# Summary of NIESR Business Conditions Forum October 2021

*The National Institute of Economic and Social Research (NIESR) hosted the Business Conditions Forum (BCF) on 6 October 2021. The aim of the BCF is to have informed and analytical discussions of data and surveys to better understand the current state of the UK economy. The discussions are held to the Chatham House Rule to encourage free and open discussion.* *NIESR is grateful to the ESRC and the Impact Accelerator Award (IAA) for funding the BCF.*

**Agenda**

The discussion at this meeting focused on the economic consequences of climate change and business preparations needed to mitigate these impacts.

**Main discussion points**

*What are the financial risks posed by climate change?*

The Bank of England Biennial Exploratory Scenario (BES) is run every two years to explore specific risks within the UK financial sector and the scenarios that were launched in June 2021 focus on the impact of climate change. The impact on both macro and climate variables were modelled as scenarios based on the implementation timeline of mitigating policy action:

i. The early action scenario assumes imminent policy action that rapidly reduces carbon emissions and achieves net zero emissions by 2050. In the process of achieving these goals there are some transition risks, but physical risks are minimal. Overall economic costs are relatively low and the impact on GDP is moderately negative.

ii. The late action scenario assumes policy action is delayed for another decade. Under this assumption, the economy would have depleted more of its carbon budget and policy implementation to limit carbon change will be much more aggressive with greater associated transition risks. This represents a confidence shock to the financial markets which results in a mild recession.

iii. A no additional action scenario assumes no policy action is taken, and emissions continue to increase over the time horizon. Severe physical risks both in the UK and globally have the most significant negative impact on GDP over the time horizon, reflecting the global nature of climate change and associated risks.

*How can climate action protect the UK's manufacturing jobs?*

Approximately half a million high-carbon jobs are at risk of offshoring if industries fail to meet climate targets and the UK falls behind other countries on decarbonising the economy. Contrary to standard carbon leakage[1] theory, key high-carbon sectors are at risk not because productive industries move to countries with lax climate policies but because industries move to countries where it is easier to decarbonise their production. The example of the steel industry is enlightening: production of high-grade steel requires coal and competitors in the industry have been seeking technological solutions to produce zero-carbon steel. Green steel projects are taking shape in European countries where there is significant public sector support and investment, catalysing the large private investment necessary. In the face of this innovation, UK steel manufacturers are becoming less competitive and may have to decrease or cease operations, leading to the loss of high-carbon manufacturing jobs across the country.

Implementing the recommendations of the Green Jobs Taskforce would resolve many of these issues, while public policies aimed at supporting green skills and public investment to retool high-carbon industries may effectively future-proof these manufacturing jobs.

*EU Carbon border adjustment mechanism (CBAM): understanding the content and economic impact*

The EU published its carbon adjustment mechanism proposal in July 2021 which outlines their plan to achieve their target of reducing emissions by 55% by 2030. While some countries' trading partners have accused the EU of using climate change policy to protect their own industries, the CBAM facilitates the equal treatment of domestic and foreign producers. The CBAM is part of the overhaul of the emission trading system that will ensure domestic and foreign products are taxed at the same rate, eliminating the threat of carbon leakage, and ensuring the market mechanism works efficiently.

In its current design, the proposal does not capture all the emissions: if importers are unsure of the emissions content of the products, the default values (based on emissions data from the 10% worst performing producers in Europe) are applied, creating a perverse incentive for those producers who do not wish to invest in the complex and costly inspections that reflect carbon content. Given that the EU is an important market for UK exports, changes to the carbon pricing scheme related to the implementation of the emissions trading system means that UK exports may be exempt from CBAM.

The meeting also discussed ongoing work in this area at NIESR, including that using NiGEM and work with the Network for Greening the Financial System.

[1] Carbon leakage occurs when businesses, due to costs related to climate change policies, move their production abroad to countries with less stringent climate policies, leading to an increase in global emissions.

**In the next 5 years, where do you see the biggest risks to your institution from climate-related shocks?**