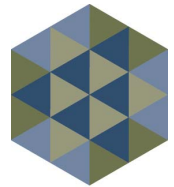


12 April 2010

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Dear Sir

**Public consultation in preparation for an analytical report on the impact of the international climate negotiations on the situation of energy intensive sectors**

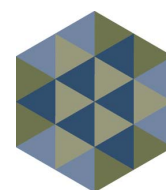
Please find enclosed E3G's (Third Generation Environmentalism) - response to the above mentioned consultation. The main observations and recommendations are highlighted below:

- The flawed concept of “carbon leakage” is not supported by any empirical evidence.
- Developed and developing countries have committed to domestic lower carbon growth since Copenhagen.
- The debate must move away from blunt protectionism to constructive support for new investments through a series of binding sectoral agreements.
- The EU must take a proactive and dynamic stance towards developing sectoral approaches in key developed and developing countries to mitigate against potential international competitiveness.
- Industrial sectors should not be permitted to use Clean Development Mechanism (CDM) permits to offset emissions but support and reward other sectors in the EU ETS that do wish to make reductions.
- Sector enquires into European cement and steel production must be priority actions for the European Commission.

Yours faithfully

Sanjeev Kumar

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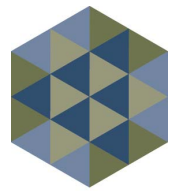
**Question 1** - In your opinion, how have key indicators of the risk of carbon leakage (such as exposure to international trade, carbon prices, etc) for the EU energy intensive industry changes since the adoption of the climate change and energy package implementing the EU's unilateral 20% emission reduction target at the end of 2008?

The flawed concept of “carbon leakage” is not supported by any empirical evidence. The criteria used by the EU to produce a list of sectors that are exposed to “carbon leakage” should not be replicated elsewhere as this was a political decision to protect industry rather than a genuine assessment of international competitiveness. For example, in 2008 the French Presidency of the EU introduced thresholds and additional criteria to ensure that as many sectors as possible would avoid auctioning in the EU ETS. The thresholds mean that irrespective of any changes in the global trade patterns or carbon prices, the sectors included on the “carbon leakage” will not change dramatically. For example, many of the sectors included on the “carbon leakage” list<sup>1</sup> conform to a trade intensity threshold of greater than 30% of Gross Value Added (GVA). This means that the EU's modelling showed that a carbon price of 30€ with 75% auctioning levels in industry did not lead to a price increase greater than 5% of GVA in these sectors. For other sectors, special thresholds were developed to ensure that they were included. Paragraph 16(a) of the EU ETS Directive 2009/29/EC was introduced expressly to protect European cement and lime sectors.

Therefore, it is vitally important to add additional criteria to gain a true appreciation of the competitive picture of industrial installations and sectors.

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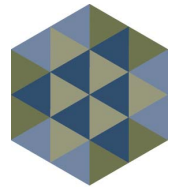
<sup>1</sup> European Commission (2009). Commission Decision of 24 December 2009 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage (notified under document C(2009) 10251) .



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The criteria, which were originally considered by the European Commission, are:

- The elasticity of demand for products from these sectors;
- The structure of the market in which industrial companies operate;
- The level of concentration and ownership structure.



**Question 2** – Do you think that the outcome of the Copenhagen, including the Copenhagen Accord and its pledges by relevant competitors of the European energy-intensive industry, will translate into additional greenhouse gas emission reductions sufficient to review the list of sectors deemed to be exposed to a significant risk of carbon leakage if so, how and why?

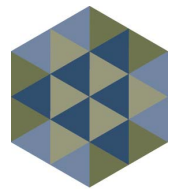
The Copenhagen discussions and the Copenhagen Accord changed the international political landscape on global emission reduction pathways. Prior to Copenhagen, the EU was able to claim that it alone was the vanguard of international efforts to address climate change. However, with the Copenhagen Accord, relevant “competitors” have committed to emission reductions. Clearly, these are not sufficient to deliver the EU’s global of averting dangerous climate change but they do go beyond what was previously on the table in the past. Now it is vitally important that the EU takes another unilateral step and implements the 30% target, both to spur other countries into similar action but also to ensure that the EU receives some benefits from the internal stimulus which was eroded by the impact of the global recession.

Many “competitors” have committed to low carbon stimulus financing to assist their recovery path from the recession. The impact of these plans on stimulating low carbon growth must be taken into account when assessing the overall competitive picture as they are moving ahead outside international discussions. For example, the US and China, two of the EU’s core “competitors” and partners have agreed a unilateral roadmap called the Electric Vehicles Initiative to capture this lucrative market<sup>2</sup>.

The EU must now conduct a thorough analysis of the activities that “competitor” countries are undertaking. This must include the following factors:

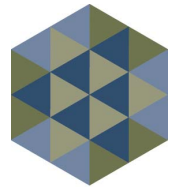
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<sup>2</sup> The White House. “US-China Electric Vehicles Initiative Fact Sheet.” (2009).



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- Scale of domestic emission reductions;
- Relative energy prices and the cost of production including labour costs;
- Demand elasticity for key products such as cement, steel and chemicals;
- Actual energy reduction and carbon management policies for industrial sectors;
- Import/export taxes on industrial primary and finished products;
- Stimulus spending;
- Currency fluctuations;
- Product standards;
- Cost of transportation and actual physical access to European markets.



**Question 3** – In your view, what would be a compelling new general economic or other factor which would require a change of the level of free allocation to sectors deemed to be exposed to a significant risk of carbon leakage?

There are three factors which support the case for a reduction in the number of allowances given for free to industry. They are:

**i) Global economic recession**

Numerous independent studies conclude that the global recession considerably reduces the impact of the EU ETS on industrial installations. For example, the International Energy Agency’s World Energy Outlook 2009 predicts that the banking of allowances into Phase III together with excessive use of cheap CDM credits is projected to result in industrial emissions being “similar to today’s level”<sup>3</sup>. Deutsche Bank recently downgraded its forecast for the EU ETS for the remainder of Phase II due to the volume of excessive allowances in the system caused by the recession<sup>4</sup>. The abundance of allowances removes the stimulus needed to drive wealth creation which in turn will make it less competitive over time. The recession was unforeseen and therefore it is essential to alter the EU ETS cap to at least allow the EU to benefit from the investments that were originally intended with when the legislation was in December 2008.

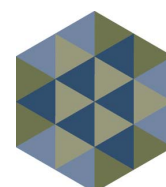
**ii) Internal market competitive distortions**

Current practice on free allocation together with the ability to carry this advantage over indefinitely into future phases causes considerable internal market distortions as outlined below:

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<sup>3</sup> International Energy Agency. (2009). World Energy Outlook 2009.

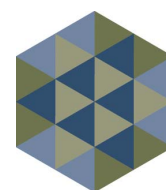
<sup>4</sup> Detuchbank. (2010). “Emissions (still) in remission: ETS forecasts 2010-2012 trimmed.” 7 April 2010.



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Plant <sup>5</sup>	2008 allocation (million)	2008 verified emissions (over allocation)	2009 allocation (million)	2009 verified emissions (over allocation)
ArcelorMittal Stainless Belgium, Châtelet TLB (BELGIUM) [Steel sector]	286,725	185,646 (1,01,079)	286,725	92,818 (19,307)
Corus Staal B.V., locatie IJmuiden (Netherlands) [Steel sector]	10,626,954	6,447,676 (4,179,278)	10,736,308	5,587,863 (5,148,445)
14220-0016 (Germany) [Steel sector]	8,655,981	4,547,719 (4,108,262)	8,655,981	3,152,609 (5,503,372)
CORUS ENGINEERING STEELS, ROTHERHAM (UK) [Steel sector]	170,848	97,310 (73,538)	44,753	170,848 (126,095)
AUBERT & DUVAL (FRANCE) [Steel sector]	51,321	44,339 (6,982)	51,321	33,039 (18,282)
ZAKŁAD WYROBÓW KUTYCH, ZAKŁAD WYROBÓW WALCOWANYCH (POLAND) [Steel Sector]	86,504	92,006 (-5,502)	86,504	87,578 (-1,074)
ŠTORE STEEL D.O.O. (Slovenia) [Steel sector]	28,319	35,090 (6,771)	28,319	18,005 (10,314)
WIELKI PIEC+STALOWNIA ARCELORMITTAL KRAKÓW (POLAND) [Steel Sector]	1,298,939	1,586,155 (-287,216)	1,298,939	848,321 (450,618)

<sup>5</sup> Data taken from EU ETS data issued by the European Commission on 8 April 2010.



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This highlights the general trend indicated by the World Energy Outlook and others that abatement is likely to be very limited within the EU during phase III of the EU ETS. It also shows that some installations have a far greater cushion that they can carry forward. This could be used to avoid having to make new investments or passed through in export prices which could cause complaints under the World Trade Organisation. These concerns are sufficient to merit an internal market review of over allocation.

**iii) Anti-trust developments in key European industria sectors**

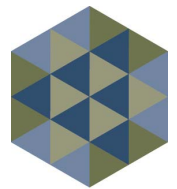
European industry continued to cause concern through anti-trust and corrupt practices. The European Commission, when initially assessing the competitive position of the European industrial sectors identified the significant capital requirements needed to operate in these sectors. It also noted the “significant track record of collusion and infringements of the competition rules” that haunts these sectors and concluded that “if companies pro[ve] to be able to increase prices by collusion, they can not be expected to have great difficulties in increasing prices to a similar extent when facing increased cost of emissions”.<sup>6</sup> There were many instances of this price collusion which emerged whilst Europe was agreeing protectionist measures.

It is now a high priority that the European Commission conducts a full sector enquiry into key industrial sectors covered by the EU ETS to ensure that the price consumers pay is subject to transparent market forces. It is unlikely that a market-based instrument such as the EU ETS will have any impact if it is applied to a sector that does not function on market forces. For example, the European Commission correctly identified that “market concentration in the

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<sup>6</sup> European Commission. (2008). Impact assessment SEC (2008) 52.



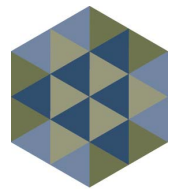


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cement industry is rather high and prone to collusion and the formation of cartels”.<sup>7</sup> On 5 November 2008, during intensive public scaremongering about “carbon leakage” the European Commission raided cement companies across the EU on suspicion of a return to cartel prices. Then on 23 September 2009 the European Commission raided Spanish cement companies on suspicion of other cartel activity. At the national level there have also been considerable attempts by governments to break up corrupt practices. For example, the German government smashed a cartel in 2006 that fixed cement prices at 70€ per tonne. After the ruling the price to consumers plummeted to 50€.

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<sup>7</sup> Ibid.

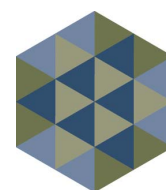


**Question 4 – Do you consider free allocation of allowances as sufficient measure to address the risk of carbon leakage, or do you see a need for alternative or additional measures?**

We do not believe that free allocation is sufficient to address “carbon leakage” because the concept is simply not proven. Importantly, financial support is needed to help industrial installations make required investments in low carbon solutions. Giving away allowances for free to industrial companies without any form of conditionality on their use is a monumental waste for the following reasons:

- Governments forego new sources of income whilst corporations receive a cash bonus for maintaining the status quo;
- Drivers for innovation are dampened leaving plants even less competitive in the long run;
- Employees within the industrial plants are placed even further at risk of job losses because of a lack of investment;
- When plants close down the public purse supports employees whilst private companies cash in the income from the allowances.

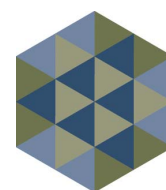
If there is a problem with “carbon leakage” it is up to the EU to be proactive in developing sectoral carbon markets in key developing and developed countries. To deliver this internationally, the EU must first start at home. This requires a new approach to European industrial policy which maximises the full investment potential within key industrial sectors and moves away from blunt protectionism which serves only to delay innovation and economic growth. The current discussion around benchmarking, which is due to finish by December 2010, is an important basis for the creation of sectoral approaches. The architecture of new European industry policy should be:



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- An assessment of each installation's potential for low carbon investment together with cost estimates. Many countries already offer free energy audits to assist industry to identify energy and carbon saving potentials. This will be the basis of a binding sectoral agreement for investment in energy conservation and emission reductions.
- A sectoral cap on emissions is set based on the reduction potential and the volume of carbon finance that the sectors are enjoying due to free allocation and over-subsidy at present.
- Benchmarks agreed with each industrial sector should ensure that allowances are issued for free on a conditional basis so that they will lead to agreed investments. Within this benchmark, a proportion of free allowances are set aside to support employees either with training and skills development or creation and support for apprenticeships and to support employees inadvertently affected by the transition to a low carbon economy. Another proportion of the allowances set aside for the benchmark is used to finance the take-up of monitoring, reporting and verification guidelines and techniques in key sectors in developing countries. This is a vital avenue for extending carbon markets and addressing potential international competitiveness concerns.

For sectors included on the “carbon leakage” list, it is vital that they maximise investments in their European installations. Therefore, they should not be permitted to squander urgently needed finance on international offsets such as the Clean Development Mechanism for compliance. Industrial sectors which are not prepared or willing to invest in their own growth must support the investment potential in other European sectors by purchasing only EUA allowances for compliance. This makes the EU ETS price more robust and stable and rewards sectors and companies who make the right investments. Allowing “carbon leakage” sectors access to offset credits also encourages the loss of European jobs by diverting investments that would have made existing



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installations more competitive and also by giving a financial incentive to shift European production abroad in order to sell credits back to European companies. In effect, the European tax payer pays for the cost of companies not investing in Europe; they also pay for higher social security contributions when companies use free allowances use these to finance production elsewhere and finally, the European tax payer also has to pick up the costs for climate change impacts because European governments were not politically strong and/or competent enough to support 100% auctioning and use the income to finance healthy and prosperous economic growth in their economies.

European industry benefits from excessive free allowances that distort international and internal market competition. Companies will have their electricity bills financed by State Aid and any investment opportunities are offset through access to the CDM. In this context, border measures are the least optimal solution as they unfairly penalise least developed countries and countries not responsible for current climate change problems. As mentioned, the optimal solution is for the EU to deliver a comprehensive international treaty that ensures key nations decarbonise the most polluting sectors. Therefore, all energy should go into designing and facilitating global sectoral carbon markets.

A legislative proposal to include shipping in the EU ETS, which is due to be released in 2011, must be brought forward to encourage development of this sectoral approach which will also have an impact on trade intensity.