

Consultation on revision of the EU Emission Trading System (EU ETS) Directive

Fields marked with * are mandatory.

Introduction

On 24 October 2014, the European Council agreed on the 2030 framework for climate and energy [1], including a binding domestic target for reducing greenhouse gas (GHG) emissions of at least 40% in 2030 as compared to 1990. To meet this target, the European Council agreed that the emissions in the EU Emission Trading System should be reduced, compared to 2005, by 43%. A reformed EU ETS remains the main instrument to achieve the emission reduction target. The cap will decline based on an annual linear reduction factor of 2.2% (instead of the current 1.74%) from 2021 onwards, to achieve the necessary emission reductions in the EU ETS. The European Council furthermore gave strategic guidance on several issues regarding the implementation of the emission reduction target, namely free allocation to industry, the establishment of a modernisation and an innovation fund, optional free allocation of allowances to modernise electricity generation in some Member States.

The strategic guidance given by European leaders on these elements will be translated into a legislative proposal to revise the EU ETS for the period post-2020. This constitutes an important part of the work on the achievement of a resilient Energy Union with a forward looking climate change policy, which has been identified as a key policy area in President Juncker's political guidelines for the new Commission.

The purpose of the present stakeholder consultation is to gather stakeholders' views on these elements. This consultation focuses on issues not yet addressed in the consultations recently conducted for the 2030 Impact Assessment[2], the Impact Assessment for the carbon leakage list for 2015-2019[3] and the consultation conducted on post-2020 carbon leakage provisions[4].

In order to take stock of the EU ETS (established by Directive 2003/87/EC) as a policy measure, this consultation also contains questions concerning the general evaluation of this policy measure. The questionnaire consists of 7 chapters. You are invited to answer questions on the chapters which are relevant to you.

0. Registration

0.1. What is your profile?*

- Business
- A small and medium enterprise
- Trade association representing businesses
- SME business organisation
- Government institution/regulatory authority
- Academic/research institution
- Non-governmental organisation
- Citizen
- Other

0.2. Please enter the name of your business/organisation/association etc.:

Carbon Market Watch / Nature Code

0.3. Please enter your contact details (address, telephone, email):*

Carbon Market Watch Nature Code - Centre of Development & Environment
Rue d'Albanie 117 B-1060 Brussels, Belgium Tel 32 2 335 36 66 email:
info@carbonmarketwatch.org

0.4. If relevant, please state if the sector/industry you represent falls under the scope of the EU

ETS:*

- yes
- no
- not relevant

Please explain:

Carbon Market Watch is an environmental NGO

0.5. If relevant, please state what sector your represent:*

- Energy-intensive industry
- Energy sector
- Other

Please specify:

Carbon Market Watch is an environmental NGO

0.6. The results of this stakeholder consultation will be published unless stated otherwise. Can we include your replies in the publication?*

- yes
- no
- partially

0.7. Register ID number (if you/your organisation is registered in the Transparency register):

7536524855990

1. Free allocation and addressing the risk of carbon leakage

The European Council has concluded that free allocation to prevent the risk of carbon leakage should not expire as foreseen in the current legislation, but should continue also after 2020 as long as there are no comparable efforts to reduce emissions in other major economies.

Extensive stakeholder consultation was already carried out on the post-2020 carbon leakage provisions, as well as on aspects related to innovation support. The process included three full-day stakeholder meetings (June, July and September 2014) and a written consultation conducted for 12 weeks (8 May – 31 July, 2014). The written consultation covered 23 multiple choice questions with space for motivations, and a question allowing respondents to bring up any other issue they felt was important or insufficiently covered.

The documents and minutes of the meetings, as well as the submissions and the analysis thereof in the case of the written consultation, are available on the Commission website.

Information from the stakeholder meetings:

http://ec.europa.eu/clima/events/articles/0090_en.htm

http://ec.europa.eu/clima/events/articles/0095_en.htm

http://ec.europa.eu/clima/events/articles/0097_en.htm

Replies and summary of the written consultation:

http://ec.europa.eu/clima/consultations/articles/0023_en.htm

The results of the above mentioned public consultation are being taken into account in the preparation of the legislative proposal. In order to reduce the administrative burden for stakeholders and the Commission, the present consultation focuses on issues not already covered in this recently finalised public consultation. Respondents are nevertheless invited to add to the replies provided in the earlier consultations if deemed necessary in the light of the conclusions of the European Council in this area.

1.1 The European Council called for a periodic revision of benchmarks in line with technological progress. How could this be best achieved in your view and, in particular, which data could be used to this end? How frequently should benchmarks be updated, keeping in mind administrative feasibility?

4,500 character(s) maximum

The benchmarks should be updated as often as possible and at least every 5 years, so as to reflect technological progress and ensure that any free allocation is based on the most up-to-date information. It is important that the benchmarks are based on the best performing installations in the world, to avoid green job leakage. By subsidizing industry for their pollution (=free allocation), European industry is at risk of falling behind in deploying low-carbon and state-of-the-art technologies compared to their competitors abroad. Basing the benchmarks on the best performing installations in the world, instead of just Europe, can help ensure that European installations receive an incentive to keep up with their global competitors. Currently, the most efficient cement production occurs in Asia, particularly in India and China for example.

In order to preserve the incentives for industry to innovate, the benchmarks should be annually adjusted by a pre-determined improvement factor, in line with the reduction of the overall emission ceiling. This ensures that all sectors covered by the EU ETS contribute to the decarbonisation of Europe's economy.

1.2 The European Council has defined guiding principles for the development of post-2020 free allocation rules which provide inter alia that "both direct and indirect costs will be taken into account, in line with the EU state aid rules" and that "the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage" while "incentives for industry to innovate will be fully preserved and administrative complexity will not be increased" and while "ensuring affordable energy prices". Do you have views how these principles should be reflected in the future free allocation rules?

4,500 character(s) maximum

We advocate for full auctioning as it is the most cost-efficient, simplest, fairest and most transparent way to allocate emission allowances. It generates revenues to support climate policies in the EU and abroad. Auctioning is also the easiest way to reduce administrative complexity and preserve incentives for industry to innovate and prevents over-allocation of free allowances to industrial sectors.

Studies have shown that so far there is no evidence for the occurrence of carbon leakage due to carbon costs. A recent academic paper from the London School of Economics highlights that even a ten-fold increase in the carbon price, while increasing energy prices by 30%, will have negligible impacts on trade patterns and carbon leakage. In other words, it is extremely unlikely that European installations will face undue carbon costs that lead to carbon leakage in the foreseeable future.

On the other hand, by (over)subsidizing industry for its pollution, industry is receiving no incentives to innovate. By receiving an overgenerous amount of free allocation, often much more than needed to cover industry's emissions, there is practically no price signal for European industry to become more efficient. As a result, in the steel sector the European installations often perform worse than the global average.

Any exemptions from full auctioning for specific sub-sectors need to be based on ex-post, verified information by independent research, for example based on the historical cost pass through rates and the historical carbon price. In any case, sectors should not be subsidized for the carbon costs that they can pass through to their customers to avoid overcompensation.

It is essential that the cross-sectoral correction factor remains a key element in the ETS directive, in order to safeguard the auctioning revenues of Member States and establish a fair distribution of the decarbonisation effort across sectors.

1.3 Should free allocation be given from 2021 to 2030 to compensate those carbon costs which sectors pass through to customers? How could free allocation be best determined in order to avoid windfall profits?

4,500 character(s) maximum

Full auctioning of allowances is the most reliable way to guarantee that windfall profits are avoided. Allowances are a public good because they represent rights to pollute. If they are given away to industry for free, they in fact represent an industry subsidy at the cost of citizens since free allocation means a significant loss of auctioning revenues to EU Member States. In the 2013-2020 period, free allocation represented an industry hand-out worth about €55 billion. To maintain the credibility of the EU ETS, the polluter pays principle should be respected and free allocation phased out.

Customers are financially compensating industry's pollution, because sectors have the ability, to a greater or lesser extent, to pass through the market price of free allocations to their consumers. This has resulted in windfall profits for heavy industry in the order of billions of euros. Windfall profits can be avoided if industrial installations are not compensated for the carbon costs that they managed to pass through to customers. This can be done by "dynamically" allocating free allowances based on an ex-post analysis of the cost pass through rates of sectors. If a sector was able to pass through an average of 70% of the carbon costs to customers for example, it should not receive more than 30% of the benchmark for free. Since customers already paid for the remainder 70% of the sector's carbon costs, the sector would otherwise accrue windfall profits.

1.4 Are there any complementary aspects you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

4,500 character(s) maximum

2. Innovation fund

The European Council has concluded that 400 million allowances in 2021 to 2030 should be dedicated for setting up an innovation fund to support demonstration projects of innovative renewable energy technologies, carbon capture and storage (CCS) as well as low carbon innovation in industrial sectors. To make this fund operational, a legal basis has to be created in the EU ETS Directive while further implementation modalities can be set out in secondary legislation. The work can build on the experience with the existing "NER300" programme which made available 300 million allowances for CCS and innovative renewable energy technologies[1].

With regard to establishing a legal basis for the innovation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:

2.1 Do you see reasons to modify the existing modalities applied in the first two calls of the NER300? Are there any modalities governing the NER 300 programme which could be simplified in the design of the innovation fund? If you see the need for changes, please be specific what aspects you would like to see changed and why.

4,500 character(s) maximum

We do not propose changes at this moment.

2.2 Do you consider that for the extended scope of supporting low-carbon innovation in industrial sectors the modalities should be the same as for CCS and innovative renewable energy technologies or is certain tailoring needed, e.g. pre-defined amounts, specific selection criteria? If possible, please provide specific examples of tailored modalities.

4,500 character(s) maximum

The selection criteria should be set in such a way so as to prioritise investment in energy efficiency improvements and renewable energy. Support for CCS innovations should be limited to industrial applications only, excluding CCS for energy production, since in industrial processes it is much more difficult to replace fossil fuel use with renewable energy. The fund should also support social innovations to train the skills needed in the transition to a climate friendly economy.

2.3 Are there any complementary aspects regarding innovation funding you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

4,500 character(s) maximum

The innovation fund should focus on technologies that have the potential to decarbonise our economy in a sustainable way. Almost half of the NER300 funding has so-far benefitted bio-energy projects. While advanced bioenergy projects can be sustainable, their potential is limited to the amount of sustainable feedstock available. Meanwhile, there are still several unsolved issues around the EU policy on bioenergy including a lack of sustainability criteria for non-liquid biomass. Strong safeguards including sustainability criteria for gas and solid biomass and ILUC factors have to be put in place to ensure that bio-energy projects reduce greenhouse gas emissions and are sustainable in the long-term. Without these safeguards, the innovation fund should prioritise other technologies that are more sustainable.

3. Modernisation fund

The European Council has concluded that 2% of the total EU ETS allowances in 2021 to 2030 should be dedicated to address the particularly high investment needs for Member States with GDP per capita below 60% of the EU average. The aim is to improve energy efficiency and to modernise the energy systems of the benefitting Member States. The fund should be managed by the beneficiary Member States, with the involvement of the European Investment Bank (EIB) in the selection of projects. To make this fund operational, a legal basis has to be created (in the EU ETS Directive), while further implementation modalities can be set out in secondary legislation.

With regard to establishing a legal basis for the modernisation fund as part of the revision of the EU ETS Directive, the Commission seeks feedback on the following questions:

3.1 Implementation of the modernization fund requires a governance structure: What is the right balance between the responsibilities of eligible Member States, the EIB and other institutions to ensure an effective and transparent management?

4,500 character(s) maximum

The European Investment Bank should become responsible for the project selection process to ensure that the Modernization Fund prioritises investments that support the EU's transition to a low-carbon economy. Strong involvement of the EIB helps to attract private funding to co-finance the selected projects, increase transparency and ensure a level-playing field for projects and Member States eligible to access the Modernization Fund.

At the same time, it is crucial that all EU Member States are involved in the governance of the Fund, in order to ensure that the money is efficiently used. This is important since the fund reduces the amount of allowances that all EU Member States can auction, thereby reducing their auctioning revenues. The Board of the EIB consists of one director nominated by each Member State and one by the European Commission and therefore transferring the governance of the fund to the EIB is also in line with the European Council conclusions.

Eligible Member States have the responsibility to submit a list of projects that meet the eligibility criteria, accompanied by environmental impact assessments for each of these projects.

Given its experience in the management and implementation of the NER300 programme, the European Commission should also play an important role in the fund's governance. The Commission should be responsible for the overall management (including the development of the eligibility criteria for projects) and the monitoring and verification of the projects' implementation. Moreover, the European Commission should assess whether project proposals submitted by Member States are in line with their 2050 low-carbon strategies and the EU's 2030 and 2050 climate and energy objectives. Such assessments would have to be taken into account by the EIB in the project selection process.

3.2 Regarding the investments, what types of projects should be financed by the modernisation fund to ensure the attainment of its goals? Should certain types of projects be ineligible for support?

4,500 character(s) maximum

There should be clear funding criteria guiding the functioning of the Modernization Fund that ensure a rapid transition away from fossil fuel use. These criteria need to ensure that no funding will be provided to fossil fuel projects, while priority should be given to projects promoting energy savings and the uptake of renewable energy. Such criteria can build upon the criteria the EIB already has in place to select projects in their climate and energy portfolio.

The Modernisation Fund should only support investments in energy efficiency and renewable energy, focusing on improving energy savings in the building sector (building renovations including refurbishment of public buildings), decentralised power and heat production (facilitating the participation of consumers in the energy market), grid connections (smart grids, super-grids) and storage infrastructure enabling further uptake of renewables.

On the other hand, projects related to coal-fired power generation (refurbishment, modernisation, life extension, biomass co-firing) should be ineligible for support as they are incompatible with the EIB's lending criteria and the EU's long-term decarbonisation target because these projects lead to a "carbon lock-in" in high emitting infrastructure.

3.3 Should there be concrete criteria [e.g. cost-per-unit performance, clean energy produced, energy saved, etc.] guiding the selection of projects?

4,500 character(s) maximum

There should be strict and transparent criteria guiding the selection of projects which need to be developed through an open consultation with stakeholders. The criteria should prioritise energy savings, the use of sustainable renewable energy and the reduction of costs for sustainable renewable energy technologies. The criteria should build upon and expand from the most recent EIB lending criteria for energy investments, including using an Emissions Performance Standard for power plants.

3.4 How do you see the interaction of the modernisation fund with other sources of funding available for the same type of projects, in particular under the optional free allocation for modernisation of electricity generation (see section 4 below)? Would accumulation rules be appropriate?

4,500 character(s) maximum

Accumulation rules should be appropriate, but only as long as projects contribute to deliver on the EU's climate objectives, are compatible with binding eligibility criteria, a framework of the EU's state aid rules and other relevant legislation.

If the same project is funded from two separate sources (the modernisation fund and funding under the optional free allocation for modernisation of electricity generation), it would be necessary to very precisely indicate and report which part of the investment is carried out with funding acquired from free allocation of allowances under Art. 10c and which part is funded with financial means from the Modernisation Fund.

3.5 Do you have views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. national climate programmes, and plans for renewable energy and energy efficiency)?

4,500 character(s) maximum

The forthcoming 2030 governance process should also establish a set of binding and strict rules for the management of the Modernization Fund (including the eligibility criteria and rules allowing timely and accurate monitoring of the progress in projects' implementation).

The selected projects need to be compatible with the revised energy efficiency and renewable energy directive and enable the transition to an efficient 100% renewable based energy system. Member States should only be allowed to access the fund after full and correct transposition of the EU's climate and energy legislations.

Benefitting Member States should adopt ambitious and binding low-carbon strategies, outlining their contribution to reach the EU's objective of 80-95% emission reductions by 2050. The strategies would have to be approved by the Commission before any funding is granted to projects in the respective Member States.

3.6 Should the level of funding be contingent on concrete performance criteria?

4,500 character(s) maximum

The level of funding should be contingent on concrete and transparent performance criteria that were developed through an open consultation with stakeholders. No funding should be provided for projects that either increase greenhouse gas emissions or support coal generation.

4. Free allocation to promote investments for modernising the energy sector

The conclusions of the European Council provide for the continuation after 2020 of the mechanism foreseen in Article 10c of the EU ETS Directive, which allows some Member States to opt to hand out free allowances to power plants in order to promote investments for modernising the energy sector. The current Article 10c modalities, including transparency, should be improved to promote investments modernising the energy sector, while avoiding distortions of the internal energy market.

With a view to reviewing and improving the current modalities as part of the revisions to the EU ETS Directive, the Commission seeks feedback on the following questions:

4.1 How can it be ensured that investments have an added value in terms of modernising the energy sector? Should there be common criteria for the selection of projects?

4,500 character(s) maximum

The continuation of free allowances to power plants can distort intra-EU competition and endanger the achievement of EU's long-term decarbonisation objective. It is clear that the preferred approach is to ensure that all power producers in the EU buy 100% of their allowances at auction from 2020 onwards.

So far, the investments did not have an added value in terms of modernising the energy sector, since they failed to support the transition away from fossil fuels. By the end of 2012, the European Commission had approved almost 680 million allowances to be handed out for free to power producers from 2013 to 2019. The corresponding investments to promote modernising the energy sector should amount to around €12 billion.

According to European Commission recommendations, Member States' modernisation investments should aim at eliminating the need to make use of the Article 10c derogation in the future. However, the requirements for power sector modernisation were hindered by unclear language in the Directive. The result was that in Poland, the largest beneficiary, and in Romania, the third largest beneficiary of Article 10c, the overwhelming majority of investments benefit existing or new fossil fuel capacity, hampering the transition to a low-carbon economy.

The current experience with Article 10c shows the need for common, binding criteria for the selection of projects to promote investments that support the EU's progress towards power sector decarbonisation.

Eligible Member States should furthermore only be allowed to allocate free allowances to power plants in line with an increasingly strict CO₂ Standard. This can help support fuel switching from more to less polluting forms of energy generation, by ensuring that the power sectors in these countries are not completely exempted from a carbon price signal.

To guarantee that investments have an added value in terms of modernising the energy sector, the following strict and binding criteria should be applied for the selection of projects:

- Projects for fossil fuel capacity, especially coal power plants, should not be eligible.
- Carbon capture and storage (CCS) and nuclear power generation (including extension of the lifetime of existing nuclear plants) should not be eligible.
- Projects should reduce greenhouse gas emissions within the derogation period and should not lead to a high-carbon infrastructure lock-in.
- Projects must be additional to currently planned investments and need to be built in the country where installations are being granted free allowances. Investments identified in the national plan should be additional to investments that are necessary to comply with other objectives or legal requirements accruing from Union law (for instance, the IED BREF standards).

4.2 How do you see the interaction of the free allocation to energy sector with other sources of funding available for the same type of projects, e.g. EU co-financing that should be made available for the projects of common interest under the 2030 climate and energy framework? Would accumulation rules be appropriate?

4,500 character(s) maximum

Accumulation rules should be appropriate, but only as long as projects contribute to deliver on the EU's climate objectives, are compatible with binding eligibility criteria, a framework of the EU's state aid rules and other relevant legislation.

If the same project is funded from two separate sources (the modernisation fund and funding under the optional free allocation for modernisation of electricity generation), it would be necessary to very precisely indicate and report which part of the investment is carried out with funding acquired from free allocation of allowances under Art. 10c and which part is funded with financial means from the Modernisation Fund.

4.3 Do you have any views how the assessment of the projects should be reflected in the forthcoming 2030 governance process (e.g. as regards improving transparency)?

4,500 character(s) maximum

Adequate public participation is crucial to help ensure that investments have an added value in terms of modernising the energy sector. The investments should be compatible with EU legislation, in line with the Member State's low-carbon strategy and enable the transition to an efficient 100% renewable based energy system.

An open consultation procedure on the national investment plans should be made obligatory. These consultations should take place both on the national and on the EU level. The comments raised by stakeholders during each public consultation should be taken into account when decisions on the investments plans are made.

4.4 The maximum amount of allowances handed out for free under this option is limited. Do you think eligible Member States should use the allowances for a period of time specified in advance (e.g. per year), or freely distribute them over the 2021-2030 period? (Please explain your motivation.)

4,500 character(s) maximum

Eligible Member States should only be allowed to allocate free allowances to power plants in line with increasingly strict CO2 emissions limits. The share of allowances that eligible Member States can freely allocate needs to decline annually in a linear manner down to 0% in 2030. From 2030 onwards, Member States should not be allowed to hand out free allowances to their power sector anymore.

4.5 Should there be priorities guiding the Member States in the selection of areas to be supported?

- yes
 no

If so, which of the following areas, if any, currently supported through investments for modernisation of electricity generation up to 2020 should be prioritised for support up to 2030 and why?

- Interconnectors
 Smart Grids
 Super-critical coal
 Gas
 Renewable energy
 Energy storage
 Energy efficiency
 Other (please elaborate)

Please explain in detail:

4,500 character(s) maximum

All modernisation investments must contribute to reach the EU's objective of 80-95% emission reduction by mid-century and aim for diversification of countries' energy mixes away from fossil fuels (applicable both to the National Plan as a whole, but also to each investment individually). Projects in the national plan should only refer to electricity generation from sustainable renewable energy sources, projects related to grid development to enable optimal integration of renewable energy, and improving energy efficiency in non-ETS sectors. Investments in coal-fired generation should be strictly forbidden, as they are incompatible with the EU's 2050 decarbonisation target.

4.6 How can improved transparency be ensured with regard to the selection and implementation of investments related to free allocation for modernisation of energy? In particular regarding the implementation of investments, should allowances be added to auctioning volumes after a certain time period has lapsed in case the investment is not carried out within the agreed timeframe?

4,500 character(s) maximum

All information about the implementation of the mechanism of free allocation to promote investments in modernising the energy sector should be publicly available and published. During the process of selecting investments, the Commission should take information and views from stakeholders into account. All investments that are submitted to the Commission selection should be accompanied by an environmental impact assessment per project.

Each investment should indicate the year of its completion. In case an investment is not carried out within the agreed timeframe, the corresponding allowances should be added to the auctioning volumes.

5. SMEs / regulatory fees / other

In order to allow taking stock of the EU ETS aspects beyond those examined by the European Council, respondents are also invited to provide feedback on certain other questions.

The Commission ensures that better regulation principles govern all of the policy work, including that the specificities of small and medium sized enterprise (SMEs) are taken into due consideration. Member States can exclude certain small installations from the EU ETS in the current trading period (2013-2020) if taxation or other equivalent measures are in place that will cut their emissions. If such a possibility was to be reviewed, a legal basis would have to be created in the EU ETS Directive.

The accurate accounting of all emission allowances issued is assured by a single Union Registry with strong security measures. The operations were centralised in a single Registry operated by the Commission, following a revision of the ETS Directive in 2009. This has replaced Member States' national Registries. Despite the considerable resources from the EU budget required for maintaining the EU Registry, as does supporting work on auctioning, the Commission does not have the possibility to charge any fees. However, Member States administrators may still charge Registry fees to account holders administered by them. There are discrepancies in fees across different Member States.

5.1 Are there any EU ETS administrative requirements which you consider can be simplified? Do you see scope to reduce transaction costs, in particular for SMEs? If yes, please explain in detail.

4,500 character(s) maximum

We do not have comments on this issue for the time being.

5.2 Member States had the possibility to exclude small emitting installations from the EU ETS until 2020. Should this possibility be continued? If so, what should be the modalities for opt-out installations to contribute to emission reductions in a cost-effective and economically efficient manner? Should these be harmonised at EU level?

4,500 character(s) maximum

We do not have comments on this issue for the time being.

5.3 How do you rate the importance of a high level of security and user-friendliness of the Union Registry? Do you think the costs for providing these services should be covered via Registry fees?

4,500 character(s) maximum

We do not have comments on this issue for the time being.

**5.4 Do you consider discrepancies in Registry fees in different Member States justified?
Should Registry fees be aligned at EU level?**

4,500 character(s) maximum

We do not have comments on this issue for the time being.

5.5 Under the current EU ETS Directive, at least 50% of the revenues generated from the auctioning of allowances should be used by Member States for climate-related purposes. For the calendar year 2013 Member States have reported to have used or to plan to use 87 % on average to support domestic investments in climate and energy. Do you consider the current provisions regarding the use of the revenues adequate for financing climate action? If not, please explain why?

4,500 character(s) maximum

The current reporting obligations are a step in the right direction to see how Member States deliver on their political commitment to using at least 50% of their auctioning revenues for climate-related purposes. However, the reports of the Member States lack consistency in accounting rules and often fail to provide details on the nature of the investments. Some Member States even failed to provide information on how they spent their auctioning revenues.

All ETS auctioning revenues should be recycled to support climate policies, both inside the EU and globally. Recycling auctioning revenues for renewable and energy saving technologies can create a virtuous cycle where application of the “polluter pays” principle can support investments in the tools needed for further decarbonisation. At the same time, EU countries have committed themselves to deliver climate finance to developing countries, including the commitment made at the UN climate summit in Copenhagen to mobilise an annual \$100 billion by 2020.

The reporting obligations under the Monitoring Mechanism Regulation should be strengthened to make earmarking mandatory for 100% of the revenues. The reporting should include detailed reporting on which policies, projects, technologies have been supported, the costs and co-benefits of these policies etc. This can enable an exchange of information across Member States and allow for the sharing of best practises, thereby increasing the effectiveness of revenue spending.

Regarding EU’s commitment to help meet the financial needs of developing countries to deal with climate change, auctioning revenues have the potential to provide a reliable and significant revenue stream. A share of the total EU ETS allowances should be earmarked at EU-level for international climate finance. The revenues resulting from the auctioning of these allowances should be directly channelled to the Green Climate Fund for mitigation and adaptation actions in developing countries. Member States would then be able to report these additional flows of climate finance as supplementary to their own budgetary climate finance contributions, applying the ETS distribution key.

6. General evaluation

**6.1 How well do the objectives of the EU ETS Directive correspond to the EU climate policy objectives?
How well is the EU ETS Directive adapted to subsequent technological or scientific changes?**

4,500 character(s) maximum

To date the EU ETS has failed to deliver on its objectives. It has failed to address the urgency and scale of the impending climate crisis and has been out of sync with the recommendations by the scientific community for many years.

The EU ETS will only drive emission cuts if the surplus of emission allowances is permanently addressed. Although important, the Market Stability Reserve will not provide a permanent solution to the surplus of EU ETS allowances, which may grow over 4 billion by 2020. It only temporarily removes allowances and returns them to the market over time. Instead, surplus allowances need to be permanently cancelled as they weaken future climate targets and undermine an adequate pollution price signal. Legislation that ensures the cancellation of surplus allowances is absolutely vital.

The increase in the linear reduction factor to 2.2% from 2021 onwards, as endorsed by the European Council in October 2014, is not in line with the EU's low-carbon roadmap to achieve 80%-95% reductions by mid-century. The linear reduction factor needs to be higher to bring the EU ETS on a cost-effective reduction path up to 2050.

Fixing the LRF to 2.2% also closes the door to an increase in EU's climate ambition, even though the Council called for more ambition when deciding on an "at least" 40% emission reductions target. In its impact assessment for the post-2020 review of the ETS directive, the Commission must reflect the "at least" 40% target and assess scenarios with an LRF higher than 2.2% which are in line with EU's cost-effective pathway to the 2050 objective.

In order to have reasonable chance to keep global temperature rise below 2°C as compared to pre-industrial levels, the EU will need to reduce its emissions by at least 95% by 2050. To achieve this upper end of the 2050 target agreed by EU leaders in 2009, a linear reduction factor of at least 2.6% should be adopted.

6.2 What are the strengths and weaknesses of the EU ETS Directive? To what extent has the EU ETS Directive been successful in achieving its objectives to promote emission reductions in a cost-effective manner compared to alternatives, e.g. regulatory standards, taxation?

4,500 character(s) maximum

The EU ETS has failed to provide any meaningful price signal to reduce EU greenhouse gas emissions. The accumulation of an enormous oversupply of pollution permits has dropped the price for allowances so significantly that the EU ETS cannot facilitate the transition towards a renewable and energy efficient economy. This was the result of a weak reduction target, the massive use of non-additional international offsets, and a static policy design without automatic adjustments if significant demand changes occur. This huge surplus of pollution permits is automatically carried-over to future trading periods and will thereby allow companies to emit more in the future. If the huge oversupply of pollution permits is not permanently cancelled, it could weaken EU's climate ambition for decades to come.

The EU ETS does not provide sufficient incentives for companies to invest in cleaner and more efficient production, risking a costly lock-in in carbon intensive infrastructure for years to come. The EU ETS must be reformed boldly if it is to become an effective climate policy instrument. Otherwise it will remain a toothless paper tiger that fails to drive the decarbonisation of EU's largest emitters.

Even with bold reforms, the EU ETS will not be able to decarbonise the EU by itself. Carbon pricing needs to be flanked by supplementary policies to fully realise its least-cost potential given known market barriers and imperfections. Technology support for renewable energy is needed in addition to carbon pricing to bring forward new mitigation options and reduce the costs for the long-term. Policies to unlock EU's cost-effective energy efficiency potential are also necessary, since the energy saving potential remains untapped even with a meaningful carbon price. In addition to nationally binding renewable energy and energy efficiency targets, complementary measures should include the adoption of an Emission Performance Standards for power plants and industrial installations as well as the possibility for Member States to unilaterally cancel surplus allowances.

These policy tools need to be designed to complement each other and work synergistically. This way, a substantially reformed EU ETS can play an important part in EU climate mitigation policy.

6.3 To what extent are the costs resulting from the implementation of the EU ETS Directive proportionate to the results/benefits that have been achieved, including secondary impacts on financing/support mechanisms for low carbon technologies, administrative cost, employment impacts etc.? If there are significant differences in costs (or benefits) between Member States, what is causing them?

4,500 character(s) maximum

Empirical evidence shows that there is no evidence of carbon leakage as defined by the EU ETS directive. This empirical evidence is confirmed by shareholders in certain energy intensive companies, who concede that the ETS has not been a significant factor in the context of competitiveness concerns, even when carbon prices reached €25/tCO₂.

On the other hand, some observers have warned of the risk of “green job leakage” i.e. clean tech firms moving overseas because Europe fails to set out ambitious climate change policies that would increase the demand for their low-carbon products and solutions. The EU ETS currently does not provide an adequate price signal to give “green” companies, which produce more efficiently or have deployed low-carbon technologies, a competitive advantage over their competitors.

6.4 How well does the EU ETS Directive fit with other relevant EU legislation?

4,500 character(s) maximum

In theory, the EU ETS directive fits well with other relevant EU legislation, including nationally binding targets to increase the share of renewables in the energy mix and the Energy Efficiency Directive. As the International Energy Agency writes in its "Summing up the parts" report, these supplementary policies are needed in addition to carbon pricing to realize EU's cost-effective mitigation potential.

In practise however, the EU ETS directive currently does not fit well with the EU's renewable and energy efficiency policies, since the climate ambition of the EU ETS is too low to capture the impact of emission reductions stemming from the renewable energy and energy efficiency directives. These inconsistencies need to be taken up in the revision of the EU ETS Directive by adjusting the linear reduction factor upwards from the current 1.74% to at least 2.6% as soon as possible.

6.5 What is the EU value-added of the EU ETS Directive? To what extent could the changes brought by the EU ETS Directive have been achieved by national measures only?

4,500 character(s) maximum

European companies operate on the EU's internal market in which there is free movement of goods and services. It is therefore important to have a system that internalizes the negative externalities of carbon pollution at a common minimum level in all Member States. Member States should however be free to go beyond the minimum level, for example by establishing an auctioning reserve price or through the unilateral cancellation of allowances. These national measures that speed up the transformation to a modern, low-carbon economy should be encouraged at the EU-level.

In general terms, the EU ETS has not responded well to the urgency of the climate crisis which is why solutions at Member State level are needed to make up for the lack of a European carbon price signal. Unfortunately, this is likely to happen in an uncoordinated way, leaving business and investors in a far more difficult position to operate in an EU with an uneven playing field.

6.6 Do you have any other comment on the revision of the EU ETS Directive that you would like to share?

4,500 character(s) maximum

Legislation that ensures the cancellation of surplus allowances is absolutely vital, since the huge oversupply of emission allowances weakens future climate targets and undermines the effectiveness of the EU ETS in delivering an adequate pollution price signal. The revision of the EU ETS Directive needs to ensure that all unused allowances (from the reserve of new entrants and from closures and partial cessations) are automatically cancelled at the end of each trading period. The revision must also ensure that there is an automatic mechanism to permanently cancel allowances if the surplus is particularly high. In addition, EU Member States should be allowed to unilaterally cancel allowances from their auctioning volumes.

Emissions from aviation and shipping pose a great challenge for EU climate policy as international emissions from both sectors are expected to grow by up to 250% by 2050, jeopardizing the climate efforts of the other sectors in the economy.

International aviation is currently exempt from fuel taxation and VAT and, unlike other travel modes, not subject to any fuel efficiency standards. Intra-EU and domestic aviation are included in the EU ETS, while international flights are temporarily suspended from the ETS until 2016 to allow time for negotiations on an effective global market-based measure applying to aviation emissions. Unfortunately, the International Civil Aviation Organization (ICAO)'s goal of carbon neutral growth post-2020 is completely insufficient and falls far short of the EU's at least 40% reduction target that applies to other sectors of the EU's economy. In case the 2016 ICAO Assembly does not propose more adequate policies to reduce emissions from international flights, the EU ETS directive must cover the emissions from international flights arriving in or departing from European airports from 2017 onwards.

Shipping is the only sector of the European economy without a binding reduction target, despite previous commitments that all sectors of the economy, including international maritime shipping, should contribute to achieving emission reductions. Without additional policies to reduce shipping's climate impact, European maritime transport activities are expected to increase by 15% in 2030 and by 40% in 2050. The EU should therefore explore options how to deliver adequate emission reductions from the shipping sector as part of the EU's at least 40% reduction target. The impact assessment accompanying the revision of the EU ETS directive should include scenarios how to integrate shipping emissions into the EU ETS.

Road fuels on the other hand should remain outside the scope of the EU ETS as inclusion undermines much more effective policies such as

standards for vehicle efficiency and clean fuels, while road transport mitigation requires a very high carbon price to deliver the same effect.

Under the EU ETS directive, the use of biomass is rated as having zero emissions. This could be a false assumption since burning biomass increases the amount of carbon in the air, just like burning fossil fuels, if harvesting the biomass decreases the amount of carbon stored in plants and soils, or reduces ongoing carbon sequestration. The carbon-neutrality assumption of biomass under the EU ETS should therefore be abolished and only applied to biomass that complies with new sustainability criteria for solid and gaseous biomass. A similar approach as for bio-liquids under the EU ETS should be followed for which sustainability criteria already exist.

Contact

✉ CLIMA-ETS-STRUCTURAL-MEASURES@ec.europa.eu
