

## Holcim Position Paper on Climate Change:

### 3. The National Allocation Plans in the EU ETS

<b>Achievements of the EU ETS in 2005 - 2006</b>	<p>One and a half year experience with the EU ETS has revealed the following realities for business and the environment:</p>
<b><i>Intended effects</i></b>	<p>Awareness of the potential impact of CO<sub>2</sub> emissions is growing in industries affected by the ETS.</p> <p>Emission allowances are traded on the market, creating a cost for CO<sub>2</sub> emissions, which is internalized. This has already led to a (significant) increase in consumer prices of electric power.</p> <p>Increasing awareness and cost drivers are leading to some emission reductions.</p>
<b><i>Unintended effects</i></b>	<p>The ETS, but especially the National Allocation Plans, cause significant undue distortion of competition without environmental benefit: between companies in a given sector, within Member States, within the European Union and with industry outside the EU.</p> <p>Because of its current design, uncertainties and wrong signals, business decisions on improvement and investments are being deferred, rather than accelerated.</p> <p>As a result, absolute CO<sub>2</sub> emissions are not reduced as much and as effectively as the system intends.</p>
<b>Root causes of current lack of success</b>	<p>Halfway through this “learning by doing” phase, the root causes for the problems of the EU ETS can be found in the design of the National Allocation Plans, and the wrong signals it sends:</p> <ul style="list-style-type: none"> <li>▪ Allocation of allowances to existing installations based on historic absolute emissions rewards emission instead of efficiency.</li> <li>▪ Unequal treatment of installations – allocating more allowances per unit of production to existing and inefficient than to new and efficient installations – inhibits the creation of tradable allowances via investment. It does not represent an incentive to rationalize or invest in assets - especially in CO<sub>2</sub> free technologies! - which goes against the system’s objective.</li> <li>▪ The lack of long-term predictability, resulting from short allocation periods and the non-sustainability of the grandfathering principle in the longer term, creates an unfavorable climate for business decision-making.</li> </ul> <p>These are all consequences of the principle of “Emission Based Allocation” (EBA), i.e. grandfathering, used in all 2005-07 NAPs.</p>

<p><b>Necessary change for success of the ETS</b></p>	<p>The system would be more effective, efficient and equitable if Performance Based Allocation (PBA), i.e. benchmarking, were used.</p> <p>With PBA, all installations in a sector are treated equally, providing right incentives for performance improvement.</p> <p>The absolute volume of allowances (CO<sub>2</sub> per year) would be defined by the multiplication of a sector performance standard (CO<sub>2</sub> emission per unit of production) with the production volume (units of production per year).</p> <p>The most simple and transparent way to apply PBA is by allocation in two steps: First, by the allocation of a volume of allowances to the total of each industrial sector (cement, power, steel, paper, etc.), followed by the distribution of this volume to all installations in the sector on an equal basis, i.e. allowances allocated per unit of production.</p> <p>Practical guidance for PBA is given in a complementary position paper.</p>
<p><b>Feasibility for 2008 – 12</b></p>	<p>Some stakeholders are uncertain about the feasibility of PBA, at least for 2008 – 12. This should not be the case:</p> <p>The survey by McKinsey, conducted in 2005 for the European Commission, identified that most industrial companies, authorities and NGOs believe PBA is feasible for 2008 – 12, without changes to the directive.</p> <p>It suffices authorities and industry to have the political willingness to do so.</p> <p>Holcim encourages stakeholders to consider using PBA for the 2008 – 12 NAPs; if not for all industrial sectors, then at least for some “pilot” sectors such as cement and electric power.</p>
<p><b>Common interest</b></p>	<p>The interests of authorities, industry and NGOs would be satisfied if the ETS could be made more effective and efficient.</p> <p>Industry should take account of the political objectives of legislators, i.e. to reduce CO<sub>2</sub> emissions, and authorities should acknowledge the practical implementation difficulties of the ETS.</p> <p>It is in our common interest to cooperate constructively and implement the necessary improvements to the system as from 2008-12 – for the sake of environmental, social and economic development in Europe.</p>

<b>Auctioning aggravates the allocation issue</b>	<p>Some stakeholders propose auctioning as a simple way to prevent the difficulties related to initial allowance allocation.</p> <p>Requiring industry to pay for 10 % or more of the needed allowances would withdraw such vast financial resources from industry that recycling of the revenues to the industry is inevitable to prevent crippling of European industry.</p> <p>This turns the issue of allocation of CO<sub>2</sub> allowances into an issue of allocation of money. Needless to say that this will be vastly more complicated.</p> <p>Auctioning thus seriously aggravates the problems it wants to solve and should therefore not be used at all.</p>
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Further information on Holcim's CO<sub>2</sub> objective and strategies can be found at: [www.holcim.com/sustainable/](http://www.holcim.com/sustainable/) or by contacting Bruno Vanderborght at: [bruno.vanderborght@holcim.com](mailto:bruno.vanderborght@holcim.com)

Zurich, 24 April 2006