbon Emissions Tax is implemented? If so, when would you begin that process?

Claire Perry: We did not learn about Pigovian taxes at Nailsea comprehensive school, but it is probably not a revenue-raising tax, because it is net, if you like; it is replacing an income. I know about the Barnett formula, having done a 500 variable regression on it in the shadow Treasury team, but I feel that the evidence is well out of date. Thank you for the question.

Of course, the budgets are in effect recommended by our excellent Committee on Climate Change, and we choose whether to accept them or not. I think it goes back to Lord Krebs's point. As a former member of that Committee, he knows the influence it has, and that if it were to be observed by the Committee that these policies were causing a departure from our budgets, we would be required to address it.

It is important to note, though, that our constant refrain about all elements of EU departure has been that we will seek to ensure that our future approach to ETS and, indeed, that our future regulations are at least as ambitious as our current situation. Of course, given the Climate Change Act, which has enshrined in law our own domestic targets, those are higher than the effort-sharing targets that we contribute to the EU. We are in a good place to continue to be ambitious, but we would rely on the CCC to help us if this unlikely event of the tax being applied had the unlikely result of causing us to deviate from our budgets.

Lord Young of Norwood Green: So you are relying on the Committee on Climate Change to say to you, "You have implemented this tax, but it is having a deleterious effect. You are not meeting the previous budgets".

Claire Perry: We rely on our excellent officials to make that point to us, and the CCC to confirm that, and under its statutory duty essentially to give us advice, which we have to respond to as to what we are going to do about it.

Q35 **Lord Krebs:** I am still banging on about the carbon tax which you obviously hope will not eventuate, but we still have to explore what would happen in the instance of a carbon tax being introduced. What clarity can you provide regarding how the Tax would be administered, and what would you intend to consult on this year if the Tax is implemented?

Expanding a little, what advice and guidance will you be providing for businesses that would be subject to the tax while you are still finalising the policy? You have already mentioned that you hope a carbon tax—were it to be introduced, and you hope it will not be—would be an interim measure before some other mechanism such as a stand-alone ETS was introduced. Do you have a sense of what that timeline would be? It is a question about the guidance on the policy, when that will be available and how long you envisage it would last if it were introduced.

Robert Jenrick: Alongside the Budget we published a technical note which set out some further details to businesses and other stakeholders who are interested in the Tax. That included payment and tax collection arrangements, amendments to the existing reporting requirements and the review and appeal process, as well as record-keeping requirements. I think that was fairly comprehensive. Through our officials at the Treasury and HMRC we have done a good deal of engagement with the key stakeholders since then, as the Finance Bill has passed through Parliament, to give them further reassurance.

Under the proposals, the emissions would continue to be reported in the same way as they are today, which is to the Environment Agency in England and the devolved regulators in Wales and Scotland. The role of the devolved administrations would remain in that respect the same as it is today, and HMRC would then collate this information and calculate the tax due and who is responsible for paying it at that point.

We have said that if we are required to implement the Tax, we would consult shortly thereafter, so as soon as practicable after exit day, on any final finer details of the policy that are required at that point. Regarding how long it might last, we do not have a clear answer on that today. I suppose one would have to balance whether the tax itself was well received and was doing the job it was supposed to do, the cost to business and to others of replacing it with yet another change to the system, and whether there is a widespread consensus that there is a better route than this such as a domestic traded ETS system. We have not reached any conclusions yet as to when we would make that decision on how we would do that. Anne-Therese, is there anything further you would like to add?

Anne-Therese Farmer: Just to reiterate, it was intentionally designed so that the monitoring and reporting for businesses is the same as it is at the moment, to try to keep it as simple as possible, bearing in mind the change. The consultation later this year, were it to come into force, would be an HMRC-led consultation, not on the big questions of tax design but on the technical questions about collection arrangements, enforcement and those sorts of questions. The HMRC would conduct that later in the year and the first tax would then be collected in 2020.

Lord Krebs: Could I go back very briefly to Lord Young's question about switching from net, which is the current budget calculations, to gross, which it would be if we were not in an ETS? Do I understand correctly that you would seek advice from the Committee on Climate Change about the existing budgets that have been passed into law that are based on a net basis and future budgets, and that you would have to change the targets because you are now excluding the allowances for the traded sector?

Claire Perry: I am not necessarily sure that that is true, and I would not want to indicate to the Committee that we had had those conversations, because we are in a hypothetical world of fallback positions, but it is an important point, and should we get to this unlikely event we would obviously have to take all these considerations into account.

Baroness Sheehan: Mr Osgood, right at the start of this session you mentioned IT planning. My question is: how much IT planning is possible in this climate of uncertainty?

Dan Osgood: Obviously, we are a member of the EU Emissions Trading Scheme at the moment, so we have a good idea of what supporting infrastructure is needed to make an emissions trading scheme work. The UK already has its own auctioning platform within the EU scheme and we would need an auctioning platform in any stand-alone or linked emissions trading scheme.

We would need a registry. There are a number of existing registries out there that it is very possible to copy from. It is just a case of managing the trading of allowances between a series of accounts. There needs to be IT infrastructure to support the monitoring, reporting and verification of emissions. Again, that already exists, so we can look to that.

A number of things would need to be in place to ensure that any emissions trading scheme was robust and secure, but there are lots of good examples out there that we can look to, particularly the EU Emissions Trading Scheme which the UK has played a leading role in shaping over the last 15 years. There will be a lot to do, but we are confident that we can deliver it in time.

The Chairman: Does the tax regime system, if we have to apply that, require new IT?

Anne-Therese Farmer: Yes, it would require some adjustments to HMRC systems, because obviously we do not do this at the moment. A lot of the ways in which we have approached the design of the Tax have had to take account of the fact that it is an unusually short lead-in time, but, yes, we fully expect to be able to do it, as we have said, on time with tax collected in 2020 for the first time.

Robert Jenrick: We have until April 2020, and it is a relatively small tax base, so there is no reason to believe that we will not be able to deliver.

The Chairman: It is a relatively small population, that is true.

Q36 **Lord Young of Norwood Green:** I think you have answered my question. You are still assessing the potential viability of a UK trading scheme from the answers that you have given, and that is a continuing process. Is that right?

Dan Osgood: Yes, and, as the Minister referred to earlier, we have been looking at other schemes elsewhere for comparison with size, number of participants, size of the market, and at some of the secondary design features that you can build into an emissions trading scheme to improve liquidity and viability in the levels of auctioning or whether people who do not have obligations can also take part in the market. There are lots of lessons that we can look to learn from the range of other international trading schemes.

Lord Young of Norwood Green: Do you think we can make it work, or is it too soon to say?

Dan Osgood: Yes, I am confident that it would be viable if we needed to go there. As the Ministers have set out, our preference at this stage is to look to explore a linked emissions trading scheme with the EU, but if that was not possible we would need to consider the right option going forward.

The Chairman: Ministers, Dan and Anne-Therese, thank you very much indeed for coming in front of us. This has been a most useful session. I bring this part of this public meeting to a close.