

POSITION PAPER ON
EXPOSURE TO A RISK OF CARBON LEAKAGE UNDER THE EU ETS

Brussels, 22nd September 2014

As the Emissions Trading Scheme (ETS) was established so as to reduce the EU CO₂ emissions, policy-makers also acknowledged underlying risks of the directive: the significant costs associated with the system were to affect the competitiveness of some industrial sectors, thus exposing them to a risk of carbon leakage. In response, the EU decided on a 'carbon leakage' status that grants those sectors free emission allowances.

As the European Commission lately published the draft list of carbon leakage sectors for the second phase (2015-2019), EuSalt and the salt industry want to re-state the importance of the carbon leakage status for the salt sector as being listed currently.

1. What does the 'Carbon Leakage' status mean? Supporting the Competitiveness of EU Industry

The 'carbon leakage' status is important not only to vulnerable industrial sectors, but also to EU competitiveness. Until other countries worldwide reach the same ambitions as the EU in defining and implementing climate policies, EU industry is to suffer a competitive disadvantage. The 'carbon leakage' status has been successful at preserving the competitiveness of those sectors and their contribution to EU economy, employment and research and innovation. The latter comprising innovations in the field of emission reduction and energy efficiency enlargement as well.

2. Consistency and Legislative Predictability

Industrial sectors, including the salt industry, have a role to play in achieving the 2020 and 2030 climate and energy targets. They hold potential to contribute to research and innovation and technology developments that will help towards a low-carbon economy. This implies significant investments that require a predictable legislative framework. With regard to 'carbon leakage', consistency in the methodology is essential when assessing vulnerable sectors. So far, the years 2013 and 2014 with 'carbon leakage' status have proven to safeguard good progress in innovations, technology developments and by that reaching higher efficiencies, more renewable energy-inputs and lower emissions.

3. Incentives and global commitments

We need to align global efforts and implementation of climate policies so as to level the global playing field. We need to reconcile climate objectives and economic activity and competitiveness, as these are inter-dependent variables. Incentives to invest in innovation and foster EU economic growth are a pre-condition to effective climate mitigation.

1. What does the 'Carbon Leakage' status mean? Supporting the Competitiveness of EU Industry

The EU is determined to take the lead in tackling climate change. In this respect, reducing CO₂ emissions and developing renewable energy sources are key targets that industry supports and works towards. Such a policy objective, nonetheless, requires significant changes and upgrades that cannot take place on the short term for many reasons. Adapting to a more sustainable society needs not work against EU economic activity and competitiveness for only the latter will enable us to achieve a low-carbon economy. As long as third countries' emission curbing policies do not match that of the EU, the risk of carbon leakage is genuine for many industrial sectors. What does the 'carbon leakage' status really mean?

The 'carbon leakage' status is granted to those vulnerable sectors whose competitive advantage would be damaged – both inside Europe and at global level – due to significant production costs increase induced by the cap-and-trade system. As a result, those sectors are not required to purchase emission allowances on the EU market. This preferential status does not confer compensations of any kind. Rather it maintains the *status quo*, enabling vulnerable sectors to maintain their competitiveness on a dynamic international market.

In so doing, those sectors are capable of maintaining a constant level of activity inside the EU, thus contributing to the national and EU GDP, and to employment likewise. As Europe is slowly, although hesitantly, walking out of the financial and economic crisis, the input of industry is needed for effective economic recovery. In addition, those sectors play an important role towards the EU 2020 and 2030 climate and energy targets, both directly and indirectly: directly, by investing in resource and energy efficiency and fostering more sustainable production methods as well as products; indirectly, by providing testing grounds and frameworks for technology development that will benefit other sectors. The 'carbon leakage' status consists of a protective measure with regard to competitiveness. By no means, does it mean that those sectors do not take part in emission reduction and research and innovation efforts. The status is and should remain a transitional measure aimed to allow industrial sectors to adapt to a new context, in which 'business-as-usual' is not permissible.

It is crucial to consider the broader perspective insofar as sectors do not operate in isolation. Rather, they are part of a more or less long value chain, in which changes within a sector will likely impact different links of the chain, whether down- or upstream. For instance, the salt industry is the starting point of a long value chain providing the raw material (salt, also known as sodium chloride) that is processed by the chemical industry and comes into the production of a wide variety of products, including PVC, glass, paper, detergents, and so on. Consequently, should a link of this chain be threatened with carbon leakage, other sectors would be affected to variable degrees, losing a customer or a supplier. The EU must keep its industrial basis for economic, competitiveness, and technological reasons. Thus far, the 'carbon leakage' status has been successful at preserving EU assets and it should continue to do so.

2. Consistency and Legislative Predictability

The salt industry supports the EU climate and energy targets and is thriving to contribute to achieving them. The development of more energy efficient and sustainable technologies and/or products, as well as that of large scale projects, goes hand in hand with large investments. Several factors come

into consideration in a company's decision to invest, not only in research but also in innovation (i.e. the outcome of research). Companies need to assess the viability of their investment and the perspectives of profits on the medium to long terms. Such projections are made in a context of stability, assuming that a certain number of variables the decision is based on will remain the same throughout the period running from the first investment up to the implementation of the project and the first profits generated.

Therefore, a predictable legislative framework that enables such long-term planning weighs in the final decision to invest in R&I. On the other hand, insecurity as to what the legislation will be in two or five years does not provide a suitable climate for such evolutions. For this reason, transparency in decision-making, clear and steady objectives and the consistency of regulations really matter to industrial activities.

In this respect and as far as 'carbon leakage' is concerned, it is essential that the methodology used for assessing those sectors is consistent throughout the different stages of the EU ETS. Despite the different phases, the implementation of the EU ETS pursues one overall objective, e.g. the reduction of greenhouse gases emissions, over a period of minimum ten years¹. Many companies that were granted the 'carbon leakage' status invested in new technologies or models already at an early stage of the system. The climate of uncertainty casted on such decisions due to objections to implementing decisions, including the list of 'carbon leakage' sectors, does not provide the necessary incentive to other future projects to see the light of day.

Furthermore, the methodology was predetermined based on a desired carbon price of €30/tCO₂, laid down in the directive. This value stemmed from a policy objective, and not on a market assessment of the potential carbon price at the time the ETS Directive came into force. Consistently, the reference carbon price used in the 'carbon leakage' assessment for the period 2015-2019 should follow the same principal, and not be based on punctual market signals. A policy target provides better predictability and investment security, especially when aiming at the long term. In the same manner that the current carbon price does not reflect the policy objective set in the 2009 ETS Directive, it may not reflect the carbon price two years from now.

3. Incentives and global commitments

The more countries will commit to equal level of efforts and comparable policies to tackle greenhouse gases emissions, the less relevant a 'carbon leakage' list will be. As mentioned above, the 'carbon leakage' status exists due to asymmetrical policies that un-levels the global playing field for industries. Aligning the policy commitments and implementation of the biggest emission emitting countries would reduce the need for exempting measures.

In addition, we need to take into account the various aspect and impacts of policies. Climate objectives need not counter the development of economic activity. Both should go hand in hand for economic recovery and growth enables the transition towards a low-carbon economy and society, namely by supporting technological transition, unlocking and attracting investments. Ambitious policy objectives such as set in the 2020 and 2030 policy framework need economic growth in Europe, in order to be

¹ The closest objective is 20% reduction by 2020, according to the EU 2020 Strategy.

attractive. This calls for more integrated policies promoting a coherent and workable framework to industry and entrepreneurs.

EuSalt is the non-profit organisation representing the common interests of salt producers located across Europe. As the voice of the salt industry, our aim is to create an interactive platform and facilitate information exchange between the industry and European and international stakeholders.
