EUROFER

European Confederation of Iron and Steel Industries

COMBATING CLIMATE CHANGE

A GLOBAL APPROACH TO FOSTER GROWTH, COMPETITIVITY AND INNOVATION FOR EUROPEAN STEEL




THE CHALLENGE OF CLIMATE CHANGE

Tackling climate change has become a major international priority which can only be effectively addressed if governments, multi-lateral institutions and the private sector work together. Europe's steel industry has made huge progress in the last 30 years in reducing its own greenhouse gas emissions. Between 1975-2005 emissions per tonne of steel produced have been cut by more than 50 %. But as the demand for commodities, in particular steel increases, a global solution is required to ensure a level playing field where all GHG emissions are considered in a fair manner. Efficient installations wherever they are located should be allowed to grow and innovate whereas higher-polluting plants should be penalised or encouraged to dramatically improve their performance.

While the steel industry welcomes the EU taking the global lead in combating climate change through the current Emissions Trading Scheme (ETS), the current system is fundamentally flawed. In particular, it restricts Europe's ability to compete on the world stage and cannot be applied globally.

Key European competitors - the BRICs (Brazil, Russia, India and China) - have stated that they will not join a cap and trade scheme as they have no incentive to join. Reaping the benefits, they will end up producing the amount which European steel companies are forced to cut from production to meet ETS allocations. As a result, China, which has already moved from being a net importer to a net exporter of steel in just four years – will see accelerated steel industry growth, at the expense of EU jobs, growth and innovation.

Steel, one of the few truly global businesses, needs global targets or a global ETS to create a level playing field for European industry. The European steel industry is proposing a Baseline and Credits approach in a revised ETS Directive, which would lead to a globally acceptable model ensuring long term cuts in carbon emissions from the steel industry. If such a system is not adopted the European steel industry will be under real threat.

WHY NOW: what is at stake for the European steel industry in the ETS review?

ETS has been operating since 2005 and is now being reviewed by the European Commission in order to determine the arrangements for post-2012.

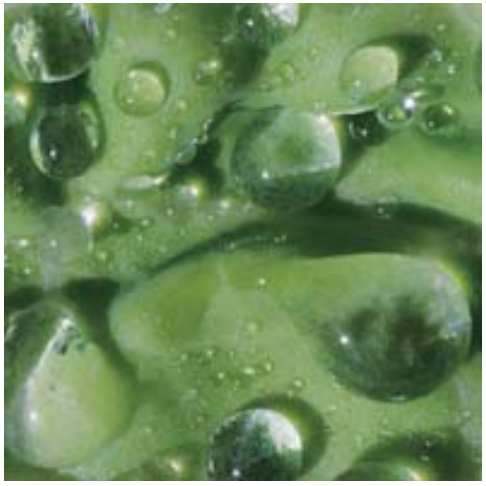
Our objective is to ensure ETS works effectively to achieve a global net reduction in CO2 emissions. Since the start of Phase I, the steel industry has alerted the EU to its concerns about the fundamental problems with the current ETS arrangement. The 30 June Review offers a major opportunity to insert language into the Review, allowing for a fuller discussion on the current system's merits and alternatives. It offers the potential to redesign the system so that it actually works to reduce global CO2 emissions.

We believe ETS requires a fundamental review because the current arrangements are not working. In many cases, ETS is simply exporting GHG emissions from the EU to non-ETS countries, like China.

That's why we are proposing the EU adopts a new Baseline and Credits approach for our sector when it revises the ETS directive. We believe the system needs to be redesigned so that it makes a significant impact on emissions at the global level. This requires a sectoral approach which encourages investment in innovative energy efficient technology, and promotes - not distorts - global competition. Most importantly, a Baseline and Credits approach can foster global industry participation in net global emissions reduction – with or without the implementation of the Kyoto commitments.

Higher-polluting plants should be penalised or encouraged to dramatically improve their performance



PROBLEMS WITH THE CURRENT ETS

Flaws in its conception

Experience with the system since 2005 exposes flaws in the underlying principles of the ETS. It is not tailored to the unique aspects of different industries (where the costs of abatement and opportunities to introduce new technologies vary widely) and fails to give an accurate snapshot of which plants and industries are actually reducing GHG emissions per unit of production.

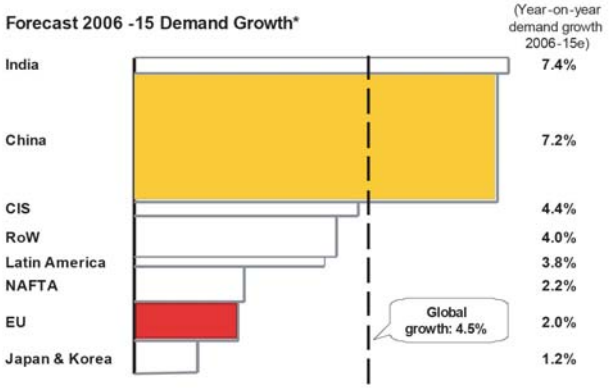
It is failing to tackle world emissions at their source

A fundamental problem with the current ETS is that it is EU-limited. This means that for steel in terms of world emissions it is ineffective. Most world steel production is outside the EU.

Last year alone global steel production was 1.2 billion tonnes. Europe's steel production was only 198 million tonnes last year. China's production alone was more than double that of the EU. IISI estimates that up to 2015, 70 % of the growth in world steel production will be in Asia.

Take into account that specific emissions by Chinese producers are far higher, more than double those of European producers. EU ETS must be seen in this context – it cannot deliver a global reduction in CO2 emissions when it covers only a fraction of direct global emissions.

Yet the present system can never become global, it is deeply unattractive to developing countries such as India and China which will not subject their economic growth to a cap.



ETS leads to export of CO2 emissions to non-ETS countries

Offset mechanisms are depleting and CO2 caps on manufacturers who cannot otherwise reduce emissions force a limit on activity, driving production out of Europe into less environmentally stringent regions, further discouraging major competitors from reducing their CO2 intensive activities should they even have the technological potential to do so. The ETS fails to effectively reduce emissions as it only covers direct emissions, resulting in the delocalisation of emissions outside the EU and increased global GHG emissions.

Only about 30% of the world's steel producing countries have signed up to the obligations of the Kyoto agreement, whereas 90% of all new capacity is being developed in the 70% not covered by a Kyoto obligation. We need a scheme that can be extended globally so that steel companies across the globe can make their contribution to overall CO2 reductions.

Chinese production is about 356 Miot and has twice the emissions rate per tonne crude steel



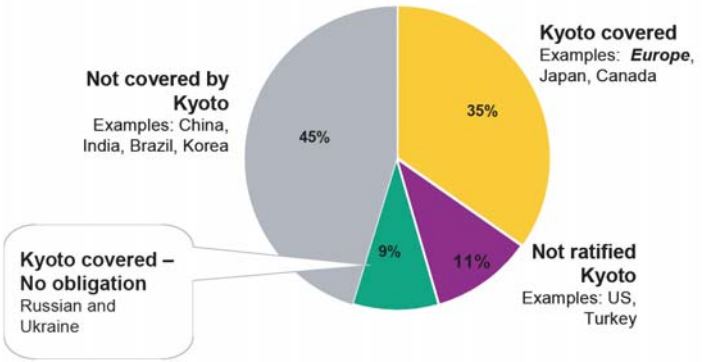

PROBLEMS WITH THE CURRENT ETS (cont.)

ETS distorts competition in the global steel market

Key competitors in the developing world are reaping the benefits as production cut in Europe is transferred to their economies, which have less stringent environmental regulations.

Having increasingly carbon intensive economies, the incentive to join a cap and trade system is further reduced. Accepting a cap would entail driving out the recent economic advantages, increasing the up-front cost of new, more efficient technology.

In addition, the current ETS is one of the important factors in the recent rise in the price of electricity, which has been seen across all major EU economies. Up to one third of the increase in the UK wholesale price of electricity since 2004 can be explained by the inclusion of the price of carbon (Source: Correspondence with DTI). Across the EU, it is giving electricity companies excess profits without actually requiring them to do anything in terms of abatement.



The present ex-ante allocation system is impractical and distorting

Carbon allocations are made years in advance often on the basis of a reference year which bears no relation to current or future market conditions. The scheme's ex-ante nature forces industry to estimate future production far in advance, when the actual market conditions cannot be foreseen more than 2-3 months ahead. In addition, the use of offset credits as a safety valve discourages investment in efficient technology within the EU.

No penalties for underperformance and no incentives for innovation

ETS also lacks a penalty for the worst performers and offers no reward for investing in energy efficient technology. The ex-ante allocation means the needs of individual European companies and their ability to grow is unaddressed. Installations receive their allocations regardless of their efficiency and nothing is done to recognise past efforts to improve or to provide incentives to improve further – it is a recipe for stagnation.

there is no level playing field and emissions are transferred from Europe to uncapped regions.




IMPACT OF CAP & TRADE ON EUROPEAN STEEL

The ETS is having a damaging effect on the European steel industry. It is unable to pass on costs of CO2 allowances and the huge increase in electricity costs to consumers. Steel, which is one of the few truly international markets, is price, not supply-location driven. With prices already pushed up as a result of electricity cost increases, this is having a direct impact on European steel's ability to compete in the global market. This has been acknowledged by the European Commission's McKinsey report, which states that as Steel is unable to pass on the additional costs of ETS to consumers, the industry is squeezed from both directions.

This will worsen if the current ETS scheme continues from 2012 without some important changes, potentially creating irreversible damage to the European steel industry, with the knock-on effect on European unemployment, a loss of knowledge, world-class expertise and R&D.

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IMPACT OF CAP AND TRADE WITH AUCTIONING: WORST CASE SCENARIO

This is seen by some as the best way of allocating CO2 in the future. In a cap and trade system the cap already establishes the price of carbon. However, auctioning would not change the level of the cap or the price of carbon. It would simply be an additional burden on industry which already faces enormous direct costs due to ETS. For steel and other energy intensive industries exposed to worldwide competition and which cannot pass on the additional costs to their customers this would be disastrous.

At only €10/tonne CO2, the extra cost to EU steel producers could be over €3.3bn per annum.

ETS has already pushed up costs, and auctioning under ETS will simply represent an additional tax which will further impede the ability of EU industry to invest to build efficiencies to improve their carbon performance. It will directly impact on their competitivity and on jobs and will drive operators from the EU.

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THE BASELINE APPROACH

The baseline and credits system would eliminate many of these concerns.

We believe that this Baseline and Credits system is the most effective in delivering real, lasting and global change to the way industry combats climate change. The system directly rewards CO2 efficiency and encourages innovation and new technologies including carbon capture and storage, with major advantages over the current ETS.

What we are proposing therefore for post-2012 is a mandatory emission trading scheme specifically for the steel sector

Baseline and credit is an approach that:

- focuses on relative plant performance instead of absolute level of output;
- that promotes reduction in emission per tonne of production through improvements in efficiencies rather than just imposing a cap on production levels.

How would it work?

The baseline is the weighted average of emissions per tonne of production for the sector. This would serve as the basis for the allocation of allowances per plant.

The performance of each plant is compared against the baseline. If they perform worse than they must pay for allocations traded from operators performing better than the baseline.

The price of these allocations will be set higher than the cost of investments in efficiencies. There is therefore a clear incentive to invest in efficiencies.

As efficiencies take hold, the baseline or sector average of emissions will move down, which will drive further investments in improvements.

So, the allocation system, which will be ex-post, will be truly performance-based with a clear discipline to improve performance.

BASELINE: THE ADVANTAGES

- delocalisation of emissions is avoided – we include both direct and indirect emissions. The Baseline approach therefore guarantees emissions are not simply taken out of Europe only to be transferred to the uncapped world;
- unlike the present ETS there is a real incentive provided to improve performance without damaging economic activity in the EU or the competitivity of the sector. There is a dynamic process through which Baseline will drive continuous efficiency improvements and emission reduction;
- most importantly, the system has a real potential to become global to fight climate change. To fight climate change, the EU needs a globally transportable model;
- The system is based on sector performance and not arbitrary national allocations, this will expose poorly performing facilities irrespective of their geographic location, to force a global cut in net emissions and provide a big premium for innovation.

Furthermore, with no barrier to production growth and by penalising inefficiency, a foreseen further 10% reduction in emissions ensures a swift decrease in the baseline. This would lead to European steel contributing an overall 30% reduction by 2020 and aims, with new technology, at achieving a 50% CO2 reduction per ton of primary iron produced beyond 2020.

The system directly rewards CO2 efficiency and encourages innovation and new technologies




THE BASELINE APPROACH: A GLOBAL MODEL

Key competitors, India and China, have already indicated their support for a global sector specific approach. Compatible with the existing Kyoto mechanisms, the proposed system is also executable outside of the Kyoto Protocol.

Using a baseline approach also allows European companies to generate emissions allowances from JI (Joint Implementation) and CDM (Clean Development Mechanism) investments in non-EU countries, enabling emerging markets to engage in climate protection.

A Baseline and Credits system would help prevent the relocation of the European steel industry abroad and would support a global reduction of CO2 emissions.

CONCLUSION

European steel is ready and willing to take on its share to reduce greenhouse gas emissions. The steel sector internationally (IISI), aims to come forward with worldwide commitments on measurable emission reductions within the next six months. A Baseline and Credits system would help prevent the relocation of the European steel industry abroad and would support a global reduction of CO2 emissions.

A highly competitive international industry, driven by technological innovation, European steel makes a significant contribution to EU and global growth. The EU steel industry unanimously supports a market-based instrument that focuses on performance that can act as a global template. We urge the European Commission and Member States to consider this alternative model, and take action to ensure that post 2012, we have in place a system that truly tackles the problem of climate change and the increasing global GHG emissions that will result from the growing demand for steel.