Survival guide to EU carbon market lobby

DEBUNKING CLAIMS FROM HEAVY INDUSTRY

Policy briefing, June 2021

Carbon Market Watch

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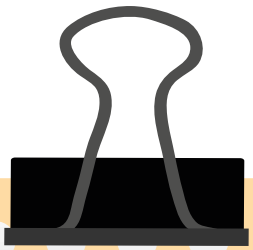


Executive summary

The EU Emissions Trading System (EU ETS) is a centrepiece of Europe's climate policy and one of its main tools to reduce greenhouse gas (GHG) emissions from Europe's industrial and power sectors. Until today, most of the emission reductions achieved under the EU ETS were driven by the power sector due to fuel switches in the production of electricity and heat (i.e. less hard coal and lignite, more renewable energy sources). On the contrary, carbon emissions from sectors like steel, cement and chemicals have barely decreased in the past decade. Yet, the same energy-intensive industries continue to push back on the impending reforms to the EU ETS.

Using position papers and submissions to the European Commission's public consultations on the topic in 2015 and 2020 from the chemicals, steel and cement sectors, this briefing scrutinises the industry's claims and talking points, analysing their influence on the processes of past and upcoming revisions of the EU ETS.

Key takeaways

- The industry lobby repeats arguments which fall under well-documented 'discourses of climate delay'.[48] Their main aim has been to divert responsibility by claiming that other sectors or regions should take action first, as well as pushing for non-transformative solutions.
- In the last EU ETS revision, the imbalance of the political influence between the industry lobby and civil society organisations led to the majority of EU lawmakers to grant exemptions to energy-intensive industries and undermine the polluters pay principle.
- Despite their current public embrace of ambitious climate policy, energy-intensive industries continue to push back against the implementation of the European Green Deal when it comes to reforms to the EU ETS.
- The industry narrative remains focused on the risk of carbon leakage despite little evidence that it has ever taken place, and the demand for free pollution permits. In addition, the economic downturn caused by the COVID-19 pandemic has been used by many industry associations as an argument against phasing out the free allocation of emissions allowances post-2020.

The energy-intensive industry lobby and the EU ETS

According to the most recent data,[1] there are around 3,398 non-governmental organisations versus 7,573 law firms, trade and business associations working to influence the decision-making machinery in Brussels.

The energy-intensive industries like steel, cement and chemicals represent a large group and have been active in influencing the EU ETS directive since its launch.

The Alliance of Energy Intensive Industries (AEII) is probably the most representative group of companies active in influencing the EU ETS. Made up of around 15 industry confederations, AEII includes CEFIC, the European Chemical Industry Council, CEMBUREAU the European Cement Association), EUROFER (the European Confederation of Iron and Steel Industries). AEII claims to represent over 30,000 companies in the EU, defining itself as 'the foundation of Europe's economic fabric, drivers of jobs and growth in Europe'.[2] Despite its public embrace of ambitious climate policy and assurance that its decarbonisation roadmap is fully aligned with the Paris Climate Agreement, AEII has continued to push back against the implementation of the European Green Deal when it comes to reforms to the EU ETS.[3] One of its goals is to ensure that the industries it represents continue to receive as many free EU ETS pollution permits as possible.

The responses to the 2021 EU ETS public consultation reveal that out of 493 respondents, 70% represented private sector stakeholders against 10% NGOs.[4] In the past, similar imbalance has led to the majority of EU lawmakers agreeing to change the rules to undermine the polluter pays principle and to grant exemptions to energy-intensive industries. This can be seen in Article 10a of the ETS directive which specifies the rules for allocating free pollution permits to heavy industries:

- In the course of the latest revision, these rules were amended to include a provision to top up the free allocations with another 3% of all allowances under the ETS if needed.
- The steel industry managed to secure a specific exemption from the annual updates to the ETS benchmarks which define the reduction rate of free allocations. The reduction rate for hot metal became fixed at only 0.2% in the lawmaking process. For all other sectors, a fact-based comparison will determine the annual reduction rate, ranging from 0.2% to 1.6%. The rules were tailored to allow the most favorable treatment of the steel sector.
- During the last EU ETS reform, the European Parliament's Environment Committee had struck an initial agreement on removing the cement sector from the ETS carbon leakage list. After Cembureau (the EU cement industry federation) rallied other industrial sectors behind its call to remain entitled to free ETS allowances,[5] the cement industry stayed on the list of sectors that receive free pollution permits.[6]

Industry lobby claims: EU ETS climate delay discourses[7] explained

Carbon pricing policies such as the EU ETS affect a wide range of stakeholders across the EU. However, the ETS's highly technical nature acts as a barrier to public participation, creating asymmetries in capacity and access to policymakers between industry stakeholders and civil society organisations.

Despite the growing concern about climate change and even the heavy polluters' public embrace of ambitious climate policy, certain industry lobbyists have continued to push back against reforms of the EU ETS. Their strategy has been mostly framed around a handful of recurring arguments which fall under well-documented 'discourses of climate delay'.[8] Their main aim has been to redirect responsibility by claiming that other sectors or regions should take action first, as well as pushing for non-transformative solutions.

In addition, technical elements of the debate are used to justify the ability to pollute for free under the EU ETS; the hypothetical risk of carbon leakage which would translate into a loss of competitiveness, economic growth and unemployment.

The following section looks at the key elements of the ETS directive and some common talking points used by the industry lobby to influence this policy during the past and upcoming revisions.

2030 versus 2050 - all talk but little action

Energy-intensive industries such as CEFIC, Cembureau[9] and Eurofer, publicly support the EU's ambition to become climate-neutral by 2050. Cembureau's Carbon Neutrality Roadmap report published in May 2020 'aspires' to be in line with Paris climate goals.[10]

However, the lobby groups' public statements do not necessarily align with their recommendations on the next EU ETS revision.

The potential strengthening of key mechanisms of the EU ETS to drive faster emission reductions are described as existential threats to the viability of their sectors. These include the increase of the rate at which emissions decrease - "Linear Reduction Factor" - the increase of the intake rate of the Market Stability Reserve, the end of free allocation. This demonstrates a somewhat two-faced approach to delay climate policy improvement in the short term, while publicly commiting to vague promises of enhanced climate action in the long term.

CEFIC (2020):

'Cefic supports the EU's ambition to become climate-neutral by 2050. Climate-neutrality by 2050 means going through a deep transformation within just one or two investment cycles. The EU chemical industry intends to grasp the opportunities arising from the transition to a climate-neutral and circular economy.'[11]

[...]

'Unfortunately, the Commission's 2030 impact assessment shows that the additional effort would fall disproportionately on the shoulders of ETS sectors.'

EUROFER (2019):

'EUROFER has established a clear set of pathway scenarios that will deliver this essential change for the sector, ensuring that Europe will remain on track to fulfil its Paris Climate Accords requirements, whilst also making European steel fit for a clean, low-carbon future.'[12]

Eurofer (2021):[13]

'The climate ambition of the EU ETS is defined by the stricter 2030 cap; rebasing (i.e. one off cancellation of allowances) and strengthening of the Market Stability Reserve (i.e. putting more allowances in the reserve) are not needed as they artificially increase the costs for the same level of climate ambition.'

AEII (2020):

'The Energy-Intensive Industries give strong support to the development of policies to enable the transition to a climate-neutral economy by 2050, whilst keeping industry competitive.'[14]

AEII (2021):

'The [...] Commission impact assessment continues to foresee marked differences in the reduction targets as well for 2030. [...] This threatens the current functioning of the ETS system and the competitiveness of industry. [...] Rebasing and strengthening of the Market Stability Reserve are not needed as they artificially increase the costs for the same level of climate ambition.'[15]

Avoiding responsibility: Blame shifting on other sectors

Until today, most of the emission reductions achieved under the EU ETS were driven by the power sector due to fuel switches in the production of electricity and heat (i.e. less hard coal and lignite, more renewable energy sources).[16]

On the contrary, carbon emissions from industrial sectors like steel, cement and chemicals have not decreased much in the past decade.[17] Yet lobbies from the energy-intensive industries continue to pass the responsibility to take climate action first on other sectors.

CEFIC (2020):[18]

'Burden-sharing between ETS and non-ETS sectors should be rebalanced and the share of the ETS-sector in the EU ambition should be reduced as industry is exposed to global competition.'

EUROFER (2021):[19]

'The higher 2030 ambition should focus on non-ETS sectors, which are not exposed to international competition and have been lagging behind in recent decades and need to accelerate their emission reductions by 2030 in view of their decarbonisation by 2050.'

To reach the increased climate targets, all sectors will need to contribute. Only if industrial emissions are drastically reduced will Europe reach its climate goals and the global temperature rise be limited to 1.5 degrees Celsius.

For that to happen, the EU emissions trading scheme must provide a robust carbon price signal, thereby creating an incentive for emission reduction.[20]

Cleaner technologies: No sticks, just carrots

Financial support and investments for industry to innovate and deploy zero-carbon breakthrough technologies is crucial to achieve climate neutrality as soon as possible. Given the amount of funding required to make this happen, it is clear that the current level of public and private funding is insufficient.

The last EU ETS revision established the Innovation Fund, successor of the NER300. The Fund covers renewable technologies, carbon capture and storage (CCS) and innovative low-carbon technologies and processes in energy-intensive industries. It amounts to an estimated 18 billion euros[21] in the coming decade. This is about 15 times smaller than the value of the emission allowances which will be handed out for free (see below - auctioning vs. free allocation).

EUROFER (2020):

'Higher climate ambition needs to be accompanied by strengthened carbon leakage protection and more measures to incentivise low carbon technologies, both by 2030 and beyond. This requires: first, free allocation and indirect costs compensation at the full level of realistic benchmarks ; second, the rapid implementation of an effective carbon border measure [...]; third, new measures to upscale and roll out low carbon technologies, such as contracts for difference.'

Cembureau (2021):

'EU ETS carbon prices and a carbon border adjustment will not be enough to create a business case for key low-carbon technologies. Many "breakthrough" technologies will require higher carbon prices if they are to be competitive. To make these technologies economically viable, supplementary policies such as carbon contracts-for-difference will be needed. Therefore the use of Carbon Contracts for Difference (CCFDs) to support industrial decarbonisation should be supported in the EU ETS.'[22]

AEII (2021):

'To accelerate the development and market uptake of low-carbon technologies, it is of utmost importance to increase the financial support for industry in line with the technology neutrality principle.'[23]

Energy-intensive industries call for government subsidies, claiming that it would cover the additional costs of using carbon-neutral technologies compared to conventional production. State aid compensation (for indirect costs), free emission allowances and the inclusion of "carbon contracts for difference"[24] in the EU ETS are all promoted as ways to support the industry in their efforts to decarbonise.

Yet it is unclear how the industry would spend these funds or whether they would actually deliver more emission reductions in these sectors. If fewer pollution permits were handed out for free, there would be more auctioning revenues that could be specifically targeted to complement public investments in clean industrial transition. This way, Europe could accelerate its progress towards a carbon-neutral industry.

In addition to incentives, technological progress also requires regulation. Energy-intensive industries are trying to shift the debate to only technological solutions with minimal regulatory interventions. This distracts from the task of strengthening the EU ETS as a climate policy instrument. Both regulation and investments in innovation are needed to create real incentives for emission reductions.

Carbon Leakage risk or myth? The free rider excuse

Carbon leakage is a term used to describe the hypothetical situation where carbon pricing under the EU ETS would force companies to move their production abroad to countries without comparable climate policies, leading to an increase in emissions globally.

ArcelorMittal (2014):
'EU energy and climate policy is punishing the steel sector and other energy-intensive industries, which is having a profound impact on our competitiveness.'

Lafarge (2013):
'Unequal carbon pricing place[s] the EU manufacturing sector in general – and the cement sector in particular – at risk of carbon leakage.'

EUROFER (2015):
'The current EU ETS proposal [is] an existential threat. [It] puts the viability of the steel industry – including its most efficient producers- at risk.'

CEMBUREAU (2015):
'[...] the current EU ETS [...] will de-industrialise Europe before it decarbonizes European manufacturing.'

CEMBUREAU (2020):

'The current carbon leakage protection framework should be maintained without changes | Other measures to further incentivise GHG reductions should be introduced.'

There has, so far, been no compelling evidence that EU's climate policies are forcing companies to move abroad and recent academic studies indicate that this is also unlikely to happen in the future.[25]

Despite lack of evidence that the risk of carbon leakage[26] [27] is real, the industry lobby has not backtracked on this matter. This does not come as a surprise, since the hypothetical risk of carbon leakage means free pollution permits, which have allowed industry to make billions of windfall profits for the industries concerned.[28] If allowances would be auctioned rather than given to emitters for free, more revenues could be used towards climate action, helping innovative sectors to reduce emissions more quickly.

CEMBUREAU (2020):[29]

'A full co-existence of CBAM and free allocation is essential to minimize risks for the industry, avoid distortions on the internal market, safeguard the competitiveness of exports, and provide certainty for investors.'

The absence of an international agreement that would put all competing manufacturers on an equal footing has been used by the European industry as justification to receive free allowances. However, now that the European Commission is expected to propose a Carbon Border Adjustment Measure (CBAM) to address this issue, the same industry confederations advocate for a full co-existence of CBAM and free allocations.

Industry associations such as Eurofer[30] demand that such a measure should be designed to complement the level of free allowances. However, if free allowances are maintained with the CBAM, companies will be de facto protected twice against the non-existing risk of carbon leakage. The combination of these two elements will further dilute any incentive for these companies to reduce their GHG emissions.

Auctioning Vs free allocation: Make the polluter pay

The default method of allocating emission allowances under the EU ETS is auctioning. It is the most transparent method for handing out emission allowances and puts into practice the principle that the polluter should pay.[31]

Allowances can also be given to companies for free, depending on the sector.[32] Free allocation is a temporary derogation to the default method of auctioning allowances. Over the trading period (2021–2030), the current rules provide at least 43% of the total number of allowances to be handed out for free. This represents over 6.3 billion ton CO_2 emissions, worth over €250 billion at current carbon prices (40€/ton CO_2). Giving allowances away for free provides little incentive for GHG emission reduction whereas increasing the auctioning share raises revenues that can be re-invested wisely in the economy. From an economic perspective, free allowances represent a market failure, since the external cost of the carbon pollution is not internalised by the industries.

EUROFER (2020):

'Cancelling free allocations would be a "…death sentence" for the European steel sector.'[33]

Cembureau (2015):

'There should be free allocation if there is not an international agreement which places all competing manufacturers on an equal footing on a global level playing field.'[34]

Large polluting industries have been very vocal about the need to maintain -and even increase- their share of free emission allowances. Free allowances create a substantial financial benefit through the generated windfall profits. The question remains how much credit policymakers give to these threats when the risk of carbon leakage remains hypothetical (see above), and all parts of society should act urgently to tackle the climate crisis.

Four factors to rule them all: BM x HAL x CLEF x CSCF

The amount of free allowances that an installation receives is determined by several factors. To explain the lobbying approach of energy-intensive industries, it is important to understand the formula according to which companies receive their free allowances:

$$FA = BM \times HAL \times CLEF \times CSCF$$

Here FA is the amount of free allowances, BM is the benchmark value, HAL is the historic activity level , CLEF is the carbon leakage factor and CSCF is the cross sectoral correction factor.

Each of the four factors in this calculation can be used as a way to argue for receiving more free emission allowances. The details seem complex, but the lobby strategy of energy-intensive industries is simple and focused on maximising the value of all four factors. The meaning of each factor is explained in more detail below.

Eurofer (2020) :

'Effective carbon leakage protection with benchmark based free allocation and indirect costs compensation.'

Statoil (2015):

'An over ambitious benchmark will increase the risk of carbon leakage.'

FuelsEurope (2015):

'FuelsEurope does not support the use of benchmarks based on theoretical "Best available technologies". A benchmark must describe the actual state of the sector and the latest technologies that are actually being applied, not just at a concept stage. This is to ensure the correct level of carbon leakage protection. Benchmarks must recognise and reward GHG performance differences in a sector. They must be set at a realistic level: an over-ambitious benchmark will artificially increase costs to the sector overall and will increase the risk of carbon leakage.'

The benchmark value (BM)

Benchmark values reflect the greenhouse gas emission performance of the 10% best installations in the EU producing a specific product.

The benchmark values should ideally incentivise low-carbon alternative technologies and products, but in reality they often support high-carbon incumbent installations at the expense of lower carbon competitors.[35] From 2021, the benchmark values determining the level of free allocation to each company are updated with an annual reduction between 0.2% and 1.6% depending on the past technological progress for the sectors. These very low annual reduction rates mean that the level of free allowances under the EU ETS does not align with a 2050 net-zero trajectory.

The steel industry even managed to secure a specific exemption[36] from the annual updates to the ETS benchmarks which define the reduction rate of free allocations. The reduction rate for hot metal became fixed at only 0.2% in the lawmaking process. If this remains the case, it would take many centuries for the steel sector's free allowances to be phased out.

Cross sectoral correction factor (CSCF)

The maximum amount of free allowances is fixed to a certain percentage (±40%) of the total available emission allowances. This is to ensure that the amount of allowances available for auctioning and delivering fiscal revenues to Member States remains predictable. In years in which the demand for free allowances exceeds the fixed limit, a cross-sectoral correction factor is applied to reduce the amount of free allocation to each industrial installation accordingly.

Industry groups such as Cembureau oppose the use of the cross-sectoral correction factor as it implies a reduction of the total number of allowances that can be handed out for free.

CEMBUREAU (2020):[37]

'CEMBUREAU is firmly opposed to both the tiering of free allowances and the cross-sectoral correction factor.'

Total (2020):

'The current auction share of 57% should be reduced. As long as a CBAM is not implemented in a sufficient number of emission intensive sectors, carbon leakage protection will be provided through the system of free allowances put in place by the Commission and the application of a correction factor (CSCF) should be avoided.'

Tata Steel (2015):

'Benchmarks for the steel sector are set at technically unachievable levels. On top of this competitiveness penalty the cross sectoral correction factor increases the under allocation even for best performers.'

AEII (2020):[38]

'The decarbonisation of the power sector (subject to auctioning) leaves room for increasing the free allocation share and avoid the cross-sectoral correction factor.'

The historical activity levels (HAL)

The historical activity level is initially used to determine the amount of free allocation to companies, and refers to a 2005-2010 reference period. From 2021, if the difference between the real activity level and the historical activity level of an ETS installation is more than 15 %, the free allocation of allowances to that installation will be adjusted.[39] Depending on the increase or decrease of production, a respective adjustment of free allowances for the company will happen in the following years.

AEII (2020)[40]:

'As soon as comprehensive data on the full impact of the outbreak become available, we urge the Commission to take the necessary initiatives to ensure that production and emissions reductions related to the COVID-19 outbreak will not unduly reduce the amount of post-2020 free allocation.'

EUROFER (2020)[41]:

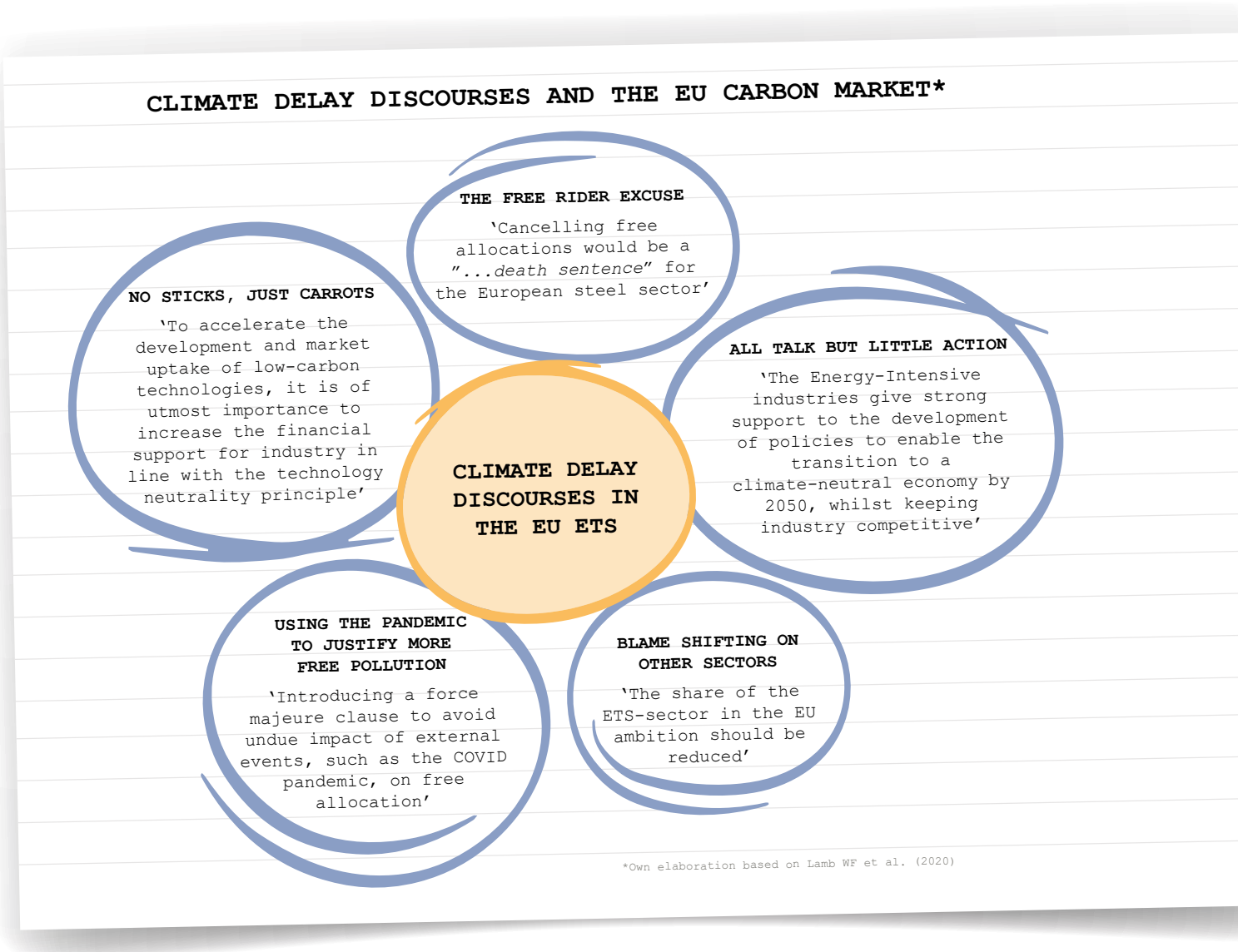
'[...] Introducing a force majeure clause to avoid undue impact of external events, such as the COVID pandemic, on free allocation. [...]'

The heavy industry lobbyists have used the COVID-19 crisis and recovery as a new framing to avoid any reduction in the amount of post-2020 free allocation due to activity level changes. This reasoning is inconsistent since it is at odds with earlier positioning of the Alliance of Energy Intensive industries. Until recently, industrial sectors were strong proponents of allocating emission allowances "aligned with real/recent production levels".[42] Today this position is abandoned, and the disruptive impacts of the pandemic are used to request more free pollution permits.

The carbon leakage exposure factor (CLEF)

Under the current trading period, the industrial sectors on the carbon leakage list receive 100% free allocation. For these sectors, the carbon leakage exposure factor is 1. Industries that are considered to be at low or no risk of carbon leakage will receive 30% of their allowances for free, and this percentage will decrease to 0% in the 2026-2030 period.[43] For these sectors, the carbon leakage factor is 0.3, and declining to 0 between 2026 and 2030.

It's important to note that sectors on the carbon leakage list represent about 96% of industrial emissions,[44] so the carbon leakage exposure factor equals 1 for the vast majority of industrial sectors. During the previous EU ETS review, several EU Member States supported the idea of implementing a tiered approach to the issuance of free allocation.[45] This was idea was strongly opposed by a group of energy-intensive industries under the name of the "Alliance for a fair ETS".[46] Interestingly, the steel association Eurofer was not part of this initiative since the steel sector would stand to benefit most from such a tiered approach.



Conclusions

Until today, most of the emission reductions achieved under the EU carbon market were driven by the power sector due to fuel switches in the production of electricity and heat (i.e. less hard coal and lignite, more renewable energy sources). On the contrary, carbon emissions from sectors like steel, cement and chemicals have barely decreased in the past decade.

The upcoming revision of the ETS rules is a crucial opportunity to ensure that the sectors covered by it reduce their emissions in line with the Paris Agreement objective. Despite their current public embrace of ambitious climate policy, energy-intensive industries continue to push back against the implementation of the EU Green Deal when it comes to reforms to the EU ETS. The industry lobby repeats arguments which fall under well-documented 'discourses of climate delay'.[47] Their main aim has been to divert responsibility by claiming that other sectors or regions should take action first, as well as pushing for non-transformative solutions. The industry narrative remains focused on the risk of carbon leakage despite little evidence that it has ever taken place. This allows the heavy polluters to continue to demand free pollution permits.

Furthermore, the economic downturn caused by the COVID-19 pandemic has been used by many industry associations as an argument against phasing out the free allocation of emissions allowances post-2020.

In addition to free pollution permits, energy-intensive industries call for other types of government subsidies. They claim that more public funding is needed to cover the additional costs of using carbon-neutral technologies compared to conventional production. While this is a fair point, it remains unclear what the outcome of all this public spending would be, or how it would deliver more emission reductions in these sectors. If allowances would be auctioned rather than given to emitters for free, more revenues could be used to support innovative sectors to reduce emissions more quickly. In addition to incentives, technological progress will also require regulation. Energy-intensive industries are drawing the solution focus towards technology support with minimal regulatory interventions. This distracts from strengthening the EU ETS as a climate policy instrument and fails to create real incentives for emission reduction.

A drastic reduction in industrial pollution is necessary for Europe to reach its new climate targets. A strong, stable and fair EU carbon price will help provide the right incentives to make that happen.

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EU Emissions Trading System (EU ETS) is a centrepiece of Europe's climate policy and one of its main tools to reduce greenhouse gas (GHG) emissions from Europe's industrial and power sectors. Until today, most of the emission reductions achieved under the EU ETS were driven by the power sector due to fuel switches in the production of electricity and heat (i.e. less hard coal and lignite, more renewable energy sources). On the contrary, carbon emissions from sectors like steel, cement and chemicals have barely decreased in the past decade. Yet, the same energy-intensive industries continue to push back on the impending reforms to the EU ETS.

Using position papers and submissions to the European Commission's public consultations on the topic in 2015 and 2020 from the chemicals, steel and cement sectors, this briefing scrutinises the industry's claims and talking points, analysing their influence on the processes of past and upcoming revisions of the EU ETS.

Supported by

The Minor Foundation
for Major Challenges

This project action has received funding from the European Commission through a LIFE grant. The content of this section reflects only the author's view. The Commission is not responsible for any use that may be made of the information it contains.