27 February 2013

Cefic contribution to consultation EC Carbon Market Report

The European Commission presented in November 2012 its Carbon Market Report containing six options and measures for structural changes of the EU ETS.

- **The European Chemical Industry supports the ETS concept of carbon trading** and consistent energy, climate and industry policies that enable innovative growth and reward performance improvement achieving agreed targets cost-efficiently.
- **The ETS is delivering on its primary objective, achieving the agreed GHG emission reductions for 2020 at the lowest cost**. Investment decisions for until 2020 have already been made in economically difficult times - relying on the current regulatory framework's stability.
- **Cefic provides robust, dynamic solutions for stimulating carbon-efficient investment and growth in Europe beyond 2020** through a holistic review strengthening the regulatory consistency with a longer-term vision for the EU in the global context.
- **The Commission's short-term ETS 'quick-fix' options for before 2020 are narrow, alleged choices only label differently same but counterproductive EU target inflation**: Unilaterally increasing the EU's GHG targets by removing allowances in different ways will not solve structural EU policy flaws. EC fixes instead increase European companies' regulatory risk, increase their exposure to EU's energy cost handicap and carbon leakage risk leading to net GHG emission increases globally, accelerate loss of EU manufacturing and employment.
- **The EU ETS must not be turned upside down into an instrument pushing up the EU carbon price** in order to extract resources for increasing government revenues or for subsidising most costly abatement technologies. Too many policy objectives will weaken the ETS efficiency.

The European Chemical Industry supports the ETS concept of carbon trading

Europe needs consistent energy, climate and industry policies that enable innovative growth and reward performance improvement achieving agreed targets cost-efficiently.

The industry sectors covered by ETS have already achieved huge gains in terms of energy efficiency and reduced emissions. The European chemical industry has halved its carbon emissions while its production grew by over 70% since 1990.

Cefic has consistently advised towards a dynamic, efficient growth-oriented scheme.

The ETS has no end date and the -1.74% reduction factor implicitly defines a GHG emission reduction target and visibility beyond 2020, e.g. for 2030, already. Neither technical nor economic impact assessments have yet been provided supporting the achievability of such an absolute reduction path. Moreover the absolute reduction path is not matched to economic activity, which could lead to investment leakage, even for the most sustainable and innovative production routes. Short-term, arbitrary market interventions and measures as proposed by the Commission within the third trading period before 2020 fall short of providing the appropriate framework in a world of global competition also in a continued absence of a globally agreed, equitable climate policy.

For any further questions please contact Dr Peter Botschek, tel. +32 2 676 73 97 (pbo@cefic.be) .

The options offered by the Commission are incomplete, offer no true choices and lack a longer-term vision: When describing the current carbon market, the EC does not consider thoroughly in the required holistic manner complexities of existing EU and national energy, industry and social policies, their often conflicting interactions and cost implications (e.g. renewables support schemes and energy efficiency measures both impacting on the carbon market). It is worth noting that not the absolute level of EU-specific costs, but the relative level compared to the global competitors is relevant for the EU industries' competitiveness.

The Commission also fails to address the global dimension of EU climate and energy policies, namely on the cost of energy for consumers.

Cefic remarks on the various short term options proposed by the Commission

Option a: Increasing the EU reduction target to 30% in 2020

In line with the standing EU climate policy position Cefic is against a unilateral increase of the EU reduction target, i.e. in the absence of comparable commitments and burdens around the globe. EU climate achievements could be jeopardised and counterproductive effects on the global climate would be provoked if the EU were to aggravate unilaterally domestic conditions for the economy.

Option b: Retiring a number of allowances in phase 3

Retiring of allowances even exceeds the current EC 'backloading' proposal. Cefic opposes strictly both backloading and retiring. The current target for the ETS sectors will be achieved cost-effectively and there is no justification to intervene to increase the cost for EU industries and consumers.

Option c: Early revision of the linear reduction factor

Cefic rejects the idea of an intervention in the ETS in phase 3 i.e. in the absence of a global climate policy agreement. Such intervention would not improve but directly worsen the measures against carbon leakage without any environmental need. Moreover, it would decrease allocation for new entrants competing on international level further below the benchmark, which would create an even more negative investment signal putting EU's global and domestic market shares and employment at risk.

Option d: Extension of the scope of the EU ETS to other sectors

In principle, an inclusion of other sectors such as transport and housing should be investigated in more detail. There are already technology and product solutions for these sectors to increase their energy and GHG efficiency. The use of these existing potentials and solutions could be further encouraged, i.e. if overall costs can be kept in balance. However, the aim of extension of the scope to other sectors must not be a backdoor measure just to cut the supply of allowances. Before considering the extension of the ETS scope, the design and proportionality of the ETS should be properly revised and improved. In any case, the broadening of the EU ETS should go together with an appropriate adjustment of the cap.

Option e: Limit access to international credits

International credits have been introduced to encourage global action against climate change. These credits build the link to other emissions trading schemes. Since climate change can only be solved globally Cefic is against restricting or even abolishing such options. Furthermore, credits can help limiting local abatement costs and risks. Accordingly limiting unilaterally access to credits invites cost risks for domestic companies and weakens EU's position and influence at global climate policy negotiations.

Option f: Discretionary price management mechanisms

The introduction of a price floor and the introduction of a price management reserve would change the current ETS system entirely: Currently the carbon price can be formed freely according to the predefined allowances quantity and supply and demand at the lowest possible cost. These price-determining mechanisms would turn the carbon market into a tax-like instrument prone to political – possibly arbitrary – intervention. There are no criteria for the "right" carbon price either.

Cefic analysis and improvement opportunities to reinforce ETS as an effective market tool for after 2020

Cefic and other stakeholders continue to make constructive, dynamic ETS design proposals.

Such reforms for the period beyond 2020 can provide the structural effects desired by all stakeholders i.e. a more dynamic approach leading to a balanced market while at the same time fostering growth and rebalancing competitiveness. Cefic and other stakeholders had made constructive, dynamic ETS design proposals which were not taken up by EU policy makers when the ETS Directive had been adopted. The EU ETS has improvement potentials keeping agreed policy objectives whilst balancing allowances supply and demand through structural reforms.

ETS weaknesses and Cefic recommendations:

- Emerging emissions trading schemes in other world regions (e.g. Australia) are learning from the EU ETS experiences and apply important improvements, such as working with realistic benchmarks based on the weighted average (rather than the best 10%), indirect allocation for electro-intensive sectors (rather than diverse, liquidity-dependent financial compensation), ex-post correction of allocation (rather than frozen 'ex-ante' allocation) and reductions that reflect economic activity. EU companies will be disadvantaged i.e. in the event that those schemes are linked.

  EU ETS and emerging schemes should converge to enable optimised globalisation of smart, cost-efficient policy.

- The absolute target setting combined with frozen 'ex-ante' allocation (fixed historic production output reference) together with unworkable and risky allocation rules for growth even reward relocation of production and investment leakage to outside EU, limit EU growth and counteract EU economic recovery. Benchmarks and a decreasing absolute cap do not provide sufficient protection for most efficient manufacturers against extra-EU competitors.

  Cefic recommends introducing relative targets based on economic activity and dynamic allocation (e.g. moving to actual production or a rolling average output reference) based on achievable benchmarks without reduction factors enabling efficient, climate-friendly growth in all sectors. Building in flexibility (i.e. as long as no global agreement), avoiding over- (in case of recession) and under- (in case of production growth) allocation of allowances.

- The EU ETS overlaps with and is affected by other policies, i.e. renewables targets and support schemes; efficiency measures while an effective link to innovation and research and development is missing.

  Cefic advises towards improved coordination avoiding a multitude of overlapping, incoherent EU and national targets and policy mixes certainly for after 2020. Keep RES costs separate for industry sectors covered by the EU ETS, turn subsidy-dependent RES into market scheme (including RES costs also costs from intermittent energy generation) to make RES competitive short-term. Link revenues to innovation, R&D. Cefic sees the EU policy on renewable energy and the EU ETS as complementary tools as long as there is no globally linked carbon market and as long as the marginal CO_2 reduction costs of renewable energies are significantly higher than those in EU ETS.

- Due to the lack of a functioning power market across Europe and due to a lack of competition with other suppliers from outside the EU, the EU power industry can pass on carbon costs to the consumers. This affects the competitiveness of i.e. power-intensive sectors such as the chemical industry (that cannot pass on such EU extra costs) and thus affects the low-carbon efficiency of the scheme (increased risk and likelihood of carbon leakage).

Cefic recommends allocating direct and indirect emission on a same footing, considering a separate policy approach for the power sector provided carbon cost efficiency is safeguarded. Indirect free allocations related to indirect carbon emissions for industrial power consumers will simplify and make obsolete the (27 different!) incomplete and uncertain national (voluntary) financial compensation schemes for sectors exposed to a significant risk of carbon leakage.

- The New Entrants Reserve is not defined for after 2020 and risks to be depleted limiting growth perspectives and adding imminent policy risk for investment for the EU economy.

Cefic recommends the New Entrants Reserve could be transformed into an 'EU Central Reserve Bank for Efficient Growth': A dynamic cap ensures that e.g. during times of crisis or recession, unused emission allowances can be put into the reserve and dynamically reallocated to ETS sectors and the market in times of economic recovery and growth according to agreed rules.

- The EU ETS is very complicated and disproportionate regarding the thousands of companies covered, i.e. SMEs: 40% of the ETS sites stand for only less than 2% of total covered emissions; 75% of ETS sites only cover 5% of emissions.

The proportionality of the ETS scope should be reviewed accordingly.

- The assessment of the Carbon Leakage List each five years creates uncertainty and an unnecessary risk for industry. A sudden significant drop in the allocation volume threatens maintenance investments of existing installation needed to stay in Europe and threatens the needed investments in new production capacity so much needed for the recovery of the economy.

In order to secure Europe's competitiveness, Cefic advises to maintain stable the carbon leakage status (as long as no global agreement setting a level playing field is reached). Current assessment methods should be complemented by inclusion differential costs for carbon emissions, feedstock (ref. shale gas), natural gas and electricity with the main competing regions and economies.

- Europe already bears much higher energy costs than other world regions and there is a consensus that Europe needs to develop affordable low-carbon technologies as a solution. The chemical industry is a taking a lead in this regard.

Cefic is open to discuss options and roadmaps towards a carbon-efficient economy and advises to strive for a competitive carbon-efficient economy by 2050 through a smooth transition where low-cost, competitive abatement technologies will be developed and put into operation first and gradually over time maintaining competitiveness at all stages of the process. The choice to roll-out extensively technologies that are not fit to current market conditions and on top cannot offer energy according to demand curves would in turn trigger a multiplication of production capacities and infrastructure to be build. Therefore the EU energy policy must make the right choices depicting the energy portfolio towards progressive renewable energy technologies that do pass the test of the market conditions and that are capable of serving energy needs without excessive accompanying capacity and infrastructure costs.