



E3G

Ten Reasons Why Giving Free ETS Allowances will Not Protect EU Jobs or Competitiveness

E3G Briefing October 2008

European industrial competitiveness is not threatened by auctioning

1. Energy intensive industries account for well under 1% of EU GDP
2. Most EU energy intensive industries have enjoyed high profits
3. The EU imports under 10% of its energy intensive goods
4. Rising transport costs impose “border tariffs” equivalent of at least €40-60 per tonne CO₂ on steel and cement imports from Asia
5. China and India do not compete on energy intensive products; only 9% of China exports to the EU are energy intensive.
6. Future competition on energy intensive products comes from Russia and the Gulf based on subsidised energy prices not carbon prices.

Giving free allowances will raise costs to European industries

7. Giving free allowances will raise barriers to linking the EU ETS with US and Japanese trading systems. This could result in border taxes being placed on €261 billion of EU exports to the USA, and result in billions of economic efficiency losses to the EU.
8. EU emission targets beyond 2020 will require energy intensive industries to cut emissions well below current Best Available Technology or other industries will face higher costs.

Innovation incentives are the best way to ensure EU competitiveness

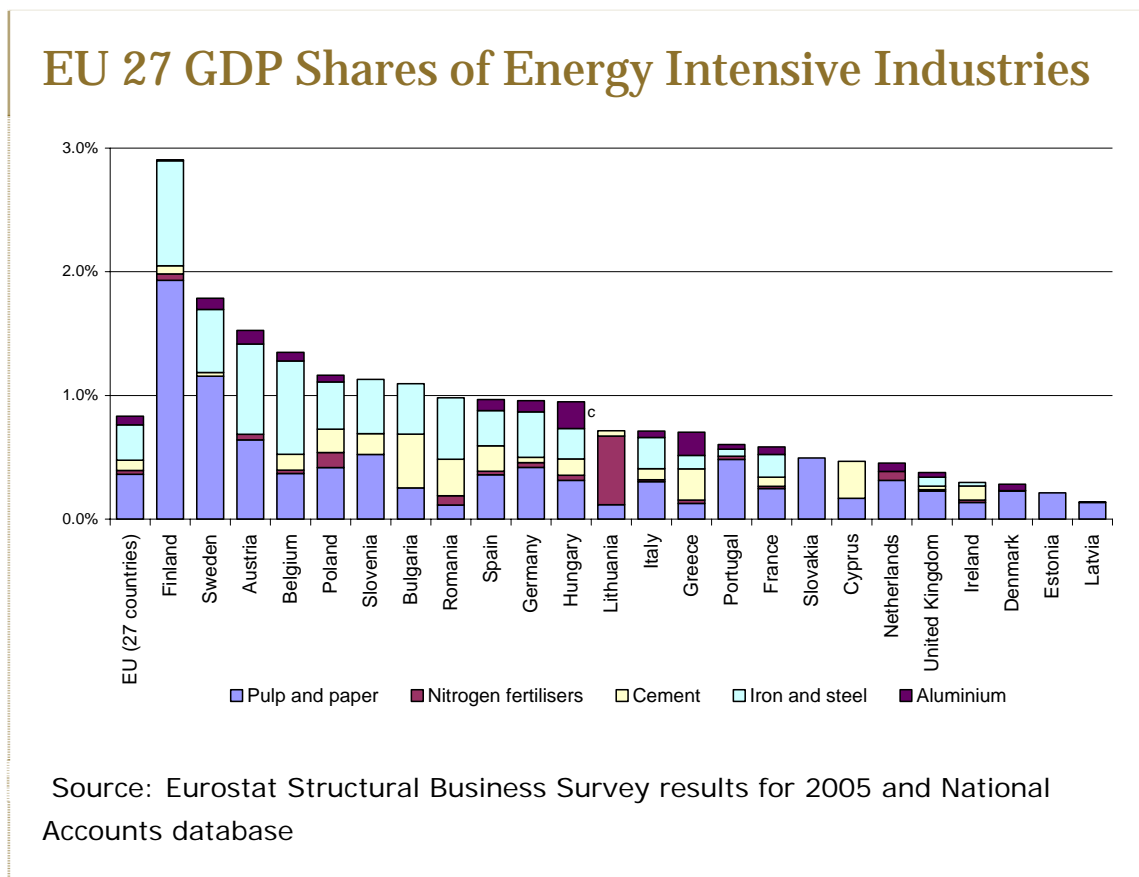
9. European companies are global leaders in very low carbon steel and cement, but giving free allowances removes incentives for aggressive RD&D and will lower their future competitiveness.
10. EU energy intensive industries have a very wide range of efficiency in the sector. Jobs and competitiveness are best preserved through using auction revenues to fund a green investment tax credit and EU RD&D fund, and building new EU markets for low carbon products.

Ten Reasons Why Giving Free ETS Allowances will Not Protect EU Jobs or Competitiveness

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1. Energy intensive industries account for well under 1% of EU GDP

Europe is not dependent on energy intensive industries for economic growth or job creation. Finland has the highest proportion of GDP accounted for by energy intensive industries at just under 3%; the EU average is under 1%. Only six countries have energy intensive shares above 1%.

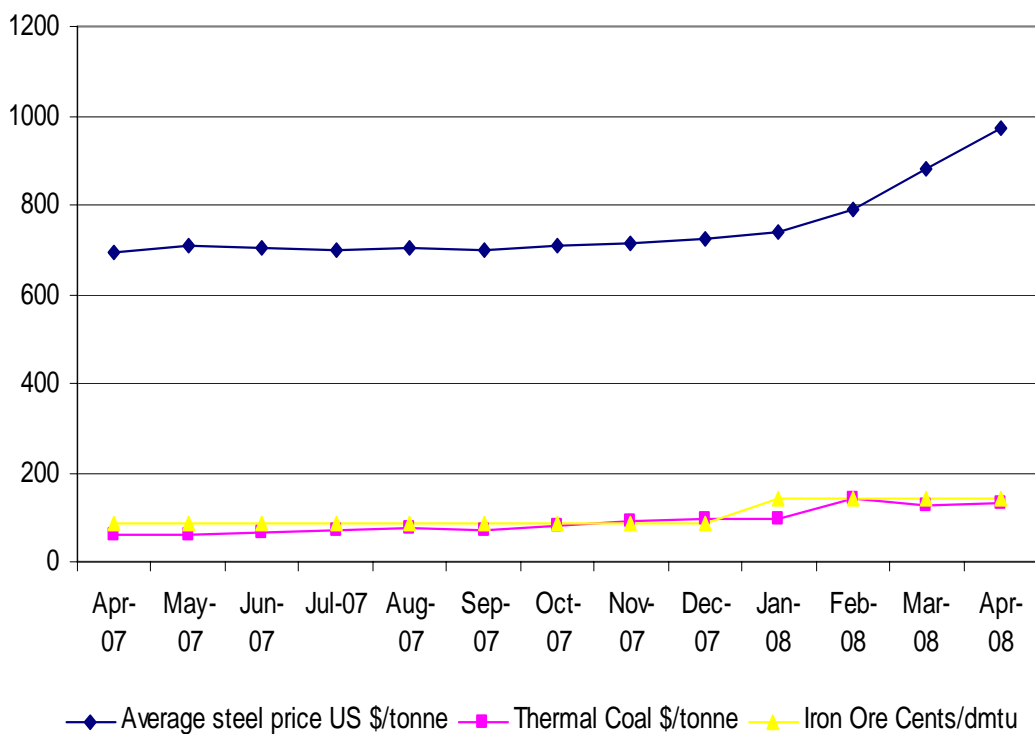


2. Most EU energy intensive industries have enjoyed high profits

Until the recent downturn, shortages on global markets due to rapid growth in China and India have driven up the prices of cement, steel and aluminium far above the percentage increases of energy and raw materials costs e.g. iron ore (MEPS Steel Prices On-Line). Over the long term EU cement prices are among

the highest in the world. Producers are enjoying high profits, especially in the EU where many plants are fully depreciated. These profits provide companies with the resources to invest in energy efficient plant. Even with the expected recession, given underlying growth trends this shortness of supply is expected to continue for many years and it is likely that prices will be strong when auctioning is introduced in 2012.

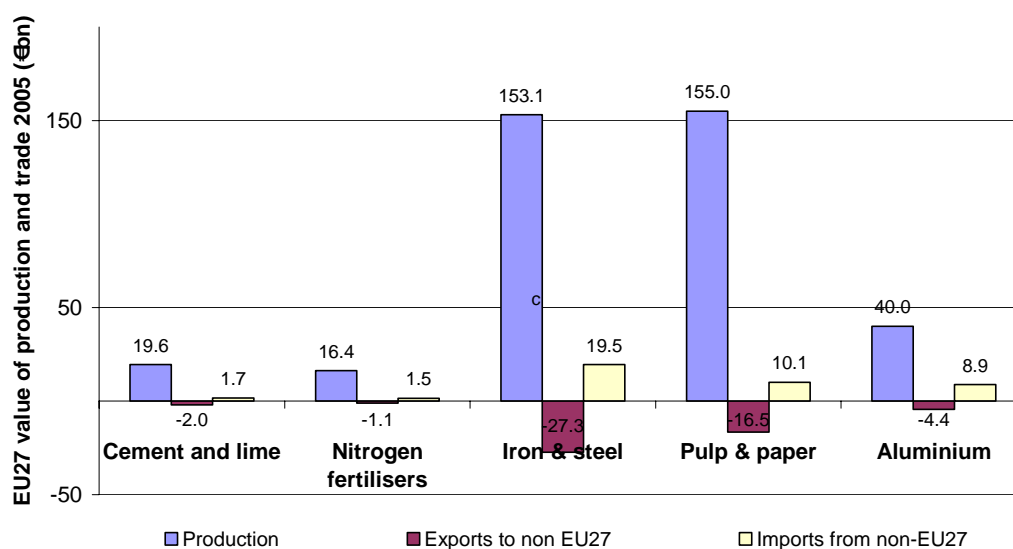
Average Steel Prices and Input Prices 2007-2008



3. The EU imports under 10% of its energy intensive goods

Despite existing differences in labour, capital and environmental costs compared to developing countries, Europe is largely self-sufficient in most energy intensive sectors. Until the recent (and temporary) steel production surplus in China from 2004/5, the EU was a net exporter of steel goods to China. Europe’s largest trade deficit in steel is with Russia, which already has binding emission caps under the Kyoto Protocol.

Energy Intensive Production, Import and Export Value EU 27 2005

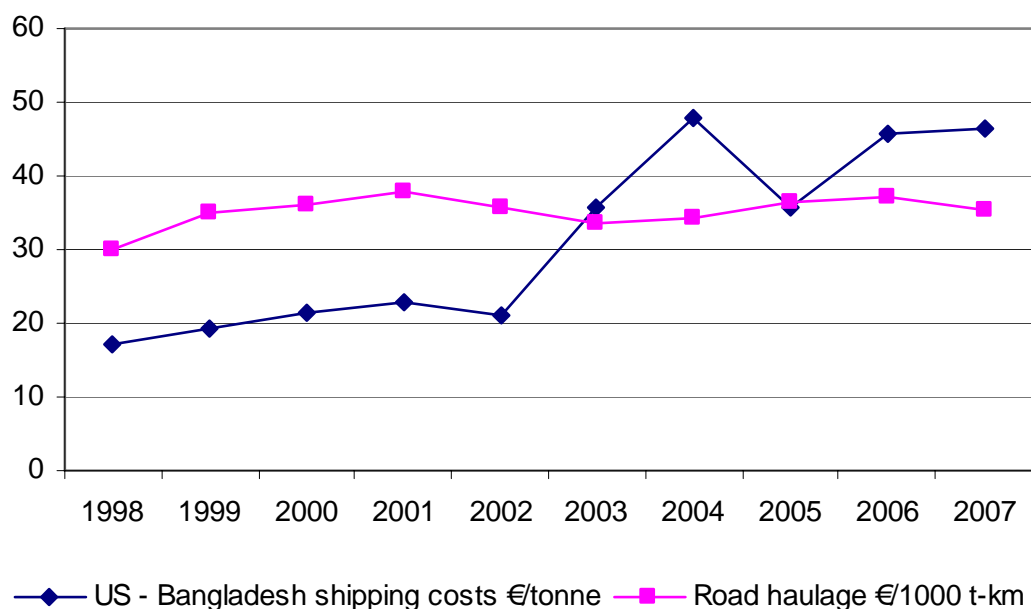


Source: Eurostat Structural Business Survey results for 2005. Data of trade relate to extra-EU27 trade with EU-27. All data for 2005c

4. Rising transport costs impose “border tariffs” equivalent of at least €40-60 per tonne CO₂ on steel and cement imports from Asia

European energy intensive industries are already protected from global competition by rising transport costs. The recent doubling of bulk shipping rates is expected to continue through the current downturn due to a structural shortage of suitable shipping capacity. For shipments from Asia or Latin America this is equivalent to a border tariff of €40-60 tonne/CO₂ on cement from and a €60-130 tonne/CO₂ for steel (IEA 2007 Efficiency Data; London Shipping Brokers bulk cargo cost estimates 2008). Only imports from close to EU borders are only slightly affected by rising shipping costs, though road haulage costs will rise significantly for cement. Inclusion of marine sector in the ETS will further increase these costs even if oil prices fall further.

Bulk Shipping Rates from Bangladesh to Europe



Source: Ocean Shipping Consultants, UK Road Haulage Association

5. China and India do not compete globally on energy intensive products; only 9% of Chinese exports to the EU are energy intensive.

India's energy intensive exports are negligible. Energy intense products make up only 9% of Chinese exports to the EU; only 1% of Chinese cement production is exported. Over 25% of the EU's exports to China are energy intensive, amounting to €20bn, with a traditional surplus in steel and some ores. The vast majority of Chinese exports have very low energy intensity and 100% auctioning will have no impact on the competitiveness of EU manufacturers in these sectors.

Chinese energy security policy is to discourage energy intense exports in order to prevent coal being diverted from the power sector which fuels their higher value-added sectors. China has recently experienced serious power shortages in some areas. China has a strong programme to increase efficiency in the steel and cement sectors, and its most modern plants exceed EU energy efficiency levels; China exports energy efficient technology in the cement and aluminium

sectors. China has removed export subsidies in the steel sector and imposed export taxes on coking coal and steel. The EU – along with the US and Japan – have complained to the WTO about these export restriction measures.

6. Future competition with Europe will come from Russia and the Gulf States based on subsidised energy not carbon prices.

The real threat to tradable European energy intensive industry (mainly steel and aluminium) whatever happens on ETS auctioning comes from Russia and Gulf States. These countries are basing their core future economic strategies on diversification from selling energy commodities to energy intensive goods, and will do this based on subsidised capital and below market energy prices. Most of these countries will have to take binding caps under a post-2012 climate regime and will be open to WTO challenge – or direct countervailing measures – if they attempt to compete on subsidised energy. These countries will adjust their input prices to undercut EU producers whatever level of auctioning is agreed, and will generally be more carbon efficient than EU producers due to modern plant and use of gas as a fuel. Remedies must come from outside climate change policy to preserve a fair economic playing field.

7. Giving free allowances will raise serious barriers to linking the EU ETS with future US and Japanese trading systems. This could result on border taxes being placed on €261 billion of EU exports to the USA, and result in billions of economic efficiency losses to the EU.

All economic modelling of climate change shows huge savings in abatement costs can be gained by combining developed country carbon markets into a fully linked system. A complex system of free allowances will raise significant barriers to linking carbon trading systems currently being developed in the US and Japan. Under the draft Warner-Liebermann legislation all EU firms receiving free allowances would be subject to border tax measures. This would impact €261 billion in EU goods trade, mainly in energy, transport and machinery; potentially reducing the EU's €80 billion trade surplus to the US (DG Trade, 2008). Differences in auctioning regulations would delay the linking of the trading systems reducing the potential for EU firms to lower their compliance costs and earn profits from emissions trading with the US.

8. EU emission targets beyond 2020 will require energy intensive industries to cut emissions below current Best Available Technology or other important industries will face higher costs.

European Commission and industry scenarios show demand for steel, cement and aluminium being stable, or even slightly increasing in a low carbon future. Steel will be replaced by aluminium in the car industry, but demand for both steel and cement is likely increase as more energy efficient buildings are constructed. Without significant incentives to deliver new approaches for radical cuts below BAT by 2020 these industries will require an increasing share of the EU emissions budget and will increase costs for other more productive European industries.

9. European companies are global leaders in very low carbon steel and cement, but giving free allowances removes incentives for aggressive RD&D and their competitiveness in future markets.

European companies have a range of existing R&D projects for producing ultra-low carbon steel and cement. In cement, geopolymers made from aluminium silicates could provide possible 80% reductions of chemical carbon dioxide emissions. Steel making could be revolutionised by iron ore electrolysis and hydrogen based steel making utilising zero carbon energy. Carbon capture and storage provides a medium term solution to reducing emissions before more advanced technologies are mature. Giving free allowances to energy intensive companies removes any commercial incentives for developing these new technologies which are also being developed in Japan and China.

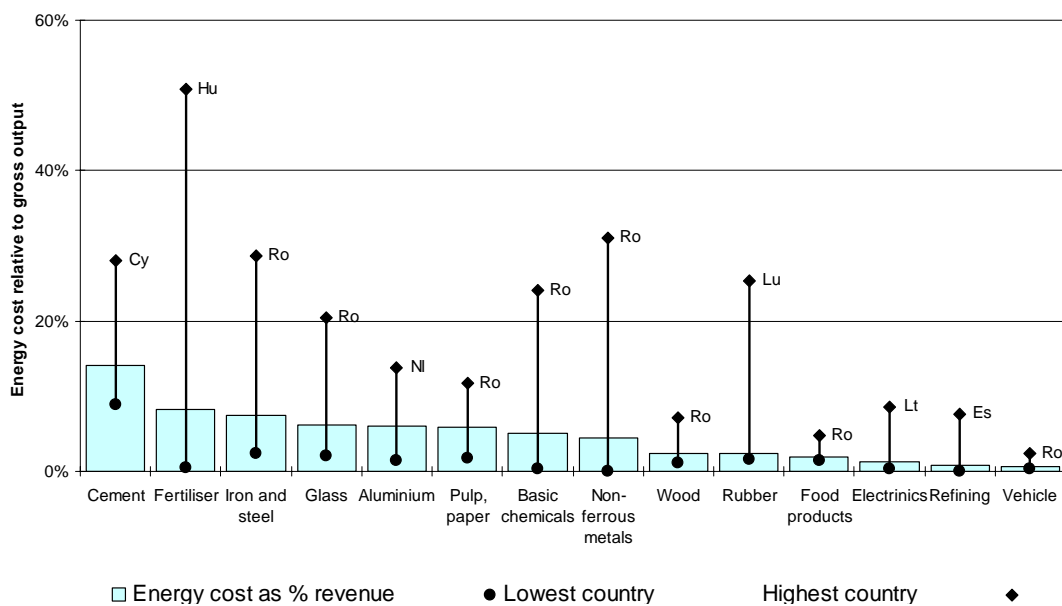
10. EU energy intensive industries have wide range of efficiency across the sector. Jobs and competitiveness are best preserved through using auction revenues to fund a sector specific green investment tax credit and EU RD&D fund.

Compared to global best practice many European plants in energy intensive sectors are underperforming, with wide variations in energy efficiency between countries. Giving these plants free allowances will not directly lead to them deciding to reinvest and remain in Europe. Given these sectors are partially shielded from international competition companies will be able to pass some of

the additional costs to consumers. The additional profit this represents may be given to shareholders or even used to fund investment outside the EU.

An alternative approach would be to channel the proceeds of auctioning back to firms via a green investment tax credit and EU RD&D fund. This would reward companies who innovate and reinvest inside the EU in new clean technology; securing jobs and revenues. By increasing incentives for accelerating the development of low carbon products such a package would allow European firms to lead in world beating technology by 2020. At this point major developing countries will begin to take on absolute emission reductions and there will be a huge demand for low carbon technologies and products in these sectors.

Energy Intensive Sectors: Energy Spending as a Percent of Added Value



Source: Eurostat Structural Business Survey results for 2005. Data for some countries is withheld because sample sizes are small. Product mixes between sectors also drive differences

About E3G

E3G is an independent, non-profit European organisation operating in the public interest to accelerate the global transition to sustainable development.

E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change.

E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

More information is available at www.e3g.org

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