CIA Chemical Industries Association

Working for chemical and pharmaceutical businesses

EU Emissions Trading Scheme

The UK chemical and pharmaceutical industries are manufacturing's number one export earner and provide essential inputs to UK value chains, including climate change solutions. Under our joint Chemistry Fuelled Growth Strategy with government we share a 2030 vision in which the sector increases its contribution to the UK economy by 50%.

However, the chemical industry is energy intensive and competes globally for product market share and investment funding. Our UK contribution therefore relies on there being a level playing field with other regions in energy related costs. So it is critical that carbon reduction provisions like the EU Emissions Trading Scheme (EU ETS) do not leave us internationally exposed.

The EU ETS is a cap and trade scheme which covers electricity generators and energy intensive industries (EIIs). Most of the scheme's allowances are sold by auction but exposed sectors receive free allocations to help cover their emissions and address competitiveness (carbon leakage) risks.

Current status

On 15 July 2015 the Commission published its proposals for a revised EU ETS directive for Phase 4 (2021-2030). The Council and European Parliament have separately produced compromise amendments. Trialog discussions with the Commission are expected to produce final revisions by the end of 2017.

The proposals target an emissions reduction of 43% (2.2% p.a.) on 2005 levels. Within this cap, there is provision for free allocation of 43% of emissions allowances to exposed sectors though 2% of this share will go into an innovation fund. The larger 57% share of allowances will be auctioned. There is continued provision for member states to compensate exposed installations for EU ETS impacts on power costs (indirect compensation) but no requirement for full harmonisation.

To address the scarcity of allowances available for free allocation, the Commission proposes to reduce the list of exposed sectors, cut allocation benchmarks by 1% p.a. and address the remaining shortfall by a uniform downward adjustment to allocations (the cross-sector correction factor). There will be mid-phase updating of production levels (used in combination with benchmarks to calculate installation's allocations) and provision for significant production increases prior to that.

Assessments by the UK government and others suggest that scarcity of allowances could leave exposed sectors around 40% short of current carbon efficiency benchmarks by 2030.

Our opinions and actions

COP21 – the agreement of inclusive climate change agreement at COP21 in Paris is a big step forward, but it is clear that this is a work in progress. It will take further rounds to produce equivalence in country level emissions reduction commitments while the regulation of business below that remains a national matter.

The cap – we recognise that the 57/43 split between auctioning and free allocations in Phase 4 will increase market liquidity but are concerned that reduced free allocation will see efficient producers facing undue carbon costs. We welcome the creation of an Innovation Fund but this should not lead to a reduction in the number of allowances available for free allocation.

Costs do not drive investment – for EIIs like chemicals, increased unilateral costs do not drive more investment but lead to investment leakage. In this situation, effective incentives are the price of carbon and technically and economically achievable benchmarks. Investment leakage, via faster depreciation of plant, is a precursor to production leakage.

Carbon leakage – plants facing higher policy costs are at a great risk of production leakage and possible closure at the bottom of a business cycle. Carbon leakage risks must be judged in the wider context of the rising cumulative impact of all energy related policy costs.

Benchmarks – we strongly agree with the UK government view that changes to benchmark values should use a strong evidence base and accurately reflect the abatement potential of the sector or generic activity. For example: for the generic fall-back benchmarks, the proposed arbitrary reductions would necessitate a switch to biomass but this raises questions about technical and economic feasibility and the availability of biomass supplies.

Updating production levels – mid-phase updating for production changes is a step in the right direction but doesn't fully optimise the use of scarce allowances.

Indirect compensation – we would like to see a more harmonised approach to indirect compensation across member states while not limiting top-ups by individual countries.

Administrative burdens – we welcome the proposed continuation of opt-out for small emitters and agree that wider simplification should be a fundamental principle.

Our proposals

More to be done – we note that projections by various bodies predict substantively higher carbon prices under 'price for protection' compromises by Council and the European Parliament (eg: €35/tCO_2 by 2024). We ask that more is done to improve the protection of exposed sectors as the compromise deal has yet to pay off.

The share of allowances for free allocation should be increased to 48% – analyses show that this share of allowances would minimise the risk of efficient producers facing unfair carbon costs. Council should therefore follow the European Parliament in backing up to 5% of allowances from auctioning being made available for free allocation, if needed. Allowances for the innovation fund should be drawn from the auction pot.

The carbon leakage list – The threshold for qualitative assessments of sectors to be added to the carbon leakage list should be reduced. There should be provision for assessment at more detailed 6 and 8 digit level and consideration given to the carbon leakage risks for aromatics, hydrogen and syngas products produced in both refineries and chemical plants including outsourced supplies

Opportunity to reserve allowances for growth – rather than cancel allowances, as proposed by Council, consider reserving these allowances for allocation to exposed sectors if there is an allowance shortage due to economic growth.

Align free allocations with more recent production levels – Council should follow the European Parliament's lead in supporting a reduction in the threshold for significant production changes from 15% to 10%. This will help to make more optimal use of the allowances for free allocation and avoid 'windfall profits' and/or under-allocation.

Benchmarks should be set at the technically and economically achievable level – based on actual data and set for the whole phase. This principle should also apply to irreducible process emissions. We support the compromises of the Council and European Parliament.

Indirect compensation provisions should be harmonised across member states – the setting of minimum levels should not limit top-ups by individual countries. The benchmark method and compensation level should be aligned with the principles applied to free allocations.

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