

ETS review, voluntary carbon markets and CBAM

Scene setter

[REDACTED] (CV in Background) is Vice President, Government Affairs, Public Policy and Issues Management at the Dow Chemical Company. He joined Dow Chemical in 2009 after serving as the Assistant Secretary for Electricity Delivery and Energy Reliability in the United States Department of Energy.

Dow is an American multinational chemical corporation among the three largest chemical producers in the world. Dow manufactures plastics, chemicals, and agricultural products. It employs about 54 000 people worldwide. The European headquarter of Dow is located in Horgen, Switzerland. The largest European site is situated in Terneuzen (NL).

At global level, Dow announced in June 2020 to reduce its net annual GHG emissions by 5 million tonnes by 2030 versus its 2020 baseline (15% reduction). By 2050, Dow intends to be carbon neutral.

[REDACTED] has indicated he wants to discuss two topics:

1. **ETS review and its impacts on the chemical industry.**
2. **Voluntary carbon markets** and the possibilities for voluntary carbon market initiatives to count towards a **CBAM-discount**

On 1 – ETS Review

We do not have individual Dow position papers, but the company is a member of **CEFIC**, the European chemical industry association. CEFIC published its position on the revision of the EU ETS and CBAM in October 2021 and, in May 2022, on REPowerEU.

Key CEFIC-requests are:

- to keep free allocation originally intended for CBAM sectors in the free allocation budget and not to auction it for the Innovation Fund;
- to increase the size of the Innovation Fund and make it entirely available for the manufacturing industry, regardless of their coverage by a CBAM;
- to harmonise indirect cost compensation at EU level;

These points make it clear that carbon leakage protection and public support for decarbonisation are the most important elements of the regulatory framework for the chemical industry. In response, we can point to the continued carbon leakage protection under the revised ETS as well as the increased Innovation Fund.

On REPowerEU, CEFIC welcomed the strategic vision on reducing dependency on Russian fossil fuel and the cascading value-chain effects stemming from the limited availability of imported base materials.

Finally, on high energy prices, a letter of 6 September 2022 underlines the immediate threat of record gas and electricity prices for energy intensive industries. For the chemical sector **especially fertiliser producers are at risk**. Data from carbon market analyst suggest that Dow curtailed output at its Hoek van Holland (NL) and Tarragone (ES) sites in August.

On 2 – Voluntary Carbon Markets and a possible CBAM-discount

Dow is supportive of carbon pricing frameworks and is involved in an initiative to establish a voluntary carbon market in the US for industry (“where voluntary refers solely to the

initial choice to participate”). It is unclear to which initiative Dow refers and the meeting could be an opportunity to learn more about it.

Dow is interested to understand whether, under the CBAM Regulation, the carbon price paid domestically (i.e. in the US voluntary ETS) would count towards a discount from CBAM.

First, it is important to note that **chemicals do not fall within the scope of CBAM**, hence there is no CBAM due and the carbon leakage protection of EU chemical plants is ensured by free allocation.

The European Parliament has proposed that organic chemicals are included in the scope of CBAM.¹

Whilst the participation in voluntary carbon markets is a praiseworthy activity in itself, it is presently of no relevance to the obligations of installations regulated under the EU ETS. [REDACTED]

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Voluntary markets credit a range of activities inside and outside company boundaries without clarity on accounting, carry with them risks of double counting and are of variable quality in terms of monitoring, quantification, and overall transparency. In general terms we have not recognised and would not recognise voluntary credits within the EU ETS, and where we are planning to allow for limited use of credits (in implementation of CORSIA) we quality compliance grade credits with a corresponding adjustment and accounting adjustment to do so. Typically, voluntary markets do not deliver this.

Objectives

- Underline the effective carbon leakage protection that will continue to be available to the chemical industry also under the revised ETS
- Acknowledge the added climate benefits that participation in voluntary initiatives can bring, but underline that the EU does not count purchased emission reductions towards EU ETS obligations. Seek to understand more about Dow's 'voluntary ETS' initiative and how emission reductions would be achieved.

- [REDACTED]

Main messages

On ETS review and free allocation

¹ This would result in the possible inclusion of 1100 products, most of which highly complex especially in terms of attributing embedded emissions to the individual components and thus increasing the administrative burden.

- The ongoing revision of the EU ETS reflects the increased EU climate ambition, primarily through its increased cap.
- The carbon leakage protection framework, based on free allocation and indirect cost compensation, remains largely intact despite the lower overall volume of allowances.
- The Commission's proposal seeks to reduce the chance of a cross sectoral correction factor having to be applied in the second half of the decade. This is achieved by a better targeting of the free allocation by way of updated benchmarks with higher maximum annual reduction rates.
- Additional funding is available for installations that want to make the transition to low-carbon production methodologies, also for sectors that are not covered by CBAM. The Commission has proposed to top-up the Innovation Fund with 50 million allowances from the existing ETS and 150 million allowances from ETS2.

On CBAM

- Free allocation will be phased out for sectors covered by the new CBAM, but under the Commission's proposal the chemical industry is not among those sectors.
- The initial scope of CBAM is limited to relatively simple products and the inclusion of a large number of chemical products is complex and would increase administrative costs.
- CBAM is designed to mirror the EU ETS in order to create a level playing field between EU and non-EU producers.
- Exemptions from CBAM are foreseen for linked ETSs with the same effective price as the EU ETS. Imports from countries or regions that apply an explicit carbon price (e.g. in the form of a carbon tax or an ETS) can apply for a discount from CBAM.
- Under the EU ETS voluntary initiatives are not relevant for the surrender obligation.

Defensives

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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- [REDACTED]
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How will you ensure that the European industry remains competitive?

- A competitive European industry is a pre-requisite for the success of the transition towards a climate-neutral, circular and digital economy.
- Our increased 2030 ambitions will accelerate the climate and energy transitions, which will help to modernise the whole EU economy and allow European companies to gain a competitive advantage. Speeding up the transition will allow European companies to reap first mover benefits in low-carbon technologies. As the cost of low carbon technologies continues to fall, carbon intensive business models are becoming increasingly unsustainable economically. These sectors will need to undergo transformations in any case.
- The policy package put in place to deliver the 2030 targets of -55% GHG emission will create many new opportunities for European businesses, both large and small, for example in low carbon technologies, renewable energy, building renovation, integrated infrastructures, transport systems, batteries, and hydrogen. We want a modern European industry that will remain a key enabler for sustainable and inclusive economic growth.
- In addition, the Commission has proposed the introduction of a carbon border adjustment mechanism for certain sectors by 2021 given the different levels of ambition that persist globally and in order to ensure a level-playing field between EU and international competitors.
- At the same time, cooperation with our international partners has to be pursued to develop new affordable solutions and to increase the level of ambition of all regions in the world in the context of the COP 26 international climate conference in Glasgow.
- Overall, stronger climate ambition will accelerate our transformation into a modern, resource-efficient and competitive economy. It will be the basis for economic growth in the 21st century and for rising living standards in Europe.

By how much will free allowances be reduced in the next years?

Free allowances will remain an important tool to protect against the risk of carbon leakage until at least 2030. However, with the reduction of the overall emissions cap in line with the -55% Climate Law objective, the overall number of free allowances available will also be reduced.

At the same time, maritime is proposed to be included in the current ETS without free allocations to the shipping industry. Therefore the impact of extending the ETS to the maritime sector will mitigate the decrease in the total number of allowances in the system and therefore the total amount of allowances available for free allocation.

To give stability to the sectors, the free allocations for the period 2021-2025 recently decided will remain stable.

The proposal also does not change the basic rules for calculating the free allocation. The Commission's proposal, however, aims to allocate free allowances in a more targeted way, and to incentivise the uptake of innovative low-carbon technologies. The maximum annual reduction rate of the benchmark values will increase from 2026 onwards, shifting more free allocation to sectors that are harder to decarbonise.

The scope of the ETS (in terms of the definition of activities) is broadened so that installations using low-carbon or zero-carbon technologies may in the future benefit from continued free allocation. It will mean that the incentives for innovation are maintained and not reduced from the prospect of losing free allocation when moving to low-carbon or zero-emission technologies.

Moreover, free allocation will be made conditional on decarbonisation efforts: installations not implementing cost-efficient measures as recommended in energy audits will have their free allowances reduced by up to 25% reinforcing energy efficiency instrument and ETS.

We would like indirect cost compensation to be harmonised at EU level. Why has the Commission not proposed that as part of the ETS revision?

- It is correct that not all Member States compensate for indirect costs and also between Member States that compensate there are important differences in the amounts they compensate. This creates an unlevel playing field.
- However, past efforts to set up a harmonised system for indirect cost compensation, for instance through an EU fund sourced from auction revenues, did not find sufficient political support, partly due to distributional questions.
- That being said, 15 Member States now provide indirect cost compensation, including the five largest economies.

Background

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Terneuzen decarbonization roadmap

The roadmap foresees the transformation of off-gases from the existing ethylene cracker into hydrogen and CO2. The hydrogen will be used as a fuel, while the CO2 will be captured and stored.

Contacts:

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