Carbon Market Watch's response to the inception impact assessment of the carbon leakage list for the period 2021-2030

Carbon Market Watch (CMW) is a not-for-profit organisation with a unique expertise on the functioning of carbon markets, advocating for fair and effective climate protection. Its network connects more than 800 NGOs and academics from 70 different countries from the global North and South.

The assessment of the carbon leakage list for the post-2020 period will need to be informed by the performance of the carbon leakage provisions to date. So far, the excessively generous handout of free permits has resulted in over 25 billion euros windfall profits (e.g. the polluter has been paid, rather than having been made to pay) and in a standstill of industrial emissions for the past five years with no foreseen emission cuts in the coming decade. There has moreover been an absence of evidence of any carbon leakage occurrences in previous phases.

Under the reform of the EU Emissions Trading System (EU ETS) for the post-2020 period, the free allocation approach will be prolonged which means that heavy industry is set to receive free pollution permits worth up to EUR 170 billion over the next decade.

In this context, Carbon Market Watch believes that the current revision of the EU Emissions Trading System (EU ETS) for the post-2020 period will fail to make the EU ETS a viable instrument to decarbonise European industry. An industrial decarbonisation strategy and a genuine reform of the EU ETS in light of the Paris climate goals are hence urgently needed to bring Europe's industry at the forefront of the global low-carbon transition and guarantee its long-term competitiveness.

Carbon Market Watch would like to make the following concrete recommendations:

- On the **trade intensity**: The assessment of other countries' climate policies to determine their comparability with the EU ETS must take the international developments on climate policies into account, including an assessment of expected policies and instrument to implement the Paris Agreement (such as the launch of the Chinese ETS) as well as the policies adopted by sub-national jurisdictions (such as the Californian ETS). In a post-Paris world, the assumption that no other jurisdiction will implement policies in the 2021-2030 period, that are comparable to the EU ETS, can no longer be justified.
- On the **emissions intensity**: The assessment must be focused on direct emissions and exclude indirect emissions as they will be covered by indirect cost compensation through state aid.
- The **additional (qualitative and disaggregated) assessments** must be based on objective, transparent, robust and harmonised rules. These assessments must inter alia take into account equal treatment with low-carbon alternatives as well as data on observed cost-pass through rates, e.g. by considering the results of existing studies prepared to that effect for the Commission. Neglect of the cost-pass-through ability has led to significant windfall profits in previous phases, which distorts markets and de-incentivises clean innovation by subsidising carbon-intensive firms.

- The assessment of **likely economic impacts** must also investigate the longer term economic impacts of the CL list in terms of competition impacts between carbon intensive and clean industries. CMW moreover advises that the longer term technological and process innovation effects for various industry sectors of *not* being listed on the CL list are investigated, and compared with the short term benefits of protecting industries from international competition.
- The assessment of **likely social impacts** must be investigated from a wider societal viewpoint and include an analysis of the social impacts associated with the loss of auctioning revenues for governments, possible windfall profits that negatively impact consumers and the level of protection from the low-carbon transition between societal groups (e.g. between industries, workers, households).
- The assessment of **likely environmental impacts** must investigate the impact of the carbon leakage provisions on the incentivies for, and the amount of, emission reductions in industrial sectors in the short, medium and long term. The effect of free allocation to industries that are not at risk of carbon leakage can be environmentally disastrous by sending a signal of low-commitment and thereby discouraging clean technological progress and process innovation.
- The assessment of **likely impacts on simplication** must analyse the impact of the carbon leakage provisions on the complexity of the EU ETS as a policy instrument (i.e. compared to the default method of auctioning) as well as on the ability of stakeholders and policymakers to still understand the EU ETS.
- Methodological choices such as the **considered time horizon** have a significant economic and social impact. The long term effects of being listed on the CL list must be considered, in terms of incentives for innovation, the likelihood of achieving the 2050 objective for industrial decarbonisation and longer-term competitiveness issues in a global low-carbon world.
- The **precautionary principle** needs to apply to EU's climate change policies, including to the development of the carbon leakage list, which means that sectors that are not at a very high risk of carbon leakage must pay for their externalities and not receive any free allowances. Reducing the number of sectors and covered emissions on the CL list will moreover provide greater predictability by clarifying when the end of free allocation is to be expected as the free allocation provision is meant to be a transitional measure.
- CMW would finally like to remind the Commission of the **fundamental right** of peoples to "a high level of environmental protection" as stated in Article 37 of the EU Charter of Fundamental Rights. The impact of the CL list on fundamental rights must hence be investigated, especially related to health and environment, through the impact that free allocation has on lowering incentives for cutting greenhouse gas emissions.