European Parliament Policy Event

'Re-plumbing the EU ETS: Low-carbon innovation and carbon leakage in a post-Paris world'

- Meeting Report -

15 March 2016

Carbon Market Watch organized a debate in the European Parliament on Tuesday 15th March 2016 kindly co-hosted by MEPs Ian Duncan (ECR), Fredrick Federley (ALDE), Jytte Guteland (S&D) and Bas Eickhout (Greens/EFA).

The event focused on the balance between innovation and carbon leakage protection. It covered a variety of positions including innovation, windfall profits by industry, just transition, and ambition in the EU climate policies in the wake of the Paris Agreement.

This event has, in light of the ongoing negotiations on the EU ETS reform proposal, contributed towards shifting the debate towards strengthening the EU ETS so it can properly function as a mechanism for reducing CO_2 while driving much needed investment into innovation and the transition towards a low-carbon economy in Europe.

The event coincided with the release of a CE Delft report on industry profits from the EU ETS, an accompanying Policy Brief and five National Factsheets (UK, Sweden, Netherlands, Germany and France) from Carbon Market Watch. Much of the debate centred on the findings of this evidence as it demonstrated the problems with the current EU ETS rules.

Key highlights can be summarised as follows:

- The CE Delft report demonstrated how heavy industry has made €24 billion in windfall profits from the EU ETS between the years 2008-2014. This is ten times more than what is currently spent on innovation under the EU ETS.
- For the EU ETS to properly function as a financing mechanism for innovation, free allowances must be replaced by increased auctioning with full auctioning in the future.
- Innovative solutions exist to decarbonise the industry sectors, but without an urgent reform of the EU ETS rules, projections show that industry's emission reductions will stall over the next 15 years.
- The EU ETS reform proposal must take the Paris Agreement into account, in terms of the carbon leakage provisions and the climate ambition level.

The full event can be viewed via web stream. To watch the video, please click here.

Below is a short summary of the presentations and discussion:

Ian Duncan (MEP, ECR) gave the opening remarks for this event as the rapporteur of the EU ETS revision in the ENVI committee. Introducing the speakers, Ian Duncan stated that 'the importance of the Emissions Trading System as a potential driver of 'innovation' arguing that a rise in the price of carbon allowances is key to promoting the innovative capacity of the EU ETS. Duncan also outlined some of the key issues for the ETS review including the linear reduction factor, market stability reserve, and perhaps the most tenuous issue, "carbon leakage".

Peter Zapfel (DG CLIMA, European Commission) presented the European Commission's perspective on the EU ETS reforms and how the Innovation Fund can function most effectively. The main points of his presentation included:

- The Innovation Fund will aim to enable renewable energy sources, CCS and low-carbon industrial innovation.
- It will be bigger than proposed by EU leaders, funded by 450 million allowances.
- Using the NER 300 as a site of learning, the Commission will aim to make the Innovation Fund an effective mechanism for driving the EU towards a low-carbon future.
- Updated benchmark values should be tied to 'rewarding and incentivising innovation' as 'innovation is key to the transition to a low-carbon economy'.

Femke de Jong (Carbon Market Watch) covered the problems currently affecting the EU ETS, highlighting the profits corporations have made from the EU's flagship carbon market and how this is damaging the prospects of the EU ETS functioning as a climate action tool. The main points of her presentation included:

- So far there has been no evidence for "carbon leakage".
- The CE Delft report highlighted the pollution profits made by industry between the years 2008-2014 from the EU ETS - The EU ETS has been a site of profit rather than a tax as industry often claims.
- Free allocations has affected the effectiveness of the EU ETS and 'reduces the incentive of companies to produce more efficiently or invest in breakthrough technologies that reduce CO_2'.

- The Paris Agreement helps to level the global playing field as it covers over 95% of global emissions', stating that 'there are no carbon leakage risks when other countries take comparable climate measure as well'.
- By limiting the amount of free allowances, more auctioning revenues can be diverted to low-carbon innovation to support the frontrunners that want to invest in breakthrough technologies.

Tomas Wyns (Institute for European Studies) presented the tangible examples of low-carbon innovation and the possibilities for their implementation. The main points of his presentation included:

- The promise of investment requires 'finding the sweet spots for low-carbon development in the industrial sector and higher competitiveness in the next decades'.
- Innovation has long investment-cycles and short timeframes for achieving EU decarbonisation targets.
- One of the barriers is the high-capital risk of introducing breakthrough technology into sectors that are not experiencing a great amount of growth.
- The Innovation Fund will have to learn from the NER 300 and have a new approach.
- Case-studies include the innovative case of Hlsarna pilot plant in the Netherlands that is driving CO_2 and production costs down by as much as 20% in the steel sector and a second case in the US that he described as the 'Holy Grail in aluminium production', that is finding inert anodes that could reduce electricity costs by up to 50%.

Benjamin Denis (European Trade Union Confederation) summarised the position of Europe's trade unions emphasising the social aspect of the low-carbon transition of Europe. The main points of his presentation included:

- 'What is at stake is changing the economy, the society, and this cannot be done without significant impact on the labour market'.
- Regional partners have pointed out 'the technological gap' between current capacity and that necessary to push regions towards low-carbon development.
- Many partners are shocked by how the EU ETS has been driven by 'short-term financial interest rather than by the need to drive investment towards low-carbon innovation in order to keep in EU a strong manufacturing base'.
- Introduction of both offensive and defensive instruments to accelerate innovation and funding.
- Current free allocation system does not ensure effective investments in low-carbon technologies.
- A Just Transition Fund is necessary to support workers that will be negatively impacted by the transition to a low-carbon economy.

Jytte Guteland (MEP, S&D) reacted to the presentations, arguing for a strong raft of reforms for the EU ETS. The main points included:

- The EU ETS reforms must be driven by innovation and ambition. More far reaching emission reductions are not only necessary after the Paris agreement, but also well within the EU's capacity.
- Free allocation should be the exception, not the rule.

- The system has ‘suffered from too generous free allocation and surplus of credits. This must change is we want to achieve real improvements in Phase 4.’
- For “carbon leakage” ‘only the most exposed receive compensation…it is important that we think about what we really want to achieve with the ETS’.
- Guteland emphasised the ‘social dimension to combatting climate change that we need not to forget. That is what will build Europe strong for the future and that is how Europe will maintain its strong and progressive production base.

Nicola Rega (CEPI) reacted to the presentations, calling for an EU ETS that promotes low-carbon investment. The main points included:

- All EU ETS reforms need to be checked against the idea of promoting low-carbon investments.
- The EU ETS ‘is good in promoting the type of innovation that is already there in the market…we need to get to deep reduction cuts and we have good ideas but the big jump is characterised by high costs and high risk.’

Adolfo Aiello (EUROFER) reacted to the presentations, drawing heavily on the steel sector’s perspective on “carbon leakage”. The main points included:

- ‘Free allocation is based on very ambitious benchmarks…and because free allocation is a safety net for the environment because free allowances are given to avoid that emissions are leaked to somewhere else.’
- For the steel sector, the historical surplus will disappear by 2020.

Closing Q&A Session

The Q&A session was lively with a range of questions from: industry groups Fuels Europe, CEFIC (chemicals) and CEMBUREAU (cement), among others; IETA (International Emissions Trading Association); and political parties including a representative from the S&D group.

Many remarks focused on the cost pass through evidence from the CE Delft report (2016) and were effectively rebuffed by Peter Zapfel who highlighted that there is empirical evidence that all industrial sectors pass through (non-existent) carbon costs. Femke de Jong, accepted that while certain issues with free allowances have been resolved in the EU ETS revision, the issue of cost pass through remains a pertinent and pressing topic yet to be addressed; pointing out that cost pass through is occurring without industry losing market share, thus undermining the argument that carbon leakage is happening.

Moving the debate towards innovation and ambition, Tomas Wyns detailed how funding can be channelled into innovation, while cautioning that ‘an industrial policy framework’ is needed that includes investment tax breaks and other measures to properly manage the deployment of new technologies. A degree of the closing question and answers discussed the necessity to strengthen the entire EU ETS system to increase the funding capacity of the ETS and provide a higher level of environmental integrity in tackling climate change.