The EU Emissions Trading System

The Linear Reduction Factor and the Auctioning Share

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After Paris, what’s next?

The Paris agreement aims to strengthen the global response to the threat of climate change by:

“pursue[ing] efforts to limit the temperature increase to 1.5°C above pre-industrial levels”

However, the EU targets are not calibrated to limit global temperature to below 1.5°C

The EU ETS ambition needs ratcheting up to be in line with the new Paris agreement:

- Implementing the 1.5°C goal by changing the Linear Reduction Factor
- Enhancing action prior to 2020 by cancelling surplus emission allowances
- Operationalizing the 5-year cycles by adopting 5-year ambition periods
- Recognizing the climate efforts of other countries by updating the carbon leakage provisions
The Linear Reduction Factor (LRF) sets the level of ambition in the EU ETS

The EU ETS proposal increases the LRF to 2.2% from 2021 onwards:

✓ In line with the EU’s 2030 climate target of 40% reductions

X Not in line with the EU’s 2050 objective of 80%-95% reductions (for <2°C)

The Commission’s 2030 Impact Assessment notes:

“This [2.2%] linear reduction factor would not decrease the ETS cap by 2050 to -90% compared to 2005 but rather to -84%. A 90% reduction was the average reduction projected for the Roadmap for moving towards a competitive low carbon economy in 2050. In order to set the cap equal to this level in 2050 the linear reduction factor in the ETS would need to further increase to -2.4% until 2050.”
The EU ETS currently not a driver for emission reductions post-2020

• According to Sandbag projections, by 2020 EU ETS emissions are reduced by 38% compared to 2005.
• With an LRF of 2.2%, by 2030 the EU ETS emissions would need to be reduced by 43% compared to 2005.

In other words, in principle the EU ETS emissions will need to decline by a mere 0.5% annually in the 2021-2030 period from the projected 2020 starting point.

... is this enough for the ETS to be the main European instrument to achieve the EU’s climate targets?
# Bringing the EU ETS in line with the 1.5°C goal

<table>
<thead>
<tr>
<th>LRF</th>
<th>In line with 80% - 95% reductions?</th>
<th>Decarbonisation of EU ETS sectors by</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2%</td>
<td>No</td>
<td>2058</td>
</tr>
<tr>
<td>2.4%</td>
<td>Yes but only for 80% reductions</td>
<td>2055</td>
</tr>
<tr>
<td>2.6%</td>
<td>Yes</td>
<td>2052</td>
</tr>
<tr>
<td>2.8%</td>
<td>Yes</td>
<td>2050</td>
</tr>
<tr>
<td>4.2%</td>
<td>Yes</td>
<td>2040</td>
</tr>
<tr>
<td>5%</td>
<td>Yes</td>
<td>2037</td>
</tr>
<tr>
<td>6%</td>
<td>Yes</td>
<td>2034</td>
</tr>
</tbody>
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The LRF needs to be raised to at least 4.2% in order to decarbonize the power and industry sector by 2040 the latest*

*It is more cost-effective to fully decarbonize the power + industry sectors as soon as possible [full decarbonisation is more expensive / difficult in e.g. the transport or agriculture sector in the short term]*
Moving beyond 20% reductions by 2020

The EU’s 2020 target has already been met today
- EEA (2015) shows that in 2014, GHG emissions were already cut by 23%
- Sandbag shows the EU is on track for 30% reductions by 2020

The EU can and should capitalize on this overachievement
- If not, the EU risks undermining its future efforts as the surplus allowances can be used by companies to continue polluting

The EU’s conditions for increasing its offer to a 30% reduction by 2020 are fulfilled with the Paris agreement
- “provided that other developed countries commit themselves to comparable emission reductions and developing countries contribute adequately according to their responsibilities and respective capabilities”
Moving beyond 20% reductions by 2020 – getting rid of the extra pounds

By 2020, the surplus emission allowances in the EU ETS could equal up to 4.4 billion (Sandbag, 2015) ≈ equal to the EU’s total annual greenhouse gas emissions

The EU could move to a higher 2020 target by cancelling the around 2 billion surplus allowances that are in the Market Stability Reserve by the end of 2020
Auctioning versus free allocation – making the polluter pay or paying the polluter?

Disadvantages of free allocation:

- The polluter does not pay [or industries make windfall profits*]
- Less public revenues: auctioning revenues are reduced by $\approx 4\text{ billion}$ for every % point you auction less in phase four. These revenues could be used to support more investments in innovation and further decarbonisation
- Reduces the incentives of heavy emitters to invest in low-carbon technologies: the EEA (2015) projects that industry emissions will not decline from now until 2030

“[The EU ETS revision proposes to hand out 6.3 billion free allowances. If, instead, these allowances were auctioned, an additional $160 billion of climate finance could be mobilised and earmarked to fund breakthrough technologies in industrial sectors]”

- The share of allowances to be auctioned by Member States should be at least 57% and increase over time to 100%
- The 2% of total allowances set-aside for the Modernisation Fund should come on top of the 57% share

*if industries make consumers pay for non-existent carbon costs
Thank you!

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The evidence for carbon leakage

- **No evidence for production displacement** due to the EU ETS so far (Ecorys, 2013)

- **No evidence for future “carbon leakage” risk**: even a ten-fold increase in carbon price and 100% auctioning will have an “extremely limited” impact on trade (LSE study, 2015)

- **Many relocation destinations (will) have similar climate policies**: as almost 190 countries have agreed to take climate actions after 2020 + carbon markets are rolled out in China, South-Korea, California, Quebec..
Making the polluter pay or paying the polluter?

The EU ETS revision proposes to continue with many of the existing “carbon leakage” rules, including the hand-out of 6.3 billion free pollution permits in the post-2020 period.

≈ a subsidy of €160 billion to heavy emitters

Unequal carbon pricing places the EU manufacturing sector in general – and the cement sector in particular – at risk of carbon leakage

-Lafarge

LAFARGE HAS MADE €485 MILLION FROM THE EU ETS IN THE YEARS 2010 TO 2014

CLAIM
Quote by ArcelorMittal: “EU energy and climate policy is punishing the steel sector…”

FACT
ArcelorMittal has made over €400 million from the EU ETS over the last 5 years.

Stop subsidising pollution
Phase-out free ETS allowances

* FT (10/11/2014) “Liberated energy policy and re-industrialisation: Europe”
** ArcelorMittal’s annual reports 2009-2014, gains from selling excess carbon permits
On increasing the environmental integrity of the EU ETS [here]

On our carbon leakage recommendations [here]

On the impact of the Paris agreement [here]