

European Union Emissions Trading System (EU ETS)



EU ETS is a cap and trade scheme to limit and progressively reduce Greenhouse Gas (GHG) emissions from power generators and heavy industry across the European Union (EU). Emissions are regulated at their point of release, with around 45% of EU fossil carbon emissions covered by the scheme.

EU ETS and its associated measures are central to EU policy to reduce the release of GHGs from European industry. Overall, the EU is committed to reducing domestic GHG emissions by 20% by 2020, 40% by 2030, and targets at least an 80% reduction by 2050 (against a 1990 baseline). For EU ETS regulated installations, this means that by the end of 2020, GHG emissions from regulated sectors are required to be 21% lower, and by 2030 43% lower (against a 2005 baseline).

EU ETS was introduced in 2005, with the third phase having begun in 2013 and running through to the end of 2020. Phase IV will run through to 2030. Negotiations are underway to set the rules for this next Phase (see separate CPI position paper).

Essentially, each installation is required to report annually its independently verified direct emissions of carbon dioxide (and other GHGs), and then surrender an equal number of allowances to cover the reported amount of emitted fossil carbon dioxide equivalent. The total number of allowances released to the market is set by government policy, while the price is set by market demand – so called “cap and trade”. Allowances are either provided for free (to obligated installations), purchased from government, or secured via secondary market trading.

Detailed information on EU ETS can be found on the websites of the European Union and the UK Government at: ec.europa.eu/clima/policies/ets/ www.gov.uk/participating-in-the-eu-ets

CPI Position

- **Support for the principles of EU ETS.** A market based cap and trade system is the most economically efficient way to drive down industrial emissions of carbon.

- **Set a target and stick to it.** Fundamental to EU ETS is setting long-term carbon targets so companies can decide if they should either invest in emission reduction, or purchase allowances. The system should be allowed to operate and the temptation for policy makers to micro-manage should be resisted.
- **Emission allowances set by benchmarks should be respected.** Energy intensive installations in the EU cannot remain competitive if faced with higher costs than competitors operating in areas with lower carbon costs. To avoid risk of carbon leakage (EU firms being driven out of the EU), then at risk firms are provided with a level of allowances free of charge. These free allocations were set by a rigorous assessment of historic data together with product energy benchmarks set by the most efficient installations. Cutting back these allocations, as has happened through the Cross Sector Correction Factor (CSCF), shows a fundamental misunderstanding of how industry works. Independently assessed proposed allocations should be respected, and there should be no scaling back to keep under the overall cap; any shortfall in allowances should be taken from the allocation held by government.
- **A global agreement is critical.** The target for reduction is global emissions – not just European. Accordingly, the overwhelming priority must be for European targets to be part of a global agreement; Europe cannot reduce global emissions on its own. Countries need to deliver commitments made as part of the Paris Climate Change Agreement and (over time) these need to be developed to provide a global scheme that reduces carbon emissions in an equitable manner.

- **Understanding and retaining carbon leakage status is critical.** Until there is a genuine global agreement then European industry must be protected from excessive carbon costs. It follows that any suggestion that the sector should lose carbon leakage protection is misguided.
- **Industry operates globally, as do carbon emissions.** Policy makers cannot assume that industrial locations are static and that, in the long term, they can continue to compete if faced with costs not faced by competitors outside the EU. Closing manufacturing in Europe reduces direct emissions, but if that manufacturing and its associated emissions are simply shifted outside the EU then the scheme damages EU industry and delivers no global environmental benefit.
- **Lower compliance cost is not a bad thing.** If the reduction targets are delivered at a lower cost than forecast this is good news – not a symptom that the scheme is broken.
- **Competitively priced energy.** Overall energy costs in line with those in competitor nations are fundamental to the long-term future of European industry. As well as the intrinsic cost of energy, UK papermakers are extremely concerned about increasing regulatory and network costs. It is the cumulative impact of policies that counts – each policy cannot be considered in isolation.
- **Electricity use should be included in benchmarks.** Benchmarks (used to set levels of free allocation) should not simply focus on heat, they should also encompass electricity use. Such a change would obviate the need for the UK compensation scheme to offset the impact of EU ETS on electricity prices.
- **Support industrial CHP electricity generation.** A major opportunity to support Combined Heat and Power (CHP), and deliver its associated environmental benefits, has been missed by removing free allocation of allowances from industrial CHP electricity. This should be reviewed in the next Phase of EU ETS.
- **Use carrots as well as sticks.** Current UK energy policy is essentially predicated on driving up the cost of using fossil fuels so that low carbon generation becomes competitive. This runs a real risk of making industry uncompetitive and driving it out of the country. To counter this, energy taxes should be used to invest in industrial efficiency – making sites more competitive as well as reducing emissions.
- **Invest revenue from the sale of allowances in energy efficiency.** Using carbon taxes to fill holes in general revenue is not a sensible or sustainable policy. Rather, such income should be used to fund a major programme supporting energy efficiency, both research and deployment.

Please see the separate CPI position statements on EU ETS Phase IV and EU ETS Post-Brexit.

CPI Director General, Andrew Large, commented: “Driving manufacturers out of Europe by making them uncompetitive through over-pricing carbon is nonsensical. Domestic manufacture is simply replaced by imported final product; carbon is a global issue and a tonne of CO₂ released outside Europe is the same as one released inside.”

Sector Background

The Manufacture of Pulp and Paper

The manufacture of pulp and paper is an EU ETS regulated sector, and all pulp and paper mills capable of producing more than 20 tonnes of product per day are required to comply with EU ETS. In the UK, 40 mills met the criteria for inclusion as at January 2017, while five were below the threshold. A number of the 40 mills are classed within EU ETS as small emitters (below 25,000 tonnes CO₂ pa emissions) of which 11 have chosen to opt out of the main scheme and into the simplified UK alternative. (A full list of UK mills can be found at: www.paper.org.uk/documents/millcapacityfinaljan16.pdf)

In 2016, these 38 mills, plus their associated CHPs, directly emitted a total of 1.64m tonnes of fossil carbon dioxide, while these installations received a total of 1.2m allowances free of charge – a shortfall of 27%.

In 2008, the start of EU ETS Phase II, UK mills emitted 3.6m tonnes of fossil carbon dioxide, meaning 2016 emissions were 48.5% lower thanks to a combination of energy efficiency, switching from fossil to biomass fuel and the closure of a number of installations. Over the same period, UK production fell from 5m tonnes of product to 3.7m. The UK is now the largest net importer of paper in the world, and over half of UK paper collected for recycling is exported unprocessed. A full summary of UK EU ETS sector emissions can be found at: www.paper.org.uk/documents/EUETS20082015summary.pdf

Carbon Leakage

A number of Energy Intensive Industries, including the manufacture of pulp and paper, are accepted as at risk of carbon leakage – the loss of investment, jobs and wealth creation to locations outside the EU with lower carbon costs. Throughout Phase III, these industries continue to receive a number of free allocations intended to cover their heat use and on the assumption that they operate at the fossil carbon efficiency of the best installations.

From January 2013, zero free allocation is provided for electricity use or generation, so adding an additional cost burden and increasing the price of electricity. The UK Government has provided a compensation package to offset some of this cost impact on the most affected installations. A number of UK paper mills are eligible for this compensation.

Brexit

Until the UK formally leaves the EU then UK installations remain fully obligated under EU ETS. Please see the separate CPI position paper on options post-Brexit.

Further Information

Further information is available from Steve Freeman, Director of Environmental and Energy Affairs, on 07775 696514 or email sfreeman@paper.org.uk.

Confederation of Paper Industries

- The Confederation of Paper Industries (CPI) is the leading trade association representing the UK's Paper-based Industries, comprising recovered paper merchants, paper and board manufacturers and converters, corrugated packaging producers, and makers of soft tissue papers.
- CPI represents an industry with an aggregate annual turnover of £6.5 billion, 25,000 direct and more than 100,000 indirect employees.
- For facts on the UK's Paper-based Industries please visit: www.paper.org.uk.

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