

3rd ETS Review Group meeting on 21/22 May 2007

Cefic contribution

The first trading phase is a learning-by-doing period from which accordingly experiences should be used to improve the scheme i.e. as from 2012 onwards. The ETS Review must result in a globally compatible system that assists in enabling industry to meet, in a more cost-effective manner, emission reduction goals and that is consistent with efficient growth and competitiveness. The EU chemical industry is taking an active role in the fight against climate change¹ and offers solutions to improve the environmental and economic efficiency of the scheme.

Any system aiming at reducing emissions must also encourage efficient growth and safeguard competitiveness, i.e. if not applied globally but limited to the EU. While targets may be challenging they must be technically and economically achievable.

National commitments under burden sharing agreements and the design of the ETS should seek to minimize competitive distortions between sectors or installations inside and also outside the EU. Competitive impacts arise from the ETS in the form of indirect costs through electricity prices ('windfall profit' issue), administrative costs e.g. from monitoring, reporting and verification requirements, and compliance costs for direct emissions. The chemical sector is vulnerable to these impacts because it participates in global markets and is unable to pass on these costs to customers. High vulnerability of the chemical industry can be illustrated by the fact that e.g. the chlor alkali industry output the electricity cost of the full manufactured cost is about 50%. Some 60% of the EU chemical industry as a

¹ The chemical industry the European chemical industry reduced energy consumption per unit of production by almost 40% from 1990 to 2004. In the same time, it decreased emissions of greenhouse gases by more than 20% despite overall chemicals production increased by more than 50%. The chemical industry is part of the solution of the climate change challenge also because its products and processes enable other sectors of the economy as well as the end consumers to save energy and emissions.

whole is itself dependent on some form of chlorine product supply.

Currently, by far the most severe cost impact is caused by the windfall profits at the power generators side, and the related windfall losses on the energy user side. The pass through of the opportunity cost of freely allocated EU emissions allowances by the power generators must be addressed as soon as possible.

In order to convince other regions to adopt the EU approach and to ease the market distortions, significant improvements to the ETS need to be made. Until there is international inclusion in emissions trading there should be no further move towards the full cost of carbon through the removal of free allocations for the direct emissions of sectors exposed to international competition.

Performance-based allocation, exclude small emitters

Cefic suggests changing the allocation methodology while safeguarding the legal integrity of emissions trading and maintaining the overall emissions cap. We propose the targeted introduction of performance-based allocation (e.g. through benchmarks) to large emitting, homogenous processes. Other activities may remain allocated with reference to historical emissions where this is the most workable methodology.

The European chemical industry consists of some 27.000 small and medium size enterprises. Cefic advises strongly that small emitters should be excluded from EU ETS since their participation is not cost effective; e.g.: research for the UK Environment Agency suggests that for operators with annual emissions below 25KtCO₂ total costs of participation are at least €3/tCO₂ and can be above €8/tCO₂.

Consider linking allocation to production

The performance-based allocation should be linked to production. This proposal would better meet allocation needs and so would address issues of concern such as relocation of production (“carbon leakage”) and binding of market share.

This approach would be consistent with the current practice of giving allowances to new entrants and withdrawing allowances after closure which is, in effect, a linkage of allocation to actual production.

Allocations can be adjusted for realised production while maintaining the integrity of the cap.

In a further step, the provision of an allowance reserve will allow benchmarked allocations to be adjusted for realised production levels while ensuring that allocations remain consistent with the overall cap. This would ensure allocation needs are fully met, on an equitable basis, and would strengthen the performance signal from the benchmark. This approach also has potential to address the “windfall profits” issue.

Harmonisation

Experiences from the first trading period in the EU ETS and from the notification of national allocation plans for the second trading period highlight the need for a further harmonisation of allocation methods in order to avoid distortions of competition affecting the internal market and EU industries’ global competitiveness.

Auctioning aggravates ETS impacts

Theoretically, auctioning of allowance would be an ideal way of allowance allocation - if applied **world-wide**. However, auctioning limited to the EU will result in a large up-front payment which will harm global competitiveness of EU business and remove funding for research and development, innovative solutions for climate change.

Auctioning emission allowances to power producers will not solve the windfall profit issue but instead turn opportunity costs into ‘real’ costs impacting just the same on the power price formation. Again, these impacts on the power price are unique in the global context and put the EU power-intensive industry competitiveness at stake.

The growing use of auctions causes more bureaucracy and, consequently, rising costs. Any recycling of auctioning revenues will lead to additional administrative procedures and costs while diversity of practice in member states may not lead to leveling the playing field.

Therefore, the chemical industry stresses that the allocation of emission allowances to all participants in emissions trading must be made fully free-of-charge, also in future periods.