



HOUSE OF COMMONS

Environmental Audit Committee

Oral evidence: Carbon border adjustment mechanisms, HC 737

Wednesday 23 February 2022

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Members present: Philip Dunne (Chair); Duncan Baker; Sir Robert Goodwill; Helen Hayes; Ian Levy; Clive Lewis; Caroline Lucas; Jerome Mayhew; Dr Matthew Offord; Valerie Vaz.

Questions 127-181

Witnesses

I: Rt Hon. Lucy Frazer QC MP, Financial Secretary to the Treasury, and Mike Williams, Director, Business and International Tax, HM Treasury.

Written evidence from witnesses:

– [HM Treasury](#)

Examination of witnesses

Witnesses: Lucy Frazer and Mike Williams.

Q127 **Chair:** Good afternoon, and welcome to the Environmental Audit Committee for the final hearing of our inquiry into carbon border adjustment mechanisms. We are very pleased to be joined today by the right hon. Lucy Frazer QC, who is the Financial Secretary to the Treasury. Perhaps you will introduce your director.

Lucy Frazer: Yes. Thank you very much, it is great to be here. Mike, do you want to introduce yourself?

Mike Williams: I am Mike Williams, business director at the Treasury.

Q128 **Chair:** From our research, we are aware that the Treasury is interested in the whole subject of carbon border adjustment mechanisms, how they might follow on from the emissions trading scheme that we operate already for domestic production, and how they might interlink with other schemes being introduced by other trading blocs or nations.

We are also aware that you have not yet formed a view, which might limit what you are able to tell us. We assume, therefore, that whatever you say in this discussion is not at this point an informed view of the Treasury, not a finite position, but we are grateful to you for coming to talk to us so that we can have a dialogue about the issues you are thinking about and that are of concern. We hope to make one or two points that you might find of interest as well.

I will kick off with a couple of fairly basic questions about how you see the risk of carbon leakage causing challenges to the UK economy. How does the Treasury monitor and mitigate that risk?

Lucy Frazer: Thank you, Chair, and thank you for identifying the position that we in the Treasury are in at the moment. We are doing significant ongoing work in Government as a whole on carbon leakage. You will know that we have a number of calls for evidence out. We are, as you say, looking keenly at the solutions both domestically and internationally. In that context, the work of this inquiry is very welcome. We are looking forward to the insights that come our way. As you say, no final decisions have been reached, so we are very pleased to have the opportunity to have the dialogue that you mentioned.

As you highlight, it is very important to consider carbon leakage and its impact on the environment, and the impact on businesses if we take domestic measures—how that would impact on our imports. This is an issue both for the environment and for us as a competitive nation.

You asked how we monitor and look at that. You will know, having seen the net zero review, that we have analysed the work and the impact of carbon leakage. We know that there are a number of views on whether there is an impact in relation to carbon leakage measures. For example,



HOUSE OF COMMONS

while the ex ante modelling tends to support the suggestion that differential carbon pricing between trading partners can create material carbon leakage risks, there are also studies looking at the first years of the EU ETS that find no evidence of leakage. It is an area that we will keep under review; it is very important for us to continue to monitor it.

Q129 **Chair:** Did you just say that there is no evidence of carbon leakage from the imposition of the ETS? Did I hear that correctly?

Lucy Frazer: The first years of the EU ETS, and limited to no evidence.

Q130 **Chair:** Okay. Have you seen evidence of carbon leakage from other activity? In other words, have other pressures on energy intensive manufacturing activities in the UK led any to offshore, and could that conceivably be related to green energy policy propositions or increased costs of operating in the UK as a result of environmental policy?

Lucy Frazer: From the evidence that I have looked at and read—I am sure you have seen this as well—the view is that at the moment people are not moving their businesses offshore in order to take advantage of less restrictive regimes. The question is whether they will do that in the future, whether they make a decision as to where their next manufacturing plant might be. We will see.

Q131 **Chair:** Have you had representations from business concerned about an increasing carbon price in the UK potentially leading them to make those decisions—essentially threatening, whether implied or explicit?

Lucy Frazer: I have been in office only a short while, and I would not say that that is the thing that is coming through my communications as one of the key issues, but Mike, you might have a better feel for that.

Mike Williams: I think that is right. Such concerns that are expressed are less specific; they are more a general concern that, if the level of taxation of carbon in the UK—the price of carbon in the UK—were significantly higher than elsewhere, we might get that incentive effect, but it has not been quite as tangible or direct as you have suggested.

Q132 **Chair:** Apparently the latest figures show that 43% of UK consumption emissions arise from imports. The whole purpose of the CBAM scheme is to bring imports into a regime. To what extent is that something that the Treasury wants to do? Is that initiative being led by the Treasury, or is the Treasury being encouraged by other parts of Government to look into such issues?

Lucy Frazer: We work very closely with BEIS on the issue of net zero and whether we solve that through CBAM or other measures—for example, the ETS. We are going to consult on that scheme shortly. It is something I am working on very closely with my counterpart in BEIS. Obviously, BEIS is in charge of climate policy and we have other responsibilities in the Treasury, but they are combined.

Q133 **Chair:** You mentioned that the changes to the free ETS allowances will be under consultation shortly. Is it the intent of the Treasury to gradually



HOUSE OF COMMONS

wean high energy intensive businesses on to an emissions trading scheme, and how is that going?

Lucy Frazer: We launched the ETS last year, so it has been in operation for a year, and we have publicly committed to two things. One is to explore expanding the scope of the ETS to two thirds of the uncovered emissions, so the answer to your first question is yes, on the basis that we want to extend it beyond the industries that are currently covered. We have also committed to introduce a net zero consistent cap no later than 2024.

Q134 **Chair:** To what extent do carbon taxes for imports coming to the UK play a role in the negotiation of the trade agreements that we are negotiating at pace around the world, following leaving the EU?

Lucy Frazer: Generally we are keen to ensure that FTAs support our climate ambitions. For example, our recent FTA with Australia has an environment chapter that commits both parties to work together to tackle climate change and uphold our obligations under the Paris agreement. I am sure you will be interested in the international schemes that are considering CBAMs of some sort. If we go down that road internationally, that is probably an international agreement outwith a trade agreement, by which I mean separate from: we are not necessarily going to agree to a CBAM within a trade agreement, but obviously we would ensure that we are continuing to meet our net zero ambitions.

Q135 **Chair:** We are going to come on to multilateral versus unilateral shortly, but do you think this could be a hindrance if we were to move ahead of other international agreements in reaching trade agreements with groups like the CPTPP?

Lucy Frazer: I suppose there are two points to that. One is that the challenges we have with the environment are an international issue, so we need to solve them internationally where we can, and it is important for countries such as ours to lead on that. It is important for us to send a message that that is something we are committed to. With the CPTPP, we are acceding to an existing arrangement, so our scope to do something in addition to what is already there is limited.

Q136 **Chair:** In other words, that would not form part of that agreement. It would have to be done separately.

Lucy Frazer: Yes, because we are acceding to something that already exists.

Q137 **Chair:** If we and the EU, for example, were to move ahead with a scheme, it would have to be negotiated in such a way that it did not conflict with other international trade agreements that we had.

Lucy Frazer: I think our scope to change what is already there is limited, so we would have to do something separately.

Q138 **Caroline Lucas:** Could say a little more about UK consumption emissions? Given that there are more emissions from consumption and



HOUSE OF COMMONS

imports than from territorial emissions, if we did not go down the route of a CBAM, could you say a little more about what the next options are? What is highest up the Treasury list of possibilities? Would it be around product standards? What other ways are you considering?

Lucy Frazer: We have to remember what levers we have in order to control emissions. Domestically, in relation to production, we have more measures to control than we do in relation to consumption and imports outside of things like CBAM. On our agenda is carbon pricing, which you know has been very effective, so we have managed to get the use of coal down by 84% as a result of carbon pricing. We have talked about the ETS. As I mentioned, we are consulting on the next steps in relation to that shortly.

We also have a number of calls for evidence out. The UK Government and the devolved Administrations launched a review of free allowances last April, and we will consult on that in due course. We have a BEIS review of the schemes to compensate energy intensive industries for indirect emission costs in electricity prices in June. We launched in December last year a call for evidence on the market for low carbon goods. We have made a commitment through our sixth carbon budget to have one of the world's most ambitious climate change targets—a 78% reduction in carbon emissions—and we have quite a lot of work in train, as I have just mentioned, to achieve that.

Q139 **Caroline Lucas:** Do you have a sense of when we will know which of that menu of options you will light upon?

Lucy Frazer: We are already doing carbon pricing in the ETS, so it is obviously developing. You mentioned product standards as well, and that is something we are looking at. They are all in progress, although they will all have different timescales. This isn't something we are standing still on.

Q140 **Chair:** May I ask one final question before I hand over to Jerome Mayhew? Who in the Treasury ministerial team was responsible for the net zero review?

Lucy Frazer: I am the Minister responsible for net zero. The Exchequer Secretary is responsible for other aspects of energy, and the Chancellor is responsible overall.

Q141 **Chair:** And the Chief Secretary?

Lucy Frazer: He is responsible for spending, so I suppose he has a role in that as well.

Q142 **Chair:** So, to the extent that spending follows from net zero policy making, he will also be involved.

Lucy Frazer: He would be engaged, yes.

Q143 **Jerome Mayhew:** Minister, before we move on to the core part of my questions, can we go back to the evidence of historic carbon leakage? We heard interesting evidence in, I think, the first session of our inquiry from representatives of the chemicals industry. As they described it, it is not



HOUSE OF COMMONS

so much that you are going to take a plant and shift it overseas, but that if you look over the last 10 years at the record of investment for additional or replacement capacity in the United Kingdom, you will see that it just isn't there, and that in itself is evidence of carbon leakage. Perhaps this is question is more for Mr Williams than the Minister; I don't know. In your review of the evidence for or against the existence of carbon leakage historically, did you assess that as a particular factor?

Mike Williams: We would always be concerned to look not just at the static picture and what happens to the manufacturing plant and whatever you have now, but at what happens to future investment. Equally, you can see from other aspects of tax, where analogous, that the greater the difference in price or level of tax, the greater the incentive to shift. There is a difficulty. You see this quite often with tax, and you see it here as well, and it is very difficult. You can't be sure that if the differential is significantly greater, you will have a more marked effect. What is very difficult—I think this is true here as in tax—is sort of scaling that where you have not got much evidence. That is where the difficulty lies.

Q144 **Jerome Mayhew:** You must be right, logically, that the greater the differential, the greater the incentive to move production. As we have seen over the last six months, the cost of carbon has only been going in one direction. The last time I checked a couple of weeks ago, it was trading at £56 a tonne. Would you accept that even if the historic evidence is nuanced—if that is the Treasury view—would it also be the Treasury's expectation that the impetus towards carbon leakage is only going to increase in the future?

Mike Williams: That depends on what other countries do vis-à-vis the UK. It is not just the UK that has made significant commitments towards net zero—it is other countries as well. I sense this is part of your question, Mr Mayhew. If you sense that there are free riders, if you like, out there who either don't meet their commitments or never make commitments, then I think the greater the differential, the more you would need to be concerned about the issue. That is probably why policy measures like CBAMs are moving up the international agenda—because it is, of course, not just the UK that will be concerned about that.

Q145 **Jerome Mayhew:** Wonderful—we are all cheering behind the international effort for there to be a global approach to this and I fully accept that the Government's primary objective is to have an international approach, but I think we have to accept that world peace is unlikely to break out anytime soon, and neither is an international approach on climate change.

That leads me neatly on to the actions that the Treasury has been taking to develop multilateral solutions to carbon leakage. We have been told by a number of Ministers over the last 18 months or so that this is an international problem and it requires an international solution. What is it? What steps have the Government been taking to achieve that international solution?



Lucy Frazer: May I touch on the first question first, and then come on to that? You make some valid points, but you also have to bear two things in mind. There are a number of reasons why people choose to invest in a country, which isn't just about profit. It is about stability. It is about attracting people to come to that particular country—do people want to live and work there? That is an investment choice about where you base your company.

I think there is a wider point. One of the reasons why I said that it is important that we lead this work, and that we have an international solution, is so that manufacturers across the globe realise that wherever they base themselves there will be consequences. The country that they are in may not have any domestic regime yet, but in the future it may have a domestic regime, or be subject to some sort of import taxation. They will be looking to the future; it might not be worth their while investing in a particular country, although it is doing nothing now, because they will have an eye to the future.

Q146 **Jerome Mayhew:** It is very interesting that you mention that because even the conversation around the imposition of CBAMs is already having a real impact on manufacturing businesses around the world. In South Africa, for example, I am aware that the automotive industry is so concerned about the European Union imposing a form of CBAM that it is changing manufacturing processes even now.

Lucy Frazer: So it does have an effect. But you asked me what we are doing as a nation on the international stage.

Q147 **Jerome Mayhew:** How are we getting the agreement that we say we want?

Lucy Frazer: The first thing to say, obviously, is that we took a significant role in COP, in terms of bringing other people to the table to reduce their carbon emissions. I know you know all that, so I won't repeat it, but I think it is important to remember.

In our presidency of the G7 we have put carbon leakage on the agenda and have made some significant progress in getting it on the agenda so that countries are talking about it. I don't think we can underestimate the impact of what we did in that role. It's not just about leaders talking about it. We brought to the table Finance Ministers and central bank Governors, and so it is now globally recognised that this is an issue that we need to solve internationally. I think that is a real achievement. What we are seeking to do, with Germany now, is to continue that work through the G7.

You will know that out there a number of carbon schemes are being proposed. There is the German climate club. There is the IMF's international carbon price floor. The OECD has some suggestions. Our role in that is to work and keep abreast of those developments—to keep interested in them and see how they develop.

Q148 **Jerome Mayhew:** One example of the kinds of clubs that you have



HOUSE OF COMMONS

described is that which was announced between the USA and the European Union—the global arrangement on sustainable steel and aluminium. This was, in my language, the low-carbon steel agreement. It was specifically said in the announcement that it was open to other like-minded countries. Do you think it likely that the United Kingdom may wish to explore membership of that particular agreement?

Lucy Frazer: It is a very interesting proposal and is at its very early stages, so we will monitor it closely. We are interested in addressing carbon leakage multilaterally, so obviously we would welcome an opportunity to explore that further. It sounds interesting, and we obviously have our own section 232 discussions going on with the US as well. I think any arrangement that we can come to bilaterally or multilaterally to solve this, either across the board or sector by sector, is something that we are open to having.

Q149 **Jerome Mayhew:** I very much welcome the point that you made about Germany taking on the presidency of the G7 in December. In their prospectuses for what they seek to lead on, carbon leakage is their first priority. It is really interesting that that has built on the United Kingdom's leadership of the G7. How close do you think we are to multilateral agreements on carbon emissions? There are the various clubs, and there are interesting proposals. Are we going to get to this in the 2020s? Do you see that as being a solution? I am going to rephrase that. The primary objective of the Government is to have a multilateral solution to carbon leakage. When do you decide that you have tried and failed, and at what date do you start thinking, "You know what? A CBAM—hopefully a multilateral CBAM—is the next best alternative"?

Lucy Frazer: As I said at the outset, we are exploring all options, so there is not a date at which we will say, "Now we are only going to do our own thing." We are exploring everything at the moment. You said our primary objective is multilateral, and obviously that would be the perfect solution, but I mentioned some of the things that we are doing unilaterally. The ETS scheme is a unilateral scheme. The EU are developing their own scheme, and we may be able to work alongside that.

Q150 **Jerome Mayhew:** We essentially copied what they did with the EU ETS, didn't we?

Lucy Frazer: Yes, we have done it. We are developing it, and we are broadening it. When you say, "What is the date?", I don't think that I, a Minister in the Treasury, can say, "This is the date at which there is going to be an international solution," because they are all at a very early stage. The EU have set out their timetable. It is quite a tight timetable, because it has to go through quite a number of procedures, but they have set out a timetable. I cannot say what is going to happen internationally, because we are but a player in that, but we are obviously exploring our own options as well.

Q151 **Jerome Mayhew:** The final area that I want to explore with you, if I may, is the potential for tensions within the various Departments of Government. The Department for International Trade is rightly very keen



HOUSE OF COMMONS

to explore free trade agreements, and it has sometimes been said that an imposition of some form of CBAM, on top of what would otherwise be a fairly straightforward free trade agreement, might complicate the role of Government in developing these. But we did hear evidence from Professor Michael Mehling of MIT, and his view was very interesting. I wonder whether either of you would like to comment on it. He said that introducing measures such as CBAMs “would not necessitate a renegotiation of existing agreements,” as such measures would be considered “the extension of an internal measure,” which is “part and parcel of international trade relations, with sales taxes, VAT” and the like. He is saying that, essentially, it should be viewed as the imposition of a national tax, and therefore outside the scope of an FTA. Does the Treasury have a view on that? Is that a view that either of you have come across before, and what would be your response to it?

Mike Williams: We have come across the view. You have to factor in, though, the WTO and GATT rules in relation to CBAMs. In reality, when you look at any particular form of CBAM, you probably are more constrained there, because clearly we have the international obligations under the WTO rules and you have to comply with those. If you look at the EU CBAM, you can see the EU making similar efforts to ensure that their CBAM stays within the WTO rules.

Q152 **Jerome Mayhew:** Under WTO rules, there is an exemption for climate-related policies, isn't there?

Mike Williams: They are subject to constraints in relation to imports of goods where there will have been carbon emissions. If you look at the other end, the ability to impose CBAMs on exports, you see more constraints, because the bar to a Government, a state, intervening in the market is greater with exports.

Q153 **Helen Hayes:** In the industrial decarbonisation strategy, the UK Government indicate that they plan to continue with free ETS allowances in the immediate future and to consider new measures, such as on the treatment of imports, only in the longer term and particularly in the 2030s and 2040s. What is the rationale for the delay in introducing new measures against carbon leakage?

Lucy Frazer: Can you just repeat that? Sorry.

Helen Hayes: In your industrial decarbonisation strategy, you indicate that you plan to continue free ETS allowances in the immediate future and to consider new measures only in the 2030 or 2040s, so my question is: why the delay in considering new measures to address carbon leakage?

Lucy Frazer: We have actually got a review at the moment into free allowances. That review started in April, and we will have to look at how free allowances would interplay if we did bring in a CBAM, because we wouldn't want somebody in this country to get a free run on carbon emissions while we were charging somebody else on imports. The answer to your question on timing would be that obviously industry has to prepare



and adjust, to ensure that it can continue, and continue to be competitive, in what are fundamental markets and industries.

Q154 **Helen Hayes:** It is accepted that industry needs time to prepare, but industry can prepare only once it knows what the Government's approach will be.

Lucy Frazer: As I said, we are in a consultation—we have launched a review into free allowances. It started in April with a call for evidence, and we will consult on that in due course. We are also exploring the ETS as a whole, which we'll also report—well, that consultation will open quite shortly. So businesses will have our views and can prepare on top of that.

Q155 **Helen Hayes:** What do you expect the timescale to be for that—for a firm view so that business can start to prepare?

Lucy Frazer: Mike, do you want to come in?

Mike Williams: It depends on what aspect. A key thing is that if you are to introduce a CBAM, you have to have a measuring mechanism; you have to specify how you measure the CO₂ emissions on the good or whatever it is that is brought into the UK. You also have to have a mechanism for working out, to the extent that a price is being paid for that, what you allow to be included in the price and what you say is peripheral or extraneous. You have to allow time for businesses to put the systems in place to do that, so you have to develop it and then they have to have time.

To go back to Mr Mayhew's example of a car manufacturer in South Africa, if we were to introduce a charge on their production from South Africa coming into the UK, they obviously would need to know how they measure the CO₂ emissions in the car that they bring to the UK and also how they measure the price they pay for that carbon. Equally—this comes back to the point about it being desirable to have multilateral agreement—if they have to, say, put a sticker on the bonnet that says, "This much carbon emissions and this much price paid for that," you don't want them, in an ideal world, to have to work that out differently for each different country. That is one of the challenges and one of the reasons why work is being done on a multilateral framework for measuring.

Q156 **Helen Hayes:** We have discussed in answer to earlier questions the complexity and the obstacles to developing multilateral approaches. I am keen to drill down to the question of when there will be action that will trigger business to take the steps it needs to take to tackle carbon leakage. What would trigger the Government to consider domestic approaches alongside multilateral solutions? When does it get too hard to deliver a meaningful multilateral approach and you have to make the decision to do something else to address the challenge?

Lucy Frazer: As I mentioned to Jerome earlier, we are not just pursuing multilateral approaches, and we are not sitting on our toes. We are looking at a number of options, and we are interested in considering and exploring a CBAM and product standards as options. We are doing our own domestic

work—the carbon pricing and the ETS. We are exploring everything. We are not going to wait for a particular moment and say, “We have not got very far, so on x date in January, we are going to do x.” We are exploring all options that are on the table.

Q157 Helen Hayes: My final question is again on the specifics of the timescale. It has been more than a year since the Climate Change Committee recommended that work begin on exploring either mandatory product standards or a CBAM. You have been clear that work is under way, but work could be under way for a very long time and still not result in a change in approach. When can we expect to see measures brought forward that will lead to action to address carbon leakage?

Lucy Frazer: You are seeing it at the moment. You are seeing progress on every single element of it. We will shortly be launching our ETS consultation. We already launched in December a call for evidence on the low-carbon goods. I set out that we have three or four calls for evidence out at the moment. We have to have those. Then we have to have consultations. Then we will build policy.

Q158 Clive Lewis: I know you say you have consultations and are looking at ETS, but there does not seem to be a sense of urgency, if I may be so bold. Given that we are looking at keeping temperatures under 1.5°C by 2030, it feels to me that there is a slightly laissez-faire, laid-back approach to this. My supplementary question would be on the fact that there does not seem to be a sense of urgency, given the deadlines we are looking at and according to the science we have signed up to. Has the Treasury considered anything other than fixes that involve market-based approaches? You did mention product assessments and so on. Is there anything else that the Treasury has looked at that goes beyond so-called market fixes, ETS and carbon-based market approaches to decarbonisation and imports?

Lucy Frazer: First, can I challenge your suggestion that we are being laissez-faire and are not sensing the urgency? I started off by mentioning, when I was asked what work we had done internationally, that we are leading, and have led over the course of our presidency of the G7, some of the work that has been kicked off internationally. We have ensured that we have private investment. The pledges made at COP mean that \$100 billion will be put forward by developed countries for the environment. Over 450 private financial institutions based in 45 countries across six countries, which are responsible for over \$130 trillion of assets, have committed to net zero by 2050 through the Glasgow Financial Alliance for Net Zero. The Treasury has done a significant amount of work through the Chancellor to ensure that we meet our climate objectives domestically and internationally. We are looking at a range of measures, as are other countries across the globe, and we are working with them on those measures. You are right that it is not just about taxation, although that is my portfolio. We committed to developing a detailed policy proposal on product standards. That began with a call for evidence on creating a market for low-emission industrial products. That was published on 6 December. It closes at the end of this month. We are progressing these

things, but they take time to develop and once they are developed, they are quite complicated.

I could take CBAMs for instance. You do not just develop a CBAM, as Mike said earlier. There are very complicated questions that you have to ask yourself in terms of what would need to be decided. That would include what sectors are covered, how we measure carbon emissions, how we ensure that the international measurement is the same across the globe, how we report on the carbon emissions, how we verify what people are saying about their carbon emissions, and how we ensure that we comply with WTO rules.

Q159 Clive Lewis: With all due respect, your Prime Minister 10 years ago, David Cameron, was hugging huskies a long time ago. You have been in Government for 10 years. How long does it take? We have known about the climate crisis for a considerable amount of time—for decades. You have been in power for 10 years.

Lucy Frazer: Clive, I think we are taking masses of action on the climate. You do not need to go into all the aspects, but this country is the largest producer of wind energy. We will be taking a whole range of action in relation to encouraging the private sector, which is going to invest £90 billion to support green energies and green products. We have got the investment bank that supports green initiatives. I do not think it is right to suggest that this Government are not taking action on climate change.

The Committee is asking me a very difficult question about how we negotiate and work globally to solve this international issue with countries that have different perspectives and views on climate change. We will have to measure and work very closely with them. That is not something that we can solve overnight, but I can assure you that it is something we are interested in looking at.

Chair: Thank you. We will get back to CBAMs with Robert Goodwill.

Q160 Sir Robert Goodwill: Thank you. We have seen in the recent turbulence in the gas markets that where the price of energy goes up and, in effect, a CBAM is taxing the energy embedded in a product, it affects some of the more vulnerable and low-income families. Have you done any modelling on this issue? What are your thoughts on how we protect low-income families, given the products they will be buying? That includes food. Ammonium nitrate is packed full of carbon, or rather it is burned to make it.

Lucy Frazer: That is an interesting question because, of course, there is the risk that as you tax products, that tax is passed down to the consumer. This is a long-term project. We need to ensure that we bring in measures that combat the production of carbon and that that is maintained, and it is not a short-term issue for the moment—although your question, Robert, is on people's minds a lot at the moment, given the cost of living.



HOUSE OF COMMONS

The Chancellor has taken separate measures on the cost of living. You will know what those measures are: the one on energy bills that he announced last month, and around the Budget the half a billion pounds for supporting vulnerable families. I think the Chancellor is very aware of the downstream impact of costs coming through. What we want to solve for is that businesses invest to ensure they are more carbon neutral in their production, and eventually that does not increase the cost of their production.

Q161 Sir Robert Goodwill: One group of people in an even more parlous financial situation than working families would be, I guess, Treasury Ministers looking at the deficit and the state of the public finances. Obviously, many of these taxes on carbon will feed through to inflation, which will feed through to benefits and pension increases. Also, the Government have a big procurement policy; they are buying lots of steel and concrete to build hospitals and so on. Have the Government done any modelling as to exactly what proportion of a proposed CBAM will actually be picked up by the Government and, thence, by the taxpayer?

Mike Williams: In reality, we have not got that far. As the Chair said at the start, the Government are looking at the CBAM; we haven't got to that. Of course, in considering introducing a new tax, we would try to work out not only who, up front, paid the tax, which would probably be the importer if you had the CBAM, but who would ultimately bear the burden of that tax. We do do distributional analyses.

Q162 Sir Robert Goodwill: Ultimately, it will be inflationary. When you have higher inflation, lots of other things happen to Government finance, in terms of borrowing ability and the index-linked increases that many people have been promised for a number of elections now.

How are we going to get people to vote for this? Turkeys tend not to vote for Christmas, and a lot of those policies will have an impact on individual voters. Are you hoping that you can persuade people that those are things that they need to vote for? I think we have quite a wide acceptance that climate change is an issue. Alternatively, will it be that basically all the main political parties will sign up to it and, therefore, it won't be a choice at an election but something that is pretty much a consensus and will be delivered whoever wins the election?

Lucy Frazer: You ask who is going to vote for this; I am not sure what we are voting for at the moment. There is not a policy on the table that we are asking people to vote for.

However, on the broader question about climate change—I think you are asking more broadly about climate change and its impact on the individual, in financial terms—I think there is an acceptance across the board, including politically, that, absolutely, we must deal with climate change. It is a challenge that is facing us as a world, and we must deal with it.

I would not assume that there are no economic benefits to tackling climate change; there are some. For example, if we, as a nation, are at the cutting



HOUSE OF COMMONS

edge of technologies that help to reduce carbon, that brings investment and jobs to this country. It is not a zero-sum game; it could be a win-win.

Q163 Sir Robert Goodwill: So, if we make aluminium from nuclear energy, we will be in a good position to export aluminium around the world, against people burning coal?

Lucy Frazer: That is one possibility.

Q164 Sir Robert Goodwill: Understood. One concern being raised is the impact that the CBAM may have on developing countries. Some developing countries rely disproportionately on things like iron ore and coal. Have the Government looked at how some of those impacts could be mitigated, or is it a case of “They will be hung out to dry, and there’s not much that we can do about it”?

Lucy Frazer: There would really be two options if we did bring in a CBAM. One would be to exclude developing countries, and another would be—as I think the EU is proposing—to support developing countries to ensure that they bring their standards up to the standard that we expect. That could be supporting them in technical production or in developing their own industries to our standards. Of course, we will have to look at those things in due course.

Q165 Sir Robert Goodwill: Finally, the EU seems to be content that if it brings in a scheme, it will be WTO compliant, but I suspect there will be others around the table at the WTO who might have other views. What level of risk is there that any scheme that we introduced, either unilaterally or among a number of rich countries, might well be challenged by other countries and found to be, in effect, a trade tariff—a barrier to trade?

Lucy Frazer: If we were to introduce the scheme, we would, obviously, take legal advice on it and ensure that it was in line with our international obligations.

Sir Robert Goodwill: Thank you.

Q166 Ian Levy: Good afternoon, Minister. Thank you for joining us today. The questions that I have this afternoon are on the proposed EU CBAM.

Could you outline for us what the Government are doing to understand the potential impacts of the proposed EU CBAM on the UK?

Lucy Frazer: We are following the development of the EU CBAM very closely. Obviously, that might have an impact on UK exporters and manufacturers. I know Mike talks to his counterpart in the EU about that—I am sure that if he wants to come in, he can.

We would expect the EU to take our ETS into account. Of course, our scheme is modelled on their scheme. If we were doing everything that they were doing under their scheme and the price were similar, we would expect them to take our own scheme into account when they bring in their CBAM.

Q167 Ian Levy: Mike might be able to follow up in answer to the next question,



HOUSE OF COMMONS

which is what engagement have you had with the EU since October? What future engagement is planned?

Mike Williams: In the spirit of being neighbours, because the UK and EU are very interested in this, we talk to the Commission about quite a lot of the international tax agenda, for example. We also talk to countries that are member states of the EU, because plainly the CBAM will not pass unless the member states sign up to it.

The sort of things we have talked to them about are the WTO compatibility, which was mentioned just now and is clearly a very important issue. Just as the UK would have to abide by its international obligations, so would the EU—they are basically similar obligations. There is a question about how we do the measuring and how far you go with the measuring. If you do not want to grind exceedingly small, you have got to have some sort of de minimis or point at which you stop.

If different countries have a different point, then the manufacturer of the goods is faced with coping with different tracking for different countries. And then there are the wider sectors. Why has the EU gone initially for the sectors that it has gone for in its proposed directive?

Q168 **Ian Levy:** My final question is what steps are needed to link the UK and the EU ETS scheme? What progress has been made on that?

Lucy Frazer: I will give way to Mike in relation to progress, but under the trade and co-operation agreement the UK and the EU agreed to co-operate on carbon pricing and included in that giving consideration to linking their respective carbon pricing schemes. In our net zero review, which we published in October, we said that we remained open to the possibility of linking the schemes, but we are not yet at that point. Do you want to come in on any specifics, Mike?

Mike Williams: It is then a question of mechanics. If you are linked, then how do you ensure there isn't a double charge, say, if you pay in one country and it is then moved into the UK, or the other way around? That is the main issue. If you are not linked but in effect you are trying to do the same thing by different means, why should we necessarily adopt the same mechanism, and how do you avoid double taxation—double charges—even within that system?

Q169 **Ian Levy:** So you have safeguards built into that as well?

Mike Williams: Yes. In a sense, that is a challenge that the international tax system has to cope with at the moment. Sometimes you address it by exemption, and you say that because tax is likely to have been paid somewhere else you do not need to do anything in the UK. In other circumstances, you say, "Well, we're not satisfied with that so we will charge you in the UK, but we will give you credit for the foreign tax." So, there are precedents that we can draw on, whether we are linked to the ETS or not.

Q170 **Valerie Vaz:** Minister, I hope you are still okay for time. I have some short questions about organisation and where the policy sits in different



HOUSE OF COMMONS

teams. We know that the Treasury has about 13 directorates. Is there a specific team working on anti-carbon leakage policy? Where does that sit and in which directorate?

Mike Williams: We have more than one team working on this. I have, for example, an environment and transport tax team in my business and international tax directorate. Our international directorate is obviously very closely involved as well, and they have a team that deals with trade. As we discussed very early on, if public expenditure is involved, obviously we would talk to the teams in our public spending groups. They were heavily involved in the green aspects of the spending review. So quite a lot of teams are involved.

You see that in other countries as well. If you look at the work we did through the OECD on a global minimum tax, say, that was basically tax functions in each country. A challenging aspect of all this is that you get far more interest. You can see that if you talk to the commission. Various of their directorates general—tax, economics, environment—are involved in this. Similarly, at the OECD, it was only tax that did the global minimum tax, but it requires the economics group—to determine what price of carbon you are supposed to be aiming for—and also involves their environmental people and their tax people. I think that is one of the key challenges that all countries face.

EU member states face slightly bigger challenges because the EU has trade competence, whereas we have trade on the same floor in our Treasury building as tax.

Q171 **Valerie Vaz:** I am smiling because I was watching “Yes Minister” last night when I should have been reading about this, so I am still not quite sure whether you have actually got a dedicated team working on this specific topic. It sounded like you were saying that little groups of people go into lots of different areas, but do you have a small or large team for this? How many are in the team working specifically on anti-carbon leakage policy?

Mike Williams: We have people across different teams because some of it is tax and some of it is trade, because of the tariff. If you did do a CBAM, you would also have issues around what you spent the money on, and that would involve more teams as well.

Lucy Frazer: May I build on that? The Treasury is responsible for economic policy, strategic oversight of the tax system and any secondary legislation that will result in tariffs, but BEIS is responsible for UK climate policy, including industrial decarbonisation, and Trade is responsible for trade agreements. You are asking what we have, and of course, we can answer that, but there will be other teams in other Departments who are equally doing that.

Q172 **Valerie Vaz:** Minister, you are extremely clever; you have anticipated my next question: how do you pull it all together? You have BEIS and International Trade, so how do you work across the three, on the three different policies?



HOUSE OF COMMONS

Lucy Frazer: As we do with anything and everything. I am regularly in subcommittees of the Cabinet discussing a range of cross-Government issues. As I said, in the work that we have done on the ETS, I have worked very closely with BEIS and Greg Hands. Only a number of weeks ago, I was in a climate action and implementation committee with all the key players from the Department—there were probably seven or eight Departments represented at that, led by Alok Sharma—and of course, there is the climate action strategy committee chaired by the Prime Minister. This is not novel; this is not the only area where there is cross-Departmental interest. Most areas of Government have a need to work cross-Departmentally.

Q173 **Valerie Vaz:** I accept that; I am trying to tease out exactly how it is working. I think the question earlier was: are we going to make our deadline when we look at everything? It is really to find that out. Who is actually overseeing this policy? In terms of Cabinet committees, is it the climate action committee or is it global Britain? Do you sit on either of those?

Lucy Frazer: I have been to the climate action and implementation committee meetings. I am not going to stray into—I do not always know what they are called when I go to them, so I am not sure whether I have gone to the global Britain meetings, but I do not want to say that I have not because I might have done, or how that, indeed is—yes.

Q174 **Valerie Vaz:** Will you let us know?

Lucy Frazer: Yes. What exactly is your question?

Valerie Vaz: Is it the climate action committee or the global Britain committee?

Lucy Frazer: Okay. I can tell you I have been to the climate action one. I will investigate the global Britain one.

Q175 **Valerie Vaz:** Turning to freeports, clearly they do not come within normal tax and customs rules, or they are just about to be set up, so how are they going to fit in in terms of all these environmental regulations? Are they going to be exempt from them? Will all the good work that the Government are doing be outside it when freeports are set up? Will they still be subject to the framework?

Lucy Frazer: That is something that we would have to consider if we brought in some legislation.

Q176 **Valerie Vaz:** Will you do that? Otherwise, as I said, the good work that is being done might be undone.

Lucy Frazer: Of course that is something that we would look into and consider.

Dr Offord: The net zero review concludes that the Treasury—

Lucy Frazer: Can I mention one point to Valerie that I forgot? Officials co-write all the papers for the committees, so if we had a joint committee



HOUSE OF COMMONS

meeting, or indeed a larger, wider one, we would be working very closely with BEIS at official level, as well as at a ministerial level, in order to make sure that we were joined up. Sorry, Matthew.

Q177 Dr Offord: The net zero review concludes that the Treasury will develop its understanding of different policy responses to the risks of carbon leakage. How will you in the Treasury be taking that work forward and what is the timescale for the work?

Lucy Frazer: I think that means everything that we have been discussing: the potential for a CBAM or product standards, the work on the ETS, or the carbon pricing system that we have got in. We are taking all those actions forward actively, and they are running to different timescales. We recognise, as Clive mentioned earlier, that this is not something where we can just sit on our hands. We are doing this in order to bring down and meet our carbon targets, which we have committed to in legislation and that we are on track to deliver. It is all part of that ambition to hit those targets.

Q178 Dr Offord: Are there staff specifically tasked with that work, or would it be individuals who are engaged on other projects at the same time?

Mike Williams: I think it will be a bit of both, not least to create the linkage. Some people will be focusing on CBAMs. Some of the people who work for me work primarily on CBAMs. There are also people looking at the tariffs aspect of this. There are other people who need to see how whatever we did on this would fit together with other things that we might be doing at the time and, more necessarily and inevitably, with what we have already got. We would then bring them in. If you do x, how do you make sure that it interacts with this thing that you already have—y—when you introduce it? That again is a reason for consulting because you cannot be sure that you would spot all the interactions. The consulting gives stakeholders a chance to flag things that they are bothered about.

Q179 Dr Offord: What would be a ballpark figure for the number of people who would have some input into this—maybe not full time, but at least some input?

Mike Williams: Given the importance of this, I would say over 100, but in a sense it is back to the measuring problem. Where do you draw the line at the de minimis? It is difficult to say with any accuracy.

Q180 Dr Offord: That's fine. My final question is whether the Treasury plans to issue a policy paper accompanying the impact assessment on the relative merits of a potential UK carbon border adjustment mechanism.

Lucy Frazer: I think we said at the outset that we were interested in this work, and we will keep you updated.

Q181 Dr Offord: Will that be this year?

Lucy Frazer: We will keep you updated.

Dr Offord: I have to leave it at that.



HOUSE OF COMMONS

Chair: Thank you very much. That is remarkable.

Lucy Frazer: Philip, it has just struck me that the global Britain must be GBO, which I regularly attend.

Chair: I think that concludes our session. Thank you very much, Minister and Mike Williams, for joining us. It is a difficult topic to discuss. We rarely have Ministers in front of us who are not explaining policy that has yet to be developed. I think that you have shown a good grasp of the topic. Thank you for joining us today.