



Briefing: EU Emissions Trading Scheme – oil refineries and international competition

- Many EU countries rely on the Former Soviet Union and the Middle East for imports of diesel fuel and jet fuel respectively; in turn they export a substantial share of their petrol to the USA.
- The EU Commission has proposed improvements to the EU Emissions Trading Scheme (EU ETS), amongst which is increased auctioning of allowances.
- In response, the European refining industry commissioned NERA Economic Consulting to analyse the exposure of the EU oil refining industry to non-EU competition, the main conclusions of which are summarised below (the report can be downloaded at our web site: www.ukpia.com under Publications)
- The industry is concerned at proposals for increased auctioning of allowances and considers that sectors such as oil refining should be allowed to compete on level terms with non-EU facilities, otherwise it will be difficult to attract necessary investment into EU refineries, resulting in decreased security of supply of oil products.
- The EU ETS needs to include effective measures to prevent the migration of industrial investment out of the EU, until non-EU competitors are also required to pay for all their allowances. This may involve free issue of allowances to industries such as refining exposed to significant risk of 'carbon leakage'.

Background

In January 2008, the EU Commission published a draft directive to improve the EU Emissions Trading Scheme for the period after 2012.

UKPIA will provide detailed comments on the proposed directive separately; however our top concern is the proposal for increased auctioning of EU ETS allowances.

For industries which are exposed to international competition auctioning would be premature until non-EU competitors face similar costs. It would discourage investment in EU refineries and result in increased emissions of CO₂ in areas such as the Middle East and Russia, increased EU imports of diesel and jet fuel, reduced EU exports of petrol, and reduced energy supply security.

In response to these concerns, the European oil industry commissioned NERA Economic

Consulting to examine in detail the exposure of oil refining to international competition.

NERA report conclusions

The key conclusions of the report are:

- the EU relies on the Former Soviet Union and the Middle East for imports of diesel fuel and jet fuel respectively, and exports a substantial share of its petrol to the USA.
- trade in all major refined products has risen over the last five years.
- trade openness in the refining sector rivals that of most other sectors affected by the EU ETS, and is mostly with countries that do not have constraining absolute targets (eg USA, Russia, Middle East). EU refineries therefore face significant asymmetric CO₂ emission costs.
- the cost of transporting refined products is low relative to the value of the fuel, and

transport costs do not represent a substantial barrier to trade.

- a CO₂ price of €20-30/tCO₂ would represent around 15-40% of average margins of complex refineries. It is reasonable to expect one or more of a loss of: market share, reduced profits, reduced exports, higher prices, emissions leakage and reduced investment.
- it seems relatively unlikely that full pass-through of allowance costs to consumers would occur given the current level of trade and possibility of increased imports.
- reduced margins would reduce the attractiveness of the EU as an investment location.

Conclusion

The draft Directive provides for measures to be taken to support energy intensive industries in the event of 'carbon leakage'. UKPIA believes that oil refining should qualify for such measures, and will be pleased to discuss how these might work.

For further information please contact Ian McPherson on 020 7269 7603 or ian.mcpherson@ukpia.com

May 2008