EUROCHAMBRES

Position Paper

12 February 2018

EUROCHAMBRES response to the public consultation on methodological choices for determining the list of sectors and subsectors deemed exposed to a significant risk of carbon leakage, for the period 2021-2030

I. General questions

This section includes general questions related to the carbon leakage list and free allocation.

Phase 3 of the EU Emission Trading System covers the period from 2013 until 2020 included and is governed by harmonised free allocation rules and an EU-wide limit on total emissions, as well as specific rules on addressing the risk of carbon leakage. What is your perception of the evolution of the risk of carbon leakage since the beginning of phase 3 of the EU Emission Trading System in 2013?

☒ Increased risk
☐ Decreased risk
☐ No significant change
☐ I don't know

If you wish, please motivate your answer:
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Globally, the gap between the EU and growth front runner countries is still widening. Against the background of an increasingly tense international business environment, differing degrees of climate protection efforts result in competitive disadvantages for EU businesses. Moreover, the recent reform of the ETS, including the increase of the linear reduction factor, the higher intake rate for the MSR, the cancellation of allowances from the MSR and the continued application of the CSCF will ultimately lead to a significant shortage of certificates. This will clearly affect the investment decisions of EU based industries.

The Paris Agreement clearly has the potential to lower this ambition gap in the future, but it is far from being a game changer. The nationally determined contributions are not legally binding and discussions on the implementation (Paris rulebook) clearly show that some important countries still oppose the idea of common rules for all emitters.

The carbon leakage list and the higher level of free allocation granted to relevant sectors and sub-sectors because of it, has been in place throughout phase 3 of the ETS. Please share your views on your administrative experience with the system, in particular whether you see scope for reducing administrative burden and/or simplification:
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In general, the administrative burden for SMEs must be reduced. Although small emitters can be excluded from the ETS, the requirement of equivalent measures has in many cases led to administrative burden and high costs for SMEs, which are clearly disproportionate to their overall emissions share. The new simplification rule for the smallest emitters (<2 500t of annual emissions) included in the post-2020 ETS reform should thus be extended to small emitters (<25 000t of annual emissions).

Moreover, In order to guarantee long-term investment security, the carbon leakage status must not be reviewed every five years, but instead remain unchanged for the entire trading period. This will not only support investments in low-carbon technologies, but also reduce regulatory risks and red tape for the entire ETS sector.

II. Methodological choices

Please bear in mind that the main elements and criteria of the assessment to determine the carbon leakage list are foreseen in the provisions of the EU ETS Directive. There are only certain methodological aspects left to be decided and they are the subject of this part of the consultation. In order to maximise the impact of the views expressed, you are therefore strongly encouraged to address the questions below while keeping in mind the aspects which are already decided on, as explained in the introductory part of this consultation.

The emission intensity of a sector is part of the criteria for assessing its exposure to carbon leakage risk. The emission intensity takes into account both direct and indirect emissions. To calculate the indirect emissions (emissions linked to the electricity consumed by the sector), electricity consumption needs to be converted into emissions by using an electricity emission factor representing the emission intensity of the electricity generation. Please share your views on the electricity emission factor to be used (In this case, electricity emission factors can either refer to average values or marginal values. The average value refers to the amount of emissions relative to the electricity produced taking into account all the different emission intensities (linked to fuel used). The marginal value reflects the incremental change in CO_2 emissions linked to the last unit of electricity consumed and differs from the average values due to the heterogeneous structure of the electricity production (certain power plants producing base load and others peak load.)):

- ☐ average value – EU average emission intensity derived from electricity generated from the total fuel mix that includes all sources of energy in Europe
- ☐ average value – EU average emission intensity derived from electricity generated from fossil fuel
- ☒ marginal value – marginal emission factor for the electricity generation determined by the specific CO_2 emissions of the 'last kWh electricity consumed'

If you wish, please motivate your answer:
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Indirect emissions should be calculated based on the marginal EU emission factor of the European grid, as the real cost of indirect CO_2 is the one of the marginal plant in the merit order. The current State Aid guidelines for compensation of indirect CO_2-costs in electricity prices are based on the principles of marginal technology (and should be maintained in the new set of guidelines as from 2020). Even though a higher share of renewable energy is being introduced in 2030, the marginal producer will be most probably a producer of electricity from fossil sources, and thus electricity prices will be affected by CO_2-prices for the next decade.

The most accurate methodology to assess the impact of carbon costs in electricity prices would be to base the emission factor for electricity on the weighted average of the marginal CO_2 emission factor for electricity supplied by combustion plants in different geographic areas.

In your view, how would you assess international climate policy and action in 2018 compared to 2013, in particular in light of the Paris Agreement?

☐ Significant progress
☒ Some progress
☐ No progress
☐ I don't know

Assessing the exposure of a sector to the risk of carbon leakage includes calculating the trade intensity of the sector. In this context, it would be useful to have a reflection on whether climate policies in countries outside the EU can be considered comparable with the EU ETS at this stage since carbon leakage can by definition only occur when production moves to areas with less strict climate policies than the EU. Do you consider that countries or regions outside the EU have climate/energy policies that can be considered comparable with the EU ETS?

Please explain following the guiding sub-questions below.

1. Which countries or regions do you consider to have comparable policies to the EU ETS?
2. Which elements of climate/energy policies worldwide should be considered in determining the comparability to the EU ETS?
3. Which elements of climate/energy policies worldwide would you find more or less ambitious than the EU ETS?
4. What do you think is the optimal way to reflect developments in climate policies in countries and regions outside of the EU in view of the facilitative dialogue and the global stocktake mechanisms foreseen under the Paris Agreement, as well as other relevant initiatives (e.g Action agenda)?
   2000 character(s) maximum

1. Only EEA countries and Switzerland, which are part of or linked to the EU ETS, have comparable policies and carbon costs in place.

2. Elements that need to be assessed are the scope of the covered sectors and thresholds, the existence of an absolute CO_2 cap (countries with less stringent absolute caps, or relative caps should not be considered comparable to the EU ETS), the existence and effectiveness of carbon leakage provisions and their impact on EU industrial competitiveness, the level of carbon prices and its impacts on electricity prices (+direct and indirect compensation measures), transparency of data, monitoring, reporting and verification rules.

3. Currently, apart from EFTA members, no other country pursues policies that are comparable in ambition to the EU ETS. The main difference between the EU ETS and the emission trading in other world regions is the fact that there are still very few nation-wide systems, capping the total amount of CO_2 emissions. Especially, the 100 % full auctioning of CO_2 emissions allowances for energy production does not exist anywhere else than in the EU. In China, the world's largest emitter, the reporting system is highly intransparent. Therefore, the real emissions of the country and its industries are unknown.

In your view, how would you assess the improvement of carbon emission intensities in production in manufacturing industry, in the EU compared to worldwide, including as regards the evolution of low-carbon investments and innovation?

☒ More progress in the EU compared to worldwide
☐ Less progress in the EU compared to worldwide
☐ Same level of progress
☐ I don't know

The EU ETS Directive foresees the possibility for qualitative assessments of sectors in view of determining their exposure to the risk of carbon leakage. The criteria and the eligibility for these assessments are laid down in the Directive. In order to ensure that such assessments are as robust, fair, transparent and equitable as the default assessments (where quantitative criteria and thresholds clearly indicate which sectors should be included in the carbon leakage list), what would you consider a good approach in terms of process? Please explain:
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Due to the changes to the quantitative assessment, more sectors are likely to qualify and apply for qualitative assessment. A coherent, transparent and equitable analysis has consequently become even more important. The European Commission should thus clearly lay out the requirements for the qualitative assessment to make the process as transparent as possible for all stakeholders.

It is also important to go beyond a simple evaluation of the final trading company's trade intensity. In particular, a broader perspective on the value chain effects is necessary. Subsectors seemingly not directly affected by direct or indirect carbon costs might depend from up- or downstream sectors facing a carbon leakage risk, and they should thus be taken into consideration. This is in particular the case for products that are produced locally and hardly traded, but that form an essential basic building block for many processes and value chains in industry. In this sense, the input-output analysis could be useful for the identification of the intersectoral forward and backward linkages, in order to select the sectors to be included in the carbon leakage list.

Besides the risk of carbon leakage, it has to be considered that increasing carbon prices in Member States covered by the EU-ETS will also amplify the risk of investment leakage. Investors in countries with rudimentary or no carbon pricing will always tent to invest in the latest and most efficient technologies available in order to guarantee the longest possible life-time of the installations. In the long term, the remaining EU installations are thus at risk of gradually becoming less efficient and competitive compared to the new installations outside the EU.

Which parameters would you consider as most relevant to assess the ability of a sector to pass through carbon costs into product prices beyond trade intensity? Please explain:
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Trade intensity (TI) is clearly the most important indicator in this context. However, products with low TI under current carbon price levels could become more trade intensive in the future. A certain flexibility to variations of TI should thus be taken into account.

Also, it must be considered that there is not always a linear correlation between production costs (factoring in carbon prices) and final product prices, which are generally determined by global market prices. Methodological attempts to align observed carbon costs with simultaneous or later market price developments thus often fail to provide a robust convincing correlation. Moreover, the ETS' impact on competitiveness is not limited to direct emission carbon cost but extends to the cost impact through the supply chain and indirect costs through higher electricity prices. The latter is particularly relevant for peripheral MS that are not well connected to the European electricity grid and thus have low transfer capacities.

The EU ETS Directive foresees the possibility to assess products and sub-sectors rather than sectors in certain cases. The criteria, eligibility and level of assessment are laid down in the Directive. In such cases of lower levels of disaggregation, there is no official publicly available data. In order to ensure that such assessments are as robust, fair, transparent and equitable as the default quantitative assessments, what would you consider as a good approach for assessment of products and sub-sectors? Please explain:
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The already tested and proven exercise of cooperating with European industry sector associations (and where necessary additionally using independent auditors and consultants) has turned out to be reliable and robust and should be maintained. The special situation of sectors which cannot provide representative NACE data of trade intensity for their products (as they provide no final but semi-finished products) but have been qualified as carbon leakage relevant must be taken into account.

Moreover, sectors on PRODCOM level which are currently on the list, should in any case be able to be included in the new list. As a consequence, it is crucial to maintain the possibility to be assessed at disaggregated level to preserve the fairness and completeness of the Carbon Leakage list. The administrative burden for the proof of the 0.2 threshold in the framework of the PRODCOM-assessment should be kept at the lowest possible level. Otherwise, there is a risk that subsectors face undue administrative burden in comparison to sectors.

In addition to this, the timing, verification, and coherence of data sets and related administrative and procedural rules are essential to preserve the equity of the carbon leakage list. In particular, the timing and administrative requirements applicable to the disaggregated assessment should be aligned with those applicable at NACE level.

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