



# Department for Energy Security & Net Zero

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Dear John,

Thank you for your letter of 11 July, regarding the Commission for Carbon Competitiveness report 'Fixing the Carbon Leak'.

The Government is committed to putting in place the necessary policies for UK industry to decarbonise successfully. As you are aware, as part of this the Government is exploring a wider package of potential carbon leakage policy measures, with the aim of ensuring that carbon leakage risks are mitigated as all stages of the UK's Net Zero transition. We fully agree that the UK must not decarbonise by deindustrialising. Instead, we are pursuing a green transition which can lead to a transformation and a renaissance in our industrial base and seize opportunities of the global green transition for jobs and investment in UK business and communities.

We are grateful to the Commission for your report, and for sharing your views and insights with the recent consultation 'Addressing carbon leakage risk to support decarbonisation'. Alongside evidence from the broad range of respondents, this will inform development of the UK's carbon leakage policy. As mentioned above, the consultation explored a package of potential measures, including a carbon border adjustment mechanism, providing industry with a strong signal that they can invest in decarbonisation in the UK without fear that their environmental efforts will be undermined.

Any potential measures would need to:

- Respond to the carbon leakage risk the UK faces in a proportionate, targeted, evidence-based, and effective way, which aligns with relevant UK decarbonisation policy including the UK Emissions Trading Scheme (UK ETS).
- Promote and encourage increased climate action both in the UK and globally, including international action to address carbon leakage, and taking into consideration countries' differing levels of development.
- Make the most of global trade opportunities and minimise any additional burden on traders.
- Be compatible with, and deliverable alongside, the Government's key domestic priorities, such as supporting sustainable and balanced growth, by minimising business compliance costs.
- Be designed in line with the UK's international obligations and commitments.

Any new carbon leakage measures would have to work cohesively with our existing carbon leakage policy measures, including the allocation of UK ETS free allowances which is governed by the UK ETS Authority.

The UK ETS Net Zero consistent cap will support our ambitious climate targets and send a clear long-term signal for decarbonisation, which is the primary goal of the UK ETS. The Authority consulted on a range of possible trajectories for a cap consistent with our climate targets. We have chosen to set the cap at the top of that range, which will keep us aligned with our Net Zero goals and carbon budgets, while providing greater flexibility to participants in the market as they decarbonise.

The overall pot of allowances that can be given out for free will reduce in line with the overall emissions cap. However, we are increasing the proportion allocated to free allowances from 37% to 40% of the overall cap. This will help smooth the transition for industrial participants, as well as giving the Authority more flexibility to mitigate the risk of carbon leakage for at risk sectors.

The Authority will maintain free allocations at their current levels until 2026 (subject to any activity level changes processes). After 2026, free allocations will continue, and we are reviewing Free Allocation rules to ensure that support from 2026 onwards is better targeted for sectors most at risk of carbon leakage.

The UK ETS has several market stability policies in place to support the market against a variety of market risks, including sustained high prices. Market policies aim to strike the balance between evolving price discovery and stable price signals. It is vital that market policies can support the UK ETS as it evolves in the future. This is why as part of the 'Developing the UK ETS consultation', published in June 2022, we called for evidence on the future UK ETS markets policy, as the first stage of a two-stage approach to policy development. This included questions on current market stability mechanisms, such as the design of the Cost Containment Mechanism.

We hope you will find this reply helpful.

Yours ever,



**RT HON GRANT SHAPPS MP**  
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**RT HON JEREMY HUNT MP**  
Chancellor of the Exchequer