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DENMARK's response to the European Commission's public consultation on carbon leakage provisions under the European Emission Trading Scheme after 2020.

About the need for addressing the issue of carbon leakage.
The EU's Emission Trading Scheme puts a price on CO_2 emissions. European industry is therefore facing costs associated to reducing emissions and buying emission allowances as well as indirect costs associated to electricity price increases due to pass-through of the emission allowance price in electricity prices. These price increases can in principle lead to the relocation of production from the EU to third countries which have not adopted similar climate policies and regulation. This relocation is often referred to as "carbon leakage".

To avoid the risk of carbon leakage, the Member States and the European Parliament adopted regulation ensuring free allocation of emission allowances to industrial sectors that are considered to be subject to significant risk of carbon leakage. The European Commission has also adopted rules that allow Member States to provide state aid for electricity-intensive industrial sectors.

In Denmark, approximately 70 Danish industrial installations receive extra free allowances because they are covered by the current carbon leakage rules.

The Danish Government considers that there will still be a need for EU regulation aimed at countering the risk of carbon leakage but believes that the current rules should be reviewed. The rules should be targeted towards the industrial sectors that are at greatest risk of carbon leakage.

Assessment of the current carbon leakage regulation.
Several studies as well as the European Commission's impact assessment indicate that there is not so far detected evidence of carbon leakage taking place due to the implementation and functioning of the European Emission Trading Scheme. This can be related to the fact that the price of emission allowances is very low and that the energy-intensive industrial sectors have been allocated free emission allowances.

A number of inexpediencies linked to the current carbon leakage regulation should be addressed in future revisions of the rules:

- Most of the industrial sectors covered by carbon leakage provisions qualify simply because there is high foreign trade intensity within these sectors. In many cases however, these sectors are only to a very limited extent affected by the costs associated with emission trading.

- The risk of carbon leakage is assessed at EU-level for each industrial sector and sub-sector. This assessment does not take into account that the risk may vary across EU depending on the extent industrial installations compete with companies in third countries.

- According to the European Commission's impact assessment most of the energy-intensive sectors have so far received surplus free allowances due to allocation based on historically higher production volumes in the years before the financial crisis. Some assurance against further overallocation is given by rules that in the event covered industrial installations reduce production levels by more than 50 per cent a reduction of allocation of free allowances of at least 50 per cent applies. Installations must therefore annually declare their activity to the national authorities whereupon the authorities decide whether to make an adjustment to the allocation of allowances. As designed today the system results in relatively extensive administrative burdens.

- The European Commission's assessment of the costs borne by industrial sectors is based on the requirements in the Emissions Trading Directive using an expected price of emission allowances of 30 Euro. Using a price well above the current price of approximately 6 Euro is likely to lead to overallocation of free emission allowances.

- The criteria for assessing the risk of carbon leakage set out in the Emissions Trading Directive has in practice resulted in substantial allocation of free allowances to about 175 industrial sectors and sub-sectors, reducing the number of allowances auctioned and thereby also reducing revenue flows to Member State Treasuries.

The Danish government's position
During political negotiations in 2008 on the revision of the Emission Trading Directive Denmark argued for more restrictive criteria for industrial sectors to qualify for carbon leakage compensation rules.

As part of the preparation of the new EU climate and energy policy framework beyond 2020, the European Commission should consider how carbon leakage rules under the EU Emissions Trading Directive could be clarified.

The European Commission should analyse further which sectors can be exposed to a real risk of carbon leakage, including whether new investments in production capacity is likely to be relocated to third countries due to the European Emission Trading Scheme. The European Commission should also make proposals on how this risk is best countered.

Denmark emphasises that the proportion of the total quantity of emission allowances allocated free of charge should be reduced significantly as compared to current rules. The proportion of emission allowances auctioned should be increased accordingly. The allocation of free allowances should be focused on sectors most at risk of carbon leakage. Within this framework, the European Commission should analyse and consider the following elements:

- The European Commission should analyse how overallocation of free allowances to each industrial sector can be avoided.

- The European Commission should consider amending the Emissions Trading Directive's provisions so that the analysis of exposure to carbon leakage can be based on a realistic expected price of emission allowances.

- The European Commission should also consider how the rules for allocation of free allowances based on high foreign trade intensity can be adjusted so that the provision only applies in cases where there is a real risk of carbon leakage.

- The European Commission should examine whether allocation of free allowances within the framework of a harmonised system can be adapted to take into account that the risk of carbon leakage within an industrial sector or sub-sector may vary across the EU. At the same time it should be ensured that the total number of free allowances is reduced while also taking into account how to limit the administrative burdens of such a system.

- Consideration should be given to continue to issuing free allocation of emission allowances to vulnerable sectors based on benchmarks taking into account the most efficient available technologies and fuels. Criteria and benchmarks for the allocation should be updated regularly in the light of technological developments and changes in the price of emission allowances as well as the competitive situation of relevant sectors. It should also be assessed whether allocation of free allowances will continue to be necessary to counter the risk of carbon leakage in the event that third countries introduce climate policies.

- The European Commission should consider and analyse the possibility of allocating free emission allowances for electricity-intensive sectors deemed to be most at risk of carbon leakage in order to compensate for increases in electricity prices that occur as a result of the EU Emissions Trading Scheme. This would avoid or reduce distortions between Member States, which may result from the current state aid rules allowing Member States the opportunity to give aid. Such an initiative can in itself increase the number of allowances allocated for free. Therefore such a scheme should be combined with a general reduction of the number of sectors that may receive free allowances, and a reduction the amount of free allowances allocated to individual sectors, so that the share of allowances allocated for free from the total quantity is reduced.

- The Commission should aim to introduce less extensive and less administratively burdensome reporting requirements in an already relatively extensive and complex administrative allocation system. An important design parameter must be to minimise the administrative burden for both businesses and competent authorities.