26 July 2021
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Labour's energy policy: A foreign policy perspective

NEW DIPLOMACY PROJECT

TOP LINES

- Debates about post-COVID recovery plans in the UK, Europe and US highlight the close relationship between energy policy and trade, foreign and industrial policy.
- Labour needs a comprehensive energy policy that addresses the relationship between reducing emissions, internalising emissions in trade policy and decarbonising domestic production as quickly as possible.
- Decarbonisation is an issue of international strategic advantage, as shown by Norway's ability to attract battery manufacturers because of its advantage in hydropower generation.
- The EU's programme to implement a trade carbon adjustment mechanism in 2023 will impose yet more significant trade losses for British exporters on European if the UK does not reach an agreement for an equitable system or equivalence. The 'race to zero' will reward the economies that decarbonise the fastest.
- Labour can establish itself as the party serious on economic matters and foreign policy by building on its green jobs platform. A comprehensive green policy must link economic competitiveness with carbon taxation or adjustment, investment in green energy, battery infrastructure and support for industries to decarbonise their operations.

BACKGROUND

Historically, energy security and foreign policy have been linked by the question of access to resources. Reliable access to oil at reasonable prices shaped British policy in the Middle East, just as the development of the North Sea's oil and gas deposits shaped diplomacy with the Soviet Union and now Russia.

Today, 'access to resources' comes in the form of attracting and sustaining manufacturing supply chains for crucial technologies, from windmill parts to batteries to solar panels, and supporting research and development into newer, more energy efficient technology.

Energy security today is therefore more about industrial, trade and environmental policy rather than the safe and reliable access to fossil fuels. This has important implications for the UK's foreign policy.

China's dominance in green technology

In particular, the UK must grapple with China's dominance in many areas of green technology. As of 2019, 90% of the world's rare earth metals were mined in China, 60% of solar panels were produced in China, 50% of electric vehicles were manufactured in China, and 50% of all cobalt, a crucial input for electronic components, was refined in China. This dominance, and subsequent dependency for the UK, is problematic on many fronts, not least due to concerns about human rights given the role of forced labour from Xinjiang in countless supply chains, including solar panels, as well as the credibility of its climate commitments.

To deal with these concerns, and avoid others, the UK should develop domestic capacity and diversify its supply chains - including working with allies in the EU and US. Decarbonisation therefore provides an opportunity to revive and modernise the nation's manufacturing base, while also ensuring strategic energy independence from China.

The UK's new emissions target

In April 2021, the UK Government enshrined a target in law to reduce emissions by 78% by 2035. Although this ambition is welcome, the target effectively sets a legal mandate without a clear investment, tax, regulatory, and trade program to achieve it. Two days later, Keir Starmer relaunched Labour's £30 billion plan to create 400,000 secure jobs in green energy and manufacturing. The new national emissions target raises a series of policy questions about how to design a sustainable jobs programme, particularly when export-oriented manufacturing and supply chains reliant on the European Union have been hit by Brexit.

The UK-EU relationship

The EU's plans for a Carbon Border Adjustment Mechanism (CBAM) are a looming challenge for UK-EU trade as well as the global trade agenda. The result is that decarbonisation is a matter of export and industrial competitiveness. The emerging economic incentives to decarbonise industrial production and consumption create a 'first-mover' advantage that will reward the states that most aggressively meet decarbonisation targets in the decade ahead.

The UK's nuclear energy market

Without substantial and immediate investment in renewables on a scale never seen before, the UK will need nuclear power to meet its net-zero emission goals.

By 2035, all of the UK's eight existing nuclear plants are due to retire from service. They supply almost a fifth of the nation's electricity. Taken together with the fact that since 2010 26 plants have closed, this presents a substantial challenge to the UK's energy policy and its ability to meet its climate goals.

Five years ago, nuclear power was at the heart of government energy policy with both Labour and the Conservatives backing the creation of a new generation of power plants. However, the Government hasn't been clear on the future of the UK's nuclear power program. Planned plants by Hitachi in Wylfa and Oldbury and by Toshiba in Moorside have been shelved. There are also concerns about the involvement of the Chinese state-owned enterprise CGN in the construction of new nuclear plants at Hinkley Point C, Sizewell C, and Bradwell.

The future of the UK's nuclear power program should not rely on foreign state-owned enterprises to fill the gap in its energy needs. Instead, existing efforts such as the provisional investments made in support of the Low Cost Nuclear (LCN) programme should be rapidly scaled up, particularly because of the future export potential of nuclear power on global markets.

A failure to make proactive investments into domestic nuclear capabilities could leave the UK Government open to foreign governments leveraging their state-owned entities and ownership of key UK infrastructure to gain diplomatic or economic concessions in other areas.

CARBON TAXATION & FISCAL POLICY

The UK suffers from carbon pricing chaos. Each sector and specific markets have differing implicit prices for carbon based on the current tax regime. The Government's approach to dealing with this is to gradually harmonise prices between sectors to raise the cost of carbon, ban the sale of petrol-powered vehicles from 2030, and offer a 'light-touch' investment strategy into green energy, retrofitting, and other decarbonisation measures driven by the private sector. However, the UK's future carbon tax policy remains a gap in this framework.

A unified carbon trading scheme is the simplest, most effective scheme equivalent to the EU's Emissions Trading System (ETS), which allows private firms to adjust its investment preferences based on market prices determined by the supply of available 'credits' to emit carbon. The supply can therefore be steadily reduced to force prices upwards and increase the cost of polluting.

Carbon prices in the EU's ETS have reached record highs this year driven by a tightening of credits in the EU and expectations of more aggressive green policies – prices have broken €50 a tonne with the expectation that it will continue to rise in the future.

The expected implementation of carbon adjustment measures in 2023 will effectively force the UK to adopt a carbon price at an equivalent level to avoid further tariffs due to a regulatory divergence for the sake of manufacturers and exporters. For now, it is yet to be decided if these various pricing mechanisms are applied to every sector equally if at all. If the UK does not follow EU carbon prices as a 'floor' for domestic rates, exports to the bloc may face increased tariff rates and exporters may lose yet more market share. The new UK emissions trading system launched in mid-May and has borne out this dynamic.

A clear carbon tax policy designed to quickly escalate the costs of carbon in a consistent, predictable manner to the EU would allow the UK to bolster international efforts led by the IMF to establish a global minimum price on carbon to prevent future trade conflicts. Furthermore, it could play an important role in attracting future FDI into the UK by making the British economy more competitive on carbon cost grounds. This could be combined with more aggressive state-led infrastructure investment and support for businesses and households affected by the adjustment.

China has only just launched its own carbon pricing scheme that only covers its energy sector, and it will probably be some time before it can exert a significant impact on emissions levels because of the immensity of the bureaucratic and administrative challenges it entails for businesses and regional governments. China's refusal to apply said pricing to its consumers of energy, namely its industries, is telling and is likely to be a source of trade friction with the EU from 2023 onwards.

Reforms to carbon tax policy in the UK could play an important role in helping the UK to relocate more production domestically, which would reduce the carbon externalities of British industry while also improving energy security.

Mitigating cost pressures from carbon taxation

The application of a uniform carbon price requires sector-specific regulatory and fiscal policy to prevent job losses and slower economic activity indirectly caused by higher-emitting sectors. In particular, manufacturing, which has already struggled due to Brexit, and supported as much as 22% of the British economy and 7.4 million jobs in 2020. Increases in operating costs pose employment, investment and demand risks for the sector. Higher operating costs can best be addressed by reducing emissions from power-generation and transport as quickly as possible while staggering carbon price increases.

Fuel-poor households and rural households with higher energy-consumption needs also face income losses without financial compensation until household energy is decarbonised and becomes more efficient. A study by the Grantham Research Institute estimates that if a carbon tax at £50 a tonne were implemented in 2020 and progressively increased to £75 a tonne by 2030, the tax would raise a total of £57 billion over that period of time. Carbon taxation can therefore create a large pool of revenues to support both households and public investments into emission-free infrastructure while mitigating negative effects from the application of said taxes.

Thus far, UK carbon prices have been slightly higher than the EU's ETS system within a consistent band. But a significantly higher price is needed to accelerate decarbonisation efforts further and can be managed with a more expansive fiscal policy framework focused on inflation levels and debt servicing costs rather than an abstract fear of rising national debt levels. Put another way, it is historically cheap to borrow at the moment. Large public investments into low-emissions or emissionless public transit, green infrastructure, upgrades to the national power grid, and funding to foster innovation and commercial adoption of green technologies are easily affordable through the revenues they raise by creating growth and lifting incomes.

Ceding this point to Conservative narratives about fiscal responsibility is a recipe for economic stagnation and climate failure. It also allows the Government to propose projects like the Woodhouse Colliery in Cumbria, the first deep coal mine proposed in the UK in 30 years, as a responsible act to ensure domestic consumers access to British steel using coal that wasn't hauled from thousands of miles away. The refusal to spend public money to create demand, support innovation, and growth slows down the adoption of cleaner production techniques by forcing private firms to make risky investments amid uncertainty about returns with an unclear forward-looking policy.

INDUSTRIAL POLICY

Norway, along with other Scandinavian and Nordic countries, has emerged as a hub for electric vehicle battery manufacturers because of the emissions footprint of its energy mix. Hydropower provides over 90% of Norway's electricity needs, and supports green industrial investment as firms look to reduce emissions along their supply chain. Norway has also used this to attract a growing number of data centres and international technology firms. The global steel industry, which is a huge consumer of energy, is also seeking less carbon-intensive sources and new markets to support future production.

Though the pace is uneven depending on the sector and industry, the trends are unmistakable. Decarbonising power-generation and transport as quickly as possible now makes economies more attractive for publicly-traded firms trying to address investor concerns about climate. Further, a carbon tax can be an instrument to improve the competitiveness of the British economy against other exporters.

However, internalising the cost of carbon through tax raises the cost of production and transport. It is therefore important to complement a tax with public investment and government support. The Industrial Decarbonisation Strategy, presented to Parliament in March, set a wide range of ambitious targets for emissions reduction, low-carbon investment and consumption, and supporting 'green' innovation, but did so relying almost entirely on carbon taxation, regulatory interventions, consumer awareness, and policies focused on financial support such as loans. There is, as yet, also no clear plan to include aviation and shipping in national decarbonisation approaches. Financial support and regulatory clarity are vital as are tax incentives, but directed state spending can generate demand for green technologies, reduce uncertainty for business, and accelerate their adoption and cost deflation.

The March budget announced by Rishi Sunak focused on financial support measures rather than spending:

- A National Infrastructure Bank with £22 billion of "financial capacity", and plans to leverage £12 billion in direct funding and a further power to guarantee up to £10 billion of debt into £40 billion of infrastructure investment.
- Climate goals incorporated into the Bank of England's policy framework, including plans to issue £15 billion in 'green' gilts.
- A combined £3 billion in grants for energy efficiency improvements among homes and businesses dating back to last July remain in place - a far cry from the £9.2 billion the Conservatives campaigned on in 2019 - and have largely not been taken up by the public, due to a combination of Covid related anxieties and the poor design of the programme.

The government's Build Back Better plan lays out a considerable increase in spending on public capital stock, offering a £30 billion increase for 2021-2022 over 2019-2020 spending levels. However, the majority of the funding increase is being funneled into HS2, while plans for electric vehicles, regional rail and other infrastructure are modest. The result is a more piecemeal, slower pace of transition from spending plans more often designed to provide convenient sources of funding for 'friendly' councils needed to maintain a majority, rather than a holistic policy framework that will benefit British exporters, industry and commuters.

In all these cases, the government's approach is largely to spend only what is strictly necessary and let the market sort itself out while relying on the 'middlemen' - banks, consultants, and contractors - to steer investment over time. There is a clear gap between the ambitious decarbonisation targets and failure to provide the most important conditions necessary to ensure the rapid adoption of green technology and low emissions in the form of strong, reliable and consistent demand.

LOCAL INVESTMENT

One of the most effective ways to unlock green investment potential for local businesses and households would be to reintroduce a national feed-in tariff (FIT) scheme for home installations of renewable energy, generally solar, as well as larger options. The Government scrapped the previous plan in 2019, the result of which has significantly undermined councils' ability to borrow through the Public Works Loan Board and partner with private investors to expand local renewable energy. Expansions of local supply will also require additional investment into demand management systems, commonly known as 'Smart Grids' that monitor and adjust supply in response to demand across the network.

Different parts of the UK face unique challenges in their path towards zero carbon. Whilst UK-wide goals are helpful, devolving power to local communities will allow for targeted carbon priorities. One interesting example is the Liverpool City Region, which under Metro Mayor Steve Rotherham was the first region in the UK the first to adopt a zero carbon target of 2040 - 10 years earlier than the national target. Not only does this localised approach allow for parts of the UK to speed up their decarbonisation, but it also impacts UK foreign policy. City diplomacy continues to grow in importance, with cities increasingly becoming global actors in their own right. A stronger devolved approach to decarbonisation will help speed up the whole of the UK's decarbonisation and allow the UK's cities to take a step forward on the global stage and boost the UK's credentials as a leader in this space.

TRADE POLICY

The UK's emissions reduction timeline is already more ambitious than that of most EU countries. This means that the UK may need carbon border adjustment mechanisms (CBAM) applied to imports which go beyond the EU's schemes. This could potentially result in retaliation from EU member states, if the scheme applies to UK-EU trade.

One concern about a CBAM is its effect on emerging economies, which are widely concerned about anticipated export losses arising from the EU's proposed CBAM. This could lead to countries pushing for concessions from the UK and other non-EU trade partners. Because of the complexities of compliance with as yet undecided EU standards and the UK's relative advantage leveraging its financial market and institutions, it makes more sense to pursue non-tariff measures such as access to preferential financing to foster trade with non-EU partners rather than risk trade conflicts over divergence with EU standards on third party trade partners.

Prime Minister Boris Johnson has suggested using the G7 as a forum to coordinate carbon adjustment approaches between the world's leading economies. Since the UK carbon pricing will probably have to conform to EU prices, the UK's interests are broadly aligned with the EU in trying to convince other leading economies to adopt analogous systems. This would also help avoid a loss of competitiveness if the EU reaches a trade agreement with leading economies such as the United States before the UK does. The onus is on the British government to play a positive role in aligning transatlantic climate initiatives to define a role for itself as a 'shaping' power on the agenda.

RECOMMENDATIONS

Given the low cost of borrowing and the enormity of the decarbonisation challenge globally, the Conservative Government should have to explain why they are so hesitant to announce a substantive carbon tax policy, enable local councils to guide green investment, or else increase public spending levels directly into green energy, low emission or emissions-free transport, and decarbonisation. There is little rational economic case to avoid spending more, and most importantly, the Government risks further undercutting the competitiveness of British exporters in the years ahead.

For these reasons, Labour should:

- Recognise that the growing number of foreign state-owned enterprises in the UK's energy markets should be considered when formulating a coherent foreign policy.
- Press the Government to make a decision about the future of the UK's nuclear power program and the participation of foreign state-owned enterprises or foreign investors that pose security concerns within it.
- Propose a program to leverage UK Export Finance's role as an export credit agency to offer preferential financing in the forms of guarantees on commercial loans or directly lent concessional loans to promote the export of 'green' goods and services from the UK to developed and developing countries alike.
- Call for public support measures or else the nationalisation of struggling emissions-heavy firms such as Liberty Steel to not only save jobs, but ensure that adequate investments are undertaken to decarbonise production and preserve the national industrial base.
- Support a carbon border adjustment mechanism, but press the Government on its application of carbon adjustment with developing economies, cuts to aid budgets, and plans to support green investment internationally.
- Press the Government on its refusal to significantly increase spending on decarbonisation, despite the fact that the cost of servicing the national debt is the lowest it has been since 1947.

- Press the Government on the need for redistributive income support for the lowest earners and those unable to work, in order to offset any increases in costs associated with decarbonisation. Revenue from a carbon tax could help with this.
- Encourage a stronger local voice in UK decarbonisation, including through local emissions targets, localised solutions and greater citizen engagement, with central Government funding.
- Strengthen environmental requirements and emissions and externality considerations for public procurement
- Call for a significant increase to the foreign aid budget and propose to offer state-backed lines of credit at preferential interest rates to exporters in emerging markets to partner with British firms to decarbonise their production.

The author

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The paper was also reviewed by an expert who has a background and experience in UK foreign policy and energy policy, who for various reasons requested to remain anonymous.

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