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Llywodraeth Cymru
Welsh Government

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Llyr Gruffydd MS Chair, Climate Change, Environment and
Infrastructure Committee
Welsh Parliament
Cardiff
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18th December 2023

UK Emissions Trading Scheme (UK ETS) publications December 2023:

- **Free Allocation Review consultation;**
- **Future Markets Policy consultation;**
- **UK ETS Long-term Pathway; and**
- **UK ETS 2023 Review**

Dear Llyr,

I am writing to update you on progress related to the UK Emissions Trading Scheme (UK ETS) following the Government Response to the “Developing the UK ETS” consultation, published in July this year. This response committed to a series of consultations to continue the development of the scheme.

The UK ETS Authority (formed of Welsh Government, UK Government, Scottish Government, and Northern Ireland Executive) have today published two consultation documents: Free Allocation Review; and Future Markets Policy. These consultations are key to ensuring the scheme continues to function as effectively as possible and encourage industry to transition to net zero. The Authority has also announced two other publications: the UK ETS Long-term Pathway and UK ETS 2023 Review. The Review is a retrospective assessment of how the scheme has operated thus far. The Long-Term Pathway sets a long-term trajectory of the scheme towards 2050.

The Free Allocation Review consultation is the second phase of the process of assessing free allocations, which are used as a way of protecting trade-exposed UK industry from global competitors not subject to carbon pricing (carbon leakage). The first phase looked at the top-down aspect of free allocations by the re-setting of the industry cap, thereby limiting the number of free allocations within the scheme. This was the top-down element as contained within the “Developing the UK ETS” consultation, for which a Government Response was published on 3 July. The consultation published today explores the bottom-

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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

up methodology and looks at ways to better target free allocations for those most at risk of carbon leakage, making sure they are supported in the transition to net zero. It will allow the Authority to provide UK ETS participants with certainty over their future free allocations. This is particularly key for Wales as some of our industries, such as steel, are very trade exposed and harder to decarbonise. They therefore currently receive high levels of support through free allocations. It is important we do not disadvantage Welsh industry; failing to do so will result in these industries relocating to countries that do not have the same climate ambitions, risking increased global emissions and an unfair transition to net zero as a result.

The Markets consultation aims to review ETS markets policy to ensure that it remains fit for purpose and is effective in managing the risks faced by an established and maturing scheme. Effective functioning of the market lies at the heart of the scheme, with auctions and trading of emissions allowances between participants generating the carbon price signal that will spur investment in decarbonisation. The consultation seeks views on the mechanisms and approaches used to keep the scheme functioning effectively.

The UK ETS Long-term Pathway is the Authority response to Mission Zero: Independent Review of Net Zero, chaired by Chris Skidmore MP. Whilst the independent review was commissioned by the UK Government, it contained recommendations for the UK ETS including setting a long-term pathway. The review received strong endorsement by all parts of the Authority regarding the importance of carbon pricing and of the central role the UK ETS will continue to play in enabling market-led delivery of net zero. The document published today therefore gives certainty that a net-zero aligned UK ETS will continue until at least 2050 and reaffirms plans to explore future development and expansion of the scheme.

Also published today is a review of the operation of the UK ETS since its launch – this review fulfils a statutory commitment. The review draws on previous consultations, market and compliance data, and an independent monitoring and evaluation study commissioned by the Authority. The Review concludes that UK ETS has been achieving its purpose and continues to be a key policy instrument for net zero. It also reiterates the Authority's commitments to build on the current operation with policy and operational improvements.

Overall, I believe that the UK ETS remains a highly influential policy lever in achieving net zero in Wales and provides a crucial platform for encouraging businesses to invest in and adopt decarbonisation technologies. The Government Response to the "Developing the UK ETS" also committed to further consultations on expanding the scheme, which the Authority intends to publish in due course. I will of course write to you again when these are published. Collectively, the information gathered will aid us in refining the scheme, allowing us to create more robust mechanisms that will incentivise innovation, drive emission reductions, and secure a resilient, sustainable future for Wales.

I am copying this letter to Huw Irranca-Davies, Chair of Legislation, Justice and Constitution Committee.

Yours sincerely,



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