

SABIC in Europe

Energy & Climate Services

Response to the European Commission consultation on Structural Reform of the EU Emissions Trading Scheme

Introduction

In its 'Report from the Commission to the European Parliament and The Council' the European Commission proposes both a short-term measure, the backloading of 900M tonnes of allowances from 2013-2015 to 2019-2020, and six non-exhaustive options for structural measures to improve the operation of the EU Emissions Trading System.

SABIC welcomes a proper and informed debate on the current functioning of the EU ETS. It is vital however that the voice of energy intensive industries competing in the global market place, including that of petrochemicals & plastics, is represented and heard in this discussion. We comment firstly on the issues surrounding the short-term backloading proposals and thereafter offer some observations on the six options listed.

Backloading

Calls for backloading take as their starting point the view that the EUETS is failing in its objective. The debate has been conducted in terms of the extent to which the EUETS will deliver the carbon targets originally set out and whether the current CO₂ price is too low. The facts are, however, that the EU will meet its 20% GHG reduction target comfortably and ahead of time, and at a very much lower societal cost that was originally projected. We would therefore contend that the EUETS fundamentally is neither 'broken' nor no longer fit for purpose, but has rather proved remarkably successful in delivering its objectives in an economically efficient way that has minimised the impact on growth, employment and competitiveness. It is vital these facts are not overlooked.

It is suggested that putting a higher price on CO₂ is necessary for tackling climate change. Specifically, proponents argue that a stable, higher price is necessary to secure investment in 'low carbon' and other emission abatement technologies. We are not persuaded of this contention: it was never the intention or design of EUETS that it should deliver stable and/or predictable carbon prices. Rather, it was explicitly designed as a cap-and-trade system to provide certainty as to an environmental outcome, as expressed in a specified percentage reduction in industrial sector GHG emissions. Having set the target, the mechanism then allows the market to determine the price required to meet the cap at the lowest cost.

The case has also been made that low CO₂ prices are preventing the EU's transition to a low carbon economy. However, 2011 saw a record amount, 32GW, of new renewable energy capacity installed in the EU, following-on from 2010 which was similarly a record. The fact that this happened in the aftermath of a global economic crisis and at a time of low Phase-2 CO₂ prices hardly suggests a market failure, or that these prices have had a damaging effect on investments. Other existing policy tools, at a Member State level, including Feed-in Tariffs, Renewable Obligation Certificates, Renewable Energy Taxes and Green Certificates are already in place to drive low-carbon investments. It makes no sense

whatsoever to use the EUETS, as a lowest-cost tool, to somehow artificially stimulate an investment case for solutions well out of the market.

SABIC remains in favour of allowing the present market mechanism to determine the cost of carbon consistent with the existing EU reduction target. We therefore oppose artificial market interference measures such as backloading. The threat of 'carbon leakage' is a very real one for many industries operating in a global marketplace with low barriers to both trade and the mobility of investment capital. Interference by the Commission in the setting of the market CO2 price will undermine – not increase – investor confidence in EUETS, threatening future investment and jobs. This comes on top of existing challenges to Energy Intensive Industries when compared to other regions such as the high price of feedstocks and energy.

Comments on the six non-exhaustive options for structural reform

The commission lists 6 options to structurally improve the EU-ETS:

- a) Increasing the EU reduction target to 30% in 2020.
- b) Retiring a number of allowances in phase 3.
- c) Early revision of the annual linear reduction factor.
- d) Extension of the scope of the EU-ETS to other sectors.
- e) Limit access to international credits.
- f) Discretionary price management mechanisms.

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

The Commission refers to a permanent retirement of allowances or a revision of the annual linear reduction factor (LRF). It states that previous analysis reveals that a retirement of 1.4 billion allowances would align with an overall target of 30% in 2020 compared to 1990. It has also suggested that the EU ETS cap would move from -21% to -34% referenced to EU ETS emissions in 2005 when the total EU target moves from 20% to 30% reduction in 2020. This move to -34% appears to be arbitrary and lacking any transparency, not apparently being based on any agreed rules.

By our calculation, -34% means that the total EU ETS cap (without aviation) would move from 1,777 Mtonne EUAs (published by the Commission) to 1,485 Mtonne EUAs in 2020. This would permanently remove ~1,520 Mtonne EUAs in the period 2013-2020.

As the Commission states, this option would not only require changes to the quantity of allowances in the EU ETS but also affect the Member State targets adopted under the Effort Sharing Decision.

Comment

- This option should – as currently stipulated in the EU ETS Directive – be reserved for the point when a new Global Climate Agreement is agreed and implemented. To proceed before that point threatens a loss of competitiveness of the European industry. Global participation in an effective agreement must remain a prerequisite for targeting a deep reduction in Europe such as the 80-95% level by 2050 referred to in the Commission's Energy Roadmap.

- In absence of a Global Climate Agreement the measure would worsen the competitive position of European industry on the wider international stage and would therefore make industry even more vulnerable for carbon leakage.

Option b: Retiring a number of allowances in phase 3

The Commission suggests that permanently retiring allowances could be done by a separate decision, to be taken by the European Parliament and Council, rather than a fully-fledged revision of the EU ETS Directive.

Comment

- As we outline above in our response to the backloading of allowances, we do not accept that the ETS is fundamentally failing in its objectives in a way that would justify a permanent retirement of allowances in the nearer-term. The number of allowances involved as well as the timing of the initial and possible repeat retirements would presumably be subject to political debate and raises serious concerns as to decision-making transparency, the nature of which threatens to undermine – not improve - trust in the EU ETS as a basis for underpinning investment decisions.
- We also see serious objections to any implementation proceeding along the lines proposed: reforms of this fundamental nature should be subject to full consultative and legislative scrutiny and should properly be handled via a fully-embracing amendment of the ETS Directive.
- See also the assessment of option a.

Option c: Early revision of the annual linear reduction factor

In the current EU-ETS rules, the total amount of allowances will decrease by the linear reduction factor (LRF) of 1.74% annually compared to the average annual total quantity for the period 2008-2012. The Directive foresees a review of the linear reduction factor as from 2020 with a view to it being adopted by 2025. It appears that this proposal would revise the linear reduction factor in the nearer-term, setting it at a level in-line with an overall EU 30% GHG reduction target compared to 1990, as described under option a.

Comment

- Increasing the linear reduction factor (LRF) in line with the target to 30% in 2020 would mean by our calculation a change from -1.74% to -3.10% as of 2013 and would imply a large removal of allowances of, we estimate, ~1,500 Mtonnes.
- This option would have a direct and double effect on the competitiveness of industry: greater scarcity of allowances leading to increasingly higher carbon prices and a lower on-going allocation to industry that continuous to worsen beyond 2020. Thus, the risk of carbon leakage would increase instead of decrease.
- See further the assessment of option a.

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

The Commission states:

“The fourth structural option could be to include sectors less strongly influenced by economic cycles. Whereas the emissions in the EU ETS decreased in 2009 by more than 11%, in the sectors outside the EU ETS this reduction was only around 4%.

The coverage of the EU ETS could therefore be expanded to other energy related CO₂ emissions in sectors currently outside the EU ETS by for instance including fuel consumption in other sectors. ... Several policy questions would need to be addressed, such as who would carry the obligation to report emissions and surrender allowances, fuel producers or users, or some kind of a hybrid system. Therefore, this measure requires more analytical work, including on how it would relate to existing policies in these sectors.”

Comment

It is accepted that this constitutes a structural reform that may merit consideration. However, there are very major dangers attached to the inclusion of new sectors without a comprehensive and thorough understanding of the potential financial consequences being first established. In particular, great care is needed to ensure adequate safeguards are built in to mitigate potential price runaway effects associated with the inherently different elasticities of response that may be introduced from new sectors currently outside the existing scope of the ETS.

Option e: Limit access to international credits

The Commission states:

In phase 4 the regulatory framework could be crafted in a manner that initially allows for no or much more limited access to international credits. This would create more certainty about the effort to be undertaken in Europe and thus could spur indigenous investment in low carbon technologies, instead of external monetary and technology transfers through the EU ETS. This may, however, have to be balanced against adverse impacts on financial flows and transfer of technology to developing countries.

...

Additional flexibility regarding the access to international credits could be foreseen in case of strong and sustained price increases. Such a mechanism could have a similar function as Article 29a of the Directive, but would not result in the rapid growth of the surplus as experienced at present. Furthermore, the right international conditions could enable a strengthening of the cap and therefore allow for additional cost containment through increased access to international credits.”

Comment

- This option is structural; it should however only be considered in the context of a new Global Climate Agreement, the implementation timeframe for which is anticipated to be post-2020. It is therefore not appropriate to consider this measure in the context of any earlier amendment of the current Directive.

- A new Global Climate Agreement may well involve the introduction of a global carbon market, thereby potentially removing a significant proportion of the present supply of international credits. Other new supply could emerge, such as from REDD (“Reducing Emissions from Deforestation and Degradation” in developing countries), but such developments are still uncertain today.

Option f: Discretionary price management mechanisms

The Commission mentions two possible mechanisms in the Carbon Market Report:

“As from the third trading period a large amount of allowances will be auctioned, a carbon price floor has been discussed as a feature applied primarily in the primary market, i.e. for auctions. A carbon price floor would create more certainty about the minimum price, giving a better signal for investors.

Alternatively, a mechanism could be devised that adjusts the supply of allowances, when the carbon price would be affected by a large temporary supply-demand imbalance, by means of a price management reserve. If decreases in the demand were to generate an excessive price decrease below a certain level deemed to affect the orderly functioning of the market, an amount of allowances to be auctioned could be deposited in such a reserve. In the opposite case, allowances could be gradually released from the reserve.

The reserve could initially be funded by reducing phase 3 auction volume by an amount corresponding to a substantial share of the accumulated surplus.”

Comment

- We do not support price floor approaches as a part of a cap-and-trade emissions market mechanism for the reasons we have set out above in our response to the short-term backloading proposal. Such mechanisms are fundamentally inconsistent with the underlying objective of achieving the requisite environmental effect at the minimum cost, raise the prospect of a heightened threat of carbon leakage and will thus undermine rather than improve investor certainty.
- We are similarly sceptical towards the merits of the second approach outlined for essentially similar reasons. While there may be merits in a ‘carbon bank’ type mechanism as has been proposed in the past, there are substantial concerns as to both the transparency and governance under which such a proposal might in practice operate that would need to be addressed before any such proposal were to be advanced.

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