

Effective ETS reform must resolve issue of indirect carbon costs compensation

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Ensuring compensation for indirect costs will be pivotal in making ETS work for power-intensive industries, argues Gerd Götz.



As the emissions trading system (ETS) reform debate intensifies, MEPs and EU member states are examining a variety of options to make the ETS a meaningful and effective system.

Options include adjusting auctioning shares, setting up innovation funds, redesigning carbon leakage lists, improving benchmarks or more accurately reflecting production levels. All are well-intentioned and some of them may indeed improve the system. However, none fundamentally address - nor resolve - the impact of ETS on power costs.

So-called 'indirect' ETS costs are extremely direct and significant for those power-intensive industries that rely on regional power mixes where users have to bear the cost of a carbon content that they have not created.

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These indirect costs have already had a massive impact on a number of the EU's strategically important industries, namely aluminium, zinc, copper and nickel. In the case of aluminium - the most electro-intensive, and therefore most exposed, industry - indirect carbon costs can be up to seven times the cost of ETS direct emissions.

The European Commission is well aware of the scale of this problem. In 2012, it determined that €1 of carbon costs translated into €0.76 of additional power costs for western European market consumers, €0.57 in the Iberian Peninsula or up to €1.06 in the Czech and Slovak markets.

For an aluminium smelter connected to the western European electricity market, a carbon price of €5 already translates into additional power costs of four per cent of today's aluminium price.

This adds around €180m in annual costs to European aluminium production. If this carbon cost increases to €30, the CO₂ cost would be equivalent to 25 per cent of today's aluminium price. For a sector selling its output at a global price, such a level of indirect costs is unsustainable and it will seriously hinder the competitiveness of the sector

This is a serious problem that requires an urgent solution. It is time to fix the EU's indirect carbon costs issue in a manner that is fair and effective.

Although direct and indirect carbon costs are the twin offspring of the EU ETS, it is striking that they are treated differently.

While direct costs are fully compensated up to benchmark levels through free allowances, indirect costs will receive only a partial compensation. In fact, under the current European Commission proposal, the existing measures will remain optional.

Other ideas, such as ramping up compensation levels as CO₂ prices increase, do not adequately address the problem the industry is facing with potential fatal consequences of power-intensive industries.

If changes are not introduced, this will lead to an outcome where power-intensive industries will only be saved after they have died. Such an approach discriminates against industries exposed to indirect emission costs without logic or reason.

It would be a meaningless paradox if climate regulations towards what's among the cleanest aluminium production in the world should lead to further shut-downs, loss of work places and research to the benefit of industry in countries that do not face such costs, so-called "carbon leakage".

With world demand for aluminium booming, industry in countries with a more polluting energy mix, weaker environmental standards and lower technological standards would take over the production

Europe shuts down.

That would increase global emissions, weaken the European economy and we would lose our lead in climate technology.

The EU must address the issue of indirect costs compensation, by applying identical principles that guide compensation for direct costs.

This requires full compensation of indirect costs at benchmark levels, guaranteeing that the top performers do not incur undue costs. No more, no less.

About the author

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[Business and industry](#) [8]

[ETS](#) [9]

[Energy](#) [10]

[Environment](#) [11]



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