

# EU Energy-intensive Industries and Emissions Trading

Losers becoming Winners?

*a CANES Working Paper*

Jørgen Wettestad





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**Abstract**

The EU Emissions Trading System (ETS) initially treated power producers and energy-intensive industries similarly, despite clear structural differences between these industries regarding pass through of costs and vulnerability to global competition. Hence, the energy-intensive industries could be seen as losing out in the internal distribution. In the January 2008 proposal for a reformed ETS post-2012, a differentiated system was proposed where the energy-intensive industries come out relatively much better. What is the explanation for the change taking place? Although power producers still have a dominant position in the system, the increasing consensus about windfall profits has weakened their standing. Conversely, the energy-intensive industries have become better organised and more active. This balance shift is first and foremost noticeable in several important EU-level stakeholder consultation processes and has contributed to learning in the Commission about the need for differentiation. Energy-intensive industries have, however, also successfully utilised the national pathway to exert influence on Brussels policy-making. Finally, growing fear of lax global climate policies and related carbon leakage has strengthened the case of these industries further. The latter dimension indicates that although energy-intensive industries have managed to reduce internal distribution anomalies, external challenges remain.

**Key Words**

climate policy, EU emission trading system, ETS, energy-intensive industries, windfall profits

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# canes

**CANES** (Climate change Altering Nordic Energy Systems) is a Norwegian-Swedish research project in which Nordic research institutions cooperate with some of the most prominent players in the energy sector to find answers to the following question:

*How are the Nordic energy markets and infrastructure affected by existing and future climate policies on EU and national levels?*

The Fridtjof Nansen Institute (FNI) is the co-ordinator of this 2007-2010 project. The research tasks are conducted by FNI in collaboration with the Stockholm Environment Institute (SEI) and Lund Institute of Technology. Energibedriftenes Landsforening (the Norwegian Electricity Industry Association), Norsk Industri (the Federation of Norwegian Industries), Statnett, Statkraft, Svenska Kraftnät and Vattenfall are industrial partners in the project.

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## 1 Introduction<sup>1</sup>

The EU Emissions Trading System (ETS) has for a long time been described by EU officials as the cornerstone of the climate policy of the European Union, with the ETS covering close to half of EU CO<sub>2</sub> emissions. Based on a directive adopted in mid-2003 (European Council, 2003),<sup>2</sup> the ETS is an instrument for allocating carbon emission allowances (in tons of CO<sub>2</sub>) to industry, which industry then can buy or sell (Delbeke, ed., 2006; Skjærseth and Wettestad, 2008). Fewer allowances should be allocated than are projected to be needed, in order to create scarcity in the market, a reasonably high and stable allowance price, and ultimately forceful incentives for abatement efforts. Hence, the allocation process becomes very important, easily creating ‘winners’ and ‘losers’ among industry groups.

The ETS targets two main groups of industrial actors: power producers (responsible for around 60% of the ETS emissions) and energy-intensive industries (such as steel and pulp and paper industries).<sup>3</sup> In the process leading up to the adoption of the initial ET Directive in 2003, power producers were arguably relative winners, for instance measured by the match between these producers’ design preferences and the final design of the Directive (e.g. Markussen and Tingaard Svendsen, 2005). This had much to do with the electricity sector being the largest and most important sector for the implementation of the system. Furthermore, it was clear that the structural position of these two industry groups differed considerably. Power producers, mainly operating in regional markets, have among other things a better ability to ‘pass through’ additional trading costs to consumers than the more globally competing energy-intensive industries. Nevertheless, these sectors were treated *similarly* in the 2003 ET Directive. Hence, it is clearly possible to consider energy-intensive industries to be relative ‘losers’ in this initial ETS process.

The post-2012 ETS (i.e. for the period 2013-2020) is now being formed, and the European Commission (hereafter: Commission) put forward a proposal for a revised ETS in January 2008 (European Commission, 2008). As the fundamental importance of the power sector for the ETS has not changed, it is both interesting and striking that a main element in the proposal is a clear *differentiation* between the power sector and energy-intensive industries. As a key element, power producers are not to receive any free allowances at all from 2013, while energy-intensive industries are set to a large extent to receive such allowances (although decreasing over time). Have the earlier relative losers within the energy-intensive industries then become winners this time? Documenting and shedding explanatory light on this change is the main purpose of this paper.

After further clarifying explanatory perspectives and analytical issues in section two of the paper, the changing treatment of industries over time will be further elaborated and discussed in section three. Section four will then discuss three main explanations, based on a multi-level perspective towards EU policy-making. Hence, the first possible explanation is that energy-intensive industries have exerted stronger and more successful

pressure on national governments in the recent process leading up to the ETS reform proposal than in the process leading up to the 2003 Directive, i.e. what may be called an intergovernmentalist perspective. The second suggested explanation is that energy-intensive industries have exerted stronger and more successful pressure on key EU bodies such as the Commission and European Parliament, i.e. an EU governance perspective. The third and final possible explanation is that the main reasons why energy-intensive industries have been treated differently this time are to be found in changes in global economic framework conditions, making energy-intensive industries more vulnerable, i.e. what may be called an economic globalisation perspective.

As the final step in the paper, in section five we will sum up main findings and wind up with a discussion of a pertinent question: even if the suggested differentiated treatment is kept intact in further EU decision-making process, does it necessarily mean that the energy-intensive industries have become winners this time around?

## **2 Shedding Light on the Treatment and Influence of Specific Industries in EU Policy – a Multi-level Perspective**

### **2.1 Introduction**

There is an increasing consensus that a multi-level approach is necessary to understand policy-making and implementation in the EU, related to such developments as the increasing importance of the supra-national European Commission and European Parliament (e.g. Hooghe and Marks, 2001) – although there is still disagreement about issues such as the possible remaining primacy of developments at the member state level (e.g. Moravcsik, 1998). This study will adopt a multi-level explanatory approach, distinguishing between national, EU and global levels (see Skjærseth and Wettestad, 2008). The different levels will first and foremost be seen as *complementary heuristic lenses* and perspectives, helping us to entangle complex and intertwined real-life processes. To the extent to which we can compare their relative explanatory value, we assume that the EU level perspective will be the most enlightening one in this particular study. The main process in question is the revision of a directive, putting the Commission automatically very much in the driver's seat and as a decision-making focal point. However, we still expect an examination of the national and global perspectives to provide additional and valuable clues to understanding outcomes.

As we are interested in the influence and ultimate treatment of specific industries in EU policy-making, we believe that the national, EU and possibly also global levels can be seen as possible *pathways* and arenas for industries to exert influence. As stated by a Brussels industrial insider, 'there are numerous pathways and 'chessboards' to watch and exert influence through – national, Commission, European Parliament, Council, and also even global federations' (Interviews in Brussels, February 2008). We will now take a closer look at these differing levels and lenses.

## 2.2 The Intergovernmentalist Lenses and National Pathway

As further elaborated in Skjærseth and Wettestad (2008), an intergovernmentalist perspective highlights the role and positions of member states for understanding the dynamics and outcomes of EU policy-making (see particularly Moravcsik, 1998). This also means that for specific European industries seeking to influence EU policy-making, there is an important national pathway. However, some member states are clearly more influential than others. There are differences, both with regard to general and issue-specific powers. Combining for instance voting power in the Council of Ministers and the sheer size of greenhouse gas emissions, countries such as Germany, Poland, Spain and the UK stand out as particularly important national pathways for industries to seek to utilise.

It has been noted that ‘some sectors of industry are better organised than others to represent their interests, often reflecting greater experience from long-fought regulatory battles’ (Newell, 2005:33). Hence, as noted in the literature on interest group representation (e.g. Greenwood, 1997; Coen, 2007), the influence of specific industry sectors both nationally and at the EU level can be assumed to be dependent upon some key *assets*. The first asset is economic strength and importance, i.e. the notion that ‘..most European firms achieve insider status from their cross-border production or size..’ (Coen, 2007:339). The second main asset is issue-specific knowledge and expertise, cf. the notion that ‘an interest’s effectiveness in influencing policy directly continues to be determined by its ability to establish a positive reputation in the European political process. That is to say, by the extent to which it can establish its reputation as a provider of reliable, issue-specific and pan-European information’ (ibid.). The third main asset is somewhat related to this latter element; it is a good reputation and standing in key national and EU bodies, with good contacts and allies.

Hence, adopting ‘intergovernmentalist lenses’, the following main and admittedly simplistic hypothesis can be formulated to guide the discussion of this perspective: the treatment of energy-intensive industries in ETS policy compared to power producers has changed because the former industries have improved their ‘score’ regarding the assets summed up above, and have become more successful in influencing key member states’ positions and hence ultimately outcomes of EU level processes.

## 2.3 The EU Governance Lenses and Brussels Pathway

The second perspective draws upon studies highlighting the increasing ‘multi-level governance’ character of the EU, and in this context, particularly the enhanced role of supra-national actors such as the Commission and European Parliament in EU policy-making (e.g. Hooghe and Marks, 2001; Fairbrass and Jordan, 2004). The Commission also has formal powers to initiate new EU policy. In the following, we will refer to this perspective as the EU governance lenses.

How then, may specific European industries influence EU policy-making through the EU pathway? This is of course a complex question and only some main elements can be summed up here. As to the three main assets

discussed in the previous section regarding economic strength and resources, size matters (Bache and George, 2006:338). Larger organisations are generally better equipped with resources than smaller ones. Large firms will often have their own R&D units, which means that they are better equipped to provide institutional actors with up-to-date expert knowledge than are smaller firms. Due to the complexity and multi-level nature of EU decision-making, it is an advantage to be able to deploy sufficient personnel to cover all possible access points.

Smaller organisations must pool resources, but combinations of interests increase the risk that they will encounter problems taking collective action. A combined group may find it difficult to agree among themselves about priorities and tactics (ibid: 339). If industries struggle with deep internal conflicts, their voice will be less convincing, and there will be more possibilities for policy-makers to ‘divide and rule’. Furthermore, the strength of the relevant industries’ organisation at the EU level, e.g. their euro-federations, is an additional relevant dimension (e.g. Grant et al, 2000, Ch.2). This also has to do with economic resources and organisation.<sup>4</sup>

Turning then to issue-specific knowledge and expertise, Bouwen (2002, 2004) argued that the degree of access that an interest group can achieve to any of the EU’s institutions depends on its ability to offer each institution the type of information that it most needs to efficiently perform its functions within the decision-making system. He identified three types of information that are important to differing degrees to the various EU institutions:

- expert knowledge
- knowledge of the needs and concerns of actors in the relevant sector across Europe
- knowledge of the specific concerns of national actors in the relevant sector

Expert knowledge is essential for the institution to understand the technical working of the market into which the legislation intervenes, providing for legislation that is more likely to be effective. Information about the needs and concerns of actors in the relevant sector enhances the legitimacy of the decision-making process, because a wide range of affected actors will feel that they have been heard, contributing to their willingness to comply and increasing the likelihood for successful implementation. Large firms are often very good at providing expert information. European and national associations are less efficient as expertise informers, but provide important information about the concerns of their constituencies.

Finally, with regard to issues of access to and status in main decision-making bodies, the Commission is an important target for interests groups because it has a central role in setting the agenda, and all proposals must pass through it (Bache and George, 2006:340). Matching demand with supply sources, Bouwen (2002:382) hypothesised that large individual firms would have the best access to the Commission, followed by

European associations, while national associations would enjoy the lowest level of access during the crucial drafting stage of legislation, while enjoying better access at later stages of decision-making. Subsequent research indicated, however, that European associations had the best access to the Commission.

Also the European Parliament (EP) attracts considerable attention from interest groups, largely due to its long-standing advisory role, forming an indirect route to influencing other institutions. Moreover, MEPs are relatively accessible. In particular, those with a constituency interest in an issue will be a focus of attention. More generally, the EP is seen as a natural ally for groups lobbying on behalf of consumers, human rights, and the environment (Bache and George, 2006:343). Bouwen (2002) expected European associations to have the best access to the EP, as an institution and national associations have a lower level of access, but are able to gain access via the national route, through the offices of individual MEPs. Large firms were expected to have the lowest level of access. These hypotheses were supported by subsequent research (Bouwen, 2004:492).

All in all, adopting EU governance lenses, we posit that the relative treatment of energy-intensive industries in ETS policy has changed because these industries have improved their EU-level 'score' regarding the assets summed up above. Hence, these industries have become stronger and more united, better at providing issue-specific knowledge, and have improved their standing in key EU bodies, leading to more success in influencing the Commission and Parliament, including important sub-bodies and collective outputs there.

## **2.4 Acknowledging Factors Outside of the EU: The Economic Globalisation Lenses**

Analysts have increasingly emphasised that insufficient attention has been given to the fact that EU policy-making and implementation has been increasingly influenced by factors and institutions outside of the EU itself (e.g. Skjærseth and Wettestad, 2002; Fairbrass and Jordan, 2004; Oberthur and Gehring, 2006). This means that a possible explanation for shifting treatment of specific industries in EU policies may have nothing to do with EU internal matters at all, but instead be caused by external developments. In shedding light upon the treatment of specific industries in EU policy-making, global economic competitiveness stands forward as a natural perspective to focus upon. With regard to economic globalisation processes and their effects, there is abundant literature to draw upon (e.g. Stiglitz, 2003; Appelbaum and Robinson, 2005).

For instance, putting on 'economic globalisation lenses' could sensitise us to the possibility that changing and increasing lower cost production of steel, cement and other products from the energy-intensive industries in countries outside of both the EU and the Kyoto Protocol could represent a real danger of 'carbon leakage', i.e. that industries leave the EU and relocate in these less 'carbon-restrained' countries. It is easy to imagine that a convincing framing of such a risk may have enhanced the argumentative power and influence of energy-intensive industries both nationally

and at the EU level. Hence, we posit here that the relative treatment of energy-intensive industries in ETS policy has changed because these industries have become more vulnerable and exposed to global competition and hence their argumentative power at various levels in EU policy-making processes has increased.

## **2.5 Concluding Notes on Methodology and Available Evidence**

Before we proceed further, an important caveat is necessary. Although we do have relevant evidence of main developments at all three levels in both the phase leading up to the initial ET Directive (i.e. 1998-2003) and developments post-2003, we cannot claim full control over the complex developments unfolding here. So the analysis provided here must be regarded as a preliminary contribution to the important task of telling the comprehensive and ‘true’ story of the ETS and the changing role of energy producers and energy-intensive industries – a contribution certain to be complemented and challenged by further research.

With regard to evidence, the analysis will be based on a combination of reports and evidence from the EU bodies and the focused industries themselves, commentaries in news services such as ENDS Daily and Euractive, and a string of interviews with EU decision-makers and industrial representatives, the most recent ones having taken place in February and October 2008 (see list in annex).

## **3 The Change to be Explained: Towards Differing Treatment of Energy-intensive Industries Compared to Power Producers**

With regard to the overall allocation ‘philosophy’, the 2003 ET Directive clearly emphasised free allocation as the dominant approach. Hence, Article 10 in the Directive stated that at least 95% of allowances should be handed out free of charge in the pilot phase (i.e. 2005-7). In the subsequent Kyoto commitment phase, at least 90% should be allocated free of charge. Furthermore, and key in this context regarding the included sectors, there were no signals to decision-makers about a differentiation in the distribution of allowances. Hence, the 2003 Directive launched a basically non-differentiated system. The main differentiation to be noted in this initial Directive was between the sectors included in the ETS and those excluded. As to possible ETS distributive effects affecting energy-intensive industries, neither indirect ETS costs internally in the EU (such as windfall profits for power producers)<sup>5</sup>, nor relocation of EU industries to economies outside of the EU and with no reduction commitments under the Kyoto Protocol (i.e. ‘carbon leakage’), were explicitly addressed in the Directive.

As noted, the 2008 proposal signalled changes. Regarding allocation philosophy, it was now stated that ‘auctioning should be the principle for all allocation, as it is simplest and most economically efficient for all allowances to be auctioned’ (European Commission, 2008). This is then reflected in Article 10a. Of particular interest in this context, *a key differentiation is proposed between installations ‘engaged in electricity*

*production* and *industrial installations*'. With regard to the former, 'full auctioning should be the rule from 2013 onwards for the power sector, taking into account their ability to pass on the increased costs of CO<sub>2</sub>' (ibid.:15). For the energy-intensive industry and other sectors covered by the ETS, a transitional system is foreseen, where 'free allocation in 2013 would be 80% of the amount that corresponded to the percentage of the overall EU-wide emissions throughout 2005-07 that those installations emitted as a proportion of the annual EU-wide total quantity of allowances' (ibid.:16). Free allocation would then gradually be reduced to zero in 2020.

Furthermore, the proposal stated that 'in the event that other developed countries and other major emitters..do not participate in an international agreement.. could put certain EU energy-intensive industries and sub-sectors in the Community which are subject to international competition at an economic disadvantage' (ibid.:16). In order to deal with this risk of 'carbon leakage', the Community would allocate allowances free of charge up to 100% to sub-sectors meeting relevant criteria. These sectors were to be identified by mid-2010, followed by an assessment of any international or sectoral climate agreements then in place by mid-2011. Based on this, some industries could continue to receive free allowances until 2020, or importers could be required to buy allowances. Hence, the issue of protecting vulnerable sectors and addressing carbon leakage was now explicitly addressed.

Finally, the power sector's 'ability to pass on the increased cost of CO<sub>2</sub>' was noted, and related to the priority given to auctioning as the dominant allocation method, that the suggested differentiation 'will also eliminate windfall profits' (ibid.:5). Hence, it can be concluded that also this internal EU distribution issue was now explicitly addressed.

## **4 Explaining the Change: Some Main National, EU and Global Developments**

### **4.1 Energy-intensive Industries becoming More Influential in Key Member States?**

Starting at the member state level, the main hypothesis here was that the relative treatment of energy-intensive industries in ETS policy has changed because these industries have become more successful in influencing key member states' positions.

Here we have both general and country-specific information. Regarding the general picture, in our Brussels interviews in 2008 several ETS observers and insiders emphasised the national-state level and developments in key member states as an important pathway for energy-intensive industries to exert influence from 2004/5. In these interviews, Finland, France, Germany, the Netherlands and the UK were mentioned as important arenas for strong lobbying from energy-intensive industries .

As to member states specifically, we are able to provide some in-depth information on the two important member states Germany and the UK.

Turning first to Germany, a key ETS country in many ways (for instance with the largest portion of EU allowances), it seems correct to say that the energy-intensive industries were also quite powerful in the process leading up to the 2003 Directive, expressing strong scepticism towards emissions trading. For instance the powerful German chemicals industry was a very visible opponent to emissions trading (Skjærseth and Wettestad, 2008). When the ETS started functioning, as further elaborated below, unexpected high allowance prices from mid-2005 were accompanied by an increasing debate and concern in EU member states and institutions about windfall profits for power producers, at the expense of energy-intensive industries and consumers more generally.

It can be argued that the windfall profits discussion took on a particularly hefty character in Germany. In the beginning of 2006, Germany's federal cartel office requested further information from the country's two major power generators (i.e. Eon and RWE) in an on-going investigation about possible abuse of dominant market position and related windfall profits. This windfall debate continued in subsequent years and is probably one of the main reasons why Germany in early 2007 adjusted its negative attitude towards the use of allowance auctioning and signalled more use of such auctioning in the years ahead (e.g. Reuters Planetark, January 22 2007). German energy-intensive industry organised in the VIK federation was also very active in the final round before the Commission's January 2008 proposal (Reuters Planetark, January 22 2008).

Turning to the UK, it is clear that the power industry was the important early target and implementer (as in most countries). In the process leading up to the 2003 ET Directive, the UK energy-intensive industries seemingly played a less prominent role than was the case in Germany. This may have something to do with these industries being far more positive towards emissions trading than their German counterparts. It may also have something to do with the general rather moderate attention given to the emerging ETS among the energy-intensive industries across Europe, compared to the more targeted power sector (as further elaborated in the next section). After the ETS started functioning, the position of energy-intensive industries also started to worry British policy-makers more. The initiative to establish the High-Level Group on Competitiveness, Energy and the Environment (as further discussed in 4.2.) came in fact from the UK (Point Carbon, January 12 2006). There was strong concern among important industry groups and also the Department of Trade and Industry (DTI) over windfall profits from 2006. For instance, a report for the DTI indicated a yearly profit increase of at least 800 million pounds for six large UK electricity generators related to the introduction of the ETS (ENDS Report, January 2006:18-19).

However, in 2007 it also became clear that all UK industries except the power sector had received more allowances than they needed in the ETS pilot phase. For instance, the ceramics sector had received 50% more allowances than they needed! (ENDS Report, June 2007:12). This probably served to soften the alarm among and pressure from energy-intensive industries. Add to this the fact that in its National Allocation Plan for the 2008-12 period (i.e. NAP II), the UK government announced an intention to auction 7-8% of the allowances. In January 2008, a UK



industry ministry spokeswoman stated: ‘For the second phase of the ETS, the UK put all the burden of emissions reductions on the generators, and required them to buy many of their allowances’ (Reuters Planetark, January 18 2008). Hence, there seemed to be a feeling in the UK that the interests and special concerns of the energy-intensive industries had been better taken care of.

All in all, although evidence is limited, there are several indications that energy-intensive industries have more strongly exerted influence in key member states. Hence, the proposed hypothesis does get some support from the available evidence. However, there are most likely several other mechanisms at work. For instance, factors such as an overall rather generous allocation of allowances to energy-intensive industries have served as something of a moderating factor.

## **4.2 Energy-intensive Industries becoming More Influential at the EU Level?**

### *4.2.1 Introduction*

Moving on to the EU level, the main hypothesis was that the relative treatment of energy-intensive industries in ETS policy has changed because these industries have improved their main EU-level assets. Hence, these industries have become stronger, more united and better able to provide issue-specific knowledge, and have improved their standing in key EU bodies, leading to more success in influencing the Commission and Parliament.

There are at least three main EU-level processes to scrutinise further: first, prior to the official start of the ETS review in November 2006, there was the establishment and functioning of the High Level Group on Competitiveness, Energy and the Environment (hereafter: High Level Group); then, in 2007 there was the European Climate Change Programme (ECCP) ETS review group; and third, there was the final ‘lobbying frenzy’ of industrial actors in late fall of 2007 and the beginning of 2008. We will now take a closer look at these processes in turn.

### *4.2.2 A New EU Channel for Energy-intensive Industries? The High Level Group*

If we step back in time, to the process leading up to the 2003 Directive, the environment directorate (DG ENV) was clearly the leading Commission ETS player. It was no secret that DG ENV had good contacts with power producers and their euro federation EURELECTRIC. This was due to the power producers’ central role in the ETS and their related interest in and learning about emissions trading.<sup>6</sup> Hence, they were knowledge providers.

When the High Level Group was established in February 2006, it arguably signalled a new dynamic in the Commission ETS institutional landscape. The Group was launched as a follow-up to the October 2005 Communication on Industrial Policy (European Commission, 2005), and comprised EU and member state representatives and various non-

governmental stakeholders (European Commission, 2006a).<sup>7</sup> The mandate of the Group was to examine the links between industrial, energy and environmental policies ‘to make sure that initiatives in each area are mutually compatible’ (ibid.:1). A discussion of the ETS was explicitly announced. A significant (but certainly not sole) background factor for the establishment of the High Level Group was the rapidly increasing concern in the EU about windfall profits. Although early ETS allowance price estimates were moderate, by the end of June 2005 the allowance price had rather surprisingly climbed to 25 euro. Power prices had also increased substantially, with analysts UBS indicating an increase in the first half of 2005 between five to eight euro (EU Energy, June 17 2005). ‘High power prices are really killing energy-intensive industries’ stated Peter Claes, president of International Federation of Industrial Energy Consumers (Reuters Planetark, June 24 2005). This increase in power prices was linked to the introduction of the ETS and hence represented an indirect effect of the ETS which came as a surprise for many actors. The increase in power prices also affected industrial actors not formally included in the ETS, such as the aluminium industry.

Regarding the organisation of the High Level Group, although it was co-chaired by the Commissioners for Enterprise and Industry, Competition, Energy, and the Environment, a dominant perception is that this was an initiative that emerged from the three former more so than the latter (Interviews in Brussels, 2008). A Brussels insider even characterised the Group as ‘Verheugen’s [i.e. the commissioner for enterprise and industry] instrument for improving the ETS’ (ibid.). With regard to the four country representatives, all had their background in the economic, trade and industry part of their bureaucracies. On paper, industrial energy producers and consumers were fairly equally represented (i.e. roughly four each). But also environmental NGOs (i.e. the G10 group of environmental campaign organisations) saw the group as ‘imbalanced’ and ‘dominated by large energy users’ (ENDS Daily, February 28 2006).

Although the conclusions from the Group balanced environmental and economic/competitiveness concerns, it can still be argued that uneasiness about the position of energy-intensive industries in the ETS was communicated both more explicitly and strongly than in previous relevant Commission documents. For instance, in the first report published in June 2006, the Group noted that ‘the energy-intensive industries <were> particularly affected by increased electricity and gas prices’. In the then on-going ETS second allocation round (i.e. for the Kyoto commitment period, 2008-12), Member States could therefore ‘consider differentiated allocation between sectors’, taking into account ‘the external aspects of competitiveness’, and EU State Aid rules (High Level Group, 2006:8-9).

Furthermore, launching the final report of the High Level Group in December 2007, Commission Vice President and Industry Commissioner Gunther Verheugen stated that ‘the specific needs of energy-intensive industries must be taken into account’ and a ‘special solution’ was needed. In addition, he claimed that ‘the EC, European Parliament and EU Council all agreed that energy-intensive industry needed special treatment’ (High Level Group, 2007; International Environment Reporter, December 12 2007; EU Energy, December 14 2007:5).

#### *4.2.3 The ECCP ETS Review Group: Another Channel Effectively Utilised by the Energy-intensive Industries?*

Let us then move on to the ECCP ETS review group (i.e. ‘the ECCP working group on emissions trading on the review of the EU ETS’). The Commission fired the official ‘starting gun’ for the ETS review process in November 2006, and the review group was the main instrument for stakeholder input. The four meetings in 2007 were attended by a wide group of ETS stakeholders, including representatives from various Commission DGs, member state representatives, industry representatives (including representatives of power producers and various energy-intensive industries), environmental NGOs, and ‘academia/think-tanks’.<sup>8</sup>

This exercise was somewhat similar to the meetings in 2000 and 2001 in the Working Group 1 under the first ECCP, in the process leading up to the 2003 ET Directive (see Skjærseth and Wettestad 2008, Chapter 5). In this initial process, power producers were, as indicated, generally comparatively knowledgeable about emissions trading and were active in the discussions. Representatives of the energy-intensive industries have remarked about this phase that ‘we slept in class’. Other Brussels insiders have noted that the energy-intensive industries were also not very well coordinated, partly disagreeing among themselves (Interviews in Brussels, 2004, 2008).

In comparison, the energy-intensive industries played a significantly more prominent and vocal role in the most recent round of stakeholder consultations. A simple numerical example of this is the third ECCP ETS review meeting in May 2007, focused on ‘further harmonisation and increased predictability’. Energy-intensive industries had 10 representatives, while ‘conventional power generators’ had three representatives. Furthermore, close to a third of the 37 speakers at the meeting represented energy-intensive industries. In the discussions, the positions of the energy-intensive industries were forcefully and coherently communicated. As stated by Brussels insiders, the energy-intensive industries stood forward as a much more united player than earlier (Interviews in Brussels, 2008. See also Gullberg, 2008:9).

As part of the consultation, these industries also put forward several elaborate position papers. Their positions were partly channeled through ‘the Key Stakeholders Alliance for ETS Review’ (the Alliance). This more ad-hoc Alliance was an outgrowth of the earlier ‘Alliance of Energy-intensive Industries’ and covers ten euro federations.<sup>9</sup> In addition to the Alliance, three euro federations submitted more independent inputs, i.e. the chemicals industry (CEFIC), the cement industry (CEMBUREAU), and the iron and steel industries (EUROFER). Furthermore, the energy-intensive industries were represented by IFIEC (i.e. the International Federation of Industrial Energy Consumers), which has mainly company members.

#### 4.2.4 *The Lobbying Spurt: Won by the Energy-intensive Industries?*

Moving on to the final months of frenetic lobbying (i.e. late 2007 and January 2008), the impression is that the energy-intensive industries also in this phase were among the most active and intense industrial actors.

BusinessEurope started the official final lobbying spurt in late November. Formerly UNICE, and including both power producers and energy-intensive industries, BusinessEurope warned in a letter to Commission President Barroso against introducing across-the-board auctioning. 'This formula is one of those that would most increase direct and indirect costs for manufacturing industry' (Reuters Planetark, November 27 2007; ENDS Daily, November 27 2007). As the deadline approached, stakeholder lobbying clearly intensified. This included several open letters, commenting upon leaked proposal drafts. For instance, in a mid-January letter to Commission President Barroso, BusinessEurope attacked the leaked plans for considerably increased auctioning. 'Increasing electricity prices will exacerbate the indirect impact on industries ... In the absence of a comprehensive international agreement, auctioning of allowances will harm the competitiveness of European companies, especially in the energy-intensive industries', BusinessEurope claimed (Reuters Planetark, January 16 2008). Furthermore, the Alliance of Energy-intensive industries sent a letter to all 27 commissioners stating that they were 'very concerned..that the Commission does not take upfront a firm stand on free allocation to globally competing industries' (Alliance of Energy-intensive Industries, January 11 2008; ENDS Daily, January 15 2008).

Hence, the Commission was engaged in intense negotiations to finalise controversial energy and climate proposals, 'under heavy attack from industry groups and some member states, who warned that the plans could destroy Europe's competitiveness'. Particularly energy-intensive industries had launched an 'aggressive lobbying effort' (Euractiv, January 21 2008). *Reuters Planetark* reported that the lobbying of the energy-intensive industries seemed to have paid off, as the steel, aluminium and cement industries seemed set to get a 'special, less strict regime'. An anonymous Commission official revealed that the energy-intensive industries 'would have a bigger initial allocation than originally planned, a lower starting point for the percentage of emissions permits to be auctioned and a slower phase-in' (Reuters Planetark, January 21 2008).

#### 4.2.5 *Winding up*

Based on evidence from both the ETS review group and the final lobbying spurt, a clear impression is that the voices of the energy-intensive industries have become more numerous, stronger and, not least, more united. In comparison, in the process leading up to the 2003 Directive, the power producers were the most active and were represented by a strong organisation (i.e. EURELECTRIC). As the energy-intensive industries now must be said to 'have woken up in the ETS class', they have also become more important knowledge providers. Their standing in the ETS Brussels game has hence clearly improved. It can very well be that the establishment of the High Level Group in early 2006 can be seen as an institutional turning point. Before that, DG ENV was very much a dom-

inant intra-Commission ETS player. Now DG Industry and Enterprise and DG Competition entered the ETS game more forcefully, and provided new institutional weight to the energy-intensive industries' concerns. In the lobbying spurt, these industries utilised several channels and pathways, targeting both Commission officials in various DGs and the Commissioners themselves.

Another important thing to note is the shifting agenda of the energy-intensive industries. Back in 2005, most attention was attracted to what may be termed internal ETS distribution anomalies, i.e. the windfall profits dimension. From 2006 on, the global competitiveness and 'carbon leakage' dimension rose up the agenda both for energy-intensive industries and EU actors and bodies. According to Brussels insiders, the windfall profits dimension would not have been sufficient to warrant a proposed relative different treatment of industries. The increasing attention and weight given to the carbon leakage dimension was a decisive factor for the Commission's willingness to propose such a differentiation (Interviews in Brussels, 2008).

### **4.3 Have Energy-intensive Industries become More Vulnerable to Global Economic Competition?**

As was discussed in section two, EU industries and policy-making in general do not operate in a vacuum. EU policies are usually nested in global regimes and, as focused upon here, EU industries are to varying degrees exposed to global competition. Hence, our third hypothesis postulated that the relative treatment of energy-intensive industries in ETS policy has changed because these industries have become more vulnerable and exposed to global competition and hence their argumentative power at various levels in EU policy-making processes has increased.

Have the basic competitive fundamentals changed markedly in recent years? A first thing to keep in mind is that there is a clear difference between the power sector and the energy-intensive industries in the EU, in that the former mainly operate in sub-regional markets within the EU, while the latter are to varying extent exposed to competition from producers located outside the EU. For instance, in 2004 the British *Carbon Trust* organization published a study of the EU ETS's implications for industrial competitiveness in the UK (Carbon Trust, 2004). Of the five sectors studied (electricity, cement, paper, steel, and aluminium), global concerns were found to be of some relevance only for the four latter. However, except for steel, global concerns would kick in only in a long-term scenario with considerably higher allowance prices. As we know, stable high allowance prices did not materialise in the ETS pilot phase. Although the carbon price climbed to a surprisingly high level in late 2005/early 2006, the price 'collapsed' in the spring of 2006 and dropped in fact towards zero in the course of 2007. So this particular 'material' factor did not change in a way that automatically supplied the energy-intensive industries with increased sympathy and argumentative power.

Furthermore, from 2006 on, several research reports which discussed global competitiveness issues were published. For instance, *McKinsey* and *Ecofys* produced a December 2006 report on 'International Competitiveness' for the European Commission as part of the ETS review process

(European Commission, 2006b). The main message was not very much different or more alarming than the previously mentioned *Carbon Trust* report. 'The overall average impact on industry margins across Europe in the short and medium term for the industries analysed is limited' (ibid.:4). The exceptions were primarily aluminium production and pulp and paper. In March 2007, a *Climate Strategies* report on EU ETS competitiveness impacts supported the nuanced and less alarmist main message put forward in previous reports (Climate Strategies, 2007). Cement, aluminium and steel were the most vulnerable, but 'market share losses <were> likely to remain moderate, even for significant price increases' (ibid.:6). It has also been pointed out that the years 2005-2007 were marked by 'remarkably' high commodity prices and profits in much of the energy-intensive industries (Convery et al., 2008).

However, other factors arguably supported a more alarmist view of developments. Although the pilot phase carbon price dipped towards zero, decisions in 2006 and 2007 on stricter allocation plans for the second phase of the ETS (i.e. 2008-12) communicated a signal about higher allowance prices in the years ahead – indicating increasing relevance of the global competitiveness concerns. For instance, in July 2007 ETS allowances for the second phase of the ETS were priced at 19,5 Euro. Add to this the continuing uncertainty about the nature of the global climate change regime post-2012. This may or may not be considered a change. Back in 2002/3, there was considerable uncertainty about the entering into force of the Kyoto Protocol, and there has been uncertainty about the post-2012 global regime for a long time. Again, the cognitive impact of this uncertainty may have increased over time, in line with reports about deadlocks and little progress in the global negotiations. Although the 'roadmap' agreed to at Bali in December 2006 included encouraging building blocks, the subsequent follow-up meetings have seemingly produced only marginal and slow progress. This has probably made the possibility of global carbon leakage more likely.

In sum, as the global competitiveness of ETS industries arguably did not change much in 'material' terms, the global competition hypothesis sheds only limited light upon the changes focused upon here. It is still worth noting that the global challenges may over time have appeared in a somewhat different and more disturbing light; fuelled more by possibilities and speculations about higher ETS allowance prices and a lax global climate regime and hence tougher framework conditions for EU industries compared to global competitors in the years ahead than by alarmist scientific reports. So a certain cognitive impact seems probable.

## **5 Winding up: Better EU Representation and Lobbying the Key Factor?**

As assumed, the EU governance perspective stands out as the key perspective for understanding the proposed changed relative treatment of energy-intensive industries. However, examining the complementary domestic and global perspectives was also useful, as this acquainted us with relevant changes occurring at these levels; making the explanatory picture richer and more complete. At the domestic level, particularly related to increasing attention to windfall profits, the specific situation for

energy-intensive industries in the ETS and hence the need for special treatment became clearer for governments throughout the EU. Also bringing in the issue of global competitiveness, the lacking progress on negotiating an effective and more inclusive post-2012 treaty provided more weight to energy-intensive industries' talk about possible global carbon leakage.

However, as noted, much evidence points towards the conclusion that the main changes which may shed light on changed treatment happened within the Brussels policy game. Put simply, a main factor seems to be that, after the ETS started functioning in 2005 the energy-intensive industries have 'woken up and got their ETS act together'. They have become stronger and more united as a group and improved their standing within the Commission in several ways. This includes both their role in getting the High Level Group established and their strong position in this group, their strong and active participation in the ECCP ETS review meetings, and their active and multi-targeted final lobbying spurt. These changes, and particularly the increasing attention being drawn to the possibilities of global carbon leakage, have contributed to a learning process within the Commission about the need for a more differentiated treatment of industries within the ETS.

With the benefit of hindsight, *the one possible key, catalytic development underpinning all this is the surprising increase in allowance prices in 2005*. This increase contributed to making the windfall profits issue and the differing structural positions of ETS industries much more politically visible and salient, and functioned as an alarm bell for a wide range of industrial and governmental actors. At the time of writing, the decision-making process on the Commission's January 2008 proposal is in full swing and the issue of the treatment of energy-intensive industries is one of the most important ones. Although examining this decision-making process is beyond the scope of this article (and the outcome is still uncertain), the message of this particular study is clear: the improved organisation of the energy-intensive industries at the EU level is a key factor to explore in order to understand both the initiation of EU ETS reform and the subsequent decision-making process, ideally much more in-depth than in this study.

Finally, let us return to the initial question raised about energy-intensive industries going from ETS losers to winners. On the one hand, a more differentiated system must be seen as a 'semi-final' victory, acknowledging the differences in the structural positions of power producers and energy-intensive industries. Hence, earlier EU internal distribution anomalies seem now set to be corrected. Furthermore, it has been pointed out that the power sector will not have many allowances to bank from the 2008-12 period and may be entirely dependent on auctioned allowances from 2013 (Carbon Trust, 2008:34). In comparison, the energy-intensive industries will probably come out better on both these accounts. On the other hand, given the remaining uncertainty related to the more detailed treatment of the most vulnerable energy-intensive industries in the ETS, and not least the considerable uncertainty surrounding the future global climate regime, it is too early to herald these EU industries as true regulatory winners.

## Notes

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<sup>2</sup> The Directive basically determined ETS design in the pilot phase (2005-2007) and Kyoto Protocol commitment phase (2008-2012).

<sup>3</sup> For instance, the following industries are members of 'the Key Stakeholders Alliance for ETS Review': cement, pulp and paper, ceramic industry, glass, lime, chlor-alkali, iron and steel, non-ferrous metals, and chemicals.

<sup>4</sup> Furthermore, it should be noted that there is a time/stability dimension to all these three strength characteristics. For instance, an industry which has for a long time been economically important may be assumed to have built up a more solid standing than a 'younger' industry.

<sup>5</sup> Windfall profits for power producers stem from these producers receiving emissions trading allowances for free and in turn reaping profits from increases in electricity prices related to the very introduction of emissions trading.

<sup>6</sup> Among other things, in 1999 and 2000 EURELECTRIC carried out emissions trading simulations (i.e. GETS I and II),

<sup>7</sup> The group had four members from European Commission directorates (i.e. G. Verheugen from Enterprise and Industry, S. Dimas from Environment, N.Kroes from Competition, and A.Piebalgs from Transport and Energy); four members from the European Parliament; four representatives of the Council (from Austria, Denmark, Finland, and the UK); and 18 representatives of 'other stakeholders' (i.e. mainly industry representatives, some ENGOS, trade unions, and energy/environmental regulators).

<sup>8</sup> The issues addressed in these meeting were 'The scope of the Directive' (first meeting); 'Robust compliance and enforcement' (second meeting); 'Further harmonisation and predictability' (third meeting); and 'Linking with emissions trading schemes' (fourth meeting).

<sup>9</sup> These federations are the European Cement Association (CEMBUREAU), the Confederation of European Paper Industries (CEPI), the Liason Office of the European Ceramic Industry (CERAME-UNIE), the Standing Committee of the European Glass Industries (CPIV), the European Lime Association (EULA), the Federation of European chlor-alkali producers (EUROCHLOR), the European Confederation of Iron and Steel Industries (EUROFER), the European non-ferrous metals industry (EUROMETAUX), the International Federation of Industrial Energy Consumers (IFIIEC), and the European Chemical Industry Council (CEFIC).



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