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STRATEGIC CHOICES FOR ETS POST-2020: ALLOW ENERGY INTENSIVE INDUSTRIES TO BE COMPETITIVE AND GROW IN EUROPE

The Alliance of Energy Intensive Industries, representing over 30.000 European companies and 4 million jobs, wishes to be an active contributor in the upcoming revision of the EU ETS. This paper contains Alliance proposals on carbon leakage protection, free allocation principles and competitiveness under ETS Phase IV to ensure simple, fair, predictable and effective rules i.e.:

- Carbon leakage protection needs to be the first element of the ETS revision based on the same criteria and assumptions as under Phase III, as well as on technically and economically achievable benchmarks;
- An EU-wide harmonized system must be put in place, which fully off-sets direct and indirect costs at the level of the most efficient installations in all Member States; therefore, no cross-sectoral correction factor should be applied to free allocation;
- Allocation methodology must be closely aligned with real/recent production levels;
- Innovation support must be extended to industrial sectors;

These principles are fully compatible with the March and October 2014 European Council Conclusions and reflect the industry contribution to the Commission questionnaire, following the meeting with Commissioner Arias Cañete in February 2015. Those principles are further detailed below.

Best industrial performers must not be penalized by ETS allocation rules

The concept of declining free allocation for industry is in contrast to the need for full protection against carbon leakage and should not serve as a justification to reduce protection. The limit on the total issuance of allowances in ETS sectors defined by Heads of State and governments covers both free allocation and auctioning. They did not impose a decrease of free allocation as such.

On the contrary carbon leakage provisions should be improved in order to encourage carbon-efficient production and growth in Europe, and allocation must be guaranteed at the level of realistic benchmarks. Only predictable and effective carbon leakage measures will enable companies to invest in innovative solutions in Europe.

Accordingly there should be no direct and indirect cost at the very least at the level of most efficient European installations in sectors at risk of carbon leakage.

The effect of the cross sectoral factor (CSCF) is that even the best performers cannot achieve these levels due to economic, technical or thermo-dynamical limits. Ignoring this turns the EU ETS into a penalty system rather than an incentivising system.

For that reason, all our sectors call for a deletion of the CSCF, in accordance with the European Council conclusions of 23-24 October 2014¹.

Current carbon leakage assessment methodology remains valid

The carbon leakage risk will not decrease and may well increase on the contrary:

- It can currently not be expected that there will be a large breakthrough in negotiations at international level that would lead to climate policies, imposing equivalent carbon costs for industries located in competing regions.
- Meanwhile, the GHG reduction target will be increased to 43% for EU ETS sectors compared to 2005 levels (meaning that the cap will be tightened)
- The Market Stability Reserve will result in rapid carbon price increases.

All Energy Intensive Industries should receive full protection at the level of the benchmark. Consequently, the quantitative and qualitative carbon leakage risk assessment criteria and assumptions as defined in 2008 remain fully valid and must remain unchanged. Energy Intensive Industries are characterised by long investment cycles. The carbon leakage list must only be updated at the beginning of each trading period.

Also, since the risk of carbon and investment leakage remains as acute as ever for EU industry, introducing differentiation in the level of protection will lead to unequal and incomplete protection for sectors at risk, and could have negative repercussions on EU industrial value/supply chains.

Establishing technically and economically achievable benchmarks

The benchmarks should be updated maximum once, ahead of each trading period to provide planning certainty for participants, decrease the administrative burdens and provide an appropriate reward for those that have invested in emissions efficiency.

The update of the benchmark values should be based on data collection from the EU companies. The process of establishing benchmarks must be as transparent as possible. If in a sector, no relevant changes in technology have taken place, such sector can request a simplified approach for data collection.

These benchmarks have to be representative for the sectors and based on representative technologies that have been adopted by the European market. Over-ambitious benchmarks artificially increase costs to industry overall and de facto undermine the effectiveness of the carbon leakage provisions. The current rules are already very stringent, as benchmarks are set according to the average of the top 10% most efficient installations in the sector; hence, even without the cross-sectoral correction factor, around 95% of the installations have to purchase allowances.

¹ See legal opinion on article 2.9 by Luther of April 2015

Indirect carbon costs need to be fully compensated throughout Europe

The current implementation of carbon leakage measures to deal with indirect carbon costs has resulted in a fragmented approach as eligible sectors exposed to electricity price increases due to carbon costs may only receive from few Member States a partial financial compensation. This creates an uneven playing field in the internal EU market, and creates a disadvantage for those installations that are not receiving any, or only partial, compensation, vis-à-vis extra-EU competitors.

While designing the new system, several measures/principles should apply:

- EU-wide harmonized system, which fully off-sets indirect costs (100% of the CO₂ cost-pass through in electricity prices) at the level of the most efficient installations in all Member States and reflects most recent production levels. Sectors with a fall-back approach should also be properly treated.
- Cost compensation could be assured using different complementary mechanisms (free allocation and/or harmonised financial compensation).
- Mechanisms should ensure predictability over the entire trading period by being described in the revised directive. The current system is unpredictable, as it relies on a state aid compensation assessment, and is granted annually, digressive and uncertain for future years.
- The eligibility assessment for such an EU-wide scheme should be based on a consistent methodology that identifies qualified sectors on the basis of their exposure to indirect carbon costs or their total electro-intensity.
- As indirect costs arise from the price setting mechanism prevailing in the power sector (marginal price setting), an EU-wide compensation scheme should be in place without delay.

For the longer term, the Commission should also assess the possibility of redesigning the electricity market in a way that prevents carbon cost pass through in electricity prices to sectors at risk of carbon leakage.

System based on real/recent production must replace the ex-ante straightjacket approach

Moving to an allocation methodology closely aligned with real/recent production levels would provide the required allowances at the level of the benchmark to companies expanding or restarting production to avoid undue costs, help prevent over- or under-allocation, stop rewarding ETS participants for moving production overseas and ensure simplified and fairer rules as regards new entrants, capacity increases or decreases, plant rationalisation and partial cessation. For example, the reference period could be the rolling year n-2. The required production data are already available as verifiers have to ascertain the activity data needed for the allocation. The bureaucratic burden will be therefore minimal.

For installations covered by fall-back approaches as opposed to benchmarks, emission reductions resulting from efficiency measures should not result in a penalty.

Creating a reserve for growth

To ensure sufficient availability of allowances for free allocation for industry, a reserve for growth would be needed. This reserve for growth would act as a buffer to ensure predictable access to both free allocation and auctioned allowances.

There are several ways to operate this proposed reserve for growth:

- It can be filled with unused free allowances due to lower production in phase III, back-loaded allowances, un-allocated allowances from New Entrants Reserve. Then it can provide allowances for growth in case of higher production.

- In addition, the Market Stability Reserve could also be used as the source for granting such allowances, if it would be designed as a sink for unused allowances from which allowances could be released for said purpose.

Support to innovation

The extension of innovation support to industrial projects is welcome. However, it should not happen at the detriment of carbon leakage protection by reducing or limiting the amount of free allocation. Industry exposed to carbon leakage risk will struggle to invest or innovate without predictable efficient carbon leakage protection.

The revenues from auctioning should be reinvested for low carbon technology support, as foreseen in the ETS Directive, or energy efficiency, but more importantly they should be used by Member States to stimulate economic growth and relevant R&D investments. Innovation funding under EU ETS should be allocated to energy intensive sectors appointed in Annex I of the directive. The NER400 should be technology-neutral and refer instead to R&D and deployment of new technologies for those Annex I sectors.

In order to achieve a realistic policy and to allow for effective reduction of emissions, there is a need to identify the abatement possibilities in the industry (linked to technological, thermo-dynamic and physical/chemical limits that cannot be overcome due to feedstock, process emissions and lack of break-through technologies). Some sectors have already developed 2050 decarbonisation roadmaps, in which transformation technologies are mentioned. A dedicated fund taking into consideration these abatement possibilities will bring innovative technologies (e.g. industrial breakthrough technologies, including CCS and CCU for industry) forward and secure buy-in of industry sectors.

Industry needs an objective impact assessment for Phase IV ETS

In light of the better regulation policy of the new Commission, an objective impact assessment on the different European energy intensive industries is crucial, taking into account their ability to reduce emissions (low carbon roadmaps). Any flawed impact assessment could lead to wrong policy decisions for the energy intensive industries in Europe.