

**TranSust.Scan Conference**

**Competitive Issues in Climate Change Policies**

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## **Operational procedures for dealing with carbon leakage**

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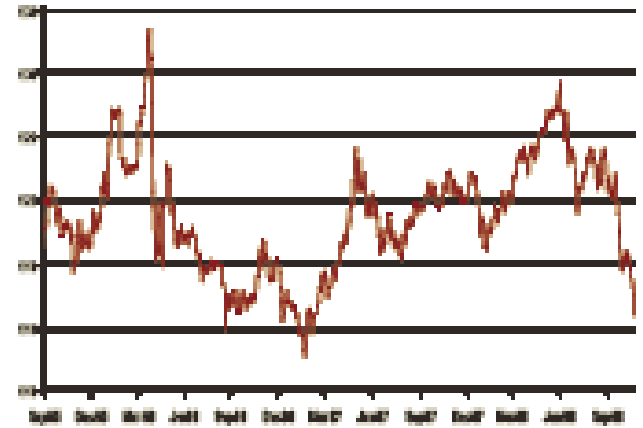
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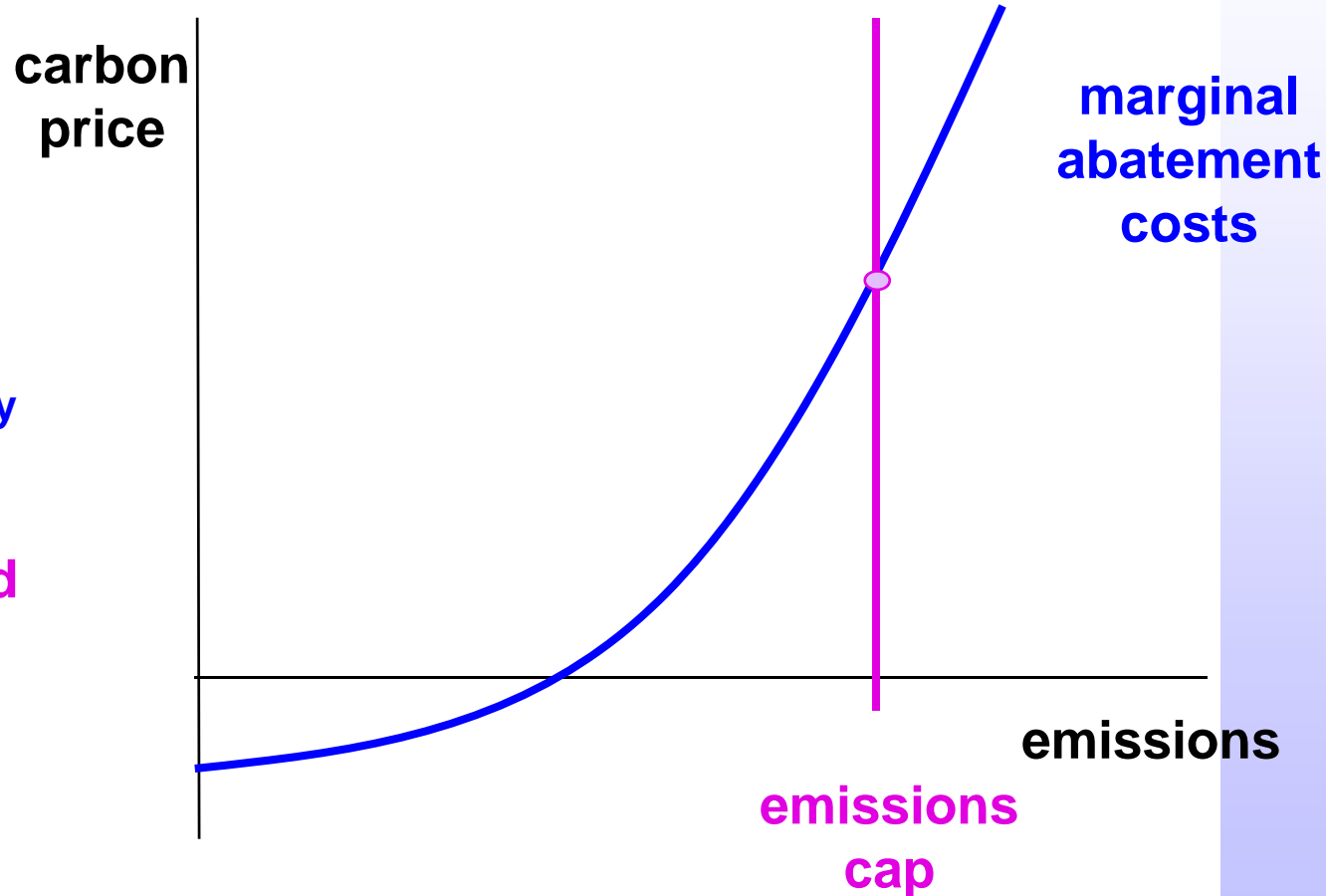




## Enhancing the carbon market

# The challenge for the carbon market

- **The 8 year time span of Phase 3 is unprecedented**
  - What does the market know about abatement costs?
  - Market price may be very volatile and vulnerable
- **Almost all emerging ETS include some kind of mechanism to stabilize the carbon price**
  - RGGI (Regional Greenhouse Gas Initiative)



# Strategic mandate for a carbon authority

- **Almost all emerging ETS include some kind of mechanism to stabilize the carbon price**
  - **RGGI (Regional Greenhouse Gas Initiative)**
- **Timing of supply of allowances for auctioning**
  - **Liquidity management –**
    - **timing of auctioning, new entries reserve, purchases on market**
    - **linking**
- **Controlling the liquidity of the carbon market**
  - **Carbon Authority intervenes on market**
- **Carbon authority**
  - **Could be an EU agency**
- **Recent non-paper by the Commission**
  - **Emphasizes that fundamentals and the long time horizon will stabilize the carbon price**

# The Commission proposal on carbon leakage

# The Commission proposal

## ■ Three sectors

### ➤ Power sector

- 0 / 0 % free allowances

### ➤ Normal sector

- 80 / 0 % free allowances

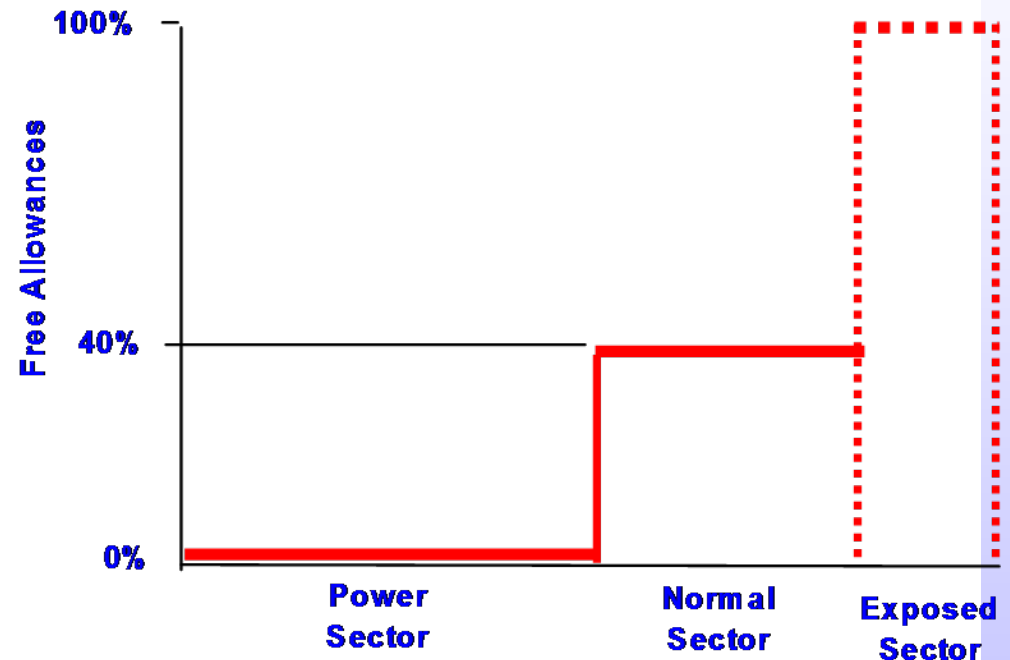
### ➤ Exposed sector

- up to 100 % free allowances

## ■ Procedure for exposed sector

### ➤ Find criteria for qualifying as exposed sector

### ➤ Decide upon the allocation of free allowances



# Commission non-papers on carbon leakage

## ■ Two non-papers

### ■ Indicator 1

- ↗ **Industry's additional costs relative to product prices, related to CO2 emissions**
  - Direct costs
  - Indirect costs from electricity

### ■ Indicator 2

- ↗ **Openness to international trade**
  - Exposure to international competition

# Proposals from Germany and France



# The emerging consensus

- The risk of carbon leakage should be dealt with by issuing free allowances
- The risk of carbon leakage will be determined by two indicators
  - (1) Carbon cost intensity
  - (2) Trade intensity

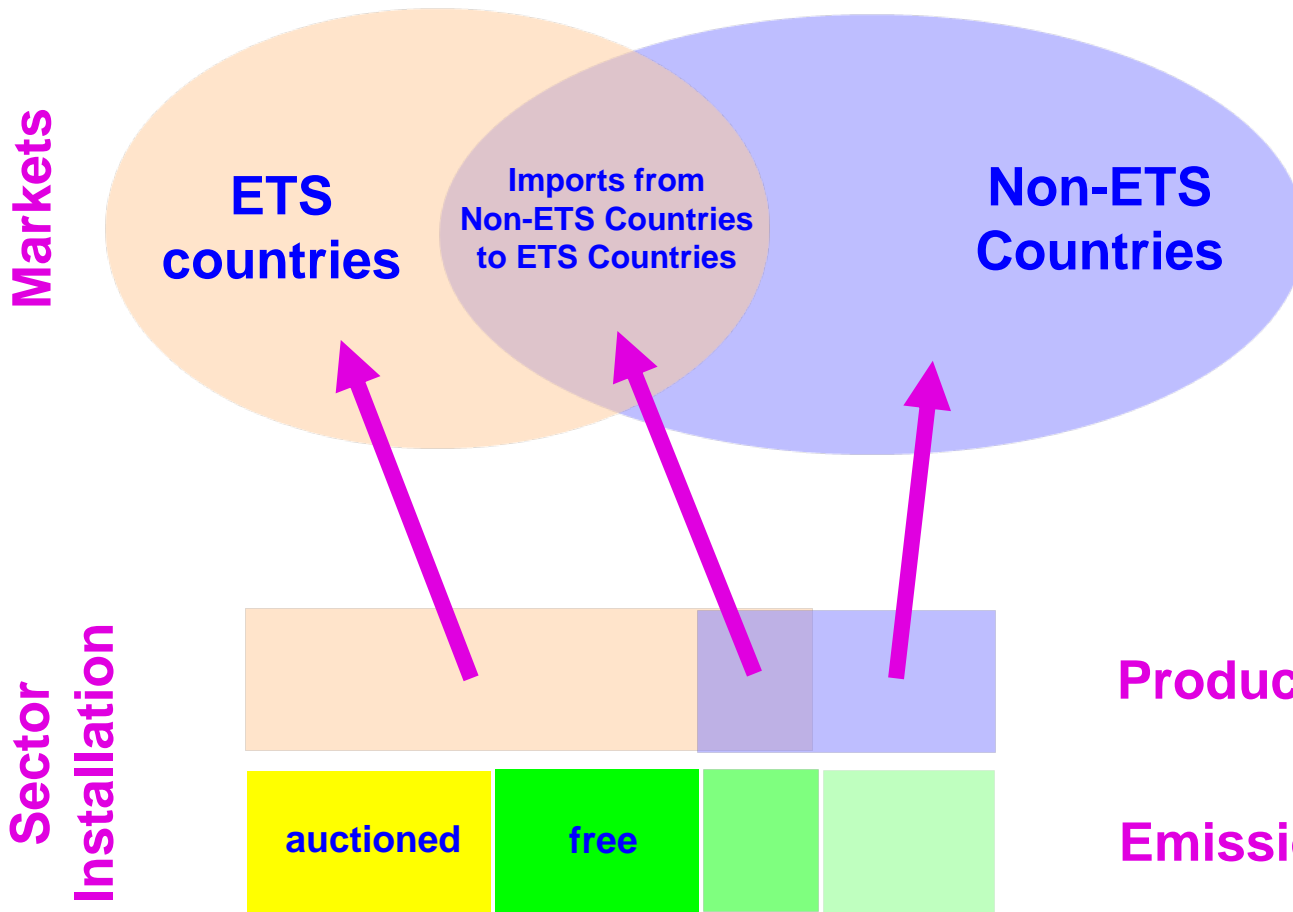
# The modified proposals by DEU and FRA

- **DEU proposal**
  - kg CO<sub>2</sub> / Euro Value Added
  - Contains a list of about 15 sectors
- **FRA proposal**
  - (a) cost + trade
  - (b) cost
  - (c) trade
  
  - No suggestions as to sectors affected
- **Cost indicator needs to reflect carbon price**
- **How to determine thresholds?**

**Operational procedures  
based on  
competitive position  
of sectors and installations**

# Carbon Leakage

## Impact on production



### ■ Trade intensity

- Relocation of production from existing installations

### ■ Export Competition

- Exports to Non-ETS Countries

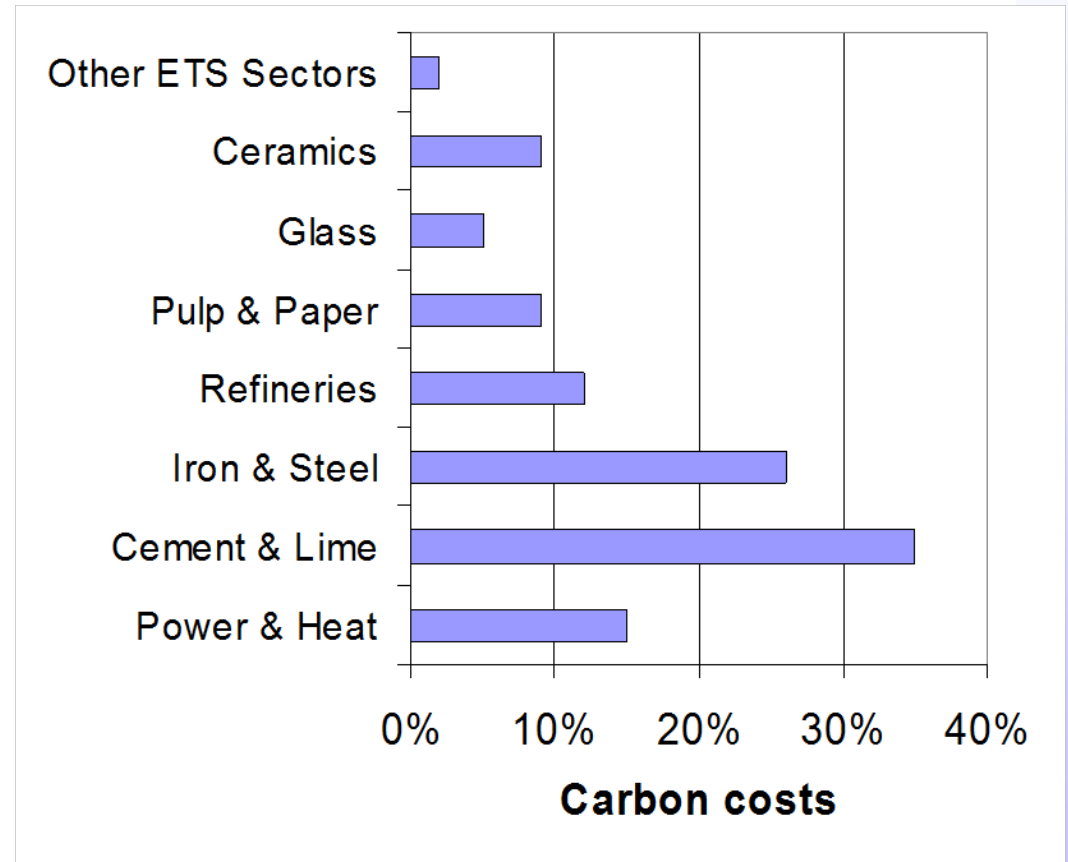
### ■ Import Competition

- Imports from Non-ETS Countries to ETS Countries

# Carbon Leakage

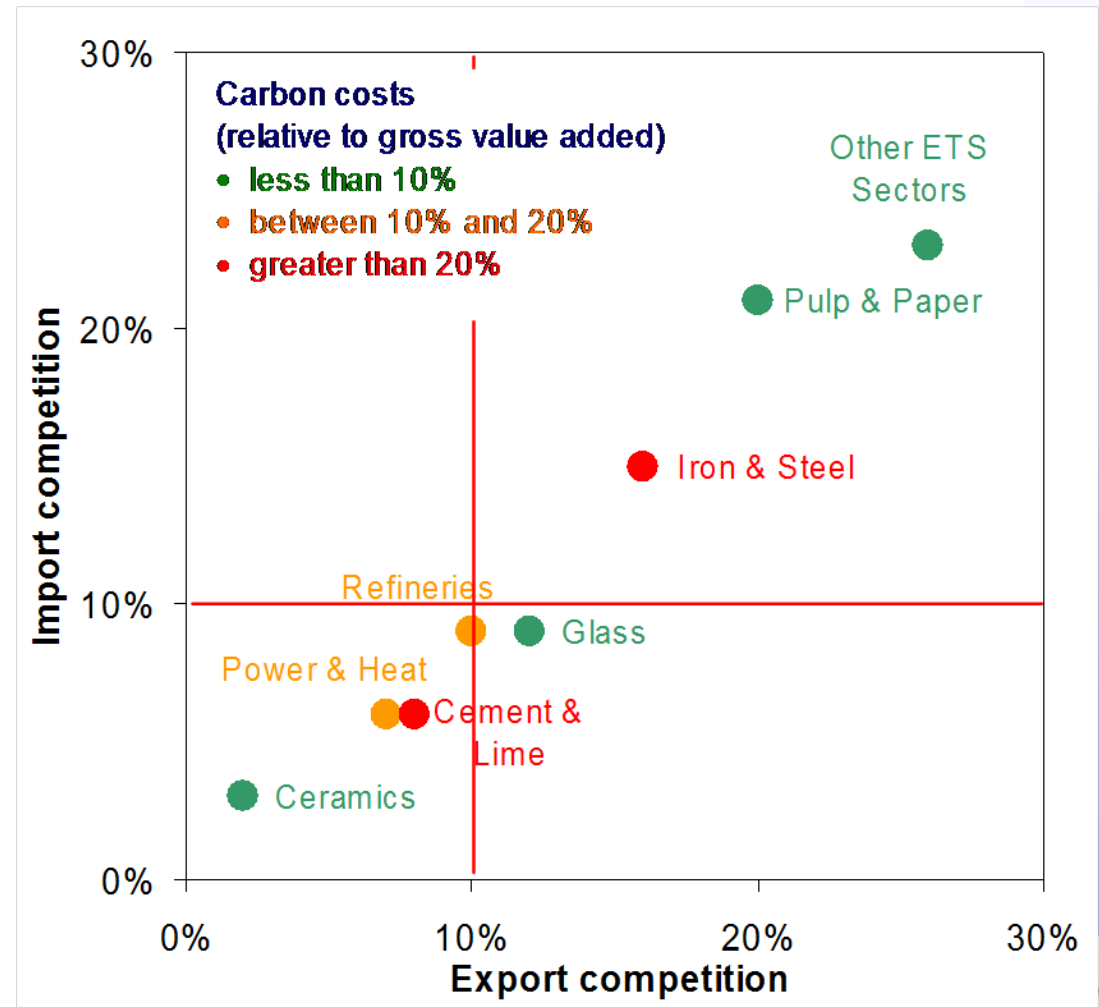
## Impact on investments

- **C-Cost intensity**
  - Relocation of new installations
- **Relocation competition for new installations**
  - C-Costs in gross value added



# Deciding about the exposed sector

- **Stage 1**  
Whenever at least one indicator for a sector (subsector or installation) exceeds a threshold, this constitutes excessive exposition to carbon leakage.
- **Stage 2**  
These indicators may serve for political decisions about the amount of free allocations.



# First conclusions

- All sectors are exposed to carbon leakage for different reasons and to different degrees
- Early political decision about carbon leakage is possible based on a set of operational criteria

**An extended proposal  
that emphasizes  
a unified procedure  
for all sectors**



# Elements of an operational procedure (1)

- All sectors start with the same share of free allowances
  - ↗ e.g. 80%
- If sectors / sub-sectors see no risk of CL this share is reduced by a fixed rule
  - ↗ e.g. 0% in 2020

## Elements of an operational procedure (2)

- If sectors / sub-sectors see a risk of CL they may opt-in for CL Monitoring
- The CL Monitoring is done annually and determines
  - The amount of risk of CL by indicators for carbon cost intensity and trade intensity
  - The amount of free allowances allocated to sectors / sub-sectors for the next year
  - These dynamic adjustments reflect changes in the carbon price and in the trade flows
- The information provided for CL Monitoring also serves for the distribution of free allowed to installations by a EU benchmarking procedure

# Advantages of this procedure

- **High flexibility with respect to**
  - **The sub-sectors involved**
  - **Unexpected changes in the carbon price and trade flows**
- **The Package needs a consensus only for the procedure of CL Monitoring but no numbers for sectors / sub-sectors.**
  - **This enables a decision of the Package by December**