



Select Committee on the European Union

Sub-Committee on Energy and Environment

Corrected oral evidence: Post-Brexit carbon pricing

Wednesday 13 February 2019

11.10 am

Watch the meeting

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

Evidence Session No. 2

Heard in Public

Questions 13 - 22

Witnesses

I: Lawrence Slade, Chief Executive, Energy UK; Roz Bulleid, Head of Climate, Energy and Environment Policy, EEF.

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Examination of witnesses

Lawrence Slade and Roz Bulleid.

Q13 The Chairman: Let us start this second session looking at emissions trading and carbon pricing post Brexit. The session is being recorded and webcast. Clearly, it is a public session. We will send you a copy of the transcript and if you see any errors, you are very welcome to come back to us and tell us. I do not think Members have to declare anything because any interests would have come out in the previous session. Welcome back to the Committee. I know you have both appeared in front of us before on various issues. Roz, would you like to start by introducing yourself quickly?

Roz Bulleid: I am Head of Climate, Energy and Environment Policy at EEF, which is an umbrella trade organisation for manufacturing. Within that we also have UK Steel, the specific trade association for the steel sector, which is heavily impacted by the EU Emissions Trading System. We have a range of other members and we also provide the secretariat for a cross-sector group of manufacturing trade associations with an interest in climate change.

Lawrence Slade: I am the Chief Executive of Energy UK, the sector trade body for the energy industry, representing generators of many different types, as well as suppliers of electricity and gas and the National Grid.

Q14 The Chairman: What policy or design issues would you need clarity on regarding a domestic emissions trading scheme? Rather tongue in cheek, I will ask you: when would you need those arrangements to be finalised in order to implement the scheme by the end of 2020? I note from Energy UK's paper that was back in June 2018 but I do not know whether that is still the answer. Who wants to take that question first?

Lawrence Slade: In preparing for today's session, I looked back at the evidence I gave last year and, without wishing to say, "I told you so", I told you so in terms of when we wanted the appropriate information and guidance. Needless to say, we still favour remaining in the EU ETS. It is the logical approach and we certainly favour staying in until the end of Phase 3. Regarding a UK ETS, I am going to repeat myself to an extent and say that we need that information immediately. We estimate—and that is all we can do—that setting up a UK ETS scheme would take about 18 months, so it is quite easy to do the maths as to when we would need to have a UK scheme ready. If we are to exit at the end of Phase 3, we need to start working on that now.

We firmly believe that the UK system should be linked to the EU ETS system. It makes perfect logic to us that you would link to the world's biggest carbon trading system. That means though that the UK scheme, at the very minimum, must mirror the EU scheme in its policy and design and how it functions, or that we should use an approach whereby a UK ETS is at least as good as the EU ETS. The worry is that if there is any divergence between a UK ETS and an EU ETS that would make linking

much harder. You mentioned it in the earlier session and I would point to some of the issues and travails of Switzerland regarding the linking process, which took seven years, I think. We should learn from that and our view is that we need to start working on that today.

The Chairman: To confirm that, your most favoured option, if it was possible, is to stay where we are.

Lawrence Slade: Our most favoured option is to stay where we are. It is working for various reasons, not the least of which is the Market Stability Reserve, which the UK had a great deal of input in, and that and other issues have meant that we have started to see the price of the EU ETS go up. It is our preferred position, yes.

Roz Bulleid: We would definitely agree on timing. We need certainty as soon as possible. Later this year companies will start budgeting for the year in which the UK scheme starts. They will have begun their budgeting in September. It is crucial that we have the details by then, but they really need them now. You are talking about 20-year investments and if you are thinking about a three-year payback, you are getting into the next scheme as well, and they need to know the rules around new entrants and what would count as a new entrant. Any further delay is very disappointing from our point of view.

We have got less far in choosing or backing a particular option. For lots of our members, the EU ETS has been problematic. It has been quite changeable. The original idea that they felt they had signed up to was a cap and a genuine market, but we have had a lot of interference, in effect, from renewables targets and other mechanisms, so it is not as pure a market. We probably differ a little on the MSR coming in to try to achieve a certain price because people felt they had not signed up for that.

However, there is real value in that common price. To date we have been very worried because the whole reason for the free allocation that was discussed earlier was to ensure that international competitiveness was not completely compromised by the EU Emissions Trading Scheme. Companies trading in global markets cannot pay an additional carbon cost without really struggling. Our concern, if you start talking about a separate UK scheme, is the impact on European competitiveness. Members' views differ slightly, but the key is to ensure that we protect competitiveness. There are other factors they would want to see. They are keen to have predictability. They want to know what support there would be for carbon emissions reduction projects. They want to know about administrative burdens and how revenues would be used.

At the moment we cannot say we like one option or another because we have not seen any details of any of the schemes. It is very hard to back a particular horse when you are not sure what you are backing. We have been making this point since soon after the referendum. We are frustrated that we are still not really seeing any details. We are being promised that there will be a consultation in the first half of this year on

the details, but that does not leave a lot of time to implement the scheme and, the less time you have, the more likely it will look like a replica of the EU ETS, which could potentially be a missed opportunity in places as well.

The Chairman: That is very useful indeed. Lord Selkirk.

Q15 **Lord Selkirk of Douglas:** From the industry's perspective, would it not be valuable to link a domestic emissions trading scheme to the EU Emissions Trading Scheme? What would be the implications of not linking the two schemes?

Lawrence Slade: My answer to that is absolutely there is a value to linking to the EU scheme. As I said earlier, the EU is the largest carbon trading scheme in the world. It makes sense for us to link to that. It helps in competitive issues but it also means that we get much better liquidity in the market. Again, you touched on this in the earlier session around the size of the market available for a UK-only scheme. Linking into a bigger scheme gives better liquidity and allows for better hedging. I can hedge one, two, three years into the future in terms of my costs going forward. It also builds a better equitable trading relationship, which is very important when we look at the island of Ireland, where the Northern Ireland market is not really of a size to operate on its own so you have to look at the whole Ireland market. Under that scenario it would be very difficult to have two different carbon trading schemes, hence my point earlier. It is logical in that regard to continue with the EU ETS, but, if you cannot, a UK ETS linked to the EU is definitely the preferable solution.

Roz Bulleid: We would share some of those concerns about a UK stand-alone market and about the liquidity. Our members are not playing the market; they are trading for compliance purposes. The people we represent do not begin to have a mandate to go in and speculate in the market. If you remove the energy sector, which perhaps needs to hedge as it is going along, it is very easy to imagine you would end up with a quite lumpy market and quite a lot of volatility, which certainly would not be a benefit. There could, though, be some benefits to the UK ETS scheme if, for instance, it took a different approach to caps or allowed offsets, which would help manage prices. It is a riskier approach but we could see some designs within a UK scheme that we would like.

Having said that, given that the key concern is competitiveness, a link to the EU ETS would be a less risky approach from that point of view. At least from that perspective you would maintain that link with European prices and not see the UK shoot ahead. We would still need to be very clear about what the UK's role in rule-making was. We would not want to be completely passive in that respect. We would want to know whether emissions caps remained aligned. We would not want the UK trying to overachieve and the rest of Europe just sucking up any extra allowances we generated as a result. Deviation in other areas, perhaps allowing opt-outs for smaller emitters, and some of those things, would also be helpful.

In comparison with Switzerland, we are a much bigger bit of the market. We are being told by officials that that is to our benefit and we should have more say than Switzerland in any linking negotiations. I can also see that it might work the other way where the EU says, "No, you can't deviate at all because you will mess up our entire market". I am still to be convinced either way on that front. There are definitely some advantages from the pricing perspective of some kind of link, although you could link to other schemes elsewhere; you do not necessarily have to look to Europe.

The Chairman: May I come back on one of your previous answers where you were saying you are trying to press Government very strongly to start to think about this or to bring proposals? Have you found BEIS, or whatever bit of Government, receptive to that? Do you feel it is on their agenda anywhere or do you feel that it is number 49 and they have got only to 24?

Roz Bulleid: I am aware there are officials in the room who have been trying, to the extent they can, to help, but every time we ask about this, we get told that all options are on the table. We have been told that for more than a year probably. It is becoming a running joke every time we meet BEIS and HMT. What is a little frustrating is that if we look at the Withdrawal Agreement and Political Declaration on future partnerships—I cannot remember exactly the right name—suddenly we have an option in there, and we were never told the negotiations had progressed to that stage. I feel there is a will to listen but we are not getting a huge amount back, and you can see an alternative scenario, I would have thought, where quite early on we had been given four worked-up examples under each of those options and we would have been able to have a discussion around those, rather than this "just talk to us" kind of attitude.

The Chairman: That is very useful, thank you. Hopefully, there might be some feedback to anybody who might be listening in. Earl of Stair.

Q16 **The Earl of Stair:** I believe that the UK has been prohibited since 1 January this year from taking part in the Emissions Trading Scheme. What impact is this having on your members at the moment? Supposing that an agreement is brought into place by the end of March, are your members currently expecting to have to pay for compliance in the first quarter of 2019 retrospectively if a Brexit deal is agreed?

Roz Bulleid: At the moment they can trade between themselves, but the UK Government are frozen out of the Registry so they cannot hold auctions or allocate free allowances. They also cannot swap international credits for EU allowances, which is crucial for a few companies that still would like that.

The Earl of Stair: They can trade among themselves.

Roz Bulleid: There is intercompany trade and you can also participate in auctions in other countries if you wish to. Having said that, there is a massive impact on our members in the sense that around about now they

would normally have received the free allocation that they would use for compliance with last year's obligations. Compliance is usually in April but because of Brexit it has been moved to next month. This was a deliberate mechanism built into the EU ETS that allowed you some flexibility as to how you used your free allocation within the scheme. It only lasts within the Phase. In 2021 they would not have been able to arbitrage between years, but at the moment there are certainly some that will now have to buy all their allowances upfront for compliance next month, when, normally, that would not be the case. Having said that, they have had warning for some time that that would be the case and most of them are relatively okay with it.

There are various other reasons. These are financial assets and there are companies that will need those freed up. If a Withdrawal Agreement is signed, there can be a negotiation. It needs to be approved but the UK Registry can be unfrozen and free allocation can take place again.

Regarding the first quarter of the year, our members are very much anticipating that if we get a Withdrawal Agreement signed, they will definitely be in the EU ETS for longer. They are responsible companies and most of industry does not have many options to suddenly do something different and emit loads more anyway. They certainly do not feel like they are getting a free ride in this quarter and they are not anticipating that. Clearly, as manufacturers, they are desperate to have a Withdrawal Agreement signed and rather than crashing out with no-deal anyway. That goes without saying. If we have a no-deal scenario and the carbon-emissions tax comes in, that would potentially start in April and there would be a gap for the first quarter. However, as I say, I do not think anybody is going crazy on that basis at the moment. Does that answer your question?

The Earl of Stair: Yes. Do you have anything to add?

Lawrence Slade: To add a few points to that, it is worth noting that if we exit on 29 March and you want to trade in allowances, you will have to register or to have registered with an EU Member State in its Scheme to be able to trade your allowances. At the moment, as Roz said, you can trade quite happily. On the basis that compliance is always retrospective, if we get a deal and we do not exit on 29 March, any generator would expect to have to pay its due allowances. Following Roz's point earlier, as responsible companies they will be looking at their allocations and, indeed, may have purchased forward anyway with hedges to cover this period.

In a no-deal scenario, the carbon tax, as Roz said, would expect to come in on 1 April. However, if there was any kind of extension to Article 50, the current hiatus would just continue and my worry then would be that any extension under those circumstances breeds more uncertainty, and that is where you start getting divergence in company strategies regarding how they are dealing with that and hedging positions start unravelling: "Am I just a UK operation? Do I have a pan-European operation where I can hedge and still buy and trade quite happily?" It is

liveable with, if you will, for this quarter, but any further uncertainty will start feeding through into costs and have bigger impacts.

The Earl of Stair: That was going to be my next question to you. You have taken the words right out of my mouth. There are plans in place for the first two options, but if Article 50 is extended it is going to start unravelling.

Lawrence Slade: That would be a response.

The Earl of Stair: Would you agree with that?

Roz Bulleid: I agree. It would be really helpful to have certainty now about what the plans would be if Article 50 were extended. That is perhaps wishful thinking. BEIS has told us repeatedly that the EU cannot possibly expect us to comply with the first quarter of 2019 in the case of no-deal, but I am a little suspicious that if we were to stay in until September, it would find some way of saying, "Hang on, you have participated in our scheme for three-quarters of the year as well; you should find some way of surrendering allowances". I am still a little anxious on that front as well. It is really weird to be in a compliance year already and not be sure what you are complying with. It is a very strange situation.

Q17 **Viscount Ullswater:** You have both expressed a desire that you would like the UK to remain in the EU ETS, and so my question is one which, in fact, I put to the previous witnesses. If we have to come out at some stage, what would be the benefits of withdrawing from the EU ETS at the end of a Phase, which I think is the end of 2020? The second part is: in your view, should the UK continue to participate in the EU ETS during Phase 4 if the transition period is extended? You probably heard me put the question and you heard the answers from previous witnesses.

Lawrence Slade: I can make a quick response. I think staying in until the end of the Phase allows for a much more orderly exit from both sides' points of view on this basis. As I said earlier, we would like to continue in Phase 4, but I would want to continue in Phase 4 only if we were going to be there for the whole Phase. I would not want to exit part way through that Phase for the reasons I have just stated.

It is worth noting, of course, that the UK had a tremendous amount of influence in the shaping of the next Phase, as indeed it did on the Market Stability Reserve, so a lot of what we would be entering into in Phase 4 we are already very familiar with as industries, having had that shaping ability around it. That is not to dismiss the earlier comments around the level of influence that we would look forward to or have in a future relationship. That is very much a question that everyone needs answering and is an unknown in that regard. I would say that it is definitely best to hang on in until the end of Phase 3 to either have the firm commitment for Phase 4 or to have exited and have the preparation under way for a UK ETS.

Roz Bulleid: I would agree with some of that. Certainly, we would like to stay in until the end of this current Phase—I think that makes some sense—but we would not want to go into Phase 4 with a situation whereby year by year we could drop out and there is that sort of uncertainty. There is a more natural break half way through when benchmarks are reorganised so you could agree to leave then. We do not want to stay in long term. That would not be our favoured option. As I said earlier, we are waiting to see the alternatives. The EU and the UK could agree this as they are talking about the Withdrawal Agreement and negotiating future partnerships and arrangements and trade deals. At that point they could have quite sensible conversations about whether it makes any sense for us to participate in Phase 4 and give us some certainty ahead of time about that. As was discussed earlier, the EU is not going to want us half-in, half-out for Phase 4 either, so I would hope that a sensible arrangement can be reached.

Q18 **Lord Young of Norwood Green:** That leads on to the question of what would be the impact on your members of a shift from an emissions trading regime to a carbon emissions tax, given that you have said you do not want to stay in for only half of Phase 4? This appears to be the destination so what is your view?

Lawrence Slade: As has been touched on a few times now, trading scheme allowances can be traded, by their very nature, and, therefore, they can be hedged. It is that hedging ability that is the major appeal in that it allows you to smooth the process and take away any volatility that comes through to the markets which, when you are talking about power prices that can be purchased one, two or three years hence, it is really important to be able to get that smooth line in terms of where prices are going instead of the spikes you see in the shorter-term markets. That is a big benefit from a tradeable scheme that we would worry we would lose if we went in for a carbon emissions tax, where we are not really sure but one assumes it would be set once a year by the Treasury, and, as you touched on in the previous session, you are rather at the whim of the Treasury as to what that tax is and what the separation is between other countries.

Roz Bulleid: Whatever our views on taxes, we do not like this carbon tax. You discussed earlier the £16 per tonne figure and where it came from. On that front, our concern is if the UK leaves with no-deal, there could be a big sell-off of UK-owned allowances and that could cause a price crash. Any deviation between UK carbon costs and EU carbon costs would be a big issue for our members. There is a risk there. It looks at the moment—understandably, as it is an interim tax—like a very blunt instrument. It does not allow any offsetting between sites or between years. You could massively outperform your benchmark at one site and underperform at another and you cannot trade those off against each other. I did a quick calculation for the steel sector based on the 2017 free allocation and emissions, assuming £16 per tonne, and if you look at it as a whole, under the EU ETS, because you get free allocations as well

which, technically, you could sell, the scheme would cost about £2 million, whereas if you turn it into a tax overnight it costs £16 million.

Over time that would disappear¹ because you will have fewer companies with surpluses. This is partly a problem with the way the benchmarks were set in the past. I am making this very complicated, I am sorry. The fact that if you outperform your benchmarks and you emit less than expected you cannot put that towards future years and you do not get any free allocation for that that you can sell. You cannot put that extra tax towards additional years, which removes some of the incentive to reduce emissions. A tax just takes you back to zero. You can do whatever you want, but you only pay zero if you have done better than your benchmark.

Lord Young of Norwood Green: Was there any consultation with you on this issue?

Roz Bulleid: Only the more general discussion of, "Talk to us and tell us what you think". We have been told that there will be further consultation on the tax if it is necessary. Obviously, there are a lot of things we would like to see improved. We would be very interested to see what the future price-setting mechanism is going to be—that is crucial—and what allowance there might be for variation between the UK price and the EU price.

Lord Young of Norwood Green: So you could do a bit of smoothing.

The Chairman: It came up in the previous session that the Government could bring the taxed emissions down or the cap down for individual organisations. Do you see that as another difficulty about that or a greater unknown, if you like, or do you think that will not happen?

Roz Bulleid: Do you mean by individual sites?

The Chairman: Each installation or whatever for which you have a free allocation, I understand you would only pay the £16 per tonne above that.

Roz Bulleid: That is your benchmark.

The Chairman: That is the benchmark, but the earlier witness questioned whether that could be reduced.

Roz Bulleid: Sorry, that is unilaterally. Yes, that would be a real worry for us because it is not just the level of the tax; it is how much of that tax you are exposed to. If either variable changed versus the EU, that would be a problem. Another factor we would want to know is if this stayed in place beyond 2021, as the EU develops new benchmarks and institutes best-performance benchmarks for the post-2020 Phase, whether those will be used as the basis of the tax and the amount of tax that you have to pay.

¹ Witness subsequently clarified that the difference would diminish over time.

Lawrence Slade: That is another point where we have no clarity over the duration of a carbon emissions tax. Is it just a short-term stop-gap measure while we bring in our own scheme or, as these things sometimes have a habit of doing, is it likely to become a longer-term solution? That would be very concerning.

The Chairman: Lord Hanworth, I think you had a couple of questions around this.

- Q19 **Viscount Hanworth** My designated question has been largely pre-empted but perhaps I should ask again: what is your assessment of the means by which the tax level for an emissions tax of £16 per tonne has been determined? The Minister asserted a while ago that it was to provide a similar price signal to the current European Union ETS. How do you assess that assertion? You have also said that you expect it to be revised once a year by the Treasury. Is that sufficiently flexible? Finally, can you elaborate on the consequences of the divergence of our tax regime in comparison with the European Union ETS? What disadvantages would there be for your membership?

Lawrence Slade: Perhaps I can kick off on that one. At the time when the £16 was announced, it was not that far out from the EU ETS price, but it is worth noting that the EU ETS is now comfortably above €20, so there has been a substantial price divergence over the last year or so already as to where that price is going. It is also worth bearing in mind that, of course, from a power generation point of view, it is the EU ETS—or the carbon emissions tax—plus the Carbon Price Support. We always must remember from this perspective that we are paying £16 plus whatever other UK-related carbon tax there is regarding getting that through. At the moment we are always looking at a price that is well above £30 per tonne of carbon, and we must think about that.

As was touched on in the previous session, that means that electricity in the UK is, in effect, more heavily taxed from a carbon point of view than electricity in the EU, which you could argue has a benefit for consumers in terms of electricity provided through interconnectors, et cetera. Further price divergence could have the effect, if the UK price goes up, of making EU-generated electricity even more appealing or could have the opposite effect depending on how the EU price goes. Again, the benefit of having a linked system and linked prices at least gives a little more stability there.

Another point I would make is that we should bear in mind that since the introduction of the Climate Change Act in 2008, the process of electricity generation in the UK has reduced its emissions by 51%, and that is, essentially, off the back of that combination of high carbon prices. We still have 49% to do, so we still need a sustained carbon price and visibility on where that carbon price is going if we are to finish the job, so to speak, in the coming years. It is also worth mentioning at this point that as a country we need to understand how carbon price is going to relate to other sectors and how we can manage that process so that it is not borne just by the electricity sector but by other areas as well. It is

going to be a headache for Government and all of industry to work out how we pay for that as we look at how we decarbonise other parts of society in the sectors.

Roz Bulleid: I think £16 per tonne was the price at the time the policy was developed. It was only briefly the price last year and since then prices have been higher. Our preference would be for a sense check. Companies are not going to be paying that tax until April/May/June next year. There is plenty of time ahead of that to review whether that aligns with what the EU price was. We would like that review to be done. There definitely needs to be some clarity about what the future price-setting arrangements will be. I think our members would be a little torn here. Some of them would probably favour predictability; for others competitiveness is such a key issue they might want a tax that was always benchmarked against the EU price. You can imagine a combination where you would have an escalator where at any point you could have a get-out if the EU price was way off. There are some quite clever tax arrangements out there.

On problems with the two prices deviating, if you are trying to sell, say, a steel commodity product, any deviation in carbon pricing is a problem of direct competitiveness and you will lose market share. You will have to absorb that extra cost yourself to keep your product competitive.

Viscount Hanworth: There is a high price elasticity of demand for steel.

Roz Bulleid: That would either decrease your direct competitiveness or mean less reinvestment into your own business. It should also be borne in mind that a lot of the companies we represent are internationally owned and it is the signal that a high carbon price sends to overseas investors. If they can see that the UK is going to be a high carbon-cost environment, it is just one more signal to them to put some investment elsewhere. This links to the point Lawrence made about the cost of decarbonisation. We are already seeing in the UK that electricity prices that are some of the highest in Europe because of the way that the costs of decarbonisation are shared out between electricity consumers within the UK. Recent research we did on the steel side found that electricity prices for UK steelmakers are now 50% higher than those in Germany and 110% higher than those in France. A way needs to be found of making sure that those costs passed through to us by electricity companies, because they can pass on costs in a way that industry cannot, are then being managed effectively and not creating this combined direct and indirect carbon cost.

Viscount Hanworth: We have very little evidence on the Government's thinking about the level of the emissions tax—or perhaps we have evidence of very little thought on the part of Government; I am not quite sure—but do you have further or more recent evidence?

Roz Bulleid: I am afraid I do not, no.

Viscount Hanworth: Thank you very much.

Viscount Ullswater: Do you have any evidence of displacement of industry because of the high price of electricity in this country—displacement of units of steelmaking or aluminium smelting?

Roz Bulleid: The problem is that it is incremental and it will come on top of a lot of other issues. It is quite hard to point to a particular plant closure or loss of investment and say that it is particularly due to that. It is the insidious impression created by a high-cost environment that means that plants just do not get the reinvestment and become less modern and less cutting-edge. You need quite a lot of investment—I do not want to quote the number because I might get it wrong—just to keep a really complicated foundation industry plant up and running in terms of general maintenance. Any loss of that investment over time is problematic.

Viscount Ullswater: It is a worry.

Roz Bulleid: It is a major worry. It varies sector by sector how much would be attributed to carbon costs but, for example, if you talk to the paper industry, it would say that the effect of some of these costs has been devastating.

The Chairman: There are a number of schemes around in energy-intensive industries but we will not get on to how effective they are. Before the session started, a number of Members were asking: apart from the energy sector, which we understand, what are the typical companies or operations in the UK that are affected by or are part of the EU ETS? Can you peel off a few sectors so we are clear on that?

Roz Bulleid: Steel, glass, paper, ceramics, car-making. Large hospitals can be part of the scheme but they can opt out sometimes as there are these opt-out rules for smaller emitters. There are mineral products such as cement and that is a major emitter. I do not know the actual number of installations but we can send that to you.

The Chairman: That gives us a flavour. Thank very much for that. Lord Rooker.

Lord Rooker: Some of us were curious about that. I have to say every time I see EEF, bearing in mind I was in manufacturing 50 years ago, I still think of it as the Engineering Employers' Federation. I realise it is a completely different organisation now. In some ways you have dealt with the issues I wanted to ask about when you talked earlier on about the way the consultation had been dealt with. The UK economy is 80% service sector and we have a diminishing manufacturing sector represented by you, which is under attack. When these new taxes are invented, I wondered, without disclosing individual details, do you come across people in Whitehall who have experience of this diminishing sector i.e. the bits left of manufacturing? It is quite clear from what you said about the ownership that the investment is multinational and people can go elsewhere. When a new tax is proposed to replace something that is flexible and which works in some ways, do you think you have been

treated fairly or with knowledge about the practicalities of the manufacturing sector in this country?

Roz Bulleid: I do not want to talk across all policy areas because I think it varies quite a lot. In my experience, and I deal with climate and environmental issues, it really depends on the civil servants and Ministers we are dealing with. We are in a strange situation with Brexit so I think it has got considerably worse. The ETS is a particularly poor example of the amount of consultation to date, and that might be just due to circumstance, but we tend to find we have problems in departments with a high turnover of civil servants. It feels like a lot of our job is that education piece—"This is what manufacturing is and these are the concerns that affect it"—and quite often we are starting from a very low base. Particularly for me, because I talk to the environmental world quite a lot, and have a foot in both camps, it is explaining, "This is about people's jobs and this is why it really matters". In some departments there are exemplary people who have spent a long time dealing with manufacturing and really understand this issue. I do not want to tar everyone with the same brush, but we certainly have to explain the significance and value of manufacturing to a lot of people.

Lord Rooker: Are you a UK-wide body?

Roz Bulleid: There are separate bodies in Scotland and Northern Ireland.

Lord Rooker: Do you know how they have been treated, bearing in mind this is a devolved issue, as we said in the previous session?

Roz Bulleid: I do not know how discussions have gone there, I have to say.

Q20 **Lord Rooker:** The question I was going to ask, which you have partly covered is: are you content—and it is a loaded question in a way because I suspect you are not—that the carbon emissions tax that was described in the Budget last year replicates the obligations under the ETS in terms of the balance of effort across installations and sectors?

Roz Bulleid: The issue I was explaining not particularly eloquently earlier about the fact that you get an allowance based on your best-performance benchmark and you have to pay tax only above that, the complication introduced by having a tax - so if you are better than the benchmark you do not get anything - will create a major difference. Some companies which would have expected a surplus in EU allowances that they could sell—and their European counterparts will still get that—will definitely feel a significant change under a carbon emissions tax. In the longer term, you can also see considerable differences. On the face of it, it looks quite straightforward in that they try to replicate the impact, but it will certainly have quite a different impact when you take into account those companies.

Lawrence Slade: I would add to that from our point of view, yes, it replicates the EU ETS but, as I touched on earlier, we have issues with

the imbalance of what it is replicating. A concern from my point of view in terms of decarbonising the UK is at some point the Government are going to have to take difficult decisions about how they approach the decarbonisation journey in sectors other than manufacturing and, from my point of view, the electricity generation sector. Those are very big decisions for the country and I worry that the current hiatus is stopping that debate happening and where the leadership is on how we start moving forward in other areas.

The Chairman: That is very useful, thank you. Are you okay with that?

Lord Rooker: No, I am thoroughly dissatisfied. They have given absolutely honest, practical answers, but I am as worried as everybody else and concerned about the hiatus and the damage to people's jobs. Quite clearly, investment decisions will be taken if we become a higher-cost country than we already are. It is obvious they will put their efforts elsewhere, so it is very unsatisfactory, but I really appreciate your answers.

The Chairman: You will have the opportunity to tell the Minister in two weeks' time.

Lord Rooker: Does she know what manufacturing is?

Q21 **Baroness Wilcox:** Are there any aspects of the carbon emissions tax which you believe still need to be clarified? Does the Government's intention to consult on the tax this year, if it is introduced, give you clarity early enough? I think the answers are going to be "no" and "no".

The Chairman: We have gone through this already. Is there anything more you would like to add?

Roz Bulleid: We would like it to be a little more sophisticated. I do not think the CCC or anyone else would agree with us, but it is worth bearing in mind that the allowance which I keep talking about, and probably confusing everyone with—the amount that you can emit before you have to pay a tax—which is based on EU free allocation, is currently about 16% lower than it ought to be. That is because there was too much free allocation in the EU so it had to introduce this cross-sectoral correction factor. Realistically, companies were entitled to have 16% more. One quite straightforward thing you could do is to take that away and give companies a slightly bigger allowance and then they will pay less tax. That will not please everybody. There are quite a lot of subtleties that could be discussed and we have not seen any discussion of any of those. Consultation would be great, but we need it to have happened by now, or as soon as possible.

Lawrence Slade: We have covered off most points about the long-term horizon. One quick point we also need to know the answer on is the role of the devolved administrations in carbon taxing. We do not know that and I think that is really important, particularly for Scotland.

The Chairman: Indeed, that is an important point. We come back to

devolution and questions of how that works in a lot of the work that we do. Lord Rooker?

Q22 Lord Rooker: I am not certain about this one because it was the same question I asked the previous witnesses. Do you have a figure for the revenue that your members receive under the EU Emissions Trading Scheme and what would be the impact on them of losing that under the carbon tax?

Lawrence Slade: From my point of view, no, it will vary from operator to operator, from year to year, depending on the hedging situation and the general pricing.

Lord Rooker: We have been given the global figure of €600 million income to the UK by previous witnesses and I presume that whatever your members get is part of that, is it, or not?

Lawrence Slade: I think that is the money that goes to the UK Exchequer.

Lord Rooker: Straight to the Treasury?

Lawrence Slade: Yes.

Roz Bulleid: That is from the sale of allowances. For our members, we do not ask about individual companies and what they spend on allowances or, if they sell allowances, what happens. Largely, as I said earlier, they do not speculate; they are trading for compliance. However, these are assets and at times of crisis they have been sold. But companies in our sector would much rather be producing their product than selling allowances. They sell allowances if they have an overallocation due to the fact they were producing more around the time of the financial crisis. The design of the scheme for good or ill—probably ill—has given them a surplus and they have sold it because they have had to. There may have been revenues for that reason but, on the whole, they are not in the market for raising revenue.

Lord Rooker: The financial experts among your members know enough about the markets to go out and buy money and things in advance to meet their commitments, so why would they not know the figures that they are getting in?

Roz Bulleid: They would not necessarily share them. It is difficult for us under competition law to ask about that sort of thing. I cannot speak for every company, and I have asked only a few about this, but compliance with the ETS sits with the compliance department. Finance departments get involved to a limited degree. They are not generally saying, "Look at what the EUA price is and how can we capitalise on this?" That is not their core market.

Lawrence Slade: As Adrian touched on previously, the EU ETS allowances are just one element of overall power pricing. You might win on one element and lose on another element. With all the different

pressures, drivers and actors within the UK power market, it would be hard to break down.

Viscount Hanworth: How are these allowances set and are they amenable to representations from you? How are they determined? What sort of bargaining goes on, if any, or is it ex cathedra allocation?

Lawrence Slade: I have to say I am unsighted on that, but I would be quite happy to drop you a note after the session on how that functions.

The Chairman: Roz, can I pick you up on this a little? As we are all aware, a couple of years ago when the steel industry and its foreign owners were having a lot of difficulty, they got quite a lot of publicity because they had made a huge amount of money by selling their allowances because production had come down. We would hope that British industry is particularly good at making itself carbon efficient, so with their allocations, surely this is, to some people, a pretty significant form of income, is it not, particularly if they are good performers in terms of their carbon footprint?

Roz Bulleid: The degree of surplus has been diminishing. If there is surplus in the steel sector, it is expected to have completely gone in another year or two. Where there has been surplus, as I was saying, it was the result of benchmarks or historical activity and levels of free allocation determined on pre-financial crisis activity levels. Industry was lobbying for a more dynamic system that would not have allowed those surpluses to build up. We wanted the amount of allocation you get to be able to be varied year by year. It is quite strange that your activity level just before the financial crisis or just after it can determine how much free allocation you receive up to 2020.

We wanted a system in which there was more variability and that would not have created those surpluses in the first instance. There have been surpluses created but, as I say, I would not always assume that companies sell at the highest point, which is what an NGO will tell you they have done, and those calculations are assuming maximum revenue. I could not comment as it varies from company to company, but, as I say, I am sure they would rather be using all those allowances to produce a product.

The Chairman: Thank you both very much indeed. It has been very clear, particularly in comparison with one of the other bits we had earlier on, and very useful. We will now be looking at our evidence. We are meeting Minister Claire Perry in two weeks' time to conclude this and to bring up a number of issues, and I suspect consultation will be one of them. I bring this public session to an end.