Update on European Emissions Trading System (ETS)

Sectoral Social Dialogue Committee "Chemical Industry" on 4 July 2007

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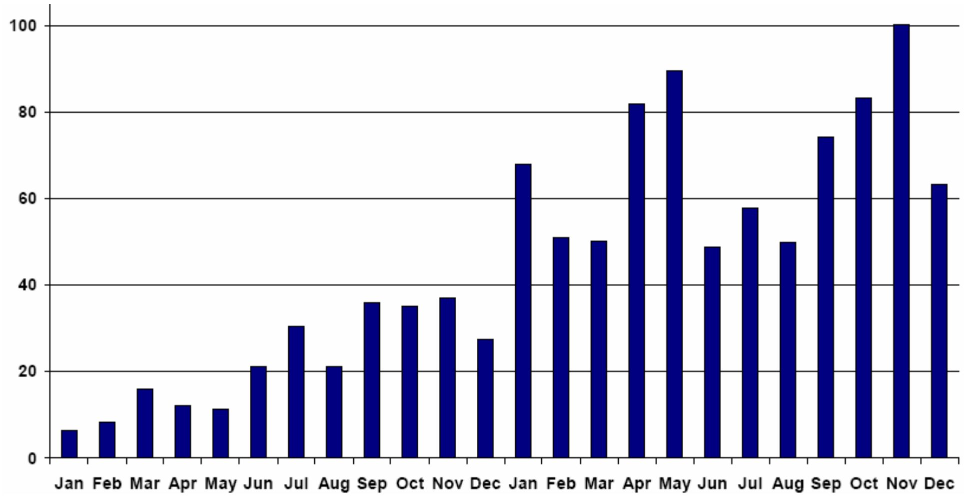
EU climate change policy developments

- 1997: UNFCCC Kyoto protocol signed; EU commits to ghg emission reductions of - 8% by 2012 based on 1990 levels
- 1998: EU member states divide the task (= Burden Sharing Agreement)
- 2005: Kyoto protocol enters into force
- 2005-07: phase I of EU's major tool: **Emissions Trading Scheme** (ETS)
- 2007:
  - EU Spring Council sets new targets: 'at least' -20% by 2020
  - EU ETS **Review** for ETS after 2012
- June 2007: US climate policy dynamics around G8 summit

Emissions Trading Scheme – How it functions

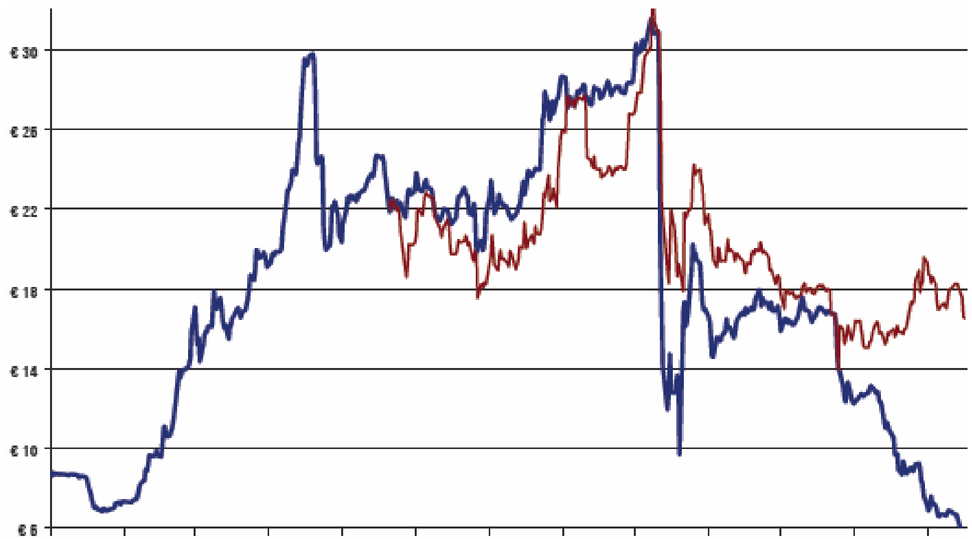
- Scope: industrial sector (about 12.000 installations)
- Installations/activities covered: i.e. combustion plants, oil refineries, coke ovens, iron and steel plants, cement, glass, ceramics, paper
- Implementation: National Allocation Plans (NAPs) detail distribution of allowances to installations based on historic emissions
- Gases covered: carbon dioxide
- Diverse implementation at national level

Development of EU ETS allowance trading in 2005-6



Volumes of allowances traded (in millions)

Allowances prices for Phase I (blue line) and Phase II (red line)



Source: Point Carbon

Emissions Trading Scheme – Distribution

80 % of the total emission volume within ETS system originated from only 740 installations

These Installations represent a limited number of major products/processes such as

- **Power plants**
- **Steel plants**
- **Refineries**
- **Petrochemical installations**
- **Cement plants**

7370 Installations in EU were responsible for only 5 % of total ETS emission

EU ETS in practice

ETS phase I is on-going (2005- end 2007):

- Chemical industry: Mainly large energy installations included
- Relatively ‘fair’ allocation, main impact through effect on power prices (indirect)
- Trading started with prices going beyond €30 / t CO_2 but since clarity about generous allocation and no banking is possible into 2nd phase: CO_2 prices have dropped dramatically (well below €1)

EU ETS in practice

- ETS failures in phase I (2005 - end 2007):
  - Severe impact on power price (Ø €8-10/MWh; opportunity cost turns into ‘windfall profit’/loss)
  - Efficiency not rewarded
  - Lack of predictability disrupts investment planning
  - Energy-intensive sectors under global competition affected

- EU far from meeting the Kyoto commitment

Outlook: EU ETS in practice

EU heading for ETS phase II (2008 - 2012):

- Chemical industry: crackers, boilers, carbon black installations included in addition
- Pressure to deliver on **Kyoto commitments** until 2012!
- Less generous allocation, more auctioning
- No solution for electricity price
    - More **auctioning** of allowances does not help!

EU ETS Review

Commission Communication COM(2006)676:

“*Building a global carbon market*“

EC identified four areas for review:

- **Scope of the Directive**
- **Further harmonisation and increased predictability**
- **Robust compliance and enforcement**
- **Linking with emission trading schemes in third countries**

EC to give consideration to:

- **Institutional and procedural aspects**
- **Relationship between EU ETS and other market based regulatory instruments**

EU ETS Review

Observed policy trends:

- **Ambitous emission targets** towards 2020/2050
- Instead of national Burden Sharing more centralised target(s) setting ?
  - EU targets will be broken down, EU-wide sectoral targets ?
- **More auctioning of allowances** to provide state revenue, equals **unpredictable upfront payment** to companies, revenue recycling questionnable
- ‘**Windfall profit**’/loss = not a priority for policy makers «collateral damage»
- **Enlarged ETS scope: Ammonia, N2O are candidates for inclusion**

Cefic is directly represented:

I. **High Level Group (HLG) on Competitiveness, Energy and the Environment**

II. **Emissions Trading Scheme (ETS) Review**

… and indirectly at numerous
EU and international fora.

ETS Review for post 2012

EC invites stakeholders to build upon experiences from 1st ETS phase and improve/enlarge ETS for post 2012

- 4 meetings from March to June 2007: report in June
- Issues: scope, harmonisation, allocation mechanisms…
- Cefic is part of the energy-intensive sectors' representation

ETS Review for post 2012: Cefic Position

- **Cefic is in favour of emissions trading**

- **Before considering enlargement of EU ETS scope, first fundamentals must be improved:**

  - Move towards globally more acceptable scheme
  - Allocation according to performance
  - No reward for relocation of production (carbon leakage)
  - Solution to ETS impact on power prices
  - Inclusion of effective JI/CDM* mechanisms

***** Flexible mechanisms under Kyoto Protocol; Joint Implementation/Clean Development Mechanisms

ETS design and competitiveness

Competitive impacts

- indirect costs through electricity prices (‘windfall profit’ issue)
- administrative costs e.g. from monitoring, reporting and verification requirements
- compliance costs for direct emissions

ETS design and competitiveness

- **The chemical sector is vulnerable**
- **We act in global markets and are unable to pass on ETS costs, i.e. impact on electricity price**
    - **The chlor alkali industry output the electricity cost of the full manufactured cost is about 50%. Some 60% of the EU chemical industry as a whole is itself dependent on some form of chlorine product supply.**

Outlook: EU climate change policy after 2012

Cefic suggests ETS Review objectives:

- Learn from phases I and II
  - Introduce **flexibility**, allow for multilateral/global approaches
  - Allocate **allowances for free** based on **performance, differentiated allocation**
  - Make ETS globally **attractive**
  - Solve '**windfall profit**' issue
  - Allow for **efficient growth**, research and innovation
  - **Focus** on the Big Few; exempt small emitters from burdensome scheme
  - EC to provide thorough **impact analyses**
  - **Improve ETS design** before enlarging the scope

... for after 2012 !

ETS design: Cefic proposes solutions

Targeted introduction of **performance-based allocation** (e.g. through benchmarks) to large emitting, homogenous processes

- Other activities may remain allocated with reference to historical emissions where this is the most workable methodology

ETS design: Cefic proposes solutions

Linking allocation to production:

- Helps meeting better the allocation needs

- Addresses issues of
  - ✓Relocation of production (“carbon leakage”)
  - ✓Binding of market share
  - ✓‘Windfall profits’
- **We want to keep EU production base**

ETS design: Cefic proposes solutions

Small emitters must be excluded from EU ETS since their participation is not cost effective

- UK Environment Agency: Operators below 25KtCO_2/a have total costs of participation of €3/tCO_2 to > €8/tCO_2
- The European chemical industry consists of some 27.000 SMEs (small and medium size enterprises)

Auctioning must remain strictly limited

- Theoretically, auctioning of allowance would be an ideal way of allowance allocation - **if applied world-wide**

- Auctioning limited to the EU will result in a
  - ✓ Large up-front payment which will harm global competitiveness of EU business and
  - ✓ Remove funding for research and development, innovative solutions for climate change

What Unions say: ETUC contribution

Sophie Dupressoir, European Trade Union Confederation:

“Competitiveness is not so much the issue today, but will be there tomorrow.

Effects can be managed. Risk of loss-loss situation. Jobs gone, and emissions up in the rest of the world.

Risks are minimal – **at maximum only 1% of EU employment**.

Not enough investments in R&D in the sectors. And there are important reduction potentials. So we need a well designed coherent approach.

Preference to **full auctioning in the power sector. EII partial auctions, based on BAT**. Adoption of **border tax adjustment** based on carbon labelling.

Key point; support R&D.”

Outlook: EU climate change policy

‘Homework’ for chemical industry:

- **Performance-based allocation** is key for preserving free allocation and avoidance of auctioning
- Installations within ETS scope:
  - Focus on **homogenous, Big Few** (i.e. crackers: APPE)
  - Work on **details** supporting **free allocation**, i.e.:
    - **Based on performance (benchmarks)**
  - Address impact of **auctioning** on competitiveness
- **Align with Unions**
- **Keep pressure** on governments and EC to solve ‘windfall’ issue

- **Small emitters: Avoid inclusion** (participation not cost-effective), demonstrate efficiency

Outlook: EU climate change policy

…more 'homework' and business opportunities:

- **Assess political and economic challenge for your company**
- **Engage in political debate**
- **Provide solutions:**
  - **Mitigation policies** (measures aimed at limiting Global Warming) **= business opportunities!**
  - **Adaptation policies** (measures aimed at adapting to Climate Change) **= business opportunities!**

Outlook: EU climate change policy

- Mid 2007: **EC Report on ETS Review**, **EC Green Paper on Adaptation**
- End 2007: EC Legislative proposal for ETS after 2012
  - 2008-2009: Legislative procedure
  - **Other EU legislation** on renewables, efficiency, CCS, …in pipeline
- Dec 2007: UNFCCC COP 13 in Bali
- 2008 - 2012: phase II of EU ETS
- 2012: Kyoto expiry date
- 2013-…: phase III of EU ETS