



The day Aristotle said: “The Tiered Approach doesn’t work”



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Aristotle, Greek Philosopher (384-322 B.C.)

Aristotle often used the reduction ad absurdum to show the untenable consequences one would ensue from accepting the item at issue. If he was alive and would hear about the Tiered Approach in the ETS review, we would probably have engaged in the following dialogue:

Aristotle: What is the purpose of proposing a Tiered Approach?

N.Reg: To avoid the so-called cross-sectoral correction factor (CSCF) – a uniformed cut in free credits allocated to each industrial installation, should the total demand exceed the total availability of free credits.

How would a Tiered Approach work?

Sectors are clustered in different groups, and receive a different level of free credits.

How would sectors be clustered?

On the basis of the different degree of the sectors’ exposure to the risk of carbon leakage, whereby industrial production would relocate outside the EU due to climate policies.

And how could different exposure levels to such risk be evaluated?

For every sector we should assess the impact of carbon pricing in and outside the EU, the carbon intensity of EU and non-EU production, specific trade patterns, products’ price elasticity, and so-forth.

Have any of these analyses been used in the proposed tiered approach?

Not really. Sectors have not been compared with their respective non-EU sectors. Instead, they have just been all lined up and assumed that the higher a sector strikes in terms of combined carbon and trade intensity, the higher it is exposed.

This is counter-intuitive: when a sector reduces its carbon intensity, shouldn’t it increase its exposure to the risk of carbon leakage?

Indeed, as relocation outside the EU in countries with less stringent carbon constraints would then increase global carbon emissions.

So far, the methodology behind the Tiered Approach doesn’t look very sound-based.

Indeed, one could argue that it is rather arbitrary and discriminatory.

Could it be legally challenged?

In case of rigid boundaries in defining the carbon leakage groups, companies not receiving the highest level of free credits will most likely go to court.

Would these companies have a chance to win?

Most likely, given the flawed methodology being used.

What would happen then?

Sectors would retroactively receive additional free credits at the highest level.

So, the risk of triggering the CSCF won’t be avoided.

Indeed.

And what if the boundaries were not rigid but rather flexible?

In this case, sectors initially allocated in some clusters would still be allowed to prove their higher need for protection, via the so-called qualitative assessment.

But if sectors will be granted additional free credits, where would these come from?

Like in past cases, the Commission would have to take a relevant amount of free credits upfront and park them aside, in case all sectors would apply and receive full protection.

Does it mean that sectors will be deemed to receive 100% free credits?

Yes, as allowances potentially needed would not be allocated.

So, also in this case, the risk of triggering the CSCF won’t be reduced.

Indeed. Additionally, a generalised

use of the qualitative assessment would exponentially increase both the administrative burden and the lack of transparency in the decision-making process.

Thanks to Aristotle, we have come to a straight-forward conclusion: the Tiered Approach defeats its original purpose, namely to reduce the risk of triggering the CSCF. With additional drawbacks impacting the stability, predictability and transparency of regulatory framework.

A better way to cost-effectively reduce industry’s demand for free credits is to focus instead on developing rules to stimulate and reward investments in low-carbon technologies. In this respect, tiering does neither. Something that even Aristotle would agree upon.



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