

Lime Sector Analysis of ‘Commission paper on Energy Intensive Industries exposed to significant risk of carbon leakage’

EuLA appreciates the opportunity to engage with the Commission on this critical issue for the sector and welcomes the Commission's efforts to provide clarity and consistency in its approach. The Commission's proposed approach of employing a high level of disaggregation of sectors, assessing the increase in production cost due to EU ETS implementation and introducing a second stage which provides flexibility for further factors to be taken into account provide good starting points for the assessment of EII exposed to carbon leakage.

Although EuLA recognises that the purpose of the methodology set in the Commission's non paper is to serve as a screening tool that can be applied to a wide range of sectors, EuLA believes that it is unlikely to capture effectively the factors that are relevant to assessing the risk of carbon leakage in all potentially exposed sectors.

In this context, EuLA would like to make the following comments:

- **Projected trade flows should be the basis for the analysis.** Simple indicators based on past data are unlikely to be informative of the future potential for trade where there is a dramatic change in relative supply costs that leads to a fundamental structural shift in the competitive position between two regions. For the Lime Sector, the increase in production cost from CO₂ is a massive 45-50% (even at a conservative €30 per tonne CO₂), which is more than 3 times the average profit margin of EU producers. Thus, the key issue for the lime sector is that although the economics of supplying the EU from abroad are currently unattractive, they could easily become attractive with a sufficiently high cost of CO₂. Therefore, for the Lime Sector current trade patterns are a **very misleading** proxy for either future potential trade flows or the ability to pass through cost. It is a standard observation in the analysis of markets and competition that the **threat** of entry can be a powerful constraint on prices, even if no entry has yet taken place. Current patterns of trade for the Lime Sector are due to existing cost structures, which involve negligible CO₂ costs. It is therefore vital that the Commission's approach takes into account the future trade exposure under the market conditions brought about by the EU ETS post 2012 proposal.
- **Impact on profit margins and “Return on Investment” would be better indicators of the costs.** The ratio between CO₂ cost and product price is not always a good indicator of exposure to carbon leakage. In reality, the extent of leakage depends on the impact on companies' profit margins and return on investment, which in turn impacts on production and investment decisions, respectively. The Commission should use a realistic forecast for the price of CO₂ post 2012 and EuLA would support the use of a sensitivity analysis using a range of CO₂ prices.
- **The 4-quadrant approach may lead to wrong conclusions.** A key aspect of the assessment methodology, but one that remains unclear from the Commission's paper, is the relative weighting or boundaries between the four categories (Figure 1 in the paper). The characterisation of high-cost, low (current) international trade activities as being at “low to moderate risk” of leakage is insufficiently justified. There is little justification for the implication that goods with high (current) trade but low CO₂ costs are more at risk of leakage than ones with high cost but low (current) trade. This implies that some marginally energy-intensive industries could be considered more at risk of leakage than ones like lime whose cost structure will be fundamentally altered by the introduction of CO₂ costs.
- **Lime and cement should not be taken together for evaluation.** Whilst the Commission paper correctly recognises the importance of carrying out the analysis at the right level of aggregation, the paper refers to the “cement and lime” sector but it should be noted that these are separate sectors and should be treated as such.

- **Assessing the result of the international agreement.** There is currently no clarity in the proposal regarding the critical success factors against which final classification of sectors will be judged.

EuLA believes that the Commission's current proposal will lead to an inaccurate assessment. In particular, **the implications of the very high cost impact (45-50% increase) for the Lime Sector and the future impact that this will have on trade exposure under the conditions brought about by the EU ETS post-2012 proposal are not adequately captured by the Commission's approach.** A helpful indicator could be the change in the margin or return on investment per tonne of product for foreign suppliers in the event of full pass-through of costs. This would give an indication of the significance of the structural shift for the sector, because the attractiveness for foreign suppliers would switch from highly negative to highly positive.

Finally, EuLA would like to thank the Commission for being given the opportunity to comment on the Commission's non paper and look forward for further cooperation in developing a system that will as far as possible reflect the reality of the threats facing the sectors concerned.

More detailed information is available at your request.

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