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CRUNCH TIME ON BREXIT AND CLIMATE POLICY

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Legal Briefings

The UK and the EU27 have said they want a close partnership post-Brexit but this year could test their co-operation on environmental protection in three ways.

Firstly, Brexit could have short term implications for the monitoring and reporting of the European Emissions Trading System – precisely at a time where annual allowances are up for negotiation. Secondly, planning for longer term climate action will become more challenging in the absence of a clear steer from the UK on whether it plans to participate in EU climate schemes and targets post-Brexit. Finally, the loss of a strong proponent of climate action in the European Council could also constrain the EU27's ambition for global climate action post-Brexit.

Despite the potentially far reaching consequences for climate policy the UK Government has not, as yet, published detailed examination of the possible impacts of Brexit. Furthermore, there was no Government climate sector analysis in the documents released by the Exiting the EU Committee of the Parliament, in late December.

THE ETS: A TEST CASE FOR FUTURE CLIMATE CO-OPERATION

Since 2005, the EU's Emissions Trading System (ETS) has acted as a pillar of EU climate action. It was modelled on a domestic scheme running at the time in the UK and its mechanism is simple: companies buy and sell emission allowances in an EU-wide carbon market, which helps reduce the EU's overall carbon emissions. It has since been expanded to include Norway, Iceland and Liechtenstein.

The UK government has stated that the UK remains ‘firmly committed to carbon pricing.’ The European Council conclusions of December 2017 have made clear that the UK would be bound by the same membership rules throughout the transitional arrangement, which is likely to last for a minimum of two years until 2021. But given the UK Government’s intention to leave the Single Market and end the jurisdiction of the European Court of Justice (ECJ) over British laws, remaining part of the EU’s ETS in the long term seems unlikely. At the same time, the EU ETS has been criticised by a number of stakeholders and the system will almost certainly need some reform to render it more effective, for instance by reviewing the size of the Market Stability Reserve. But even then, any adjustments as a result of Brexit will not be enough to serve as a replacement for the structural review of the EU ETS.

Post Brexit, the UK’s domestic emissions targets will continue to be based on the Climate Change Act, which is independent of the UK's participation in the EU ETS. The UK could also look to set up a domestic emissions trading system, which it could then link to the ETS or other carbon trading systems, such as the regional systems in North America. For example, there have been attempts to link the Australian emission trading system to the EU ETS, although this was not pursued due to the repeal of the Australian system in 2014. And while the EU has expressed interest in establishing a link to the Chinese emission trading system and other forms of multilateral cooperation, currently only one country, Switzerland, has a linked trading system to the EU’s ETS. However, discussions took several years and were partly delayed due to Switzerland’s decision to introduce quotas on EU workers in 2016; a decision was only finally agreed in November 2017, once Switzerland reversed its decision around quotas and, together with the EU, had agreed to look into the creation of a joint judicial/legal framework to govern bilateral relations. This highlights the political instability of the sector by sector approach – and the EU’s leverage in certain discussions.

Finally, the UK could introduce an economy wide carbon tax, but abandoning emissions trading and moving to a pure taxation system also brings with it difficulties. Although the 2017 UK Autumn Budget makes clear that carbon prices would ‘continue to target a similar total carbon price (i.e. a combination of the existing ETS and carbon support prices) until unabated coal is no longer used’, the planned closure of coal fired power stations by 2025 indicates only a short term political commitment. Whatever the UK’s future engagement with the ETS, Brexit is raising important strategic choices that need to be decided in the short term. None of these options are simple and would take time to implement, which is why a transitional arrangement with the ETS may be necessary.

NEGOTIATING BREXIT AND THE ETS: BETWEEN TWO PHASES

The timing of Brexit negotiations coincides with important discussions for the ETS. The current phase of the ETS expires in December 2020 and it is still unclear whether the UK will seek to remain within the current phase and even attempt to be permanently part of it; and, if so, the extent to which it can influence debates around future allowances and targets without a formal seat in the European Council. But Brexit will impact monitoring and reporting in the ETS, even before the UK leaves.

At present, participants in the ETS will need to surrender credit allowances for 2018 by 30 April 2019, i.e. after the UK has left the EU, but in the transitional phase. In the absence of a clearly defined transitional period, and the assurance that the UK will remain part of the ETS in 2019 and beyond, British firms may choose to sell all their credits next year thereby flooding the carbon market with a massive surplus of credits. This in turn would lead to a drop-in credit prices, undermine the rationale behind the scheme and, in the worst case, result in its collapse.

To pre-empt such an outcome, the European Commission proposed a legislative change on 25 October 2017, where any credits granted to British entities from January 2018 onwards would be tagged, and become worthless on the day that the UK's exit from the ETS. But this proposal risks creating a two-tier allowances-system, where British allowances would become second level because of the uncertainty relating to their status. As a result, the UK Government suggested that it move its deadline to surrender emission credits forward to 22 March 2019, although this was initially rejected by the EU27 on the grounds that it would constitute a domestic measure and not a Union-wide amendment. The UK Government then threatened that it would derail other legislative reforms to the EU's ETS post-2020 structure unless its amendment was accepted.

On 30 November, the EU27 and the UK did reach a preliminary agreement on the treatment of British credits: the UK would change its submission deadline to 15 March 2019 and in exchange, the EU27 would not tag British credits (at least for now). However, the EU27 have made clear that this agreement would be revisited in 2018, most likely in the spring. If the UK were to leave the EU without a deal that would keep it in the EU ETS, the EU would almost certainly commence tagging British allowances either directly following the decision or from 1 January 2019 onwards, the start of the next monitoring period. Their cooperation already appears to be tested.

BREXITING FROM THE EUROPEAN CLIMATE REGIMES: IMPACT ON THE EU

The UK is also part of the EU's 2020 and 2030 climate legislation. The UK's current contribution to the EU's planned CO2 emissions reductions is above the EU average, which means that a UK exit from the EU ETS would lead to a reduction in the cap which is greater than the reduction in emissions. In order to respect its emissions reduction targets after Brexit the EU27 would need to increase their emissions cuts by 138 Mt CO2e by 2030 (representing about 4.5 per cent of additional efforts). Whilst this may lead to a tighter balance between supply and demand for EUAs, the overall net effect might be relatively small due possible adjustments to the Market Stability Reserve (MSR) and it is likely that the price of EU ETS allowances post 2020 may only be slightly higher than at present.

While the European Commission's 2018 workplan identifies the Clean Energy Package and climate change policies as priorities, revising legislative targets remains politically sensitive and could be further hampered by the loss of UK influence in the European Council. Maintaining the UK in the EU's broader climate dialogue could be mutually beneficial and indeed, desirable.

The UK will also need to establish its own position within the UNFCCC and its own carbon reduction pledge (Nationally Determined Contribution) as part of the Paris Agreement. The UK Government has been a strong advocate over the years of progressive action to reduce greenhouse gas emissions and post-Brexit, the Government intends to 'continue to be a leading actor, working with European and other international partners, in global efforts to tackle major challenges, including climate change'. One way to do this would be to strengthen the current domestic target outlined in the Climate Change Act. The UK could also develop even closer alliances with other like-minded countries, such as Norway or Canada.

As the Brexit negotiations move into phase 2, energy and climate change policies offer an opportunity for the UK and the EU27 to demonstrate that common action brings mutual benefits in meeting objectives of global importance. But before then, some strategic choices will need to be made – and fast. This will be to the benefit of the environment and the Brexit process in general.

This article authored by Antony Froggatt and Georgina Wright, Chatham House, and Silke Goldberg, Herbert Smith Freehills was first published in Energy & Climate Intelligence Unit on 3 January 2018.

KEY CONTACTS

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