POSITION PAPER

MAY 2015

Solutions for a well-functioning, fair and effective EU Emissions Trading System

The European Council Conclusions of October 2014 provided detailed guidance to prevent the risk of carbon leakage after 2020.

Cefic supports reformed ETS as a market-based mechanism for reducing industrial emissions at the lowest cost possible for society. In light of the Council Conclusions, we are calling on the Commission to ensure that undertakings at risk of carbon leakage receive full, free allocation of allowances up to benchmark levels of carbon efficiency and, provided they meet those levels, are able to grow in the EU without incurring additional carbon costs. To that end, **Cefic** and ten other sectors[1] within the Alliance for Energy Intensive Industries have **jointly proposed** specific measures for the reform of the EU ETS carbon leakage system that would:

(i) Align free allocations **with real/recent production levels**.

(ii) Use the **MSR as a dynamic "reserve for growth"** thereby removing the need for a cross sectoral correction factor.

(iii) Bottom-up review towards technically and economically achievable **benchmarks** to provide a real incentive to invest in greater efficiency rather than to reduce production.

(iv) Secure sectors at risk of carbon and investment leakage from both **direct and indirect** costs up **to their benchmark levels of efficiency.**

(v) Extend innovation support to industrial sectors.

Free allocation based on real/recent production levels

The current system of allocation, based on historical production, requires an undertaking that increases production to purchase allowances, while an undertaking that reduces production still gets allowances to sell. Our proposed reforms of basing free allocation on real/recent production levels are administratively well manageable and would eliminate this cost penalty on growth and windfall profits from decreased production. They would thus strengthen the ETS incentive to invest in greater efficiency and facilitate carbon-efficient growth in the EU.

The MSR as a "dynamic reserve for growth"

The **Market Stability Reserve** would be used to support industrial growth. Undertakings that grow would receive allowances from the reserve to cover increased production at benchmark levels.

Undertakings that reduce production would surrender the resulting surplus allowances to the reserve. This proposal for dynamic allocation removes over- and under allocation and negates the need for a separate limit below the total cap on the available allowances for industry and with it also the cross-sectoral correction factor. Using the MSR as dynamic reserve for growth also makes expendable undue interventions such as imposing excessively stringent benchmarks or arbitrary carbon leakage criteria.

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[1] 17 April 2015 along with *CEMBUREAU, CEPI, CERAME-UNIE, EAA, EULA, EUROALLIAGES, EUROFER, EUROMETAUX, FEVE, FUELSEUROPE*

Technically and economically achievable benchmarks

Benchmarks set the performance level of carbon emissions at which undertakings get full free allocation for compliance. In a more dynamic allocation system, undertakings that do not meet the benchmark will have to purchase allowances and have a 'cost incentive' to reduce emissions by increasing carbon efficiency. Undertakings that meet the benchmarks have a 'profit incentive' to even further improve efficiency thereby freeing allowances for sale. A decision to invest in increased efficiency will be supported by realistically achievable benchmarks[2].

Indirect carbon costs

For indirect carbon costs, Cefic supports an EU-wide harmonised system, which fully off-sets indirect costs at real/most recent production levels (100% of the CO2 cost-pass through in electricity prices) at the level of the most efficient installations.

Funding low-carbon technology innovations

Cefic welcomes the proposed NER400 and supports the reinvestment of auction revenues in developing, and innovating down the cost of, low-carbon technologies including new catalysis, and breakthrough technologies such as CCS and CCU. We particularly welcome the extension of this support to industrial projects and maintain that the fund should be technology neutral, referring to R&D and the deployment of new technologies.

Cefic underlines that the above proposals will be all the more important in the event that the carbon price differential between the EU and third countries remains. In the absence of equivalent carbon pricing measures in competing World regions, measures such as the MSR, which will lead to an increase in the EU carbon price, must be accompanied by full and effective carbon leakage prevention.

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[2] Current benchmarks are very strict and provide full free allocation to only 5% of undertakings in each sector. These benchmarks should be reviewed in cooperation with the sectors to ensure that they are realistically achievable, statistically robust, taking into account the specificities in the different sectors.

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About Cefic

Cefic, the European Chemical Industry Council, founded in 1972, is the voice of 29,000 large, medium and small chemical companies in Europe, which provide 1.2 million jobs and account for 17% of world chemicals production.