

# EUROCHAMBRES Position Paper 2007



## *Review of the EU Emissions Trading System*

June 2007

## SUMMARY

- The main goals of the review process should be to make the Emissions Trading System (ETS) predictable, to streamline and simplify it in order to reduce red tape as much as possible, and to promote a harmonized system.
- The competitiveness of European businesses and their potential for growth must be a key objective when designing the new ETS.
- Only a well functioning and cost-effective ETS can serve as a good practice model for other regions of the world or form the basis for a global Emissions Trading Scheme.
- Small emitters (producing less than 50,000 tons of CO<sub>2</sub> per year) should be excluded from the scheme.
- Small emitters should not be exposed to further monitoring requirements, and the administrative procedures for obtaining certificates should be simplified especially for them.

## **GENERAL COMMENTS**

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EUROCHAMBRES agrees with the Commission that it is of utmost importance that the EU ETS, as a market-based instrument, is streamlined so that greenhouse gas emissions can be reduced in a cost-effective manner and so that it can serve as a role model for schemes in other parts of the world.

The main goal of the review process should be to make the system predictable, to streamline and to simplify it and, above all, to promote a harmonized system, because only a well functioning and cost-effective system can serve as a good practice model for other regions of the world or could form the basis for a global Emissions Trading Scheme. This should be achieved as soon as possible.

We welcome the fact that the Commission takes the regulatory stability and predictability seriously and starts now to develop the measures that will take effect at the start of the third trading period in 2013, since timely information about any changes is paramount for businesses to adjust. We stress that the new rules for the next trading period must be clear early enough (at the end of 2010) to create a predictable market for both industry and carbon trading sector.

Our comments in this paper are based on the issues outlined in the Commission's communication "Building a global carbon market – Report pursuant to article 30 of Directive 2003/87/EC"<sup>1</sup>, and therefore concentrate mainly on the ETS review.

While this paper does not treat the many other current climate change policy topics in depth, EUROCHAMBRES stresses that, as a general rule for European climate change mitigation efforts, the international context must be kept in mind. As an economic player responsible for a shrinking proportion of global green house gas emissions, the EU should not end up being the sole active promoter of climate protection. Following on from the first positive steps at the G8 summit in Heiligendamm, negotiations about the global post-Kyoto framework should aim at joint world-wide emission reduction actions to which Europe can contribute without endangering its competitiveness.

## **THE SCOPE OF THE DIRECTIVE**

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### 1. Definition of combustion installations

We support measures that lead to more clarity and uniformity of application of the ETS in the Member States, and therefore we are in favour of legal definitions that are simple and clear-cut to improve the scope of the directive.

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<sup>1</sup> COM(2006)676 final



## 2. Participation of small installations

EUROCHAMBRES welcomes the fact that the cost/benefit ratio of the participation of small installations in the scheme is being looked into before any changes are made.

Taking into consideration that participation in the ETS entails much paper work for the company as well as for the authorities/agencies that have to monitor the scheme, we believe that it makes more sense not to oblige small installations to participate in the ETS. We welcome initiatives to establish workable thresholds that facilitate discerning which companies need not participate. These thresholds have to be implemented in the same way across all Member States so that distortions of competition are avoided.

The more than 70 % of the covered installations which are small emitters (i.e. with less than 50,000 tons of CO<sub>2</sub> per annum) should be excluded from the scope of the directive, because they produce only about 5 per cent of the CO<sub>2</sub> emissions covered by the directive today whereas they are required to fulfil the same administrative requirements (e.g. monitoring, reporting, verifying) as large emitters.

In line with the above argument, combustion installations smaller than 50 MW should be excluded.

However, a possibility to opt in could be granted to all companies operating installations in the fields covered by the ETS.

We view with a critical eye the "other policies" mentioned in the Commission's communication as an alternative to including small installations in the ETS. Given the fact that other sectors of the economy have substantial shares in the total amount of greenhouse gas emissions<sup>2</sup>, EUROCHAMBRES believes that those should be tackled first, before imposing further measures on industry.

## 3. Extending the ETS to other sectors and gases

An inclusion of additional sectors and gases (such as CH<sub>4</sub> or N<sub>2</sub>O) would contribute to spreading greenhouse gas reduction efforts more evenly over sectors, might make the market for allowances more liquid, and may be a relatively cost-efficient way of regulating those emissions compared to other policy instruments. However, the extension would burden additional companies with the pertinent bureaucracy.

Therefore, we believe that harmonizing the existing system and ensuring its smooth working should have priority over extending the scheme to other sectors and/or gases. Priority should also be given to including more countries in the system instead of covering more industry sectors within the EU. (See also the comments on linking on page 6.)

## 4. Unilateral inclusion of sectors and gases by Member States

We oppose this. Allowing unilateral action by Member States contravenes the aim of ensuring largely similar operating conditions for installations in different countries.

## 5. Recognition of Carbon Capture and Storage

Recognizing carbon capture and storage within the ETS is vital. A stable legal framework to define the appropriate conditions<sup>3</sup> should be implemented at the earliest possible point in time – optimally already for the trading period starting in 2013.

Other projects involving carbon sinks (e.g. reforestation) carried out under defined conditions should also be taken into account. The conditions for being able to include those emission reductions must be applied in a harmonised way across the EU.

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<sup>2</sup> A recent [FAO study](#) shows that global livestock industry produces 18% of all greenhouse gases (GHG), and within the EU, the household and transport sectors have been identified as large emitters with 10.1% and 19.3% respectively of GHG emissions of the EU25 in 2003. (Source: EEA Report 8/2006)

<sup>3</sup> For example, it should be possible that consortia that pool their resources to collectively store or capture carbon dioxide can receive recognition of the avoided emissions.



## 6. EU-level approval process for JI/CDM projects

In order to harmonise and provide for a coherent application of the ETS across Europe, a uniform approval process for emission reduction projects carried out in the framework of the JI/CDM mechanisms would be advisable. The application procedure should be as uncomplicated as possible in order to facilitate participation in such projects also by SMEs.

Installations covered by the ETS should be able to fully use Emission Reduction Units/Certified Emission Reductions obtained from JI/CDM to meet their obligations, due to their higher economic and ecological efficiency.

## **FURTHER HARMONISATION AND INCREASED PREDICTABILITY**

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### 7. Harmonised approaches to new or closing installations

Enabling new entrants to enter into markets is important, in order to prevent the abuse of dominant market positions by established players. Dropping reserves for new entrants can cause major barriers for entering the markets, therefore we urge to keep this instrument, administrating them EU-wide when using EU-wide allocation methods. Harmonisation and pooling of national reserves should be considered:

We believe that common rules for the administration of the national reserves or even an EU-wide new entrant reserve can contribute to a comparable treatment for new entrants in all Member States. This is welcomed, as it will allow operators to choose the location for a new installation on the basis of purely business-related criteria, without having to take into account the availability of allowances or the different policies applied to new entrants in the Member States.

Pooling all Member States' new entrant reserves may be more beneficial, as a smaller total amount of allowances will have to be set aside as compared to the situation where each Member State keeps the reserve for itself. Thus, more allowances will be available for allocation to the existing companies in the first place, which will help avoid too steep an increase in prices.

A national contact point for companies should remain in any case, so that they have easy access to information and can communicate in their own languages.

### 8. EU-wide cap or one cap per Member State?

It should be remembered that the EU has a common binding Kyoto-target and proposes a 30 per cent reduction target for the post-Kyoto negotiations at COP/MOP 3 in Bali. Following the line of argument in point 7 above, a common cap may contribute to ensuring equal treatment of installations across the EU. Further analysis and discussion of the consequences of an EU-wide cap on the basis of studies would be welcomed.

For businesses, predictability of the regulatory framework is an important factor. Therefore EUROCHAMBRES recommends the development of a calculation model for the cap which will be used for a longer period of time. However, the formula to be developed must be flexible enough to incorporate changes in the market and the environment. One element of this could be to express the cap as a specific value per unit of GDP instead of an absolute figure, so as to allow for economic growth.

### 9. Allocation of allowances to sectors/installations

For EUROCHAMBRES, it is important that allocation mechanisms are designed such that there is no discrimination between or within sectors. A certain degree of harmonisation on European level would also be useful in order to avoid distortion of competition. Therefore we support EU-wide allocation methods in principle, but several pre-conditions must be met before switching from national allocation to an EU-wide allocation can be considered:

- Exempt small emitters (less than 50.000 tonnes per year) from the scope of the EU-ETS. Small emitters should have the possibility to opt in on an individual basis, to enable the use of the benefits of the EU-ETS, supporting investments in greenhouse-gas efficiency;



- Examine which sector (group of installations) manufactures goods that can be brought into a homogenous benchmarking system;
- Set EU-wide benchmarks for these goods;
- Keep national allocation for sectors without benchmarkable products;

Following these steps, a homogenous EU-ETS will be set up, establishing a level playing field between the Member States. Longer trading periods would become feasible.

The benchmark approach also has the advantage that early action is not discouraged in those sectors that are not yet part of the ETS. As emissions related to the transformation of certain raw materials (such as in the production of steel, cement, bricks etc.) cannot be reduced in the short term except by decreasing the production volume, it should be considered whether they could be exempted from the ETS, if the company can show that BAT is being applied.

#### 10. Auctioning of allowances

Auctioning is often seen as an efficient mechanism for the allocation of scarce goods. However, when strategic thinking of market actors is taken into account, it is evident that some financially strong companies may buy up as many allowances as possible and simply keep them, attempting to drive up costs for their competitors. SMEs, especially, would most likely find it difficult to finance the "investment" in the quantity of allowances needed for a certain period of time. They may be forced to take out loans and would thus incur interest expenses in addition to the cost of the allowances.

These additional costs for the installations can weaken the industries facing international competition (especially towards non EU members). They have to be weighed against the hidden costs in other allocation systems, where mistakes in allocation may well be hard to correct and have great impact on individual companies. Any auctioning or other allocation system has to be evaluated not only for installation cost but also for inefficiency costs in order to find the best possible model.

Another open question is how the revenue from the auction should be spent. Depending on its use, an unjustified redistribution from one sector of the economy to another may occur. Therefore, if auctioning was to be adopted for more than a marginal portion of the total allocations, it must be ensured that the revenue is used to propose support for energy efficiency investments to enterprises covered by the ETS.

#### 11. Predictability – periodic redesign of the ETS

Nowadays, businesses are likely to also calculate expected cost/revenue from purchase/sales of emission allowances when drawing up feasibility studies for projects or investments. Therefore, predictability is of great importance to them. However, a mechanism design aimed at predictability may well reduce flexibility and the chance to adjust the system to changes in the market environment. Here it is important to strike the right balance between these two desirable attributes of the ETS mechanism.

Establishing 10-year-trading periods may add to the stability of the ETS.

The important role of ERUs and CERs for the industry, as well as for the carbon trading sector must be recognized. Therefore JI/CDM projects must remain an integrated design part of both EU and global climate regimes after 2012. JI/CDM as well as the possibility to use ERUs and CERs must not end after 2012.

At this occasion, EUROCHAMBRES stresses the importance of including representatives of business and other stakeholders also in the process of future revisions of the ETS.



## **ROBUST COMPLIANCE AND ENFORCEMENT**

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### **12. Monitoring and reporting**

Monitoring and reporting is important for the evaluation and further development of the ETS, as market transparency supports the system's efficiency. However, monitoring and reporting requirements must respect the participants' need to keep some business information confidential. In line with Better Regulation efforts, the requirements should be designed in such a way that the amount of time spent on filling in forms – printed or electronic - is kept to a minimum.

We therefore suggest that the Commission should examine whether the reporting obligations could be integrated with those required by other regulations (e.g. 166/2006(EC) on the European Pollutant Release and Transfer Register), whereby double reporting of similar data sets could be avoided.

EUROCHAMBRES also propose to introduce simplified monitoring and reporting procedures for installations causing emissions of less than 100,000 tonnes per year.

Instead of monitoring, reporting and verifying CO<sub>2</sub> emissions from combustion in today's strict manner, it should be made possible to use a document by the energy supplier that specifies the fuels delivered as well as the total CO<sub>2</sub> emissions that result from burning these fuels (emission factor). In most cases it is very easy for energy suppliers to provide this information with the invoice, whereas this will significantly reduce the administrative burden on small companies without reducing the accuracy required for monitoring and verification.

### **13. Verification**

Independent verifiers (organisations as well as individuals) should be recognized EU-wide once they have been approved by a Member State. Uniform rules should be set for the approval of these verifiers, to contribute to comparable verification practices in all Member States. Annex V of the ETS directive is detailed enough for the verifying process.

Enabling verifiers to operate also in other Member States may encourage them to invest time in deepening their expertise for certain types of installations, as they may be able to use this knowledge more often than if they were able only to apply it in one Member State. These economies of scale as well as the higher competition between verifiers may lead to reduced cost for the companies being verified.

## **LINKING WITH THIRD COUNTRY ETS – INVOLVING DEVELOPING AND TRANSITION COUNTRIES**

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Climate change is a global problem. Therefore, EUROCHAMBRES supports the EU taking an active role in international climate protection politics. However, there should not be a unilateral imposition of restrictions on EU firms, which add cost but are not reflected in increased market share.

It is therefore important to involve as many other countries as possible in the emissions reduction efforts, also with a view to creating demand for the technologies developed in Europe, so that EU companies can profit from the first mover advantage they gained.

EUROCHAMBRES therefore welcomes efforts to extend the ETS to other countries, as additional participants make the market more efficient and more economic, because newly participating states may have more potential for cost-efficient emissions reductions left. In addition, large emitters in Asia and the Americas (also regions, in cases where the whole country has not yet ratified the Kyoto protocol) should be encouraged to join the ETS, as this would remove the competitive disadvantages imposed on installations located in Europe.

For the time being, it is important to keep the possibility to make use of the higher potential for cost-efficient reductions which is left in economically less developed countries. Therefore, EUROCHAMBRES calls also for the possibility to fully include JI/CDM certificates into the ETS.



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For further information about the position paper:

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