**INTERNATIONAL FEDERATION
OF INDUSTRIAL ENERGY CONSUMERS**

IFIEC Europe

Brussels 30 July 2007

Response to the EU Green Paper "Market based instruments for environment and related policy purposes"

1. IFIEC Europe represents energy intensive industrial consumers. For our members, energy is a major component of operating costs and directly affects competitiveness.

2. Designing the legislative structure for 27 member states presents a challenge that will not be realised by retaining the thinking and methods developed for the original Community of 6. IFIEC believes that this has already resulted in a programme leading to constraints on manufacturing, despite the apparent support given publicly to the Lisbon Strategy. The Commission must find a better balance between promoting innovation and encouraging environmental improvement without prejudicing its manufacturing base.

3. The Green Paper and the principles being proposed are important for the development of the EU. Market based structures and arrangements should have a greater role in administrative thinking in future and IFIEC looks forward to this Green Paper making the first real step in such a change.

4. However, any market based instrument (MBI) will have an administrative framework set by Governments to achieve a policy objective. This means that they are not opening up a freely functioning market and the criteria included to achieve the policy add cost that affects competitiveness. To have value, MBI's must make technology innovation and efficiency improvement measures attractive without adding cost to the company concerned.

5. The products of energy intensive industries within the EU are internationally traded on global, highly competitive markets. Mechanisms that result in off-shoring these productions into other regions with less stringent climate change and environmental frameworks do not help to achieve the goal of fighting global climate change.

6. Not all of the questions are answered as some are not the focus of IFIEC's concerns and others have largely been met by responses to earlier paragraphs. IFIEC remains available for discussion with the Commission and other parties to develop this thinking further.

IFIEC Europe's Response to the questions

1. What are the areas and options for the further use of market-based instruments at EU or national level?

7. MBI's can play an important role in delivering environmental objectives in a cost-efficient and flexible way. Potentially, market based mechanisms can be applied to any aspect of life; social or industrial, but must be tailored to suit the individual circumstance of the market being entered. They need to be designed by those who appreciate not just the technical criteria, but the alternatives that could be opened by those with greater market experience. The recent development of hedge funds has altered the characteristics of markets. Many of

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the energy related questions that will influence the environmental improvement programme will potentially come under the influence of such markets. Mechanisms need to take account of these developments and restrict the potential if it is considered disadvantageous.

8. Experience with the EU Emissions Trading Scheme (EU ETS) reflects this, as its efficiency in delivering real and cost-efficient Greenhouse Gas (GHG) reductions has yet to be demonstrated fully. The EU ETS design, the link with malfunctioning electricity and gas markets and the lack of a global framework to cut GHG, risks the dislocation of European energy-intensive industries for no environmental benefit. Actions that result in GHG emitters moving outside EU to regions where requirements are reduced are not an answer.

9. One principal aspect is to agree the forms of scheme. There appear to be three main approaches:

   9.1. front loaded schemes (taxation);
   9.2. incentive based programmes with charges levied if commitments are not met;
   9.3. full market mechanisms inside of which the allowance costs vary depending on market trading principles.

10. IFIEC favours the second of these as they retain capital in companies unless commitments are not met. They are flexible and allow the inclusion of criteria that provide for derogation where circumstances change outside of the control of the company yet which have a direct effect on the ability to produce at optimum efficiency. This would cover changes in Government policy that alter economic criteria and that could lead to companies being penalised twice; firstly for investment that can no longer deliver at planned levels and then from the resulting financial penalties. It is possible that there could be a move in time towards the third option, but much greater experience is needed both in scheme design and practical operation before any wider adoption of MBI's is considered. It is this category that would include arrangements such as EU ETS and the faults in this clearly need correction before considering extending the range of such mechanisms.

2. *Should the EU more actively promote environmental tax reforms at national level and how could the Commission best facilitate such reforms?*

11. Taxation is the least appropriate market based instrument to address environmental goals in the current global context as it does not provide businesses with the necessary flexibility in deciding how those goals can best be met. It is a blunt instrument that takes cash flow and capital from companies, so reducing their ability to invest. Rather than putting an additional burden on business through increased taxation, the Commission should promote mechanisms to recognise innovation and then to encourage investments in new and greener technologies, through agreed procedures that do not contradict competition law. The aim should be to emphasise innovation within the broad concepts of competition law, not to focus in such a way that the law becomes a deterrent to progress. In this connection, IFIEC welcomes the statement from the European Parliament (17 July) resulting from Budget cuts in Heading 1A funding. This suggests that despite statements from the Commission, support for promoting the Lisbon Strategy is being reduced.

12. For most IFIEC members, the IPPC law applies. This brings the BAT concept into practice and requires efficiency assessments across all elements of environmental risks and how these are managed. The scope for further major changes in performance against BAT assessments is limited unless new energy technologies are developed. The gains made become incrementally smaller, whilst the costs rise. Adding further taxation to this burden will not produce the levels of environmental improvement some expect, other than by forcing further manufacturing closures and driving investments to parts of the world where different criteria apply. The products of IFIEC members are often traded internationally, which also delivers economic pressures that drive investments in efficiency and reduced energy intensity. For ready acceptance by industry, new mechanisms need to operate in the

same manner, using market mechanisms and pressures as the drivers.

3. ***Would the establishment of the abovementioned MBI Forum be useful to stimulate exchanges of experience/best practice on Environmental Tax Reform between Member States?***

4. ***How does the need to reduce the tax burden on labour in many Member States fit with the objective to promote innovation and to support research and development in order to shift towards a "greener" economy? How can this be achieved while at the same time respecting the budgetary neutrality? Would a more significant tax shift towards environmentally damaging activities be the right answer?***

13. IFIEC does not believe that creating another Forum is necessary. The development of the Lisbon Strategy and the ambitions for a "greener" economy are core to both the Commission's programme and that of the Council. They should be handled within the Institutions already in place rather than creating one without official status. The key questions are the allocation of funding to an agreed R&D programme and transferring the emphasis from taxation to market based criteria. This will mean agreement between national authorities for a programme they fund centrally under Commission auspices, rather than transferring national taxation rights to Brussels.

14. Our answer to question 2 also applies to second part of this question. It is right that programmes should be risk based and the current legislative actions on manufacturing in general and the IPPC sectors in particular provide examples of this. It is now the other sectors of the economy, that need a similar focus as households, public services and transport are now where the questions need to be asked. Households are now the single, largest demand sector for electricity generation where no use efficiency measure is required. National Governments need to consider the extent to which they will apply the same levels of stringency to these sectors as they have done to manufacturing before this question can be answered with any expectation of realistic policy emerging. Moving policy to cover those sectors now seen as more environmentally damaging must not mean damaging the competitiveness manufacturing processes in the EU that have already responded by improved efficiency and environmental performance.

5. ***What is, in the light of national experiences, the best way to advance the process of reforming environmentally-harmful subsidies?***

15. The fundamental need is for full and effective liberalisation of energy markets. Without this, the many subsidy type supports will not be resolved, although the extent to which all Governments are supportive of this change appears questionable. This must come first, as although programmes EU ETS clearly need to be reformed, the failures in this are directly linked to the lack of a true EU energy market. EU ETS based on CO_2 reduction was taken forward on the current basis despite warnings about effects that have become only too evident. Similarly, unless the thinking changes that the only way to promote favoured technologies is to allow energy prices from other techniques to rise to give an illusion of cost-effectiveness, much of the necessary reform will never advance. IFIEC has responded separately to the EU ETS review consultation and rejects any suggestion of extending the EU ETS approach to including such as SO_2 and NO_X until the original scheme is changed and operates to the satisfaction of all parties involved.

16. Not all subsidies are based on stimulating "green" criteria, despite part of the outcome being environmental. There are other social and economic reasons why national Governments may consider support necessary. There is more to providing a balanced set of national arrangements than environmental criteria alone. Furthermore, it must not be considered to be subsidisation if energy intensive industries are granted special exemptions as foreseen in the energy taxation directive (2003/96/EG). Such exemptions are correctly provided for in order to take account of the risks to the competitiveness of efficient manufacturing processes in global terms.

6. Would the suggested changes to the Energy Taxation Directive and the proposed approach to its scope be the best solution for ensuring coherence between the Directive and EU ETS? Are there other options to achieve this objective?

7. What are the potential options that should be explored in order to provide the necessary incentives to encourage the EU's trading partners to undertake effective measures to abate greenhouse gas emissions?

17. It is significant that the problems in the EU ETS scheme result amongst other reasons, from the limited number of companies that trade and the influence of brokers who are not involved in the companies for whom the scheme was designed. Their experience of operating in market exchanges means they have a far better understanding of trading principles and the realisable potential than others Their objectives are not aligned with those of the companies, nor necessarily with the objectives of the scheme originators in the Commission.

18. The many smaller companies, particularly in the manufacturing sector, are unlikely to focus on EU ETS trading (or in any other such scheme), as they are concerned with their core business and its products. We hope that the current review of the EU ETS will resolve these problems. While trading systems for other emissions may be less complicated, it would be prudent to postpone the introduction of new programs until all are fully informed by current experience.

19. The Joint Research Centre (JRC) report of 13 July state "Even if the EU and the Member States have adopted numerous successful measures to curb energy consumption and associated CO_2 emissions, the electricity consumption in the residential sector of the EU-25 grew at a rate comparable to overall GDP (10.8 percent), effectively nullifying overall savings between 1999 and 2004". This suggests that even if EU residents see climate change as a real issue. Either they are not making the direct connection between this and their own consumption patterns, or are not prepared to change their personal living styles to the extent necessary to make the individual changes, possibly because the direct financial cost of doing so is too high. Taxing them further to promote change is unlikely to be successful and may create unacceptable difficulties at national level.

20. IFIEC's discussions outside EU suggest that neither companies nor Governments will commit to schemes that do not have a realistic technological basis. Even the well publicised plans in some USA States will not pass local legislatures otherwise. The Commission must change its thinking that constraint and taxation is the way to meet unrealistically ambitious carbon reduction targets. Both individuals and companies will respond much better to incentives based on energy efficiency, realisable technologies and research programmes to take the science further.