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Darren Jones MP
Chair of the Business, Energy and Industrial Strategy Committee
House of Commons
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Dear Darren,

Post-transition period regime for UK carbon pricing

Thank you for your letter dated 17 November, following my appearance before the Committee. I am writing to inform the Committee that having carefully considered both options and the views of our devolved colleagues and stakeholders, the Government has decided to implement a new and ambitious UK Emissions Trading Scheme (UK ETS) from 1 January 2021. We will not be progressing the option of a Carbon Emissions Tax.

The introduction of a UK ETS ensures that the UK maintains its global leadership in the pricing of greenhouse gas emissions after the UK ceases to participate in the EU Emissions Trading System (EU ETS) at the end of the Transition Period; and that it does so in a way that promotes cost-effective decarbonisation. Implementing a UK ETS allows us to harness the power of the market to deliver emissions reductions at the minimum possible cost to the UK economy. In doing so, it supports and incentivises innovation and drives trade and growth. The UK ETS will be a critical tool in the delivery of the Government’s Net Zero 2050 commitment, Carbon Budgets, and other decarbonisation targets.

The UK was instrumental in the development of emissions trading. We have therefore taken the best features of the EU system, while taking the opportunity to design our system appropriately for an independent UK market. Full details of the design of the UK ETS can be found in the Government and Devolved Administrations’ response to the consultation on the future of UK carbon pricing.

We have legislated for the UK ETS through The Greenhouse Gas Emissions Trading Scheme Order 2020 (which came into force on the 12th November) and a second amending Order in Council which includes provisions for the free allocation of emissions allowances and the UK ETS Registry. This amending Order is expected to be in force by 31st December 2020. Auctioning regulations will also shortly be introduced under the Finance Act 2020. These will establish rules for the auctioning of emissions allowances, mechanisms to support market stability, as well as regulations for the trading of emissions allowances and market oversight.

Our UK ETS is more ambitious than the EU system it replaces - from day one the cap on emissions allowed within the system will be reduced by 5%, and we will soon consult on aligning it with net zero. This will enable the UK to create the world's first net zero cap and trade system. We will also work towards expanding the UK ETS and developing it to support the UK's negative emissions capacity.

At the same time, we will ensure that UK business is protected from the risk of carbon leakage by continuing to provide free allocation, which we will also review to ensure it better fits the UK context.

We have worked collegiately and effectively across the four governments – and with other Whitehall departments – in the development of the UK ETS over the past months and years. As part of our close and cooperative working with the Devolved Administrations, their views have been understood and communicated clearly throughout process of reaching a decision on the UK's post-Transition Period carbon pricing policy.

We have considered the views of affected stakeholders in making this decision, both through information gathered from our formal consultation, "The Future of Carbon Pricing" and subsequent Government Response, and views expressed outside of formal consultations. The scheme's introduction will provide continuity of emissions trading for UK businesses, and full support and guidance will be available to scheme participants. The operation of the scheme will be familiar to participants, ensuring minimum disruption.

The UK ETS will also allow us to expand carbon pricing across the economy and encourage innovation in emerging decarbonisation technologies. We have committed to exploring expanding the UK ETS to the two thirds of uncovered emissions, and will set out our aspirations to continue to lead the world on carbon pricing in the run up to COP26. This will also include how the UK ETS could incentivise the deployment of greenhouse gas removal technologies.

You also asked about the Government's longer-term commitment to linking. The UK ETS will deliver our ambitious climate objectives as we leave the EU ETS at the end of the Transition Period. We recognise the importance of international co-operation on carbon pricing and the important role international carbon markets can play. The UK is open to linking the UK ETS internationally in principle and we are considering a range of options, but no decision on our preferred linking partners has yet been made.

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Minister of State for Business, Energy and Clean Growth