3rd stakeholder meeting on carbon leakage

Ensuring effective future protection: What carbon leakage criteria and thresholds for carbon leakage groups

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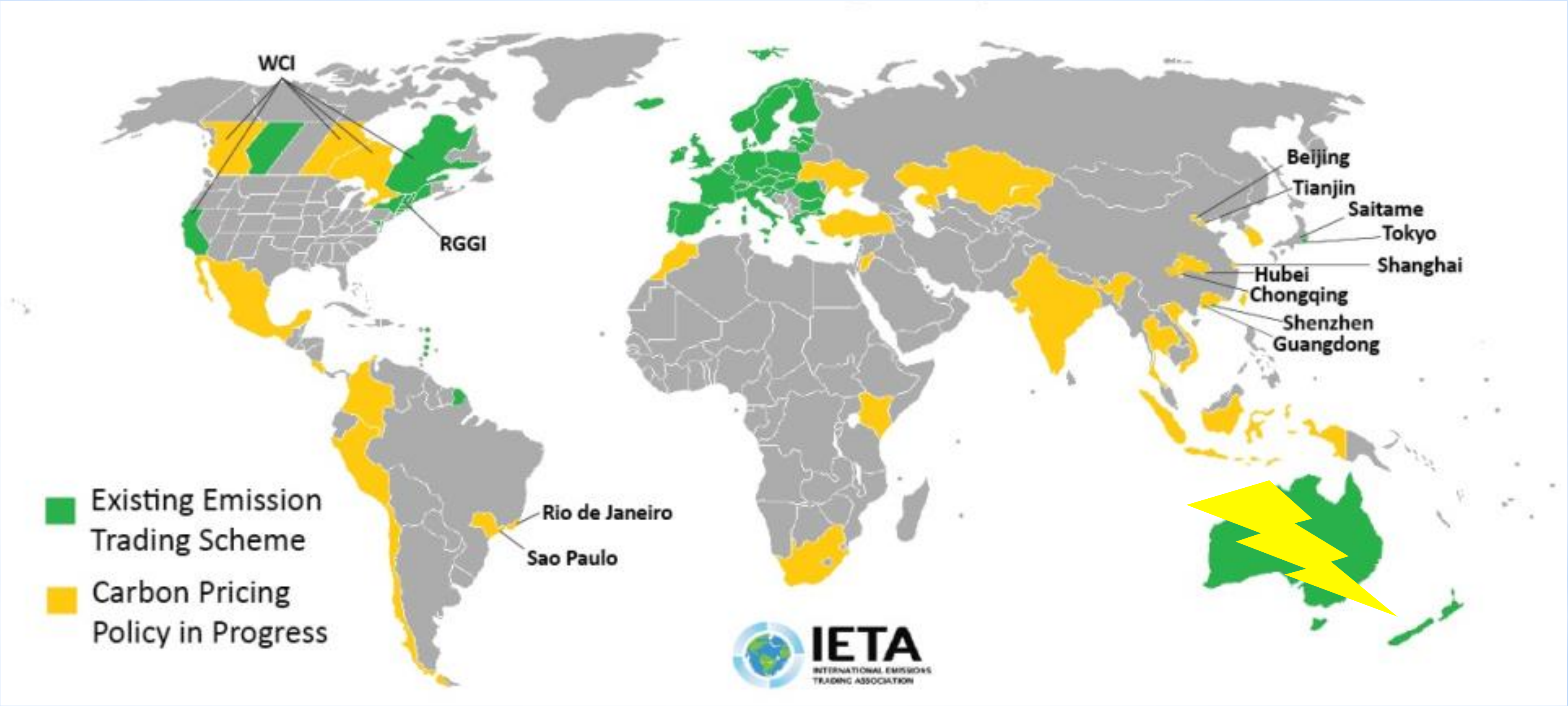
Emissions Trading in 2014



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What's at stake?

Post-2020: Rules to be renegotiated

- EU objective of 80-95% GHG emission reduction by 2050 & includes objectives for all sectors
- Discussion about carbon leakage does not put into question this objective, but it's about determining the allocation process
- Trend towards full auctioning
  - Political indication that no free allowances would continue beyond 2027
    ➔ problematic if no comparable international measures are in place
- 95% of industrial emissions included in CL list
  - As total cap of allowances decreasing → fewer allowances will be available
  - With the current system, there will be insufficient free allowances for those facing a real risk of CL

    ➔ What criteria should be used to determine how each sector will be affected?

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Current criteria & thresholds

- **2 indicators:**
  - **Carbon cost indicator**

$$CarbonCost = \frac{DirectCost + IndirectCost}{GVA}$$

Direct Cost = (Direct Emissions – Free Allocation) * Carbon price

Indirect Cost = (Electricity Consumption * Emission Factor) * Carbon price

  - **Trade intensity indicator**

$$TradeIntensity = \frac{Imports + Exports}{Turnover + Imports}$$

- **3 criteria for a (sub)sector to be considered at risk of CL**

(1) Carbon Cost exceeds 5% AND the Trade Intensity exceeds 10%; or

(2) Carbon Cost exceeds 30%: or

(3) Trade Intensity exceeds 30%

% of industrial emissions currently receiving free allowances

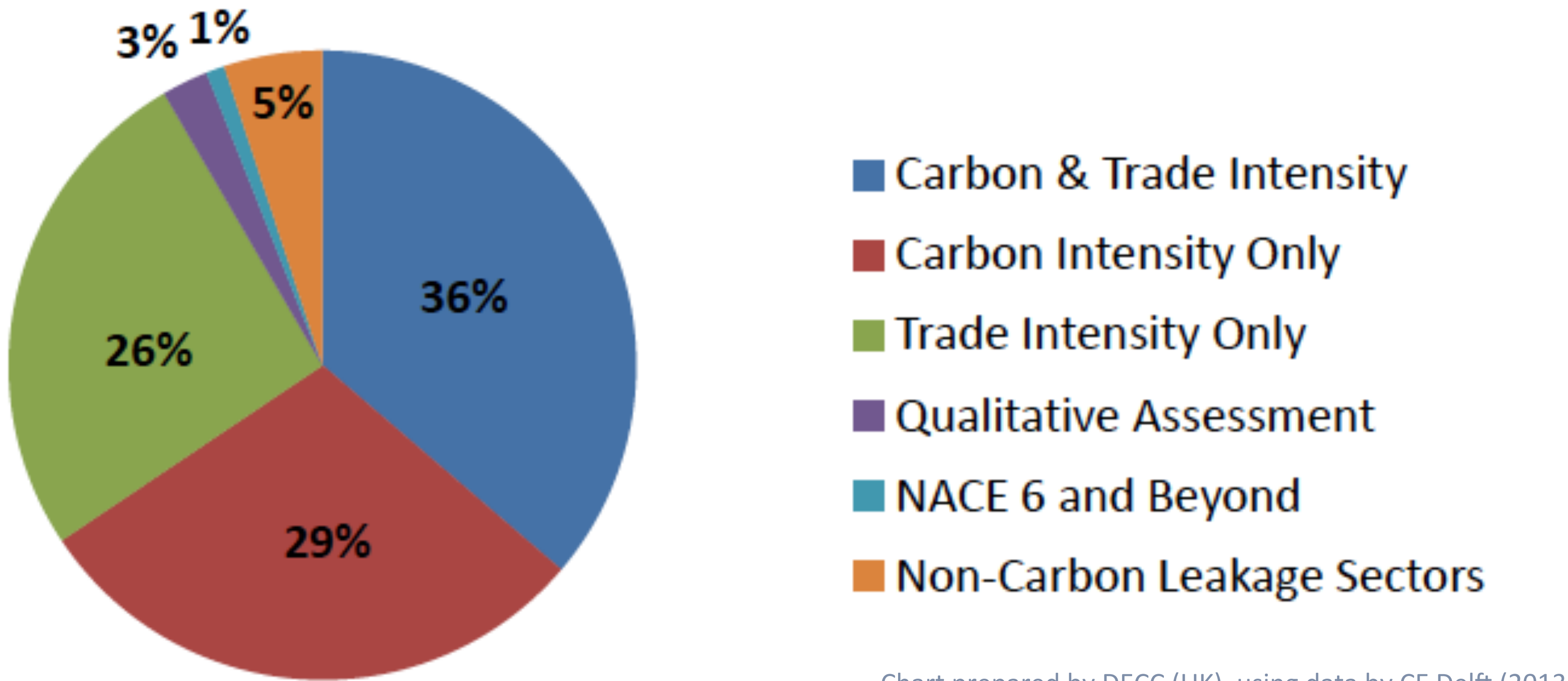

Chart prepared by DECC (UK), using data by CE Delft (2013)

133 sectors are on the CL list because they meet the trade-intensity indicator, representing 26% of industrial emissions

Estimates based on data by CE Delft (2013)

Current criteria & thresholds - assumptions

Assumptions assumed for the indicators

- Carbon price of € 30 per tonne of CO_2 equivalent
- Free allocation assumed in direct cost calculation (in 2013 and 2014: assumed free allocation of 25% for all allowances needed by sectors on CL list)
- An emission factor for electricity of 0.465 tonne of CO_2 per Megawatt
- Cost pass-through assumed at 100% for power and 0% for other sectors

➢ **Assumptions need to be looked at as part of the future calculations for assessing the risk of carbon leakage**

What other variables could play a role for future criteria & thresholds? (non-exhaustive)

- Recognising the **cost of carbon**, which differs from sector to sector
- Recognising **international measures** in place for reducing emissions, rather than assuming a lack of carbon policies outside the EU;
- Possibility to **pass-through costs**
- Recognising **abatement options** available in each sector, when assessing the risk of carbon leakage
- **Price elasticity of demand** (low price elasticity and high potential for product substitution could limit the risk of carbon leakage, and vice versa)
- Should **stand-alone criteria** continue playing a role?
- **Should these assumptions be revised periodically**? How to balance flexible rules with regulatory certainty?

Points for discussion

More targeted list of sectors at risk of carbon leakage?

- Should sectors on a focused list benefit from 100% free allocation up to the benchmark? How is this compatible with a decreasing cap of allowances?
- Or should a wide scope continue to apply, and other ideas be introduced to address the lack of insufficient free allowances?
    - International credits? / reserve ? / financial compensation? / recycling revenues from auctioning? Etc.

In/out vs. tiered-approach?

- Clear rules of an in/out approach also mean it becomes a political decision to include or not a (sub)sector on the list
- Graduated approach may make more sense but does not guarantee adequate compensation for all
- E.g. California & Australia

Political context

- Technical aspects such as criteria & thresholds are increasingly becoming politically scrutinised
- Unless facts-based, and justifiable, carbon leakage provisions post-2020 risk dividing opinions
- Additional requirements & conditions likely to be expected if free allocation continues & is perceived to be too generous

➔ New list should protect those (sub)sectors with a justified risk of carbon leakage due to the EU's carbon policies

➔ Use objective & demonstrable criteria and assumptions that are set at EU level

Thank you

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