

Considerations for the Copenhagen Climate Conference

Mitigating Climate Change successfully whilst Maintaining innovation and economic growth

Aim

1. An effective agreement in Copenhagen is crucial for future global climate policy. A politically feasible agreement needs to be cost-efficient – delivering each tonne of GHG emission reduction at the lowest cost possible. At the same time, a level playing field for industry around the world must be achieved. An emission trading system with an allocation of emission allowances based on benchmarks provides a solution to both challenges. In addition, it saves industry the onerous burden of auctioning and preserves industry's capacity to invest in further climate mitigation and adaptation efforts. In view of the on-going negotiations for a post-2012 climate agreement, this paper aims to inform policy-makers worldwide about the allocation based on benchmarks to ensure that the most efficient climate policy system is chosen in Copenhagen. IFIEC Europe believes that this approach – if adopted in emission trading systems around the world – provides a realistic basis for the development of a fully linked global carbon market including the advanced developing nations as soon as possible – preferably by 2015¹.

Global Climate Policy: General principles

2. Global warming is a threat which must be addressed. Energy-intensive industries in Europe – IFIEC Europe's members – accept their important role in mitigating climate change: they have reduced and intend to continue to reduce their GHG emissions. However, their competitiveness is a key pre-requisite for the efficient reduction of GHG emissions. The economic implications of climate change policies – and thereby their ultimate success – depend on the chosen instruments. Climate change policy and economic growth can be aligned, if:
 - 2.1. A balanced worldwide policy framework is agreed which adequately shares GHG reduction costs between the main global competitors.
 - 2.2. Common but differentiated responsibilities are the basis for comparable burdens for industry in developed and developing nations.
 - 2.3. Climate change policy covers GHG reductions in all sectors, including transport, commercial and residential sectors, and does not focus on industry alone.
 - 2.4. Research delivers new energy efficient technologies and adequate incentives for technology transfer between nations are created.
 - 2.5. The emerging global carbon market creates a global level playing field that is transparent and free from manipulation. Sectoral approaches should not endanger a global uniform carbon price.
 - 2.6. Electro-intensive industry is compensated for the CO₂ cost impact on electricity prices until competing industry, elsewhere, bears equivalent costs.
 - 2.7. A reasonably challenging but realistic reduction target is set.
 - 2.8. Emission allowances to industry are allocated on the basis of benchmarks until industry everywhere bears equal cost.

¹ The EU strives for an OECD carbon market by 2015 and the inclusion of the advanced developing countries by 2020. IFIEC Europe considers that the advanced developing countries should join much earlier and that certainty about their inclusion is needed in the short term.

Allocating emission allowances based on benchmark

3. The methodology of allocating emission allowances is pivotal for the success of an emission trading system. For IFIEC Europe benchmarking is the approach to choose. Benchmarks set clear yardsticks for an efficient manufacturing process and give robust and predictable signals for a low carbon industry. Benchmarks avoid the unnecessary and excessive drain of financial means from industries – means which can be better mobilized in a goal-oriented way to invest in and implement efficiency improvement measures.

How benchmarking works

4. **The allocation of emission allowances is based on product benchmarks:** A benchmark defines the number of emission allowances which a given installation receives per unit of production. Benchmarks are defined for the most important products covered by the emission trading system².
5. **Learning from experience:** Benchmarks are a well-known management tool to industry and are, for example, used in environmental regulation to set the basis for permit conditions. Furthermore, the EU is currently defining benchmarks as these will be the basic method for free allocation of emission allowances after 2012.
6. **Benchmarks should be comprehensive:** Benchmarks should be based on the overall emission balance, i.e. direct and indirect (electricity) emissions.

The advantages of benchmarking

7. **Supports the growth of efficiently operating companies:** Each company has the same incentive to improve the efficiency of production processes. Those companies above the benchmark seek to reduce their cost burden (= cost of buying emission allowances) while those at or below the benchmark seek to increase their advantage (= income from selling emission allowances). That means the carbon price signal for production works effectively.
8. **Achieves GHG reduction results:** The carbon price signal that drives production and investments in higher efficiency is the same under auctioning and benchmarking. Thus, benchmarking achieves the same GHG reduction as auctioning.
9. **Is cost-efficient:** Benchmarking keeps costs for consumers and the economy low because only the inefficient GHG emissions (e.g. above the benchmark) need to be paid for³. In other words, auctioning is more expensive but does not lead to higher GHG reductions⁴, since the reduction target – the total cap – is equal and fixed.
10. **Makes a global system possible as worldwide support is likely:** Benchmarking does not have the disadvantages of alternative allocation methodologies: Auctioning is rejected by developing countries based on the huge cost-disadvantage for their economies. Historical grandfathering was abandoned in the EU because of its lack of effectiveness⁵.

² With 50 to 75 product benchmarks at least 90% of all emissions of industries in EU ETS (steel, cement, refineries, chemicals, paper and pulp, non-ferrous metals, glass and ceramics) will be covered. The world will be in the advantageous position to build on the EU exercise of establishing benchmarks.

³ Ecofys (March 2008), "The IFIEC method for the allocation of CO₂ allowances in the EU Emissions Trading Scheme", see www.ifieceurope.org: An analysis of the feasibility of the IFIEC proposal within the electricity sector and a comparison of the effectiveness and the costs of the different allocation methods. Ecofys calculated a saving of between €55-83 billion for EU consumers each year when using dynamic benchmarking rather than auctioning in the electricity sector.

⁴ Loske, Schyns (2008), Trilogy Study "The benefits and feasibility of an ETS based on benchmarks and actual production", see www.ifieceurope.org. This study analyses in more detail the interdependencies between the carbon prices signals, effectiveness and carbon leakage. It is shown that auctioning is theoretically the best method if it is applied globally; otherwise there will be carbon leakage. Dynamic benchmarking (with actual/recent production) is the best method towards a global carbon market with full participation.

⁵ It rewards high polluters, whereas investments in lower emissions are punished by allocating fewer emission allowances in the next trading period.

11. **Enables differentiated but converging global system:** Regionally differentiated benchmarks – which do not require absolute caps for developing nations that do not allow for growth – encourage clean growth through assuring scarcity of allowances, are a fair and acceptable basis for globally shared objectives, and provide a shared carbon price signal within the major global nations.
12. **Is no obstacle to the dynamics of the global economy:** In a global system, the dynamics of competition between companies and nations cannot be disregarded. The changing patterns of actual production volumes rather than historic – outdated – figures must be reflected in the allocation. Otherwise competitive distortions – disadvantaging newcomers – would be the result. With actual or recent production as the allocation basis there is also a supply response avoiding too low carbon prices (a proper system should foresee in addition a mechanism to avoid too high carbon prices).
13. The worldwide developments are substantiating IFIEC Europe’s vision: The most important emerging emission trading schemes – e.g. USA and Australia – are based on dynamic benchmarking or equivalents thereof which fully compensate the CO₂-impact on electricity prices e.g. by allocating for direct and indirect (electricity) emissions.

Summary

14. To ensure cost-efficiency, the allocation mechanism within an emissions trading system is crucial. The experiences with the EU system have shown huge problems with historical grandfathering which have led to the abandonment of that allocation mechanism. The alternative – auctioning – is unlikely to be accepted globally because of its cost implications. Furthermore, it requires a complex system of exemptions as long as a global system does not exist. IFIEC Europe promotes the concept of benchmarking for a global climate change system post-2012 as it enables effective and cost-efficient GHG emission reductions in industrial sectors. Indirect cost effects from the pass through of auctioning expenses by electricity producers must equally be cancelled for electro-intensive industries. The main benefit of benchmarking is that it is likely to be a widely acceptable solution to the challenges that are to be mastered and that it is a way to include the patterns of dynamic global competitive markets. Finally, this concept enables industry to continue to deliver innovative and efficient solutions for a low carbon world.

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About IFIEC Europe

The International Federation of Industrial Energy Consumers represents companies in energy intensive industries in Europe for which the cost and availability of energy and power are significant factors affecting their ability to compete in world markets.