

**The Rt Hon Vince Cable MP**

Secretary of State for Business  
Innovation & Skills

The Rt Hon Nick Clegg MP  
Deputy Prime Minister  
Cabinet Office  
70 Whitehall  
LONDON, SW1A 2AS

19 April 2011

The Rt Hon George Osborne MP  
Chancellor of the Exchequer  
HM Treasury  
1 Horse Guards Road  
LONDON, SW1A 2HQ

Dear Nick and George,

I have seen Chris Huhne's letter of 5 April 2011 asking for agreement to a number of carbon budget related recommendations made by the Committee on Climate Change (CCC).

I have addressed each of the recommendations individually.

**We should not, at this stage, amend the second and third carbon budgets**

I agree that it is right not to change these levels at the current time.

**We should accept the CCC's advice to set a zero limit on use of international credits (outside of the EU Emissions Trading System) in the second carbon budget period**

I do not see any particular difficulties with this proposal and agree that we should set a zero credit limit for the second carbon budget.

**We should not rule out the use of carbon trading to meet the fourth Carbon Budget**

I agree on the basis that whichever level we decide upon for the fourth budget we should maintain the flexibility to purchase credits.

1 Victoria Street, London SW1H 0ET  
[www.bis.gov.uk](http://www.bis.gov.uk)

## **We should accept the CCC's recommended fourth budget level of 1950 MtCO<sub>2e</sub>**

I have a number of concerns about supporting the CCC's recommended level at this time, even with the option of trading. It is important that we strike the right balance between our pursuit to decarbonise the UK economy whilst ensuring that UK economic growth and employment is sustained. I would ask that HMT's analysis of the macro-economic impacts of this move is shared with colleagues.

I understand that the DECC Impact Assessment shows that this level (1950MtCO<sub>2e</sub>) of abatement may not be technically feasible within the UK domestically; and is not cost-effective on all three measures of cost effectiveness. Specifically, this level is inconsistent with the static view of cost effectiveness, as derived by HMG carbon prices.

Agreeing too aggressive a level risks burdening the UK economy with extra costs which would be detrimental to UK undermining the UK's competitiveness and our attractiveness as a place to do business. My most specific concern in this regard is that the level of 1950MtCO<sub>2e</sub> assumes that we will secure a future EU ETS cap consistent with a 30% emissions reduction target by 2020. If we were not to achieve this ambition it could mean that we would have to move to a tighter traded sector target. This would either involve a unilateral withdrawal of ETS allowances to force a move to a tighter ETS cap, the purchase of international carbon credits or a combination of both.

Moving to a tighter ETS cap risks disadvantaging EU industry to outside competitors and could lead to significant fiscal costs. The CCC's December report highlighted this view with respect to intended budgets for the second and third carbon budget, saying, "It would in any case be highly desirable that any UK commitment to tighten the traded sector budget should be made in combination with similar tightening across Europe." At this juncture, and with energy intensive industries acutely concerned about any further unilateral steps that the UK may make, it is prudent to adopt as a target a level for the traded sector that is consistent with the current EU ETS cap.

DECC's Impact Assessment shows that option 3 (2170 MtCO<sub>2e</sub>) is the only level that is cost effective on all three measures of cost effectiveness, and statically the most cost effective option. However, I recognise the need to show continued wider leadership across the green agenda. Therefore, I would be prepared to accept the more ambitious option 4 and recommend that we accept the CCC's recommendation for the non-traded sector. This level keeps us on course to meet our 2050 target and entails a steeper reduction in emissions than the previous government set for carbon budgets 1- 3, which easily justifies our position as *Greenest Government Ever*.

For these reasons, I am unable to give clearance to the proposal as it stands. I would request that an urgent EAC Meeting is convened to discuss our views and to allow colleagues to fully consider all of the impacts of this decision.

I am copying this letter to the Prime Minister, members of the Home Affairs Committee, members of the Economic Affairs Committee and to Sir Gus O'Donnell.

A handwritten signature in black ink, appearing to read 'Vince Cable', with a long horizontal flourish extending to the left.

**VINCE CABLE**