Emergency MEP briefing

Motion for a resolution objecting to the 2015-19 carbon leakage list

Sandbag calls on ENVI Committee Members to support Motion B8-0000/2014 on Wednesday 24th September 2014 and object to the Commission's Draft Decision D034266/01 on the ETS carbon leakage list for 2015-2019. The methodology applied in the Draft Decision captures too many activities which are not genuinely exposed to carbon leakage and leads to the continued over-allocation of free allowances to industry. The Commission should be asked to submit a new decision to the Climate Change Committee using more realistic parameters.

As the Motion indicates, the Commission's draft decision continues to apply a €30 price forecast for European Union Allowances in 2020 when the Commission's own Reference Scenario and other analysts surveyed in the Commission's Impact Assessment expect a price of only €10 in 2020 under current policy. This artificially high price leads to an artificially long list of products being defined as at risk of carbon leakage. This is because two of the most important criteria for determining that a product is at significant risk of carbon leakage are if:

- the carbon price faced in 2020 would represent more than 30% of Gross Value Added
- the carbon price faced in 2020 would represent more than 5% of Gross Value Added and Trade Intensity with non-EU countries is above 10%

Leakage exposed products are able to access 100% of their benchmarked free allowances across years 2013-2020. Non-exposed products receive 80% of their free allowances in 2013 declining to 30% in 2020. **Being on the carbon leakage list effectively doubles the free allowances a product is entitled to over the 2015-2019 period.**

By applying this €30 price in its draft decision, the Commission directly ignores the recommendations from the Impact Assessment which conservatively suggests that a 2020 price of €16.50 should be used to assess the risk of carbon leakage. **The Impact Assessment calculates that narrowing the list of "at risk" sectors will free up around 500 million allowances to auction, delivering an additional €5 billion in revenue to Member States. It also indicates that many allowances would also be redistributed to the sectors that really need them.** This redistribution can take place because there is a ceiling on the total volume of free allowances available to industry each year. When the total allowances applied for exceed that ceiling, a cross-sectoral correction factor reduces allowances to all installations by the same percentage to bring them back under budget. A narrower leakage list would reduce the total volume of allowances submitted, weakening the correction factor applied.

The Motion also advises that manufacturers have accumulated a significant surplus of free allowances by 2013. Awarding unnecessary allowances to sectors which are not genuinely exposed to carbon leakage risks exacerbating a continuing problem of over-allocation of free allowances to many sectors.

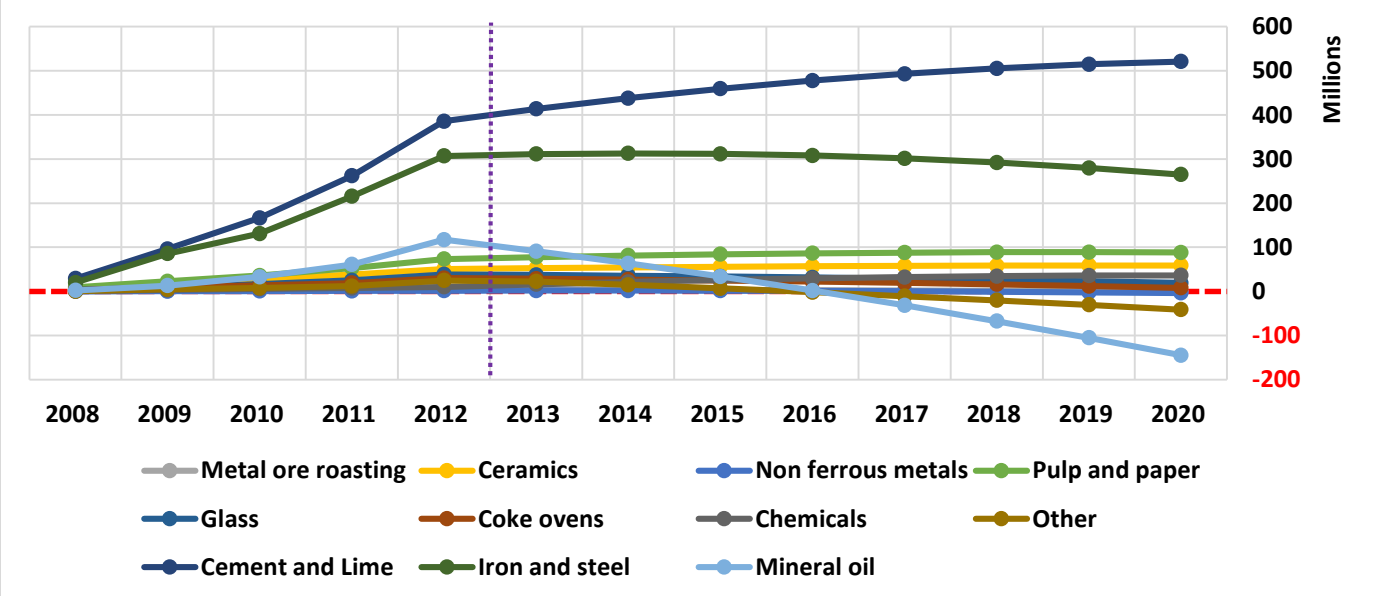

Figure 1 Cumulative balance of free allowances with emissions projected at 2013 levels (2008-2020) Source: EU Transaction Log, Sandbag calculations. Includes offsets already surrendered for 2008-12, but not 2013. Iron and Steel allocations have been adjusted down for waste gas transfers using a methodology provided by Arcelor Mittal.

In the chart above we depict the surpluses free allowance we can expect to accrue to manufacturing sectors until 2020 if current carbon leakage rules continue as the Commission proposes. **NB: The only assumption in this chart is that emissions continue at 2013 levels across the rest of Phase 3. This chart contains represents official data on free allocations until 2020 and verified emissions until 2013.**

In our chart the large surpluses in the cement and steel sector conceal what is taking place in smaller sectors. In the table below we place our projected balance of surplus free allowance and compare this in relative terms against 2013 emissions for each sector. Note that, on the basis of our simple projection, most sectors will remain oversupplied by more than a year's worth of free allowances by 2020, with both Cement and Ceramics oversupplied by roughly 4 years' worth of allowances.

Sector	2013 balance of free allowances (Mt)	2013 balance relative to 2013 emissions	2020 balance of free allowances (Mt)	2020 balance relative to 2013 emissions
Ceramics	52.7	411%	59.0	460%
Cement and Lime	413.5	296%	520.8	373%
Pulp and paper	77.6	270%	88.3	307%
Iron and steel	311.2	280%	264.7	239%
Glass	37.2	198%	19.3	103%
Chemicals	16.1	45%	36.4	101%
Coke ovens	28.9	125%	7.9	34%
Metal ore roasting	4.9	140%	-0.6	-17%
Non ferrous metals	1.9	14%	-3.6	-27%
Mineral oil	91.1	68%	-144.8	-108%
Other	22.4	81%	-41.2	-150%

Table 1: Cumulative balance of free allowances relative to 2013 emissions. Source: EU Transaction Log, Sandbag calculations. Includes offsets already surrendered for 2008-12.

The only sectors that are short of allowances are Metal Ore Roasting, Non-Ferrous Metals, Mineral Oil and the "Other" sector (which captures a miscellany of smaller installations). At most these sectors face a shortfall equivalent to a year and half's emissions. To put these shortfalls in context, sectors not at risk of carbon leakage were supposed to receive only 55% of their benchmarked free allowances across the eight years of Phase 3 (equivalent to being short by roughly 4 years allowances by 2020). Also, sectors in which a large proportion of emissions are from installations that are highly inefficient compared with best available technology can expect to face significant shortages of allowances against their benchmarks.

Part of the reason the carbon leakage list has become so politicised is because the current system of assigning allowances is highly unresponsive to changes in industrial output. The volume of free allowances constricts steadily over time for products that are not defined as "at risk". This has left all sectors scrambling to get on to the leakage list so they can maintain or grow their output in the future without incurring rising CO_2 costs. Artificially extending the list of "at risk" sectors to everyone, though, is not a sustainable solution to this problem. Deeper reforms are needed in the 2030 framework to encourage green industrial growth in the longer term.

In conclusion, Sandbag finds that the carbon leakage protections currently offered to manufacturing sectors for 2015-19 are excessive. We therefore recommend that ENVI MEPs support the motion objecting to the Commission's carbon leakage list for 2015-2019. This will ensure that:

- **industry does not acquire significantly more free allowances than are needed to protect it against carbon leakage**
- **Member State auction revenues are not unnecessarily diminished**
- **industries with a genuine need for free allowances will be able to access more of them under a weaker cross-sectoral correction factor.**

Sandbag is a London-based climate change NGO and think-tank campaigning for an effective carbon market. Visit our website at: www.sandbag.org.uk. For further information about this briefing contact:

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