



House of Commons
Environmental Audit Committee

**Greening imports:
a UK carbon border
approach: Government
Response to the
Committee's Fifth
Report of Session
2021–22**

**Second Special Report of Session
2022–23**

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Environmental Audit Committee

The Environmental Audit Committee is appointed by the House of Commons to consider to what extent the policies and programmes of government departments and non-departmental public bodies contribute to environmental protection and sustainable development; to audit their performance against such targets as may be set for them by Her Majesty's Ministers; and to report thereon to the House.

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Second Special Report

The Environmental Audit Committee published its Fifth Report of Session 2021–22, [Greening imports: a UK carbon border approach](#) (HC 737) on 4 April 2022. The Government response, in the form of a letter to the Chair from the Financial Secretary to the Treasury, Rt Hon Lucy Frazer QC MP, was received on 7 June 2022 and is appended below.

The Financial Secretary also wrote to the Chair on 16 May 2022 to notify the Committee of the written Ministerial Statement on carbon leakage mitigations made to the House that day. For completeness the text of that letter and of the statement are also appended.

Appendix 1: Government Response

I want to start by thanking the Environmental Audit Committee (EAC) for their inquiry into Carbon Border Adjustment Mechanisms (CBAMs), for inviting me to provide evidence, and for this report.

During the evidence session, I provided the Committee with an overview of the Government's approach to carbon leakage, including our preference for an international solution and our stance on other measures such as mandatory product standards, CBAMs and the UK's work on carbon pricing more broadly.

The Government is taking ambitious domestic action to tackle climate change and recently published a consultation on developing the UK Emissions Trading Scheme (ETS) so it can become the world's first net zero carbon cap and trade market.

While domestic action is critical, climate change is a global issue. When the UK took on the COP26 Presidency, only 30 per cent of the world was covered by net zero targets – now over 90 per cent of the global economy is committed to net zero.¹ In 2021, the UK hosted COP26 and led agreement of the Glasgow Climate Pact, which will speed up the pace of climate action.

Recent global events and the resulting increase in energy prices reinforce the importance of the transition to clean energy which will also strengthen energy security and reduce the UK's dependence on fossil fuel. We also want to see other countries do more to drive down their emissions and we continue to work on the global stage to support more ambitious international action, recognising that net zero delivery pathways will differ by country.

I hope my attendance at the evidence session, my letter from 16 May where I updated the Committee on progress in this area, and this response to the Committee's recommendations, demonstrate that the Government understands that as we transition to net zero the risk of carbon leakage is real.

A UK Carbon Border Approach

Recommendations, paragraph 5: *We recommend that the Government commence work immediately on developing a comprehensive UK carbon border approach, in order that*

1 [COP 26 ends with global agreement to speed up action on climate change - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/cop-26-ends-with-global-agreement-to-speed-up-action-on-climate-change)

this might be implemented during the 2020s. We recommend that this include a CBAM as part of a co-ordinated set of policies including product standards, alongside work to build consensus with trading partners, industry and consumers on the need for this policy response. The Chancellor of the Exchequer should provide an initial report to the House on progress on a CBAM not later than Budget 2023. We recommend that the Government build on its COP26 climate leadership internationally through pursuing long-term multilateral solutions alongside this ambitious UK approach.

The Government agrees that we need multilateral solutions. Indeed, we are firmly of the view that the best way to address carbon leakage would be for all countries to move together in pricing and regulating carbon emissions. We are committed to building on our COP26 climate leadership by working with our international partners to develop a common global approach to carbon pricing and leakage.

The UK is working internationally to promote carbon pricing as a key tool to help other countries deliver their climate targets. To this end we are active contributors to the World Bank's Partnership for Market Readiness (PMR) and Partnership for Market Implementation (PMI) programmes, and bilaterally we are working through the UK Partnering for Accelerated Climate Transitions (PACT) programme.

In parallel we are working with our G7 and G20 partners to build a common understanding of carbon leakage risks and develop the tools and insights that we will need to tackle it collectively. We support the important independent technical and analytical work of International Organisations, like the IMF and OECD, to close the technical and analytical gaps (for example, on the measurement of embodied emissions). Under our G7 Presidency last year, the UK drove forward action on global industrial decarbonisation of high-carbon sectors that are easily traded (e.g., steel, aluminium), in particular through the G7 Industrial Decarbonisation Agenda. We continue to work on these issues, actively engaging with Germany's climate club proposal. We are also supportive of the increasing drive to collaborate on multilateral and plurilateral solutions for carbon leakage in the G20, WTO and other fora.

Multilateral solutions will take time to develop, so we must consider the case for targeted and proportionate domestic measures in parallel. Therefore, as set out to Parliament on 16 May we have announced our intention to consult later in the year on a range of carbon leakage mitigation options, including on whether measures such as product standards and a CBAM could be appropriate tools in the UK's policy mix. This announcement does not commit the Government to any course of action down the line, but will enable us to better understand our options. The consultative process follows BEIS's Call for Evidence 'Towards a market for low emissions industrial products' which closed in February and BEIS's current consultation on the ETS.

The Government is clear that any policy or suite of policies we may pursue would need to carefully balance a range of priorities for the UK, both domestically and internationally, including compliance with WTO rules and our staunch commitment to free and open trade, alongside carefully considering the needs of developing countries.

As we determine our future approach to carbon leakage, we will, of course, continue our ongoing engagement with our domestic and international partners as you recommend, and we will keep the House updated on developments.

International considerations on the design of a carbon border approach

Recommendations, paragraph 8: *Our recommendations to Government on the design of the carbon border approach are as follows: 8 A: to ensure, from the outset, that the carbon border approach is designed to adhere to the principles of common but differentiated responsibilities and respective capabilities set out in the Paris Agreement and Glasgow Climate Pact in respect of low- and middle-income country trading partners. This might be through the CBAM design itself, or through a complementary policy in parallel to the CBAM; 8 B: to ensure that the UK CBAM is designed in accordance with WTO rules; 8 C: to establish forums to enable inclusive engagement with trading partners on the design and implementation of the carbon border approach. These should include forums specifically for engagement with low- and middle-income country trading partners; and 8 D: to conduct analysis to understand how the carbon border approach might interact with free trade agreements.*

Upholding trade openness remains a priority for this Government. As set out above, if implemented, the Government is clear that any policy or suite of policies would need to carefully balance a range of priorities for the UK, including compliance with WTO rules and our commitment to free trade alongside carefully considering the needs of developing countries. We will continue working with our international partners to advance our global climate goals, while maintaining a fair and open trading system.

The UK is actively involved in discussions in the G20, the WTO and the OECD to ensure we are building an approach to carbon leakage mitigation that works for the broadest range of countries, including emerging market economies and developing economies. As the current chair of the Committee on Trade and Environment and an active participant in Trade and Environmental Sustainability Structured Discussions (TESSD), the UK will continue to engage with all partners to explore trade-related solutions to carbon leakage at the WTO. The UK sees the TESSD as a space in which to discuss evidence, solutions to tackle the root causes of carbon leakage, and WTO-consistent approaches.

The Government appreciates the importance of considering the interests of low- and middle-income country trading partners. The UK is already supporting developing countries with their climate change ambitions, having doubled our international climate finance to £11.6 billion over the next 5 years including over £590 million to support REDD+ which helps developing countries reduce emissions from deforestation and benefit from carbon trading rules. Additionally, we have provided £20 million to the Partnership for Market Implementation fund to help developing countries put a price on their emissions using carbon taxes and emissions trading schemes. We will continue to work closely with developing countries to support their commitments on climate change, including their work on carbon pricing.

Stakeholder engagement and further design considerations

Recommendations, paragraph 13 C: *Set out in its response to this report – how it intends to ensure open and transparent communication on progress on its actions to ensure businesses do not face any unreasonable barriers to trade, to provide greater clarity to UK industry. 13 D: Engage directly with affected stakeholders in Northern Ireland and the EU during the design stage of any UK carbon border approach. 16 A: Clearly define its objectives for any*

carbon border approach at the outset, and ensure the choice of policy options and design consideration at each stage is led by these objectives. These should encompass the need to drive decarbonisation across the economy to address climate change, whilst ensuring low- and middle-income countries, vulnerable households and wider environmental goals, such as nature, are not adversely impacted. 16 B: During the design stage of the carbon border approach, engage with industrial stakeholders and conduct impact analysis across sectors, so as to understand the most effective policy instruments and implementation timescales for each sector and ensure industries at all stages of the value chain, including end users, are involved in the design of the carbon border approach. This engagement should be conducted through specific forums which bring stakeholders, including industry, academics, the environmental community and consumer groups, together alongside representatives from all relevant Government departments. 16 C: Carry out a specific assessment of the impact on SMEs during the design phase of the carbon border approach, and set up a forum for engagement with SMEs. The UK's carbon border approach should also include a plan for communicating changes with SMEs and should ensure that ease of administration is built into design. 18 A: Include a strategy to engage with the public in the design of the carbon border approach to develop and maintain public support and keep the public informed of the changes that would occur, the rationale and methodology supporting the changes, and their impact and timescales. 18 B: Conduct analysis to understand any potential impact on consumers, including vulnerable and low-income households, and ensure the carbon border approach includes any measures needed to address this. 20 B: During the design stage, establish methods for monitoring and understanding the impacts of the carbon border approach once implemented. This should include mechanisms for periodic consultation with stakeholders, including those in industry, academics, the environmental community and consumer groups.

As noted above, we have announced our intention to consult on a range of carbon leakage mitigation options, including on a UK CBAM, later this year. This announcement does not commit the Government to any course of action down the line, but will enable us to better understand and develop our options. Our intention is to seek a wide range of views from stakeholders on the UK's future carbon leakage mitigation policy. The Government is committed to communicating in an open and transparent way as we develop our carbon leakage mitigation policy options. It is essential that, if implemented, these policies are designed with the needs of stakeholders, the interests of consumers, and the wider impact (including on trade) in mind.

We are aware that if implemented, differing approaches may be required for certain sectors, types of firms, and geographical locations, and we will continue to work with all relevant stakeholders to understand these nuances. We will also carefully assess the potential impact of any carbon leakage mitigation measures on business and consumer prices and will use those assessments to inform any future decisions on the right policy response.

Recommendations, paragraph 20 A: *Ensure, through the oversight of both Cabinet Committees on Climate Action, that the UK's carbon border approach is aligned with existing environmental, trade, development and fiscal policy, through both its design and implementation stages. This should include setting out how the carbon border approach would interact with the tax and customs arrangements in Freeports.*

The Government agrees with the importance of aligning our approach to carbon leakage with our wider environmental, trade, development, and fiscal policy. We will continue to engage with all the appropriate Cabinet Committees as we consult on a possible UK CBAM, and other possible mitigation measures. We will also continue to work across Government to align any future approach, if implemented, with existing policies, including tax and customs arrangements in Freeports.

EU CBAM implications for the UK, including NI

Recommendations, paragraph 13 B: *Set out in response to this report – how it intends to work with stakeholders in the EU and UK to understand how the proposed EU CBAM would affect the UK, including in Northern Ireland.*

We are actively engaging with the EU on their CBAM proposals through formal channels, such as our UK Mission to Brussels, and informal channels, as we do on other elements of the international tax and trade agendas. The UK has ambitious carbon pricing through our emissions trading scheme and Carbon Price Support mechanism. We expect the EU CBAM to take account of this in its implementation.

We will continue to engage with stakeholders and monitor developments closely so we can build a full understanding of the implication of the EU CBAM on the UK's trading relationship with the EU, including with respect to Northern Ireland.

Recommendations, paragraph 13 E: *Before the end of 2022, launch a consultation on measures to link the UK and EU emissions trading schemes.*

The Government is open to linking the UK ETS internationally in principle and is considering a range of options. No decision on any preferred linking partners has yet been made. Under the Trade and Cooperation Agreement (TCA) the UK and EU have agreed to give serious consideration to linking their respective carbon pricing systems. Cooperation and dialogue on carbon pricing, including by considering linking, will continue to be important as both parties strive to deliver ambitious climate targets.

Yours sincerely,

The Rt Hon. Lucy Frazer QC MP

Appendix 2: Letter to the Chair from the Financial Secretary to the Treasury, Rt Hon Lucy Frazer QC MP, dated 16 May 2022

Update on carbon leakage mitigations

I would like to thank the Committee for its inquiry into carbon border adjustment mechanisms (CBAMs), including inviting me to an evidence session and for the subsequent thought-provoking report of 4 April to which I will respond in full.

I am writing to you to provide the Committee with an update on progress in this area beforehand.

Your report recommends that work to develop a UK CBAM begins immediately and I agree on the importance of this. I am pleased to inform you that the Government will announce its intention, in a WMS to be laid today, to consult later this year on a range of carbon leakage mitigation options, including on whether measures such as product standards and a CBAM could be appropriate tools in the UK's policy mix. Alongside government thinking and the experience of others around the world also considering policies in this space, consulting will inform our approach on the options for mitigating against the risk of carbon leakage.

We believe that the best way to address carbon leakage would be for all countries to move together in pricing and regulating carbon emissions, and we are strongly committed to working with our international partners to develop a common global approach to carbon leakage in parallel. Nevertheless, international solutions can take time to develop and that is why it is right that we are exploring a range of domestic options now.

Once again, I would like to express my gratitude for your engagement on this area and for the recommendations set out in your paper.

Yours sincerely,

The Rt Hon Lucy Frazer QC MP

Appendix 3: Written Ministerial Statement made by the Financial Secretary to the Treasury, Rt Hon Lucy Frazer QC MP, on Update on carbon leakage mitigations, dated 16 May 2022 [UIN HCWS26]

The Government is taking ambitious domestic action to tackle climate change and recently opened a consultation on developing the UK Emissions Trading Scheme (ETS), so the UK can become the world's first net zero carbon cap and trade market.² While domestic action is critical, climate change is a global issue. When the UK took on the COP26 Presidency, only 30% of the world was covered by net zero targets – now over 90% of the global economy is committed to net zero. In 2021, the UK placed climate change and nature at the top of the international agenda during its G7 and COP26 presidencies, presiding over the agreement of the Glasgow Climate Pact, to speed up the pace of climate action.

The Government also wants to see other countries do more to drive down their own emissions and we continue to work on the global stage to support more ambitious international action. Recent global events and the resulting increase in energy prices reinforce the importance of transitioning to clean energy to ensure energy security and reduce our dependency on imported fossil fuels.

In parallel, Government is considering domestic action to continue to ensure the integrity of UK action to reduce its carbon emissions against carbon leakage, as our existing carbon leakage protection measures, including free allowances under the UK ETS, evolve to achieve our net zero objectives. This will also ensure that UK businesses are not disadvantaged. Carbon leakage is the displacement of production, and associated emissions, from one jurisdiction to another, due to different levels of carbon pricing and climate regulation across those jurisdictions.

The best way to prevent carbon leakage would be for all countries to move together in pricing, regulating, and therefore reducing carbon emissions. We are strongly committed to working with our international partners to develop a common global approach to carbon leakage. Multilateral solutions can take time to develop, however, and while we will continue to work on international solutions with partners, options for domestic action must be considered in parallel.

The Government is therefore exploring a range of policies that could potentially mitigate future carbon leakage risk. These include policies to grow the market for low emissions industrial products, on which the Department for Business, Energy and Industrial Strategy recently undertook a Call for Evidence. Today, we are announcing that it is our intention to consult later in the year on a range of carbon leakage mitigation options, including on whether measures such as product standards and a carbon border adjustment mechanism

2 [Developing the UK Emissions Trading Scheme \(UK ETS\) – GOV.UK \(www.gov.uk\)](#)

(CBAM) could be appropriate tools in the UK's policy mix. A CBAM applies a carbon price to specified imports, in order to mitigate differences in carbon pricing between jurisdictions, and therefore reduce the risk of carbon leakage.

The Government is clear that any policy or policies would need to carefully balance a range of priorities for the UK, both domestically and internationally, including compliance with WTO rules and our staunch commitment to free and open trade, alongside taking into account the needs of developing countries. As we determine our approach to carbon leakage, we will continue our ongoing engagement with our domestic and international partners.