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."***

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The Linear Reduction Factor determines how fast the emissions in the EU ETS decline each year.

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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

LRF	In line with 80% - 95% reductions?	Decarbonisation of EU ETS sectors by
2.2%	No	2058
2.4%	Yes but only for 80% reductions	2055
2.6%	Yes	2052
2.8%	Yes	2050
4.2%	Yes	2040
5%	Yes	2037
6%	Yes	2034

The LRF needs to be raised to at least 4.2% in order to decarbonize the power and industry sector by 2040 the latest*

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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]

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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

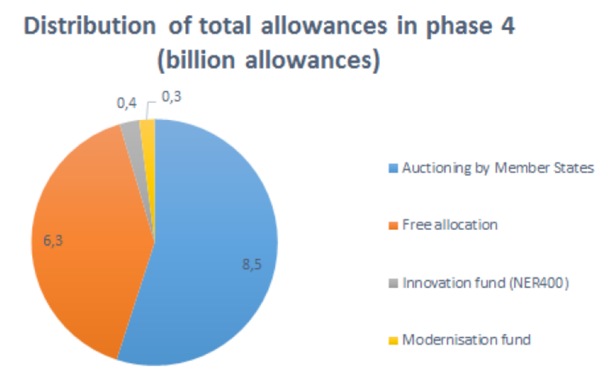
By 2020, the surplus emission allowances in the EU ETS could equal up to 4.4 billion (Sandbag, 2015) ≈ equal to the EU's total annual greenhouse gas emissions

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 ≈ **€4 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*

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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

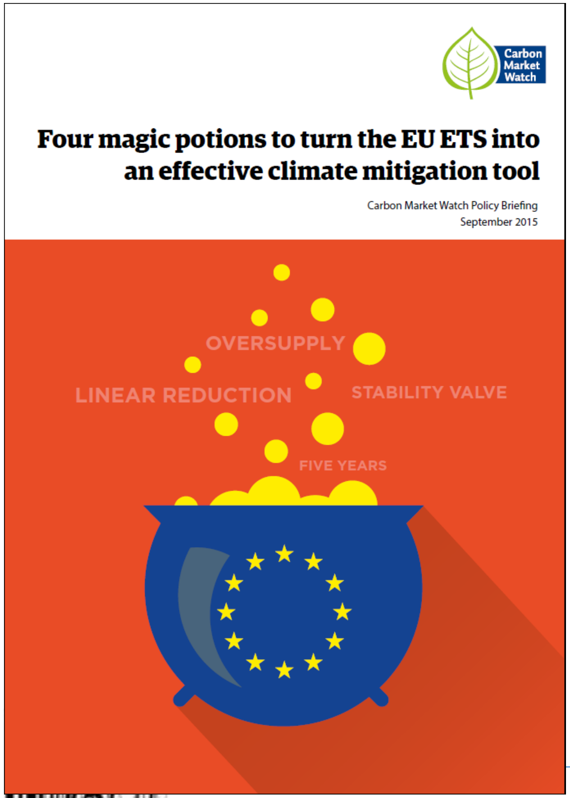
Read more …

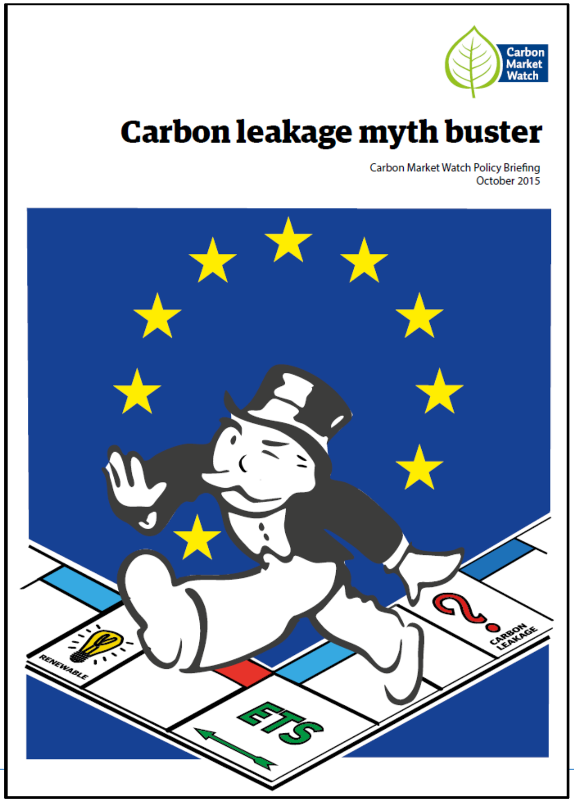
www.carbonmarketwatch.org

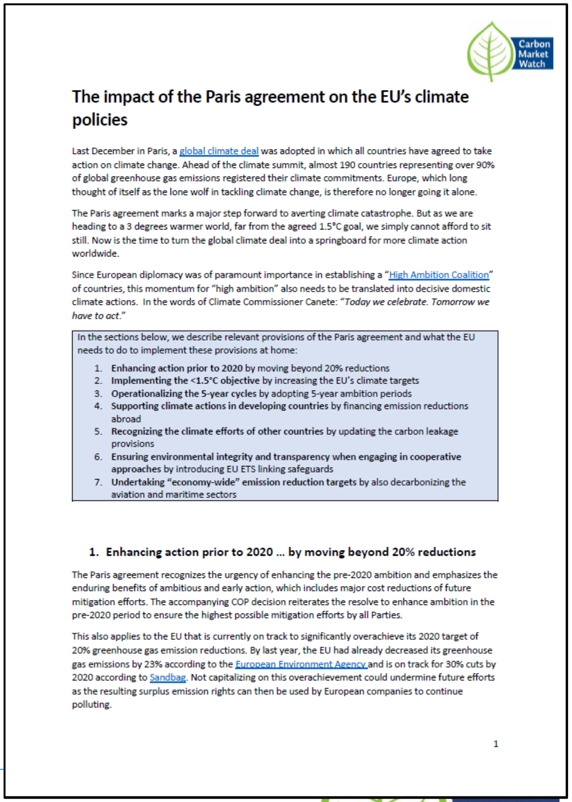
On increasing the environmental integrity of the EU ETS here

On our carbon leakage recommendations here

On the impact of the Paris agreement here







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The impact of the Paris agreement on the EU's climate policies

Last December in Paris, a global climate deal was adopted in which all countries have agreed to take action on climate change. Ahead of the climate summit, almost 190 countries representing over 90% of global greenhouse gas emissions registered their climate commitments. Europe, which long thought of itself as the lone wolf in tackling climate change, is therefore no longer going it alone.

The Paris agreement marks a major step forward to averting climate catastrophe. But as we are heading to a 3 degrees warmer world, far from the agreed 1.5°C goal, we simply cannot afford to sit still. Now is the time to turn the global climate deal into a springboard for more climate action worldwide.

Since European diplomacy was of paramount importance in establishing a "High Ambition Coalition" of countries, this momentum for "high ambition" also needs to be translated into decisive domestic climate actions. In the words of Climate Commissioner Canete: *"Today we celebrate. Tomorrow we have to act."*

In the sections below, we describe relevant provisions of the Paris agreement and what the EU needs to do to implement these provisions at home:

1. **Enhancing action prior to 2020** by moving beyond 20% reductions
2. **Implementing the <1.5°C objective** by increasing the EU's climate targets
3. **Operationalizing the 5-year cycles** by adopting 5-year ambition periods
4. **Supporting climate actions in developing countries** by financing emission reductions abroad
5. **Recognizing the climate efforts of other countries** by updating the carbon leakage provisions
6. **Ensuring environmental integrity and transparency when engaging in cooperative approaches** by introducing EU ETS linking safeguards
7. **Undertaking "economy-wide" emission reduction targets** by also decarbonizing the aviation and maritime sectors

1. Enhancing action prior to 2020 … by moving beyond 20% reductions

The Paris agreement recognizes the urgency of enhancing the pre-2020 ambition and emphasizes the enduring benefits of ambitious and early action, which includes major cost reductions of future mitigation efforts. The accompanying COP decision reiterates the resolve to enhance ambition in the pre-2020 period to ensure the highest possible mitigation efforts by all Parties.

This also applies to the EU that is currently on track to significantly overachieve its 2020 target of 20% greenhouse gas emission reductions. By last year, the EU had already decreased its greenhouse gas emissions by 23% according to the European Environment Agency and is on track for 30% cuts by 2020 according to Sandbag. Not capitalizing on this overachievement could undermine future efforts as the resulting surplus emission rights can then be used by European companies to continue polluting.

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