Carbon Market Watch
Press statement for immediate release

European carbon market does not move with the climate urgency of our times

BRUSSELS, 14 July 2021 The European Commission's proposals to improve the EU Emissions Trading System (ETS) and establish a Carbon Border Adjustment Mechanism (CBAM) are not in line with the Paris Agreement and Europe's historic responsibility to cut emissions. The legislation initiative keeps neglecting the "polluter pays" principle of the EU Treaties and continues massive free emission handouts to industry.

Today, the European Commission launched the Fit-for-55 package, a large set of climate and energy laws - new and revised - that is supposed to propel the EU towards climate neutrality. Key elements of the package are the ETS and CBAM proposals.

Emission reductions

In the proposal, the overall climate target to be achieved by the EU ETS by 2030 is 61% below 2005. This will be achieved through a combination of increasing the Linear Reduction Factor (to 4,2%) and a one-off reduction of the cap.

Sabine Frank, Executive Director at Carbon Market Watch said:
"The European carbon market is still trying to buy time which doesn't exist. The key parameters for improving the EU ETS don't match the level of emission reductions needed to limit the climate crisis, just as the -55% goal remains inadequate."

Free emission allowances

The main focus of improving the EU carbon market should be on the better application of the "polluter pays" principle and the reduction of the free emission allowances to heavy industry. With this proposal instead, the vast majority of the free pollution subsidies remain unchanged, although research by CE Delft shows that heavy industries like steel, cement, and petrochemicals have made up to 50 billion euros in profits from the EU carbon market between 2008 and 2019.

Sam Van den plas, Policy Director at Carbon Market Watch said:
"Reducing the free permits handed out to large polluting industries will become a

auctioned instead."

The Carbon Border Adjustment Mechanism (CBAM) will allow an overlap with free allocation until 2035. Instead of having a CBAM as an alternative to free allocation of emission allowances, this proposal reinforces measures against phantom carbon leakage.

Agnese Ruggiero, Policy Officer at Carbon Market Watch said:
"The Commission is doing things backward. A CBAM that opens the door to free allowances beyond 2030 is worse than having no CBAM at all. Such an exemption would let large polluters completely off the hook and send a very negative signal internationally."

Carbon pricing for transport and buildings

The EU carbon price signal will be extended to cover transport and buildings. This is conceived as a separate carbon market covering fossil fuel use in these two sectors. Allowances in this system will be entirely auctioned as no free allocation is foreseen. The revenues generated from the auctioning of allowances will be used to support further decarbonisation and low-income households.

Sam Van den plas, Policy Director as Carbon Market Watch said:
"Putting a price on carbon emissions of transport and buildings needs to be considered carefully in order for it to be a sensible climate policy. It is essential that existing regulatory measures and standards are maintained and strengthened. A key precondition is that a social redistribution instrument is put in place to ensure that lower-income households and consumers are not negatively impacted."

Shipping

The new proposal extends the EU carbon market rules to cover emissions from intra-EU shipping, ships at berth, and half of both incoming and outgoing voyages. There will be no free allowances, however, the expansion will only be fully operational in 2026 - with shipping not paying the full price of its pollution until then.

Wijnand Stoefs, Policy Officer at Carbon Market Watch said:
"The EU ETS expansion to shipping is more than welcome. The IMO has failed to push the climate transition of the shipping sector, and the EU is now finally showing leadership. However, there is no valid reason to wait until 2026 to make the shipping industry pay fully for its pollution."

Aviation

The aviation sector will continue to benefit from excessive privileges, as international flights (i.e. not intra-Europe) will remain exempted from EU ETS obligations. Instead, the Commission proposes to have emissions from these flights addressed by CORSIA, a UN offsetting scheme that covers only a very small fraction of

For flights between European countries, the EU ETS will continue to apply, and the Commission proposes to phase-out the free allocation of allowances progressively until it reaches zero by 2027.

Gilles Dufrasne, policy officer at Carbon Market Watch said:
"Regulating international aviation emissions through CORSIA leaves the door wide open for airlines to purchase cheap and dubious carbon offsets, which will do nothing to incentivise in-sector emission reductions."

Next steps

The Fit-for-55 package will be negotiated in the coming months and years involving Members of the European Parliament and governments from all EU Member States.

Sabine Frank, Executive Director at Carbon Market Watch said:
"Instead of keeping the EU carbon market fit for polluters, responsible policymakers should now make the EU ETS fit for the planet. We count on them to deliver a strong and meaningful EU ETS that will provide the necessary incentives to reach climate neutrality by 2040."

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- Details on numbers: the overall **ETS emission reduction target** is proposed to be -61% by 2030 compared to 2005. The linear reduction factor is changed to 4,2 % after the final agreement on the ETS Directive. The increased linear reduction factor is combined with a one-off adjustment of the cap so the new linear reduction factor has the same effect as if it applied from 2021.
- **Free allocation:** The proposal includes an option to make 25% of free allocations to heavy industries conditional on energy efficiency investments. However, details on how this works are left to the EED. To be truly effective, this conditionality should be strictly enforced and industry should prove these investments are additional to business as usual.
- Another key element is the increase of the **ETS benchmark improvement rates**, which define the level of free allowances. The upper threshold is increased to a maximum of 2.5% instead of 1.6%, which entails a faster yearly reduction of free allowances for sectors to which this higher level is applied. Unfortunately, the lowest improvement rate remains at 0.2% and covers big polluters like steel. This is problematic because there's a big risk that major polluters will still be exempted and keep receiving significant free pollution subsidies.
- **CBAM:** The proposal states that no free allowances should be given to sectors covered by CBAM from the date on which CBAM comes into force. However, the following paragraph contains a derogation "for the first years of operation of CBAM". This derogation allows EU industries to continue receiving free allocation until 2035 albeit reduced from 2025 onwards.

About Carbon Market Watch

Carbon Market Watch scrutinises carbon markets and advocates for fair and effective climate action.

We are active at European, international and grassroots levels to advocate for stronger environmental and social integrity of carbon markets and other non-market carbon reduction instruments. For more information, visit www.carbonmarketwatch.org

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