POSITION

26 May 2008

BUSINESSEUROPE POSITION PAPER ON THE PROPOSAL OF THE EUROPEAN COMMISSION FOR THE REVISION OF THE EU EMISSION TRADING DIRECTIVE (DOC. COM 2008-16)

EXECUTIVE SUMMARY

BUSINESSEUROPE supports the Commission's broader objectives for the revision of the EU Emissions Trading Scheme (ETS) Directive.

Business is in favour of an improved emission trading scheme which, operated under the right conditions, will provide the most cost-effective instrument to reduce greenhouse gas emissions and to realise emission reduction commitments. At the same time, it is crucial for the viability of the system that it takes into account that business is operating in an increasingly globalised economic environment and that only companies with a good competitive position are able to invest in low-carbon options. Therefore BUSINESSEUROPE urges the following improvements to the directive:

- *Prevent negative direct and indirect effects of the ETS on the competitiveness of the manufacturing sector in the absence of an international agreement with equivalent burdens for industry outside Europe*
- *Continue to carry out free allocation to sectors exposed to international competition even after 2020 in the absence of such an international agreement*
- *Target auctioning revenue to promote the competitiveness of EU business and EU business activities in the area of climate change*
- *Agree on the rules and modalities for auctions so that they can start in time and enable companies to purchase allowances to guarantee on-going operations*
- *Undertake a full impact analysis of any future international agreement before EU targets are changed*
- *Carry out analyses to evaluate the burdens on the ETS and non-ETS sectors to ensure that cost-efficient reductions are identified and undertaken*
- *Widen JI/CDM credit limits to improve the cost-efficiency of the ETS and promote the use of these mechanisms to promote sustainable development*
- *Make the new entrant reserve allow effective operation/rationalisation of production*
- *Predictability is essential: determine elements critical to EU business within the legislation rather than leaving it to the comitology procedure.*

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BUSINESSEUROPE has examined the Commission proposal for the revision of the EU emission trading directive. It supports the Commission's broader objectives for this revision. The proposal includes a number of positive elements, whilst a number of other elements give cause for great concern and require significant amendment. These include:

1. POSITIVE ELEMENTS

a) Increased harmonisation

- in the single EU-wide cap,
- in the sector and combustion plant definitions,
- in the allocation of allowances to new entrants (single EU new entrant reserve).

b) Improved predictability and confirmation of banking, i.e. the possibility of transferring unused allowances from one trading period to the next.

c) The "limited" step made towards opt-out for small installations with emissions of less than 10,000 tonnes a year is welcome. Nevertheless, the threshold should be raised to a minimum for emissions for all covered installations of at least 25,000 tonnes. Small installations emitting less than 25,000 tonnes per year only account for 3% of total ETS emissions. Exempted installations should be subject to alternative measures which will deliver comparable carbon savings.

d) On allocation provisions, we welcome that the allocation method for emission allowances will take into account the efficiency of different installations and modes of production through the further development and use of benchmarking.

2. ELEMENTS REQUIRING IMPROVEMENT

2.1 Prevent negative effects of allocating allowances via auctioning to the manufacturing sector in the absence of an international agreement

a) Analytical background

Auctioning within the EU of allowances for the manufacturing sector would have two types of very negative consequences:

- negative *economic and social* consequences as European manufacturing industry faces international competition and will be burdened by additional costs linked to auctioning. These costs would come as an addition to the considerable burden imposed on energy-intensive, and particularly electro-intensive, industries through the impact on the electricity price of the EU ETS.

- negative *environmental* consequences as relocation of some production outside the EU will result in higher greenhouse gas emissions, notably when this takes place in less environmentally efficient facilities (a development which the Commission defines as ‘carbon leakage’).

b) Evaluation of the Commission’s proposal

The Commission’s proposal is designed to mitigate the negative environmental impacts linked to auctioning in the absence of an international agreement but fails to comprehensively address the negative economic consequences that would arise should an international agreement not create a level playing field amongst companies in competing nations[1]. Furthermore, an unacceptably complex burden of proof (involving non-manageable tasks in terms of data collection and economic forecasting) is put on business to demonstrate, years in advance, that carbon leakage and economic consequences will result from auctioning.

In addition, the fact that the Commission could wait until as late as June 2010 before it determines which sectors are exposed to carbon leakage would create a long time of uncertainty with very negative effects on business strategies and investment planning and thereby on growth and employment in these sectors.

c) The way forward

Against the above background BUSINESSEUROPE:

- considers that the Commission’s current approach based on carbon-leakage-linked criteria is not appropriate for preventing the negative economic impacts of EU auctioning of ETS allowances in the absence of an international agreement;
- insists that the decisions regarding the granting of free allowances must be taken in the new ETS directive itself, within the regulatory process, and must not be left to a future comitology process. The process of granting allowances must be based on a pragmatic, evidence-based approach assessing the exposure of sectors to international competition;
- asks that high priority is given to the definition of robust criteria for assessing whether a future international agreement will ensure burden-sharing with equivalent efforts;
- insists that manufacturing industries exposed to international competition must receive 100% free allocations against independently scrutinized technology or efficiency benchmarks unless and until there is an international agreement with

[1] The Commission’s focus on negative environmental impacts (and not on overall negative economic impacts) is reflected in recital (19) page 16 and in article 10a points 8 and 9 of document COM 2008-16. It should also be noted that the criteria the Commission uses to assess the existence of additional emissions due to carbon leakage are fairly basic. For example, the Commission only takes account of the environmental efficiency of manufacturing installations in non-EU countries. It takes no account of the carbon intensity of the electricity consumed by these installations, or of the higher CO_2 emissions that could be generated by extra transport occasioned by the shift of production.

equivalent burdens for industry outside Europe. It should be noted that the granting of 100% free allocations does not mean that companies concerned will avoid the costs of the ETS, because in order to meet the emissions reduction cap imposed by the ETS they will still have to invest in carbon abatement technologies and buy allowances on the market. Industry covered by the ETS has to reduce emissions by 21% by 2020 compared with 2005, no matter the allocation method.

Auctioning is appropriate for sectors that can pass through costs (such as electricity). However, it is nevertheless imperative to identify and address the effects that this pass-through has on installations exposed to international competition. Auctioning should be introduced in a stepwise manner in the electricity sector to avoid dislocations in the power market.

2.2. Full auctioning for all "covered" sectors starting in 2020

The move to full auctioning for all sectors as envisaged in Article 10a gives little or no clarity about the equivalent measures from our international partners that would justify such a move nor on the timing by which these measures should effectively be in place. BUSINESSEUROPE urges that free allocation to those sectors exposed to international competition are continued until measures which result in an equivalent burden are effectively implemented and enforced in other major emitting countries.

2.3. Auctioning revenue should be targeted to promote the competitiveness of EU business and EU business activities in the area of climate change

Business is the source of the "income" from auctioning and, therefore, it is appropriate that this revenue is used to improve the competitiveness of EU business and to promote EU business activities in the form of increased R&D in climate-related technologies, technical improvements, renewables, energy conservation and efficiency measures.

2.4. Auctioning certainty

Where auctioning will take place, for example in the power sector, the modalities and quanta for auctioning must be established, in consultation with affected parties, by the end of 2010 at the latest. Auctions must start to be held in 2011. Moreover, it is of utmost importance to organise auctions in such a way that financial speculation is avoided.

2.5. Automatic change in targets in the event of an international agreement

The European business community fully supports the need to reach an international climate change agreement. The EU's commitment to increase emission reduction efforts in the event of an international agreement is an important signal to other jurisdictions. However, any ratified international agreement must create comparable and enforceable carbon restraints before passing burdens such as higher GHG targets onto business. Therefore criteria are needed against which an international climate agreement can be evaluated. For BUSINESSEUROPE, any revision of the EU commitments should involve a full re-evaluation of the impacts on individual sectors as well as the “non-covered” sector to ensure that cost-effective emissions reductions are achieved.

2.6. Burden on the ETS sector

In the proposal, there is the considerable discrepancy between the reduction target required of “covered” sector and that of other sectors. The minus 21% target for industry based on a base year of 2005 means in reality that the covered sector will have been required to already reduce emissions by more than 30% if related to the 1990 base year. The tasks of reducing emissions must be spread across all sectors in an equitable manner through thorough and transparent analyses taking into account actions already undertaken as well as cost-efficiency.

It is essential that the right signals are given to Member States to reduce emissions within all sectors, particularly households, where cost-effective investments can be found. Furthermore, reductions in the non-ETS sectors must not lead to distortions in competition across the EU between companies.

2.7 Increasing JI/CDM credit limits will improve the cost-efficiency of the ETS

Limits on the use of JI/CDM credits are appropriate in order to maintain the principle of ‘common but differentiated responsibility’. However, the directive’s proposed limits are too severe. Widening the limits will increase the efficiency of the EU ETS, reduce the carbon migration risk, provide a better signal to carbon market project developers and increase the contribution of the EU ETS to global sustainable development and the establishment of an international agreement on climate change.

The veto on certain types of projects by Member States must not allow the EU to re-define the “quality” of projects that have been approved under the procedures contained within any international regime. Regulations on the acceptance of credits from projects must be consistent with those agreed under international agreements.

2.8. New entrant reserve should enable effective operation/rationalisation of production

The definition of ”new entrant” should be adjusted to allow companies, where possible, to concentrate their production on their most efficient sites within the EU. To this end, it is key to ensure a fair and consistent treatment of the three possible industrial scenarios: running existing installations, increasing capacity of existing installations and developing new installations. BUSINESSEUROPE considers the proposed size of the “new entrant” reserve (5% of the overall cap) to be too large. The reserve should be of a size commensurate with growth in those sectors that are able to draw from the reserve.

2.9. Governance

There is concern that comitology is used for the development of many of the measures within the proposal. The comitology process lacks the transparency and effective stakeholder consultation, which is necessary to decide on essential aspects of the directive, such as allocation methodologies. In particular, BUSINESSEUROPE insists that the decisions regarding the granting of free allowances must be taken in the new ETS directive itself, within the regulatory process.

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