

Ensuring effective protection against carbon leakage after 2020 - A must for the European-based flat glass industry

Position paper on the EU ETS post-2020

The 2014 quantitative assessment carried out by the European Commission for establishing the carbon leakage list for the period 2015-2019 has shown a **20% increase in the effective risk of carbon leakage in the flat glass sector**, compared to the previous assessment done in 2009. At the same time, **the level of protection against risks of carbon leakage is diminishing** due to a faster reduction of free allowances allocated to industrial sites according to the rules of phase III of the EU ETS.

These two diverging trends are a source of great concern within the flat glass sector and explain why Glass for Europe calls on a comprehensive reform of the carbon leakage protection mechanisms under the EU ETS post 2020.

The EU ETS is a source of costs for the flat glass industry, which has to acquire CO₂ allowances for the vast majority of its EU-based plants to operate. So long that emission trading schemes have not become global and therefore that competitors do not bear the same costs, the EU ETS contributes to weakening the competitiveness position of European-based glass industries vis-a-vis third country competitors. As such, it indirectly favors production reduction in the EU and rises in imports into the EU from non EU countries without carbon constraints.

For these reasons, the flat glass industry needs to be fully protected against risks of carbon leakage. Glass for Europe calls on EU decision-makers to ensure full and effective compensation under the form of free allowances for industries exposed to risks of carbon leakage after 2020. **Only thanks to full and effective compensation, will the flat glass industry be able to continue manufacturing in Europe its energy-saving products and will the industry be able to ensure sustained investments in high-tech manufacturing and product innovation.**

Key parameters to ensure protection against carbon leakage:

- ▶ The exposure of industrial sectors to risks of carbon leakage needs to be focused on energy-intensive industrial processes and must remain based on objective criteria;
- ▶ Manufacturing sites belonging to sectors exposed to risks of carbon leakage should receive a sufficient free allowances, in line with updated CO₂ benchmark figures and actual production;
- ▶ cross sectoral correction factor (CSCF) should be removed to ensure that the number of free allowances granted to EU industrial sites does not reduce faster than their estimated GHG improvement potential. The CSCF effectively annihilates carbon leakage protection measures.

Background

Since many years the EU is a worldwide frontrunner in climate change mitigation. It has unilaterally committed to reduce its GHG emissions by 20% by 2020 and by 40% by 2030. It operates the EU ETS 'cap and trade's system to achieve GHG reduction objectives in most industrial sectors.

Because other major economies do not have the same level of commitment or any commitment at all to reduce their GHG emissions, EU industries face extra costs for climate change mitigation which are not faced by their international competitors. These extra costs affect the profitability of EU industries, reduce their investment capacity and their competitiveness and thus generate risks of relocation of these industries outside the EU borders, the so-called 'risk of carbon leakage'.

In order to reduce the risk of carbon leakage, i.e. the risk of relocation of industrial activities covered by EU ETS outside the EU, industries exposed to risks of carbon leakage are entitled to receive free CO2 allowances up to the benchmark level. Even though the free allocation of ETS allowances does not completely offset the lack of level playing field between EU and non-EU based industries, it nevertheless allows industry to invest in the efficiency of its plants as it helps preserving investment capacity.

Given that investment cycles in the flat glass industry are over 15 years, long-term certainty and predictability is needed to foster investments of flat glass companies in the EU. It is therefore important that the EU defines the rules on the EU ETS and carbon leakage provisions that will apply post 2020 as of now. Ensuring effective and long-lasting protection against the risk of carbon leakage should be a primary objective of the EU reform so as to enable Europe's industrial actors to keep on manufacturing in Europe the solutions for a competitive and sustainable low-carbon economy.

1. The current method for assessing industries exposed to carbon leakage could be marginally improved

To Glass for Europe, the current criteria based on a CO2 cost and external trade metrics, as well as the current thresholds, are appropriate to define risks of carbon leakage. The assessment leading to the carbon leakage list could be nevertheless improved.

First, **the list of sectors exposed to carbon leakage must be established for the entirety of each trading period** of the EU ETS, to ensure certainty and long-term visibility to industry and investors.

Second, the CO2 cost metric should be made more relevant to analyze the impacts of carbon cost on sectors' profitability. To that end, **the CO2 cost over GVA criteria could be replaced by a CO2 cost over Gross Operating Surplus (GOS)**. The 5% threshold should stay unchanged.

Third, **the assessment should focus on those industrial activities that are really covered by the EU ETS and in particular on energy-intensive sectors**, whose competitiveness is most affected by high energy and carbon costs. When it comes to glass industries, an assessment at NACE 3 or 4 level is not necessarily appropriate to identify the relevant industrial activities that are falling under the EU ETS. The assessment at NACE 4 level thus consistently under-estimates risks of carbon leakage in the flat glass sector. Quantitative assessments should be based either on 'industrial activities' or be also possible at NACE 6 or 8 digit level.

Current thresholds should be maintained. Raising thresholds would send a damaging signal to EU industries, meaning that fixing a cap to free allowances is more important than industrial competitiveness.



2. The level of free allowances allocated to each industrial site should evolve in a realistic way

Given that the level of protection against risks of carbon leakage directly depends on the number of allowances attributed to each installation, a realistic benchmark level is required to ensure adequate protection for all European installations within an industry sector. In addition, the calculation of free allocation should be based on actual production data and no longer on historical production.

In principle, **benchmarks should be revised to reflect technology developments** and deployment. However, to provide certainty to industry and investors, the benchmark level should be aligned with the ETS phases and established for the entirety of the next trading period.

Besides, **the revision of benchmarks should ensure that free allowances are gradually reduced at levels that reflect the industry's concrete ability to improve GHG performance**. In the case of the flat glass industry, there is a 5 to 10% reduction potential of GHG emission per output unit by 2030, provided that ongoing R&D delivers the desired outcomes. **Any artificial factor reducing free allocation at a faster pace should be removed**.

3. The Cross Sectoral Correction Factor should be removed

Under phase III of the EU ETS, the cross sectoral correction factor (CSCF) is applied every year to the overall amount of free allowances. It therefore forces a steep reduction of free allowances which de facto entails a gradual reduction of protection against carbon leakage regardless of effective risks.

Because of its cross sectoral nature, this factor is disconnected from both the real potential to reduce GHG emissions in each sector. This disconnection penalizes all manufacturing sites, including best performing ones, which see their level of free CO₂ allowances reducing faster than their actual CO₂ reduction potential. **This factor therefore acts as a strong disincentive to manufacturing investments in the EU** as it only creates the middle- / long-term prospect of higher carbon and manufacturing costs in the EU than in neighbouring countries.

The CSCF needs to be abandoned and other mechanisms could be put in place to ensure a realistic decrease in free allowances: either a regular review of the benchmarks (as advocated earlier) or the instauration of a sectoral reduction factor that reflects each industry's effective GHG reduction potential when using best available technologies.

Glass for Europe is the trade association for Europe's flat glass sector. Flat glass is the material that goes into a variety of end products, primarily in windows and facades for buildings, windscreens and windows for automotive and transport as well as solar energy equipment, furniture and appliances. Glass for Europe brings together multinational firms and thousands of SMEs across Europe, to represent the entire building glass value-chain. It is composed of flat glass manufacturers, AGC Glass Europe, Guardian, NSG-Group, Saint-Gobain Glass Industry and Siseçam-Trakya Cam, and works in association with national partners gathering thousands of building glass processors and transformers all over Europe.

