Carbon Pricing

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Energy Policy Insights

Briefing paper: Carbon Pricing

Contents

This AMP Clean Energy briefing paper outlines the policy landscape on industrial decarbonisation and focuses on hydrogen infrastructure development, reporting & monitoring, energy efficiency and emissions reduction measures. The paper provides key background information, a summary of overarching themes and upcoming policies that businesses need to be aware of to help shape their Net Zero strategy.

AMP Clean Energy is a distributed energy business focussed on net zero solutions to decarbonise heat and grid solutions which enable the growth of renewables. We provide businesses with fully funded low carbon solutions and typically invest between £100k to £25million per project. With 160 projects in our portfolio, we have been helping organisations to become more sustainable over the past 10 years.

https://www.ampcleanenergy.com/net-zero-funding

Introduction

Carbon pricing is a core element of emissions reduction in the UK.

Placing a cost on emissions creates a technology-neutral incentive for businesses to invest in emissions reduction measures. The UK Emissions Trading Scheme (UK ETS) is the main method by which the UK manages this, by placing a 'price on carbon'. The UK ETS replaced the UK's participation in the EU ETS as of 1 January 2021 and maintains the aim to provide long-term carbon price signals for heavy industry and the aviation and power sectors.

The UK ETS works through the 'cap and trade' principle, with the cap set by total amount of greenhouse gases which can be emitted by certain sectors. Scheme participants can buy emissions allowances and/or receive free allowances (1 allowance = 1 tonne CO2e), which they can use or trade with other participants. Free allowances are typically received by companies whose competition would be most hindered by a higher carbon price than competitors. At the end of a year, businesses must surrender allowances to cover their emissions; any leftover allowances can be carried over or sold.

There has been criticism of the efficacy of the UK ETS as an emissions reduction tool, as well as the practice of allocating free allowances. Less than half of UK emissions are currently covered by the scheme. Further, the carbon price under the UK ETS has been reaching record highs in recent months, with British competitors paying higher emissions prices than European counterparts. Ministers have so far chosen not to intervene to address the higher prices.

Only approximately 30-40% of UK emissions are currently covered by the UK ETS.

The Policy Landscape

The UK ETS cap is reduced over time, so that total emissions must fall. This is intended to create increasing financial pressure for businesses to move towards energy efficiency and emissions reduction.

The Government has committed utilising the UK ETS to incentivise cost-effective abatement in industry at the pace and scale required to reach net zero, and the upcoming policy landscape provides evidence of this. In particular, the live consultation on the future of the UK ETS proposes a timeline for aligning with net zero commitments and increasing the scope of emissions covered. The proposed changes would come into effect in the next 2-4 years and include aligning total allocations with net zero (trajectory seen below), resetting the industry cap, changing methodology for free allocations, expanding coverage within current sectors and to new sectors, and more.

There are several uncertainties over the future of the UK ETS, including further expansion of the scope and/or if the scheme will link with the EU ETS. The scope has been a point of consideration in this first review, and government has indicated that Greenhouse Gas Removal (GGR) projects and land use & agriculture may be incorporated into the UK ETS in the future. However, there has been no indication of whether the scheme will be linked with the EU.

Alongside strengthening the UK ETS, government is taking an increasingly holistic view of environmental impact. In the next few years, policies will come into effect to expand transparency in industrial and commercial practices, and HMG aims to support a growing market for greener industrial products. Further, the 'Fairness and Affordability' consultation this year will be a first step towards rebalancing electricity and gas prices. These measures, combined with the increasing stringency of the ETS, aim to drive businesses towards decarbonisation.

> *"Emissions are becoming increasingly expensive, and the financial case for energy efficiency and emissions reduction will continue to grow.*
>
> Mark Tarry

Developing the UK Emissions Trading Scheme (UK ETS)

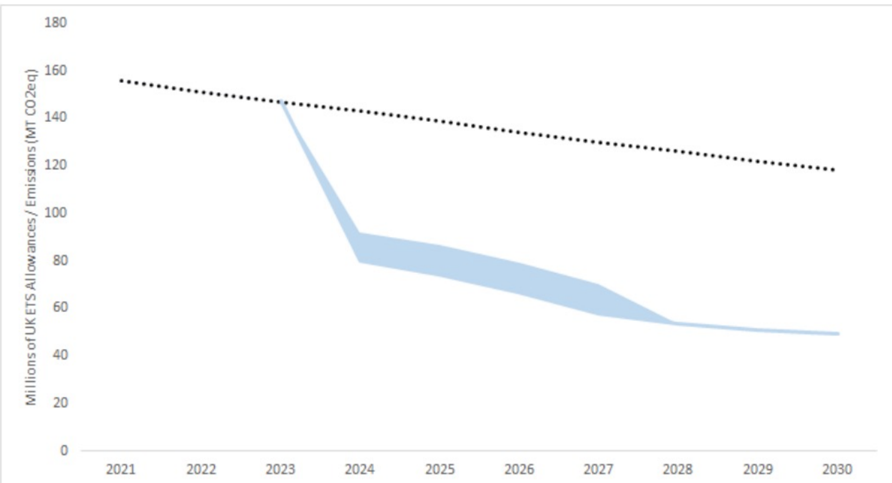

Figure 1.2: The currently legislated cap (dotted line), which is not consistent with delivering net zero, will remain in place until end 2023. The illustrative trajectory below, represented as a range, is shaded in blue.

How could this impact your business?

Industrial and business decarbonisation policies are likely to have knock-on effects when combined with increasingly stringent carbon pricing.

Key points of consideration include:

1. Companies already in scope for the ETS should prepare for the scheme to be aligned with net zero and consider how current proposals will impact business plans (such as tightening the cap and/or reduction of free allowances). The government intends for ETS alignment with net zero to provide certainty for businesses to invest in low carbon technology; forward-thinking companies should consider potential opportunities in this area.
2. Government is progressing towards a holistic view of environmental impact; this may change the scope of industries and practices which are covered by carbon pricing or other reporting and monitoring schemes. Companies already covered by the ETS should consider how this may impact business plans, and those who are not covered may consider how they would be impacted if the UK ETS eligibility is expanded to include them.
3. Forward-thinking companies should consider the financial impacts of upcoming changes. There may be opportunities to take advantage of new markets (such as low emissions industrial products), as well as potential impacts from of upcoming efforts to rebalance electricity and gas prices, aiming to support green choices.

Summary

The recent ETS consultation has indicated Government's intended direction of travel for carbon pricing over the next few years. Following this, it is likely that emissions will continue to become increasingly expensive, with fewer opportunities for companies to avoid paying. Further, industries and smaller businesses which were not previously in scope are increasingly likely to fall under the ETS and related schemes in the future.

> *All businesses should consider whether they are prepared for an increasingly stringent and all-encompassing UK ETS.*
>
> Mark Tarry

Future Policy Timelines

Note: this list is not exhaustive, but rather a representation of key items which have been identified through ongoing monitoring and forecasting work.

Year	Targets, policies, and consultations

2022	Consultations (awaiting response, live, and upcoming):
	
	• **Live consultation:** 'Developing the UK Emissions Trading Scheme (UK ETS)' (UK Gov, closing 17 June 2022). Includes proposals for:
	  • Aligning UK ETS cap with net zero
	  • Review of free allocation
	  • Expanding UK ETS coverage, both within covered sectors and to include new sectors
	
	• **Consultation response:** ''Towards a market for low emissions industrial products: call for evidence' consultation (UK), including proposals for:
	  • Defining low carbon at the sector level; possibly with one definition covering a broad range/all products in a sector
	  • Levels defining 'low carbon' will gradually become more stringent
	  • Demand-side policies to be introduced consistently across targeted sectors and manufacturers of specific products, rather than applying only to large businesses
	  • A rolling approach to the new policy, with some sectors and products to be 'early beneficiaries'
	  • Businesses required to report (at least) at the start of the policy and when there is a change to operational emissions or stringency
	  • The responsibility of supplying data for imported products is expected to fall to those that import or place products on the market, who in turn would be required to collect this data from the manufacturer of the product.
	
	• **Consultation response:** 'Designing a framework for transparency of carbon content in energy products: call for evidence' (UK, closed 2021). The response will likely include commentary and proposals on:
	  • Whether annualized retrospective renewable energy matching under the current framework acts as a barrier to transparency
	  • How to ensure consumers are provided with more transparent and accurate information on carbon content when they are choosing their energy services and products
	  • The role of other forms of low carbon power
	  • Opportunities for innovation that can accommodate flexibility technologies in the future framework
	
	• **Expected consultation:** Fairness and Affordability Call for Evidence, aiming to rebalance electricity and gas prices and to support green choices, with a view to taking decisions in 2022 (UK Gov, not yet published)

Year	Targets, policies, and consultations
2023	• Expected consultation: Proposals for changing methodology of free allocation in UK ETS, scope expansion within covered sectors
2024	• UK ETS cap aligned with net zero (UK, pending confirmation in Government Response) • Further updates to UK ETS, including: net zero aligned free allocation, legislation for CORSIA, removing physical site visits (UK, pending confirmation in Government Response)
2025	• Tax between electricity and gas equalised (UK Gov)
2026	• Updates to UK ETS, including changes to distribution of free allocation (UK, pending confirmation in Government Response)
2030	• 43 - 53% reduction in industrial emissions, compared to 2019 levels (UK Gov)
2035	• 50TWh per year of fossil fuels in industry replaced by low carbon alternatives (UK Gov) • 63-76% reduction in industrial emissions, compared to 2019 levels (UK Gov) • 11 $MtCO_2e$ worth of savings, including up to 3 $MtCO_2e$ of potential abatement in the Iron and Steel sector (UK Gov)
2050	• 87-96% reduction in industrial emissions, compared to 2019 levels (UK Gov)

To find out how AMP Clean Energy can support your business with your Net Zero strategy, contact Stuart Reid, Head of Net Zero Customer Solutions on **07833 231085** or **stuart.reid@ampcleanenergy.com**

These policy briefing papers have been developed and produced in association with Hutcheson Associates.

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