



## Recommendations from the Alliance of Energy Intensive Industries on the review of the EU Emissions Trading System

Brussels - 05 February 2021

### Context

The impact assessment accompanying the Commission communication on the “[2030 Climate Target Plan](#)” suggests a highly demanding reduction target for ETS emissions of -65% for 2030, while the current ETS level foresees a -21% reduction for 2020 and a -43% for 2030. Such a projection means a three-fold increase in reduction efforts required for EU industries under the future ETS Directive compared to the current level, to be achieved over a shorter timeframe of about 8 years. The same impact assessment confirms the high exposure of energy-intensive industries to the carbon leakage risk due to unilateral climate ambition (in Part 1, pages 79 and 86, tables 16 and 23, and Part 2, pages 111 and 113, tables 47 and 49).

To achieve the emission reduction goals and to protect the competitiveness of energy intensive industries, the Alliance of Energy Intensive Industries has the following recommendations for the next ETS revision:

#### **1. Contribution of EU ETS and non-ETS sectors (i.e. burden-sharing)**

Achieving more ambitious emission reduction targets by 2030 requires reductions in all sectors of the economy. Since 2005, EU ETS sectors and non-ETS sectors (covered by the Effort Sharing Regulation) have been reducing CO<sub>2</sub> emissions at significantly different rates, with ETS-sectors compelled to strive towards a -43% reduction target against the -30% for ESR sectors compared to 2005. It is noteworthy that EU ETS sectors have kept reducing their emissions at a faster pace than ESR sectors.

The abovementioned Commission impact assessment continues to foresee marked differences in the reduction targets as well for 2030. The projections show -65/-69% in each of the scenarios for ETS-sectors and -39/-41% for non-ETS (in Part 1, table 28, page 129). This threatens the current functioning of the ETS system and the competitiveness of industry. The sole -65% GHG reduction target is expected to decrease the cap level by 2 billion allowances, in turn translating into a decrease of 800 million free allowances.

Hence, the Effort Sharing Regulation and the ETS Directive need to address sectors currently covered by the Effort Sharing to deliver a fair share of emission reductions.

## **2. Strengthened carbon leakage protection for EU ETS sectors**

The replacement of European production by imports from foreign countries with lesser carbon constraints negatively affects both the Union climate action efforts worldwide and the competitiveness of its industrial basis. As demonstrated by increasing rates of substitution of domestic products with high-carbon footprint imports across the whole value chain, carbon leakage is indeed a solid reality for many EU industries. For sectors exposed, it is then essential that the ETS system will be able to mitigate the risks of carbon leakage.

To this extent, it is crucial that:

- The provision linking the level of carbon leakage protection to the overall ETS cap level (i.e. the share of free allowances distributable), is reviewed. The revision needs to avoid the overall carbon leakage protection to drop considerably at a pace faster than our capacity to cope. Energy-intensive industries have a lower abatement potential (22%) compared to the power sector (70%). This results in the latter driving the cap level down speedily.
- Furthermore, the current free allocation system is based on benchmarks which decrease in parallel with GHG reductions. The cost of low carbon technologies is not reflected in carbon leakage measures based on GHG.
- A sufficient level of free allocations must therefore be maintained and any type of reduction avoided, along with the provision of complementary policies supporting investment' efforts in clean technologies development and deployment. In particular, in the revised ETS the application of the cross-sectoral-correction factor shall be impeded.
- The amount of free allocations needed to prevent carbon leakage needs to be calculated before engaging in other regulatory initiatives potentially impacting the number of free credits. The decarbonisation of the power sector (subject to auctioning) leaves the room for increasing the free allocation share and avoid the cross-sectoral correction factor. Should any other instrument, such as for example a Carbon Border Adjustment Mechanism, be introduced, it should include a solution for exports like e.g. a carbon rebate, and it should co-exist with the current system of free allocation, to provide certainty for low-carbon investments and avoid market distortions.

## **3. Avoiding extension of the ETS scope to non-ETS sectors with higher abatement costs and no international competition**

The building and transport sectors have different CO<sub>2</sub> abatement costs, elasticities and risks of carbon leakage as well as limited or no exposure to international competition compared to energy-intensive industries. Their inclusion in the ETS system is, therefore, expected to drive carbon prices up substantially. This would exacerbate carbon costs and carbon leakage risks for sectors exposed to international competition.

The Alliance sees the need for fairer burden-sharing and appropriate GHG reduction measures in these sectors. However, the Alliance is not in favour of the inclusion of any of those sectors in the EU ETS. Should the Commission consider making these sectors subject to a European carbon market, this

should be done through dedicated and separate cap-and-trade systems, without any links to the existing ETS as long as relative abatements costs do not converge.

#### **4. Cost-efficient achievement of the ETS target without rebasing and MSR strengthening**

The climate ambition of the EU ETS will be defined by the stricter 2030 cap. This needs to be achieved in the most efficient way to reduce costs for compliance operators as well as the whole EU society (through higher indirect costs passed on in the electricity price). Rebasings (i.e. one-off cancellation of allowances) and strengthening of the Market Stability Reserve (i.e. putting more allowances in the reserve) are not needed as they artificially increase the costs for the same level of climate ambition. Instead of invalidating allowances in the MSR, it must be considered to use them for innovation and to avoid a CSCF.

#### **5. The allocation of ETS revenues to support industrial decarbonisation**

For the revised ETS system to meet its emission reduction targets sustainably, it is of utmost importance to increase the financial support and enabling framework for the development and market uptake of low-carbon technologies in line with the technology neutrality principle. The EU ETS revision could be an opportunity, amongst other policies and measures, to allow the development of new applications based on carbon circularity. As acknowledged by the Commission inception impact assessment on 2030 climate targets, *“the carbon price alone will at the levels estimated for this decade – not sufficiently trigger the demonstration and deployment of clean technologies both in the transport and industry sector at scale [...]”* (in Part 1, page. 121). The current debate on filling the EU budget via the ETS auction revenues risks undermining the potential of industrial decarbonisation:

The Commission 2018 Clean Planet Strategy attached particular importance to electrification as one of the key routes for decarbonisation. With increased carbon prices, indirect carbon costs for the industry will increase and thus, it is essential that adequate state aid for indirect carbon costs is provided. If these revenues instead go to the EU budget, then, fewer resources would be available to provide compensation.

#### **6. Addressing the impact of the COVID pandemic on free allocation**

While a comprehensive assessment of this unprecedented and unforeseeable crisis will be possible only in the near future, the coronavirus outbreak could likely have a disruptive effect on production volumes.

According to the existing rules, after affecting the emissions/free allocation balance in 2020, this situation would impact post-2020 free allocation both in the first sub-trading period (as a result of the 2-year rolling average’s adjustments in 2021 and 2022) and in the second sub-trading period (as a result of the reference historical activity level based on the average of the period 2019-2023).

As soon as comprehensive data on the full impact of the outbreak become available, we urge the Commission to take the necessary initiatives to ensure that production and emissions reductions related to the COVID-19 outbreak will not unduly reduce the amount of post-2020 free allocation.