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Carbon Leakage Qualification Criterion in the ETS

A qualitative assessment and a recognition that globally priced industries are incapable of passing on additional costs are needed to ensure equal treatment for EU non-ferrous metals producers

This paper outlines to policymakers the importance of maintaining the possibility for (sub) sectors to apply to be accessed for carbon leakage via a qualitative assessment in Phase IV of the ETS. It looks at the impact that the removal of this qualitative assessment possibility would have both for the European non-ferrous metals sector and for the ETS itself (Negligible emissions reductions). It encourages policymakers to take into account the specifics of the non-ferrous metals sector and to recognise that globally priced industries (i.e. those whose price is set by London Metal Exchange or other similar global pricing mechanisms) cannot pass on their addition costs in Phase IV of the ETS.

This paper makes two recommendations to policymakers:

- 1) Maintain the option for a qualitative assessment for carbon leakage qualification and protection*
- 2) Incorporate the 'price-taker' market characteristics as a recognition that globally priced commodities cannot pass on their addition carbon costs.*

Why the option of the qualitative assessment to carbon leakage risk must be maintained in Phase IV

i. **Market complexity: An arbitrary quantitative 'one size fits all' approach by second best indicators is unable to grasp the 'on the ground' market complexities**

A purely mathematical, quantitative formula - the multiplication of a non-linear factor (trade intensity) and a linear factor (emission intensity) - is unable to grasp the complexities of market conditions. In order to adjust for this, additional, *qualitative* criterion, are needed to balance out the significant methodological weakness of the rather arbitrary procedure of multiplying trade intensity by emission intensity. As a result of the non-ferrous sectors price taker characteristics, any additional load makes Europe's producers anti-competitive vis-à-vis producers outside of the EU.

ii. **Limited application: Given the process, only a limited number of sectors qualify via a qualitative assessment**

It should be noted that the burden of proof always rests with the sector/sub sector to demonstrate its eligibility to qualify for a carbon leakage assessment under a qualitative approach. Large amounts of documentation and data are required to be submitted by each (sub) sector in order to even be considered for carbon leakage exposure. This has de facto led to only a small group of entitled sectors applying. Indeed, under the current carbon leakage list (2013-2020), only a very small number of (sub) sectors qualified via a qualitative assessment.

iii. **Negligible impact on overall emissions reduction**

Elsewhere, it should be noted that the impact of removing the qualitative threshold on total sector emissions volume is negligible (A few percentage of the total free allocation). It is EuroMetaux's view that citing administrative burden or a blanket desire to reduce the number of sectors of the carbon leakage list does not represent a good enough reason to remove these sectors from the list. Similarly, it is also Eurometaux's view that a desire to "simplify" the ETS by removing the qualitative assessment does not represent a good enough



reason either. Indeed, the chief impact of the removal would be to undermine the effectiveness of the ETS and would, in essence, be bad regulation – something which runs counter to the EU’s ‘Better Regulation’ agenda.

Why the price taker market characteristics need to be incorporated as a recognition that globally priced industries cannot pass on their addition costs.

i. Price taker specificities and indicator shortcomings

Eurometaux would highlight to co-legislators that price-taker market characteristics need to be taken into account. Price takers are sectors whose products are demonstrably incapable of passing on additional local costs – e.g. sectors traded on global commodity exchanges such as the London Metals Exchange (LME) or other global pricing mechanisms. As a result of these sector’s price taker characteristics and globally traded LME copper commodity price, any additional load is anti-competitive.

Inability to pass on cost is best reflected in a very high value of the price elasticity of demand. However, due to a lack of data, the ETS relies on the second best indicator of trade intensity for which most non-ferrous sectors only show medium values. As a result of using this non-optimal indicator, the quantitative approach underestimates the carbon leakage risk of the non-ferrous metals sector. Therefore the possibility to show the real risk by a qualitative approach is needed.

ii. Regulatory Consistency

It should be noted that a similar approach, which combines quantitative and qualitative methodology and incorporates the price taker criteria, is currently used for the **EU’s State Aid Guidelines for the indirect costs of the ETS (2012/C 158/04)**. In the guidelines, it was noted that “*account was taken of available market related evidence indicating that the (sub)sector cannot pass on the increased indirect emission costs to its clients without losing significant market share in favour of its third country competitors*”¹. In order to ensure regulatory continuity a similar approach needs to be followed in Phase IV of the ETS.

iii. The contribution of non-ferrous metals to the circular economy

As noted in a recent European Parliament report², EU Climate legislation needs to take into account the positive role base metals play in the circular economy, helping to significantly reduce raw energy and material input. By using a solely quantitative approach, industry efforts to increase the recycling of complex, metals bearing materials, containing more and more plastics (e.g. electronic scrap and automotive wire harnesses) would be undermined.

Looking ahead, the likely result of not incorporating the price taker criteria would be that the recycling/production of these raw materials would instead take place in countries with poorer technologies and less stringent environment standards. The more non-ferrous metals that are produced & recycled in Europe overall, the better in the global fight against climate change.

Policy Request

Eurometaux calls for:

1. **Maintaining the option for a qualitative assessment for carbon leakage qualification**
2. **Incorporating the ‘price-taker’ criteria as a recognition that globally priced industries cannot pass on their addition costs**

Contact Person:

Cillian O’Donoghue, Energy and Climate Change Manager, +32 2 775 63 12

E-mail: cillianodonoghue@eurometaux.be

¹ Communication from the Commission — Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post-2012 (SWD(2012) 130 final) (SWD(2012) 131 final)

² Report on developing a sustainable European industry of base metals – Committee on Industry, Research and Innovation, Text adopted December 2015, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0460+0+DOC+XML+V0//EN>