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Alleged competitiveness concerns of the EU ETS

Round Table on Environmental Protection and Climate Change (27 May 2008).

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Key points

- What European leadership means...
- The health of the European economy
- An efficient design for a global carbon market
 - Centralised cap setting
 - All permits to be initially distributed through auctions
 - 50% of revenue to be earmarked to support developing countries
 - 50% of revenue to be earmarked to support European decarbonisation
 - Moving away from external and internal offsetting

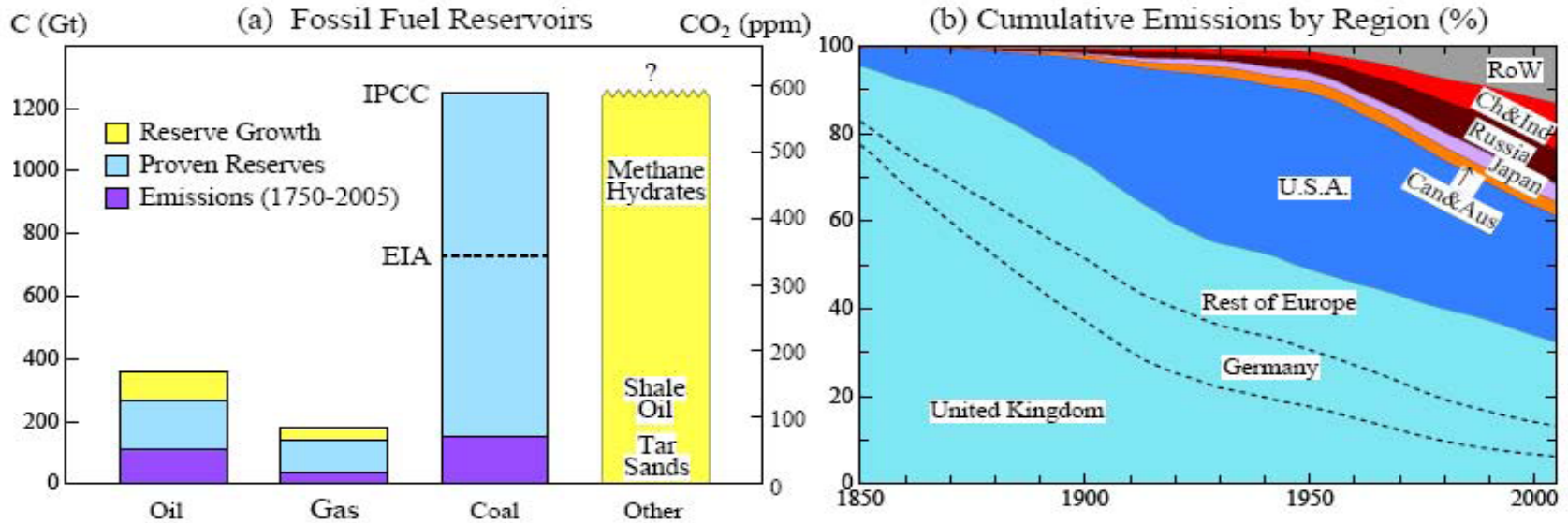


1. Leadership

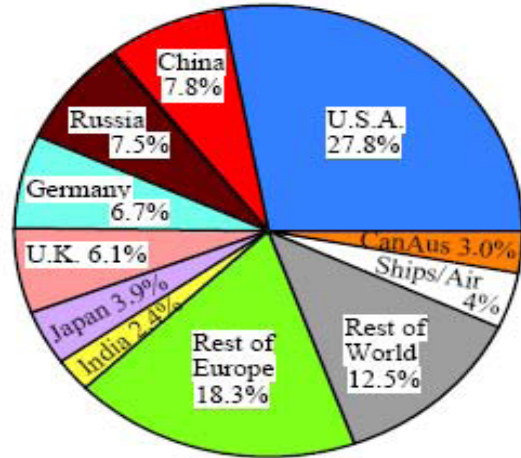




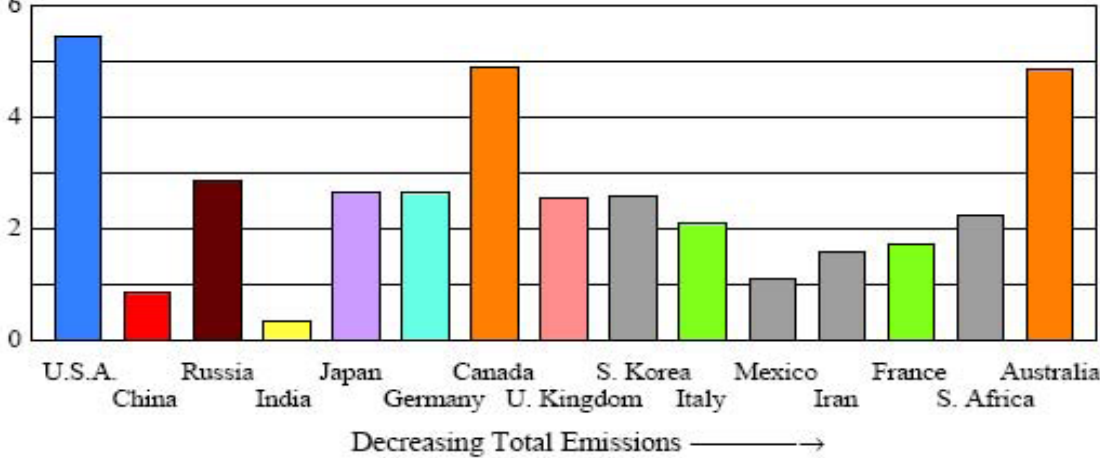
1a. Leadership: Historic responsibility



(c) Cumulative Emissions to 2005



(d) 2003 Per Capita Fossil Fuel CO₂ Emission Rate (10³kg Carbon/year/person)





1b. Leadership: Historic responsibility

- Europe, in particular, Germany and the UK, have been responsible for emitting most of the CO₂ that is currently in the atmosphere.
- CO₂ remains in the atmosphere for over 100 years so the current increases in greenhouse gases result from developed country actions.
- Therefore, developed countries **MUST** take the lead to clean up their mess and set an example for others.
- Developed countries must also make contributions to the climate change impacts that developing countries are facing now!





1c. Leadership: Impacts of inaction in Europe and Asia

Table 6.12. Indicative estimates of regional exposure as a function of elevation and baseline (1995) socio-economics. MER – market exchange rates (after Anthoff et al., 2006).

Region	Exposure by factor and elevation above mean high water								
	Land area (km ²)			Population (millions)			GDP MER (US\$ billions)		
	1m	5m	10m	1m	5m	10m	1m	5m	10m
Africa	118	183	271	8	14	22	8	11	19
Asia	875	1548	2342	108	200	294	453	843	1185
Australia	135	198	267	2	3	4	38	51	67
Europe	139	230	331	14	21	30	305	470	635
Latin America	317	509	676	10	17	25	39	71	103
North America	640	1000	1335	4	14	22	103	358	561
Global (Total)	2223	3667	5223	145	268	397	944	1802	2570

Impact of global average sea level rise:

Source: Working Group II, IPCC 2007





1d. Leadership: impacts of weak action in Europe

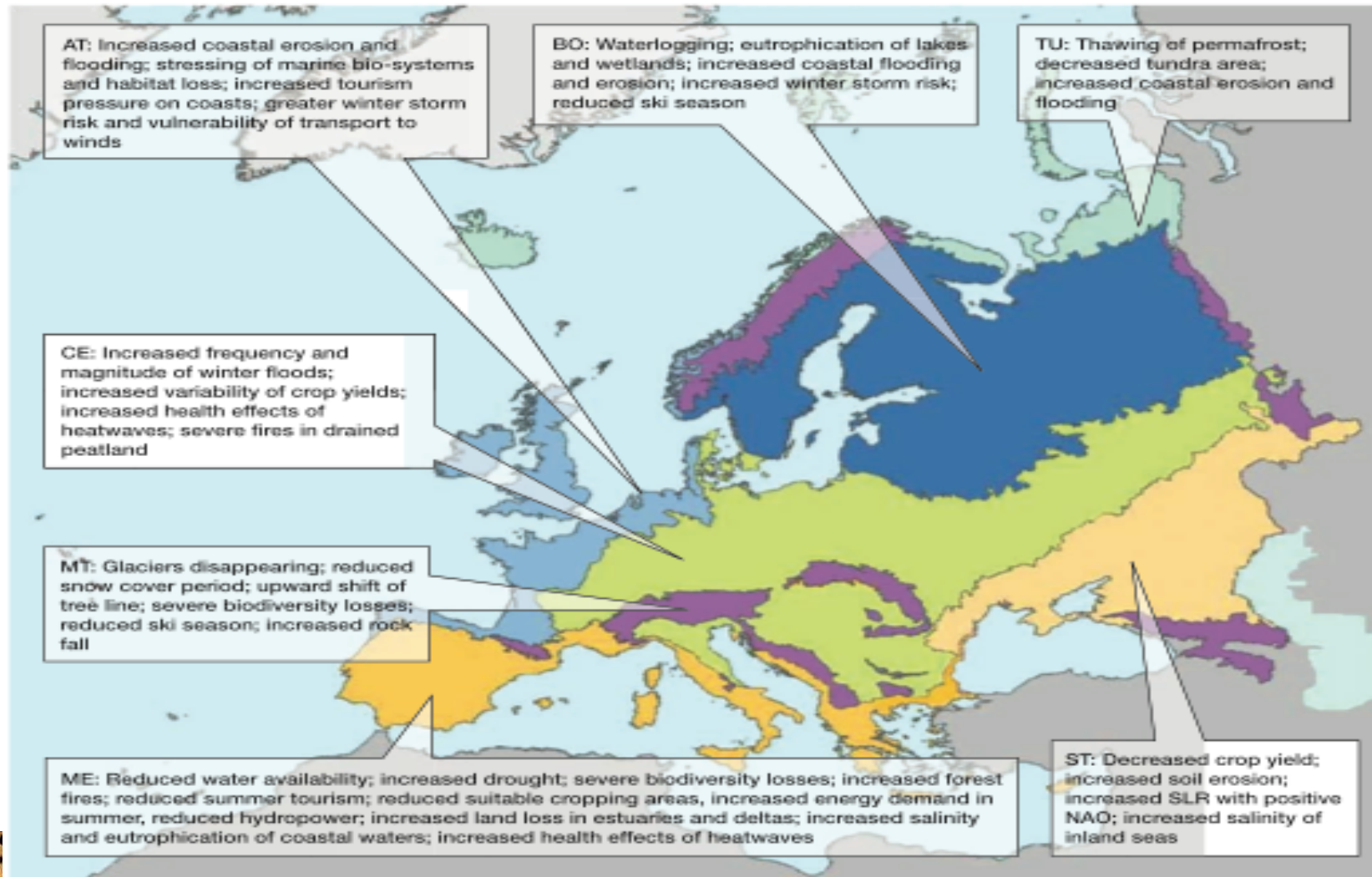


Figure 12.3. Key vulnerabilities of European systems and sectors to climate change during the 21st century for the main biogeographic regions of Europe (EEA, 2004a): TU: Tundra, pale turquoise. BO: Boreal, dark blue. AT: Atlantic, light blue. CE: Central, green; includes the Pannonian Region. MT: Mountains, purple. ME: Mediterranean, orange; includes the Black Sea region. ST: Steppe, cream. SLR: sea-level rise. NAO: North Atlantic Oscillation. Copyright EEA, Copenhagen. <http://www.eea.europa.eu>





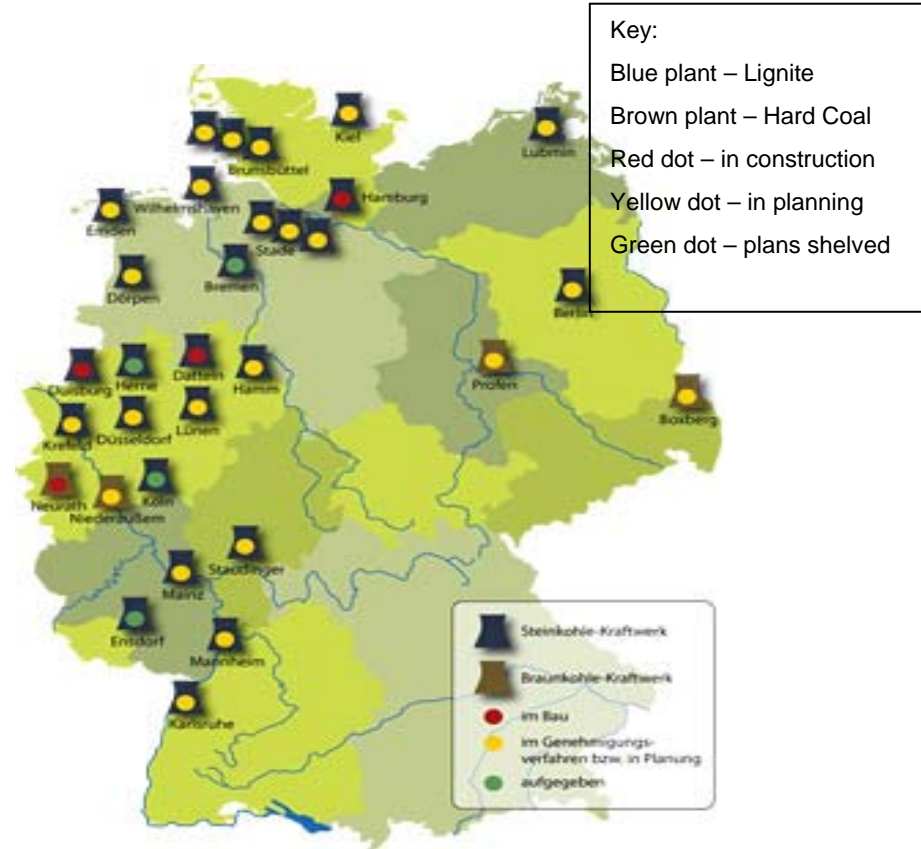
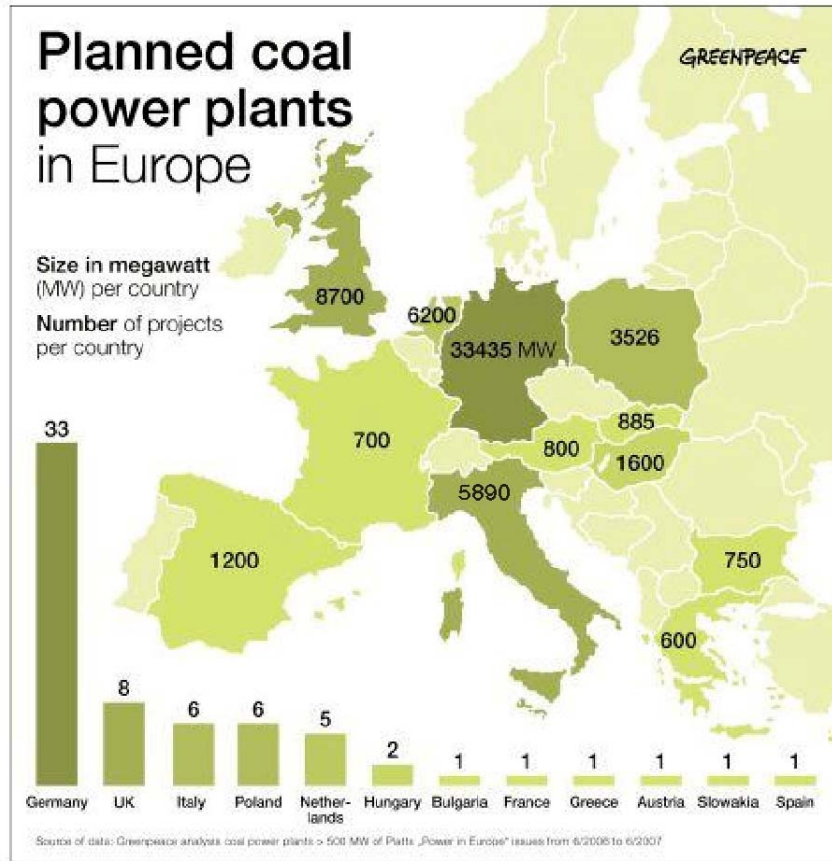
1e. European leadership means:

- Making emission reductions in Europe (30% EU wide emission reduction). This does not include external (CDM/JI) or internal offsetting.
- An additional 15% emission reduction to be achieved by supporting adaptation, technology cooperation and mitigation in developing countries.
- *Common but differentiated responsibilities implies developed nations to make significant emission reductions first...*
- Avoiding the threat of trade war (border taxes or carbon equalisation) to developing countries.





EU Climate policy simply isn't working..



2. Health of the European economy





2a. Industry scaremongering: The audacity of the current EU-wide debate

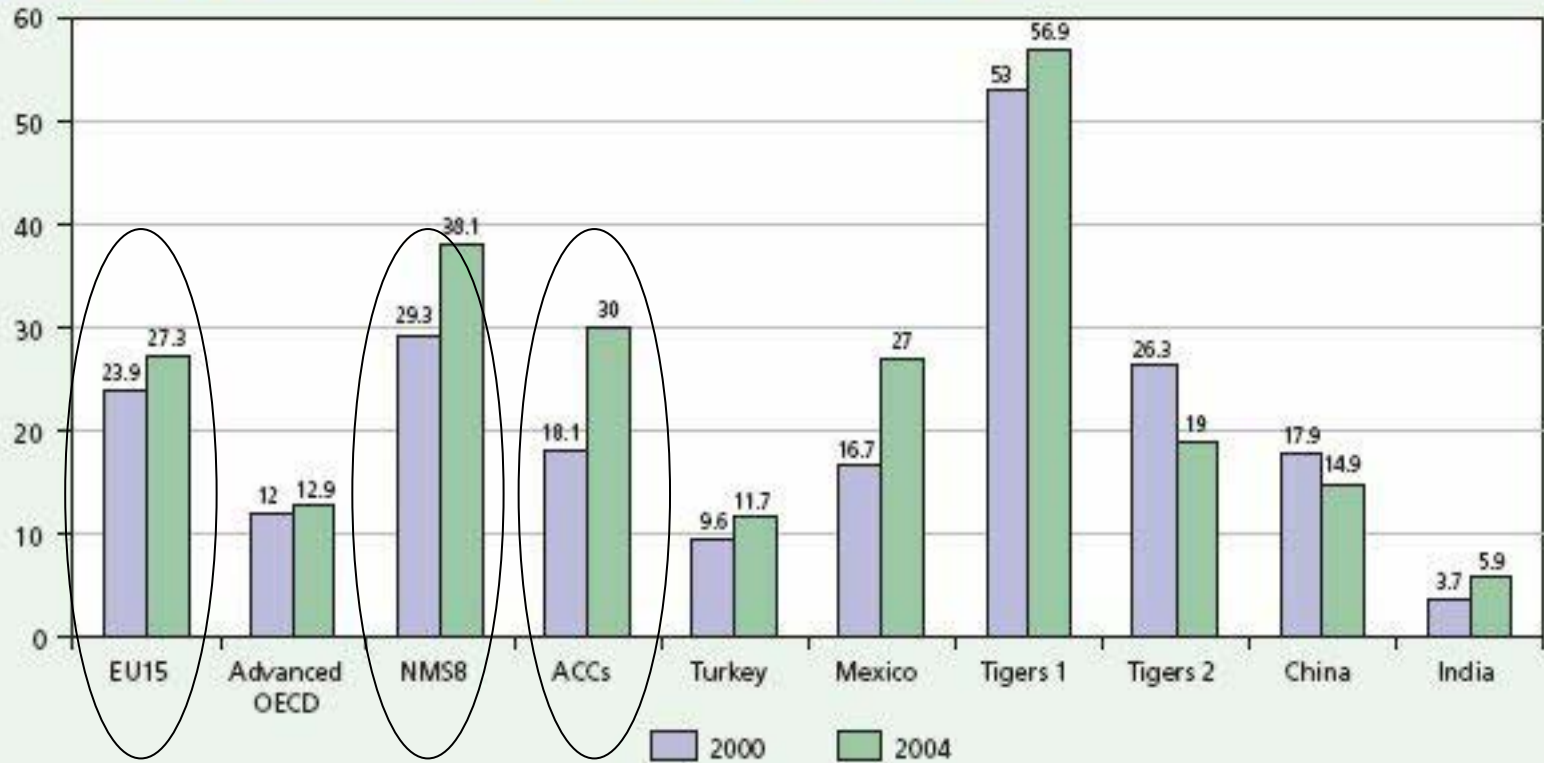
- Industry will leave Europe if it has to buy pollution permits in auction.
- Industry should have free pollution permits and a reduced emission reduction effort.
- Need border taxes to penalise poor countries for rich countries historic environmental destruction.
- Auctioning in the EU ETS is the biggest threat to current and future economy of Europe.
- Europe should do very little unless poor countries take equal climate mitigation measures.





2b. Health of the European economy

Figure 1: The stock of foreign direct investment (FDI) in % of GDP, 2000 and 2004





2c. Investment trends

- Europe is the largest global trading block.
- It has continually attracted investment and including Foreign Direct Investment because of the size of the market.
- Investments have been made, and continue to do so under the guise of increasing environmental, social and health & safety legislation many of which is taken unilaterally.



3. Design features of an effective EU ETS





3a. Centralised cap

- Centralised cap to 2028.
- Need to have review every 5 years to, if needed, alter the annual linear reduction.
- Should carry the linear reduction to 2050 by which stage the EU and other developed countries must have decarbonised (note this is a conservative estimate based on a target of 450ppm CO₂ concentration in the atmosphere to give a probability of about 50% of staying below 2°C average temperature rise).





3b. Auctioning: All permits **MUST** be auctioned

Auctioning is “**the simplest and generally considered to be the most economically efficient system**... [auctioning] “eliminates windfall profits and put new entrants and higher than average growing economies on the same competitive footing as existing installations”. European Commission (2008)

Auctioning:

- Applies the ‘polluter pays principle’
- Ensures the full cost of carbon is factored into investment decisions;
- Avoids **windfall profits** to the most polluting sectors eg a report commissioned by WWF estimates that that windfall profits in Phase II (2008-2012) of the EU ETS for the power sector in Germany, UK, Poland, Spain and Italy alone may accumulate up to **71 billion Euros**;
- Provides carbon finance for investment in climate protection and wealth generation;
- Rewards the most efficient low carbon production.





3c. Centralised EU-wide benchmarking does not work!!

- *Free permits do not account for the emission reduction effort AND also the cost of indirect emissions. So they are a fraction of the solution.*
- A Carbon Trust study concluded that with free permits “**an incentive remains for these sectors (cement and steel) to reduce domestic production, sell the allowances and import substitutes or carbon-intensive intermediate products**”. Source: The Carbon Trust (2008).
- Data is commercially sensitive and open to gaming.
- **Impossible to set EU wide benchmarks** for installations eg aviation ETS example as well as current N₂O case where the best available technology removes N₂O but the standard sets the benchmark to give permits to existing plants. Benchmarks freeze technological innovation and importantly do not stimulate new jobs/investment.





3d. Offsetting

- 20% target has scope for limited CDM
- 30% has scope for a lot of CDM (600-800MtCO₂).
- There is no quality criteria or process to address quality in the CDM as well as targeting sustainable development in the poorest countries.
- Domestic offsets are proposed with no cap on their quantity, and quality criteria. **This loophole inflates the cap!**



4. The distortion of competitiveness and “carbon leakage”





4a. What are we talking about?

- **Carbon leakage** = “ETS induced relocation of production/emissions to regions outside of ETS”.

German Federal Ministry for the Environment (2008)

- **Carbon leakage is less likely to occur** if carbon costs can be passed on consumers if products are highly specialized if other aspects dominate location decisions (e.g. exchange rate risks, transport costs, close cooperation with EU partners).

German Federal Ministry for the Environment (2008)

- Leakage must mean that emissions, if relocated, increase!





4b. Criteria for assessing competitiveness..

- The criteria outlined below must be applied to all sectors to allow for a true discussion about alleged competitiveness impacts.
 1. Trade intensity
 2. Market structure/concentration
 3. Installation level historic investment against company and market trends





4c. European Commission overview

- “Due to the need of significant capital requirements, energy intensive industries tend to operate in fairly concentrated markets. Some of these industries have a significant track record of collusion and infringements of the competition rules. If companies prove to be able to increase prices by collusion, they can not be expected to have great difficulties in increasing prices to a similar extent when facing increased cost of emissions”. (European Commission 2008).





4d. Trade intensity. eg cement sector

- Cement is cheap to produce. Main cost comes from the transportation of cement in bulk. (Cost of transporting 1 tonne of cement by road is 100Euro).
- Cement is largely produced for domestic consumption and over production facilitates export.
- Cement plants are capital intensive (A new cement plant costs typically over 10 million Euros per 100,000 tonnes of cement produced. UK Government stipulates that any new plant should have access to at least 25 years supply of cement and existing plant should have cement stock reserves for 15 years).

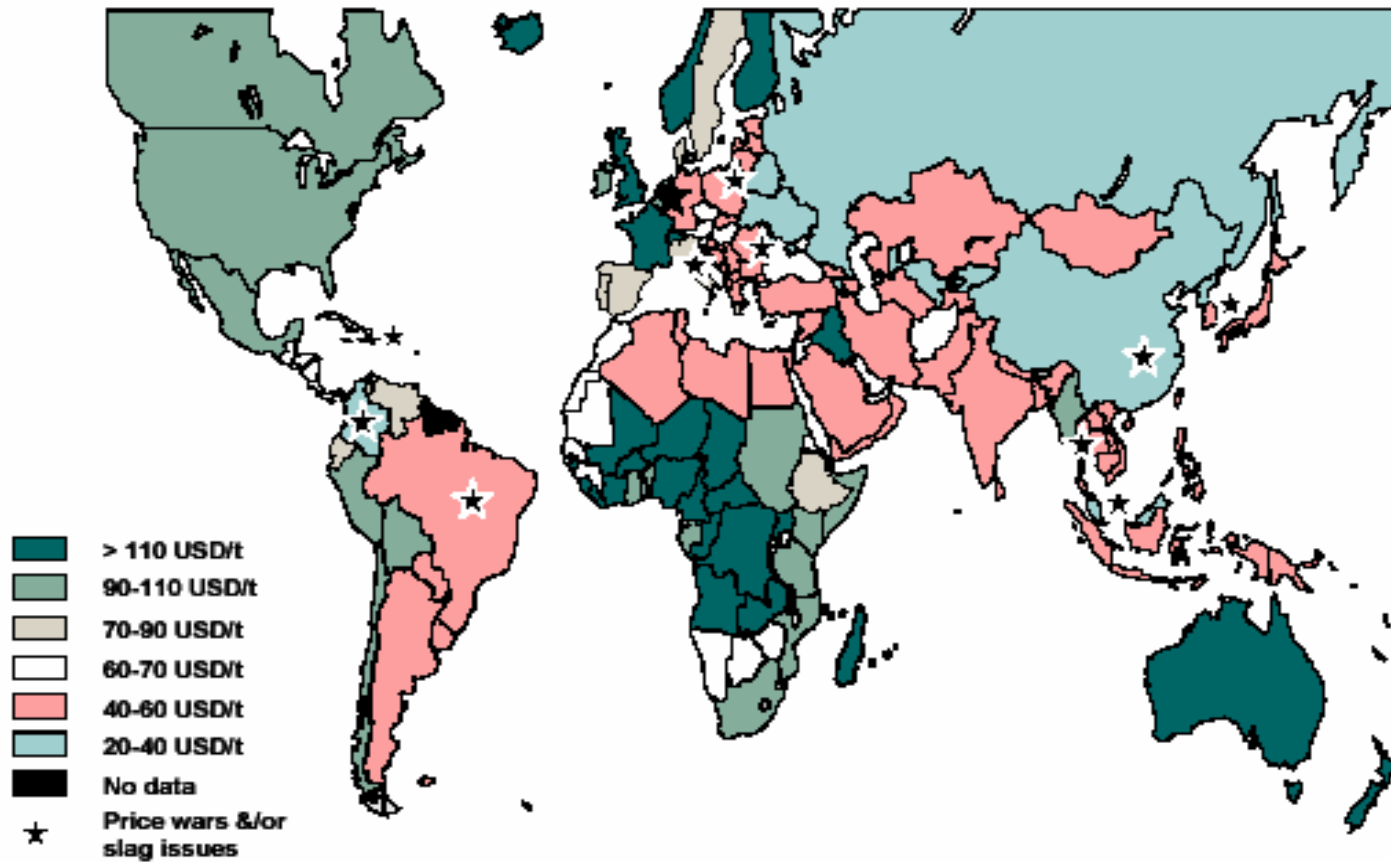
Key facts:

1. Currently only 8% of cement consumed in the EU comes from non-EU countries.
2. Current demand (about 80% of the above 8% total non-EU imports) for cement comes from Italy and Spain. Local cement companies reduced production capacity which has led to increased demand for imports.
3. Egypt has a 11 USD per tonne of cement export tariff on to encourage domestic consumption.
4. The United States is the largest market for Chinese cement. Other customers include the Taiwan, Hong Kong, the Philippines, South Korea, Brunei, Malaysia, Vietnam, Singapore, and Macao. (WBCSD. 2002)





4e. Trade intensity (Major difference in global cement prices)



Source: Exane BNP Paribas estimates





4f. Market structure

- “Market concentration in the cement industry is rather high and **prone to collusion** and formation of **cartels**”.
- “The cement sector is unlikely to be **significantly exposed to international competition** due to high transportation costs”.
(European Commission 2008).





4g. Market structure

- Cartel cases:

(1994) **European Commission** fines cement cartels **13.5m Euro**¹ and concludes “Anti-competitive practices and agreements constitute economic infringements designed to maximise the profits of the participating undertakings. The harmful effects for the markets and for consumers are particularly serious in the cement sector, since they are passed on to the construction and housing sector and to the real-estate market in general”. (European Commission). ¹(Note – fine level later changed.)

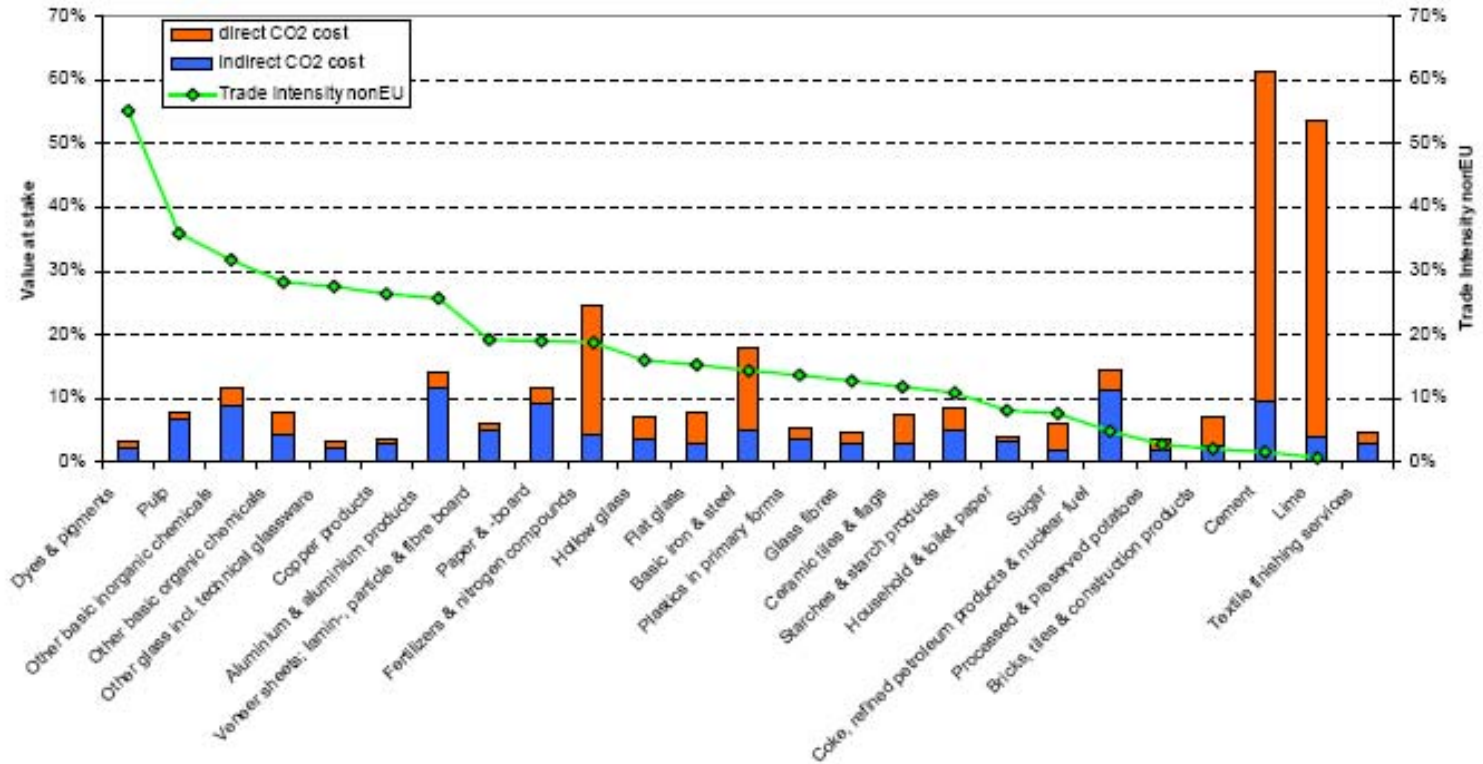
(2002) **German government** smashed a major cartel in the cement sector with fines of **660m Euro**. (Guardian. 2002).

(1999) **Commission** fined 8 European steel companies (including Corus, Mannesmann, Vallourec and Dalmine) were fined **99m Euros** for rigging stainless steel tubes market. (BBC. December 1999).





4h. Assessment by the German Government



German Federal Ministry for the Environment (2008)





4i. Installation level investment: Arcelor steel plant in Liege, Belgium, 2003-today

- Guy Dollé (CEO in 2003) announced that 6 smelters to be run down to closure. Investment focus on producing flat carbon products near coasts to maximise profits from exports to Asia.
- This decision was based on the conclusions of an in-depth study which took account of market shifts in prices and volumes, cost increases, the amount of investment required and environmental issues with the plant.
- 2007 ArcelorMittal decides to reopen the plant because of the high price of steel.
- Key points:
 - (i) The company made a business decision not to invest in the installation.
 - (ii) Current problem down to lack of investment from the company.
 - (iii) No impact on the overall profitability of ArcelorMittal.





4j. Summary of criteria for assessing competitive concerns if there is no international agreement

- An installation must present its case to an independent institution/ agency/process.
- Historic investment trends in an installation against historic investment trends across the company.
- Energy efficiency potential in an installation. This survey must be performed by an independent expert.
- Demand for the installation's product in the region, country and internationally.
- Regional trade barriers – transportation costs, access to markets, output specifications, etc
- Low carbon production technologies and techniques available in the sector.





4k. Solutions

- **Use of auctioning revenue to stimulate investment is key.**
 - Free permits are not likely to lead to new investment in efficient European plant upgrades or new plant.
 - Auction revenue should be used to part or fully finance investment in low carbon technologies, techniques, R&D&D.
 - **Investment in capital infrastructure provides an asset for the EU.** It will remain over and above the operational costs of a company. It allows for new entrants to produce on a modern, low carbon site rather than a simple transfer of money that can be spent on a number of costs, overheads, dividends, etc..
 - Free permits support a global brand not an installation and local employment. They exclude future generations from employment.





4I. Border taxes/carbon equalisation

- Need to move away from the politics of confrontation to the politics of peaceful cooperation to address the global challenge of climate change.
- Similar measures have not been proposed in other legislation before such as pensions, healthcare, 35 hour working week?
- Trade war and retaliatory impacts have not been measured! What is the impact on domestic sales – textiles, automobiles?
- What is the benchmark for measuring imports? Who sets this? How is it measured? Will you penalise European companies that import to Europe?
- WTO rules mean that EU companies have to demonstrate that importers are not exposed to the same level of injury. This means that they need to have been subject to a tax or an equivalent measure such as 100% auctioning.





Conclusions

- 100% auctioning is crucial to allow member states to direct investment into low carbon technologies and techniques.
- Competitiveness concerns should be considered **if there is NO international agreement.**
- If there is no international agreement on climate change then **an independent agency/institution/process should be set up to assess claims from an installation.**
- Need for an examination of the impact of large polluting sectors on the overall European GDP.





**Wake up!
It's time to fight!!!!**



www.panda.org/climate

