Northern Ireland Assembly

Committee for Agriculture, Environment and Rural Affairs

OFFICIAL REPORT (Hansard)

Greenhouse Gas Emissions Trading Scheme Order 2020: Department of Agriculture, Environment and Rural Affairs

22 October 2020

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Declan McAleer (Chairperson)
Mr Philip McGuigan (Deputy Chairperson)
Mrs Rosemary Barton
Mr John Blair
Mr Maurice Bradley
Mr Harry Harvey
Mr William Irwin

Witnesses:

Mr Richard Coey	Department of Agriculture, Environment and Rural Affairs
Mr Phil Elliott	Department of Agriculture, Environment and Rural Affairs
Mr John Mills	Department of Agriculture, Environment and Rural Affairs
Dr Hugh McGinn	Northern Ireland Environment Agency

The Chairperson (Mr McAleer): I welcome from the Department, via StarLeaf, John Mills, grade 5 head of environmental policy division; Richard Coey, grade 7, from environmental policy division; Hugh McGinn, grade 7 principal scientific officer; and Phil Elliott, senior scientific officer. I invite the officials to commence their briefing.

Mr Richard Coey (Department of Agriculture, Environment and Rural Affairs): Good morning, Committee. I am not sure whether John Mills is on the line. He was supposed to be.

The Chairperson (Mr McAleer): His name animated, but his face has not appeared yet. Would it be OK if one of the other three of you began the briefing? John can then join in.

Mr Coey: Yes. That is fine. Good morning, Chair and Committee. As you know, with me this morning are Mr Mills — hopefully — as well as Hugh McGinn from the Northern Ireland Environment Agency (NIEA) and Phil Elliott, who works alongside me on the emissions trading policy team. You will be aware that we briefed the Committee on the emissions trading scheme (ETS) and the statutory instrument, the Greenhouse Gas Emissions Trading Scheme Order 2020, on 17 September.

The Order is now scheduled for debate in the Assembly on 3 November, as was previously agreed by the Executive when they approved the policy approach back in May. That is a week earlier than we had originally anticipated, so, once again, we find that we are working to pressing timescales. The need to bring the debate forward is so that the Order, if passed, can be cleared at a Privy Council meeting on 11 November.

The Order establishes the legal framework for a UK emissions trading scheme. That will replace our current membership of the EU emissions trading scheme, which will cease at the end of this year. An exception to that is that Northern Ireland power generators will remain within the EU ETS in order to maintain a level playing field in the single electricity market (SEM). Note that the Order that is being debated on 3 November does not provide for that. Separate legislation is being drafted to do that under the European Union (Withdrawal) Act 2018. The intention is for that legislation to be laid in Westminster in November 2020.

A further complication is that the UK Government are keeping another option open: implementing a carbon emissions tax instead of a UK ETS. We have no insight into when that decision is to be made and whether it will be affected by the outcome of negotiations. At the previous Committee session, we were asked about a local impact assessment of the changes. Subject to the Minister's approval, we said that we would provide that to the Committee before the debate on the Order, and that remains the case. I should be clear on one point, though: an impact assessment has been carried out and was published *[Inaudible.]*

The Chairperson (Mr McAleer): Richard, we are losing you.

Mr Coey: *[Inaudible.]*

The Chairperson (Mr McAleer): Richard, can you repeat that last point? The broadband is cutting out.

Mr Coey: Right. OK.

I said that I should be clear on one point: an impact assessment has been carried out and was published along with the UK Government and devolved Administrations' response to the consultation on the future of UK carbon pricing back in July. That was a UK assessment. It covered Northern Ireland but was not disaggregated by region. Just as there was none for Northern Ireland, there was no separate assessment for Wales, Scotland or England.

The UK impact assessment and our own outline compare moving to the UK ETS with staying within the EU ETS. I do not want anybody to get too excited about the local impact assessment. The impact made by the Order is very small, for two reasons. First, the vast majority of our emissions and ETS costs arise from generators that are staying within the EU ETS, so there is no impact there. Secondly, the policy approach taken in establishing the UK ETS is to make transition from the EU scheme to the UK scheme as smooth as possible for operators. There is no marked impact from the change in schemes, and there is not intended to be. There is a more stringent cap in the UK scheme, but free allowances are retained at EU scheme levels, and there is sufficient headroom to mitigate any impact. On climate change ambition, there is a commitment to reviewing the UK ETS in the light of forthcoming advice from the Committee on Climate Change (CCC) on achieving the net zero target.

At the Committee meeting on 17 September at which we discussed the ETS, you were provided with the UK ETS common framework summary note. We are told that a phase 3 Cabinet Office review has been completed. Work has progressed well on both the framework outline agreement (FOA) and a concordat and will shortly be subject to devolved Administrations' ministerial write-round. The FOA and concordat will then go to the Joint Ministerial Committee (JMC) and will then be available for scrutiny by the Committee for Agriculture, Environment and Rural Development.

To conclude my opening remarks, I will stress a few key points about the Order in question. The Order is to establish a UK ETS. It is being debated in all four UK legislatures and needs to be passed in them all. The purpose of the UK ETS is to encourage cost-effective greenhouse gas emission reductions that contribute to the net zero target. The scheme's scope includes energy-intensive industries, the electricity generation sector — excepting Northern Ireland generators — and aviation, and it establishes a cap on annual emissions.

By virtue of the Northern Ireland protocol, Northern Ireland electricity generators will remain within the EU ETS in order to maintain a level playing field of carbon costs in the single electricity market on the island of Ireland. In the UK ETS, the initial level of the cap will be 5% below that which would have been the case had we stayed in the EU ETS. That means that the UK standard is more ambitious than if we had stayed in the EU ETS, but its impact is limited in the early years in order to provide for a smooth transition. That will be reviewed in line with advice from the Committee on Climate Change.

Finally, the Order also establishes monitoring, recording, verification and enforcement arrangements. In Northern Ireland, the regulator will be the Northern Ireland Environment Agency. That concludes my remarks. Thank you, Chair.

The Chairperson (Mr McAleer): Do any of the other officials want to add anything before I invite questions from Committee members?

Dr Hugh McGinn (Department of Agriculture, Environment and Rural Affairs): Nothing from me.

The Chairperson (Mr McAleer): OK.

Mr McGuigan: Thanks for that, Richard. Any proposal that reduces greenhouse gas emissions is to be welcomed, but a few issues stand out for me with the ETS. You said not to get too excited about its impact in the North, because those industries that are within the single energy market are not included, but there are still a number of companies in the North on which it will impact. The Committee was discussing earlier this morning how there are large amounts of money involved in trading these carbon budgets. I have concerns about the Order. In the Assembly, we have had the renewable heat incentive (RHI) scheme and the renewables obligation (NIRO) scheme, which we have heard about recently. Is there any potential for companies to exploit the scheme to make sums of money through trading?

I also want to ask about the potential for a carbon tax being introduced over and above the ETS, because emissions is a devolved matter but tax is not. Can you clarify the level to which the emissions scheme will be devolved? Will local industry benefit? Will money that comes from that tax feed into helping local companies or will it come back to the Executive? What devolved decision-making powers will we have under the scheme?

You said that the Committee on Climate Change is producing a report that may have an impact on a review of the ETS. Clare Bailey, who is not with us today, has submitted, on behalf of a number of parties, a private Member's Bill to bring in a climate Act for the North. If we were to have a climate Act in the North within a year or a year and a half, how would that impact on any of this?

Finally, I am not saying that this is likely to happen, but what happens if the Assembly does not support the ETS Order following the debate?

Mr Coey: I will start with your last point, Philip, about what might happen if the Order is not supported in the Assembly. In theory, the scheme could go ahead on a GB basis and not include Northern Ireland. That would leave a carbon pricing gap for Northern Ireland, however. How would that be dealt with legislatively? I cannot profess to be familiar with or expert enough on the legal detail to answer that, but, as I said, it is a possibility.

The main difference between a carbon tax and the emissions trading scheme is that the emissions trading scheme is driven by market forces, so the price of carbon fluctuates daily. The price of carbon under a carbon emissions tax, however, would be set at a level and be reviewed by the UK Government in the annual Budget, so it would not fluctuate.

Whether the scheme is open to abuse by companies depends on how they manage their allowances and how they buy and sell them. The same process will apply under a future UK ETS as has applied under an EU ETS. We in DAERA and the Environment Agency are not familiar with the market trading behaviour of the companies that will participate in the scheme. It is not something of which we are aware. Carbon is a commodity and, like any other commodity, will be traded as such. I do not expect there to be any change in the behaviour of the market, the participants or their agents under the transition to the new scheme, given that it follows the same principles as the EU ETS.

Has that covered the main points? Have I missed anything? I feel as though I have missed something.

Mr McGuigan: If the advice from the Committee on Climate Change suggests that emissions should be lowered, what impact would that have on the review? Would having our own climate Act in the North have any impact on any future ETSs?

Mr Coey: I have to confess that I do not know. I have not seen the detail of the climate change legislation that was announced yesterday. Having a carbon emissions tax would not be ideal, because, under it, the price of carbon does not fluctuate. The principles behind the carbon emissions tax mean, however, that, under the UK emissions trading scheme, free allowances would be allocated to companies. The principle of free allowances and free allocations was explained to the Committee at our previous presentation on 17 September. The number of free allocations would, I think, mirror the number of allowances granted for free under a carbon emissions tax. There would therefore be similarities in the incentives for companies to keep their emissions down. The carbon emissions tax would then apply to any emissions over and above the number of allocated free allowances under the tax. There would still be that incentive to reduce emissions, but the main difference would be that the carbon price would be set annually and would not fluctuate.

Mr McGuigan: Thank you.

Mr Blair: Thank you for the information, Richard. I previously raised a concern and I remain concerned that the UK Government have not included Northern Ireland in a direct consultation on the impact assessment. As I say, that remains my position.

Some of the detail that you have already given has answered questions that I was likely to ask. I am keen to know what consideration the Department gives when it is presenting an analysis to the Committee or anyone else to the need to strike a balance between the environment and the economy/business. For example, if the proposed UK ETS cap is to be lower than the EU ETS cap, as has been stated, how will that impact on the environment? On a separate issue, given that there are those who are still intent on building municipal waste incinerators in this jurisdiction, should we be looking at the carbon pricing of such installations?

Mr Coey: The impact of the proposed 5% reduction in the cap equates to something like 156 million tons of carbon a year out of available allowances in the first year of the UK ETS. The predicted business-as-usual emissions for the industries that are captured by the UK ETS is 126 million tons to 131 million tons. There is therefore sufficient headroom in the number of available allowances in the first year of the scheme to cover the predicted emissions. That has been done to facilitate the transition from the EU scheme to the UK scheme, but the reduction in the cap signals the intention for greater climate ambition on the part of the UK scheme. As I said, there is therefore sufficient headroom to cover the predicted allowances initially, and that was done to strike a balance between climate ambition and the impact on businesses in transitioning to a new scheme.

I will say something about widening the scope of the scheme to bring in further industries. To facilitate transition from the EU ETS to the UK ETS, the scope of the UK scheme is initially to include those industries that would have been included under the EU ETS. The scheme will be reviewed during the first phase, and I suppose that there is the possibility that we could bring further installations, industries and sectors into the scheme in the future. Initially, the scope has been kept the same as under the EU ETS, in order to facilitate the smooth transition to the new scheme, but that is not to rule out further sectors being included in any future iteration or revision of it.

The Chairperson (Mr McAleer): On that point, Richard, I know that there is a cap set and that it will be lowered over time. Will that cap harmonise with changes to the EU ETS cap? We obviously want to prevent carbon leakage.

Mr Coey: Our preferred option is that we have a scheme that will be linked to the EU emissions trading system. That would create a wider carbon market and create a wider availability of allowances to sectors across the UK and the EU. In that scenario, I suggest that, with cap reduction, there would be more scope for alignment. The EU can always review its scheme as well. I am not familiar enough with the review schedule, and I am not sure whether Hugh or Phil is any more familiar with it than I am. The EU scheme can therefore be reviewed, and there is the potential for its cap to be reduced also. How that would align with the UK ETS, however, I am not sure. Ideally, as I said, we would have a linked scheme. That is the preferred option.

Mrs Barton: Thank you very much for your presentation. My question is, again, on the impact assessment. We are told that it was a UK-wide assessment. Was any drilling down done into the submissions from any of the Northern Ireland companies so that we can at least get a Northern Ireland perspective?

Mr Coey: No. In the impact assessment that the Department for Business, Energy and Industrial Strategy (BEIS) carried out initially to support the statutory instrument, it was not possible to disaggregate the information to Administration level, and that was the case for the other three countries of the UK as well as for Northern Ireland. We are finalising a local impacts paper that looks at the impacts for Northern Ireland. We hope to get that finalised very shortly. Indeed, we expect to have that with the Committee prior to 3 November, the proposed date of the debate. That impact assessment will drill down to a Northern Ireland-specific level.

Mrs Barton: I am asking you to do a bit of crystal ball gazing now, but, if there is no deal, what will the impact be on the carbon tax or the UK ETS?

Mr Coey: Unfortunately, I cannot answer that question. The same question came up in a debate at Westminster at, I think, the start of September. Minister of State Kwasi Kwarteng from BEIS was unable to give any insight into what scenario would produce either a UK ETS or a carbon emissions tax. We hope to get clarity on that soon. As soon as we do, we will, of course, share that information. Unfortunately, I cannot at this stage say when the decision will be made or under what circumstances. The outcome will be either the UK emissions trading scheme or a carbon emissions tax.

Mrs Barton: Thank you.

(The Deputy Chairperson [Mr McGuigan] in the Chair)

Mr Harvey: Richard, would the overall cost to emitters be similar under the UK ETS and a carbon tax?

Mr Coey: The value of the carbon emissions tax is yet to be set to the value per ton of carbon. Hugh, correct me if I am wrong, but the proposal for the level of carbon tax is to base it on what the predicted carbon value per ton will be for the next six months and what it has been for the previous six months. The UK Government will try to align that as quickly as possible with what they predict the UK emissions trading scheme carbon price will be and what the EU emissions trading scheme carbon price has been. That tax will be set by the Treasury, as it is a reserved matter. The intent is to keep it aligned as closely as possible with what the predicted price is under the UK ETS. There is no guarantee there, however. Under an emissions trading scheme, as I said, the carbon value will fluctuate. Nobody can predict how high or how low it will go. Under a carbon tax, it will be set. As I say, it should be set in such a way as to try to align it as closely as possible with what the values are predicted to be under an emissions trading scheme.

Mr Phil Elliott (Department of Agriculture, Environment and Rural Affairs): May I come in there, Richard? The mechanism for setting the price of carbon is based on the auction reserve price of £15 a ton, which is the lower level, and then using a cost containment mechanism as an upper ceiling. The modelling has predicted that the carbon price window will be between £15 and £32 for the years 2021 to 2024. That is the window within which the UK Government estimate the carbon price to be for the UK ETS. That will then be reviewed.

Mr Harvey: That is OK. My next question was to ask when that will be reviewed, but you have answered it, so that is fine. Thank you very much.

The Deputy Chairperson (Mr McGuigan): Are you happy enough, Harry?

Mr Harvey: Yes.

The Deputy Chairperson (Mr McGuigan): William.

Mr Irwin: Sorry.

The Deputy Chairperson (Mr McGuigan): You were caught in the middle of a yawn.

Mr Irwin: The proposal for the ETS is that the UK will set a price for trading and for an emissions tax. Is that to protect smaller companies? I am just thinking out loud, but I would have thought that the difficulty with having a free trading scheme would be that it puts very large companies at an advantage. They can afford to pay more.

(The Chairperson [Mr McAleer] in the Chair)

Mr Coey: I suppose that there is a protection under the emissions trading scheme for free allowances. Companies that would be vulnerable to what is classed as "carbon leakage", which is when a company decides to relocate to a jurisdiction that does not have a carbon price or has a lower carbon price, will be allocated a certain number of free allowances to allow them to continue to operate. That is similar to what has been the case under the EU emissions trading scheme for the past 20 years. It has not financially disadvantaged anybody.

For smaller operators, there is the facility for a small emitters opt-out, whereby they can opt out of the formal trading scheme and be issued an emissions target, as such, to aim towards. They can then trade on the open market. If they breach the allowance that they have been allocated, however, they have to pay a civil penalty. Hugh, can you keep me right here? Is that correct?

Dr McGinn: That is correct. If they fail to meet their target, they have to purchase the value of a target breach. If they were, say, 100 tons over their target, they would have a penalty for 100 tons of CO_2.

Mr Coey: To answer your question, the scheme will not make any difference to what has been the case under the EU ETS, so it will not disadvantage any companies or put them in a different situation to that which they would have been in had they remained in the EU ETS.

Mr Irwin: That is good. That makes it clear.

The Chairperson (Mr McAleer): For clarity before we conclude, because I have no other members looking to come in, in the previous briefing that we got from you, the point was made that allowances can be banked, traded or sold to reduce greenhouse gas emissions. The price is £27 an allowance. Are there a finite number of those particular allowances? How are allowances regulated? If, say, a company were to have a certain number of allowances, what would stop it from just holding on to them until the price rose and then start trading them again? That is the last issue that I want to ask about.

Mr Coey: The first point to make is that there is a cap on allowances, so a finite number of them are established under the scheme. Those allowances are subdivided into a number of categories. A number of allowances within that cap are set aside for free allocation to those companies that are entitled to a free allowance. A certain number of allowances are set aside in what is called the "new entrants' reserve", which is for new companies coming online that may be entitled to a free allowance or a free allocation. There is also a separate section of allowances available for auction and for trading on the open market.

How those allowances are traded, and the trade and market behaviour of the individual companies and brokers that trade in carbon, is an area in which I do not profess to be an expert. That is an area in which we, as a Department and as a regulator, do not get involved.

To answer your question, yes, there is a possibility that brokers will buy up allowances, hold on to them and trade them — buy and sell them — as they would do any other commodity. There is, however, a cap on the number of allowances that are available. Within that cap, various sections are set aside for the different purposes: new entrants' reserve; free allocation; and those that can be traded on the open market. As I said previously, carbon is a commodity like any other, and it can be traded as such. I am not an expert on market behaviour, however, so I cannot comment on that; in fact, we just do not have that information.

Mr Elliott: Richard, may I add something about the finance side? Sitting alongside this Order in Council under the Finance Act 2000 are two finance statutory instruments that cover the auctioning of allowances and the role of the national conduct authority. There are checks and balances there, through Treasury, to prevent abuse of the system.

Mr Coey: Thanks for that.

The Chairperson (Mr McAleer): Thank you very much. I take the opportunity to thank you for your attendance and for providing comprehensive answers to all our questions.