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CARBON LEAKAGE IN THE EU EMISSIONS TRADING SYSTEM

I am writing in response to a question raised during the Select Committee on the European Union's evidence hearing on 15 July 2013, regarding the measurement of carbon leakage as a result of costs related to the EU Emissions Trading System.

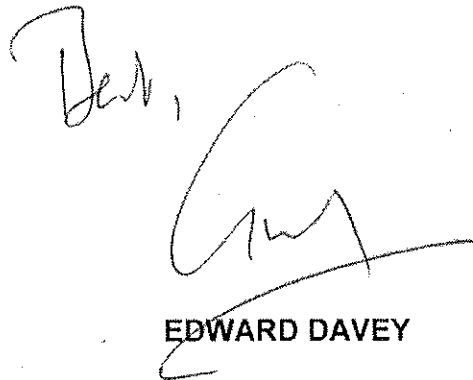
At the hearing, I informed the Committee that my Department has commissioned a study by Vivid Economics, investigating the extent of carbon leakage as a result of direct costs related to the EU Emissions Trading System. The study will also critique the current criteria for assessing carbon leakage risk, and provide an evaluation of different measures to mitigate the risk. The final results of the study are expected later this autumn, and I will be happy to provide the Committee with a copy of the report once it has been published.

The ETS Directive outlines a set of criteria for assessing whether a sector is at significant risk of carbon leakage as a result of direct costs of the EU Emissions Trading System. Sectors are deemed at significant risk where EU ETS-related costs will increase production costs by at least 5% as a proportion of gross value added, and the intensity of trade with non-EU countries is over 10%. Alternatively, where either of these criteria is above 30%, that criterion alone is sufficient to deem the sector at significant risk of carbon leakage. Qualitative assessment may also be used to add sectors to the 'carbon leakage list', to take into account abatement potential, market characteristics and profit margins.

Evidence – including studies by CE Delft, the Oke Institute and Climate Strategies - indicates that only a small number of sectors are likely to be genuinely at significant risk of carbon leakage. However under the current criteria by which risk of carbon leakage is assessed, 176 sectors – with responsibility for 95% of non-power sector emissions under the EU ETS - have been deemed at significant risk, and are therefore eligible for 100% free allocation of allowances up to their sector benchmark. The Government wants to

ensure that, as the total EU ETS cap declines in the future (thereby reducing the total number of allowances available for free allocation), those sectors genuinely at significant risk receive sufficient compensation to fully protect them. We have expressed this view to the European Commission and called for protection to be focused on such sectors.

I am very aware of the real risk of carbon leakage for some sectors, and support measures both to mitigate this risk and to safeguard the competitiveness of UK industry. The Government is committed to ensuring businesses are sufficiently protected, and will continue to monitor and evaluate both the risk of carbon leakage and the measures in place for its mitigation.

A handwritten signature in black ink, appearing to read 'Ed Davey', is written over a horizontal line. The signature is fluid and cursive.

EDWARD DAVEY