

Cefic contribution to consultation on EC proposals of 25 July 2012 on “fixing” the ETS/”backloading”

The European Commission presented on 25 July 2012 its plans to change the Emissions Trading System (ETS) Directive and the Auctioning Regulation.

Currently, about 10,000 plants of energy providers and manufacturing industry in the EU are required to buy and sell emission allowances that define the total emissions cap for Europe, namely the CO₂ the ETS sectors are allowed to release into the atmosphere. Since 2008, the spot price for the allowances has gradually fallen to a low of around €7 per tonne of CO₂, which, according to the Commission, does not drive low carbon investment to the desired extent. The Commission thus proposes to withhold part of the CO₂ allowances allotted to the period 2013-2015 and eventually give them back for auctioning between 2018 and 2020 to temporarily reduce the number of certificates in the market (called “backloading”).

This proposed market intervention is aimed to be achieved through a change to the ETS Directive. This requires approval of the European Parliament and the Council. While the potential economic and social impact of such market intervention with varying backload quantities (400, 900 and 1,200 million tons) shall be analysed only by the end of this year, the Council and Parliament have been invited to endorse the EC proposal.

Cefic urges EU institutions to reject the EC proposal, which would open doors for unrestricted market interference in the ETS and undermine trust in the carbon market.

Thorough revision process – not arbitrary market intervention – needed to strengthen ETS as key EU climate policy tool:

- Cefic supports cap & trade as a market instrument to achieve the agreed greenhouse gas (GHG) emission reduction target as a guaranteed outcome. The ETS is delivering the expected results: Industry sectors covered by ETS are on track to meet the EU goal of a 20% reduction in GHG emissions, and the current carbon price shows that this can be done at a cost-effective price.
- Policy makers cannot plan the economy and the resulting exact demand for emission rights in advance. In a future ETS Review, the current inflexible ex-ante allocation rules should be replaced by dynamic allocation, more tailored to both benchmarks and most recent production output, thus avoiding under- or over-allocation.
- The reduced demand for emission allowances partly results from the current recession. Withdrawing the “surplus” allowances would have the effect of locking in the recession and inhibiting recovery and growth.
- More consistency is needed between EU policies on ETS, energy efficiency and renewable energy. High energy costs already provide a strong incentive for the EU industry to reduce carbon emissions, independently of the ETS. Interfering in the carbon market to push up the carbon price is not the right way to encourage low carbon investments, since these are being supported through other mechanisms and policy tools.
- The EC proposal made on 25 July is not “clarifying” the ETS Directive. It is AMENDING the Directive to give the Commission unconstrained power to intervene in the market via the Comitology procedure, to establish an “orderly functioning of the market”.
- There is no definition of an “orderly functioning of the market” and the circumstances in which it would be appropriate to intervene. The proposed changes would amount to a “carte blanche” enabling the Commission to take any steps it considers appropriate, even retroactively. In short, the ETS would cease to be a free market-based mechanism.

How ETS affects the EU chemical industry:

Numerous power and manufacturing installations of the chemical industry are already subject to the ETS. In the third trading period from 2013 on, this number will increase and include the bulk of GHG emissions from the EU chemical industry.

During the current trading period, the CO₂ certificates allotted to the chemical industry may exceed the demand of individual chemical companies. One major reason for this is companies' early investment in highly efficient power plants (combined heat and power) for energy supply.

In the third trading period, which only begins in 2013, all certificates for industrial electricity supplies will have to be purchased. The number of CO₂ certificates allocated free-of-charge for chemical production is based on very ambitious EU-wide benchmarks (based on the performance of the 10% best installations of a sub-sector). As a result of the diverse ghg efficiencies of plants and their technologies, we expect allocation for many chemical plants to be insufficient to various degrees in the coming 3rd phase of the ETS. Moreover, due to the auctioning of all certificates for electricity generation, chemical companies may face an annual undersupply, very much depending on the economic recovery. Note: There is a direct (need to purchase emission rights for electricity production) and an indirect (carbon cost included in purchased electricity) carbon cost to chemical companies negatively impacting on the global competitiveness of the European chemical industry: The magnitude depends on the trading price of CO₂ certificates.

Background

Why we think EU ETS works:

- **The ETS meets the goal of capping emissions while keeping prices low**
 - ✓ Guarantees that the fixed absolute reduction (-21% cap) will be reached at the lowest possible cost.
 - ✓ Market forces are working as planned, creating the lowest possible carbon price.
 - ✓ The whole idea of a cap and trade system like the ETS is to provide certainty on the environmental outcome and then let the market determine its price. Those calling for a fixed, predictable carbon price are in reality advocating for a carbon tax – which would provide price predictability but no certainty on the level of emissions reductions.
- **Investments in a low carbon economy have increased despite low carbon prices**
 - ✓ “Low ETS prices” are NOT delaying more costly options such as offshore wind and carbon capture and storage (CCS).
 - ✓ Investments for new renewables capacity in the European Union had a record year in 2011, following the previous year's record due to existing incentive schemes.

Proposed policy changes need ‘fitness check’:

- **Pushed-up carbon costs would accelerate carbon leakage (relocation of manufacturing to outside of European Union) and competitiveness loss for EU industry**
 - ✓ Europe is the only region to have a carbon market price resulting from a fully functioning cap and trade system. The direct and indirect carbon costs place a burden on the EU industry in international competition.
 - ✓ Another loser is the environment, as higher costs in Europe accelerate investments in more GHG intensive economies outside Europe. A recent study carried out in Northern European countries points to an increasing risk of carbon leakage for industries such as steel, paper and chemicals.
- **Using the right policy tools for the purposes**
 - ✓ There are multiple policy tools to drive low carbon investments. A cap and trade system like ETS is not the appropriate mechanism to stimulate or subsidise long-term the most expensive technologies like solar power generation, off-shore wind or carbon capture and storage.
 - ✓ A review of several EU directives such as the ETS, Energy Efficiency and Renewables will be needed to ensure a smart set of policies that work in harmony with one another.
 - ✓ The review of the ETS Directive will be necessary to address the shortcomings of the system.
 - i. For example, the problem of a potential oversupply of carbon allowances in a recession and undersupply during an economic boom could be solved by using a dynamic baseline based on the most recent production output, instead of a historic reference period used now.
 - ii. The present rules pose barriers and risks for growth, the New Entrants Reserve (NER) will not yet be refilled when depleted and there is not yet NER defined after 2020. Furthermore there are huge operational risks for investments because the allocation is now based on the 2 highest production volumes in the 3 (or 6) months after start-up thus ignoring usual problems like lack of market demand, still not extended downstream plants or technical start-up problems. The latter do occur more in case of innovative new process designs, which are essential on the road to a low carbon economy.
 - iii. The inherently unstable financial compensation for the increased electricity prices due to the EU ETS is no basis for investments in electro-intensive industries in Europe. This affects the maintenance of existing manufacturing plants and investments for growth. An indirect allocation of allowances complementing the present allocation for direct emissions is a logical solution.
 - iv. The allocation for incumbents may be curtailed by a cross-sectoral correction factor. The allocation for heat from electricity generators suffers from an annual reduction according to the “Linear Factor” (LF). The allocation for new entrants also, thus decreasing the allocation continuously while at the same time a very “top 10%” is also applied. All these correction factors and the early application of the ‘top 10%’ should be evaluated against the background of still zero carbon cost for our main competitors outside Europe (US, China, India, etc.).
 - v. In a world of increasing globalization of production and trade, the certainty that EU ETS sectors are at risk for carbon leakage should be significantly increased. Intermediate assessments, like the ones planned for 2014 and 2019, add to the uncertainty for investors. Such assessments should be transformed to or complemented with assessments of any carbon cost impact of Europe's main competitors (US, China, India, etc.). European business should be sure that any move from 100% free allocation

- according to benchmarks towards more auctioning will only be made if and when most of our competitors do the same.
- vi. Proportionality of ETS scope and ETS objectives: Less than 2% of emissions are covered by 40% of ETS sites; 75% of ETS sites only cover 5% of emissions. It is disproportionate to burden such a large number of plants with EU ETS bureaucracy and costs: Maximizing the ETS scope for trading purposes is not among the declared objectives of ETS Directive.

The chemicals industry and carbon emissions

- ✓ EU chemicals industry supports the EU's GHG reduction target (minus 20 per cent by 2020), and has a track record of reducing its carbon footprint.
- ✓ Between 1990 and 2009, production in the EU chemicals industry, including pharmaceuticals, rose by 60 per cent, while total greenhouse gas (GHG) emissions fell by 49 per cent - from 286.8 million tonnes in 1990 to 147.4 million tonnes of CO₂ equivalent in 2008.
- ✓ GHG emissions per unit of energy consumption have been reduced by 9.4 per cent, and GHG emissions per unit of production, or GHG intensity, have fallen by 67.9 per cent since 1990.
- ✓ The chemicals sector has innovative products that can help lower overall CO₂ emissions, for example materials for more energy-efficient buildings and lightweight materials for vehicles.