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The Key Stakeholders Alliance for ETS Review

Brussels, 21st May 2007

Lowering Production is no Benefit for the Environment, says European Industry

The European Commission declared in November 2006 that the incentive to lower production is seen as a benefit of the EU Emissions Trading Scheme (EU ETS):
"Three major alternatives exist, which are equally legitimate: investing in emissions reductions and selling freed allowances, reducing production volume and selling freed allowances, or maintaining/expanding production volume while buying additional allowances needed".

European industry cannot agree with the "incentive to shrink" and "disincentive for growth". Lower emissions in the European Union do not contribute to a better climate when equal or even higher emissions elsewhere are disregarded. One of the founding fathers of emissions trading, J.H. Dales, proclaimed already in 1968: *"Pollution in one region must never be reduced by increasing pollution in another",* thus condemning "leakage".

Such a policy undermines the commitment of industry to invest in maintaining a European manufacturing base and to pursue R&D activities in the European Union. It cannot be considered good governance. Furthermore, CO_2-emission from shipping would increase in relation to goods that would have to be imported in the EU.

Moreover, the underlying view of a static, frozen economy distorts the integrity[1] of the Internal Market and hampers prosperous economic development and employment.

European industry cannot acquiesce in the loss of industrial competitiveness through high electricity prices caused by the "incentive to shrink". The resulting unprecedented economic rents turn the present scheme into a one-sector winner.

Aims of the Directive

The contested reduction is not intended in the aims of the ETS Directive:

- Council decision 94/69/EC approved the ultimate objective of the UNFCC on Climate Change to achieve worldwide stabilisation of greenhouse gases in the long run (recital 3). The "leakage" of emissions does not support this objective.
- The Directive aims to contribute to fulfil the commitments of the EU and Member States more effectively and with the least possible diminution of economic development and employment (recital 5).
- The provisions of the EU ETS are to contribute to preserving the integrity of the Internal Market and to avoid distortions of competition (recital 7).
- The Directive will encourage the use of more energy-efficient technologies, including combined heat and power, producing less emissions per unit of output (recital 20).
- The Directive establishes the EU ETS to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner (article 1).
- The [national allocation] plan shall not discriminate between sectors (Annex III, 5).

Clearly, the aim of the Directive is to discourage inefficiency and to encourage efficient production growth through innovative and energy-efficient technologies.

The present implementation of the EU ETS achieves exactly the opposite. As a point in case, many reports signal that investments in combined heat and power (CHP) are not encouraged by the present interpretation of the EU ETS.

New entrants

The theory of the static approach stipulates that new entrants must buy all allowances. The Commission states[2] that *"having new entrants buy allowances in the market or in an auction is in accordance with the*

[1] Winning of market share by efficient producers is hindered instead of stimulated, winners must buy allowances for growth. Losers of market share are protected. The present interpretation of rules of the EU ETS forces a penalty payment of the winners to the losers.
[2] Guidance notes on allocation, reiterated in the Commission communication "Building a global carbon market", 13 November 2006, COM (2006) 676 final, page 7.

principle of equal treatment". It is well documented[3] that this practice actually hinders the deployment of low carbon technologies. Obviously if a firm is grandfathered allowances while a new entrant has to pay, competition is distorted[4].

Lisbon strategy, High Level Group on Competitiveness, Energy and the Environment and the Energy Package

The Lisbon strategy aims to promote innovation, growth of efficient production and employment. The HLG reiterated in its second report the urgency to improve on incentives for low carbon technologies and the pivotal role of fair and free competition. The Energy Package road map towards a low carbon economy – in which industry plays an essential role – explicitly mentions that low carbon technologies be encouraged.

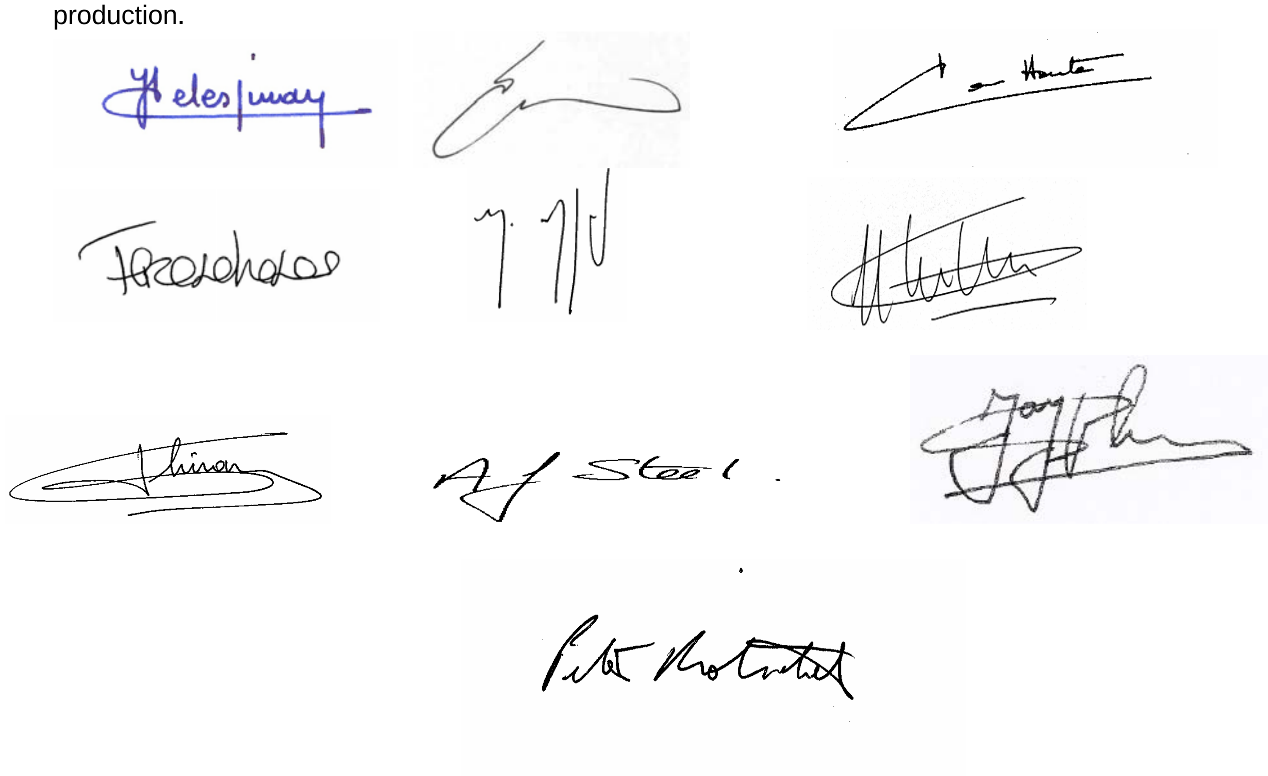
The "incentive to shrink" runs contrary to the Lisbon strategy, the HLG conclusions and the aims of the Energy Package. Therefore, the assumed de-industrialisation of Europe – mentioned in the guidance note on allocation of 22 December 2005 (page 4): *"… the parallel decline of the secondary sector experienced in European economies further contribute to this effect* [improving carbon intensity]" – is ineffective and unnecessary.

Conclusion

European industry calls on the European Commission, the European Parliament and Council to take an early and unequivocal position in the review of the EU ETS Directive against the contested principle in the mentioned communications, notably with regard to the legitimacy of lowering production and selling freed allowances, distortions of the free market and for new entrants the unsolvable problems and threat of unequal treatment.

The statements in the communications lack both environmental and business logic. They run against the intentions and aims[5] of a fair and effective emissions trading.

For the 3rd period, from 2013 onwards, regulatory stability is required to ensure the necessary investments to reduce emissions and to prepare for those investments already in the 2nd period. To this aim, to solve the pressing problems, industry proposes a solid alternative: performance-based allocation based on actual production.



[3] See for example the Stern Review Report page 334 and the CEPS Task Force Report nr 57 "Reviewing the EU ETS – part II", 1 March 2006, page 17.
[4] "The European CO_2 Emissions Trading System and state aid", Stefan Weishaar of METRO, Maastricht University, faculty of law, September 2006, page 5.
[5] Council Decision 2006/512/EC, amending Decision 1999/468/EC laying down the procedure for the exercise of implementing powers, states that European Parliament or Council may oppose draft measures if "the draft is not compatible with the aim or the content of the basic instrument …"

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