

# Key Objectives for Brexit Transition of Carbon Reduction Schemes

## UK Emissions Trading Group, July 2018

The UK's departure from the EU has raised questions about how the UK will regulate carbon emissions following its exit from the EU and specifically whether the UK will remain in the EU ETS, develop a domestic trading scheme or adopt other measures which might include climate change agreements, wider carbon taxation etc.

The ETG "Golden Rules" (attached) provide a useful set of criteria to evaluate all schemes for carbon reduction. These criteria are particularly relevant to considering the possible transition from the EU ETS to a different type of scheme at the end of the agreed transition period and the orderly conclusion of Phase 3 of the EU ETS. Considering these criteria, ETG would highlight the following high-level objectives for a successful transition from the ETS to any replacement UK scheme should the UK Government choose to leave the EU ETS.

- **Continued environmental delivery and credibility.** The scheme should ensure that the UK remains on track to meet its domestic and international carbon reduction obligations at low-cost. The scheme should continue to provide assurance that emissions are accurately monitored and transparently reported.
- **Predictability and equity.** To avoid damaging impacts to international competitiveness, the scheme should avoid step changes in the carbon price faced by companies (under an ETS and/or tax) and the reductions required by companies and industry sectors. The design of a replacement scheme should be announced as far in advance of implementation as possible. The methodology and timetable for regulatory changes which affect carbon prices, taxes, emission targets etc within that scheme should also be set out in advance to allow industry to reasonably predict and respond to likely future changes.
- **Flexible compliance.** The scheme should retain the flexibility for industry to manage the risks associated with carbon pricing and volume uncertainty by allowing prices to be hedged wherever possible and through limited banking and borrowing of performance against abatement obligations (or equivalent provisions).
- **Compliance burden maintained or decreased.** The cost burden to industry of operating and complying with the scheme should not increase. The costs of monitoring, reporting and verification should remain efficient and proportionate to achieving environmental delivery.

## **ETG GOLDEN RULES – MAY 2009**

In order for any emissions trading system to be successful it must meet certain criteria:

Environmental rationale – the trading system must, and must be seen by all parties, to be achieving a valid environmental objective to reduce emissions.

Economic rationale – the trading system must, and must be seen by all parties, to be more flexible and cost-effective than other ways of achieving the environmental objective.

Credibility – the system must be credible since only credible systems succeed. Hence, the administrative procedures must be adequate to ensure compliance with the climate change goals. There must be an element of trust since in many cases pragmatic solutions to problems will be needed. Appropriate monitoring and verification will enhance credibility.

Simplicity – simplicity is essential in the design, operation and administration of the system. Good simple, pragmatic solutions will be more successful in achieving the environmental and economic objectives where more complex ones will fail. A deviation from simplicity should only be introduced when demonstrably necessary.

Equity – inequities within the system should be minimised as far as possible. Since the valuation of companies and their investment policies have been based on certain explicit and implicit rights it is important that any trading system does not introduce a step-change shock to the status-quo but enables the achievement of the desired objective.

Transparency – the system must be transparent so that there is national and international confidence in the system. For confidence in the system the disclosure of information must be conducted in a controlled and well signalled manner.

Predictability and Certainty - in order to inspire business confidence, encourage innovation and investment there must be a high degree of certainty so that business can invest. Predictability is the ability to forecast scarcity within the market i.e. level of abatement required against unconstrained emissions. This can be undermined by political and regulatory uncertainty for example through overlapping policy measures.

Market Integrity – an efficiently functioning system is one with a mature and robust emission allowance market that has the confidence of investors and is capable of providing the long term price signals. A stable and deep emissions market will assist in developing a liquid market with the objective of minimising price volatility and market shocks.

Inclusivity – the system should be as inclusive as possible in the long term though some restrictions will be necessary in the short term.