INTERNATIONAL FEDERATION
OF INDUSTRIAL ENERGY CONSUMERS

IFIEC Europe

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IFIEC Europe's Comments to the
EU Commission's Communication „Further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emissions Trading Scheme" (COM (2005)703 final), dated 22.12.2005

IFIEC Europe believes the new EU ETS Guidance Note allows the malfunctioning EU Emissions Trading regime to continue unchanged

After one year of experience of the EU Emissions Trading Scheme (EU ETS), IFIEC Europe, which represents energy intensive industries in the EU, continues to point to its failings and negative consequences. On the one hand, any contribution to reduced carbon emissions is questioned, whilst on the other, the severe influence on the electricity price is leading to large amounts of losses for consumers and windfall profits in the same volume for the electricity generators. Energy intensive industry suffers from this severe blow to its competitiveness.

Industry is not alone in evaluating the first experience with EU ETS negatively. All over the EU, the scepticism is immense and is still growing further. The need for a comprehensive overhaul of the system is recognized more and more. In a resolution, the Council of the EU consequently invited the Commission to propose changes to the system urgently:

INVITES THE COMMISSION TO

- *Take the need for long term regulatory certainty and transparency and cost-effectiveness into account in its forthcoming review of the EU ETS, in the context of the ongoing development of the EU's medium and long term strategy to tackle climate change. The Commission should thus review this scheme and should table as soon as possible proposals, as appropriate, to make this scheme more effective while taking into account the need for promoting competitiveness and an affordable energy supply.*
- *Base this review on comprehensive and reliable data and ensure the remedies to possible market disturbances in sectors affected by the EU ETS are provided in good time.*

Quotation from the Energy Council of the EU, 1 – 5 Dec 2005

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However, nothing of these tasks and their urgency was reflected in the EU Commission's Communication "Further guidance on allocation plans for the 2008 and 2012 trading period of the EU Emission Trading Scheme" ("Guidance Note"). It simply does not mention the serious problems of the system's functioning. This must mean: EU Commission is accepting windfall profits for electricity generators, the export of emissions due to reduced industrial activity in the EU at least for the next 7 years. This response of the Commission cannot be construed as "as soon as possible" or "in good time" as requested by the Council. IFIEC fails to see how the resulting negative consequences for the EU economy are in accord with the Lisbon strategy.

IFIEC Europe requests that the allocation of allowances in phase 2 (2008-2012) be based on the forthcoming review of the EU ETS. Commission and Member States must rise to this task, as solutions need to be found for the shortcomings of the scheme. The effectiveness of the ETS must be ensured, whilst taking into account the competitiveness of EU industry.

Furthermore, IFIEC Europe signals the following:

- The Guidance Note was prepared and finalized <u>without any stakeholder consultation</u>. This is not acceptable and might give the impression that the Commission is avoiding dealing with the serious problems which exist in the current functioning of the system.
- The provisions regarding <u>new entrants</u> made in the Guidance Note clearly do not contribute to certainty of investment in the spirit of the Lisbon strategy. Instead of stimulating efficient industrial growth and innovation, the Guidance Note states that having new entrants buy all allowances would be in accordance with equal treatment. Based on this questionable opinion, the Commission's recommendation is that the new entrants' reserve is not to be replenished after exhaustion. However, this constitutes a clear and significant disadvantage compared to incumbents and especially discourages new investments. It contradicts the intended support of innovative technologies.
- The <u>quantification</u> of the foreseen CO_2 emissions reductions within the EU ETS in the 2nd trading period by 6 % compared with the 1st trading period follows a simplistic linear approach (see fig. 13, p. 5). This is in clear contradiction with criterion 3 of Annex 2 to the Guidance Note. In this criterion the Commission refers to technological potentials and achievable progress to be taken into account as an upper limit for the cap. A linear 6 % lower target for the EU ETS sector does not present an appropriate and realistic approach. This does not do justice to all the different elements within EU ETS, including process related emissions, which cannot be reduced in the medium term.
- Stressing the non-acceptance of <u>ex-post adjustments</u> disregards the economic logic behind the current serious EU ETS problem of windfall profits to the electricity generators: ex-ante frozen caps for individual operators. Ex-post adjustments are therefore necessary to solve this problem, as they would lead to real encouragement for efficiency improvement investments and innovation in a stable and predictable way. Furthermore, market distortions by freezing market shares as a result of the current grandfathering system would also be solved. The Commission's rejection of such an element in the emission allowances allocation is therefore counterproductive to establishing an efficient and effective system, which could make EU ETS a really positive example for a future global scheme.
- The Commission itself excludes the 1st trading period years from being part of any <u>baseline period</u> for the 2nd trading period (see fig. 27 p. 8). This uncertainty for operators for subsequent periods and the absence of a clear alternative prove that the functioning of the current EU ETS does not set the right signals and incentives for efficiency improvement measures and investments.

<u>Conclusion</u>

The Guidance Note will not result in a significant improvement of EU ETS. To the contrary, it conserves the existing problems for another significant period and thus further counteracts to the achievement of the EU Lisbon Strategy. This document cannot be seen as a signal for a new EU industry policy approach of making the EU a more attractive place for industry. This intention was announced in October 2005 accompanied by the establishment of a high level group on competitiveness, energy and the environment. If Member States act in line with their above quoted invitation at the EU Energy Council, they should question whether this Guidance Note approach can be regarded as reasonable and acceptable.

While EU industry confirms its commitment to the Kyoto protocol objectives, it urges the EU Commission and Member States to redesign EU ETS as soon as possible. An effective and cost-efficient regime is essential to allow EU industry to compete globally, thus contributing further to efficient and environmentally friendly manufacturing and further improve the global greenhouse gas balance. The process of drafting NAPs II at Member States level, as well as approving them at EU level, must be part of this redesign.