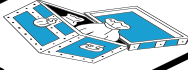




Carbon leakage myth buster

UNITED KINGDOM

WINDFALL
PROFIT



FREE



ALLOCATION



CARBON
LEAKAGE

National Fact Sheet

March 2016

Executive summary

This policy brief interprets the findings of a new study by CE Delft¹ that shows how energy-intensive companies in the UK have massively profited from their pollution to the count of €3.1 billion because they are deemed to be at risk of “carbon leakage”. “Carbon leakage” refers to a hypothetical situation where companies transfer production to countries with weaker climate policies in order to lower their costs. Under the current EU Emissions Trading System (EU ETS) rules, industrial companies that are believed to be at risk of “carbon leakage” are awarded free pollution permits.

- **Free allocation has resulted in significant windfall profits for corporations.** Windfall profits occur when industrial companies are over-subsidised for their pollution. **Energy-intensive companies in the UK made over €3 billion** from the EU ETS during 2008-2014². The corporations in the UK that were able to make the most profits from the EU’s carbon market are Tata Steel (€870 million), Lafarge (€160 million), Hanson Cement (€125 million) and Total (€120 million).
- **European taxpayers are picking up the bill as governments forego income and lose out on revenues from auctioning these pollution permits.** As a result of free allocation, less money is available for investments in the climate friendly transition of the European economy. In the 2008-2014 period, the UK government has given out 1.3 billion free pollution permits and has thereby **missed out on at least €16.3 billion in auctioning revenues**³.

In the coming months, European policymakers will revise the current EU ETS rules for the post-2020 period. The policy brief concludes with recommendations how to change the current carbon leakage rules to ensure that further windfall profits are avoided.

What are windfall profits?

The current EU ETS rules hand out free emission allowances to industrial companies deemed at risk of “carbon leakage”. The emission allowances that are given away for free represent subsidies, since governments forego income and lose out on revenues from auctioning these pollution permits. Windfall profits occur when industrial companies are over-subsidised for their pollution. This can, for example, happen when too many free emissions allowances are given away that can be sold for a profit in the market.

Heavy industry made over €3 billion windfall profits from the EU ETS

Some corporations have used the EU ETS to increase their cash flows by using the theoretical risk of “carbon leakage” as an argument to receive pollution subsidies from governments. **Heavy industry in the UK was able to generate about €3.1 billion in windfall profits from the EU ETS** during 2008-2014 in the following ways⁴:

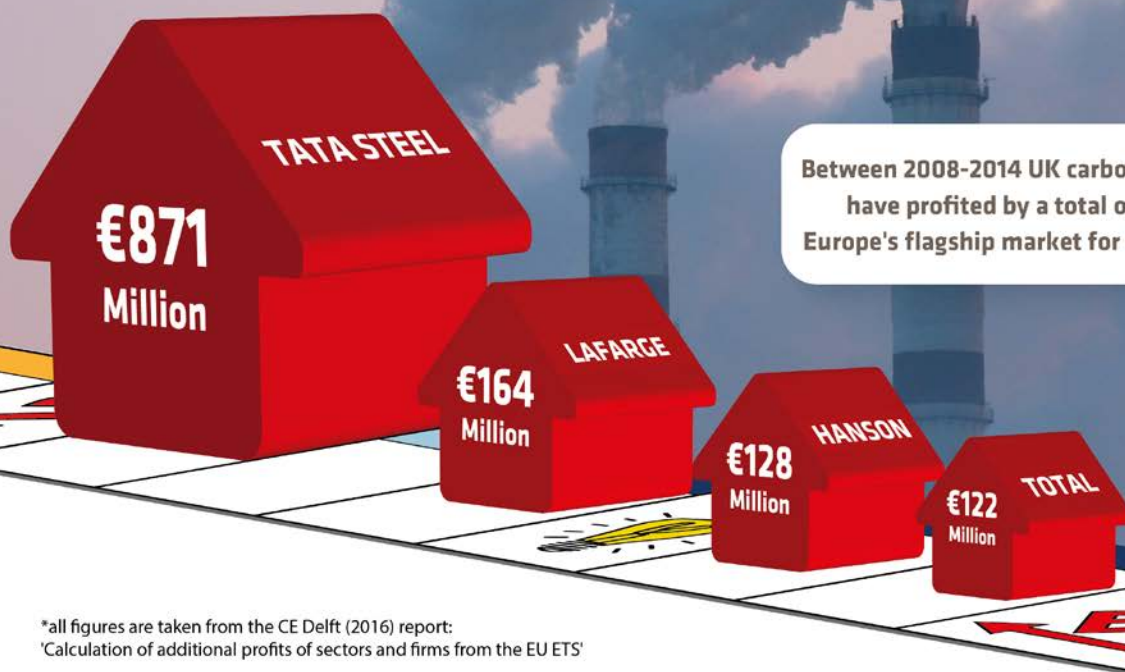
1. **Windfall profits from surplus: €1,010 million.** Industries have received more emission allowances for free than they actually need, and are able to sell their surplus for a windfall profit in the market.
2. **Windfall profits from offsets: €58 million.** The price for international offsets is much lower than the price for emission allowances. Industries have, therefore, bought international offsets to comply with their targets, and are able to sell their remaining free allowances for a profit in the market.
3. **Windfall profits from cost-pass through: €2,035 million.** Industries have generated windfall profits by letting their customers pay the price for freely obtained emission allowances.

The sectors in the UK that have profited most from the EU ETS so far are the iron and steel, extraction of crude oil and gas, refineries and cement sectors. Within these sectors, the cement sector was able to generate the most money from receiving too many free allowances and selling this surplus for profits in the market.

Sector	Windfall profits from surplus	Windfall profits from offsets	Windfall profits from min. cost-pass through	Total windfall profits
Iron and steel	€78 million	€22 million	€744 million	€844 million
Extraction of oil and gas	€71 million	€11 million	€559 million	€641 million
Refineries	€126 million	€4 million	€504 million	€635 million
Cement	€255 million	€8 million	€104 million	€367 million
Petrochemicals	€123 million	€6 million	€64 million	€192 million



Profits from over-subsidising carbon pollution



⁴all figures are taken from the CE Delft (2016) report: 'Calculation of additional profits of sectors and firms from the EU ETS'

Tata Steel, Lafarge, Hanson Cement and Total are the corporations in the UK that have made the most profits from the EU's carbon market. Tata Steel was for example able to make about €870 million from the EU ETS of which €164 million from being able to sell excess free emission allowances. Lafarge was able to make over €160 million and Caste cement around €128 million.

Company	Sector	Windfall profits from surplus	Windfall profits from offsets	Windfall profits from min. cost-pass through	Total windfall profits
Tata steel	Iron and steel	€164 million	€22 million	€685 million	€871 million
Lafarge	Cement	€118 million	€6 million	€40 million	€164 million
Hanson cement⁵	Cement	€103 million	€1 million	€24 million	€128 million
Total	Refineries	€48 million	€0.4 million	€74 million	€122 million

Unsubstantiated “carbon leakage” claims by heavy industry

In the past years, industry lobbyists have made several unsubstantiated claims about the impact of the EU ETS on their competitiveness. Certain corporations have made profits worth hundreds of millions of euros from the EU's climate policies, while still claiming that the EU ETS is impacting their competitiveness.

Claim by Tata Steel: “The proposals [on the EU ETS reform] represent a risk for the steel production in Europe. This model would be leading to a shrinking process in the industry.” (2015)⁶

Fact: Tata Steel UK has made more **over €800 million** from the EU ETS in the 2008-2014 period according to the CE Delft (2016) report. Although the UK steel sector has been in difficult waters recently, this seems largely due to the low demand and steel “dumping” by Chinese producers and not by the EU ETS.

Claim by Lafarge: “Unequal carbon pricing place[s] the EU manufacturing sector in general – and the cement sector in particular – at risk of carbon leakage” (2013).⁷

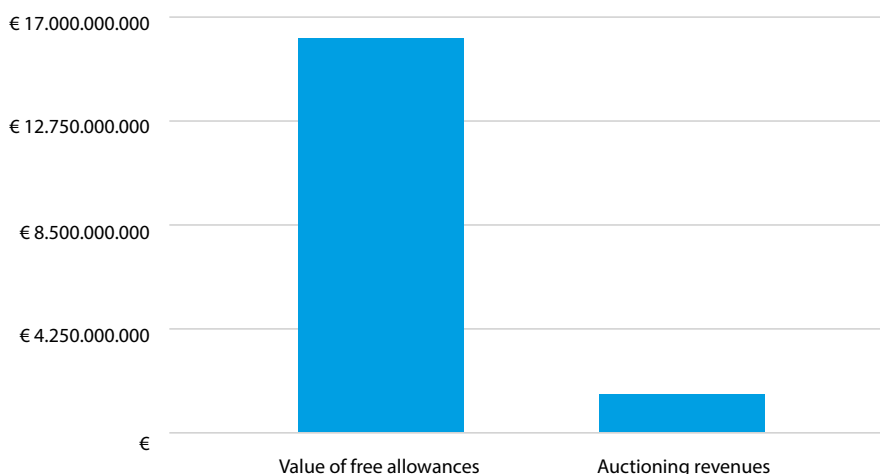
Fact: The cement company has made **€485 million** from the EU ETS in the years 2010 to 2014 according to its own [annual reports](#). Lafarge UK has made over **€160 million** from the EU ETS in the 2008-2014 period according to the CE Delft (2016) report.

Free allowances – less money to invest in the low-carbon transition

Giving free emission allowances to industry reduces the amount of allowances that governments can auction, and hence reduces the auctioning revenues that could be mobilised by governments. Consequently, free allocation means that less money is available for investments in the low-carbon transition of the European economy.

Between 2008 and 2014, 1.3 billion allowances were given out for free in the UK with an equivalent value of €16.3 billion. **The UK government therefore lost out on €16.3 billion in auctioning revenues.**

In the same period, **the UK generated over €887 million from auctioning allowances.** All of these revenues were invested in Europe and third countries for climate purposes.⁸



Conclusions

There are at least four problems related to the “carbon leakage” rules under which industrial sectors are able to receive free pollution permits:

1. **Free allocation has resulted in significant windfall profits for corporations: energy-intensive companies in the UK made over €3 billion** from the EU ETS during 2008-2014.
2. **European taxpayers are picking up the bill as governments forego income and lose out on revenues from auctioning these pollution permits.** In the 2008-2014 period, the UK government has **missed out on at least €16.3 billion in auctioning revenues.**
3. Without an urgent change of rules, **emission reductions of industry will stall over the next 15 years.** Giving away free emission allowances reduces the incentive of companies to produce more efficiently or to invest in breakthrough technologies that reduce CO₂.
4. **The Paris agreement will level the playing field across the global economy after 2020.** When relocation destinations have similar climate policies to the EU ETS, there will be no “carbon leakage” risks. Studies have furthermore not been able to find evidence for “carbon leakage”.

Recommendations

The ongoing legislative process to revise the EU ETS rules for the post-2020 period provides an important opportunity to revise the current “carbon leakage” rules. The lessons learned so far are important to ensure that further windfall profits at the expense of taxpayers are avoided and, instead of subsidising pollution, European governments will invest in innovations that lead to low-carbon societies.

Key recommendations

- **Phase out the free allocation of pollution permits** by gradually increasing the share of allowances to be auctioned from the current 57% to 100% in the future.
- Introduce a tiered “carbon leakage” approach and **target free allowances only to those that really need it.** The left-over free allowances should be cancelled or auctioned for innovation support.
- **Annually reduce the amount of free allowances that an installation receives** (the *benchmark*) in line with the overall decarbonisation pathway of the EU ETS.
- **Invest more auctioning revenues in climate friendly innovation and support the frontrunners that want to invest in breakthrough technologies.**

For more information see: <http://carbonmarketwatch.org/myth-buster/>

1. CE Delft (2016), Calculation of additional profits of sectors and firms from the EU ETS. [See here](#)
2. All the information on windfall profits is taken from the CE Delft report (2016), Calculation of additional profits from the EU ETS, [see here](#). These calculations show how much money companies and sectors were able to make from the EU ETS in theory, the actual profits could differ depending on the company strategies.
3. Based on information provided by CE Delft (2016), using average annual carbon prices. [See Here](#)
4. CE Delft (2016), Calculation of additional profits from the EU ETS, see here. For (1) the windfall profits are calculated for the whole industry sector, while for (2) and (3) only the 15 most polluting sectors are taken into account. In addition, the windfall profits from offsets (2) are only calculated for the period up to 2012
5. referred to as Castle Cement in CE Delft report (2016)
6. Comment by Karl-Ulrich Kohler (former European CEO of Tata Steel) in the GWPF (2015), [see here](#)
7. Lafarge answer to the public consultation on the 2030 climate and energy framework (2013), [see here](#)
8. Data taken from the European Commission climate action progress reports from 2014 and 2015



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