

Carbo diem

Seizing Italy's opportunities in the EU ETS



About Sandbag

Sandbag is a UK based not-for-profit campaigning organisation dedicated to achieving real action to tackle climate change and focused on the issue of emissions trading. Our view is that if emissions trading can be implemented correctly, it has the potential to help deliver the deep cuts in carbon emissions the world so badly needs to prevent the worst impacts of climate change

Through producing rigorous but accessible analysis, we aim to make emissions trading more transparent and understandable to a wider audience than those already involved in the market. In particular, we hope to shed light on the challenges the EU ETS faces in becoming a truly effective scheme for cutting emissions and to advocate the solutions that can help it to work better.

**We would very much welcome hearing the views of others on this subject.
To find out more and to join the debate, visit us at sandbag.org.uk.**

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Cover image: Statue of Horace (Quintus Horatius Flaccus), Venusia, Italy

Italian version also available

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Executive Summary

To date Italy has perceived its obligations under both the Kyoto Protocol and the EU Emissions Trading System purely as a punitive cost to be shouldered rather than an opportunity for development. Not only has this made Italy nervous of European efforts to increase climate ambition, it has become a self-fulfilling prophecy: to meet its Kyoto targets Italy stands to spend billions of Euros on emission reductions overseas that would have been better spent improving Italy's energy infrastructure and security. Without a change in strategy Italy stands to haemorrhage additional billions meeting its European climate commitments through to 2020.

Italy's wasteful Kyoto strategy

If it is to avoid missing its Kyoto targets for 2008-2012, Italy will need to purchase some 181Mt of Kyoto credits, which could cost the government as much as €1.8 billion¹. Perversely, over the same period, the Italian government will award 166Mt of superfluous permits to select installations in the EU ETS.

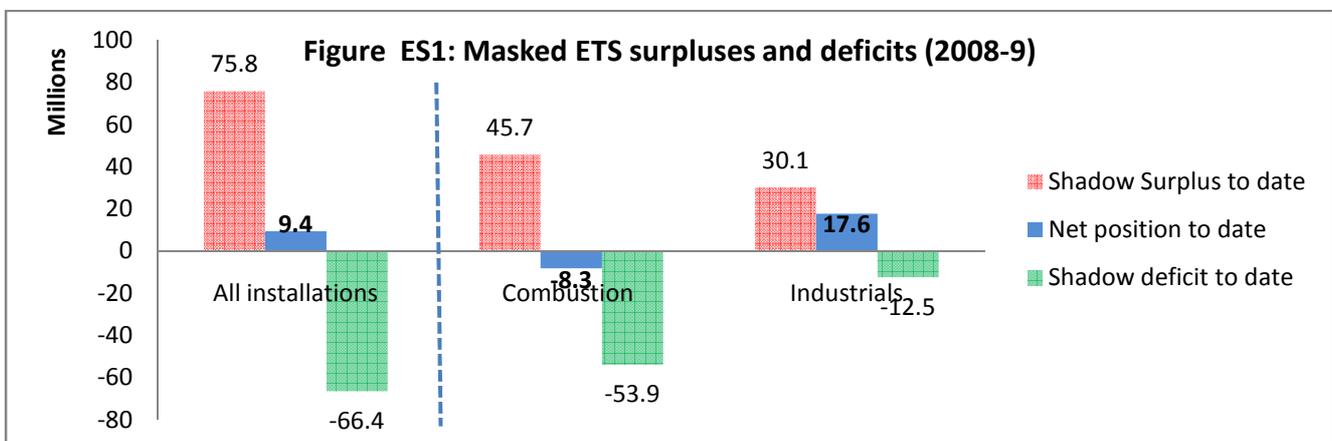
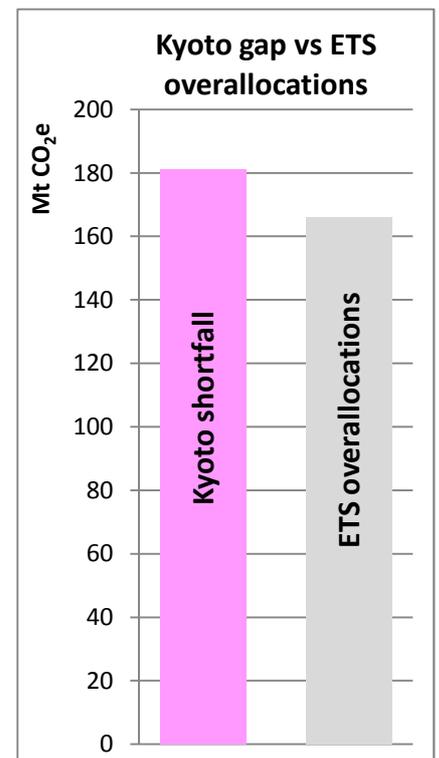
Had Italy shouldered greater effort in its traded sector by adopting a National Allocation Plan without 166Mt superfluous permits, it would only need to buy 15Mt of Kyoto credits, avoiding €1.7 billion in unnecessary costs.

Overallocation in the EU ETS

So far in this trading period, Italian installations have been given 9.4 million permits more than were required to cover their emissions. This overall figure consists of a 75.8Mt surplus accruing to some installations concealed by a shortfall of 66.4Mt to others (see below).

Over the course of Phase 2 (2008-2012) we project Italy to be short 40.3Mt (against 1,048Mt of total traded emissions) with the concealed surpluses growing to 166Mt as described above.

Poor allocation decisions compounded by the effects of recession mean that the Italian government stands to give away 166Mt of carbon assets worth €2.5 billion to installations that do not need them.²



¹ Based on current AAU prices of €10

² Based on current EUA prices of €15

Offsetting in the EU ETS

Within the traded sector, an anticipated rise in Italy's use of offsets towards the end of Phase 2 makes it likely that all of the 40.3 Mt reductions required in Italy's traded sector will be met overseas while domestic emissions carry on as usual.

Based on current usage patterns alone, we project 38.8Mt of offsets to be purchased by 2012, representing €485 million which could potentially have been spent on domestic infrastructure.³

Italy's 2020 commitments

Under the EU Effort sharing agreement Italy is committed to reducing its emissions by 13% in those sectors of the economy which are not within the EU ETS. Based on policies implemented as of 2009, the European Commission estimates that Italy is likely to exceed its 2020 carbon budget by 8%. Meanwhile, those sectors of the economy within the EU ETS will face stricter allocations in Phase 3 (2013-2020) potentially increasing their reliance on offsets.

Without increased efforts to reduce domestic emissions, Italy stands to find itself in the same expensive predicament again in ten years time, spending billions of Euros in both public and private money on foreign offsets instead of investing this money at home.

Seizing the opportunities ahead

Extend the scope of the EU ETS

While harmonised allocation rules prevent Italy from requiring deeper reductions of its existing ETS installations in Phase 3 (as it could have in Phase 2), one way Italy might consider meeting its anticipated 2020 shortfall in the non-traded sector is to unilaterally extend the scope of the ETS to encompass additional installations or additional sectors of the national economy.

Italy is not alone, however, in being off track to meet its 2020 targets for the non-traded sector. 16 other Member States are currently in a similar position. Italy should have little trouble, then, in finding allies to expand the scope of the entire EU ETS so that these reductions can be achieved more flexibly and affordably and diminish or prevent the need for offsetting at state level.

Bring ETS investment money into Italy through complementary policies

If Italy enacts strong policies to encourage domestic abatement, it can discourage Italian installations from meeting their ETS compliance by buying carbon permits elsewhere in Europe, or by purchasing offset credits from further abroad.

Sufficient ambition could even bring money into Italy, by generating spare EUAs that Italian installations can sell to companies elsewhere in Europe. This is particularly true after 2013 when harmonised allocation rules create a level playing field across the states participating in the scheme.

While this would potentially make it more expensive for the affected installations to achieve their caps, it would better ensure that Italy benefits from its compliance obligations. To avoid adversely affecting competitively exposed industries, these complementary policies should focus on the power sector or other competitively insulated industries in the scheme.

³ Based on current CER prices of €12.50

“To take a decision now on the climate at a European level...looks absurd, it is like when someone is down with pneumonia and thinks about having a perm.⁴”

– Prime Minister Silvio Berlusconi (December 2008)

“There are no conditions for a move to 30% given that we are still in a financial crisis⁵... Italy is not available to endorse a unilateral commitment from 20% to 30%⁶”

– Environment Minister Stefania Prestigiacomo (11 June 2010)

Italy has made itself conspicuous amongst EU Member States for its consistently negative positioning on a range of climate change issues in recent years. This year, Environment Ministers from UK, Germany, France and Sweden, as well as the Danish Prime Minister, Rasmussen, have vocally endorsed a unilateral European move to 30% emissions cuts (against 1990 levels) by 2020.

Emissions reductions caused by the recession have brought Europe much closer to a 30% target. Year-on-year emissions dropped 2% in 2008⁷ and a staggering 7% in 2009⁸, bringing emissions down to 17.3% against 1990 levels, just a hairs breadth away from the 20% commitment⁹. This in turn has made a 30% target more affordable –analysis by the European Commission estimated this to cost €81 billion, up from the €70 billion the original target had been priced at.¹⁰

When the European Environment Agency reported on Europe’s progress towards its Kyoto obligations, only Italy and Austria were in danger of failing to meet their targets. Most recently, Italy has resisted the Commission’s proposal to prevent industrial gas credits from entering the scheme.¹¹

In the following report we review Italy’s recent environmental performance – with a particular emphasis on the traded sector – to explore to what extent it’s resistance to proposed climate legislation is justified or prudent. We find that Italy’s lack of climate ambition in the sectors of its economy covered by the EU ETS has placed it at risk of missing its Kyoto targets. We also find that its heavy reliance on offsets to meet its climate obligations both in the traded and non-traded sectors of the economy is unnecessarily diverting money out of the country that could be better spent renovating Italy’s energy infrastructure and protecting its long term energy security.

⁴ «Prendere una decisione sul clima adesso a livello europeo mi sembra che sia abbastanza inopportuno», anzi «assurdo», «È come uno che ha la polmonite e pensa di farsi la messa in piega...» 11.12.2009, Il Sole 24 Ore <http://www.ilsole24ore.com/art/SoleOnLine4/Economia%20e%20Lavoro/2008/12/vertice-ue-compromesso.shtml?uuid=35e1b8fe-c76c-11dd-9b35-0552e13c14c8&DocRulesView=Libero>

⁵ http://www.minambiente.it/opencms/opencms/home_it/showitem.html?item=/documenti/comunicati/comunicato_0019.html&lang=it

⁶ http://www.minambiente.it/home_it/showitem.html?lang=&item=/documenti/comunicati/comunicato_0134_a.html

⁷ EEA Annual GHG inventory <http://www.eea.europa.eu/publications/european-union-greenhouse-gas-inventory-2010>

⁸ EEA press release <http://www.eea.europa.eu/highlights/recession-accelerates-the-decline-in>

⁹ EEA press release <http://www.eea.europa.eu/highlights/recession-accelerates-the-decline-in>

¹⁰ EC Staff Working Document SEC (2010) 650

¹¹ <http://www.pointcarbon.com/news/1.1486545>

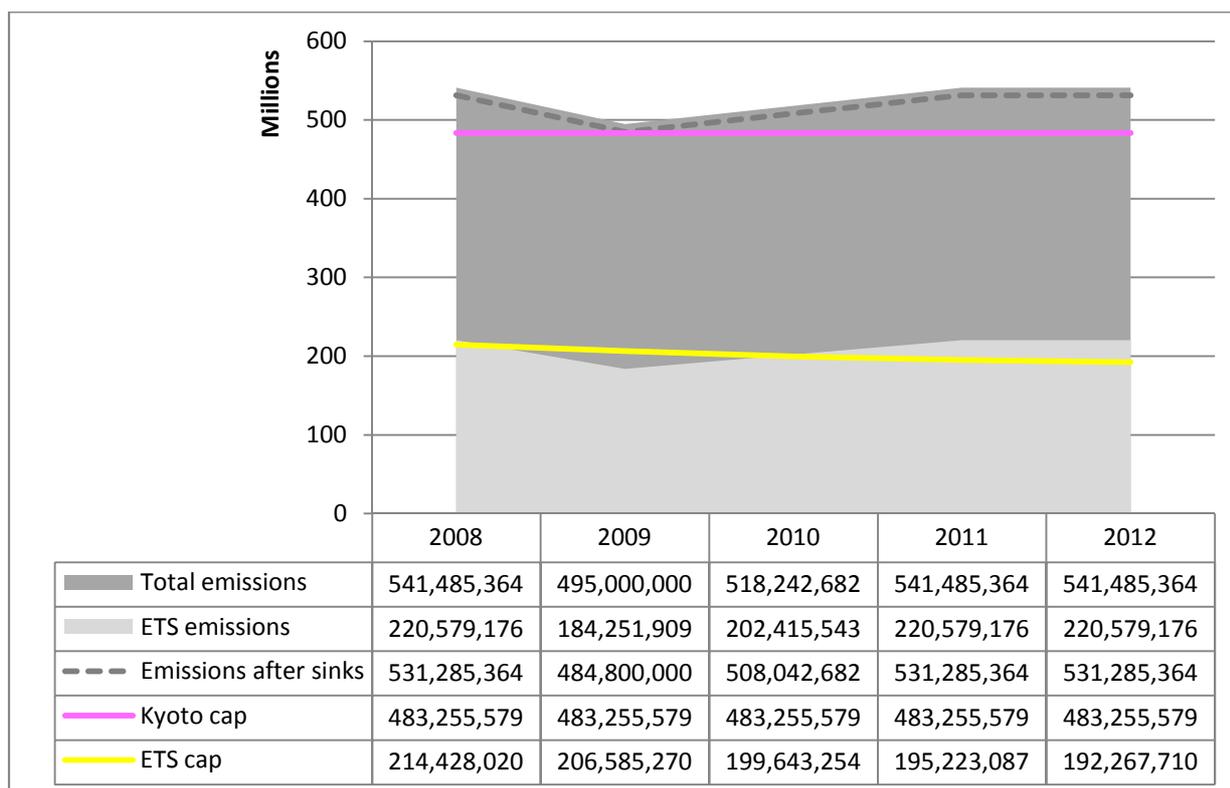
Italy under Kyoto (2008-2012)

As part of the EU15's commitment to an 8% cut on 1990 emissions, Italy agreed to shoulder a 6.5% cut under the Kyoto Protocol. This equates to an annual budget of 423Mt tonnes over the 2008-2012 commitment period.

Recent analysis by the European Commission finds that, while the EU15 is on track to stay comfortably within its collective Kyoto budget, Italy is failing to pull its weight and is set to miss its national budget by 6.7%.¹² This puts Italy in a tight corner – it will either need to wring large carbon reductions out of its non-traded sector or spend precious public funds on Kyoto credits if it is to meet its compliance obligations.

Our own simplified projections for Italy's performance against its 2008-2012 caps in both the traded and non-traded sectors are given in Figure 1 below. Even after carbon sinks are taken into account we anticipate that Italy will fail to meet its Kyoto targets for any year of the period, including recession struck 2009. Over the whole period we find Italy likely to miss its target by 181.2Mt insofar as it relies on domestic measures. Point Carbon arrives at slightly more conservative figure of 138Mt¹³ while the Commission expects Italy to be 123Mt over budget.¹⁴

Figure 1: Italy under the Kyoto Protocol¹⁵



¹² European Commission, Progress Towards Achieving the Kyoto Objectives [COM\(2010\) 569](#). The European Commission finds only one other country, Austria, at risk of missing Kyoto targets across 25 EU27 Member States with Kyoto commitments. [Point Carbon](#) finds Spain also at risk.

¹³ See <http://www.pointcarbon.com/aboutus/pressroom/pressreleases/1.1478058>

¹⁴ EC Staff Working Document for Progress Towards Achieving Kyoto Targets [SEC\(2010\) 1204](#) p.10

¹⁵ We project emissions will rebound halfway to 2008 levels in 2010 and return to 2008 levels for the 2011-12 2010 economy wide emissions estimates are from p.72 of [EEA Report 7/2010](#) Sinks are assumed to stay constant at 2008 levels (10.2Mt) throughout the Phase 2008-9 economy wide emissions (and 2008 sinks) are from [EEA GHG data viewer](#) 2008-9 emissions data from [CITL](#) as of May 17th 2010. Incomplete installation data ("-1s) has been ignored 2008-12 ETS cap is taken from Italy's National Allocation Plan which annually reduces power allocations

Italy is not only conspicuous in its distance from its Kyoto targets, but also in the way it has tried to meet them: Italy is more reliant on domestic forestry credits than any other EU Member State and currently plans to generate 10.2Mt carbon removal units (RMUs) a year. This represents a quarter of the RMUs created in the whole of the EU15 and is nearly twice as many as produced by the next largest user, Spain.¹⁶ Were it not for these removal units, representing 51Mt of domestic carbon reductions between 2008 and 2012, Italy would be 232.2Mt away from its Kyoto targets.

Italy had not anticipated relying on domestic measures alone to meet its targets, but had planned to purchase some 85.5Mt carbon using Kyoto flexible mechanisms – the second largest purchasing plan in the EU27¹⁷. Remarkably, while this would still fail to bring it under budget, Italy has recently *downsized* its government purchasing plan to just 30.8Mt of credits¹⁸, leaving it missing its Kyoto budget by some 150.4Mt according to our estimates.

Table 1: Kyoto budget shortfalls in the Italy’s non-traded sector¹⁹

	A: Whole economy (Kyoto)	B: Traded sector (EU ETS)	Non-traded sector
Emissions (after sinks)	2,586,698,775	1,048,404,980	1,589,293,795
% of emissions	100%	40.5%	60.5%
Cap	2,416,277,897	1,008,147,341	1,408,130,556
% of cap	100%	41.7%	58.3%
		Non-traded shortfall	181,163,239
		Kyoto purchasing plan	30,800,000 ²⁰
		Remaining gap	150,363,239

Most analysts expect that Italy will ultimately expand its purchasing plans to cover this Kyoto shortfall. If it does so, in order to keep costs down Italy is likely to prioritise buying “hot air” credits, i.e. the surplus AAUs that Eastern-bloc countries inadvertently gained when their economies collapsed before the start of the Kyoto compliance period.

This could represent €1.8 billion in taxpayers’ money leaving Italy²¹, money that could have otherwise been spent overhauling Italian energy infrastructure to increase the country’s energy independence and energy security.

This situation could have been avoided through greater reliance on the traded sector and complimentary climate policies to achieve emission reductions.

¹⁶ See EC [Staff Working Document](#) for “Tracking Progress towards Achieving Kyoto Targets p.10

¹⁷ Behind Spain’s 289Mt, see EC [Staff Working Document](#) for “Tracking Progress towards Achieving Kyoto Targets p.10

¹⁸ <http://www.pointcarbon.com/aboutus/pressroom/pressreleases/1.1478058>

¹⁹ Data sources as from footnote 15.

²⁰ <http://www.pointcarbon.com/aboutus/pressroom/pressreleases/1.1478058>

²¹ i.e. AAUs at €10

Italy under the EU ETS (2008-2012)

Italy's National Allocation Plan (NAP) outlining its carbon budgets over Phase 2 (2008-2012) of the EU ETS has become something of a political football. The Berlusconi administration has alternated between accusing the Prodi government of weak negotiation on Italy's behalf and arguing that the European Commission dealt with Italy unjustly in rejecting its first NAP.

The reasons for the Commission's rejection of the proposed NAP are publically available²². Chief amongst the Commission's concerns was that an insufficient proportion of Italy's efforts towards its Kyoto targets were being met by the ETS. The Commission feared that, without more help from the traded sector, Italy was unlikely to meet its Kyoto targets:

*"...the Commission lacks sufficient reassurance that Italy will achieve its Kyoto commitment unless increased efforts are made... As Italy has not sufficiently demonstrated to the Commission that it can make these increased efforts solely in the sectors not covered by the [Emissions Trading] Directive, the [traded sector needs] to carry at least a proportionate burden."*²³

As our previous section confirms, the Commission's concerns in 2007 have since been vindicated. Had Italy made more ambitious reductions in its traded sector in Phase 2, it would not find itself in the difficult position of struggling to find public money with which to buy Kyoto credits.

Greater reliance on reductions in the traded sector is not, however, a silver bullet to preventing Italian money from fleeing overseas: without complementary policies, this problem is simply displaced from the Italian taxpayer to the Italian private sector and the Italian energy consumer. Tougher ETS obligations could simply encourage Italian companies to increase their purchase of European Union Allowances from installations elsewhere in Europe, or offset credits from further abroad. We revisit this problem further below. Firstly, it is important to establish that the rumours of the difficulties Italy faces under the ETS have been greatly exaggerated.

²² Commission Decision on Italian NAP, 15 May 2007

²³ Paragraph 7, Commission Decision on Italian NAP, 15 May 2007

The stringency of the Phase 2 cap

Several prominent Italian politicians and civil servants have bemoaned the burdens the ETS places on Italy, but so far Italy is actually benefitting from the scheme, accruing a net surplus of 9.4Mt to date. Our projected outlook for the whole phase finds Italy facing a net shortfall of 40.3 Mt (against total emissions of 1,048Mt). This represents an emissions cut of 4% over the full 5 years.

Figure 2: Italy under Phase 2 of the EU ETS (2008-2012)²⁴

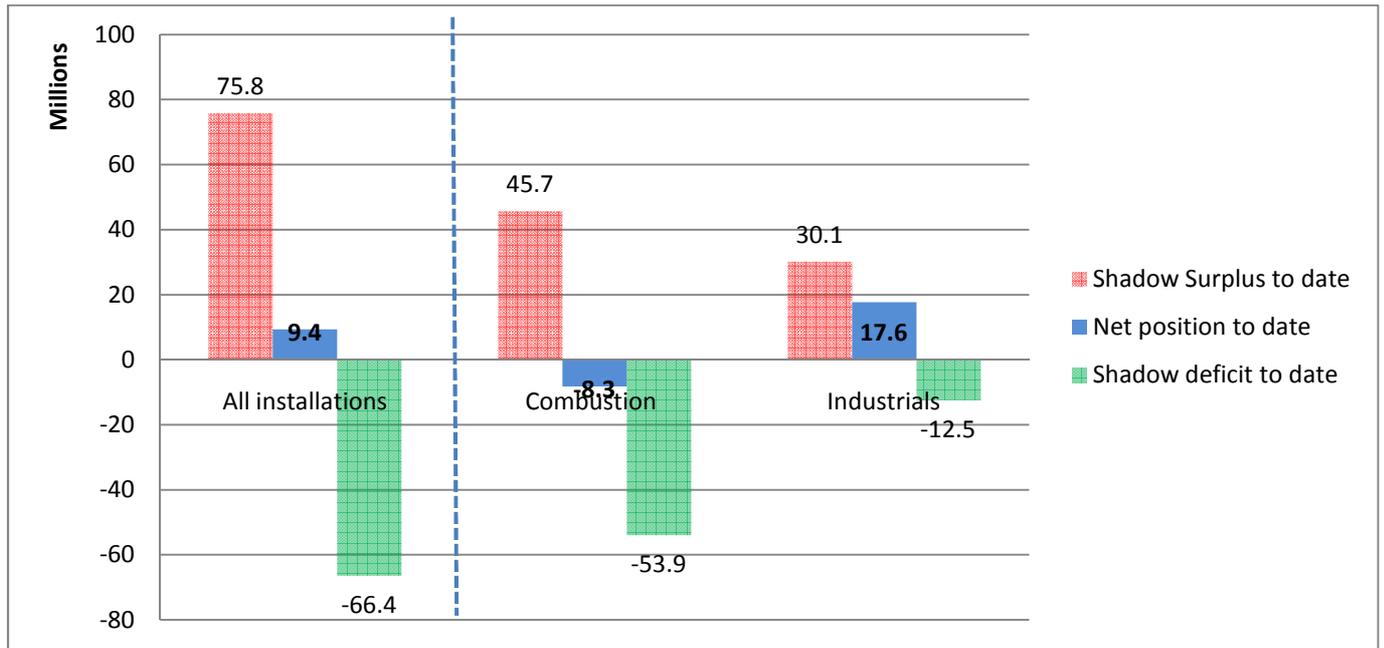


It is important to put this shortfall at the over the course of the phase into perspective. Firstly, this is not an unusual shortfall amongst the largest emitting Member States: for example Germany *already* faces a shortfall of this size against just its 2008-2009 allocations despite the recession lowering its expected emissions for these two years.

Secondly, and more importantly, Italy's net shortfall across Phase 2 disguises large over-allocations to some Italian sectors and subsectors. Overleaf, Figure 3 reveals these "shadow" surpluses and deficits masked by the net position to date:

²⁴ See footnote 15 for information on data sources

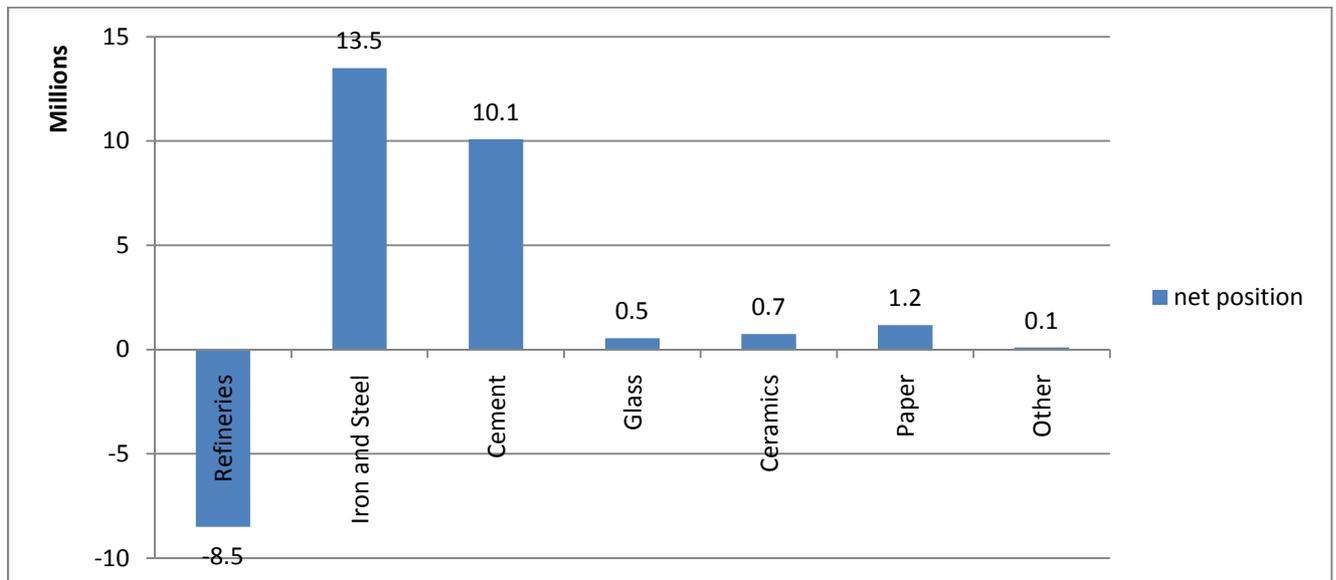
Figure 3: Masked surpluses and deficits (2008-2009)²⁵



Thus Italy's surplus position of 9.4Mt actually consists of some 75.8Mt in overallocations that are masked by shortfalls mainly in the power sector and the refineries industry.

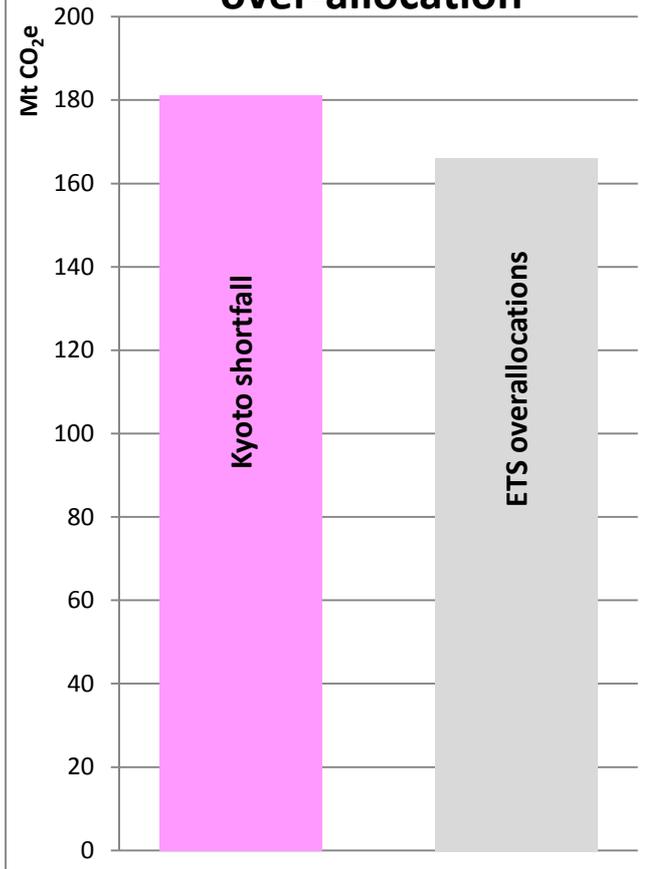
The lion's share of this overallocation falls to combustion installations which feed into industrial processes. The remainder is concentrated in the steel and cement industries as we see partly broken down in Figure 4:

Figure 4: Net position of Italian industrial sectors (2008-2009)



²⁵ Emissions and allocations data taken from CITL. Cap figures higher than NAP in Figure 1 and 2 as CITL accounts for allocations to new entrants.

Figure 5: Kyoto gap vs ETS over-allocation



Thus we find that Italy has much larger problems in terms of wasting EUAs from its NAP on excess free allocations to steel, cement and combustion installations than it has from any net shortage.

We project that these over-allocations across the Italian traded sector are likely to grow to roughly 166Mt by the end of the phase, representing assets worth nearly €2 ½ billion at current EUA prices²⁶.

Had Italy adopted a Phase 2 NAP 166Mt smaller, this additional effort in its traded sector would have reduced its 181Mt Kyoto shortfall to only 15Mt. This 92% reduction in the shortfall could save Italy as much as €1.7 billion in foreign carbon credits.²⁷

Alternatively, Italy could have reserved as much as 100Mt of ETS permits to sell at auction, generating revenues of €1.5 billion²⁸. Had the NAP been reduced by 66Mt and the maximum 100Mt auctioned. Italy's Kyoto shortfall of 115Mt would have cost it substantially less, generating a net profit of €350million.²⁹

²⁶ We apply our standard emission projection forward – emissions achieving the average 08-09 levels in 2010 and recovering to 2008 levels for the rest of the phase. Allocations outside of the power sector remain constant. We use an EUA value of €15.

²⁷ Based on current AAU prices of €10

²⁸ Based on current EUA price of €15

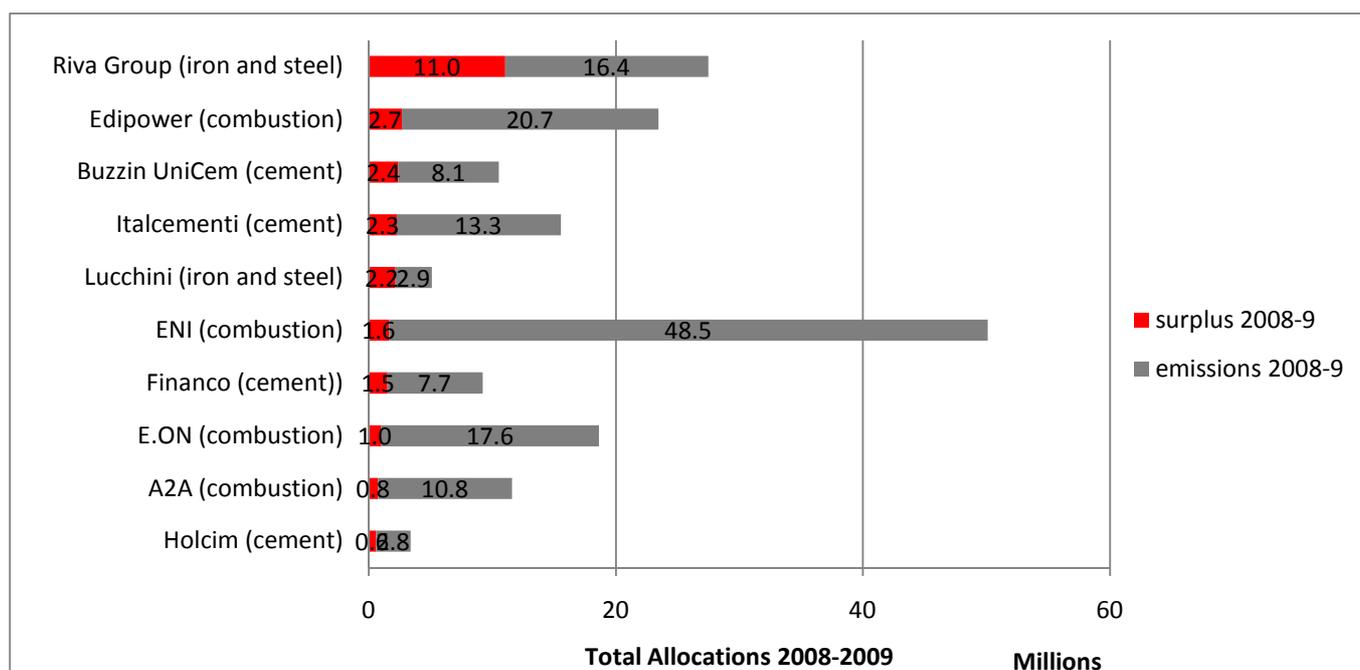
²⁹ i.e. €1,500 million - €1,150 million (based on a €10 AAU price)

Overallocation in Focus – Italian Fatcat Companies

Looking closer at some of the specific Italian companies which have been most overallocated to date, we find that just 10 companies account for a third (25.2Mt) of the masked surpluses in the scheme to date.

Unusually, Italy has gone to extraordinary efforts to buffer its electricity companies with generous allocations. Four of our top ten “carbon fatcats” are power companies: Edipower, ENI, E.ON and A2A. This is an unusual strategy considering Italian power companies are not competitively exposed.

Figure 6: Italy’s top surplus holding companies (2008-9)



There is also evidence to suggest that some overallocated companies and installations are profiteering from the scheme by surrendering offset credits for compliance instead of the EUA permits they were given for free. As EUA permits have a slightly higher market value than offset credits purchased (CERs, ERUs), the extra EUAs freed up can then be sold on at a profit.

Table 2: Offset substitution by overallocated companies (2008-9)

	08-09 EUA surplus	Current value ³⁰	Offsets substituted	Value gained ³¹	Total windfall
Riva	11,049,918	€ 165,748,770	0	€ 0	€ 165,748,770
Edipower	2,689,193	€ 40,337,895	0	€ 0	€ 40,337,895
Buzzin UniCem	2,402,151	€ 36,032,265	70,000	€ 175,000	€ 36,207,265
Italcementi	2,253,893	€ 33,808,395	322,822	€ 807,055	€ 34,615,450
Lucchini	2,170,332	€ 32,554,980	0	€ 0	€ 32,554,980
ENI	1,630,904	€ 24,463,560	0	€ 0	€ 24,463,560
Financo	1,511,627	€ 22,674,405	690,741	€ 1,726,853	€ 24,401,258
E.ON	1,015,850	€ 15,237,750	36,938	€ 92,345	€ 15,330,095
A2A	754,920	€ 11,323,800	223,949	€ 559,873	€ 11,883,673
Holcim	595,024	€ 8,925,360	70,000	€ 175,000	€ 9,100,360
TOTALS	26,073,812	€ 391,107,180	1,414,450	€ 3,536,125	€ 394,643,305

³⁰ Calculated at €15

³¹ Calculated at €2.50 (i.e. €15 EUA price - €12.50 CERprice)

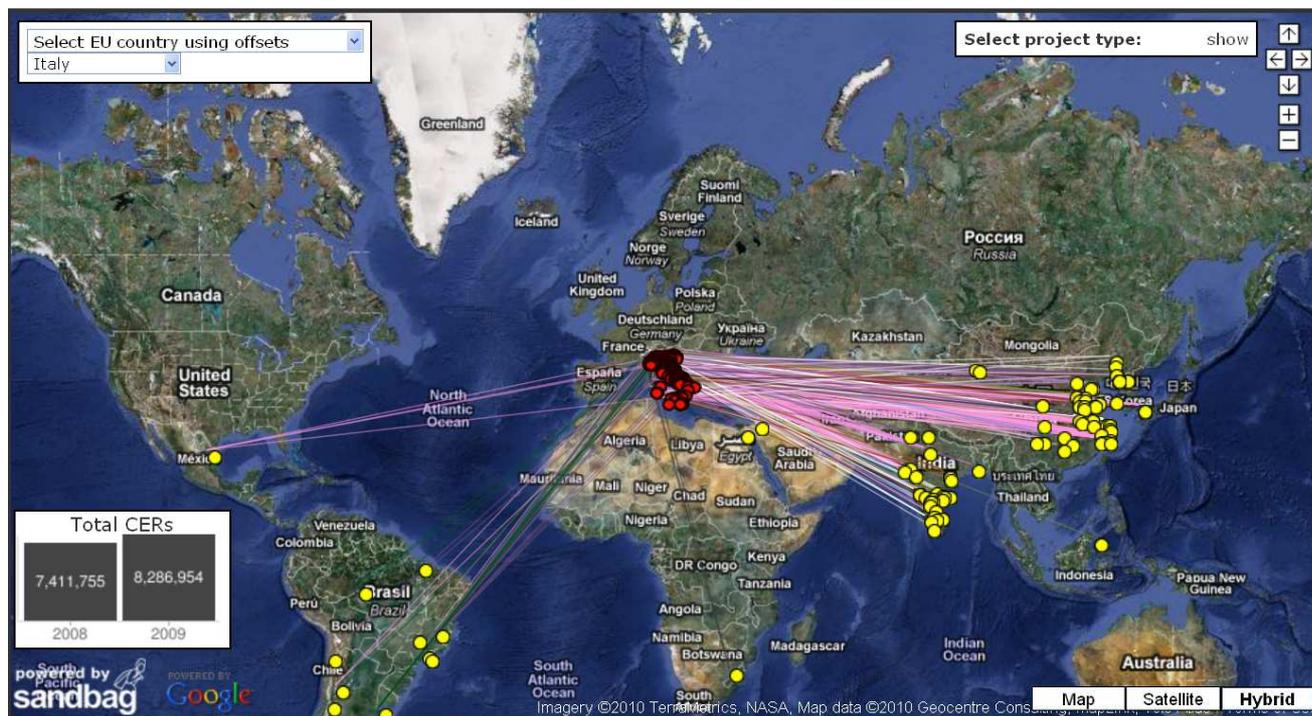
Offsetting in the Italian traded sector

The European Commission allowed Italian installations to make use of offsets (CERs and ERUs) equivalent to 15% of their allocated permits. This provides Italian installations a maximum legal allowance of 151Mt in offsets over and above the 1,008Mt in their NAP.

Two years into the scheme Italian installations have used 16.2Mt of offsets. We expect a steep rise in the number of offsets surrendered for compliance towards the end of the phase as industrial installations seek to anticipate a scarcity of EUAs and CERs in Phase 3 as both benchmarked allocations and potential offset restrictions come into force.

Even on current patterns of use, we can expect 38.8Mt of offsetting to take place in Phase 2, which will absorb almost all of the net EUA shortfall in Italy and finds the EU ETS driving only 1.5Mt of domestic abatement against over a billion tonnes of emissions across the phase (i.e. a cut of only 0.15%).

Figure 7: Map of Italian offsets under the EU ETS (2008-2009)³²

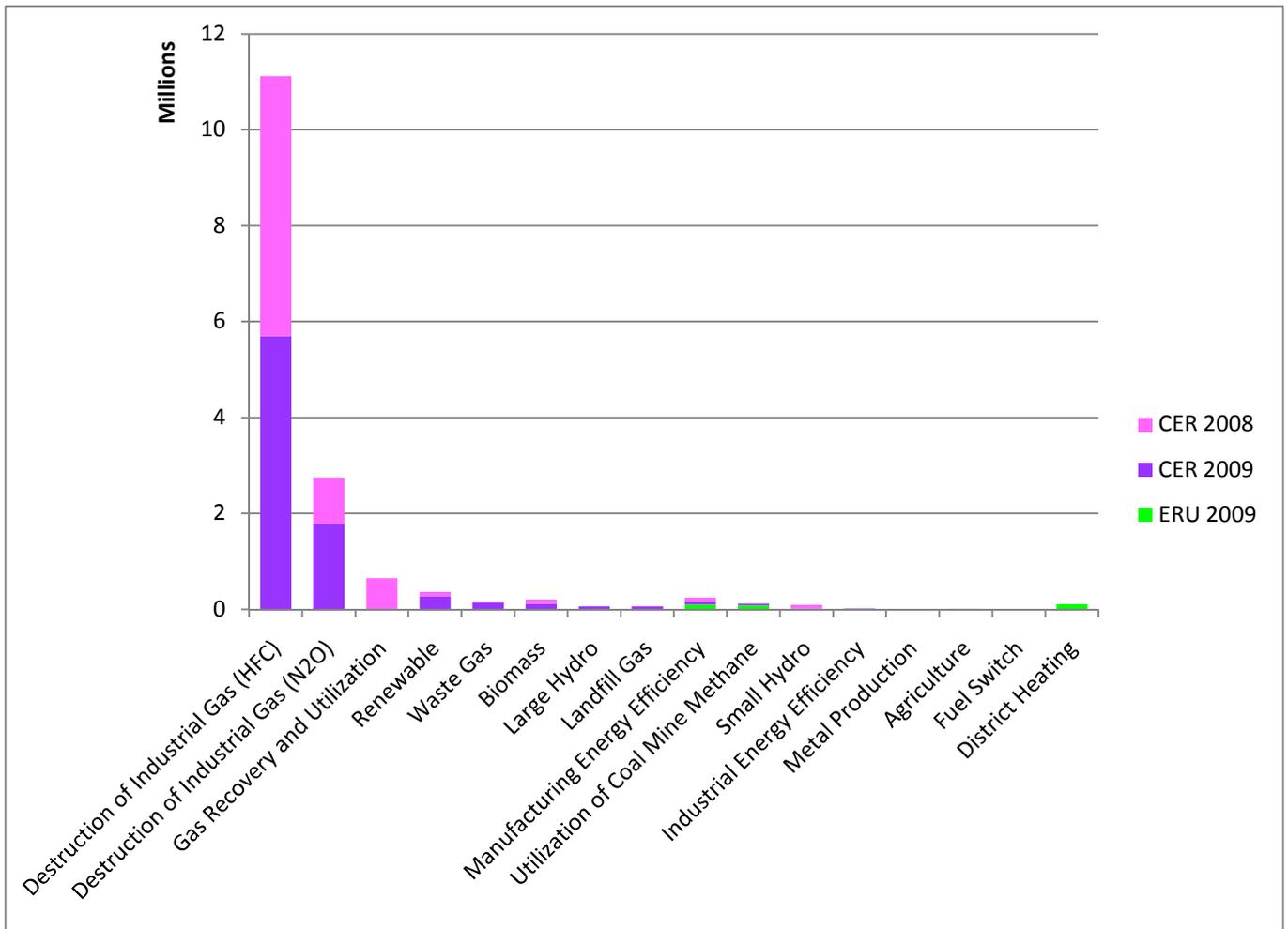


In Figure 8, overleaf, we show the distribution of Italian offsets across different kinds of projects. The preponderance of industrial gas destruction projects is clear, with 87% of offsets purchased going to HFC and N₂O projects whose environmental value is coming increasingly under suspicion. This report is written against a backdrop of moves by the European Commission to ban industrial gas offsets.³³

³² <http://www.sandbag.org.uk/maps/offsetmap/>

³³ http://ec.europa.eu/clima/news/docs/proposal_restrictions_final.pdf

Figure 8: Distribution of Italian offsets in the EU ETS (2008-2009)³⁴



Both in the traded sector and the non-traded sector, then, we find Italy essentially throwing money away on environmentally questionable Kyoto credits in order to fulfil its climate obligations at minimum cost. This is – manifestly – a very wasteful compliance strategy.

Even if it proved more expensive in the short term, it would have been far wiser for Italy to use its compliance obligations as an opportunity to invest in its own infrastructure and protect itself from the volatile fossil fuel prices and higher energy costs we can expect in the medium to long term.

³⁴ [Sandbag reports](#) International Offsets and the EU 2008, International Offsets and the EU 2009, ER Who?

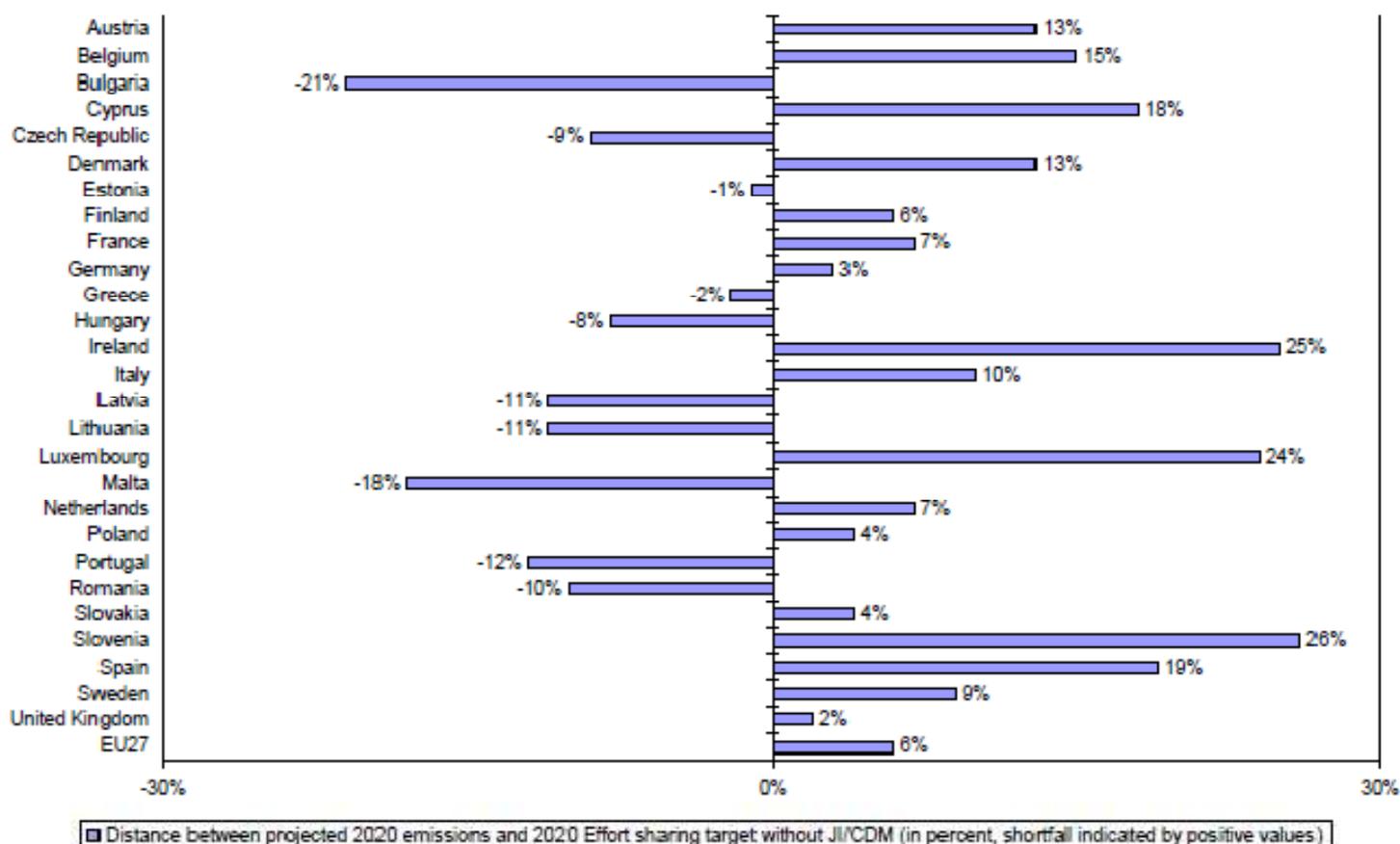
Italy's 2020 commitments

Under the EU Effort Sharing Agreement, Italy committed to reduce its emissions in the non-traded sector by 15% against 2005 levels by 2020³⁵; however, projections by the European Commission find Italy stands to miss this 2020 emissions budget by 8% based on policies implemented as of 2009.³⁶ Unless it changes its policies, Italy might therefore expect to face a repeat of its current Kyoto predicament a decade from now, where it will once again be obliged to spend billions of Euros in public money on international offsets. This repeat predicament could also be exacerbated by an exhaustion of domestic carbon sinks or a tightening of regulations on RMUs or equivalent land use credits.

Earlier in this report we have described how over the current Kyoto commitment period, Italy neglected the opportunity to undertake deeper carbon reductions in its traded sector where they could have been achieved more easily and flexibly. This avenue will no longer be open to Italy after 2013, as allocations of carbon permits in the ETS will be harmonised across the EU; however, another way to undertake more effort within the traded sector is to widen the scope of the scheme to cover additional installations or even new sectors of the economy.

While the unilateral opportunities for sectoral scope change are limited by the installation focus of the ETS Directive, Italy is not alone in facing a gap to its 2020 targets – 16 other EU27 member states face the same problem (see Figure 9 below). Italy should have little trouble, then, in finding allies who are keen to embrace scope expansion in order avoid state expenditure on offsets and/or to give their private sectors greater flexibility in achieving emissions reductions through the ETS.

Figure 9: Projected gap to 2020 targets from non-traded sectors³⁷



³⁵ Decision No [406/2009/EC](#) of the European Parliament

³⁶ EC [COM\(2010\) 569](#) Progress Towards Achieving Kyoto Objectives p.16

³⁷ Graph taken from Figure 6 of EC [COM\(2010\) 569](#) Progress Towards Achieving Kyoto Objectives p.16

Large, competitively insulated sectors like transport and heating are promising candidates for inclusion; however, the need to control these sectors upstream could potentially require a reopening of the ETS Directive. Reopening the Directive presents both environmental risks and opportunities, and the EU would need to take great care that any increase in scope was not undermined by a decrease in ambition.

Unfortunately, Italy's problems with excessive compliance money flowing overseas do not end with the non-traded sector: offsetting by Italian companies in the EU ETS is likely to be aggravated in Phase 3 (2013-2020) by a more stringent supply of EUAs and a massive reduction in free allocations. Meanwhile, our projections find that, in principle, as many as 1.8 billion offset credits will be available over Phase 3.³⁸

If Italy hopes to channel some of this private finance into renovating Italy's infrastructure, it will need to enact ambitious laws which ensure that a large share of this abatement takes place domestically, taking pains not to punish its competitively exposed sectors. It should also support current proposals to improve the quality and diminish the supply of offsets available to the traded sector in Phase 3, thereby making domestic abatement more financially attractive.

³⁸ Sandbag, [Cap or Trap](#), September 2010

Conclusion – reframing compliance to benefit Italy

This report finds that the difficulties Italy faces under existing climate legislation are mostly of its own making. Insofar as Italy presents these difficulties as grounds for resisting ambitious and effective European climate policies, policy makers should be aware of the strategic errors Italy has made in handling its climate commitments to date.

Italy's minimalist approach to meeting its climate obligations is set to drive up to €2.2 billion of state and private money out of the country – mostly to environmental projects of questionable environmental value.

The state's decision to shield industries in its traded sector from the obligation to reduce their emissions has unnecessarily jeopardized Italy's compliance with the Kyoto protocol and is set to cost the state €1.7 billion in Kyoto credits.

This protection of the traded sector seems completely unnecessary given:

- a) the modest 40.3Mt shortfall of permits we can expect over Phase 2
- b) the likelihood that this domestic shortfall will be met entirely through private offsetting
- c) the large surplus key installations are set to acquire over Phase 2, which, at 166Mt, stands to be 4 times larger than the anticipated net shortfall.

Over 2008-12, Italy's private sector will spend at least €485 million outsourcing carbon reductions to developing countries. Without a change in strategy, Italy stands to haemorrhage billions more in offsets purchased by both its traded sector and the state between 2013 and 2020.

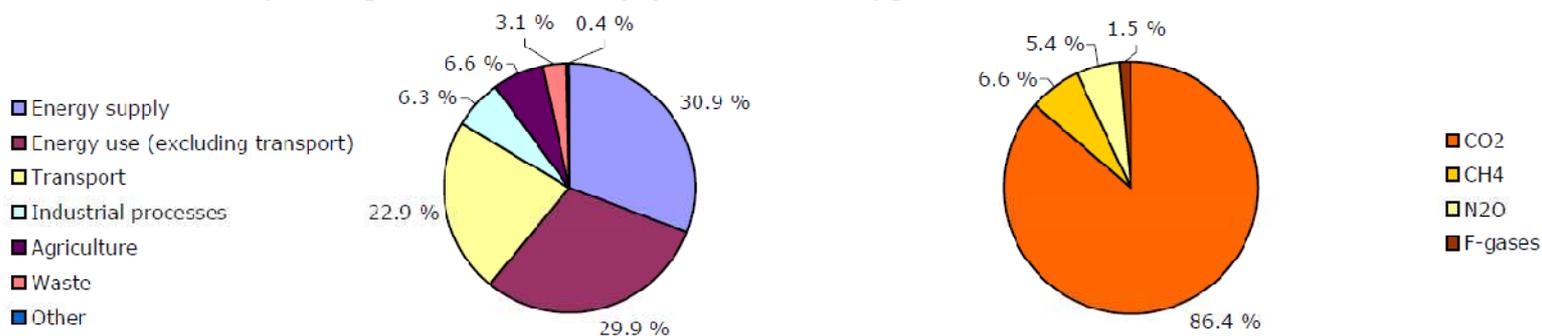
Going forward we recommend Italy enact stronger domestic climate policies to drive carbon abatement within the competitively insulated sections of its traded sector. This will oblige Italian companies to invest in Italy's energy infrastructure rather than paying for cheap credits overseas.

We also recommend Italy join forces with other Member States to expand the scope of the traded sector to encompass a larger share of the European economy's emissions, thereby enabling Italy and other states to more easily meet their 2020 climate obligations in the non-traded sector, which they are currently expected to miss by a large margin.

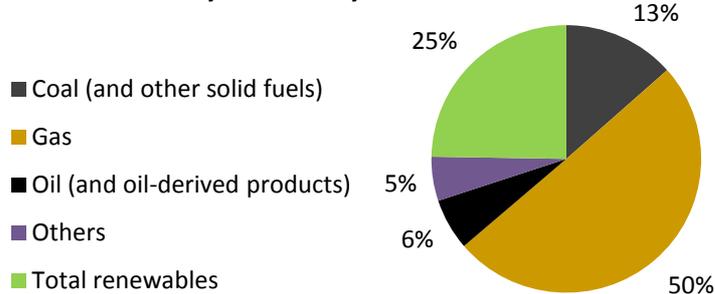
A punitive view of climate obligations has driven Italy to pursue a strategy of minimizing its commitments and meeting these at minimum cost. As this report shows, this "race to the bottom" has been a very wasteful strategy. We encourage Italian policymakers, to reframe climate policy as an opportunity to enhance Italian infrastructure, improve national energy security, and better prepare the country for success in a global low-carbon economy.

Appendix 1: Key Italian energy indicators

Share of GHG emissions (excluding international bunkers) by main source and by gas in 2008 ³⁹

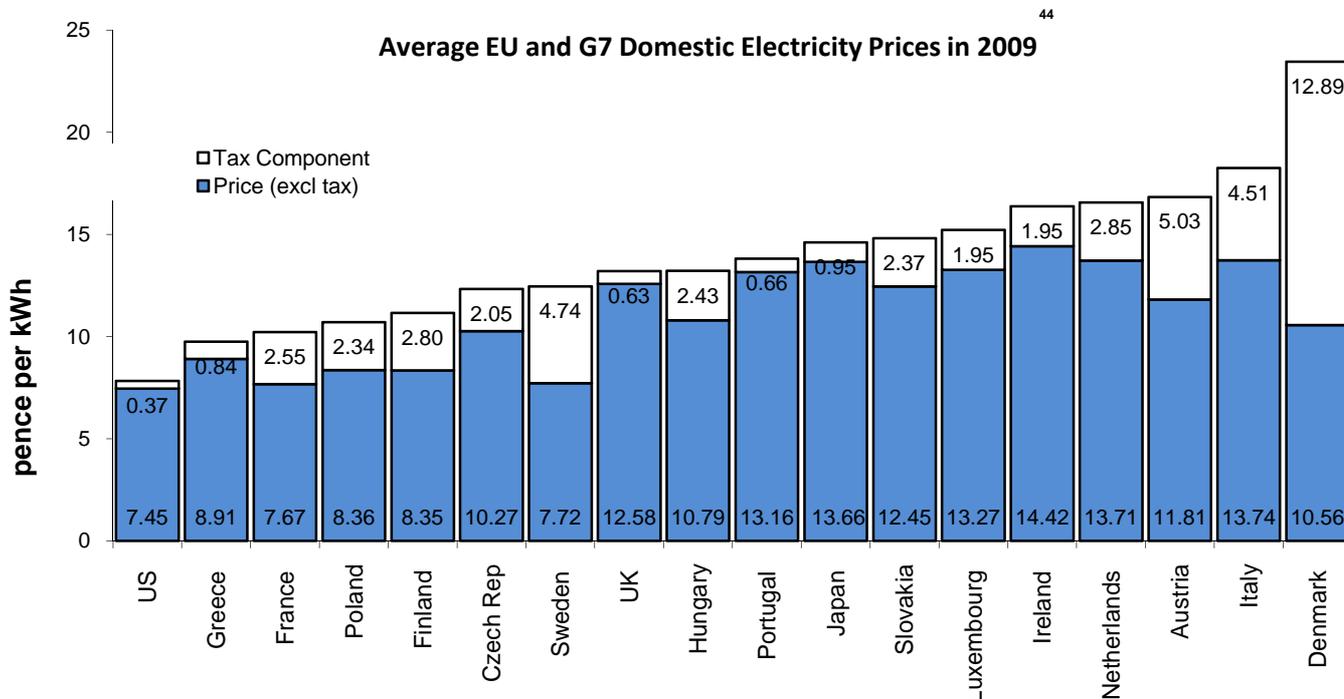


Italy - Electricity Production Mix 2009 ⁴⁰



Carbon intensity of the Italian economy (gCO ₂ /€GDP) ⁴¹					
base	ETS Phase 1			ETS Phase 2...	
1990	2005 ⁴²	2006 ⁴³	2007	2008	2009
508	464	443	429	426	410

Average EU and G7 Domestic Electricity Prices in 2009 ⁴⁴



³⁹ Taken from EEA Tracking Progress Towards Kyoto

⁴⁰ <http://www.autorita.energia.it/it/dati/eem6.htm>

⁴¹ Taken from EEA Tracking Progress Towards Kyoto unless otherwise noted, €GDP is fixed at 2000 levels.

⁴² Derived from IEA Italy report 2007, price converted from 2000\$US

⁴³ Taken from EEA GHG Trends and Projections 2009

⁴⁴ Derived from IEA, Energy Prices and Taxes via DECC website